
DECONSTRUCTING THE REGULATORY AND JUDICIAL BATTLE OVER MODERN PREDICTION MARKETS

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ABSTRACT

This paper provides a critical legal analysis of the rapidly evolving regulatory landscape governing prediction markets in the United States, focusing on the divergent paths of decentralized platforms like *Polymarket* and federally regulated exchanges like *Kalshi*. Historically, the Commodity Futures Trading Commission (CFTC) maintained a highly restrictive posture toward event contracts, routinely barring retail markets tied to political outcomes or socially sensitive events under the auspices of public interest and the prevention of illicit gambling. However, the legal boundaries of this framework have been radically upended by parallel developments: the 2022 administrative enforcement action against *Blockratize, Inc. (Polymarket)* and the landmark 2024 federal court ruling in *KalshiEx LLC v. Commodity Futures Trading Commission*. This study dissects the core statutory interpretations, jurisdictional conflicts, and administrative law doctrines that define how these platforms operate under the Commodity Exchange Act (CEA).

By critically examining the mechanics of on-chain smart contracts versus centralized clearinghouses, this paper evaluates how the elimination of administrative deference has re-shaped agency authority over novel financial instruments. We analyze the judicial dismantling of the CFTC's expansive definition of "gaming" and explore the emerging regulatory friction between federal pre-emption and state-level anti-gambling enforcement. Ultimately, this paper argues that while current judicial trends favor market expansion, the structural vulnerabilities of prediction markets—including manipulation, localized insider trading, and oracle verification failures—necessitate a modernized, consumer-centric regulatory paradigm that balances macroeconomic informational utility with robust public interest protections.

Introduction: The Epistemic and Regulatory Paradox of Event Contracts

Prediction markets operate as decentralized or centralized platforms where participants buy and sell contracts tied to the occurrence of specific future events, effectively converting real-world uncertainties into tradeable assets (*Ugalde, 2026*). The basic financial asset used in these markets is an Arrow-Debreu security, which pays out a fixed sum (typically \$1.00) if a specified contingency occurs and terminates worthless if it does not (*Diercks, 2026*). Because the market clearing price reflects the aggregate, risk-neutral probability distribution assigned by market participants to an event, these platforms have emerged as highly dynamic, high-frequency forecasting tools capable of 1955analyses1955 traditional polling methodologies and macroeconomic surveys (*Diercks, 2026; Rabinovitz, 2025*).

Despite their demonstrable forecasting utility, prediction markets occupy a deeply contested legal gray zone in the United States, suspended between the statutory boundaries of federal commodities regulation and state-level anti-gambling statutes (*Saunders, 2026*). The primary federal regulator, the *Commodity Futures Trading Commission* (CFTC), derives its authority from the *Commodity Exchange Act* (CEA). Under the CEA, the CFTC is tasked with ensuring market integrity, preventing manipulation, and protecting retail investors from predatory financial products. For decades, the Commission weaponized its statutory mandate to severely restrict commercial event contracts, maintaining that markets tracking political elections, sporting events, or public policy outcomes amounted to nothing more than look-alike financial gambling (*Beylin, 2024; Saunders, 2026*).

This restrictive paradigm created a stark operational dichotomy in the industry. On one side stand platforms like *Kalshi*, which elected to seek formal registration as a Designated Contract Market (DCM) to operate within the strict confines of federal oversight. On the other side stand decentralized protocols like *Polymarket*, which leveraged *blockchain* architecture to operate globally outside the traditional regulatory perimeter. This paper critically 1955analyses the defining legal flashpoints of both models, evaluating the case law and enforcement actions that have permanently re-aligned the intersection of administrative law, financial technology, and gambling jurisprudence.

The Decentralized Frontier: The 2022 Polymarket Consent Order

The legal battle over decentralized prediction markets reached a critical inflection point on

January 3, 2022, when the CFTC issued a binary Cease-and-Desist Order against Blockratize, Inc., the operational entity behind *Polymarket* (*In re Blockratize, Inc. d/b/a Polymarket*, 2022). The CFTC's enforcement action centered on a fundamental jurisdictional assertion: that the event contracts offered by *Polymarket* constituted "swaps" or "binary options" under *Section 1a(47)* of the CEA, and therefore could only be offered to retail consumers on a fully registered and regulated exchange.

