**IN THE UNITED STATES DISTRICT COURT FOR
THE DISTRICT OF COLUMBIA**

KALSHIEX LLC, Plaintiff, vs. COMMODITY FUTURES TRADING COMMISSION, Defendant.	Civil Action No. 1:23-CV-03257-JMC

BRIEF OF *AMICUS CURIAE* ARISTOTLE INTERNATIONAL, INC., IN SUPPORT OF PLAINTIFF'S MOTION FOR SUMMARY JUDGEMENT

Michael J. Edney

D.C. Bar Number: 492024
HUNTON ANDREWS KURTH LLP
2200 Pennsylvania Avenue NW
Washington, D.C. 20037
medney@HuntonAK.com

Ethan Rosen

D.C. Bar Number: 1736636
ARISTOTLE INTERNATIONAL, INC.
205 Pennsylvania Avenue SE
Washington, D.C. 20003
Ethan.Rosen@Aristotle.com

Counsel for Amicus Curiae Aristotle International, Inc.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Local Rule 7(o)(5), undersigned counsel certifies:

Amicus Curiae Aristotle International has no parent company, and no publicly held company has a 10% or greater ownership interest in it.

STATEMENT OF AUTHORSHIP AND FINANCIAL CONTRIBUTIONS

Pursuant to Local Rule 7(o)(5), *Amicus* certifies that no counsel for any party authored the brief in whole or in part, and no entity or person other than the *Amicus* contributed money that was intended to fund the preparation or submission of this brief.

INTEREST OF *AMICUS CURIAE*

Aristotle International, Inc. ("Aristotle"), through its PredictIt, Inc. subsidiary, acts as a clearing house and service provider to Victoria University of Wellington's PredictIt market, which has offered contracts comparable to those at issue in this matter.

PredictIt began operating pursuant to a No Action Letter issued to Victoria University by the Commodity Futures Trading Commission ("CFTC" or "Commission") Division of Market Oversight in 2014.[1] Within the bounds of the 2014 No Action Letter, PredictIt has offered Congressional Control Contracts for the 2016, 2018, 2020, and 2022 election cycles. In servicing these markets, Aristotle has generated valuable experience and data relevant to issues in this matter.

Aristotle is a plaintiff in a challenge to the CFTC's arbitrary and capricious decision to withdraw the 2014 No Action Letter.[2]

Aristotle also has applied to operate a Designated Contract Market ("DCM"), which would allow it to operate similarly to Kalshi, the Plaintiff in this matter. Aristotle's application is currently pending before the CFTC. If Aristotle's application is approved, Aristotle intends to offer contracts similar to those offered by Kalshi on a DCM.

[1] CFTC Letter No. 14-130.
[2] *Clarke v. CFTC*, 74 F.4th 627 (5th Cir. 2023).

INTRODUCTION

KalshiEX LLC ("Kalshi") is a Designated Contract Market ("DCM") regulated by the Commodity Futures Trading Commission ("CFTC" or "Commission"). On June 6, 2023, Kalshi notified the CFTC that it intended to list two contracts for trading ("Proposed Contracts").[3] While the Proposed Contracts are described as "Congressional Control" contracts, they ultimately resolve based upon the political party affiliation of either the Speaker of the House of Representatives of the United States or the President Pro Tempore of the United States Senate.[4]

Pursuant to the relevant regulation,[5] the CFTC subjected the Proposed Contracts to a 90-day review period, which ended with the rejection of the relevant contracts in a Final Order ("Order" or "the Order").[6]

The Administrative Procedure Act requires courts to set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). In making a decision, the agency must "address important aspect[s] of the problem." *Gresham v. Azar*, 950 F.3d 93, 102 (D.C. Cir. 2020) (*internal citation omitted*). The agency also must demonstrate that it considered arguments and evidence to the contrary; it may not merely state that it has considered the concern. *Id.* at 103. The agency may not "offe[r] an explanation for its decision that runs counter to the evidence before the agency." *Am. Wild Horse Pres. Campaign v. Perdue*, 873 F.3d 914, 923 (D.C. Cir. 2017). It also must not "brush[] aside critical facts." *Id.*

[3] "Re: KalshiEX LLC - Commission Regulation 40.2(a) Notification Regarding the Initial Listing of the "Will <chamber of Congress> Be Controlled by <party> for <term> ?'Contract," KalshiEx LLC, June 12, 2013, www.cftc.gov/sites/default/files/filings/ptc/23/06/ptc0612232834.pdf.

[4] *Id.* at 7.

[5] 17 CFR § 40.11(c).

[6] "In the Matter of the Certification by KalshiEX LLC of Derivatives Contracts with Respect to Political Control of the United States Senate and United States House of Representatives," Commodity Futures Trading Commission, Sept. 22, 2023, www.cftc.gov/sites/default/files/filings/documents/2023/orgkexkalshiordersig230922.pdf.

at 932. When departing from past practices, the agency must "acknowledge the change and offer a reasoned explanation for it." *Id.* at 923.

