

## FEDERAL PREEMPTION IN SPORTS PREDICTION MARKET LITIGATION: THIS SHOULDN'T BE A JUMP BALL

By Rob Schwartz<sup>1</sup>

Early in 2025, two federally regulated derivatives exchanges (“designated contract markets” or “DCMs” in legal parlance) began listing contracts whose prices are tied to the outcomes of sports events. Other parts of the derivatives ecosystem followed suit—multiple DCMs now list them; futures commission merchants (“FCMs”) and other brokers offer them to customers; and derivatives clearing organizations (“DCOs”) clear each trade. All of these entities refer to and treat the contracts as “swaps,” subject to regulation under the exclusive jurisdiction of the Commodity Futures Trading Commission (“CFTC”). In nationwide litigation, however, a handful of courts have held that sports event markets are not meaningfully different from sportsbooks regulated by states. One commented that the products “are sports wagers and everyone who sees them knows it.”<sup>2</sup>

That was probably meant as a barb, but it raises an overlooked issue. It is not true that “everyone” knows sports event contracts are state-regulated wagers—the derivatives industry’s own terminology shows that. And surprising as it may seem, under the Commodity Exchange Act (“CEA”), industry consensus is what matters.<sup>3</sup>

### 1. Litigation Background

Sports event contracts instantly became popular upon launch. Weekly trading volume now sits in

the billions of dollars. That success has led to coverage in the mainstream media; sports-betting companies entering the space; futures-industry incumbents offering them alongside traditional financial products; partnerships between DCMs and NHL teams; and an investment by the best power forward in the NBA. Predictably, state gaming regulators took note. Ten states issued cease-and-desist orders asserting violations of state law and threatening enforcement actions. Eight threatened to revoke the gaming licenses of any sports-betting companies involved. Litigation exploded, and there are now dozens of pending lawsuits in state and federal courts involving not only states, but also Indian tribes, gaming trade associations, and private plaintiffs.

The central issue in most of these cases is not whether DCMs should be allowed to offer contracts based on sports events. That is a policy question ill-suited to judicial resolution. The *legal* question is whether the CEA preempts state gaming laws in the context of exchange-traded sports event contracts. The CEA gives the CFTC “exclusive jurisdiction” over exchange-traded swaps.<sup>4</sup> The four DCMs and one FCM involved in the litigation contend that the sports event contracts are swaps, subject to that exclusive federal jurisdiction, and states therefore have no role.

One court, in two separate opinions, balked that any interpretation of “swap” that covers a transaction whose payout is based on the outcome of a sports event is too “broad,”<sup>5</sup> a “sea change”<sup>6</sup> with “no limiting principle,”<sup>7</sup> “sweep[ing in] nearly all sports wagering,”<sup>8</sup> and with the potential to include contracts on “anything imaginable with a potential downstream financial consequence.”<sup>9</sup> Underlying those criticisms and others seems to be a general disbelief that Congress could have intended a defi-

<sup>1</sup>Rob Schwartz is a partner in the Washington, D.C., office of Morgan Lewis. Before joining Morgan Lewis, he spent 13 years at the Commodity Futures Trading Commission, including as its General Counsel and its Deputy General Counsel for Litigation.

inition broad enough to involve the CFTC in anything connected to sports.

But while the DCMs' and FCM's interpretation of the term "swap" may be "broad" and "sweeping," it is if anything too modest.

The CEA's definition of "swap" is expansive and includes a long list of specific contract types and several general descriptions of transactions that, even if they are not named in the list, qualify as swaps nevertheless. The event-contract cases have zoomed in on one subparagraph of the definition, Section 1a(47)(A)(ii), which says that a "swap" includes any agreement, contract, or transaction "that provides for any . . . payment . . . that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence."<sup>10</sup>

With the focus on that subparagraph, points of controversy include whether sports are sufficiently "associated with a potential financial, economic, or commercial consequence," and even what the word "event" means. As to the former, the two courts to reach the question both held that they are.<sup>11</sup> As to the latter, one court spent several pages and consulted five dictionaries noodling on the difference between an "event" and an "occurrence," eventually articulating that an event is a type of "happening of some significance that took place or will take place, in a certain location, during a particular interval of time."<sup>12</sup> The court then explained that the outcome of a game may be an "occurrence" but is, among other things, insufficiently significant to be an "event" under the subparagraph.<sup>13</sup> It's hard to tell from the court's discussion much about what else would or wouldn't qualify, but in a subsequent decision, the court bolstered its conclusion with the famous "I know it when I see it" test—in the context of a litigation outbreak, more or less an invitation to future disorderly state-by-state incursions on the CFTC's jurisdiction.<sup>14</sup> We need to zoom out.