The Statutory Definition of a Swap

Under the CEA, an "*excluded commodity*" includes any occurrence, extent of an occurrence, or contingency that is beyond the control of the transacting parties and is associated with a financial, economic, or commercial consequence. Because *Polymarket's* contracts settled based on political, economic, or cultural milestones, they fell squarely within the definition of an excluded commodity. Crucially, Section 2€ of the CEA explicitly makes it unlawful for any person other than an *Eligible Contract Participant* (ECP)—generally defined as high-net-worth individuals or institutional entities—to trade a swap unless the transaction is conducted on, or subject to the rules of, a registered *Designated Contract Market (DCM)* or *Swap Execution Facility (SEF)*.

Polymarket had operated as an unregistered web-based platform that utilized smart contracts deployed on the Polygon *blockchain* to execute, clear, and settle binary options. The CFTC asserted that because the platform maintained control over the user interface, curating markets, and deploying the underlying code, it was actively operating an unregistered facility for the trading of retail swaps.

The Resolution and Geo-Fencing Remedy

Faced with escalating administrative liability, *Blockratize* settled with the Commission. The terms of the consent order required the platform to:

1. Pay a \$1.4 million civil monetary penalty.
2. Cease and desist from violating Section 2€ of the CEA.
3. Wind down all non-compliant markets and implement strict IP-based geo-fencing to completely exclude United States residents from participating on the platform.

The *Blockratize* settlement highlighted a profound structural tension in decentralized finance (DeFi). While the underlying smart contracts remained *permissionless* on the *blockchain*, the centralized front-end infrastructure operated by an identifiable corporate entity provided a clear handle for regulatory enforcement. *Polymarket's* subsequent compliance strategy—shifting to a purely off-shore retail model while barring domestic users—demonstrated that jurisdictional boundaries could still be enforced against decentralized web applications through front-end interdiction, even if the underlying ledger remained globally accessible.

The Regulated Battleground: KalshiEx LLC v. CFTC (2024)

While *Polymarket* retreated to international waters, *Kalshi* embarked on a direct litigation challenge against the CFTC's administrative boundaries. As a registered DCM, *Kalshi* sought formal regulatory approval to list "Congressional Control Contracts"—binary event contracts allowing participants to trade on which political party would secure majority control of the U.S. House of Representatives or Senate.

The CFTC's Prohibition Order

On September 22, 2023, the CFTC issued an official administrative order completely prohibiting *Kalshi* from listing these political contracts (*KalshiEx LLC v. CFTC*, 2024). The Commission predicated its prohibition on Section 5c(c)(5)(C) of the CEA, codified at 7 U.S.C. § 7a-2(c)(5)(C), which features a "*Special Rule*" empowering the CFTC to review and disallow event contracts if they are found to involve certain enumerated prohibited categories or are determined to be "contrary to the public interest." The specific statutory text invoked by the Commission provides that the CFTC may disallow contracts that involve:

"...gaming, or activity that is unlawful under any State or Federal law."

The CFTC argued that trading on the outcome of a congressional election inherently "*involved gaming*" because it was functionally identical to election gambling, an activity historically prohibited or strictly restricted across numerous state jurisdictions. Furthermore, the Commission asserted that because the execution of such contracts could violate state-level anti-wagering laws in jurisdictions where election betting remains a criminal offense, the contracts also involved "activity that is unlawful under State law." Finally, the CFTC issued a broad public interest determination, concluding that commercializing election outcomes threatened

the institutional integrity of the democratic process, created adverse incentives for voters, and forced the regulator into the untenable role of an election-monitoring policing agency (*Beylin, 2024; Ugalde, 2026*).

The District Court's Vacatur and Statutory Interpretation

Kalshi immediately filed suit in the United States District Court for the *District of Columbia*, challenging the CFTC's order as an ultra vires overreach under the Administrative Procedure Act (APA). On September 6, 2024, District Judge *Jia Cobb* issued a landmark ruling vacating the CFTC's order (*KalshiEx LLC v. CFTC, 2024*). Judge Cobb's legal analysis turned on a strict *textualist* critique of the agency's interpretation of the phrase "involve gaming."

The Court ruled that for an event contract to "*involve gaming*," the underlying event or contingency upon which the contract settles must itself be a game (such as a sporting event or a casino match). Because a congressional election is a constitutional process and not a game, the contract could not be said to "involve gaming" under the plain meaning of the statute.

"*The CFTC's interpretation stretches the word 'involve' beyond its contextual breaking point,*" Judge Cobb observed. "A financial contract based on a real-world political outcome does not transform the political process itself into a game."