Before it prohibits a DCM from listing a contract, the CFTC is required to adhere to a two-step process. 7 U.S.C. § 7a-2(c)(5)(C). First, it must determine that the contracts involve: (1) activity that is unlawful under any Federal or State law; (2) terrorism; (3) assassination; (4) war; (5) gaming; or (6) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest. Second, it must determine that the contracts are contrary to the public interest. Importantly, the statute requires the CFTC to find that a contract meets both prongs of the test before the CFTC may prohibit its listing.

The CFTC found that the Proposed Contracts relate to both gaming and activity that is unlawful under State law and that the Proposed Contracts are contrary to the public interest. The Commission's Order, however, deviates from the legal requirements found in the statute, fails to consider arguments and evidence presented to the Commission during the notice and comment period, and fails to demonstrate that it seriously considered arguments and evidence that disagree with the Commission's final conclusions. The Order is also inconsistent with the Commission's previous treatment of contracts offered by DCMs,[7] including those offered by Plaintiff Kalshi, and risks creating chaos in regulated markets. For these reasons, the Order should be found to be arbitrary and capricious.

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[7] The Order is consistent with the logic of the Commission's 2012 NADEX order prohibiting similar contracts. As discussed below, both the NADEX Order and the Kalshi Order are inconsistent with the current regulatory environment. *See In the Matter of the Self-Certification by North American Derivatives Exchange, Inc., of Political Event Derivatives Contracts and Related Rule Amendments under Part 40 of the Regulations of the Commodity Futures Trading Commission, Order Prohibiting the Listing or Trading of Political Event Contracts*, at 4, https://www.cftc.gov/PressRoom/PressReleases/6224-12.

ARGUMENT

I. ELECTION CONTRACTS ARE NOT GAMING

According to the CFTC, Kalshi's Proposed Contracts are akin to a spin of a roulette wheel: a game of chance with no economic utility. This characterization of the Proposed Contracts is both unsupported within the Order and is out of sync with market realities.

The CFTC's Order found that the Proposed Contracts constitute gaming, which the CFTC defines as being synonymous with gambling, betting, or wagering. The CFTC broadly defines these terms to mean that the relevant statute prohibits risking something of value based upon the occurrence or nonoccurrence of a future event, or a contest of others. Order at 8-10. Noting that many regulated futures contracts would potentially fit this definition, the CFTC adds that gaming, by definition, does not correlate to the price of commodities and other financial instruments. *Order* at 10 n.25. The CFTC then claims that "the economic impacts of the outcome of contests for Congressional control are too diffuse and unpredictable to serve the hedging and risk management functions that futures contracts have traditionally been intended to serve." *Id.*

A. The proposed contracts serve an economic purpose

Several of the comments submitted during the CFTC's Notice and Comment Period disputed the CFTC's premise regarding the hedging function of these products. The CFTC is required to provide its rationale for disregarding significant objections and evidence to its decision making. *Stewart v. Azar*, 313 F. Supp. 3d 237, 264 (D.D.C. 2018) (citing *Bowman Transp., Inc. v. Arkansas-Best Freight System*, 419 U.S. 281, 296, 95 S.Ct. 438, 42 L.Ed.2d 447 (1974)).

The CFTC fails to grapple with the clear flow of economic effects from elections. It notes the reasoning of the many commentors who describe a clear link between election results and economic outcomes, and merely characterizes this link as "diffuse and unpredictable." Order at 16. It states, ignoring comments to the contrary, that Kalshi and the commentors have failed to identify specific links between elections and economic consequences. Order at 17. The CFTC had an obligation to do more than "[n]od[] to concerns raised by commenters only to dismiss them in a conclusory manner." *Gresham*, 950 F.3d at 103. The CFTC's conclusion is divorced from reality, and ignores clear evidence that traders already consider election results in their investing strategies.

PredictIt Data, for example, already appears on the Bloomberg Terminal, where investors can see current probabilities of election winners. BlackRock offers a Geopolitical Risk Indicator, which highlights several potential risks, including those of US-China strategic competition and technology decoupling, and climate policy gridlock, which are directly impacted by American congressional elections.[8] Political risk insurance is already widespread,[9] and political risk is a staple topic at leading business schools including Wharton,[10] Stanford,[11] and Harvard.[12] While political risk insurance has traditionally been offered to American or European-based companies doing business in Africa, Latin America, and parts of Asia, coverage for U.S.-based risks is now

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[8] "BlackRock Geopolitical Risk Indicator," BLACKROCK, www.blackrock.com/corporate/insights/blackrock-investment-institute/interactive-charts/geopolitical-risk-dashboard.

[9] Political Risk Insurance, NAIC, https://content.naic.org/cipr-topics/political-risk-insurance. *See also, e.g.*, https://starrcompanies.com/Insurance/Casualty/Political-Risk; https://www.allianz-trade.com/en_global/news-insights/business-tips-and-trade-advice/what-is-political-risk-and-how-to-protect-against-it.html; https://www.aig.com/business/insurance/political-risk; https://www.lloyds.com/conducting-business/risk-locator/business-guidance/political-risk; https://www.marsh.com/us/services/politicalrisk/insights/political-risk-map-2021.html; https://www.aon.com/risk-services/crisis-management/political-risks.jsp.