## 2. The Dodd-Frank Act

The definition of "swap" comes from Title VII of the Dodd-Frank Act of 2010,<sup>15</sup> which Congress passed to guard against a repeat of the 2008 financial crisis in which "derivatives were in the center of the storm."<sup>16</sup> Before the crisis, swaps markets in the multiple hundreds of trillions of dol-

lars were generally unregulated and traded in an opaque and decentralized system. Traders' positions, exposures, and risks were therefore "unseen and unknown" to regulators and market participants alike.<sup>17</sup> When the financial system began to fail, swaps markets that had "spiraled out of control" fueled "escalat[ing] panic" in the economy, forcing the government into draconian measures to contain the damage.<sup>18</sup>

Congress in 2010 overhauled the system to bring swaps under strict federal supervision by the CFTC. Certain Dodd-Frank provisions encourage exchange-trading of swaps, and the statute made the CFTC's jurisdiction over those transactions "exclusive."<sup>19</sup> Although credit default swaps were the primary culprit in this aspect of the meltdown,<sup>20</sup> Congress took no chances with other varieties. The statute defines "swap" (and thereby delineates the CFTC's jurisdiction) to include dozens of transaction types, most of which had nothing to do with the financial crisis. In 2008, nobody panicked about weather swaps or emissions swaps, but both are in the definition among a long list of others.<sup>21</sup>

Long lists, however, can be full of holes. One cynic wrote long before Dodd-Frank that "[t]he major impulses to successful financial innovations have come from regulations and taxes."<sup>22</sup> A list full of holes can encourage transactions structured to avoid regulation. In 2010, Congress knew what it didn't know—what would arise in the future. The statute therefore includes a catchall providing that any "agreement, contract, or transaction" is a swap if it "is, or in the future becomes, commonly known to the trade as a swap."<sup>23</sup> When industry terminology for a transaction is sufficiently widespread, it triggers the CFTC's jurisdiction. For exchange-traded sports event contracts, that horse has left the barn.

## 3. Sports Event Contracts—Commonly Known to the Trade as Swaps

The concept of interpreting terms as commonly known to the trade is old—it dates back at least to the 19th century when courts used it to interpret contracts to ensure that "[g]eneral usage, and not individual opinions, make a custom that can control."<sup>24</sup> A "commonly known" test appeared in the Securities Act of 1933 where Congress defined "security."<sup>25</sup> In derivatives regulation, it first appeared in the Commodity Exchange Act of 1936 in a prohibition on, among other things, commodity options. It covered any

transaction that “is of the character of, or is commonly known to the trade as, a . . . ‘put’ [or] ‘call.’ ”<sup>26</sup> Note Congress’ use of the disjunctive. A transaction could legally be a put or call option—and therefore subject to federal jurisdiction—*either* because of its character *or* because of industry parlance. That formulation stuck, and today the CEA defines an “option” to include “an agreement, contract, or transaction that is of the character of, or is commonly known to the trade as, an ‘option.’ ”<sup>27</sup>

In Dodd-Frank, Congress simply borrowed the phrase “commonly known to the trade” and used it to define “swap.” Like the definition of option, the swap definition is disjunctive so that an instrument can be a swap either because of its character (such as depending on the occurrence of an “event” with “a potential financial, economic, or commercial consequence”) or because of what the industry calls it.<sup>28</sup> In contrast to the courts’ cramped focus in event-contract litigation, Congress did not intend a narrow or nuanced definition—it intended for the CFTC’s jurisdiction to be expansive, future-proof, and airtight.

Exchange-traded sports event contracts are commonly (and perhaps universally) known to the trade as swaps. Multiple DCMs now list them as swaps. Others have announced plans to do so in the future. Each time a DCM lists a new one, it notifies the CFTC as required before listing a swap. Registered FCMs and other brokers offer them as swaps. Each trade is cleared as a swap by one of several CFTC-registered DCOs. The FCMs and DCOs who offer or clear them hold their customers’ or members’ funds in CFTC-regulated swap-customer accounts at banks that must acknowledge that the money belongs to customers for trading swaps. No part of the industry seems to disagree with this terminology.

The test is undeniably broad. But for courts concerned that a broad definition would “sweep in nearly all sports wagering,” the “commonly known to the trade” test is safe ground: *Off-exchange* transactions that depend on the outcome of a sports event (or sports “occurrence”) are not known to anyone as swaps. The CFTC’s authority over those is clear—it has none. The test therefore leaves sports betting comfortably under the jurisdiction of states and tribes.

