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Don’t Bet on Bankruptcy: Prediction Markets and the Limits of Insolvency Law

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William A. Organek
Zicklin School of Business, Baruch College, City University of New York

Nizan Geslevich Packin
Zicklin School of Business, Baruch College, City University of New York and ECGI

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Abstract

Prediction markets have become multibillion-dollar platforms for putting a price on uncertainty in politics, sports, finance, and even war. States and the federal government are fighting to establish regulatory authority over them. But what happens if one becomes insolvent?

Prediction markets depend on contingent event contracts whose value may turn on disputed facts, manipulable information, and uncertain legal status. A court confronting a failed prediction market may therefore need to resolve not only what law applies, but also what happened, before it can value the estate at all. At the same time, prediction markets strain ordinary bankruptcy doctrine governing the debtor, claim classification and priority, executory contracts, and dispute settlement.

This uncertainty extends beyond doctrine to whether ordinary bankruptcy rules apply at all. If event contracts are derivatives—as the federal government argues—the Bankruptcy Code's financial contract safe harbors may switch off some of bankruptcy's central protections. If state efforts to outlaw many event contracts succeed, bankruptcy itself may be unavailable.

These issues shed light on broader debates in bankruptcy theory. They challenge the growing reliance on market prices as evidence of value and cast doubt on whether specialized resolution regimes designed for financial institutions translate to claims whose factual and legal predicates remain unsettled. To keep bankruptcy judges from making consequential policy decisions during a freefall bankruptcy, this Article advocates for an insolvency-aware framework that regulates event contracts based on their economic function.

William A. Organek

Zicklin School of Business, Baruch College, City University of New York

Nizan Geslevich Packin

Zicklin School of Business, Baruch College, City University of New York and ECGI

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DON'T BET ON BANKRUPTCY: PREDICTION MARKETS AND THE LIMITS OF INSOLVENCY LAW

William A. Organek[*] *& Nizan Geslevich Packin*[**]

Prediction markets have become multibillion-dollar platforms for putting a price on uncertainty in politics, sports, finance, and even war. States and the federal government are fighting to establish regulatory authority over them. But what happens if one becomes insolvent?

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[*] Assistant Professor of Law, Zicklin School of Business, Baruch College, City University of New York; Managing Editor, Harvard Law School Bankruptcy Roundtable.

[**] Neuberger Berman/Zicklin Family Chair, and Professor of Law, Zicklin School of Business, Baruch College, City University of New York; Member, European Corporate Governance Institute. Author order is alphabetical by surname and does not otherwise reflect the relative contribution of either author. The authors would like to thank []. The authors used generative AI tools for limited editorial assistance. All errors are ours.

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INTRODUCTION

Prediction markets have exploded in popularity, transforming from academic curiosities into multibillion-dollar, consumer-facing platforms that facilitate trading on politics, sports, geopolitics, and even clinical-trial outcomes and FDA approvals.[1] To date, media, political, and judicial attention has largely been focused on the legal battles over whether prediction markets should be legal and if so who should regulate them,[2] insider trading,[3] market manipulation,[4] and morally controversial markets.[5] Yet amid this scrutiny, one question has received little scholarly attention: what happens if a prediction market fails?

This question exposes assumptions bankruptcy usually takes for granted. Bankruptcy doctrine presumes that firms possess identifiable assets, determinable liabilities, and objective facts from which value can be inferred. Prediction markets systematically unsettle each of these premises. Their assets and liabilities consist of contingent claims whose value depends on uncertain future events, contested methods of verification, and

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[1] Nizan Geslevich Packin & Sharon Rabinovitz, *Prediction Markets as a Public Health Threat*, SCIENCE, 392, 257 (2026) (describing prediction markets' evolution and commercialization in recent decades); *see also* Elaine Chen, *Kalshi Comes for Biopharma, with Prediction Markets for Clinical Trials and FDA Approvals*, STAT NEWS, July 16, 2026, https://www.statnews.com/2026/07/16/kalshi-new-offering-prediction-market-clinical-trials-fda-approvals/ (reporting Kalshi's launch of clinical-trial and FDA-approval markets); Bernd Johannes Wuebben, *Prediction Markets as the Informational Substrate of the Machine Economy* (Mar. 18, 2026), SSRN, https://ssrn.com/abstract=6561300 (theorizing prediction markets as information infrastructure).

[2] *See* notes 53-67, *infra*, and accompanying text.

[3] *See* Raj Ashar, *Insider Trading in the Era of Prediction Markets,* VIRGINIA BUS. L. REV (forthcoming: 2027), SSRN, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5617110 (exploring gaps between traditional insider-trading doctrine and prediction-market structures); Joshua Mitts & Moran Ofir, *From Iran to Taylor Swift: Informed Trading in Prediction Markets* (Mar. 16, 2026), SSRN, https://ssrn.com/abstract=6426778; Nizan Geslevich Packin, Maya Shaton, Elior Sulem & Sharon Rabinovitz, *Inside the Odds*, 31 VAND. J. ENT. & TECH. L. __ (forthcoming 2027).

[4] *See* David Purdum, *NFL Asks Prediction Markets to Stop Manipulable Trading,* ESPN, Mar. 30, 2026, https://www.espn.com/nfl/story/_/id/48338843/nfl-asks-prediction-markets-stop-manipulable-trading.

[5] *See* Matt Lavietes, *Polymarket Apologizes for Allowing Wagers on Fate of U.S. Pilots Downed in Iran,* NBC NEWS, Apr. 4, 2026, https://www.nbcnews.com/news/us-news/polymarket-apologizes-allowing-wagers-fate-us-pilots-downed-iran-rcna266715 (Polymarket also removed the market).

an unsettled legal status. As a result, a bankruptcy court may be required to determine the factual and legal predicates that establish value *before* it can value the estate. Rather than merely allocating economic value, bankruptcy courts may therefore decide which disputed facts or legal rules govern creditor rights. Prediction markets thus reveal the extent to which bankruptcy depends on stable legal and factual foundations that are largely taken for granted in more conventional reorganizations. By examining where those foundations break down—in facts about valuation, specific components of bankruptcy doctrine, and the legality of the underlying business—this Article identifies both the limits of existing bankruptcy doctrine and broader implications for the regulation of emerging financial markets.

One might imagine that, much like the proverbial "house" in Las Vegas, prediction market platforms are merely intermediaries that match counterparties[6] and thus are unlikely to lose money. But prediction markets face ordinary operational and business risks, as well as distinctive legal, market structure, and liquidity risks, that could each lead to declining revenues or even insolvency. Such an insolvency would present three chief practical difficulties, all of which are foundational to the bankruptcy system: valuation, the application of key provisions of the Bankruptcy Code, and the overall impact of legal and regulatory uncertainty on insolvency.

First, consider valuation. Bankruptcy ordinarily assumes that parties or courts can estimate with reasonable certainty the value of a debtor's assets using objective facts and accepted valuation techniques.[7] Prediction markets invert that process, since valuation of event-contract exposures may depend on disputed or manipulated factual inputs, contested methods of verification, regulatory treatment, and the solvency of the platform itself. Resting on such shaky foundations, quoted event contract prices may compound rather than cure the problem, notwithstanding bankruptcy's growing reliance on "direct market evidence" to determine value.[8] The

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[6] *See generally* John M. Yun, *Overview of Network Effects & Platforms in Digital Markets*, SSRN, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3733656 (Nov. 19, 2020) (defining and describing the economics behind platforms).

[7] *See* Michael Simkovic, *The Evolution of Valuation in Bankruptcy*, 91 AM. BANKR. L.J. 299, 299-300 (2017).

[8] *See* Mark J. Roe & Michael Simkovic, *Bankruptcy's Turn to Market Value*, 92 U. CHI. L. REV. 285, 288–300 (2025) (increased judicial reliance on direct market evidence of value); *accord* Kenneth Ayotte & Edward R. Morrison, *Valuation Disputes in Corporate Bankruptcy*, 166 U. PA. L. REV. 1819, 1830–35, 1843 (2018); *In re Cent. Ice Cream Co.*, 836 F.2d 1068, 1072, 1072 n.3 (7th Cir. 1987) (Easterbrook, J.) (promoting market valuation over judicial valuation); *but cf.* Diane Lourdes Dick, *Valuation in Chapter 11 Bankruptcy: The Dangers of an Implicit Market Test*, 2017 U. ILL. L. REV. 1487, 1489–95

result is that a bankruptcy judge may have to determine the factual predicates of some or all of a platform's event contracts before she can value the estate, making reorganization exceptionally difficult and unpredictable.

Second, key provisions of bankruptcy law are difficult to apply to prediction markets. Identifying the debtor, classifying and prioritizing claims, determining whether event contracts are executory, and approving settlements all become harder when platforms resist conventional classifications of debtors, assets, liabilities, and counterparties. Courts may therefore be forced to make decisions ex post without much statutory or precedential guidance. As with crypto bankruptcies, they may do so with little capacity to account for broader policy implications.[9]

Third, the market's unsettled legal status may change bankruptcy treatment or access altogether. States, the Executive, and Congress continue to contest how prediction markets should be regulated, and some states have even sought to outlaw whole classes of event contracts or to ban prediction markets entirely.[10] While this regulatory debate among sovereigns has many consequences, it has two direct effects on the treatment of a prediction market platform in insolvency. If event contracts are derivatives, as the federal argument currently argues, the Bankruptcy Code's financial-contract safe harbors can displace ordinary creditor protections such as the automatic stay and avoidance rules.[11] More fundamentally, if contracts or platforms are made illegal, bankruptcy protection itself may be unavailable. Analogies to two industries—legal cannabis[12] and state insurance—highlight that neither federal prohibition nor fragmented state regulation offers a satisfactory framework for resolving prediction market insolvencies.

(warning that judicial reliance on implicit market checks can entrench debtors' self-serving valuations where no genuine market test has occurred).

[9] *See* Yesha Yadav & Robert J. Stark, *The Bankruptcy Court as Crypto Market Regulator*, 96 S. CAL. L. REV. 1479, 1500-10 (2024) (describing how bankruptcy courts resolved open regulatory and classification questions in the crypto insolvencies on an ex post basis).

[10] *See* Nate Raymond, *US Regulator Sues to Block Minnesota's First-In-Nation Ban on Prediction Markets*, REUTERS, May 19, 2026, https://www.reuters.com/world/us-cftc-sues-minnesota-block-law-related-prediction-market-2026-05-19/; Ryan Wooden, *Are Sports Prediction Markets Legal? Status of Kalshi and Polymarket in All 50 States*, CBS SPORTS, July 22, 2026, https://www.cbssports.com/prediction/news/prediction-market-legal-states/ (California and Texas ban sports betting, while Utah considering full ban).

[11] *See* 11 U.S.C. §§ 362(b)(17), 546(g), 559-60; Mark J. Roe, *The Derivatives Market's Payment Priorities as Financial Crisis Accelerator*, 63 STAN. L. REV. 539 (2011); Mark J. Roe & Stephen D. Adams, *Restructuring Failed Financial Firms in Bankruptcy: Selling Lehman's Derivatives Portfolio*, 32 YALE J. ON REG. 363, 377-80 (2015).

[12] *See* William A. Organek, *Up in Smoke: Bankruptcy by Contract in the Legal Cannabis Industry*, 98 AM. BANKR. L.J. 239, 256-58 (2024).

The concerns raised by prediction markets contribute to two strands of bankruptcy literature. The first concerns valuation. Valuation uncertainty sits at the heart of Chapter 11,[13] drives the reorganization bargain struck in the shadow of absolute priority, and ultimately determines the allocation of corporate ownership among competing constituencies.[14] While some critique absolute priority, defenders suggest that it is precisely the need to limit inaccuracy or unpredictability in valuation that counsels in favor of the absolute priority rule that undergirds bankruptcy law.[15] Yet analyzing prediction markets helps identify an underappreciated factor supporting absolute priority: the nature of the insolvent firm. Firms with high-variance assets are more difficult to value than firms whose assets have more stable values. Observable prices may be less probative of value when they depend on disputed facts, heterogenous settlement rules, shifting regulation, insufficient disclosure, or even the solvency of the platform itself. Prediction markets, with event contracts that may lack stable factual or legal predicates, fit the bill, but so might others such as startups or catastrophe insurers. Considering prediction markets therefore exposes the particular difficulties faced when valuing certain kinds of firms, adding support to arguments in favor of absolute priority.

A second strand of literature concerns institutional design. Banks,[16] broker-dealers,[17] and futures commission merchants[18] eschew bankruptcy

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[13] *See* Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930, 1943-44 (2006); Ayotte & Morrison, *supra* note 8, at 1819–24.

[14] *See* Baird & Bernstein, *supra* note 13, at 1932–41 (analyzing how uncertainty about a firm's value shapes bargaining among creditor classes under absolute priority); Mark J. Roe & Michael Simkovic, *Absolute Priority, Relative Priority, and Valuation Uncertainty in Bankruptcy*, 173 U. PA. L. REV. 389, 394–402 (2025).

[15] Absolute priority "pays creditors according to their contractual and statutory hierarchical priorities," with higher-ranked creditors paid in full before lower-ranked creditors are paid anything. Roe & Simkovic, *supra* note 25, at 406 (defining absolute priority), 407-12 (describing debate within the literature); 11 U.S.C. §§ 1129(a)(8), (b)(2) (implementing absolute priority).

[16] *See* Robert R. Bliss & George G. Kaufman, *U.S. Corporate and Bank Insolvency Regimes: A Comparison and Evaluation*, 2 VA. L. & BUS. REV. 143, 145–52, 160–68 (2007); Richard M. Hynes & Steven D. Walt, *Why Banks Are Not Allowed in Bankruptcy*, 67 WASH. & LEE L. REV. 985, 991–1004 (2010); 12 U.S.C. § 1821(c)–(d) (providing for FDIC receivership and resolution).

[17] *See* Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa–78*lll* (providing a specialized liquidation regime for broker-dealers); Sheila Cheston, *Investor Protection Under SIPA: A Reassessment and Recommendations for Future Change*, 19 COLUM. J. L. & SOC. PROBS. 69 (1985); Thomas W. Joo, *A Comparison of Liquidation Regimes: Dodd-Frank's Orderly Liquidation Authority and the Securities Investor Protection Act*, 6 BROOK. J. CORP. FIN. & COM. L. 47 (2011).