[10] *See How Companies Can Navigate Political Risks Successfully*, KNOWLEDGE AT WHARTON, https://knowledge.wharton.upenn.edu/article/companies-can-successfully-navigate-political-risks/.

[11] *See Political Risk: How Businesses and Organizations Can Anticipate Global Insecurity*, STANFORD UNIVERSITY, https://fsi.stanford.edu/publication/political-risk-how-businesses-and-organizations-can-anticipate-global-insecurity.

[12] *See Managing 21st-Century Political Risk*, HARVARD BUSINESS REVIEW, https://hbr.org/2018/05/managing-21st-century-political-risk.

under discussion.[13]

American elections have clear and predictable economic consequences. One paper found that a full 4.35 percent of U.S. companies could be labeled as "blue," meaning their stocks perform better under a Democratic President.[14] The same study found that "red" firms constitute 5.11 percent of stocks. Red and blue stocks are subject to 48 percent higher volatility than colorless ones in election years. An investment strategy of longing and shorting opposite-colored stocks at the beginning of a new administration was projected to generate an abnormal return of 9.3 percent per year.[15]

Many of the economic effects of elections are both direct and entirely predictable. Candidate Biden, for example, repeatedly campaigned on his plan to revoke the permit for the Keystone XL Pipeline.[16] He followed through with this promise on his first day in office.[17] Investors in Keystone's operator and related companies clearly could have hedged their positions based on projected outcomes in the Presidential race. As discussed below, partisan control of Congress has similarly predictable consequences for red and blue stocks, leading to obvious hedging opportunities.

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[13] *See Political risk coverage for US may be live issue after riots shake country*, S&P GLOBAL MARKET INTELLIGENCE, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/political-risk-coverage-for-us-may-be-live-issue-after-riots-shake-country-62627872; *Insuring Political Risk in the United States*, PILLSBURY, https://www.policyholderpulse.com/insuring-political-risk-united-states/.

[14] Yan, Yuxing, *Red vs. blue stocks: politics and profitability of firms*, PROCEEDINGS OF 27TH INTERNATIONAL BUSINESS RESEARCH CONFERENCE, June 12, 2014.

[15] *Id.* at 190.

[16] Oliphant, James, *Democrat Biden Says He Would Kill Keystone XL Pipeline*, REUTERS, May 19, 2020, *available at* www.reuters.com/article/idUSKBN22V0RF/.

[17] E.O. 13990, *Executive Order on Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis* (Jan. 20, 2021).

The CFTC attempts to undermine this predictability of these economic consequences by pointing out that there are several steps between an election and the enactment of a law, such as approval by both Chambers of Congress and a presidential signature. Order at 16 n.16. While it is certainly true that there are steps between elections and the enactment of legislation, both lawmakers and market participants are already fully capable of tempering their expectations as to whether certain types of legislation will be enacted based on the partisan control and makeup of both Chambers, and on the occupant of the White House.

Consider, for example, the reaction to the news that Democrats had won control of the Senate, clinching a legislative trifecta (meaning that Democrats held majorities in both the Senate and the House of Representatives, and the President was a Democrat), after the Georgia runoffs in the 2020 elections. Former House Speaker Nancy Pelosi said that the results "change the dynamic in the Senate, but also in the country."[18]

Senator Wyden (D-OR), the contemporaneous incoming Chairman of the Senate Finance Committee, said that the change in Senate control "gives us the opportunity to have a very different set of choices."[19]

Both of these lawmakers were referring to the possibility of passing legislation through the Budget Reconciliation process, which they immediately understood would allow them to pass partisan legislation on a limited set of topics. The subsequent reconciliation bills, known as the

[18] Ferris, Sarah *et al.*, *Jubilant Democratic Leaders Look to Move Fast after Georgia Surprise*, POLITICO, Jan. 6, 2021, *available at* www.politico.com/news/2021/01/06/congress-democratic-takeover-georgia-senate-455333.

[19] Emma, Caitlin, *Georgia Just Delivered Democrats Their Most Powerful Weapon*, POLITICO, Jan. 8, 2021, *available at* www.politico.com/news/2021/01/08/georgia-senate-democrats-powerful-weapon-budget-456116.

American Rescue Plan and the Inflation Reduction Act, included $1.843 trillion[20,21] in new spending through 2031 along with reductions in spending on prescription drugs and new tax credits for renewable energy and electric vehicle investment. This spending was well within investor expectations of what a Democratic Congressional majority could focus its lawmaking power on.