#### 4. Conclusion

It may seem odd that a stampede of exchanges, brokers,

and clearinghouses can make a swap of something through the simple accumulation of their own opinions. Consider though what the “commonly known to the trade” test does: Rather than acting as some escape hatch from government oversight, the provision brings transactions *into* a system of strict federal regulation. After the financial crisis, Congress had powerful motivation to cover the waterfront, and it probably suspected that not everyone would like it. We happen to be in a situation where an industry *wants* federal regulation. But the statute’s meaning does not depend on who wants in or who wants out.

None of this, it bears emphasis, pertains to whether federally regulated exchanges *should* be permitted to offer contracts on sports events, though much of the litigation seems preoccupied with that question. The real issue in these cases is who decides. To that end, Congress has given the CFTC ample authority to prevent DCMs from listing contracts it finds problematic. The dismay here is in large part due to the fact that the CFTC has not done so for sports event contracts. That is a policy dispute to be settled by policymakers.

Meanwhile, as courts continue to wrestle with the nuances of one subparagraph of the “swap” definition, the markets themselves have resolved the “who decides” question in favor of the CFTC. That concept is not new or peculiar to the CEA. It is also Congress’ design, and it leaves the policy questions where they belong—out of the hands of courts.

#### ENDNOTES:

<sup>2</sup>*KalshiEX, LLC v. Hendrick*, 2025 WL 3286282, at \*8 (D. Nev. 2025) (“*Kalshi*”).

<sup>3</sup>7 U.S.C.A. § 1a(47)(A)(1)(iv).

<sup>4</sup>*Id.* § 2(a)(1)(A).

<sup>5</sup>*North American Derivatives Exchange, Inc. v. Nevada on Relation of Nevada Gaming Control Board*, Comm. Fut. L. Rep. (CCH) P 35564, 2025 WL 2916151, at \*9 (D. Nev. 2025) (“*Crypto.com*”).

<sup>6</sup>*Crypto.com*, 2025 WL 2916151, at \*10.

<sup>7</sup>*Id.* at \*9.

<sup>8</sup>*Id.*

<sup>9</sup>*Kalshi*, 2025 WL 3286282, at \*9.

<sup>10</sup>7 U.S.C.A. § 1a(47)(A)(ii).

<sup>11</sup>*KalshiEX LLC v. Orgel*, 3:26-cv-00034, ECF Doc. 48, at 17 (M.D. Tenn. Feb. 19, 2026); *KalshiEX LLC v. Flaherty*, 2025 WL 1218313, at \*6 (D.N.J. 2025).

<sup>12</sup>*Crypto.com*, 2025 WL 2916151, at \*6-9.

<sup>13</sup>*Id.*

<sup>14</sup>*Kalshi*, 2025 WL 3286282, at \*8 (quoting *Jacobellis v. State of Ohio*, 378 U.S. 184, 197, 84 S. Ct. 1676, 12 L. Ed. 2d 793 (1964)).

<sup>15</sup>Pub. L. No. 111-203, §§ 701-774, 124 Stat. 1376, 1641-1802 (2010).

<sup>16</sup>Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report*, at xxv (2011).

<sup>17</sup>*Id.*

<sup>18</sup>*Id.* at xxiv, xxv.

<sup>19</sup>7 U.S.C.A. § 2(a)(1)(A).

<sup>20</sup>*The Financial Crisis Inquiry Report*, at xxiv.

<sup>21</sup>7 U.S.C.A. §§ 1a(47)(A)(iii)(XVII), (XXII).

<sup>22</sup>M. Miller, *Financial Innovation: The Last Twenty Years and the Next*, *Journal of Financial and Quantitative Analysis* (Dec. 1986).

<sup>23</sup>7 U.S.C.A. § 1a(47)(A)(ii)

<sup>24</sup>*Marine Nat. Bank v. National City Bank*, 59 N.Y. 67, 74, 1874 WL 11357 (1874).

<sup>25</sup>Pub. L. No. 73-22, § 2, 48 Stat. 74 (1933).

<sup>26</sup>Pub. L. No. 74-675, § 4c(B), 49 Stat. 1491 (1936).

<sup>27</sup>7 U.S.C.A. § 1a(36). Several other current CEA provisions also use the “commonly known” test. 7 U.S.C.A. §§ 1a(48) (“swap dealer”), 6c(a)(2)(A)(i) (“wash sale” or “accommodation trade”), 6c(a)(5)(C) (“spoofing”), 13(c) (“margin account, margin contract, leverage account, or leverage contract”).

<sup>28</sup>*Id.* at § 1a(4)(A).