[18] *See* 11 U.S.C. §§ 761–767; 17 C.F.R. § 190.00 *et seq*.; Anita K. Krug, *Uncertain*

for specialized resolution regimes. This departure is justified by arguments for consumer protection, reduced systemic risk, and speed.[19] Yet these templates translate poorly to prediction markets. Prediction markets pose little risk of destabilizing runs, are not sufficiently integrated into the financial system to warrant extraordinary protections, and generally involve speculative contracts rather than claims requiring special customer protection. Finally, the novel claims that would be brought against insolvent prediction markets may favor greater judicial involvement to resolve novel questions of classification, priority, and valuation.[20]

This Article does not attempt to resolve every question of prediction market regulation.[21] But the insolvency issues it analyzes leads to three insolvency-focused predictions. First, regulation should account for insolvency consequences ex ante, with a national framework often preferable to fragmented state regulation absent a comprehensive state architecture. Next, any prohibition on event contracts should specify how existing event contracts (especially ones involving offshore counterparties or prediction market platforms) will be unwound.[22] Finally, in considering how to regulate prediction markets, policymakers could take a page from recent coordinated SEC-CFTC treatment of cryptocurrency markets and consider a multi-regulator framework that classifies event contracts by economic function rather than forcing them into a single legal category.[23] This may mean that some event contracts are treated as derivatives, others are treated as gambling, and still others may receive other treatment.

The analysis in this Article proceeds in four parts. Part I briefly

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Futures in Evolving Financial Markets, 93 WASH. U. L. REV. 1209 (2016).

[19] *See* Franklin R. Edwards & Edward R. Morrison, *Derivatives and the Bankruptcy Code: Why the Special Treatment?*, 22 YALE J. REG. 91, 97 (2005) (systemic risk); Joo, *supra* note 17, at 49 (protect customers and promote investor confidence); Bliss & Kaufman, *supra* note 16, at 147-48 (reduce disputes and expedite resolution).

[20] *See generally* Owen M. Fiss, *Against Settlement*, 93 YALE L.J. 1073 (1984) (courts answer important public law questions and set valuable precedent for future disputes).

[21] *See*, *e.g.*, Ananya Chetia, *How Are Prediction Markets Taxed? The IRS Hasn't Provided Guidance Yet*, CNBC, July 18, 2026, https://www.cnbc.com/2026/07/18/how-are-prediction-markets-taxed-the-irs-hasnt-provided-guidance-yet.html (tax treatment depends in part on broader regulatory treatment).

[22] *See* Aislinn Keely, *Kalshi Unwound Mich. Trades Before CFTC Order, Court Told*, LAW360, July 18, 2026, https://www.law360.com/articles/2502987/kalshi-unwound-mich-trades-before-cftc-order-court-told (Kalshi's inability to comply with competing orders issued by a state court and a federal regulator placed it in an "impossible position").

[23] *See SEC and CFTC Joint Final Rule, Application of the Federal Securities Laws to Certain Types of Crypto Assets and Certain Transactions Involving Crypto Assets*, SEC and CFTC, Mar. 23, 2026, https://www.sec.gov/files/rules/interp/2026/33-11412.pdf (hereinafter, "SEC and CFTC Joint Final Rule"); Lev E. Breydo, *Clarifying Crypto: A Unified Market Structure Taxonomy*, SSRN, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=6031955.

describes prediction markets, examines recent controversies and legal battles, and describes platform insolvency risks. Part II explores three points of tension that a prediction market platform insolvency could introduce to bankruptcy practice: valuation, doctrinal inapplicability, and potential illegality. Part III develops the Article's contributions to valuation theory and institutional design literatures. Finally, Part IV offers some normative prescriptions for weighing bankruptcy's role in the overall regulation of prediction markets, as well as a functional framework for broader questions of prediction market regulation. The Article then briefly concludes.

I. PREDICTION MARKETS: WHAT ARE THEY, WHY ARE THEY CONTROVERSIAL, AND HOW MIGHT THEY FAIL?

Prediction markets have rapidly grown into a multibillion-dollar industry with event contracts spanning politics, sports, finance, and many other domains. Their growth has produced controversy and regulatory scrutiny, but little attention to how a platform might fail. This Part describes prediction markets, surveys relevant controversies and legal disputes, and identifies distinctive insolvency risks.

A. What Is a Prediction Market?

Prediction markets "are exchange platforms that specialize in offering event contracts."[24] Event contracts pay based on the (non)occurrence of an event.[25] Since contracts on prediction markets trade continuously, their prices correspond to market-implied probabilities of the (non)occurrence of the underlying event.[26] Their growth reflects both demand to hedge specific risks[27] as well as an expansion of gambling.[28] Yet

[24] Karl E. Schneider & Rena S. Miller, *Prediction Markets: Policy Issues for Congress* 1, CONG. RESEARCH SVC., Mar. 20, 2026, https://www.congress.gov/crs_external_products/IF/PDF/IF13187/IF13187.3.pdf.

[25] *Id*. Most prediction market event contracts are binary, meaning that counterparties bet on whether an event occurs or not. Nevertheless, some contemplate the possibility of three or more potential outcomes. *See* KalshiEX LLC Rulebook, Version 1.28, June 1, 2026, Chapter 1, definition of "Scalar Contract", KALSHI, https://kalshi-public-docs.s3.amazonaws.com/regulatory/rulebook/Kalshi%20DCM%20Rulebook%20v.1.28%20clean.docx.pdf (hereinafter, "Kalshi Rulebook").

[26] *See Prediction Markets*, CME GROUP, https://www.cmegroup.com/markets/prediction-markets.html ("[p]rices correspond to what the market currently believes is the likelihood of the result happening.").

[27] Victoria Liu & Djavaneh Bierwirth, *A Primer on Prediction Markets*, WHARTON FUTURE OF FINANCE INITIATIVE, Jan. 23, 2025, https://wffi.wharton.upenn.edu/blog/a-primer-on-prediction-markets/.

[28] *See generally* Karl Lockhart, *Betting on Everything*, 66 B.C. L. REV. 2175 (2025).

from a legal perspective, prediction markets resist stable classification.

Prediction markets can simultaneously resemble commodity derivatives exchanges, gambling operators, and technology-mediated marketplaces, while in some cases incorporating elements of decentralized or quasi-protocol governance. One way to understand prediction markets is as exchanges for derivatives-like instruments.[29] Event contracts are contingent claims whose value turns on future events, generating useful price signals and placing them naturally within the domain of commodities regulation.[30] Proponents of this framing seek to legitimize prediction markets as tools for information aggregation and market-based forecasting, and point to substantial literature suggesting they can be more accurate than other comparable mechanisms.[31] Some remain skeptical as to whether prediction markets reliably generate socially beneficial information in practice, particularly where participation incentives, informational asymmetries, or market design distort price formation.[32] Prediction market operators prefer this classification, perhaps because it subjects them to a single federal regulator and avoids thorny questions about gambling and consumer protection.[33]

An alternative view is that prediction markets closely resemble gambling.[34] Participants stake money on uncertain outcomes, often in environments characterized by rapid trading, high volatility, and limited informational symmetry. Bettors on discrete events such as elections, sports outcomes, or geopolitical developments typically do not have meaningful

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[29] *See* Notice of Proposed Rulemaking, Prediction Markets 6-8, CFTC, June 10, 2026, https://www.cftc.gov/media/14151/NPRM_PredictionMarkets060926/download (prediction markets are markets on which "'event contract' derivatives" are traded, "[t]he underlying price for an event contract is determined by market participants' continuous buying and selling," and prediction markets serve hedging, "information aggregation, price discovery, and price dissemination functions.") (hereinafter, "CFTC NPRM 6/10/2026").

[30] *See id*.

[31] *See* Erik Snowberg, Justin Wolfers & Eric Zitzewitz, *Prediction Markets for Economic Forecasting*, in 2A HANDBOOK OF ECONOMIC FORECASTING 657 (Graham Elliott & Allan Timmermann eds., Elsevier 2013); Anthony M. Diercks & Jared Dean Katz, *Kalshi and the Rise of Macro Markets*, FEDERAL RESERVE BOARD, Feb. 12, 2026, https://www.federalreserve.gov/econres/feds/files/2026010pap.pdf (empirical evidence that prediction markets can be more accurate than alternatives and provide useful data that is traditionally unavailable).

[32] *See* Rebecca Haw Allensworth, Note: *Prediction Markets and Law: A Skeptical Account,* 122 HARV. L. REV. 1217 (2009).

[33] *See*, *e.g.*, Olivier Acuna, *Kalshi Follows CFTC In Suing Minnesota Over Law Criminalizing Prediction Markets*, CoinDesk, May 29, 2026, https://www.coindesk.com/policy/2026/05/29/kalshi-follows-cftc-in-suing-minnesota-over-law-criminalizing-prediction-markets.

[34] *See* Ilya Beylin, *Event Contracts Are a Step Too Far for Derivatives Regulation*, 4 U. CHI. BUS. L. REV. 77 (2025).

risk exposure to these events *other than the event contract itself*. As such, these contracts may mirror betting more closely than traditional financial hedging or risk transfer. As one of us has previously argued, prediction markets can borrow the visual and rhetorical cues of finance while enjoying gambling-like engagement design, asymmetric information environments, and loss-amplifying participation patterns.[35]

A third characterization views prediction markets as platform-based marketplaces. From this perspective, the platform matches users, defines events, sets participation rules, specifies whether events have "occurred",[36] and determines settlement procedures.[37] This framing emphasizes private ordering and suggests a neutral role for the market operator/platform, akin to that of an exchange in more traditional financial markets.[38] Decentralized platforms may partially automate or distribute some of these functions, in turn making the ontological interpretive rules set by the platform even more important.[39]

These overlapping characterizations are significant because the same platform may invoke the language of financial markets to attract users and signal legitimacy, rely on platform governance to structure participation and settlement, and yet face regulatory scrutiny grounded in gambling law. That classification uncertainty carries directly into insolvency. But before turning to failure, a brief recounting of the controversies facing prediction markets is useful for establishing the stakes of prediction market regulation, whether before the first bet is placed or after a prediction market fails.

B. Who Could Predict the Controversy?

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[35] Nizan Geslevich Packin, *Why Prediction Markets Look Like Finance But Behave Like Gambling*, FORBES, Mar. 16, 2026, https://www.forbes.com/sites/nizangpackin/2026/03/16/why-prediction-markets-look-like-finance-but-behave-like-gambling/.

[36] There are entities that undertake this function in more traditional markets, such as in the market for credit default swaps, where some entity needs to determine whether a "default" has occurred or not. *See* Credit Derivatives Determinations Committee, https://www.cdsdeterminationscommittees.org/.

[37] *See* Kalshi Rulebook, *supra* note 25 (fulfilling these functions).

[38] Schneider & Miller, *supra* note 24, at 1 (prediction markets do not involve a bookmaker setting odds); *but see* Matt Levine, *Prediction Market Making Is Hard*, BLOOMBERG, Apr. 13, 2026, https://www.bloomberg.com/opinion/newsletters/2026-04-13/prediction-market-making-is-hard (noting that as prediction markets evolve most transactions will involve a market maker who, through its separate proprietary trading activity, demonstrably does not hold a neutral view on outcomes).

[39] *See* Alexander Osipovich & Krystal Hur, *Polymarket's $269 Million Question: Did U.S. Forces 'Enter' Iran?*, WALL ST. J., Apr. 11, 2026, https://www.wsj.com/world/middle-east/polymarket-iran-war-bets-975909a3.

Prediction markets have drawn criticism for their accessibility to retail users, spectacular gains and losses,[40] susceptibility to manipulation, and morally controversial contracts. These controversies matter because they shape regulatory treatment and ultimately affect how a platform insolvency would unfold.

1. Manipulation, Ontological Uncertainty, and Moral Limits on Markets

Prediction markets can combine the patina of finance-like legitimacy with gambling-like risks. Research on gamblified finance demonstrates how digital platforms can leverage design features to encourage risk-taking while obscuring underlying asymmetries.[41] Similarly, work on decentralized financial infrastructures highlights how ostensibly inclusive or innovative systems can produce new forms of predatory exposure, particularly for less sophisticated users.[42] Finally, emerging empirical evidence also suggests that prediction-market participation may be highly unevenly distributed, with sophisticated participants capturing disproportionate gains while retail users absorb a larger share of losses.[43]

These concerns become more acute where prediction markets do not merely reflect uncertainty, but create incentives to influence or distort the events on which they are based. In such settings, the line between participation and manipulation becomes blurred, and the integrity of both the market and the underlying real-world process is called into question. For example, professional sports leagues have raised objections to prediction-market trading tied to game outcomes, warning that such markets may create incentives for insiders to influence events or the informational environment surrounding them.[44] Election officials have voiced a parallel concern—that market odds diverging from certified results could corrode public confidence in elections and create incentives to shape outcomes.[45]

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[40] *See*, *e.g.*, Georgia Fern, *A Single Polymarket Trader Lost $4.2 Million on the World Cup in Less Than 24 Hours—Here's How*, INC., June 15, 2026, https://www.inc.com/georgia-fearn/single-polymarket-trader-lost-four-million-on-world-cup-in-less-than-24-hours/91361322 (multiple back-to-back bets on soccer matches).

[41] Nizan Geslevich Packin, Doron Kliger, Amnon Reichman & Sharon Rabinovitz, *Hooked and Hustled: The Predatory Allure of Gamblified Finance,* 2025 COLUM. BUS. L. REV. 1 (2025).

[42] Nizan G. Packin & Yafit Lev-Aretz, *Crypto-Native Credit Score: Between Financial Inclusion and Predatory Lending,* 45 CARDOZO L. REV. 845 (2024).

[43] Pat Akey, Vincent Grégoire, Nicolas Harvie & Charles Martineau, *Who Wins and Who Loses in Prediction Markets? Evidence from Polymarket* (Mar. 18, 2026), SSRN, https://ssrn.com/abstract=6443103.

[44] *See* Purdum, *supra* note 4.

[45] Carrie Levine, *Prediction Markets Place Odds on Election Results. Officials Say They Could Erode Public Trust,* SALON, Aug. 13, 2026,

More troubling still are contexts in which prediction markets intersect with high-stakes geopolitical or human outcomes. Bettors reportedly threatened journalist Emanuel Fabian in an effort to change reporting on an Iranian missile strike.[46] Similarly, reports indicate that people interfered with weather monitoring stations at Charles de Gaulle International Airport in Paris to win prediction market wagers, despite such interference potentially placing passengers and crew in danger.[47] In another case, a think tank employee was fired after "being discovered to have edited an interactive map of the Russia-Ukraine conflict that formed the basis for a Polymarket wager related to Russia's advance."[48] Other creative methods of cheating expose the difficulty of maintaining settlement integrity once financial incentives become tied to real-world data production.[49] Federal regulators have since opened a review of so-called 'mention markets' for precisely this susceptibility to manipulation, prompting Kalshi to withdraw its sports 'mention' contracts.[50] Markets tied to the fate of individuals, including wagers on whether soldiers would be rescued or killed, highlight the ethical limits of commodifying uncertainty.[51] These and other controversies have forced platforms to retract markets, change their Terms of Service, or otherwise apologize for outcomes, revealing both governance gaps and reputational fragility.[52]

These cases also illustrate a deeper concern. Where market

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https://www.salon.com/2026/08/13/prediction-markets-place-odds-on-election-results-officials-say-they-could-erode-public-trust-partner/ (originally published by Votebeat, Aug. 10, 2026).

