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September 22, 2022

**BY E-MAIL AND ELECTRONIC SUBMISSION**

Mr. Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21 Street NW
Washington, DC 20581

Re: Comments in Response to the Commission's Request for Comment on KalshiEx, LLC's Proposed Event Contracts

Dear Commissioners:

We greatly appreciate this opportunity to comment on the political event contracts (**Contracts**) that our client KalshiEx, LLC, a designated contract market, submitted to the Commodity Futures Trading Commission for approval on July 19, 2022. The Commission determined to solicit public input regarding the Contracts on August 26, 2022, by posting to its website 17 questions about them (**Questions**). As always, the Commission should be applauded for its measured and deliberate approach to considering matters, like the Contracts, that are significant to the development and growth of financial markets.

As a Firm, we have worked for decades to assist financial institutions, operating companies, and investment funds with all manner of transactional, litigation, and regulatory matters involving the derivatives markets. This experience is enhanced by our colleagues who have enjoyed the privilege of serving on the Commission Staff and our more recent experience representing fintech companies.

We greatly respect the Commission as an institution that serves the public interest, as well as the professional staff who work tirelessly to pursue that end. Former employees of all three branches of the federal government are well represented at the Firm. So we can appreciate the effort it requires for the Commission to focus on specific issues like this one, given the heavy workload that it carries in effecting Congressional rulemaking mandates while seeking to ensure market integrity, to protect customers and investors, and to enforce the law in cases where it may have been violated.

With our esteem for the agency in mind, and in full candor, we respectfully submit that the Commission is taking the wrong approach to evaluating the Contracts, in the following respects:

- It is wrong to review the Contracts under Regulation 40.11.
- It is wrong to suggest, as the Questions do, that the Contracts must be shown to have an "economic purpose" like hedging or price basing before they can be approved.
- It is wrong to suggest in the Questions that the Contracts are themselves some type of gaming.
- It is wrong to suggest in the Questions that the Contracts may be ill-suited to the hedging needs of individuals and that other derivatives contracts may be more suitable.
- It would be wrong to disapprove the Contracts based on a finding that they are contrary to the public interest.

We address these points below, while also offering our view of what the right approach would be in each case.

**It is wrong to review the Contracts under Regulation 40.11.** Kalshi submitted the Contracts for review and approval under Regulation 40.3. Under paragraph (b) of that Regulation, the Commission must approve "a new product unless the terms and conditions of the product violate" either the Commodity Exchange Act or Commission Regulations. The Contracts do not violate the law or the rules at issue, which means that they should have been reviewed and approved within either the 45 days allowed the Commission by Regulation 40.3(c) or an extended period as agreed by the Commission and Kalshi under Regulation 40.3(d).

According to the Commission's letter to Kalshi on August 26, 2022, however, the Contracts are instead being reviewed under Regulation 40.11 on the basis that they "may involve, relate to, or reference an activity enumerated in Commission [R]egulation 40.11(a) and [S]ection 5c(c)(5)(C) of the Commodity Exchange Act." The "activit[ies] enumerated" in those provisions are terrorism, assassination, war, gaming, and crime (something illegal). As we explain below, the Contracts involve, relate to, or reference none of these things.

***Instead***, the Commission should consider the Contracts under Regulation 40.3, which is the provision under which Kalshi submitted them.[1]

[1] This view was first publicly articulated as to the Contracts in Commissioner Pham's dissent to the Commission's decision to review the Contracts under Section 5c(c)(5)(C).

**It is wrong to suggest, as the Questions do, that the Contracts must be shown to have an "economic purpose" like hedging or price basing before they can be approved.** That test is not to be found in the Commodity Exchange Act at any point in its history. The Commission does not have statutory authority to impose such a test. In fact, we have found that, at most, Congress advanced the idea of an "economic purpose" test in a bill that never made it into the Commodity Exchange Act.[2] Nor is there anything in the operative sections of the statute and the rules to indicate that a test Congress never adopted should have any relevance to the Commission's deliberations today.