Furthermore, the Court rejected the CFTC's argument regarding state law illegality. Judge Cobb clarified that the statute targets contracts where the *underlying activity* itself is illegal (e.g., *contracts settling on the success of an illicit drug shipment or an unauthorized terror finance transaction*). Because voting and running for political office are perfectly lawful activities, the contracts did not involve illegal state activity. The fact that the *trading* of the contract might separately violate a state's anti-gambling laws did not grant the CFTC a blanket mandate to veto contracts under the Special Rule.

The D.C. Circuit Court of Appeals subsequently denied the CFTC's emergency motion for a stay pending appeal, confirming that the Commission had failed to demonstrate a likelihood of success on the merits or irreparable public injury. This judicial *greenlight* triggered an explosive expansion of commercial political betting markets in the United States, driving unprecedented trading volume and permanently altering how the financial industry prices political risk (*Diercks, 2026; Rabinovitz, 2025*).

Architectural Comparison: Centralized vs. Decentralized Legal Frameworks

Legal & Operational Metric	Centralized Model (Kalshi)	Decentralized Model (Polymarket)
Primary Regulator	CFTC (Designated Contract Market)	None (Formally geo-fenced from US)
Jurisdictional Nexus	On-shore (United States federal court jurisdiction)	Off-shore corporate stack (Blockratize / Global retail base)
Asset Clearing / Custody	Centralized clearinghouse (Kalshi Kclearing)	On-chain smart contracts (Polygon / USDC)
Settlement Mechanism	Internal operations team / Human arbitration	Decentralized Oracle (UMA Optimistic Oracle)
State Law Exposure	High vulnerability to state criminal gaming suits	Insulated via strict non-US user onboarding

The Oracle Problem and Legal Liability

A critical legal vulnerability specific to decentralized prediction markets is the "*oracle problem*"—the mechanism by which real-world data is safely ingested onto *the blockchain* to trigger contract settlement (Kota, 2026). *Polymarket* relies heavily on the UMA Optimistic Oracle, an incentive-compatible decentralized dispute resolution protocol where token holders vote on contested outcomes.

From a legal liability standpoint, if a decentralized oracle resolves a market erroneously or is subjected to a coordination exploit where token holders vote against reality for financial gain, the legal recourse for aggrieved traders is highly uncertain. In a centralized model like *Kalshi's*, a settlement error or market manipulation event gives rise to a clear breach of contract claim or a regulatory enforcement action for violating *DCM Core Principles*. In contrast, a smart contract settlement dispute leaves users with virtually no central corporate counterparty to sue, raising novel questions about whether oracle voters can be held collectively liable as a general

partnership under state partnership laws.

The Post-Chevron Landscape and State Preemption Crises

The judicial defeats suffered by the CFTC must be contextualized within the broader structural shift sweeping across American administrative law. The Supreme Court's definitive overturning of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.* has stripped federal regulators of their historical privilege of judicial deference. Under the contemporary post-Chevron framework, courts no longer defer to an agency's colorable interpretation of an ambiguous statute; instead, judges exercise independent judgment to resolve statutory ambiguities.

In *Kalshi*, the impact of this shift was immediate. The CFTC could no longer argue that its interpretation of "*gaming*" or "*public interest*" was entitled to administrative deference as an expert regulator. The court analyzed the text of the CEA afresh, applying traditional canons of statutory construction that severely hemmed in the agency's discretionary authority.

The Emerging State and Tribal Gaming Conflict

As federal regulatory authority has receded due to these restrictive judicial rulings, a secondary legal crisis has erupted along federal-state power lines (*Saunders*, 2026; *Vincent*, 2026). Historically, when the CFTC formally authorizes a financial product on a DCM, that product falls under the CFTC's exclusive jurisdiction, effectively preempting conflicting state gambling laws under Section 2(a)(1)(A) of the CEA (*Beylin*, 2024).

However, because the federal courts have ruled that political event contracts do not constitute "*gaming*" under the CEA, several state attorneys general and tribal gaming commissions have argued that these contracts are completely decoupled from the CFTC's exclusive jurisdiction over derivatives. Consequently, over a dozen U.S. states have initiated independent civil and criminal actions against prediction platforms, asserting that commercial event contracts constitute unauthorized sports and political wagering under local state penal codes (*Vincent*, 2026). Arizona, for instance, has pursued aggressive criminal investigations against centralized operators, creating a highly fractured operational matrix where an event contract can be perfectly lawful under federal commodities law yet simultaneously viewed as a *criminal misdemeanor* under state gambling statutes (*Saunders*, 2026; *Vincent*, 2026).