[46] *See* Emanuel Fabian, *Gamblers Trying to Win a Bet on Polymarket Are Vowing to Kill Me if I Don't Rewrite an Iran Missile Story,* TIMES OF ISRAEL, Mar. 16, 2026, https://www.timesofisrael.com/gamblers-trying-to-win-a-bet-on-polymarket-are-vowing-to-kill-me-if-i-dont-rewrite-an-iran-missile-story/.

[47] Joe Wertz, *France Probes Weather Data Tampering After Surge in Polymarket Bets*, BLOOMBERG, Apr. 23, 2026, https://www.bloomberg.com/news/articles/2026-04-23/france-probes-weather-data-glitch-after-surge-in-polymarket-bets.

[48] Denitsa Tsekova & Leonardo Nicoletti, *Prediction Markets Are Minting a New Type of Insider Trader*, BLOOMBERG BUSINESSWEEK, July 20, 2026, https://www.bloomberg.com/graphics/2026-polymarket-traders-who-knew-the-future/.

[49] Alex Goldenberg, *Prediction Market Cheating Gets Creative*, WALL ST. J., May 10, 2026, https://www.wsj.com/opinion/prediction-market-cheating-gets-creative-3068365e.

[50] Bobby Allyn, *Feds Probe 'Mention Markets' Amid White House Kalshi Controversy,* NPR, Aug. 13, 2026, https://www.npr.org/2026/08/13/nx-s1-5930689/cftc-probe-mention-markets-prediction-markets-kalshi.

[51] *See generally* Michael J. Sandel, WHAT MONEY CAN'T BUY: THE MORAL LIMITS OF MARKETS (2012) (discussing the moral issues presented by creating markets in certain topics, such as betting on occurrences related to the death of particular individuals).

[52] Matt Lavietes, *Polymarket Apologizes for Allowing Wagers on Fate of U.S. Pilots Downed in Iran,* NBC NEWS, Apr. 4, 2026, https://www.nbcnews.com/news/us-news/polymarket-apologizes-allowing-wagers-fate-us-pilots-downed-iran-rcna266715.

settlement depends on publicly reported information, participants may have incentives to manipulate not only prices, but the informational inputs that determine outcomes. In worst-case scenarios, actors are rewarded not for being accurate, but for making outcomes happen—whether through information manipulation, strategic behavior, or more direct forms of interference. Even if these examples are outliers, they reveal structural features of prediction markets in which incentives, information, and real-world events become entangled in ways that challenge traditional assumptions about market neutrality.

2. How Should Prediction Markets Be Regulated, and By Whom?

As of this writing, the fundamental status of prediction markets remains in flux, with legal battles primarily centered around whether federal or state regulation should apply. The CFTC treats prediction markets as exchanges regulable under the Commodities Exchange Act,[53] with event contracts treated as a type of derivative ("often a swap with a binary payoff structure") for purposes of regulation under the CEA.[54] In contrast, at least twenty states have challenged this characterization, asserting the ability to regulate, partially ban, or entirely outlaw prediction markets as forms of gambling.[55] State victories to date include a Washington state court order requiring Kalshi to geofence users from sports, politics, and mention markets;[56] a preliminary injunction in Nevada state court permitting state gambling regulation;[57] and a federal district court decision in New York

[53] 7 U.S.C. §§ 1-26.

[54] CFTC Letter No. 26-08 2, Prediction Markets Advisory, Mar. 12, 2026, https://www.cftc.gov/csl/26-08/download; *see also* CFTC NPRM 6/10/2026, *supra* note 29.

[55] *See* Davis Giangiulio, *CFTC Sues Kentucky Over Prediction Markets Enforcement Actions; First 'Red State' to Face Such Lawsuit*, CNBC, June 23, 2026, https://www.cnbc.com/2026/06/23/cftc-sues-kentucky-over-actions-against-prediction-markets.html.

[56] Order Granting Prelim. Inj., Washington v. Kalshi, Case No. 26-2-10264-3 (SEA) (King County Super. Ct. Aug. 13, 2026) (available at: https://agportal-s3bucket.s3.us-west-2.amazonaws.com/Consumer%20Protection/64_OrdGrantAmendMtnPI.pdf?VersionId=a9FvcaBwWpQETWxbKUdHL1jqjTOD6XAi); *see* Jake Goldstein-Street, Kalshi Ordered to Sharply Curtail Operations in WA, WASH. STATE STANDARD, Aug. 13, 2026, https://washingtonstatestandard.com/2026/08/13/kalshi-ordered-to-sharply-curtail-operations-in-wa/.

[57] See *Nevada Gaming Control Board Granted Preliminary Injunction Against Kalshi*, NEV. GAMING CONTROL BOARD, Apr. 3, 2026, https://www.gaming.nv.gov/siteassets/content/about/press-release/ngcb-granted-preliminary-injunction-against-kalshi.pdf; *see also KalshiEX, LLC v. Schuler*, No.2:25-cv-1165, 2026 WL 657004 (S.D. Ohio Mar. 9, 2026) (denying injunction sought by Kalshi to prevent the Ohio Casino Control Commission from regulating the company's prediction

refusing to enjoin New York's cease-and-desist action against Kalshi, now on appeal.[58]

Yet prediction markets and the federal government have also won several high-profile cases. A federal judge temporarily blocked Arizona criminal charges against prediction-market operators at the CFTC's request,[59] and Minnesota's statewide criminalization of prediction markets[60] was enjoined by a federal court before taking effect.[61] The most significant platform victory to date was at the Third Circuit, where the court accepted Kalshi's federal preemption argument.[62] Nevertheless, courts remain divided: a majority of courts have sided with states and a minority (though this minority includes the only appellate decision to date) have sided with prediction market platforms.[63] The national stakes are illustrated by an amicus brief filed by nearly forty states[64] supporting Massachusetts' suit against Kalshi.[65] In that suit, Massachusetts successfully argued to a lower state court that prediction markets constitute gambling, and the regulation of gambling at a state level is "an exercise of traditional state police power."[66]

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markets).

[58] *KalshiEX LLC v. Williams*, 2026 U.S. Dist. LEXIS 149977 (S.D.N.Y. July 7, 2026) (denying Kalshi's motion for a preliminary injunction quashing New York's cease-and-desist letter and actions).

[59] Reuters, *US Judge Blocks Arizona Criminal Case Against Kalshi at CFTC's Request*, REUTERS, Apr. 10, 2026, https://www.reuters.com/world/us-judge-blocks-arizona-criminal-case-against-kalshi-cftcs-request-2026-04-10/.

[60] Nate Raymond, *US Regulator Sues to Block Minnesota's First-In-Nation Ban on Prediction Markets*, REUTERS, May 19, 2026, https://www.reuters.com/world/us-cftc-sues-minnesota-block-law-related-prediction-market-2026-05-19/.

[61] *See* Samantha Elkins, *Federal Judge Blocks Minnesota's Prediction Market Ban Days Before It Takes Effect*, NBC NEWS, July 27, 2026, https://www.nbcnews.com/tech/tech-news/minnesota-prediction-market-ban-blocked-federal-judge-rcna589494.

[62] *Kalshiex v. Flaherty*, 2026 U.S. App. LEXIS 9948 (3d Cir. Apr. 6, 2026).

[63] *See* Gillian R. Brassil, *Wisconsin Prediction Market Crackdown Endures CFTC Challenge*, BLOOMBERG LAW, July 29, 2026, https://news.bloomberglaw.com/securities-law/cftc-loses-bid-to-halt-wisconsin-prediction-market-crackdown; Natalie Weger, *CFTC Fights Setbacks in Quest to Lock Down Prediction Markets*, BLOOMBERG LAW, July 29, 2026, https://news.bloomberglaw.com/securities-law/cftc-fights-setbacks-in-quest-to-lock-down-prediction-markets.

[64] Brief of Amici Curiae of Nevada, Ohio, 35 Other States, and The District of Columbia Supporting Appellee, Apr. 24, 2026, https://ag.ny.gov/sites/default/files/amicus-curiae/massachusetts-v-kalshiex-llc-amicus-brief-2026.pdf.

[65] *Commonwealth v. Kalshiex, LLC*, No. 2584CV02525, 2026 LX 33147 (Jan. 20, 2026).

[66] *Commonwealth v. Kalshiex, LLC*, No. 2584CV02525, 2026 LX 33147, at *19 (Jan. 20, 2026). States are uniquely situated to bring suits against companies for consumer protection purposes. *See generally* William Organek, *Mass Tort Bankruptcy Goes Public*, 77 VAND. L. REV. 723 (2024) (describing the distinctive procedural and strategic

This case remains pending in front of the state's court of last resort.[67]

Taken together, it appears clear that the legal status of prediction markets is *anything but* clear. Divergent federal and state decisions and the importance of the federal preemption issues involved may invite Supreme Court review, while adverse state rulings could sharply curtail platform business models. Understanding these stakes gives some insight into one of the ways a prediction market platform could go bankrupt, the topic of the next Section.

C. Potential Causes of Prediction Market Insolvency

A prediction market could fail for the ordinary reasons any business could: excessive debt, poor management, competition, an economic downturn, litigation, or any number of other causes.[68] However, prediction markets face two other distinctive risks: regulatory and legal uncertainty, and market structure and liquidity provisioning.

First, legal or regulatory setbacks could sharply reduce platform revenue. In addition to the suits described above, pending federal legislation would classify event contracts relating to politics, war, and sports betting, or that are not used for "hedging or mitigating commercial risk," as illegal.[69] Platform users even trade on this possibility: a Polymarket contract recently implied a roughly 23% chance of a nationwide sports prediction market ban.[70] Intervention by the Supreme Court seems likely,[71] with another Polymarket contract assigning a 70% chance that the Court accepts a sports event contract case by December 31, 2026 is 70%.[72] Because sports

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advantages state attorneys general have when bringing suits in their *parens patriae* capacity).

[67] *See* Nate Raymond, *Massachusetts Top Court Appears Open to State Ban on Kalshi Sports Betting*, REUTERS, May 4, 2026, https://www.reuters.com/legal/government/massachusetts-top-court-appears-open-state-ban-kalshi-sports-betting-2026-05-04/.

[68] For an illuminating analysis of losses in the casino industry, and particular losses in casinos formerly owned by President Trump, *see* Jonathan C. Lipson, *Making America Worse: Jobs and Money at Trump Casinos, 1997-2010*, SSRN, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2845554 (Oct. 8, 2016).

[69] STOP Corrupt Bets Act, H.R. 8123, 119th Cong. (2026).

[70] *See Law banning sports prediction markets enacted in 2026?*, POLYMARKET, https://polymarket.com/event/law-banning-sports-prediction-markets-enacted-in-2026 (last accessed July 29, 2026).

[71] *See* Natalie Weger, *CFTC Fights Setbacks in Quest to Lock Down Prediction Markets*, BLOOMBERG LAW, July 29, 2026, https://news.bloomberglaw.com/securities-law/cftc-fights-setbacks-in-quest-to-lock-down-prediction-markets.

[72] *See SCOTUS accepts sports event contract case by...?*, POLYMARKET, https://polymarket.com/event/scotus-accepts-sports-event-contract-case-by-july-31-2026 (last accessed July 29, 2026).

compose almost 90% of Kalshi's event contract inventory, a nationwide sports event contract prohibition could be devastating for its business.[73]

Market structure and liquidity provisioning creates separate, more foundational solvency risks. This can arise in one of several ways. Platforms could engage in loss-making proprietary trading, but as of now this appears quite rare. The largest prediction market platforms—Polymarket and Kalshi—specifically disclaim any proprietary trading.[74] In addition, the CFTC states that regulated platforms should not "compet[e] against" its users.[75] The CFTC has also proposed restrictions on common ownership or control between a platform and an affiliated trading firm,[76] citing advantages in connectivity, information, and internal enforcement that could make affiliated proprietary trading unfair.[77] The new proposed rules nevertheless permit the establishment of affiliated market makers,[78]

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[73] Schneider & Miller, *supra* note 24.

[74] *See Market Integrity*, POLYMARKET US POLICY, https://www.polymarketexchange.com/market-integrity.html ("On Polymarket US, participants buy and sell shares representing the outcomes of future events . . . and trades are matched with other users, not the house."); *Free Markets Over Monopolies*, KALSHI POLICY, https://kalshi.com/policy-center/markets-over-monopolies ("Platform is neutral. No stake in the outcome.").

[75] *Understanding Prediction Markets and Event Contracts*, CFTC, https://www.cftc.gov/LearnandProtect/PredictionMarkets (CFTC frequently-asked questions website states that "CFTC-regulated exchanges . . . provide a platform for trading and are not competing against you."); *see also* 7 U.S.C. § 7(d)(16) (conflict of interest rules for DCMs); 17 C.F.R. §§ 38.850-51, Appendix B to Part 38, Core Principle 16(a) ("contract market[s] should provide for appropriate limitations on the use or disclosure of material non-public information gained through . . . an ownership interest in the contract market").

[76] *See CFTC Seeks Public Comment on Notice of Proposed Rulemaking Concerning Affiliations Among Certain CFTC-Regulated Entities*, CFTC, July 30, 2026, https://www.cftc.gov/PressRoom/PressReleases/9274-26; *Request for Comment: Conflicts and Affiliations NPRM* 26-27,73-118, CFTC, July 30, 2026, https://www.cftc.gov/media/14446/ConflictsAndAffiliationsNPRM073026/download.

[77] *Request for Comment: Conflicts and Affiliations NPRM* 93-95, CFTC, July 30, 2026, https://www.cftc.gov/media/14446/ConflictsAndAffiliationsNPRM073026/download (hereinafter, "CFTC RFC 7/30/2026"); *see generally* Eva Su, *Payment for Order Flow (PFOF) and Broker-Dealer Regulation*, CONG. RESEARCH SVC., Feb. 20, 2024, https://www.congress.gov/crs_external_products/IF/PDF/IF12594/IF12594.2.pdf (describing this possibility in other financial contexts).

[78] A "market maker" is "a firm that stands ready to buy or sell a stock listed on an exchange at publicly quoted prices." *Executing an Order*, SEC, https://www.investor.gov/introduction-investing/investing-basics/how-stock-markets-work/executing-order. Market makers quote a price at which they would buy more shares (the bid) and a price at which they would sell more shares (the ask). They "reduce volatility and facilitate price discovery in the stock market by providing a limited trading range on the security they make a market in." Adam Levy, *What Is a Market Maker*, THE MOTLEY

but prohibit affiliated firms that engage in directional trading (i.e., that seek to "convert operational and informational advantages into proprietary profit").[79] Some smaller prediction market platforms that are not regulated as designated contract markets by the CFTC may still engage in such behavior, and for those platforms losing proprietary trades could pose an insolvency risk.