Section 5c(c)(5)(B)—which we submit is the correct statutory standard—states that "[t]he Commission shall approve a new contract or other instrument unless [it] finds that the new contract or other instrument would violate the Commodity Exchange Act (including regulations)." No part of the Commodity Exchange Act contains an express economic purpose test. Nor does a designated contract market like Kalshi have to explain the economic purpose of new contracts when they voluntarily submit them for Commission review under Regulation 40.3.

"A submission requesting approval shall," as Regulation 40.3(a)(4) explains:

> Include an explanation and analysis of the product and its compliance with applicable provisions of the [Commodity Exchange] Act, *including core principles*, and the Commission's regulations thereunder. This explanation and analysis shall either be accompanied by the documentation relied upon to establish the basis for compliance with the applicable law, or incorporate information contained in such documentation, with appropriate citations to data sources[.]
>
> (Emphasis added.)

No section of the Commodity Exchange Act or the Commission's Regulations contemplated by this instruction states that a designated contract market must provide an economic purpose for new contracts that it has submitted for Commission review. For example, none of the "core principles" for designated contract markets, which are found in Section 5 of the Commodity

[2] *See, e.g.,* Aron and Jones, "States' Big Gamble on Sports Betting," UNLV Gaming Law Journal, Vol 12: Issue 1, Article 4 at n.92 (2021) ("The economic purpose test is derived from an unadopted version of former [Commodity Exchange Act] [S]ection 5(g). Congress instead adopted the Senate's broader version of [S]ection 5(g) that included a 'public interest' standard.") That broader "public interest standard" was struck from the Commodity Exchange Act by the Commodity Futures Modernization Act of 2000. *See* Pub. Law No. 106-554, 114 Stat. 2763, § 110(2) (2000) (striking the prior Section 5 of the Commodity Exchange Act, which included the "public interest standard").

Exchange Act and Part 38 of the Commission's Regulations, impose an "economic purpose" requirement on contracts that the market lists of trading.

The Commission has decided to evaluate the Contracts under Section 5c(c)(5)(C) as a type of "gaming" contract, and therefore it is proceeding to review the Contracts for approval under Regulation 40.11. Even under those two provisions, no requirement for establishing a contract's economic purpose can be found. Section 5c(c)(5)(C)(i) provides that the Commission "may determine" that contracts on events that reference terrorism, assassination, war, and gaming are "contrary to the public interest." Similarly, Regulation 40.11(a)(2) prohibits a registered entity (like a designated contract market) from "list[ing] for trading or accept[ing] for clearing" a contract that references an activity "similar to" terrorism, assassination, war, gaming or crime if the Commission determines that the contract would "be contrary to the public interest." The "public interest" is not the same thing as an "economic purpose," and the Commission has not elsewhere suggested that they are equivalent. Indeed, the Questions treat the concepts of "economic purpose" and "public interest" separately.[3]

***Instead***, the Commission should determine whether the Contract meets the requirements stated in the plain statutory and rule text of the relevant authorizing provisions. As explained earlier, we think those provisions are Section 5c(c)(5)(B) and Commission Regulation 40.3.

**It is wrong to suggest in the Questions that the Contracts are themselves some type of gaming.** Doing so conflates an enumerated event with the Contracts themselves, which are binary options. That is, the Contacts could only fall within the ambit of Section 5c(c)(5)(C) and Regulation 40.11 if the Commission's premise were that the Contracts themselves—rather than the events that they reference—constitute gaming. The Contracts do not reference an event of terrorism, assassination or war; nor do they involve anything that is illegal under federal or state law. Elections are plainly lawful. For the Commission's premise to be valid, then, it would also have to be possible for there to be contract that itself would be an event of terrorism, assassination, war, or crime. That would be a total non sequitur.

