July 25, 2024

Via Electronic Submission

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Event Contracts (RIN 3038-AF14)

Dear Mr. Kirkpatrick:

Paradigm Operations LP ("**Paradigm**" or "**we**")[1] appreciates the opportunity to comment on the U.S. Commodity Futures Trading Commission's ("**CFTC**" or the "**Commission**") proposal to further specify the types of event contracts that fall within the activities listed in Section 5c(c)(5)(C) of the Commodity Exchange Act ("**CEA**") and are contrary to the public interest.[2] As further explained herein, Paradigm has significant concern that the Event Contracts NPRM represents a broad and untethered ban on a wide variety of products that could further the goals of the CEA to promote responsible innovation.[3] Unfortunately, the approach set forth in the Event Contracts NPRM is to ban most types of event contracts without conducting any review of the terms of the particular event contracts, developing an understanding of the hedging utility of the products, or otherwise evaluating the merits of prediction markets as innovative derivatives platforms that further democratic values. The CFTC instead chooses to take a line from Mel Brooks' *Blazing Saddles* in concluding: "I don't know, but whatever it is, I hate it."[4]

As further explained below, Paradigm urges the CFTC to withdraw the Event Contracts NPRM and reconsider its approach for the following reasons:

(1) The Event Contracts NPRM would outlaw a broad class of innovative derivatives products before U.S. market participants have had an opportunity to fully realize their benefits. The CFTC's decision to exile these products to minimally regulated offshore and over-the-counter markets will impair opportunities for financial innovation domestically.

(2) The CFTC's proposal is less motivated by an earnest desire to protect the public than an aversion to event contracts generally. As further explained below, the CFTC misinterprets a Senate colloquy addressing CEA Section 5c(c)(5)(C) in a manner that is at odds with the

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1 Paradigm is a registered investment adviser that manages funds focused on crypto and related technologies at the frontier. Paradigm invests in, builds, and contributes to companies and protocols with as little as $1M and as much as $100M or more. More information about Paradigm is available online at https://www.paradigm.xyz/.

2 *Event Contracts*, 89 Fed. Reg. 48968 (June 10, 2024) ("**Event Contracts NPRM**").

3 *See* CEA Section 3(b).

4 BLAZING SADDLES (Crossbow Productions Feb. 7, 1974).

plain language and purpose of the statute. Moreover, the CFTC failed to perform the analysis required under Section 5c(c)(5)(C), in excess of the agency's statutory jurisdiction.

(3) The CFTC's proposal adopts a definition of the term "gaming" that is profoundly unclear and does not provide any articulable standards that would allow for a market participant to determine whether or not an event contract involves such activity. This level of regulatory vagueness is arbitrary and capricious.

(4) Political event contracts offer a plethora of concrete benefits that the Event Contracts NPRM fails to adequately consider. Broadly, these types of event contracts can encourage participation in the democratic process and promote trust in its legitimacy. Additionally, political event contracts allow businesses to hedge risks associated with a wide range of political and electoral factors.

Should the CFTC decide not to withdraw the Event Contracts NPRM, it should at the very least, narrow the scope of the definition of "gaming" as explained below and remove any public interest determination from the rule. The single worst move the CFTC could make is to let this rule proceed without changes. That is the definition of a risky gamble.

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I. The Event Contracts NPRM Is a Value-Based Subjective Regulation that Would Outlaw Innovative Products and Drive Burgeoning Financial Technology Businesses Offshore

The Event Contracts NPRM proposes to interpret Section 5c(c)(5)(C) of the CEA, which provides that the CFTC may determine that an event contract that involves an enumerated activity is contrary to the public interest. The enumerated activities listed in the statute include an activity unlawful under any Federal or State law, terrorism, assassination, war, gaming, and other similar activities determined by the CFTC to be contrary to the public interest. Under the Event Contracts NPRM, the CFTC concluded that any contract that involves an enumerated activity is contrary to the public interest and therefore cannot legally be offered for trading or cleared on a CFTC-registered platform. As explained further herein, the CFTC's interpretation of CEA Section 5c(c)(5)(C) is inconsistent with the plain language of the statute, does not provide sufficient analysis to allow the public to provide informed comment, and is excessively broad so as to be inconsistent with the structure of the CEA.