Market making itself is a second source of solvency risk. Prediction markets "list a large and continuously refreshed population of individual small, short-lived, and idiosyncratic contracts,"[80] many of which would be too thinly traded to establish tradeable prices without market makers. Platforms could rely on affiliated or third-party market makers, but each approach creates a different solvency risk for the platform.

Affiliated market makers can supply liquidity to the "long tail" of contracts that unaffiliated market makers may rationally ignore.[81] But an affiliate market maker, by necessity, must sometimes take "directional proprietary positions . . . in connection with its obligation to maintain two-sided quotations."[82] That is, sometimes an affiliate market maker must use its own balance sheet to place bets so as to be able to serve its market-making function, building an inventory of event contracts held over time. The CFTC's proposed rules expressly acknowledge this possibility, declining to prohibit affiliated market makers from holding net directional positions.[83] If those inventory contracts resolve against the affiliate, losses may weaken both the market maker and its parent platform.

On the other hand, unaffiliated market makers avoid direct proprietary exposure.[84] However, an unaffiliated market maker must be incentivized to engage with the platform, particularly "for an unproven [prediction market] venue or across a broad and thin contract universe."[85] To do this, prediction market platforms pay market makers through established liquidity incentive programs and designation as market makers.[86] If a platform does not balance this customer acquisition expense

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FOOL, Oct. 12, 2025, https://www.fool.com/terms/m/market-maker/.

[79] *Request for Comment: Conflicts and Affiliations NPRM* 96, 102-03, CFTC, July 30, 2026, https://www.cftc.gov/media/14446/ConflictsAndAffiliationsNPRM073026/download.

[80] *Id*. at 96.

[81] *Id*.

[82] *Id*. at 103.

[83] *Id* at 103-04.

[84] *See*, *e.g.*, *Susquehanna Predictions*, https://sig.com/predictions/.

[85] CFTC RFC 7/30/2026, *supra* note 77, at 96-97.

[86] *See Liquidity Rewards*, POLYMARKET, https://docs.polymarket.com/programs/liquidity-rewards; *Liquidity Incentive Program*, KALSHI, https://help.kalshi.com/en/articles/13823851-liquidity-incentive-program; *How to Become a Market Maker on Kalshi*, KALSHI, Apr. 28, 2026,

appropriately, it can create insolvency risk. *Over*incentivizing liquidity can cost the platform more than the resultant customer activity produces.[87] Alternatively, *under*incentivizing liquidity can leave contracts illiquid and drive away users. Major prediction markets and unaffiliated market makers may try to address the potential tension between over- and underincentivization by providing the market maker with an equity stake in the platform.[88] While this can align the interests of the unaffiliated market maker and the platform, it raises other conflicts of interest concerns and correlates potential losses at the market maker and the platform.

Thus, contrary to popular imagination, prediction market platforms are not literally a "house" immune from loss. It is difficult to know how likely the insolvency of one or more prediction market platforms might be, though perhaps these platforms themselves could help us discover this likelihood through an event contract offered on just this topic. The authors were unable to locate any such event contract as of the time of this writing. However, if a prediction market platform filed for bankruptcy, its effects would be felt throughout the economy, as many thousands of retail traders engage with these services every day.[89] Thus it is important to understand how a prediction market might fare in the current bankruptcy system. Unfortunately, answering this question would not be easy for at least three key reasons: valuation difficulty, doctrinal inapplicability, and potential illegality. These are discussed in the next Part.

II. HOW WOULD BANKRUPTCY COURTS HANDLE A PREDICTION MARKET PLATFORM INSOLVENCY?

A major prediction market platform insolvency would pose a formidable challenge to a bankruptcy court based solely on its size and the number of retail traders affected.[90] But scale would only be the beginning,

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https://help.kalshi.com/en/articles/13823819-how-to-become-a-market-maker-on-kalshi.

[87] *See generally dYdX: Liquidity Providers' Incentive Programme Review*, ARXIV, July 8, 2023, https://arxiv.org/abs/2307.03935.

[88] *See* Katherine Doherty & Isis Almeida, *Jump Trading Poised to Gain Stakes in Kalshi and Polymarket*, Bloomberg, Feb. 9, 2026, https://www.bloomberg.com/news/articles/2026-02-09/jump-trading-poised-to-gain-stakes-in-kalshi-and-polymarket.

[89] *See* Neil Metha, Katherine Long, and Caitlin Ostroff, *Why Almost Everyone Loses—Except a Few Sharks—On Prediction Markets*, WALL ST. J., May 3, 2026, https://www.wsj.com/finance/investing/polymarket-kalshi-betting-profits-prediction-markets-eb23ac11 (Polymarket has at least 2.3 million accounts); *Prediction Market Kalshi Boosts Valuation to $22 Billion with Fresh $1 Billion Investment*, YAHOO! FINANCE, May 7, 2026, https://finance.yahoo.com/markets/options/articles/prediction-market-startup-kalshi-boosts-150029134.html (Kalshi has 2 million monthly users).

[90] As a comparison, the bankruptcy of FTX, a major cryptocurrency exchange with

as a prediction market platform insolvency would present distinctive doctrinal problems.

This Part addresses three such difficulties. First, valuing event contracts would be unusually burdensome because they are susceptible to manipulation and regulatory risks. Second, core bankruptcy rules concerning the identity of the debtor, claim priority, executory contracts, and dispute settlement would be challenging to apply to prediction market platforms. Third, the ordinary rules of bankruptcy may be entirely inapplicable: classification of event contracts as derivatives would activate the Bankruptcy Code's financial contract safe harbors,[91] while laws that made some or all event contracts illegal could threaten access to federal bankruptcy protection. These problems lay the foundation for the broader theoretical questions addressed in Part III.

A. Practical Valuation Difficulties for Prediction Markets

At first glance, continuously-quoted event contract prices appear to make valuation easier because they reflect the market's assessment of whether the underlying event will (not) occur. But this appearance is misleading. Regulatory decisions can alter enforceability, liquidity, or the ability to withdraw funds. Some or all of these risks may not be fully incorporated into the quoted price of event contracts.[92] But leaving these risks aside, valuations of event contracts are unstable for more fundamental reasons.

1. Regulatory Treatment, Volatility, and Valuation Methodologies

In traditional bankruptcy proceedings, courts generally attempt to stabilize claims by fixing values at a particular moment in time. Prediction

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more than one million customers, remains ongoing nearly four years after its filing. *See* Gabrielle Salusbery, *FTX May Have More Than 1 Million Creditors*, BANKINGDIVE, Nov. 15, 2022, https://www.bankingdive.com/news/ftx-may-have-more-than-1-million-creditors/636608/; *FTX to Pay Creditors Another $900 Million in Fifth Bankruptcy Distribution*, YAHOO! FINANCE, July 17, 2026, https://finance.yahoo.com/markets/crypto/articles/ftx-pay-creditors-another-900m-202800082.html. The case has generated nearly $1 billion in professional fees. Jonathan Randles, *FTX's $950 Million in Bankruptcy Fees Among Costliest Since Lehman*, BLOOMBERG, Feb. 26, 2025, https://www.bloomberg.com/news/articles/2025-02-26/ftx-s-950-million-bankruptcy-fees-among-costliest-since-lehman.

[91] *See* Roe, *supra* note 11, at 547.

[92] *Cf.* David Rothschild & David M. Pennock, *The Extent of Price Misalignment in Prediction Markets*, 3 ALGORITHMIC FINANCE 3, 4 (2014) (describing counterparty risk as having a "non-negligible," but ultimately not quantified, effect on an empirical arbitrage prediction market experiment).

markets complicate that process because the underlying obligations may remain unresolved, disputed, or probabilistic at the moment insolvency occurs.[93] If event contracts are characterized as derivatives, parties or courts may attempt mark-to-market valuation or close-out mechanisms.[94] But if the contracts are instead viewed as gambling obligations or platform-mediated informational products, there may be no accepted methodology for determining value, enforceability, or even whether the obligation itself should survive insolvency.[95] In either case, regulatory treatment—which is today uncertain—directly impacts valuation methodology, and this problem may be particularly pernicious for smaller or more volatile event contracts.

If event contracts are treated as derivatives, the quoted prepetition prices would be an obvious starting point for valuing claims for unpaid event contracts brought against a platform. However, the Third Circuit has held in the somewhat similar derivatives context that "when the market is dysfunctional and the market price does not reflect an asset's worth [one should] turn to other determinants of value."[96] Prediction markets could present just this problem.

If so, the value of claims on unpaid event contracts would be ascertained based on the terms of the event contract itself.[97] In Kalshi's case, the relevant information would be included in the contract's Terms and Conditions.[98] In the event of an ambiguity, "[t]o settle a Contract . . . Kalshi has *sole discretion* to interpret a Contract's Terms and Conditions."[99] In making such a determination, Kalshi says that it *may* rely on the last traded price, the binding and unappealable determination of Kalshi's

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[93] *See* Baird & Bernstein, *supra* note 13 (valuation uncertainty affects bargaining and priority outcomes in Chapter 11 reorganizations); Matt Levine, *Traders Do Something About the Weather*, BLOOMBERG (Apr. 23, 2026), https://www.bloomberg.com/opinion/newsletters/2026-04-23/traders-do-something-about-the-weather (illustrating how prediction markets may recursively influence the underlying events on which settlement depends).

[94] *See* Stephen J. Lubben, *The Bankruptcy Code Without Safe Harbors*, 84 AM. BANKR. L.J. 123, 130 (2010) (defining close-out netting).

[95] *Cf.* Kara Bruce, Christopher K. Odinet & Andrea Tosato, *Bankrupt Crypto Organizations*, 104 N.C. L. REV. 657 (2026) (describing instability surrounding valuation, governance, and claims treatment in decentralized crypto insolvencies).

[96] *Credit Agricole Corp. v. Am. Home Mortg. Holdings, Inc. (In re Am. Home Mortg. Holdings, Inc.)*, 637 F.3d 246, 257 (3d Cir. 2011).

[97] *See Lehman Bros. Holdings v. Intel Corp. (In re Lehman Bros. Holdings)*, 2015 Bankr. LEXIS 3991, at *32 (Bankr. S.D.N.Y. Sept. 16, 2015) (since the derivatives in question were contracts, "the Court must apply principles of contract interpretation" to determine how value is calculated).

[98] *Market Outcomes*, KALSHI, Mar. 17, 2026, https://help.kalshi.com/en/articles/13823826-market-outcomes.

[99] Kalshi Rulebook, *supra* note 25, Rule 6.3(c) (emphasis added).

internal Outcome Review Committee, or another method.[100] In bankruptcy, responsibility for resolving contractual ambiguity would fall to a bankruptcy court.[101] For Kalshi, its discretion could be replaced by the court's, which may try to rely on mechanisms used in other derivatives contexts such as netting amounts owed or requiring contracts to be marked to market, as well as perhaps relying on other general legal principles.[102] However, none of the court's tools would eliminate the underlying interpretive problem.

Polymarket presents a different institutional problem. It disclaims all settlement responsibility and relies upon a decentralized blockchain-based protocol called UMA to verify outcomes.[103] UMA, in turn, depends upon third parties posting bonds in cryptocurrencies and voting to resolve disputes, with (dis)incentives for (in)correct answers.[104] Event contracts on Polymarket would likely face many of the same valuation issues as those faced by Kalshi. In addition, even if Polymarket's event contracts are treated as derivatives (and thus *Polymarket's* actions would not be barred by the automatic stay), it is unclear whether third-party determinations by *UMA* would be barred by the automatic stay because such actions would set the amounts that might be owed to counterparties.[105] But even if UMA's actions were not stayed, for the reasons described above with respect to Kalshi the values fixed by UMA may not be dispositive.

Timin creates a separate valuation risk, particularly for thinly-traded or volatile event contracts. Typically, a derivative is valued as of the date of the debtor (or trustee's) rejection of the contract or the date the contract is liquidated, terminated, or accelerated.[106] Giving the debtor discretion as to *when* to value an asset can distort incentives by allowing the debtor to lock in low damages while retaining potential upside.[107] The

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[100] *Id*.

[101] *Cf.* Andrea Tosato, Diane Lourdes Dick, & Christopher K. Odinet, *Debt Tokens*, 173 U. PA. L. REV. 1103, 1140-49 (2025) (dismissing the "code is law" ethos present in some cryptocurrency contexts and describing how this was ignored in the context of OPNX, a cryptocurrency-based bankruptcy claims trading platform); *see also In re Celsius Network LLC*, 647 B.R. 631, 637 (Bankr. S.D.N.Y. 2023) ("The issue of ownership of the assets in the Earn Accounts is a contract law issue.").

[102] *See Lehman Bros. Holdings v. Intel Corp. (In re Lehman Bros. Holdings)*, 2015 Bankr. LEXIS 3991, at *33-66 (Bankr. S.D.N.Y. Sept. 16, 2015) (discussing the factors why the court relied on one party's loss calculations rather than another's).

[103] *Resolution*, POLYMARKET, https://docs.polymarket.com/concepts/resolution.

[104] *How Does UMA Work?*, UMA, July 9, 2026, https://docs.uma.xyz/protocol-overview/how-does-umas-oracle-work.

[105] 11 U.S.C. § 362(a)(1)-(3), (6).

[106] 11 U.S.C. § 562(a).

[107] Anthony Casey, Brook Gotberg, & Joshua Macey, *Crypto Volatility and the* Pine Gate *Problem* 2, Mar. 21, 2023, https://bankruptcyroundtable.law.harvard.edu/wp-

concern is smaller for platforms that take no directional positions, but affiliated market makers may hold positions. Moreover, distress may depress prices across the platform, and in that case fixing the value of an event contract on the date chosen by the prediction market platform would effectively force out-of-the-money contract counterparties "to sell at the bottom of the market."[108] It would also cause out-of-the-money counterparties to lose the option value of their investment[109]—an essential reason to enter into the transaction for anyone who purchased an event contract for less than 50 cents.

Finally, there is little guidance as to how event contracts might be valued in bankruptcy if they are treated not as derivatives, but as gambling contracts. Gambling is typically regulated on a state level,[110] and as discussed *infra* state-regulated markets typically have comprehensive regulatory frameworks that govern failures. In the absence of such a framework, bankruptcy courts might need to make many difficult determinations that would undoubtedly involve significant delays and costs.[111]

2. Verification, Manipulation, and Ambiguity—Within and Across Platforms

Settlement of an event contract requires some mechanism to determine whether or not the underlying event occurred.[112] This verification may be centralized (in the case of Kalshi) or decentralized (in the case of Polymarket), and is usually governed by platform rules, oracle systems,[113]

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content/uploads/2025/10/Casey-Gottberg-Macey-Harv-Bankr-RT-1.1939_2.pdf (discussing this in the volatile cryptocurrency market).

[108] *See id*. at 3 (discussing this in the volatile cryptocurrency market).

[109] *See id*. at 2.