As they demonstrated in early 2021, market participants can understand the legislative process. The iShares Global Clean Energy ETF ($ICLN), an index of equities in the clean energy sector (which was substantially affected by the Budget Reconciliation process), rallied after Democrats won control of the Senate, increasing by a full 17 percent between December 31, 2020, and January 8, 2021, far outpacing the Dow Jones Industrial Average which rose by 1.6 percent during the same period. The Global X Lithium & Battery Tech ETF ($LIT), which tracks companies involved in the production and processing of Lithium, a key element of electric vehicle and other battery production, rose by 14.5% during this same period. Investors did not consider it likely[22] that Congress would pass other Democratic campaign priorities, such as a minimum wage increase, that could not easily be included in the Budget Reconciliation process.[23]

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[20] Congressional Budget Office, *Estimated Budgetary Effects of HR 1319, American Rescue Plan Act of 2021 as Passed by the Senate on March 6, 2021*, Mar. 2021, *available at* www.cbo.gov/system/files/2021-03/Estimated_Budgetary_Effects _of_HR_1319_as_passed_0.pdf.

[21] Congressional Budget Office, *Estimated Budgetary Effects of H.R. 5376, the Inflation Reduction Act of 2022, as Amended in the Nature of a Substitute (ERN22335) and Posted on the Website of the Senate Majority Leader on July 27, 2022*, Aug. 5, 2022, *available at* www.cbo.gov/system/files/2022-08/hr5376_IR_Act_8-3-22.pdf.

[22] A PredictIt market asking if the Democratic trifecta would raise the minimum wage to $15 per hour peaked at an average daily trade price of $0.17, implying that traders thought that such an increase was always below a 20% probability. *See* https://www.predictit.org/markets/detail/7075/Will-Biden-policy-to-raise-minimum-wage-to-$15-per-hour-in-2021-succeed.

[23] Sozzi, Brian, *Don't Expect a $15 Federal Minimum Wage: Goldman Sachs*, YAHOO! FINANCE, Feb. 8, 2021, finance.yahoo.com/news/dont-expect-a-15-federal-minimum-wage-goldman-sachs-130431033.html.

The CFTC further attempts to undermine the economic purpose of these contracts by referring to their binary nature. Order at 18. According to the CFTC, the binary payout of these contracts limits their utility as a hedging vehicle, and makes them akin to sports betting. While the contracts do payout in a binary fashion, this conclusion ignores the real-world utilization of prediction market contracts.

Prediction market positions are tradeable until the date of settlement. On both PredictIt and Kalshi, traders who purchase shares at one price are free to sell shares prior to the resolution of the market. In PredictIt's market asking about partisan control over Congress following the 2022 midterm elections, for example, 68 percent of shares purchased over the life of the market were sold at least once prior to the settlement of the market. In the equivalent 2020 market, 80 percent of shares were sold at least once prior to settlement. Contrast this with the typical all-or-nothing structure of a gambling bet. Once a gambling bet is made there is no secondary market where a participant can exit the bet.

While the final payout structures in gaming and prediction markets are similar—all to the correct side, and nothing to the incorrect side—the free tradability of prediction market positions prior to settlement makes the uses and behavior of prediction market positions quite different from gaming. On PredictIt, typical traders do not buy and hold shares to the payout date for an all or nothing result, but instead make an investment, observe a profit or loss, and exit the market via a trade with a payout of some amount other than the binary $0 or $1. Similar behavior is evident in non-binary futures markets where many traders take and then exit positions before settlement dates.

Kalshi's Proposed Contracts, thus, are not equivalent to a spin of the roulette wheel or a bet on a football game. There is clear evidence, which the CFTC failed to substantively address as required by the APA, that the Proposed Contracts have serious economic value. Yes, there are steps between elections and the enactment of legislation. No, these steps do not eliminate the hedging value of Kalshi's Proposed Contracts. The CFTC's conclusion is in error, and its mishandling of record evidence is arbitrary and capricious, all in violation of the APA.

II. THE CFTC IS IMPROPERLY SUBSTITUTING AN ECONOMIC PURPOSE TEST FOR THE STATUTORILY MANDATED PUBLIC INTEREST TEST

After finding that the Proposed Contracts constituted both gaming and activity that is unlawful under state law, the Commission was required by the statute to proceed to an analysis of whether the Proposed Contracts were within the public interest. 7 U.S.C. § 7a-2(c)(5)(C). The CFTC—citing to a single exchange between two Senators—proceeded to describe the mandated test as a "form of the 'economic purpose test'" that was in a previous version of the statute. Order at 13. The economic purpose test, however, was repealed in the Commodity Futures Modernization Act of 2000 (CFMA). If Congress had intended only ten years later to re-enact that test, it would have used the same phrase. Instead, Congress deliberately chose to use a facially broader phrase, "public interest." Indeed, in the colloquy cited by the CFTC, a question is posed regarding "economic use" but answered using the statutory phrase "public interest."[24]

The CFTC cannot act in a way that "is manifestly contrary to the statute," as it did when it swapped in a repealed Economic Purpose test where the statute uses a Public Interest test. *See, e.g.*, *Good Fortune Shipping SA v. Comm'r*, 897 F.3d 256, 261 (D.C. Cir. 2018).[25] Indeed, the

[24] 56 Cong. Rec. S5906-07 (July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln), *available at* https://www.congress.gov/111/crec/2010/07/15/CREC-2010-07-15-senate.pdf.

