

PredictIt Triumphs Over Regulatory Arrogance

An appeals court rejects the CFTC's arbitrary order to shut down the political futures market.

By Donald L. Luskin

PredictIt, a small online political-futures market operated by a New Zealand university, has won an important court ruling against the Commodity Futures Trading Commission, which seeks to shut it down. The case could eventually shake the foundations of the regulatory state.

I wrote about the case, *Clarke v. CFTC*, on these pages in November. PredictIt is a web site that allows traders to buy and sell real-money futures contracts on politics. As of Monday, for instance, you could buy a contract that Joe Biden will be re-elected in 2024 for 45 cents. If he wins, the contract will pay \$1, and you'll earn a profit of 55 cents. The site was established as an experimental laboratory by the Victoria University to explore whether such markets could produce predictive information that might be better than conventional polling.

PredictIt began operating in 2014, after the university received a “no-action letter” from the CFTC’s Division of Market Oversight. The letter exempted the exchange from onerous regulations that apply to regular futures markets, provided it constrain customer positions to \$850 in any one contract, operate as a nonprofit, and limit the contracts it offered to those directly pertaining to politics and political decisions.

No-action letters like PredictIt’s and similar vehicles such as “guidance letters” and “dear colleague letters” pervade the modern regulatory state. As a class they are known as “subregulation”—that is, rules that bypass the normal statutory rulemaking processes called for by each agency’s own establishing legislation and overall by the Administrative Procedure Act of 1946. No-action letters are a green light to proceed with an activity that may run afoul of regulation. They are granted at the unaccountable discretion of the regulators.

They are rescinded in the same manner, as PredictIt learned in August 2022. After almost eight years in operation—during which it successfully served more than 175,000 traders, listed more than 29,000 contracts, provided a living research laboratory for political scientists, and gave citizens a new way to express their political views—the CFTC without warning yanked the 2014 no-action letter and ordered the online exchange to shut down. No specific reasons were given, and there was no process for appeal.

The following month a group of PredictIt traders and service providers sued in federal court in Texas, seeking an injunction against the CFTC’s shutdown order. They asked for a finding that the no-action letter constituted a license that under the APA couldn’t be revoked arbitrarily or capriciously. After the district court sat on the petition for months, the plaintiffs appealed to the Fifth U.S. Circuit Court of Appeals.

The CFTC's arguments before the appellate court were a case study in regulatory arrogance. The commission said it owed PredictIt no explanation because the no-action letter was originally granted by staff at their discretion. Because it wasn't a "final action," the CFTC claimed, it wasn't subject to review of any kind, including by the courts.

According to the CFTC, the plaintiffs also had no standing to sue, because the no-action letter was granted not to them but to Victoria University. Never mind that the traders faced unpredictable potential losses in a hurried shutdown, or that service providers would see their investments in infrastructure wiped out. The CFTC said they could obtain financial relief by suing each other.

During oral arguments in February, Judge James Ho said the CFTC was treating the no-action letter "like a license to bully." In its July 21 ruling written by Judge Stuart Kyle Duncan, the court treated the letter instead as a license to operate. For the first time, a no-action letter was held to be a license on which the recipient relied, because a license can't be rescinded without cause and without due process, including judicial review.

Such accountability promotes good regulation. When a regulator has to state the cause, the regulated party has an opportunity to repair deficiencies—and if it does, the cause goes away. The causes become a road map for regulators and for courts, to which regulated parties have the right to appeal. Because the Fifth Circuit recognized the reliance interest of third parties—in this case, the traders and service providers that were harmed—there is a broad new platform for anyone harmed by the arbitrary and capricious application of subregulation to seek judicial review.

No-action letters, the Fifth Circuit ruled, are "final actions." In other words, subregulation is regulation. The PredictIt decision in *Clarke* may be cited to constrain other subregulatory prohibitions or commands such as those promulgated in "dear colleague letters." The Fifth Circuit has instructed the district court to grant the injunction and hear the case on the merits. The CFTC is unlikely to appeal to the Supreme Court at this stage, but the issue seems likely to work its way to the justices, either in this case or another.

We can't be sure why the CFTC decided to put a thriving political futures market out of business. After the PredictIt decision, six Democratic senators, led by Oregon's Jeff Merkley and including Massachusetts' Elizabeth Warren and Rhode Island's Sheldon Whitehouse, wrote to CFTC Chairman Rostin Behnam urging the commission not to permit any new political markets.

But that's a rearguard action. Thanks to arrogant regulatory overreach, the attack on political markets backfired in the Fifth Circuit. PredictIt will stay in business, and regulators will face new accountability.

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