[110] For more on gambling laws in the United States and particularly sports betting and the states' authority *see* Marc Edelman, John T. Holden & Adam Scott Wandt, *U.S. Fantasy Sports Law: Fifteen Years After UIGEA,* 83 OHIO ST. L.J. 117, 135-40 (2022).

[111] *See* Adam J. Levitin, *Not Your Keys, Not Your Coins: Unpriced Credit Risk in Cryptocurrency*, 101 TEX. L. REV. 877, 883-84 (2023) (noting that creditors stand to lose more money when bankruptcy treatment is uncertain).

[112] *See* Kalshi Rulebook, *supra* note 25, Chapter 1, definition of "Underlying" (defined as the "index, rate, risk, measure, instrument, differential, indicator, value, contingency, occurrence, or extent of an occurrence the Expiration Value of which determines whether a Contract is in-the-money".).

[113] Oracles "are third-party services that provide smart contracts [on the blockchain] with external information. They serve as bridges between blockchains and the outside world [because b]lockchains and smart contracts cannot access off-chain data (data that is outside of the network." *What Is a Blockchain Oracle in Crypto*, COINBASE, https://www.coinbase.com/learn/crypto-glossary/what-is-a-blockchain-oracle-in-crypto.

or other external information sources. This verification process presents two interrelated issues: manipulation and ambiguity. These issues, in turn, are made more complex when considering how they are treated both within a given platform and across platforms.

Manipulation can make it difficult to determine whether a contract should pay at all.[114] But placing the question of manipulation to the side, valuation is difficult because event contracts are often drafted against events that are not naturally binary or may be susceptible to multiple interpretations. Whether a public figure "mentioned" a word, whether military personnel "entered" a country, or whether a person "performed" at an event may sound straightforward at the moment the contract is listed, but each formulation embeds latent ambiguities that become salient only after money is at stake.[115] Those ambiguities are manifestations of bounded rationality in contract design. Prediction-market platforms must specify ex ante rules for events whose factual and linguistic boundaries may be highly contestable ex post.[116] Oracle systems and platform-defined resolution rules merely relocate, rather than eliminate, this interpretive problem.

While such ambiguities and the need for interpretation may be present in any contract,[117] the problem is potentially amplified for prediction markets for several reasons. Contracts on prediction markets span unusually varied topics, resist standardization, and are often one-off instruments for which costly interpretation may not be justifiable.[118] In addition, to date there does not seem to be a concerted effort on the part of prediction market platforms to be systematic or consistent in creating rules of interpretation.[119] For Kalshi and other centralized prediction markets the problem may be particularly acute because there may be a conflict between

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[114] *See* notes 46-52, *supra*, and accompanying text.

[115] *See* Matt Levine, *Truth Machines Go to War*, BLOOMBERG, Apr. 6, 2026, https://www.bloomberg.com/opinion/newsletters/2026-04-06/truth-machines-go-to-war.

[116] *See id*.

[117] Ambiguity is not unique to prediction market contracts, and exists even in highly standardized financial markets. *See* Vincent S.J. Buccola, Jameson K. Mah, & Tai Zhang, *The Myth of Creditor Sabotage*, 87 U. CHI. L. REV. 2029, 2040 (2020) (discussing how the "prosaic ambiguities" of the "highly standardized" credit default swap market are resolved by the ISDA Determinations Committee, a body composed of representatives of the International Swaps and Derivatives Association's membership); *see also The Credit Derivatives Mailbag*, ISDA, Feb. 3, 2015, https://www.isda.org/2015/02/03/the-credit-derivatives-mailbag/.

[118] *Cf*. Baird & Bernstein, *supra* note 13, at 1943-44.

[119] *See* Christopher Beam, *Homophones, Plurals and Language 'Rulescucks' Are Roiling Prediction Markets*, BLOOMBERG, Mar. 27, 2026, https://www.bloomberg.com/news/articles/2026-03-27/kalshi-faces-growing-problem-with-grammar-language-disputes.

generating platform engagement and correctly interpreting the contract.[120] Moreover, Kalshi's internal teams may not have the requisite expertise to interpret the incredibly broad array of topics covered by event contracts that may be listed on the platform. Finally, and perhaps most importantly, any need for interpretation about an event contract that came before a bankruptcy judge might present a twofold problem: not only would the judge need to decide an interpretive question about what particular words mean, but in some cases she may also need to decide *whether* the event in question had actually occurred—a far cry from merely enforcing a preexisting agreement.

Cross-platform differences further magnify this problem. Prediction markets lack the long performance histories that anchor the valuation of mature securities markets.[121] Meanwhile, superficially similar contracts may use different settlement rules, producing different outcomes and creating arbitrage opportunities.[122] For example, in the 2024 Presidential election, Polymarket and other platforms resolved their contracts based on media network calls of the election, while Kalshi and other platforms resolved their contracts based on who was inaugurated. Thus, even though the end result was the same (President Trump was elected and inaugurated), it was conceivable that a major network could have called the election for Harris while Trump was ultimately inaugurated.[123] As a result, "substantial and persistent cross-platform price divergence [was] observed even in this information-rich environment."[124] Combining all of these different aspects—the difficulty of verifying what occurred, the potential for manipulation, and the variations across platforms—would add to the difficulties that a bankruptcy judge would face in valuing claims in the insolvency of prediction market platform.

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[120] Decentralized platforms such as Polymarket, using the UMA protocol, could also be subject to gamesmanship in determining whether an event contract pays out, though it would require substantial coordination and might become prohibitively expensive. *See FAQs—Security*, UMA, https://docs.uma.xyz/faqs#security.

[121] *Cf.* Roe & Simkovic, *supra* note 14, at 416 (information uncertainty requires more factfinding to determine value, thus driving up cost and reducing accuracy); *see also* Ayotte & Morrison, *supra* note 8, at 1825-31 (typical valuation methods depend on assumptions which are made more accurate in markets with extensive empirical histories).

[122] *See* Jonas Gebele & Florian Matthes, *Semantic Non-Fungibility and Violations of the Law of Once Price in Prediction Markets*, ARXIV, Jan. 5, 2026, https://arxiv.org/html/2601.01706v1 (from a dataset of 100,000 events across major prediction market platforms, 6% of all events are concurrently listed across platforms, but diverge in price by 2-4% even in liquid markets).

[123] *Id*.

[124] *Id*.

3. The Uncertainty Caused by Insolvency Itself

Insolvency itself creates a final valuation obstacle. Once a platform is distressed, its contract prices may reflect not only the probability of the underlying event but also expected nonpayment, delay, and bankruptcy costs. Knowing this and the potential for additional cost and delay if a platform were to become insolvent, the ex ante incentives of participants on the platform would change.[125] Price thus becomes endogenous to the very insolvency the court managing, and may confound attempts at valuation through the proxy of the event contract's price.[126]

B. How Would Black-Letter Bankruptcy Law Operate in a Prediction Market Insolvency?

Beyond practical valuation difficulties, a prediction market insolvency would present doctrinal difficulties. It would strain black-letter law concerning the identity of the debtor, claim classification and priority, executory contracts, and dispute settlement.

1. Prediction Markets, DAOs and the Idea of a Clearly-Bounded Debtor

Some prediction-market platforms combine offshore entities,[127] tokenized governance arrangements, decentralized oracle systems, smart-contract execution, and community-based dispute resolution mechanisms.[128] These arrangements may provide operational flexibility and regulatory arbitrage advantages during ordinary market activity. However, they can be unstable during insolvency because they make it difficult to identify the debtor, determine who may commence proceedings or represent the estate, classify token holders' claims, and administer digital assets.[129]

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[125] *See* Barry E. Adler, *Bankruptcy and Risk Allocation*, 77 CORNELL L. REV. 439, 444–48 (1992).

[126] *Cf.* Alan Schwartz, *A Normative Theory of Business Bankruptcy*, 91 VA. L. REV. 1199, 1203 (2005) (increasing the likelihood of collections in insolvency lowers interest rates and increases investment across the economy, with the opposite effect for decreased likelihood of collections).

[127] *See* Kate Knibbs, *Americans Are Trading Billions of Dollars on Polymarket's Banned Offshore Platform*, WIRED, June 11, 2026, https://www.wired.com/story/polymarket-study-illegal-trades-offshore-billions/. In addition, Polymarket's Terms of Service expressly provide that disputes are governed by Panamanian law. *See* Polymarket Terms of Use, Section 8, POLYMARKET, https://polymarket.com/tos (last visited Aug. 5, 2026).

[128] *See* notes 103-104, 113, *supra*, and accompanying text.

[129] Bruce *et al*., *supra* note 95, at 666-74. For more on the U.S. regulatory landscape for digital assets, *see* Kevin Werbach, *Digital Asset Regulation: Peering into the Past,*

Decentralized autonomous organizations ("DAOs") make this problem concrete.[130] Like some prediction market platforms, DAOs operate through token-based governance systems, pseudonymous participants, smart contracts, decentralized treasuries, and fragmented cross-border infrastructures.[131] These features can obscure who controls them, who owes fiduciary duties to whom, where assets are located, and in some cases whether the DAO itself constitutes a "person" capable of entering bankruptcy proceedings at all.[132] As a result, financial distress often exposes profound uncertainty regarding who may commence proceedings, who may represent the estate, whether token holders resemble creditors or equity holders, and how digital assets should be identified, valued, and distributed.

The Hector DAO proceedings illustrate these tensions. Affected by cyberattacks, alleged security breaches, and broader crypto instability, Hector DAO's token holders voted to dissolve the organization. But the liquidation process itself became chaotic after additional vulnerabilities and litigation emerged. Instead of proceeding through a conventional Chapter 11 reorganization, Hector DAO relied upon a British Virgin Islands receivership coupled with Chapter 15 recognition proceedings in the United States.[133]

The proceedings showed how insolvency can require decentralized organizations to reconstruct centralized authority ex post. Hector DAO ultimately relied upon appointed receivers, coordinated judicial supervision, and litigation stays to preserve assets and prevent individual token holders from racing to seize assets.[134] In this sense, financial distress exposes the continuing importance of centralized legal ordering even within purportedly decentralized ecosystems.

These lessons apply to the potential insolvency of a prediction market platform. Centralization remains important for disclosure, judicial oversight, identifying insiders, and marshalling estate property to subject it to court supervision. Yet many decentralized projects intentionally diffuse

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Peering into the Future, 64 WM. & MARY L. REV. 1251, at 1271-74 (2023).

[130] *See generally* Jonathan Brogden & Alexander Bradley-Sitch, *Deep Dive into DAOs: The Practical Risks of Existing Nowhere*, DAC BEACHCROFT, Feb. 4, 2025, https://www.dacbeachcroft.com/en/What-we-think/Deep-dive-into-daos-the-practical-risks-of-existing-nowhere; Bruce *et al*., *supra* note 95.

[131] For more on how DAOs operate *see generally* Kevin Werbach, Eva Micheler, and Bianca Kremer (eds), FOUNDATIONS OF DECENTRALIZED ORGANIZATIONS: BLOCKCHAIN AND THE FUTURE OF CORPORATE LAW (2026).

[132] *See* 11 U.S.C. §§ 101(15), (41) (definitions of "entity" and "person"), 109 (who may be a debtor); Brogden & Bradley-Sitch, *supra* note 130.

[133] Nizan Geslevich Packin, How Hector DAO's Bankruptcy Case Is Shaping the Future of DeFi, BLOOMBERG LAW, Aug. 20, 2024, https://news.bloomberglaw.com/us-law-week/how-hector-daos-bankruptcy-case-is-shaping-the-future-of-defi.

[134] *Id*.

operational authority across protocols, governance participants, liquidity providers, and affiliated entities, making it difficult to identify the debtor, determine who may commence proceedings or represent the estate, classify token holders' claims, and administer digital assets.[135] These uncertainties can substantially increase transaction costs, reduce institutional confidence, and complicate creditor recovery. Prediction markets operating through decentralized or quasi-decentralized architectures[136] may therefore encounter substantial bankruptcy complications precisely because insolvency law continues to depend upon the existence of a stable, identifiable debtor capable of being subjected to judicial administration.

2. Classification and Claim Priority

How a prediction market platform is characterized for other regulatory purposes—as a derivatives market, a gambling hub, an information platform, or something else—can directly affect how claims are considered in bankruptcy. Uncertainty in classification therefore leads to uncertainty in legal treatment in bankruptcy. Users could resemble customers whose assets are being held or intermediated by the platform. In such cases, claimants would be treated based on the language of the respective platform's terms of service, which could vary from a full disclaimer of any control[137] to custody of customer funds by the platform itself.[138] Courts could plausibly also classify claimants as unsecured creditors asserting contractual claims, counterparties to contingent financial instruments, or even equity-like participants in a speculative enterprise. Each characterization carries materially different consequences for priority, recovery, and procedural protections.[139] A court treating market participants as customers or custodial claimants may prioritize the return of segregated assets, while a court viewing the same participants as counterparties to speculative wagers may instead treat them as holders of contingent

[135] Bruce *et al*., *supra* note 95, at 666-74.

[136] Polymarket is the most famous decentralized prediction market and the largest by far, but other notable ones include Limitless, Myriad, and Opinion. *See* Debbie Soon, *Beyond Polymarket and Kalshi: 5 Prediction Markets We Are Paying Attention To*, PRIVY, Dec. 16, 2025, https://privy.io/blog/beyond-polymarket-and-kalshi-five-prediction-markets-we-are-paying-attention-to.

[137] *See* Polymarket Terms of Use, Section 2a, POLYMARKET, https://polymarket.com/tos (last visited Aug. 5, 2026).

[138] *See* Summons, *Wisconsin v. Kalshi, Inc. et al.*, Case No. 2026CV001248 (Dane Cty. Cir. Ct., Wisc.), Dkt. 1, at 21 (available at: https://www.wisdoj.gov/PressReleases/complaint-kalshi-sc.pdf), *removed to Wisconsin v. Kalshi, Inc. et al.*, Case No. 3:26-cv-00378 (W.D. Wisc.).

[139] *See* Douglas G. Baird, ELEMENTS OF BANKRUPTCY 3-5 (7th ed. 2022) (explaining that bankruptcy outcomes depend heavily upon the characterization and priority of claims).

unsecured claims.[140]

Claim priority, the amount ultimately recovered, and the recipient of such recoveries can also depend on the identity of the claimant. Recent consumer data suggest that prediction-market users may lose more than sports bettors, and that losses fall most heavily on thinly-capitalized, lower-volume, lower-wallet users with meaningful informational and execution disadvantages.[141] To defend such users and to make the claim that these results arise from illegal behavior, individual plaintiffs and state attorneys general have brought consumer protection and tort litigation in parallel with the gambling/derivatives litigation discussed above.[142] Since early 2025, plaintiffs and state attorneys general have pressed deceptive-advertising, unfair-practices, defective-design, and "illegal product" theories against wagering and prediction-market operators, contending that platforms marketed allegedly unlawful gambling as lawful event contracts and engineered features that target and exploit compulsive users. These claims are significant for insolvency precisely because they survive the platforms' preferred defense: even if a court ultimately resolves the preemption and classification questions in favor of a federally regulated exchange, consumer-protection liability persists as an independent basis for recovery. In an estate, such claims would arrive as contingent, unliquidated, and potentially enormous demands.[143] And if the eventual legal classification of event contracts results in greater success for claims brought by states on consumer protection theories than corresponding claims from individuals, the state claims may be more valuable and/or attain higher priority than other types of claims by other creditors.[144]

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[140] *Cf. In re MF Global Inc.*, 515 B.R. 193 (Bankr. S.D.N.Y. 2014) (addressing customer status and distribution priorities in the context of derivatives-related insolvency).