[25] *See also Dorszynski v. United States*, 418 U.S. 424, 449 (1974); *Escondido Mutual Water Co. v. La Jolla Band of Mission Indians,* 466 U.S. 765, 772 (1984) ("congressional intent finds clear expression in the words of the statute") (Marshall, J., concurring); *North Dakota v. United States*, 460 U.S. 300, 312 (1983) ("[I]t should be generally assumed that Congress expresses its purposes through the ordinary meaning of the words it uses, we have often stated that '[a]bsent a clearly expressed legislative intention to the contrary, [statutory] language must ordinarily be

CFTC itself has proclaimed that it has "discretion to consider other factors in addition to the economic purpose test in determining whether an event contract is contrary to the public interest."[26]

The CFTC then erroneously concluded that "it has not been demonstrated that the Congressional Control Contracts could reasonably be expected to be used for hedging and/or price basing on more than an occasional basis or that the Congressional Control Contracts could reasonably be expected to be used predominantly by market participants having a commercial or hedging interest." Order at 19. As discussed above, this conclusion is in error, and this Court should reject it.

III. THE PROPOSED CONTRACTS ARE WITHIN THE PUBLIC INTEREST

As described above, the economic purpose of the Proposed Contracts has already been extensively demonstrated to the Commission, which has not seriously grappled with the evidence put before it. The Proposed Contracts also pass the Public Interest test that the Statute requires the CFTC to follow.

In particular, the Proposed Contracts would serve the public interest through their ability to generate probabilities of the occurrence or non-occurrence of future events. In the context of elections, the general public has already demonstrated a significant interest in these probabilities.

When event contract markets, such as PredictIt and Kalshi, offer contracts for sale, they are initially offered without any sale price attached. The contracts generate prices when traders—

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regarded as conclusive.'" (quoting *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)).

[26] *See In the Matter of the Self-Certification by North American Derivatives Exchange, Inc., of Political Event Derivatives Contracts and Related Rule Amendments under Part 40 of the Regulations of the Commodity Futures Trading Commission, Order Prohibiting the Listing or Trading of Political Event Contracts*, at 4, *available at* https://www.cftc.gov/PressRoom/PressReleases/6224-12.

one buying the "Yes" side of the contract option and the other buying the "No" side—agree on a price. This price then repeatedly changes over the course of the life of the contract as traders digest new information. These prices continuously reflect the probability of the specified event outcome occurring, and they reflect the consensus of the wide diversity of opinions and worldviews of a diverse pool of traders.

This is the essential public service that prediction markets offer. They serve an information aggregation function for individual members of the public, as well as academics, companies, and governments who use them to further their research, manage their business operations, and set policy.[27] Since its launch in 2014, PredictIt prices have generated significant public interest. These prices have been widely cited in media[28] and among investment analysts, often as an alternative to polling or election models. PredictIt data has been used by students and academics at over 130 universities across a wide range of subjects including microeconomics, political behavior, computer science, and game theory.

Well more than a million unique individuals visited the PredictIt website during the week of the 2020 election, far in excess of the number of individuals buying and selling contracts during this time period. This activity indicates that members of the public were visiting PredictIt not only to make trades, but also to see how the market was reacting to information as it came in. It also shows that the public sees prediction market data as an important tool in understanding election results, which are often unclear and even misleading as individual counties across the country

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[27] Hong, L., & Page, S. (2012). *Some Microfoundations of Collective Wisdom*, a chapter in H. Landemore & J. Elster (Eds.), *Collective Wisdom: Principles and Mechanisms* at 56-71, Cambridge University Press, doi: 10.1017/CBO9780511846427.004

[28] *What to Expect in 2021 According to Prediction Markets*, THE ECONOMIST, Jan. 2, 2021, https://www.economist.com/graphic-detail/2021/01/02/what-to-expect-in-2021-according-to-prediction-markets

report partial results. PredictIt traders, for example, had priced in that candidate Biden was likely to win the State of Michigan in 2020, well before ballot returns from Detroit gave him the lead in the official count. In a recent example, PredictIt traders digested early returns and concluded that former President Trump was almost guaranteed to win the 2024 Republican Presidential Primary election in New Hampshire, even as these returns showed a close race.[29]

PredictIt market prices receive significant attention from the news media, political actors, and investors. This is precisely because, over time, political prediction markets have built a reputation for accurately reflecting the probability that a candidate or party will win an election.

The diversity of available viewpoints is essential to the accuracy of these price movements, and it distinguishes prediction markets from other tools such as expert forecasts.[30] In a political prediction market, individuals make trades based on a significant number of data sources. These include objective measures like polling results, fundraising, and endorsements, but they also include subjective measures like debate performance, the perceived impact of press reports, local yard sign or bumper sticker sightings, and perceived crowd sizes. One pool of traders, for example, may see a candidate's debate performance as likely to help earn votes, while others may see such a performance as likely to do more harm than good. Substitutes like polling aggregates or expert forecasts cannot serve as substitutes for the public service that prediction markets provide.