Prior to addressing the numerous deficiencies with the Event Contracts NPRM, Paradigm submits that it is important for the CFTC to recognize its role in regulating markets. The CFTC is not a value-based regulator. As a general matter, the CEA does not authorize the Commission to impose its value judgements on whether a contract is in the public interest. Rather, Congress generally saw fit for the financial markets, the exchanges in particular, to determine those products that furthered the public interest by virtue of being consistent with regulatory core principles, promoting price discovery, risk management, and other considerations. In this regard, CEA Section 5c(c)(5)(C) should be read in a manner consistent with the overarching statute. An overly broad reading of this Section authorizing the CFTC to make a public interest determination would circumvent the intent of Congress for the markets to generally determine whether a contract is in the public interest.

Moreover, the Event Contracts NPRM is inconsistent with the CFTC's stated pro-innovation agenda. In CFTC Chairman Behnam's recent testimony to the U.S. Senate Committee on Appropriations, Subcommittee on Financial Services and General Government, the Chairman used the words "innovation"

and "innovative" ten times to describe the CFTC's approach to regulating derivatives markets and emerging technologies.[5] Yet the CFTC's proposal would effectively outlaw some of the most innovative financial markets in the United States and drive a burgeoning industry of financial technology businesses and entrepreneurs offshore. Such a ban would take place without the CFTC or its Staff evaluating the contours of a particular contract or group of contracts as contemplated in the plain language of CEA Section 5c(c)(5)(C)(i) ("The Commission may determine that *such agreements, contracts, or transactions are contrary to the public interest*….") (*emphasis added*).[6]

Indeed, the CFTC seeks to dictate the types of financial markets and businesses that are suitable for it to regulate, and therefore be permitted to exist in the United States. Those financial markets and businesses that the agency does not wish to regulate would be forced to find a home offshore. The CFTC complains that it does not have the "specialized experience" necessary to oversee these markets and Congress could not have possibly intended for it to use its resources in this way.[7] Yet the CEA conferred upon the CFTC broad regulatory jurisdiction over any "commodity," which is defined to include "all goods and articles" (except onions and motion picture box office receipts) and "services, rights, and interests . . . in which contracts for future delivery or presently or in the future dealt in."[8] The CFTC does not have the authority to decide that it would prefer not to regulate certain types of commodities enumerated in the CEA without reasoned analysis. It is the expectation of the American public that the CFTC will develop the specialized expertise and resources to regulate the markets that Congress tasked it with regulating. The tail does not wag the dog.

Paradigm urges the CFTC to reconsider this flawed approach that, as set forth below, lacks meaningful analysis. As we have seen with crypto asset markets, a failure on the part of regulators to meaningfully engage with innovative technology businesses will simply cause these businesses to move offshore outside of the reach of the Commission and to the detriment of the American public. The CFTC would cede this industry to offshore jurisdictions, over-the-counter trading and black markets outside of the agency's regulatory perimeter. Like blockchain technology, prediction markets have found product-market fit on a global scale as a means for people and businesses to hedge the risk associated with events of economic consequence, such as the result of a political election or sporting event. The CFTC's proposal to establish a prohibition on prediction markets will simply mean that the CFTC has no influence upon the global regulatory framework for these markets. Paradigm submits that Congress intended for CFTC-registered platforms to have the freedom to offer innovative financial products involving any "commodity" under the regulatory supervision of the CFTC, absent particularized findings supported by a thoroughly developed factual record and reasoned analysis that a specific contract, or group of contracts, is contrary to the public interest.