[141] *See* Chavdar Vasilev, *Prediction Market Users Lose More Than Sports Bettors, New Data Reveals*, GAMBLING INSIDER, Apr. 2, 2026, https://www.gamblinginsider.com/news/151976/prediction-markets-higher-losses-bettors-citizens-data.

[142] *See* Ross Weingarten et al., *The Expanding Role of Consumer Protection Laws in Prediction Markets Litigation,* STEPTOE LLP CLIENT ALERT, Aug. 3, 2026, https://www.steptoe.com/en/news-publications/the-expanding-role-of-consumer-protection-laws-in-prediction-markets-litigation.html.

[143] On the "illegal product" theory, see, for example, Complaint, *People v. KalshiEX LLC,* No. 453272/2026 (N.Y. Sup. Ct. N.Y. Cnty. July 31, 2026). On the parallel duty-of-care question, see *Macek v. DraftKings, Inc.*, No. 5:25-cv-01995-JFL (E.D. Pa. Mar. 23, 2026) (holding that Pennsylvania law imposes no duty of care to protect users from gambling harm), appeal docketed (3d Cir. 2026); *cf. Youngs v. DraftKings, Inc.,* No. 2:25-cv-00179 (D.N.J. Nov. 19, 2025) (declining to dismiss deceptive-advertising claims challenging "risk-free" promotions).

[144] *See* William A. Organek, Purdue*'s Side Effects: Using Due Process to Realign Mass Tort Bankruptcies*, 50 B.Y.U. L. REV. 1031, 1066-75 (2025) (discussing open questions of priority and distribution when governments become litigants on behalf of

This threshold instability of the nature of the claim and the identity of the claimant has cascading effects. If the legal status of contracts is uncertain, then the classification of claims becomes unstable. If classification is unstable, then priority and distribution become unpredictable. And if those outcomes are unpredictable, the incentives of participants, both before and during distress, may shift in ways that exacerbate instability.[145] Prediction markets therefore present not a single classification problem, but a layered one. Platforms occupy multiple legal categories simultaneously, draw on different regulatory logics, and generate claims whose status depends on how those layers are resolved. Bankruptcy law, which relies on relatively fixed categories, encounters these markets at a moment when categorization itself is unsettled.

3. Executory Contracts, Over-Rejection, and the Limits of Section 365

Prediction-market positions raise difficult questions under section 365, which governs the assumption and rejection of executory contracts.[146] Executory contracts are those on which material performance remains due on both sides.[147] But applying existing doctrine to event contracts is made challenging because it is not clear (1) whether an event contract is "executory" and thus able to be rejected, (2) how damages for rejection should be calculated, or (3) if rejection simply allows the platform to cancel contracts for which it (or its affiliated market maker) is out-of-the-money.

First, are event contracts executory for purposes of section 365? Traditional executory contract analysis assumes a bilateral agreement with ongoing obligations on both sides.[148] However, prediction-market contracts may not fit neatly within this framework. Once a position is entered, the primary remaining obligation is settlement, which depends on the occurrence and verification of an external event. But "where 'the only remaining obligation is the [debtor's] duty to pay'—the contract is not executory."[149]

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injured individuals in mass tort bankruptcies).

[145] *See* Robert J. Landry III & Nizan Geslevich Packin, *Strategic Bankruptcies and Systemic Shocks: Rethinking Corporate Reset in Today's Economy*, 62 AM. BUS. L.J. 245 (2025).

[146] 11 U.S.C. § 365.

[147] *See* Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973).

[148] *See* 3 COLLIER ON BANKR. ¶ 365.02 (noting that the legislative history of the Bankruptcy Code "endorses the 'Countryman'" Test as the traditional test, but that some courts have used it as only part of their analysis).

[149] *Spyglass Media Group, LLC v. Bruce Cohen Prods. (In re Weinstein Co. Holdings, LLC)*, 997 F.3d 497, 505 (3d Cir. 2021) (quoting *In re Teligent, Inc.*, 268 B.R. 723, 732

Two objections to this line of thinking present themselves. One objection is that one could argue that the prediction market's outstanding obligation is not merely to pay, but to *verify* the (non)occurrence of the trigger of the event contract. This may be true for some platforms, but for platforms like Polymarket that outsource verification to a third-party service like UMA the platform *itself* may not have any obligations beyond payment.[150] A further and more challenging objection that the prediction market platform may not be a counterparty to the transaction. If the platform truly is just acting as an intermediary, then the executory contract analysis may not apply since the contract is not a contract *of the platform-debtor*. However, as noted above in some circumstances a prediction market platform may have an affiliated market maker that does carry positions on its own books. In other cases, the platform may serve as a custodian of funds. Consequently, the doctrinal question cannot be wholly eliminated, as it appears likely that a platform (through an affiliate) may have at least *some* contracts in which it takes a position or holds funds at the moment of insolvency.

Next, if a prediction market platform rejects an event contract, how should damages be calculated? The timing of assumption or rejection becomes critical. In a fast-moving market environment, delays in settlement or uncertainty regarding contract status may trigger runs, reduce liquidity, and exacerbate distress. Indeed, as discussed below, this is at least part of justification for specialized insolvency regimes for financial firms such as broker-dealers, designated contract markets, and banks.[151] Moreover, the rejection framework presumes that damages can be calculated based on the value of the contract immediately before the bankruptcy filing.[152] But as

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(Bankr. S.D.N.Y. 2001)).

[150] Recent developments may add more complexity to this issue. Polymarket, for example, has agreed to settle covered sports contracts using official data supplied by an integrity-and-data provider, so that each market resolves on the same verified information delivered to the leagues themselves. That arrangement reduces manipulation risk, but it relocates the settlement mechanism into a third-party licensing relationship, which reframes the oracle problem as a section 365 problem. The data-and-settlement license becomes a critical executory contract: if it is rejected in bankruptcy, or if the counterparty terminates on the platform's default, the estate may lose the very mechanism required to resolve open positions, leaving contingent obligations that cannot be settled at any price. *See* Press Release, Genius Sports Ltd., Polymarket and Genius Sports Expand the Role of Official Data, Exclusive Live Sports Streaming and Integrity Services in Prediction Markets (Aug. 4, 2026), https://www.geniussports.com/newsroom/polymarket-and-genius-sports-expand-the-role-of-official-data-exclusive-live-sports-streaming-and-integrity-services-in-prediction-markets/.

[151] *See* notes 239-277, *infra*, and accompanying text.

[152] *See* 11 U.S.C. §§ 365(g), 502(g) (treating rejection as a breach deemed to occur immediately before the petition, relegating the counterparty to a prepetition unsecured

discussed above, in prediction markets this value is inherently unstable and dependent on evolving probabilities and informational inputs.

Moreover, this statutory valuation mechanism exacerbates a central problem that arises from the statutory design of section 365. Generally, a debtor in possession may assume the contracts it finds valuable and reject the rest, leaving rejection claimants to be paid in devalued "bankruptcy dollars."[153] That asymmetry gives every debtor an incentive to over-reject, even when rejection makes the contract counterparty worse off than the corresponding benefit to the estate.[154] But this asymmetry is exacerbated by the nature of prediction markets. It seems quite likely that a subset of a prediction market platform's event contracts will not yet have resolved as of the time of bankruptcy, but will have resolved by the time a debtor-platform elects to assume or reject. For such contracts, the platform "would have incentives to break up its portfolio along self-interested lines" or "delay its decisions" until prediction markets resolved in its favor, thereby "keeping the winners and rejecting the losers."[155] These features of the statutory framework and prediction market platforms suggest that section 365 may be poorly suited to contracts whose value is probabilistic and whose performance depends on contested external events.

4. Rule 9019 and the Structural Mismatch of Settlement

While bankruptcy is inherently adversarial due to its zero-sum nature, rules and norms exist to encourage settlement.[156] Chief among these is Rule 9019, pursuant to which courts can approve settlements between the debtor and its creditors within a range of reasonableness.[157] In prediction markets this framework at least partially breaks down, posing challenges to the doctrinal standard used to approve settlements and the effects such compromises could have on event contract outcomes.

Settlements in bankruptcy under Rule 9019 are approved or rejected under well-established doctrine. A court must make an "informed, independent judgment" as to whether a settlement is "fair and equitable" and "in the best interests of the estate."[158] It need not conduct a "mini trial" on the merits of an issue to be compromised, but a court must be sure that

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claim).

[153] *See* Roe & Adams, *supra* note 11, at 374–78.

[154] *See* Jesse M. Fried, *Executory Contracts and Performance Decisions in Bankruptcy*, 46 DUKE L.J. 517, 522-23 (1997).

[155] *See* Roe & Adams, *supra* note 11, at 383.

[156] *See In re Wythe Berry Fee Owner LLC*, 660 B.R. 534, 536 (Bankr. S.D.N.Y. 2024).

[157] *See* Fed. R. Bankr. P. 9019; *In re Adelphia Commc'ns Corp.*, 327 B.R. 143, 159 (Bankr. S.D.N.Y. 2005).

[158] *In re Drexel Burnham Lambert Grp.*, 134 B.R. 493, 496 (Bankr. S.D.N.Y. 1991).

the settlement does not "fall[] below the lowest point in the range of reasonableness."[159] To meet this standard, many circuits have adopted a multifactor test that considers the likelihood of litigation success, the costs and delays attendant to litigation, the interests of creditors, and other aspects of the suggested compromise.[160]

If an event contract is not well-defined or the underlying factual predicates have been manipulated, that defect affects more than the equities of a proposed compromise. Approval of a compromise may not merely resolve a dispute. It may instead determine the factual predicate on which the claim itself depends, ratifying potential manipulation and establishing entitlements that differ from what the contract would have granted. This problem is especially acute when the contract attempts to reduce an incompletely specified event to a binary outcome.[161] The ambiguities present in any contract are particularly salient for event contracts because the question is not merely what happened, but what the contract was capable of meaning once an ambiguous event actually occurred.[162]

That feature makes compromise unusually fraught. A compromise may appear efficient because it reduces litigation costs, delay, and uncertainty. Yet it may preserve distorted outcomes, validate flawed oracle mechanisms, or benefit participants who shaped the market's informational environment. In ordinary bankruptcy, settlement is typically downstream from the dispute. In prediction markets, settlement may be constitutive of the dispute itself. The court is not simply choosing among reasonable compromises over a known disagreement. It may be choosing which version of a contested event, informational source, or settlement mechanism will govern the allocation of value. Bankruptcy may thereby validate one version of reality over another.

The traditional range-of-reasonableness inquiry may therefore be insufficient where the settlement itself shapes both economic outcomes and the informational conditions that give rise to those outcomes. This concern parallels broader bankruptcy scholarship showing that settlement can do more than merely implement preexisting entitlements. Instead, bargaining and settlement can construct and redefine those entitlements.[163]

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[159] *In re W.T. Grant Co.*, 699 F.2d 599, 608 (2d Cir. 1983), *cert. denied*, 464 U.S. 822 (1983).

[160] *See Motorola, Inc. v. Official Comm. of Unsecured Creds. (In re Iridium Operating LLC)*, 478 F.3d 452, 462 (2d Cir. 2007).

[161] *See* notes 114-116, *supra*, and accompanying text.

[162] *See* Levine, *supra* note 115 (observing that prediction-market payout disputes often resemble technical legal disputes over whether an event has occurred, but in settings far broader and less institutionally settled than traditional commercial contracting).

[163] Jonathan C. Lipson, *Bargaining Bankrupt: A Relational Theory of Contract in Bankruptcy*, 6 HARV. BUS. L. REV. 239 (2016) (explaining that bankruptcy outcomes are

Compromise can define a dispute, determine a claim's factual basis, and determine rather than merely allocate value. This is perhaps a more extreme version of a problem frequently identified by critics of early settlements within bankruptcy cases that determine value and distributions without the safeguards of the plan approval process.[164]

C. What if the Bankruptcy Code Does Not Apply? Derivatives and Illegality

The prior Section discussed the doctrinal difficulties that could arise if prediction market platforms were to file for bankruptcy. This Section turns to an antecedent question: what happens if some or all of the Bankruptcy Code does not apply to prediction market platforms at all? Derivatives are exempt from key provisions of the Bankruptcy Code, while illegal businesses may be barred entirely from bankruptcy protection.

1. Derivatives and the Bankruptcy Safe Harbors

If prediction-market contracts are characterized as derivatives, they may fall within the Bankruptcy Code's safe harbor provisions. These safe harbors exempt certain financial contracts such as derivatives from bankruptcy's automatic stay, avoidance, and *ipso facto* rules, allowing financial counterparties to close out positions and net exposures quickly.[165] Thus, although a bankruptcy filing typically pauses creditor collections through the automatic stay, allows certain prebankruptcy payments made by the debtor to be unwound, and disallows contract termination merely because of a bankruptcy filing, for derivatives "each rule is reversed to favor the derivatives . . . creditors."[166] Proponents of the safe harbors argue that these rules are designed to minimize systemic contagion in traditional financial markets.[167] While many criticize this reasoning,[168] to the extent the safe harbors serve a salutary purpose in some cases those arguments are less

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shaped through relational bargaining rather than fixed contractual rights); *cf. Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451 (2017) (rejecting settlement via structured dismissal as being beyond the authority of the Bankruptcy Code).

[164] Bruce Grohsgal, *Absolute Priority Redux,* 10 WM. & MARY BUS. L. REV. 1 (2018) (explaining how early settlements can reshape creditor recoveries and challenge priority norms).

[165] *See* note 11, *supra*, and accompanying text.

[166] *See* Roe, *supra* note 11, at 547.

[167] *See generally* Edward R. Morrison, Mark J. Roe & Christopher S. Sontchi, *Rolling Back the Repo Safe Harbors*, 69 BUS. LAW. 1015 (2014); Edwards & Morrison, *supra* note 19 (explaining the policy rationales for special bankruptcy protections applicable to derivatives markets).

[168] *See* Roe, *supra* note 11; Roe & Adams, *supra* note 11, at 377-80; Morrison *et al*., *supra* note 167.

availing in the context of prediction markets.