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[29] *Who will win the 2024 New Hampshire Republican primary?*, PREDICTIT, *available at* https://www.predictit.org/markets/detail/8071/Who-will-win-the-2024-New-Hampshire-Republican-primary (last visited Jan. 31, 2024).

[30] Miller, Thomas W., *Predicting the 2020 Presidential Election*, DATA SCIENCE QUARTERLY 1.1 (2021).

The case for prediction markets relies on the same insight that supports democracy[31] and the efficiency of a market economy.[32] The aggregate of the decisions of millions of voters or consumers will produce better outcomes than decisions made by even the best qualified experts. Some modern research suggests that both diversity of viewpoint and individual expertise are important to the accuracy of prediction markets.

The Commission is further concerned that unscrupulous individuals will spread misinformation in order to both manipulate Kalshi's Proposed Contracts and to "influence elections or electoral perceptions" by causing price movement on the contracts. Order at 20. This concern ignores the role that prediction markets already serve as a counterweight to the unscrupulous use of polling, which is already a widespread practice.

In contrast to the barriers to manipulation in well-functioning, liquid markets, public opinion polls are routinely used with the express intent of manipulating perceptions of likely success, fundraising, and voting. Pollsters can publish the results of Push Polls, which measure voter attitudes about candidates, but only after the voters have heard targeted negative or positive messages about said candidates.[33] Partisan and in-house campaign pollsters routinely manipulate sampling methodologies, question design, and even polling times and methods to generate positive indicators for their clients, and release the most favorable results to the public. Other pollsters may manipulate their data, using the same tactics discussed above, in order to prevent the release

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[31] This is not a new observation. Two millennia ago, Aristotle, in his seminal work *Politics*, made a compelling case that collective judgment is as good or better than that of experts.

[32] Hayek, Friedrich A., *The Use of Knowledge in Society*, AMERICAN ECONOMIC REVIEW 4 at 519-530 (1945).

[33] *See* Jonathan S. Fox, *Push Polling: The Art of Political Persuasion*, 49 FLA. L. REV. 563 (1997).

of outlier polls in a practice known as "herding."[34] In the 2022 midterm elections, Democratic strategists raised credible concerns that partisan Republican pollsters were "flooding" polling averages in order to manipulate public perceptions.[35]

Efforts to manipulate well-functioning markets in similar ways are simply profit opportunities for informed traders, who are financially incentivized to discern fact from fiction. The approval of the Proposed Contracts would not lead to the sort of manipulation about which the Commission is concerned. Rather, it would be a significant tool in combating election misinformation.

IV. THE CFTC IS ARBITRARILY INTERPRETING THE COMMODITY EXCHANGE ACT IN A WAY THAT IMPERMISSIBLY DEVIATES FROM PAST PRACTICES WITHOUT OFFERING EXPLANATION

The CFTC's conclusion that Kalshi's Proposed Contracts constitute impermissible gaming, or are contrary to state law, is inconsistent with its treatment of other contracts.

The CFTC's Order claims that the use of the word "involve" in the statute means that the CFTC can prohibit both "contracts whose underlying [purpose] *is* one of the enumerated activities, and contracts with a different connection to one of the enumerated activities because, for example, they 'relate closely' to, 'entail,' or 'have as an essential feature or consequence' one of the enumerated activities." Order at 6-7. The CFTC then cites several state statutes that define gaming as akin to taking a stake on the outcome of a contest of others or on a future contingent event that is not influenced by one of the parties taking a stake. *Id.* at 8-9. The CFTC also notes that some states explicitly prohibit gaming on elections. *Id.* at 9. For the CFTC, the fact that an

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[34] Silver, Nate, *Here's Proof Some Pollsters Are Putting a Thumb on the Scale*, FIVETHIRTYEIGHT, Nov. 14, 2014, *available at* fivethirtyeight.com/features/heres-proof-some-pollsters-are-putting-a-thumb-on-the-scale/.

[35] Shepard, Stevan, *The Biden Gap and the Partisan Poll Flood: Breaking Down the Latest Senate Surveys*, POLITICO, Nov. 1, 2022, *available at* www.politico.com/news/2022/11/01/biden-gap-senate-surveys-00064362.

election is a contest of others is enough to define the Proposed Contracts as both impermissible gaming, and impermissible violations of state law. *Id.* at 8-12.

In effect, the CFTC argues that the enumerated prohibitions do not merely extend to what people are trading on, but can extend to the act of trading altogether. This reading fundamentally deviates from the CFTC's interpretation of the statute in other contexts, including in its past dealings with Kalshi, and risks undermining the rationale for regulated futures markets altogether.

Consider, for example, the fact that the CFTC, for over a decade, has permitted Kalshi[36] and other DCMs[37] to list contracts that resolve based upon the number of hurricanes that hit in a given calendar year. These contracts would potentially constitute unlawful gaming in several states.[38] Kalshi has offered contracts on the outcome of the Academy Awards,[39] despite the fact that at least two states have already explicitly regulated these contracts as gaming.[40] Kalshi offers

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[36] *Number of Hurricanes in 2023?*, Kalshi, *available at* kalshi.com/markets/hurctot/number-of-hurricanes.

