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Commodity Futures Trading Commission
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September 12, 2022

Dear Mr. Sebastian Pujol Schott:

This letter is a response to the Commodity Futures Trading Commission (CFTC) review of the proposed derivatives contracts from KalshiEX, LLC under 17 C.F.R. §40.11. These proposed contracts' payoffs are based on political events and primarily turn on the composition of the two houses of our federal legislature (the "*Suspended Contracts*").

I am a professor of business law at Seton Hall Law School, and, among other things, previously practiced derivatives law in regulatory and transactional capacities at Sullivan & Cromwell LLP and Sidley Austin LLP. My scholarship focuses on derivatives and other financial markets. I write in my personal capacity, and the views expressed in this letter represent only my personal views. The views expressed in this letter are not the views of Seton Hall University, Seton Hall Law School, or anyone else associated with Seton Hall.

I write to respectfully urge you to consider two issues relevant to the CFTC's review of the Suspended Contracts.

A. Clear Notice as to Basis for Review

The first issue is primarily procedural and relates to due process and expectations of accountability. The CFTC bases the suspension and review on a general reference to 17 C.F.R. §40.11(a) (the "*Relevant Regulation*") and Section 5c(c)(5)(C) of the Commodity Exchange Act (the "*Statutory Provision*"). Textually, the Relevant Regulation is as broad if not broader than the Statutory Provision so only the former is discussed to keep things simple. The Relevant Regulation enables the suspension and review process to be initiated if a proposed contract either (a) "involves, relates to, or references terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law" or (b) is both similar to an activity listed in the excerpted language and the CFTC determines is "contrary to the public interest." Note that suspension does not require a determination that the contract is contrary to the public interest if the activity involves, relates to, or references "terrorism, assassination, war, gaming, or an activity that is unlawful under any State

or Federal law” (“*Regulated Activity*”); however, the CFTC must make such determination if the contract involves, relates to, or references an activity that is not a Regulated Activity but similar to a Regulated Activity.

When initiating a review of the Suspended Contract, the CFTC did not indicate whether, in the CFTC’s view, such contract involves, relates to, or references (a) gaming, (b) an activity that is unlawful under any State or Federal law, (c) an activity that is similar to gaming and contrary to public interest, or (d) an activity that is similar to an activity prohibited under State or Federal law and contrary to public interest. This makes it difficult to understand the validity of the suspension and review process, and to participate in the comment process. As a neutral observer interested in the integrity of markets, agency process and elections, I am unable to perform the necessary research and analysis to succinctly, and efficiently respond to the request for comment and participate in the process the Commodity Exchange Act envisions. This is especially the case because invocation of the 40.11(c) process may be based on the CFTC viewing the Suspended Contracts as implicating or being similar to activities prohibited under State or Federal law. But there are thousands of such prohibitions and no commentator can be expected to know which of these is the potential basis for invoking suspension and review. When the CFTC triggers the 40.11(c) process, the CFTC should concretely identify its basis for doing so, including which if any Federal or State laws may be relevant.

The CFTC has an exceptionally difficult role and set of obligations and is doing an extraordinary job with limited resources. However, I hope that going forward more is done to developing a transparent and accountable deliberative process for *genuinely* involving neutral experts and other members of the public in notice and comment.

B. The Substance of Suspended Contracts

The second issue is more substantive. Any financial contract may be used for speculation and thus can be used for gaming. This is true of a loan (even of a company with a solid credit rating) or a consumer note and is true of traditional futures, options and derivatives on energy, agricultural, metal and other tangible commodities. Derivatives on excluded commodities necessarily *may* be used for gaming. No serious person believes that the Statutory Provision (or Relevant Regulation) were meant to apply to every derivative on an excluded commodity.

Instead, when applying these authorities, the CFTC should genuinely delve into the function of the relevant contract. This may be particularly difficult before having opportunity to observe how the contract is used in the market. The CFTC appears to be engaging in this difficult analysis, partly through the request for comment. The question of how much non-speculative use is expected will be one of judgment. On the one hand, there is always the possibility that a derivative on an excluded commodity will be used to effectively gamble. On the other hand, there will always be clever, attenuated arguments that any event has economic repercussions that may need to be hedged. This is particularly true when a platform is paying legal and other experts to legitimate its product. When the CFTC is deciding on these questions, I urge the CFTC not to make the decisions political. Instead, I recommend a structure where the deliberations are largely entrusted to a committee of CFTC employees that have the resources to bring in external expertise and carry out a technocratic process for evaluating the bona fide value of the contract as a hedge.

The Commissioners' and Chairperson's role in reviewing these determinations should be effectively limited to reversals for gross error.

As explained above, it is beyond me (and I believe your other commentors) to review all State and Federal laws to understand how they may be implicated. But I think there is a genuine question whether the hedging value of these contracts is too low for them to be anything other than speculative instruments and transactions in them to be indistinct from gambling. Separately, although I do not believe it is necessary to the CFTC's analysis, I do believe there is a strong public interest in insulating Congressional elections from distortion (whether real or perceived) through financial markets.

On the other hand, I recognize that these questions are oftentimes better left to Congress. If it can single out box office receipts and onions, it should be able to enumerate election related or other politically relevant contracts. Whether instead of or in addition to your efforts in reviewing the Suspended Contracts, I urge you to reach out to members of our federal legislature to seek more clarity through statutory amendment. Gridlock and other failures in our legislature have led to federal financial regulators taking on greater and greater policy responsibility, partly because of a relative lack of talent in other public bodies. This is a concerning trend, and Congress should be forced as much as possible to do its job of governing the nation in an apolitical, informed and responsible manner.

In conclusion, I applaud your work and appreciate the difficult decisions that have to be made and the challenges of designing a responsive, inclusive, rational process. I would be glad to hear from you at ilya.beylin@shu.edu to discuss these and related matters further whether via setting up a call or through correspondence.

Sincerely,



Professor Ilya Beylin