If that is not the Commission's premise on this reading, then the Commission would have to take the position that *any contract* referencing a type of event enumerated in Section 5c(c)(5)(C) would be gaming. This would mean that a contract on an event of terrorism, assassination, war, or crime would be a form of gaming, too. Setting aside the propriety of such a thing, if the statute were to be read this way, doing so would make the enumerated categories other than gaming superfluous. That is, the statute could accomplish the goal of prohibiting gaming simply by prohibiting gaming, full stop. Taking Section 5c(c)(5)(C) to mean that all referenced contracts are

[3] *Compare* Questions 6-11 (economic purpose) *to* Questions 12-17 (public interest).

gaming contracts would be wrong, however. It is canonical that each word in a statute must be given separate effect.

There is nothing in the statutory text that treats gaming differently from the other enumerated event types. A contract on war would be prohibited just the same as a contract on gaming would be prohibited, for example. A contract does not *become* gaming because of what it references; to hold so would be contrary to what the statute and the rule both say.[4]

***Instead***, and if it is to proceed under Section 5c(c)(5)(C) and Regulation 40.11, the Commission should review whether *the event underlying* the Contracts is itself gaming. That is easily answered: Elections are not "gaming," whether the gaming definition relied upon is widely accepted or more abstruse.[5]

**It is wrong to suggest in the Questions that the Contracts may be ill-suited to the hedging needs of individuals and that other derivatives contracts may be more suitable.** The Commodity Exchange Act does not provide that a new contract can be approved only if it is suitable for use by customers and investors. Nor does the statute give the Commission the discretion to determine whether new contracts are suitable for any particular purpose before they are approved. Rather, Section 5c(c)(5)(B) states that, in reviewing a new contract, the Commission "shall approve [it] unless the Commission finds that [it] would violate" the statute or Commission Regulations. And, even for as far as it goes, Section 5c(c)(5)(C) does not impose a suitability standard or give the Commission authority to disapprove contracts because the Commission thinks that other, existing contracts are more fit for the intended purpose.[6]

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[4] The Commission must apply the Commodity Exchange Act as it is written by Congress and passed into law. In this regard, other agency publications have given weight to certain remarks made during a Congressional floor debate about the statutory provision at issue. *See e.g.,* CFTC, Statement of Commissioner Dan M. Berkovitz Related to Review of ErisX Certification of NFL Futures Contracts (Apr. 7, 2021) (discussing an unpublished decision to disapprove sports contracts following their withdrawal from consideration by the ErisX contract market), *available at* https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721. What two Senators said in a floor debate does not control where, as here, the full Senate and the House of Representatives spoke unambiguously in the statute. Still, what those Senators were discussing makes clear that they thought Section 5c(c)(5)(C) would prohibit "gambling" with its reference to gaming, including "futures contracts" or other "event contract[s] *around sporting events such as the Super Bowl, the Kentucky Derby, and Masters Golf Tournament*." *See id.* (emphasis added).

[5] For this reason, we do not attempt to suggest to the Commission what the "right" definition of gaming should be. Doing so would be beside the point.

[6] For example, at least one other designated contract market has self-certified contracts on large events that may have diffuse but nonetheless significant impact on individuals. *See* Atlantic Named Storm Landfall Options Contract (filed June 13, 2016) (enabling contract market participants the opportunity to hedge risks associated with hurricanes or tropical storms falling within a specified geographic area; contracts could be used for hedging different risks), *available at* https://sirt.cftc.gov/sirt/sirt.aspx?Topic=TradingOrganizationProductsAD&Key=34704.

***Instead***, the Commission should apply the statutory standard of Section 5c(c)(5)(B) as it was written by Congress.[7]

**It would be wrong to disapprove the Contracts based on a finding that they are contrary to the public interest.** The "public interest" is relevant to Commission reviews under Section 5c(c)(5)(C) and Regulation 40.11(a) in three ways, none of which are germane to the Contracts:

- *First*, clauses (i)(I)-(V) of Section 5c(c)(5)(C) state that the Commission may determine a contract is "contrary to the public interest" if it involves terrorism, assassination, war, gaming, or crime. Plainly, an election is not any of those things.