II. The CEA Does Not Authorize the CFTC to Ban Certain Event Contracts Without Reviewing the Contracts or Understanding the Nature of the Activity

The Event Contracts NPRM seeks to interpret CEA Section 5c(c)(5)(C) to prohibit an exchange from listing, or a clearing organization from clearing, any contract that involves an enumerated activity

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5 *A Review of the President's Fiscal Year 2025 Budget Requests for the U.S. Securities and Exchange Commission and the Commodity Futures Trading Commission Before the Subcomm. On Fin. Serv. and Gen. Gov't of the S. Comm. On Appropriations*, 118th Cong. (2024) (statement of Chairman Rostin Behnam, U.S. Commodity Futures Trading Comm'n).

6 CEA Section 5c(c)(5)(C)(i).

7 Event Contracts NPRM at 48983.

8 CEA Section 1(a)(9).

because those contracts are by definition contrary to the public interest. This proposed approach conflicts not only with the plain language of the CEA, but also the CFTC's own description of the statute in the Event Contracts NPRM.

As stated in the Event Contracts NPRM, CEA Section 5c(c)(5)(C) establishes "a two-step inquiry. First, the Commission must assess whether a contract in a specified excluded commodity 'involve[s]' an [enumerated activity] . . . . If the Commission determines that the contract involves such activity, the Commission must assess whether the contract is contrary to the public interest."[9] Rather than follow its own interpretation that CEA Section 5c(c)(5)(C) necessitates a two-step approach, the CFTC consolidates the two-step approach into a single step. As proposed, the Event Contracts NPRM simply concludes that any contract that involves an enumerated activity is contrary to the public interest.

Paradigm agrees with Commissioner Mersinger that the Event Contracts NPRM appears to be "motivated more by a seemingly visceral antipathy to event contracts than by reasoned analysis."[10] Indeed, the Event Contracts NPRM is devoid of analysis of a particular contract or group of contracts to support a determination that listing the contact is contrary to the public interest. Instead of engaging in meaningful analysis, the proposal merely pivots to a colloquy between Senators Diane Feinstein and Blanche Lincoln regarding the proposed Dodd-Frank Act provision that ultimately became CEA Section 5c(c)(5)(C) (the "**2010 Colloquy**") to arrive at the conclusion that any contract that involves an enumerated activity is by definition contrary to the public interest.[11] In other words, all event contracts that involve enumerated activities are contrary to the public interest because of the 2010 Colloquy.

The CFTC's tunnel-vision reading of the CEA is flawed for two critical reasons. First, the CFTC misreads the 2010 Colloquy because the focus of the discussion is on contracts that "would not serve any real commercial purpose," so it is the economic purpose, not the nature of the event that is the focus of contracts that should be prohibited.[12] This careful reading of the 2010 Colloquy is consistent with the language of the CEA, which states that if a contract involves gaming then the CFTC "may" prohibit listing the contract if it determines the contract (or group of contracts) to be contrary to the public interest. By contrast, reading the 2010 Colloquy to prohibit listing contracts that involve an enumerated activity would render the 2010 Colloquy at odds with the plain language of the CEA. If Congress intended to prohibit all contracts that involve an enumerated activity, it would have done so. Second, the CFTC cannot abdicate its responsibility to conduct the public interest analysis set forth in the statute in favor of the 2010 Colloquy. Such abdication is clearly in excess of CFTC's statutory jurisdiction in violation of the Administrative Procedure Act ("**APA**").[13]

To be clear, the CFTC must engage in the two-step process required by the CEA: (1) does the contract involve an enumerated activity; and (2) if so, is the contract contrary to the public interest. The Event Contracts NPRM contains no meaningful or substantive analysis as to why any contract, or group of contracts, that involves an enumerated activity is contrary to the public interest. The CFTC should view the act of banning a contract from trading on a regulated exchange as an extreme action that warrants considerable review based upon the particularities of a contract or group of contracts. In fact, CEA Section 5c(c)(5)(C) demands such a review by explicitly providing that "the Commission may determine that ***such***

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[9] Event Contracts NPRM at 48970-71.