Market Integrity and New Regulatory Vulnerabilities (2025–2026)

As prediction markets have scaled into multi-billion-dollar liquidity pools, the nature of their legal vulnerabilities has evolved from foundational jurisdictional disputes to sophisticated operational and market integrity challenges (*Nechepurenko*, 2026). The massive capital flows observed throughout recent election cycles have exposed these platforms to unique forms of market manipulation and insider trading that defy traditional commodities enforcement frameworks.

The Challenge of Informed Flows and Insider Trading

Traditional insider trading doctrine under the CEA and CFTC Rule 180.1 requires a breach of a pre-existing duty or the misappropriation of material, non-public information (MNPI) derived from an insider source. However, prediction markets are uniquely designed to aggregate "informed flow"—including non-public polling data, internal political strategizing, or pending judicial determinations (*Nechepurenko*, 2026; *Ugalde*, 2026).

The CFTC's aggressive enforcement actions in early 2026—including the landmark Maduro enforcement action and parallel actions *channeled through Kalshi*—demonstrate that federal regulators are actively attempting to adapt traditional market abuse theories to event contracts (*Nechepurenko*, 2026). When a political operative or an institutional researcher trades on an event market using exclusive access to non-public policy drafts or internal campaign data, the traditional line between legitimate information-based trading and illegal market manipulation becomes profoundly blurred.

Furthermore, the introduction of advanced multi-agent AI oracle systems to auto-resolve complex, long-tail event queries introduces unprecedented vectors for manipulation (*Kota*, 2026). If an automated oracle network relies on LLM-driven consensus to resolve a highly contested market payout, bad actors can actively manipulate the primary informational ecosystem—injecting coordinated disinformation campaigns into indexed web search layers—to trick the automated settlement agents into triggering a fraudulent market resolution (*Kota*, 2026).

How the United Kingdom Handled Prediction Markets: The Betting Exchange Lens

The UK has avoided the jurisdictional identity crisis seen in the US by looking directly at the

economic reality of the transaction rather than its marketing. The UK Gambling Commission (UKGC) explicitly views peer-to-peer prediction markets as **Betting Intermediaries** under the **Gambling Act 2005**.

- **The Regulatory Mechanic:** If a platform allows UK residents to trade on the outcome of an event, it must secure a remote betting intermediary license. The UKGC treats them essentially like traditional sports betting exchanges (e.g., Betfair), where the platform takes no market risk but charges a commission on transactions.
- **Integrity and Consumer Protection:** Because they are licensed as gambling entities, prediction markets in the UK are bound by strict sports and event integrity protocols. If a market enables users to profit from an outcome under someone's control (like a specific player incident in a sport), it triggers rigorous *anti-match-fixing and anti-money laundering (AML)* compliance.
- **The Financial Boundary:** If a contract mimics a traditional financial variable (like interest rates or currency pairs), it crosses over into the jurisdiction of the Financial Conduct Authority (FCA) as a binary option, which faces highly restrictive retail marketing bans.

How the European Union Handled Prediction Markets: Fragmentation and the MiCA Hammer

The EU currently lacks a unified, cross-border framework for prediction markets, resulting in a deeply fragmented landscape. However, the regulatory environment is being radically reshaped by local gambling crackdowns and overarching crypto laws.

- **National Prohibitions:** Individual member states have weaponized their national gaming authorities to block these platforms. For example, France's *Autorité Nationale des Jeux* (ANJ) and regulators in *the Netherlands* have declared peer-to-peer prediction markets illegal, ordering platforms like *Polymarket* to actively geo-block their citizens. Conversely, jurisdictions like Gibraltar have begun issuing bespoke licenses to accommodate the sector.
- **The MiCA Deadline Compliance:** The biggest existential threat to crypto-native prediction platforms in Europe is the **Markets in Crypto-Assets (MiCA)** regulation.

Under MiCA rules, the "Outcome Tokens" (*the YES/NO contracts that maintain a value tethered between \$0.00 and \$1.00 and settle in stablecoins*) face being classified as **unregistered, surrogate stablecoins**.

- **The Asset Exchange Trap:** If a platform facilitates the issuance and trading of these event-linked tokens without being a registered Crypto Asset Service Provider (CASP), it faces catastrophic structural fines under EU financial law.