[37] Commodity Futures Trading Commission, *Cantor Futures Exchange, L.P: Rule 40.2 New Contract Submission—Atlantic Named Storm Landfall Binary Option Contract Submission #2016-5*, Jun. 13, 2016, *available at* www.cftc.gov/sites/default/files/filings/ptc/16/06/ptc061416 cantordcm001.pdf.

[38] *See*, *e.g.*, Ala. Code § 13A-12-20 ("A person engages in gambling if he stakes or risks something of value upon the outcome of a contest of chance *or a future contingent event not under his control or influence,* upon an agreement or understanding that he or someone else will receive something of value in the event of a certain outcome." (emphasis added)); S.D. Codified Laws § 22-25A-1 ("For the purposes of this chapter, the term, bet or wager, means to directly or indirectly take, receive, or accept money or any valuable thing with the understanding or agreement that the money or valuable thing will be paid or delivered to a person if the payment or delivery is contingent upon the result of a race, contest, or game *or upon the happening of an event not known to be certain*." (emphasis added)).

[39] *Oscar for Best Picture?*, Kalshi, kalshi.com/markets/oscarpic/oscars-best-picture#oscarpic-24 (last visited Jan. 31, 2024).

[40] *Indiana Allowing Wagers on Who'll Win Oscars next Month*, ASSOCIATED PRESS, Jan. 25, 2020, apnews.com/general-news-250e97f04a6e20dcdaf559b29289fcc1; *New Jersey Division of Gaming Enforcement Announces Academy Award Wagering Information*, NEW JERSEY OFFICE OF ATTORNEY GENERAL, Feb. 10, 2020, www.njoag.gov/new-jersey-division-of-gaming-enforcement-announces-academy-award-wagering-information/.

contracts on weather events in New York City,[41] even though such bets would likely constitute unlawful gaming under New York State law.[42]

The CFTC has an obligation under the Administrative Procedure Act to acknowledge and explain its departure from past practices, lest its actions be found to be arbitrary and capricious. *Grace v. Barr*, 965 F.3d 883, 903 (D.C. Cir. 2020). This includes an obligation to reconcile the Order's interpretation or application of a statute with the agency's previous interpretations and applications of it. In its Order, the CFTC fails to acknowledge, let alone explain, why the same logic that found the Proposed Contracts to relate to violations of state laws or gaming deviates so significantly from the statutory interpretation used to permit contracts on weather or the Academy Awards, among others.

The CFTC's attempts to defend this discrepancy is in a footnote. There, it declares that elections are sometimes referred to as "contests" and have uncertain economic effects. Order at 10 n.25. This footnote is part of a larger section attempting to explain why the Proposed Contracts constitute gaming. Importantly, though, the CFTC fails to explain why it is applying this standard to Kalshi's Proposed Contracts, and not to other contracts, or even to the act of trading altogether. The Grammy Awards, which the CFTC sees as within the scope of allowable contracts,[43] may be referred to as contests. The CFTC has also permitted contracts on developments in Artificial

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[41] *Total snow in NYC this month?*, Kalshi, https://kalshi.com/markets/snownym/total-snow-in-nyc#snownym-24jan (last visited Jan. 31, 2024).

[42] *See* N.Y. Penal Law § 225.00(2) ("A person engages in gambling when he stakes or risks something of value upon the outcome of a contest of chance or a future contingent event not under his control or influence, upon an agreement or understanding that he will receive something of value in the event of a certain outcome.").

[43] *Grammy for Record of the Year?*, Kalshi, https://kalshi.com/markets/gramroty/grammy-for-record-of-the-year#gramroty-66 (last visited Jan. 31, 2024).

Intelligence,[44] the economic effects of which are fiercely debated.[45]

The Commission fails to acknowledge or grapple with the fact that its disapproval of the Proposed Contracts differs from its longstanding practices. The future sale price of a traditional commodity is clearly a "contingent event" not in the control of the parties to a futures contract. Under the reasoning the CFTC advances in the Order, nearly every transaction regulated by the Commodity Exchange Act would be in violation of some state gaming laws.

The CFTC's arbitrary interpretation of the relevant statute risks creating havoc in regulated event markets. If the CFTC were serious about its interpretation of the legal standard articulated in the Order and applied it consistently elsewhere, it would undermine the rationale for every market regulated under the Commodity Exchange Act, as nearly all futures markets may in some way "involve" gaming or risk overlapping with state laws. Nowhere in the Order does the CFTC address the sweeping consequences of the Order's interpretation of the Act. Nor does the CFTC attempt to reconcile this interpretation with decisions it has made and contracts it has allowed in the past. The CFTC's Order fails to adequately explain how it is that Kalshi's Proposed Contracts constitute gaming, but other contracts offered on DCMs do not. Both of these shortcomings define the arbitrary decisionmaking prohibited by the Administrative Procedure Act. The CFTC must provide the public with a definition of gaming that it can consistently and non-arbitrarily apply to proposed contracts. It has not done so.