[10] Event Contracts NPRM at 48993 (Appendix 3 – Statement of Commissioner Summer K. Mersinger).

[11] *See* Notice of Proposed Rulemaking at 48970.

[12] 156 Cong. Rec. S5906-07 (daily ed. July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln).

[13] 5 U.S.C. § 706(2)(A), (C); *See, e.g.*, *Brown v. Gardner*, 513 U.S. 115, 120 (1994) (invalidating an agency's regulation that violated the intended meaning of a governing statute).

agreements, contracts, or transactions are contrary to the public interest." (*emphasis added*).[14] Notwithstanding the plain language of the statute, the CFTC argues that "the statute does not require this public interest determination to be made on a contract-specific basis."[15] The banning of products without reviewing such products is analogous to the aforementioned logic in *Blazing Saddles*, the CFTC does not know the particulars of a contract, but it hates the contract. Tellingly, the CFTC does not cite to the language of CEA Section 5c(c)(5)(C) or any legislative history in support of its interpretation because neither support the CFTC's purported reading of the statute. Rather, the CFTC cites to its general rulemaking authority to reimagine the language of CEA Section 5c(c)(5)(C) in a way that fits its purpose. The CFTC's general rulemaking authority does not include the ability to reimagine the provisions of the CEA, such authority solely vests with Congress.[16]

III. The Proposed Definition of "Gaming" Is Excessively Broad, Arbitrary and Untethered to Any Meaningful Limiting Principle

The Event Contracts NPRM proposes to define "gaming" as "the staking or risking by any person of something of value upon: (i) The outcome of a contest of others; (ii) The outcome of a game involving skill or chance; (iii) The performance of one or more competitors in one or more contests or games; or (iv) Any other occurrence or non-occurrence in connection with one or more contests or games."[17] The CFTC also provides that the term "includes, but is not limited to, the staking or risking by any person of something of value upon the outcome of a political contest, including an election or elections, an awards contest, or a game in which one or more athletes compete, or an occurrence or non-occurrence in connection with such a contest or game, regardless of whether it directly affects the outcome."[18] As noted immediately above, the Event Contracts NPRM carries with it a determination that any contract that involves the above definition is categorically contrary to the public interest.

The proposed definition of gaming is problematic for a number of reasons. First, under prong (iv) of the proposed definition, the definition includes "any other occurrence or non-occurrence in connection with one or more contests or games." The Event Contracts NPRM provides no discernible limiting principle or framework to understand what it means to be "in connection with" a game or contest. As a result, the public cannot provide meaningful comment to the CFTC regarding the scope of the definition. Rather, the public must look to the CFTC to understand what it means to be "in connection with" a game or contest, which falls far short of APA standards for agency rulemaking.[19] Furthermore, the CFTC's basis for

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[14] CEA Section 5c(c)(5)(C)(i).

[15] Event Contracts NPRM at 48978.

[16] *See Merck & Co. v. United States Dep't of Health & Hum. Servs.*, 385 F. Supp. 3d 81, 92 (D.D.C. 2019), aff'd, 962 F.3d 531 (D.C. Cir. 2020) ("Even broad rulemaking power must be exercised within the bounds set by Congress."); *Levine v. Apker*, 455 F.3d 71, 85 (2d Cir. 2006) ("What agencies may not do, however, is edit a statute. Categorical rulemaking, like all forms of agency regulation, must be consistent with unambiguous Congressional instructions. And, an agency may not promulgate categorical rules that do not take account of the categories that are made significant by Congress."); *Am. Fed'n of Lab. & Cong. of Indus. Organizations v. Chao*, 409 F.3d 377, 384 (D.C. Cir. 2005) (holding that an agency's broad rulemaking authority cannot be used to override specific statutory directions from Congress) (citing *Whitman v. Am. Trucking Associations*, 531 U.S. 457, 484 (2001)).

[17] Event Contracts NPRM at 48974.

[18] Event Contracts NPRM at 48992.