First, it is not clear that prediction markets always, or even usually, perform the same economic function as traditional derivatives markets. Derivatives generally reallocate risk that exists *independently of* the derivatives contract. For example, interest rate swaps allow parties with floating interest rate exposure to hedge their risk by trading it for a fixed rate.[169] For most event contracts, however—and certainly for the majority of sports betting and mentions market contracts—the risk only exists *as a result of* entering into the event contract. For example, most Polymarket or Kalshi participants have no economic stake in whether Elon Musk says "Mars" during an interview or on who wins a sports match *until they buy an event contract on that topic*.

Next, the size and interconnectedness of these markets are simply not comparable. For example, take the interest rate swaps market, a derivatives market with a notional value of $545 *trillion* as of 2025.[170] Just this one derivatives market is five orders of magnitude—that is, hundreds of thousands of times—larger than all prediction markets combined.[171] Put another way, *daily* turnover on this one market is nearly two hundred times larger than *annual* turnover on all prediction market platforms combined.[172] Since derivatives markets are also highly interconnected, losses on these contracts could compound and lead to system-wide effects.[173] Contrast this with prediction markets, where losses on event contracts may hurt

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[169] *See*, *e.g.*, Stefan Avdjiev, Patrick McGuire, & Goetz von Peter, *International Finance Through the Lens of BIS Statistics: Derivatives Markets*, BANK FOR INT'L SETTLEMENTS, Dec. 8, 2025, https://www.bis.org/publ/qtrpdf/r_qt2512d.htm (describing using interest rate swaps to hedge against interest rate risk).

[170] *Global OTC Derivatives Market*, BANK FOR INT'L SETTLEMENTS, https://data.bis.org/topics/OTC_DER/tables-and-dashboards/BIS%2CDER_D5_1%2C1.0 (values for 2025-S2, category swaps, notional amount).

[171] *See* Ivan Wu & Bryan Samsoedin, *Kalshi, Polymarket Open Interest Falls 20% As World Cup Frenzy Winds Down*, THE BLOCK, July 20, 2026, https://www.theblock.co/news/markets/2026-07-20-kalshi-polymarket-open-interest-falls-20-as-world-cup-frenzy-winds-down-408965.

[172] *Compare Global FX Trading Hits $9.6 Trillion Per Day in April 2025 and OTC Interest Rate Derivatives Surge to $7.9 Trillion: Triennial Survey*, BANK FOR INT'L SETTLEMENTS, Sept. 30, 2025, https://www.bis.org/press/p250930.htm (interest rate swaps hit $7.9 trillion in daily turnover) *with* Boaz Sobrado, *How Prediction Markets Actually Grew in 2025*, FORBES, Dec. 16, 2025, https://www.forbes.com/sites/boazsobrado/2025/12/16/how-prediction-markets-actually-grew-in-2025/ (~$44 billion in trading volume across all prediction market platforms in 2025).

[173] *See*, *e.g.*, Mark Paddrik, Sriram Rajan, & H. Peyton Young, *Contagion in Derivatives Markets*, 66 MGMT. SCI. 3603 (2020) (describing and formally modeling how payment shortfalls in derivatives markets can "become amplified as they cascade through the network of exposures.").

individual bettors, but are unlikely to have knock-on effects, and even if they did such secondary consequences should be far smaller.

Third, the protections that the derivatives safe harbors provide sophisticated counterparties in liquid and interconnected markets are likely less appropriate in prediction markets. While both involve contingent claims, as discussed above prediction markets generally involve less sophisticated counterparties, in many cases may have less liquidity, and may be more susceptible to manipulation. While sophisticated parties may prefer the derivatives safe harbors, unsophisticated retail traders in prediction markets likely prefer the standard bankruptcy protections offered under the Code.

In addition to these questions is the more practical problem: with legal uncertainty as to how event contracts are currently treated, how should a bankruptcy judge decide the classification question today? The result is a binary classification problem with no satisfactory outcome. Either event contracts are forced into a derivatives framework that may be inappropriate, or they remain outside of it despite the federal government urging that they be included within it. Either result creates uncertainty and inconsistency for all involved.

2. Illegality and the Risks of Foreclosing Access to Bankruptcy

As discussed above, there is a nonzero risk that some or all event contracts currently listed on prediction market platforms are found to be illegal. Alternatively, a Supreme Court decision may punt on the issue, leaving prediction markets in something of a legal grey zone with perceived (if not actual) legality varying with presidential administration and enforcement priorities.[174] To explore the effects that this legal instability could have, this subsection will examine two analogous product market: the market for state-legal but federally-illegal cannabis, and the state-regulated insurance market.

i. Cannabis: Federal Illegality and State Legality Foreclose Bankruptcy Protection

Cannabis provides a useful analogy for the bankruptcy consequences of legal uncertainty. Although cannabis is legal for medical use in forty-two states and recreational use in twenty-four, it remains generally illegal under federal law.[175] This dual status, federally illegal, but

[174] This is of course true across domains. *See generally* Elena Kagan, *Presidential Administration*, 114 HARV. L. REV. 2246 (2001).

[175] 21 U.S.C. § 812(b)(1); *Where Marijuana is Legal in the United States*,

legal on a state level, means that cannabis companies cannot file for bankruptcy protection under Chapters 7 or 11 of the Bankruptcy Code.[176] Because cannabis is illegal under federal law, federal bankruptcy courts have consistently denied bankruptcy protection to cannabis debtors for fifteen years.[177] In rejecting these filings, courts have reasoned that cannabis companies cannot use the authority of a federal court to ratify the continued violation of federal law, and that approving a bankruptcy filing of a federally-illegal business would violate several provisions of the Bankruptcy Code.[178] The consequence is that distressed cannabis businesses are denied the principal federal mechanism for preserving going-concern value and orderly resolving creditor claims.

The uncertain legal status of prediction markets creates a risk of a similar outcome. This is especially true under pending federal legislation that would ban event contracts relating to politics, war, and sports betting, or that are not used for "hedging or mitigating commercial risk."[179] For instance, such a law would classify almost 90% of Kalshi's event contract inventory as illegal.[180]

In that circumstance, arguments analogous to those used against cannabis debtors could be made: a prediction market might be unable to use federal bankruptcy law if its plan depended upon resuming federally unlawful activity, and a trustee might be unable to administer or settle contracts whose legality was itself in question. If bankruptcy protection is uncertain or not available, the risks borne by creditors will likely increase, potentially raising financing costs and reducing enterprise value.[181]

Moreover, these effects would likely be substantially larger for prediction market platforms than the corresponding costs imposed by uncertainty in the legal cannabis industry, because prediction markets are larger and more interconnected than their cannabis counterparts. The largest prediction market platforms are each an order of magnitude larger than the largest legal cannabis companies,[182] while the millions of users on these

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MJBIZDAILY, June 20, 2025, https://mjbizdaily.com/map-of-us-marijuana-legalization-by-state/.

[176] *See* Organek, *supra* note 12, at 243.

[177] *Id*. at 256.

[178] *Id*. at 256-58.

[179] STOP Corrupt Bets Act, H.R. 8123, 119th Cong. (2026).

[180] Schneider & Miller, *supra* note 24.

[181] *See* Schwartz, *supra* note 126, at 1207-1220.

[182] Organek, *supra* note 12, at 271; *Kalshi Raises $1 Billion at a $22 Billion Valuation as Institutional Adoption Accelerates*, KALSHI, May 7, 2026, https://news.kalshi.com/p/kalshi-raises-1-billion-22-billion-valuation-institutional-demand-surges; *Polymarket in Talks to Raise Money at About $15 Billion, The Information Reports*, REUTERS, Apr. 19, 2026, https://www.reuters.com/business/polymarket-talks-raise-money-about-15-billion-valuation-information-reports-2026-04-20/.

platforms dwarfs the customer base of the largest legal cannabis companies.[183] In addition, the ubiquity of prediction market platforms and their interconnections with the financial system could make the collapse of a major platform more damaging to the broader economy than the insolvency of a cannabis company.[184]

While cannabis may offer the clearest analogy for the possibility that illegality might foreclose bankruptcy altogether, the crypto winter may provide a upper benchmark for the potential scale and systemic consequences of uncertainty. The collapse in crypto markets in 2022 erased roughly $2 trillion in asset value and produced a series of interconnected failures.[185] Although much of that destruction reflected market forces rather than bankruptcy law, the crisis unfolded against a background of considerable regulatory uncertainty[186] and competing claims of enforcement authority[187] that likely contributed to this value destruction. Without a regulatory architecture to resolve them (or prevent their collapse *ex ante*), failing crypto firms were shunted into the bankruptcy system.[188]

This, in turn, exposed a second danger relevant to prediction markets. Bankruptcy judges were required to resolve important questions about the treatment of crypto assets and customer claims on an ex post, case-by-case basis, despite bankruptcy courts being poorly positioned to establish comprehensive financial regulatory policy.[189] Even if these were the correct decisions for the case at bar, they necessarily disregarded the "potentially systemic consequences within the crypto-ecosystem [or] the economic damage inflicted" as a result.[190] Regulatory uncertainty thus migrated into bankruptcy, where judges made consequential policy choices

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[183] *See* note 89, *supra*.

[184] *See* Francisco Rodrigues, *Kalshi Secures License to Offer Margin Trading to Institutional Investors*, COINDESK, Mar. 28, 2026, https://www.coindesk.com/markets/2026/03/28/kalshi-secures-license-to-offer-margin-trading-to-institutional-investors; Alex Immerman & Santiago Rodriguez, *Prediction Markets: They Grow Up So Fast*, Apr. 16, 2026, ANDREESSEN HOROWITZ, https://a16z.com/prediction-markets-they-grow-up-so-fast/.

[185] Dante Disparte and Mandeep Walia, *2022 Was a Hard Year for Crypto, But It May Have Been Just What the Industry Needed*, WORLD ECON. F., Apr. 14, 2023, https://www.weforum.org/stories/2023/04/2022-was-a-hard-year-for-cryptocurrencies-but-it-may-have-been-just-what-the-industry-needed/.

[186] Emily Nicolle, Olga Kharif, and Stacy-Marie Ishmael, *All the Ways that Crypto Broke in 2022*, BLOOMBERG, Dec. 22, 2022, https://www.bloomberg.com/graphics/2022-crypto-contagion-from-bitcoin-to-FTX/.

[187] *See* Yadav & Stark, *supra* note 9; Carol R. Goforth, *Regulation by Enforcement: Problems with the SEC's Approach to Cryptoasset Regulation*, 82 MD. L. REV. 107 (2022).

[188] Yadav & Stark, *supra* note 9, at 1521–32.

[189] *Id*. at 1500-10, 1521-32, 1535.

[190] *Id*. at 1542.

without the benefit of a settled legislative framework. This uncertainty, in turn, raised questions about market integrity that rippled out to other parts of the crypto universe and may have exacerbated the scale of the crypto winter.[191]

Prediction markets could combine the uncertainty of the cannabis industry with the scale, and to a lesser extent the interconnectedness, of the crypto industry. These potentially wholly or partially illegal industries may, like cannabis companies, be unable to access bankruptcy protection. And the freefall insolvency of a prediction market platform could have substantial knock-on effects on the broader economy, even if not as large as those experienced during the 2008-10 financial crisis. Finally, bankruptcy judges may be forced to answer thorny legal questions about federal preemption, the legality of specific contracts under federal or state law, how to unwind illegal contracts, and a host of other policy questions for which they are ill-equipped.[192]

ii. State Legality and Federal Nonintervention Harms Product Offerings and Requires Substantial State-Level Regulation

Even if prediction markets are clearly legal under federal law, if a federal preemption argument is unsuccessful then platforms could still be subject to a wide range of legal regimes on a state level. In this case, insurance could provide a useful analogy.[193] Though legal under federal law, insurance it is mostly regulated by state law under the McCarran-Ferguson Act.[194] A similar federal-light, state-heavy regime for prediction market platforms would create two problems relevant for insolvency: by fragmenting the national market, such a regime would reduce the value of prediction market platforms while making them more difficult to wind down in case of insolvency.

State-by-state regulation tends to increase compliance costs, restrict

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[191] *Id*.

[192] *See* Rafael I. Pardo & Kathryn A. Watts, *The Structural Exception of Bankruptcy Administration*, 60 UCLA L. REV. 384, 423-24 (2012).

[193] *See*, *e.g.*, Liz Hoffman, *A Soccer Team Bet Against Itself. This Is the (Good) Future of Prediction Markets*, SEMAFOR, June 4, 2026, https://www.semafor.com/article/06/04/2026/a-soccer-team-bet-against-itself-this-is-the-good-future-of-prediction-markets (describing a professional soccer team's purchase of event contracts as a form of insurance against losses for poor performance).

[194] *See* Jonathan R. Macey & Geoffrey P. Miller, *The McCarran-Ferguson Act of 1945: Reconceiving the Federal Role in Insurance Regulation*, 68 N.Y.U. L. REV. 13, 14-15 (1993); *but see* Baird Webel, *Insurance Regulation: Background, Overview, and Legislation in the 114th Congress*, CONG. RESEARCH SVC., Dec. 30, 2016, https://www.congress.gov/crs-product/R44046 (detailing some federal regulation of insurance companies implemented since the passage of the McCarran-Ferguson Act).

product offerings, create barriers to entry, and encourage regulatory arbitrage. This is the case in the insurance market, where national operators must obtain licenses in each state and comply with differing product, disclosure, regulator pre-approval, and other regulatory requirements in each jurisdiction.[195] Similar rules for prediction markets could prevent some event contracts from being offered nationally,[196] increase compliance costs,[197] and reduce market liquidity. Differences among state regimes could also encourage regulatory arbitrage by firms and users—a phenomenon already seen through the use of VPNs (even though VPN usage violates the Terms of Service of some platforms).[198] The result would likely be smaller and more fragmented markets, and a platform divided among numerous state regulatory regimes could be more difficult to sell, finance, or reorganize.

The analogy to insurance markets also illustrates the difficulty of resolving the failure of a nationally-operating company outside of bankruptcy. Insurance companies are excluded from filing for bankruptcy protection, [199] and are instead liquidated under state law procedures that are considered "long [and] cumbersome."[200] Nevertheless, this system is workable in large part because the resolution of insurance insolvency is embedded within an extensive state-by-state regulatory structure.[201] State regulators monitor solvency, impose capital and product requirements, administer guaranty funds to protect policyholders, and can even step in to take control of troubled insurers.[202] As a result, state insurance insolvency is

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[195] Loftin Graham & Xiaoying Xie, *The United States Insurance Market: Characteristics and Trends*, *in* HANDBOOK OF INTERNATIONAL INSURANCE 28, 30–31, 45-47 (J. David Cummins & Bertrand Venard eds., 2007).

[196] *See* Sabrina Du & Cameron M. Ellis, *Multidimensional Barriers to Entry in the Insurance Industry*, 18 ASIA PACIFIC J. RISK & INS. 21, 23-24, 33 (2024).

[197] *See* David A. Hyman, *Health Insurance: Market Failure or Government Failure*, 14 CONN. INS. L.J. 307, 311-13, 317-18, 322 (2007).