V. THE COMMISSION MISUNDERSTANDS THE NATURE OF THE PROPOSED CONTRACTS

Nor does the Commission's stated concern that approval of the Proposed Contracts could

[44] *OpenAI achieves AGI this year?*, Kalshi, https://kalshi.com/markets/oaiagi/openai-achieves-agi#oaiagi (last visited Jan. 31, 2024).

[45] *What Will Artificial Intelligence Mean for Your Pay?*, THE ECONOMIST, Nov. 16, 2023, *available at* www.economist.com/finance-and-economics/2023/11/16/what-will-artificial-intelligence-mean-for-your-pay.

require the Commission to "investigat[e] election-related activities – potentially including the outcome of an election itself" – support the Commission's decision. Order at 22. The concern fundamentally misunderstands the Proposed Contracts that the Commission rejected, is at odds with the Commission's current practices, and is contrary to evidence in the rulemaking record. The Commission's reliance on this reason for rejection of the Proposed Contracts is arbitrary and capricious.

The Contracts in question would resolve based upon the political party affiliation of the individuals who fill two offices at a provided date: those of the Speaker of the United States House of Representatives, and of the President Pro Tempore of the Senate. Both of these positions are filled, not as a direct result of popular elections, but by votes within their respective chambers.[46] Notably, PredictIt has run markets—within the same election cycle—on both the ultimate partisan composition of any given chamber of Congress,[47] and on the election of the Speaker of the House.[48] The prices for these two markets do not always correlate.[49]

Any claim of impropriety in an election, made in good faith or otherwise, would simply

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[46] *Office of the Speaker*, GOVINFO, Government Publishing Office, www.govinfo.gov/content/pkg/GPO-HPRACTICE-108/pdf/GPO-HPRACTICE-108-35.pdf (last visited Jan. 30, 2024); *President Pro Tempore*, GOVINFO, Government Publishing Office, www.govinfo.gov/content/pkg/GPO-RIDDICK-1992/pdf/GPO-RIDDICK-1992-107.pdf (last visited Jan. 30, 2024).

[47] *Which party will win the House in the 2022 election?*, Predictit, https://www.predictit.org/markets/detail/6892/Which-party-will-win-the-House-in-the-2022-election (last visited Jan. 31, 2024).

[48] *Who will be Speaker of the House of Representatives in the next Congress?*, Predictit, https://www.predictit.org/markets/detail/7326/Who-will-be-Speaker-of-the-House-of-Representatives-in-the-next-Congress (last visited Jan. 31, 2024).

[49] On January 3, 2023, for example, PredictIt shares of Democratic House Leader Hakeem Jeffries traded as high as $.07, indicating that Republican Leader McCarthy's failure to earn the necessary votes created a 7% chance that the Republican-majority House would elect a Democratic Speaker. *See Who will be Speaker of the House of Representatives in the next Congress?*, PredictIt, https://www.predictit.org/markets/detail/7326/Who-will-be-Speaker-of-the-House-of-Representatives-in-the-next-Congress.

not be relevant to the resolution of these contracts, and would not require the CFTC to conduct an investigation regarding the results of an election.

This is exactly how the CFTC has treated other contracts run on Kalshi in the past, and the CFTC has not articulated why these contracts are distinct from contracts on the passage of the Bipartisan Innovation Act[50] or a NEPA Permitting Reform Bill,[51] among others. These contracts, which were offered without objection from the CFTC, similarly resolve based upon votes of members of the United States House of Representatives and United States Senate, without regard to any claim relating to the election of any given member.

CONCLUSION

The CFTC's Order is arbitrary, capricious, and otherwise contrary to law. The Order is an anomaly in the current regulatory environment, and the CFTC fails to explain why its treatment of the Proposed Contracts deviates so substantially from that of other contracts put before it. The Order's conclusion that the Proposed Contracts lack an economic purpose is both unexplained and out of line with the evidence put before the Commission. The Order misapplies the statute-mandated text, and proceeds to misunderstand both the value and the nature of the contracts. For these reasons, the Court should determine that the Order is arbitrary and capricious, hold it unlawful, and set it aside under 5 U.S.C. § 706.

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[50] *Bipartisan Innovation Act by election day?*, Kalshi, https://kalshi.com/markets/usica/bipartisan-innovation-act#usica (last visited Jan. 31, 2024).

[51] *NEPA permitting reform bill by January 02, 2023?*, Kalshi, https://kalshi.com/markets/nepa/nepa-permitting-reform-bill#nepa-23jan02 (last visited Jan. 31, 2024).

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Respectfully Submitted,

HUNTON ANDREWS KURTH LLP

By: */s/ Michael J. Edney*
Michael J. Edney

D.C. Bar Number 492024
Hunton Andrews Kurth
2200 Pennsylvania Avenue NW
Washington, D.C. 20037
medney@HuntonAK.com

Ethan Rosen
D.C. Bar Number: 1736636
Aristotle International, Inc.
205 Pennsylvania Avenue SE
Washington, D.C. 20003
Ethan.Rosen@Aristotle.com

Counsel for Amicus Curiae Aristotle International, Inc.