[19] *ACA Int'l v. Fed. Commc'ns Comm'n*, 885 F.3d 687, 700 (D.C. Cir. 2018) (holding that a regulation is arbitrary and capricious if it fails to articulate a "comprehensible standard" for assessing the applicability of a statutory category) *quoting U.S. Postal Serv. v. Postal Regul. Comm'n,* 785 F.3d 740, 753 (D.C. Cir. 2015); *See Pearson v. Shalala*, 164 F.3d 650, 660 (D.C. Cir. 1999) (noting that an agency's failure to define a vague regulatory standard was arbitrary and capricious and in violation of the APA).

including this prong in the definition is because such an event "would be as much of a wager or bet on the game or contest as staking or risking something of value on the outcome of the game or contest would be."[20] Given that the CFTC did not provide a comprehensive definition of what it means to be "in connection with" a game or contest, the CFTC has no basis to claim that the occurrence or nonoccurrence of an event in connection with the game is the same as a wager on the outcome of the game itself.

Moreover, the CFTC's characterization of political contests, awards contests, and sporting events as forms of "gaming" is arbitrary and capricious. Congress elected to enumerate in Section 5c(c)(5)(C) certain activities, such as terrorism, assassination, and war, but did not include political contests, awards contests, or sporting events in this list. The CFTC now seeks to rewrite Section 5c(c)(5)(C) to include political contests, awards contests, and sporting events as types of "gaming," despite Congress's clear decision to exclude such activities, except to the extent a political contest or other event implicates matters of terrorism, assassination, or war. Every derivative instrument requires the parties to the agreement to risk money on the value of some underlying asset. The idea that the fact that the underlying asset involves a political contest, awards contest, or sporting event rather than the price of pork bellies makes it a "game" is nonsensical. The CFTC seeks to craft an arbitrary definition of "gaming" that would simply include those products that it does not prefer to regulate. Indeed, the proposed definition does not even align with the term's ordinary meaning or contemporary usage. Merriam-Webster defines "gaming" as "the practice or activity of playing games for stakes" and "the practice or activity of playing games (such as board games, card games, or video games)."[21] Although it would be deemed derogatory to refer to elections as "games" in modern discourse, the Event Contracts NPRM suggests that the outcome of the democratic process of electing the President of the United States is conceptually identical to the result of a round of Yahtzee. This inference is a bridge too far without express direction from Congress.

IV. The Proposed Rules Seek to Include an Appendix, Without Providing Any Meaningful Opportunity for Notice and Comment

The Event Contracts NPRM asserts that under Rule 40.11(a)(2), the CFTC holds the authority to identify additional activities that are similar to the enumerated activities, and to make a determination that event contracts based on those similar activities are contrary to the public interest.[22] The CFTC also states that it intends to publish an appendix in conjunction with any final rule enacted as part of the present rulemaking providing guidance as to factors it would consider when making a determination that an additional activity is similar to an enumerated activity and that contracts based on that activity are contrary to the public interest.[23] The idea of finalizing a rule appendix without going through notice and comment represents a dangerous track given the lack of transparency in government action.

The Event Contracts NPRM provides no insight as to how the Commission will determine if an additional activity is similar to an enumerated one, nor does it explain how the accompanying public interest analysis would be conducted. The CFTC's proposal to withhold the appendix from public comment as part

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[20] Event Contracts NPRM at 48975.

[21] *Gaming*, Merriam-Webster.com. https://www.merriam-webster.com/dictionary/gaming (last visited June 25, 2024).

[22] Event Contracts NPRM at 48984.

[23] *Id.*

of the proposed rulemaking and instead publish it as part of a final rulemaking without any opportunity for public notice and comment would violate the APA.[24]

V. Political Event Contracts Can Reinforce Democratic Norms, Promote an Interest in the Political Process and Enable Stakeholders to Hedge Material Economic Risks

Political event contracts in particular serve an important purpose in reinforcing democratic norms, encouraging civic participation and enabling the hedging of material economic risks. Event contracts do not harm our democracy, they *protect* our democracy.