The Indian Landscape: The PROG Act and the Enforcement Friction

India's legal landscape completely pivoted with the enactment of the *Promotion and Regulation of Online Gaming (PROG) Act, 2025*, and the subsequent *Rules, 2026*.

The Statutory Reality: The PROG framework imposes a blanket, uncompromising ban on all "*online money games*"—explicitly encompassing games of chance, games of skill, or any hybrid model that involves staking money on an uncertain outcome for a financial return.

Legal experts classify platforms like *Polymarket* and *Kalshi* squarely as prohibited online money games under Indian jurisprudence. Consequently, the Ministry of Electronics and Information Technology (MeitY) has issued aggressive advisories *under Section 69A of the Information Technology Act* ordering the blocking of these domains.

The Enforcement Blindspot

Despite the statutory ban, an operational gray market persists. Off-shore, decentralized protocols bypass domestic banking blockades by utilizing non-custodial crypto wallets and *stablecoins (like USDC)*. Furthermore, the domestic use of *Virtual Private Networks (VPNs)* has muted the efficacy of standard web-blocking orders, allowing Indian retail capital to continue trading on global event outcomes.

What India Can Learn and Do: A Policy Roadmap

India cannot rely on a 20th-century framework of simple URL-blocking to govern a decentralized, Web3-driven information economy. To effectively handle prediction markets, India should adopt a multi-pronged, modernized strategy:

1. Shift from a Blanket Ban to a Risk-Based Tiered Framework

Treating a market that predicts a devastating monsoon or macroeconomic GDP data the same as an illegal sports betting app is an analytical misstep. India should create a clear regulatory carve-out under the Online Gaming Authority of India:

- **Permissible "Forecasting Contracts":** Allow licensed platforms to operate peer-to-peer markets strictly limited to weather, economic indicators, and corporate data, recognizing their immense corporate and public policy utility as information aggregation tools.
- **Prohibited "Wagering Contracts":** Maintain absolute bans on sports, political elections, and socially sensitive outcomes (such as *public safety or violent events*) to protect democratic and athletic integrity.

2. Implement the "MiCA Lesson" on Payment Aggregators and Stablecoins

Instead of chasing individual user IP addresses or VPN configurations, the Indian government should choke off the underlying liquidity architecture. Following the EU's approach to crypto asset service providers, India should:

- Enforce strict liability on domestic centralized crypto exchanges (VDA service providers regulated by the FIU) to block outbound transfers of *stablecoins* directly linked to known smart-contract addresses associated with prediction protocols.
- Bar domestic payment gateways and card networks from processing off-shore deposits to any platform characterized by binary event contract settlement.

3. Establish Localized "Information Oracles"

To prevent foreign decentralized protocols from *monopolizing* the narrative on domestic Indian events (like *state elections or corporate mergers*), India should foster an on-shore, heavily regulated predictive ecosystem. By licensing domestic "*Information and Prediction Exchanges*" under strict KYC and capital-adequacy norms, the state can capture the macroeconomic benefits of crowd-sourced wisdom while ensuring robust consumer protection, taxation compliance under the *IGST Act*, and strict market abuse oversight.

Conclusion

The legal evolution of prediction markets from 2022 to 2026 represents a profound paradigm shift in financial regulation. The CFTC's historical attempt to suppress event contracts through expansive administrative interpretations was decisively halted by the federal judiciary's embrace of strict *textualism* and the dismantling of administrative deference. The *Kalshi* decision effectively transformed prediction markets from illicit gambling venues into legally protected financial instruments under the umbrella of federal derivatives regulation. As prediction markets increasingly dictate how public institutions, journalists, and corporate boards interpret reality, the legal system can no longer treat them as mere speculative side-shows. Future regulatory efficacy will depend on the implementation of cross-jurisdictional standards that directly address the unique architecture of event contracts—specifically targeting oracle manipulation, insider information asymmetry, and consumer exploitation—while preserving the powerful macroeconomic forecasting capability that makes these markets uniquely valuable to a modern informational economy.

To escape this enforcement trap, the next frontier of financial jurisprudence must abandon binary legal classifications and instead adopt a risk-tiered, architecture-aware framework. By actively regulating payment gateways, implementing strict on-chain oracle oversight, and distinguishing between public utility forecasting and pure political wagering, modern regulators can successfully mitigate the systemic threats of market manipulation while safely harvesting the immense epistemic power of *crowd-sourced intelligence*.

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