- *Second*, clause (i)(VI) of Section 5c(c)(5)(C) explains that the Commission may determine that a new contract is contrary to the public interest if it involves "*other similar activity* determined by the Commission, by rule or regulation, to be contrary to the public interest" (emphasis added). An election is not similar to terrorism, assassination, war, gaming, or crime.

- *Third*—

  - Paragraph (a)(2) of Regulation 40.11 provides that a contract may not be listed for trading or cleared if it "involves, relates to, or references an activity that is similar to" terrorism, assassination, war, gaming, or crime, "*and* that the Commission determines, by rule or regulation, to be contrary to the public interest" (emphasis added). While the Commission may be inclined to think that the Contracts are contrary to the public interest, its ability to disapprove them becomes operative only if it determines that elections are events "similar to" those enumerated earlier in the Regulation. We doubt the Commission would be able to make such a determination on any realistic set of facts.

  - Instead, the Commission would have to consider the reference to "public interest" in paragraph (a)(2) of Regulation 40.11 as a freestanding power to reject *any* contract that it determined to be contrary to the public interest.

[7] In addition, the Questions that ask about the potential impacts of the Contracts on federal campaign finance laws are irrelevant under the standard that the Commission is directed to apply by Section 5c(c)(5)(B). That subject is outside the scope of Section 5c(c)(5)(B) and, as we explain in the next section, the "public interest" language in Section 5c(c)(5)(C) and Regulation 40.11 does not admit for any consideration of campaign finance law, beyond perhaps an event that violates campaign finance law (i.e., illegal conduct). A campaign finance violation is different than an election outcome.

> That would make a cannon of a rifle. An agency must not read into a rule a broader power than exists in the authorizing statutory language. The "public interest" power reserved to the Commission in Section 5c(c)(5)(C) only extends to activity "similar to" terrorism, assassination, war, gaming, or crime. Going beyond that with the rule would be going beyond what the law allows.[8]

***Instead***, the Commission should approve the Contracts under Section 5c(c)(5)(B) and Regulation 40.3, which impose no public interest requirement. The same result would be reached even if the Commission were to proceed under Section 5c(c)(5)(C) and Regulation 40.11 and, in doing so, applied "public interest" as it is used in those provisions.

* * * * *

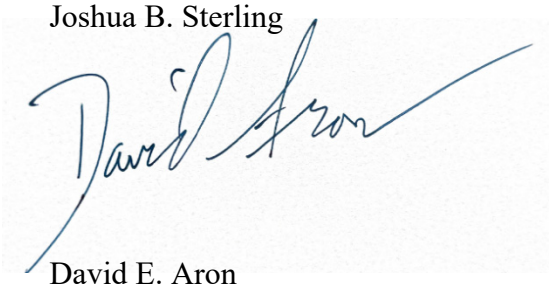
[8] This may well be why the Questions conflate the Contracts with gaming itself—because to read the statute as written would mean the Contracts are permissible under Section 5c(c)(5)(C) and Regulation 40.11.

We greatly appreciate the care and attention that the Commission has given to the Contracts. They are indeed of great significance to the development and growth of financial markets, so we thank the Commissioners and the professional staff of the Commission for the time that they are continuing to dedicate to them. While we applaud those efforts, we disagree with the approach being taken. We think the Commission is fundamentally mistaken to evaluate the Contracts as if they involve, reference, or relate to gaming. They simply do not.

We thank the Commission once more for undertaking a deliberate, public process with regard to the Contracts. We are confident that, through processes like this one, the Commission will continue to be a leader in fostering responsible innovation in our financial markets.

Very truly yours,

Joshua B. Sterling



David E. Aron

cc: The Honorable Rostin Behnam, Chairman
The Honorable Kristin N. Johnson, Commissioner
The Honorable Christy Goldsmith Romero, Commissioner
The Honorable Summer K. Mersinger, Commissioner
The Honorable Caroline D. Pham, Commissioner
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