Political event contracts have a proven track record of predicting the ultimate outcome of elections and other political outcomes. In an age in which many American citizens have grown to distrust the country's democratic institutions, political prediction markets can provide a helpful check on such skepticism. Additionally, political prediction markets can combat the growing trends of voter apathy and civic disengagement by providing incentives for voters to learn about the candidates and policies at issue.[25]

Political event contracts can also be used by companies to hedge risk related to an election, legislative vote or judicial decision. The outcome of political events can have a massive impact on global markets, and it is reasonable business practice for companies to hedge these risks. In the U.S., congressional action (or inaction) directly impacts what laws are or are not passed; which presidential nominees are confirmed; and whether a company's tax burden will dramatically change from one year to the next.[26] For example, in recent years various crypto market structure bills have been introduced, with none passing so far, and the probability of any of those bills becoming law is heavily dependent on which party controls Congress. A U.S.-based crypto firm may wish to use event contracts to hedge its risks related to the uncertainty of which political party will control Congress and by extension the probability of a certain proposed market structure becoming law.[27]

Further, political event contracts allow companies to hedge against risks that flow from the partisan composition of government. For example, if that same crypto firm anticipates needing to raise capital after the next congressional election, and the cost of doing so may rise or fall depending on which party is in control and that party's stance on crypto regulation, then the firm may use event contracts to mitigate that risk.[28]

We are at a perilous time in history, with many Americans questioning the validity of our elections and democratic processes. The answer to that threat is not to further shut out the light that markets provide, but to open our process up to more transparency, which political event contracts can help provide. As the

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[24] *See* S. Rep. No. 752, at 14 (1946) ("Agency notice must be sufficient to fairly apprise interested parties of the issues involved, so that they may present responsive data or arguments relating thereto").

[25] Vitalik Buterin, An Introduction to Futarchy, Ethereum (Aug. 21, 2014), https://blog.ethereum.org/2014/08/21/introduction-futarchy.

[26] Brief of Paradigm Operations LP as Amicus Curiae in Support of Plaintiff's Motion for Summary Judgment at 2–4, KalshiEx LLC v. CFTC, No. 23-cv-03257-JMC (D.D.C. 2024).

[27] *Id.* at 3.

[28] *Id.* at 7–8.

increasingly ultimate authority on democracy Justice Louis Brandeis himself said, "sunlight is said to be the best of disinfectants."[29]

VI. Recommendations

Paradigm respectfully requests that the CFTC consider revising or withdrawing the Event Contracts NPRM to account for the positions discussed herein. If the CFTC chooses to revise, rather than withdraw, the Event Contracts NPRM, we recommend that the Commission adopt an interpretation of "gaming" that accurately tracks the legislative history of CEA Section 5c(c)(5)(C) and real-world definition of "gaming" and does not broaden the scope of the term to include all political, sports, and awards outcomes. In addition, Paradigm recommends that the CFTC continue with its established practice of conducting contract-specific case-by-case review under Rule 40.11(c) and not adopt a blanket, and possibly unlawful, determination that all contracts involving enumerated activities are not in the public interest. Finally, Paradigm recommends that the CFTC propose the contemplated appendix providing guidance as to the factors it would consider when making a determination that an additional activity is similar to an enumerated activity for public notice and comment before finalizing such an appendix as part of any rulemaking.

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Paradigm appreciates the CFTC's consideration of our comments and would be pleased to engage with the CFTC as the Proposed Rule develops. If you have questions or would like to discuss these comments further, please reach out to agrieve@paradigm.xyz.

Sincerely,

Alexander Grieve
Government Affairs Lead, Paradigm

cc: Neal Kumar
Michael Selig
Matthew Goldberg
Willkie Farr & Gallagher LLP

[29] Louis D. Brandeis, *What Publicity Can Do*, HARPERS WEEKLY, Dec. 1913, at 10, https://www.sechistorical.org/collection/papers/1910/1913_12_20_What_Publicity_Ca.pdf.