[198] *See* Rene Millman, *Polymarket Blocks VPNs and Tightens Identity Verification as Over 30 Countries Ban the Betting Platform*, TECHRADAR, May 28, 2026, https://www.techradar.com/vpn/vpn-privacy-security/polymarket-blocks-vpns-and-tightens-identity-verification-as-over-30-countries-ban-the-betting-platform.

[199] 11 U.S.C. § 109(b)(2). Holding companies of insurance companies can and do file for bankruptcy. *See* Rick Archer, *Texas Insurer Hits Ch. 11 with $134m Debt, Prepackaged Plan*, LAW360, June 16, 2026, https://www.law360.com/mergersacquisitions/articles/2490270.

[200] Bill Goddard, *The New World Order: Financial Guaranty Company Restructuring and Traditional Insurance Insolvency Principles*, 6 BROOK. J. CORP. FIN. & COM. L. 137, 137 (2011).

[201] *Id*. at 138-39.

[202] *State Insurance Regulation* 3-5, NAT'L ASS'N OF INSURANCE COMMISSIONERS, 2011, https://content.naic.org/sites/default/files/inline-files/topics_white_paper_hist_ins_reg.pdf; Webel, *supra* note 194.

quite rare.[203]

Although many states have proposed legislation regulating prediction markets, none have suggested comprehensive frameworks akin to a state insurance market. Without it, an industry regulated on a state-by-state level could prove unusually difficult to unwind.

III. PREDICTION MARKETS COMPLICATE THE LITERATURE ON VALUATION AND ALTERNATIVE RESOLUTION MECHANISMS

The practical and doctrinal problems identified above also illuminate two long-running debates in bankruptcy scholarship. First, prediction markets complicate the growing turn towards direct market evidence of value. They show that observable prices can sometimes obscure rather than clarify when the factual and legal predicates of value are themselves unstable. Second, prediction markets complicate the conventional case for specialized, expedited resolution regimes when customer protection, continuity, or systemic risk makes speed especially valuable. Because event contracts may remain contingent or disputed, greater judicial involvement may be needed before positions can be sensibly transferred, netted, or liquidated. This Part explores each of these in turn.

A. The Limits of Market Evidence of Value When the Predicates of Value Are Uncertain

"Valuation disputes lie at the heart of the Chapter 11 reorganization process," two prominent bankruptcy scholars explain.[204] As we have seen in the prior Part, the nature of prediction markets makes valuation more challenging. A bankruptcy court may be required to value unresolved event contract positions whose payment depends on uncertain future events, ambiguous contractual terms, contested methods of verification, unpredictable regulatory treatment, and even perhaps the solvency of the platform itself. Yet these practical difficulties also sheds new light on broader theoretical literature regarding the turn to market value as the lodestar for bankruptcy valuation and the merits of absolute versus relative priority as the fundamental principle of bankruptcy recoveries.

1. Endogenous Prices and the Turn Towards the (Prediction) Market

A generation of bankruptcy scholarship has moved decisively toward the market. Where courts once resolved valuation disputes by

[203] Macey & Miller, *supra* note 194, at 18, 68-69.
[204] Ayotte & Morrison, *supra* note 8, at 1820.

choosing among the competing projections of rival experts, they increasingly defer to observable prices—the amount a bidder will pay in a going-concern sale, the trading value of a debtor's funded debt, the take-up of a rights offering—as the most reliable evidence of what a firm is worth.[205] The intellectual appeal of this turn is considerable. Market prices aggregate the dispersed information and committed capital of parties who stand to gain or lose by being right, and they are far harder for a self-interested debtor to massage than the discounted-cash-flow model of a retained expert.[206] Whole-firm sales have also become far more common,[207] while judges increasingly feel confident that the "direct market evidence" of securities prices or offers to purchase are the most reliable indicia of value.[208] On the prevailing account, this migration toward direct market evidence explains much of Chapter 11's modern success.

Prediction markets would seem to be the apotheosis of that trend. Every event contract arrives with a continuously quoted price that purports to express, in cents on the dollar, the market's collective estimate of the probability that a specified event will occur.[209] If observable prices are the gold standard of valuation evidence, a platform whose entire book consists of nothing *but* observable prices should be the easiest firm in the world to value. That intuition, however, is precisely backwards.

A prediction market's prices are not exogenous observations of value; they are endogenous to the very questions a bankruptcy court would be asked to resolve. As Part II explained, an event contract's price depends on contested factual predicates, heterogeneous and sometimes conflicting settlement rules, manipulable informational inputs, unresolved regulatory risk, and the solvency of the platform itself. Each of these makes the quoted price a worse, not a better, proxy for value.[210] A price that embeds a

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[205] *See* Roe & Simkovic, *supra* note 8, at 288–300; Ayotte & Morrison, *supra* note 8, at 1830–35.

[206] *See VFB LLC v. Campbell Soup Co.*, 482 F.3d 624, 633–34 (3d Cir. 2007) (treating contemporaneous market evidence as more probative of value than litigation-driven expert valuation where the market was informed)

[207] *See* Simkovic, *supra* note 7, at 306.

[208] Ayotte & Morrison, *supra* note 8, at 1825; Roe & Simkovic, *supra* note 8, at 300-04.

[209] *See, e.g.,* CME Group, Prediction Markets, https://www.cmegroup.com/markets/prediction-markets.html.

[210] *See* Di Dai et al., *Settlement Manipulation in Prediction Markets* (2026), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=7028398 (traders may influence settlement outcomes, thereby impairing price discovery); Giovanni Angelini & Luca De Angelis, *When Do Markets Fully Process Public Information? Evidence from Real-Time Prediction Markets* (June 5, 2026), https://arxiv.org/abs/2606.07811 (finding that prediction-market prices can underreact to public information and that adjustment varies with liquidity and salience); Gebele & Matthes, *supra* note 122 (finding persistent price

material probability that the platform will not pay, that the contract will be voided as an unlawful wager, that does not account for the arbitrage opportunities across different platforms with different settlement rules, or that an oracle will resolve an ambiguous term against the holder is not "direct market evidence" of the contract's worth in the sense the literature contemplates. It is direct market evidence of a compound wager on value, verification, legality, non-manipulation, and payment all at once. In short, when the predicate factual and legal questions remain unsettled, an observable price does not *resolve* that uncertainty but merely *reflects* it—the price is itself partly a product of these unanswered questions.

The extent of the incidence of this uncertainty may vary. Uncertainty about a particular contract will directly affect the counterparties, but may affect platform value only indirectly if the platform is not the counterparty, does not custody funds, or does not control settlement. A platform's exposure could also vary as disputes proliferate or if the platform offers a greater number of contracts that are more susceptible to manipulation. As we have seen, different platforms use distinct business models, some of which involve greater or lesser direct control over these aspects of a transaction. But even when a platform acts as a relatively neutral intermediary, uncertainty surrounding its markets may affect whole-firm value through expected fee revenue, liquidity provisioning costs, customer participation, regulatory exposure, or other factors.

Prediction markets thus raise related but distinct valuation questions. A court may need to (1) determine the value of individual unresolved positions, (2) decide the amount and priority of claims those positions generate against the debtor, and (3) adjudicate the enterprise value of the platform. The difficulties attendant to these tasks relates to broader questions in bankruptcy literature around the merits of absolute versus relative priority, discussed next.

2. Valuation and Absolute Versus Relative Priority

A core principle of the Bankruptcy Code is that creditors are paid according to the rule of absolute priority.[211] While this has been the rule under US bankruptcy law for nearly a century,[212] there is still a long-running debate within bankruptcy scholarship about whether this is the best rule, or if it should be replaced with another rule known as relative

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differences across economically equivalent prediction markets and linking them to differences in event definitions, resolution semantics, venue structure, and related frictions).

[211] 11 U.S.C. §§ 1129(a)(8), (b)(2).

[212] *See Case v. L.A. Lumber Prods. Co.*, 308 U.S. 106 (1939).

priority.[213] Recent arguments in favor of absolute priority focused on how, given the types of valuation techniques available, absolute priority leads to easier, more accurate, and more stable valuations.[214] Prediction markets highlight an additional component that can be considered in this debate: the nature of the insolvent firm. Some firms will be more difficult to value than others, and as a firm becomes more difficult to value the arguments in favor of absolute priority become stronger.

i. Absolute Priority versus Relative Priority

Briefly, absolute priority means that unless parties agree to different treatment, creditors are paid according to their statutory and contractual priorities, and lower-priority creditors do not recover unless higher-priority creditors are paid in full.[215] This creates a well-understood set of distortionary incentives for a company that is currently distressed but may recover later.[216] Senior creditors prefer early repayment because they will not benefit from a later recovery. Meanwhile, junior creditors and equityholders will delay financial restructuring (even if early restructuring would be less costly) or take risky bets because they retain upside if the firm recovers while bearing only limited additional downside risk.[217] Finally, even without gamesmanship, absolute priority extinguishes the interests of junior claimants before an unexpected rise in firm value would place them back in the money.

To address these flaws, critics of absolute priority propose a system of relative priority.[218] Relative priority would grant junior creditors purchase options for the distressed firm exercisable if the firm appreciates some time after exiting bankruptcy, with the options priced to reflect the probability of such appreciation.[219] This would enable lower-ranked creditors to appropriately share in the potential firm recovery while reducing harmful strategic behavior.[220]

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[213] Roe & Simkovic, *supra* note 14, at 405-12 (discussing the debate and citing sources on both sides).

[214] *See id*. at 415-30, 440-43.

[215] *See id*. at 406.

[216] *Id*. at 392, 394, 407.

[217] *See* Lucian Ayre Bebchuk & Howard F. Chang, *Bargaining and the Division of Value in Corporate Reorganization*, 8 J. L. ECON. & ORG. 253 (1992).

[218] *See generally* Douglas G. Baird, *Priority Matters: Absolute Priority, Relative Priority, and the Costs of Bankruptcy*, 165 U. PA. L. REV. 785 (2017); Anthony J. Casey, *The Creditors' Bargain and Option-Preservation Priority in Chapter 11*, 78 U. CHI. L. REV. 759 (2011); AM. BANKR. INST., COMMISSION TO STUDY THE REFORM OF CHAPTER 11, 2012-2014, FINAL REPORT AND RECOMMENDATIONS 207-24 (2014).

[219] Roe & Simkovic, *supra* note 14, at 394, 407-08.

[220] *Id*. at 409.

Nevertheless, recent critics of relative priority observe it demands substantially more information from the valuation process, generates more uncertainty about the eventual outcome of a restructuring, and reduces the utility of price-based market evidence of value.[221] A party valuing a firm under absolute priority (whether a judge, creditor, or potential acquirer) need only determine an estimate of the value of a firm at a given point in time. Under relative priority, however, the valuer must determine not only the value of the firm, but also "the range of potential value outcomes surrounding that [point estimate] and the probability of each of those outcomes eventuating."[222] Moreover, each potential claimant could present a distinct set of values and probability distributions. So a valuer would need to determine both the point estimate and a measure of variance of firm value over time. This is far more difficult to do, and real-world valuations rarely even attempt to estimate value variance.[223]

Understanding the valuation difficulties arising from relative priority requires us to consider two associated costs. First, it is more difficult to predict how a restructuring may turn out if it depends on all the different probability distributions that need to be considered under relative priority. This would affect the incentives of the relevant parties, leading to more litigation and reducing the likelihood of value-maximizing settlements.[224] In addition, relative priority makes market evidence less useful for determining value. An observable market price can provide evidence about what an asset or firm is worth today, but it does not necessarily answer how the firm's future value is distributed among numerous possible outcomes at some future date.[225] As shown in the next subsection, prediction markets highlight that the burden of probabilistic estimates does not depend solely on the priority rule, but also on the nature of the firm being reorganized.

ii. The Nature of the Firm Matters to the Priority Debate

These critiques of relative priority demonstrate how introducing more probabilistic judgments into the bankruptcy process reduces its accuracy, efficiency, and utility. While these critiques may hold *in principle* regardless of the type of firm being valued, *in reality* the burdens of such probabilistic estimates are not evenly distributed across firm type. Some firms begin the bankruptcy process with assets and liabilities that are considerably more sensitive to uncertain future outcomes than others. For

[221] *Id*. at 416.
[222] *Id*. at 417-18.
[223] *Id*. at 422-23.
[224] *Id*. at 401.
[225] *Id*. at 423-27.

those firms—such as prediction market platforms—even valuation under a system of absolute priority may implicate some of the probabilistic difficulties associated with the valuation and information critique of relative priority.

Since event contract values vary over time, valuing a prediction market platform would require the valuer to undertake valuation calculations more similar to those required under relative priority than would be needed for a firm with more stable assets. This is true despite the fact that event contracts have a price that reflects a market judgment of their probability of (non)occurrence, because prediction market accuracy varies over time and is imperfect.[226] As a result, a valuer would not be able to depend upon the market price of a given event contract at the time of insolvency as a wholly-reliable indication of its value at some future date.

Calibration data illustrates the point. Calibration asks whether contracts priced at a given probability actually resolve at roughly that frequency across a sample.[227] Data demonstrates that by this measure, the accuracy of event contracts varies as the contract gets closer to real-world resolution. For example, Polymarket contracts are around 80% accurate one week before resolution.[228] This means that one week before resolution, only 80% of markets were correctly predicted by prices for those markets. Accuracy increased to 90% four hours before resolution.[229] Excluding outlier markets priced above 90% or below 10% lowers these figures to 58.7% and 76.7%, respectively.[230] Data from Kalshi similarly shows that prediction markets may be less reliable in circumstances where probabilities are between 30% and 80%.[231] And one study of more than 2,500 election-related contracts found 78% accuracy on Kalshi and 67% on Polymarket, with price changes shaped more by the actions of traders in individual markets than any changes in the political landscape.[232] The significance of

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[226] Despite this, prediction markets may be superior in some cases to other prediction tools. *See* Alex McCullough, *Polymarket Brier Score*, DUNE, https://dune.com/alexmccullough/polymarket-brier-score (last accessed Aug. 18, 2026).

[227] Calibration accounts for the fact that, as an example, a contract priced at 70 should imply a 30% probability of nonoccurrence. *See A Brief on Brier Scores*, UNIVERSITY OF VIRGINIA LIBRARY, https://library.virginia.edu/data/articles/a-brief-on-brier-scores.

[228] Alex McCullough, *Polymarket Historical Accuracy*, DUNE, https://dune.com/alexmccullough/how-accurate-is-polymarket (last accessed Aug. 16, 2026).

[229] *Id*.

[230] *Id*.

[231] *Are 90% Prediction Markets Reliable? A Kalshi Political Calibration Study*, LYCHEE DATA, June 11, 2026, https://lycheedata.com/guides/kalshi-political-prediction-market-accuracy.

[232] Joshua D. Clinton & TzuFeng Huang, *Prediction Markets? The Accuracy and Efficiency of $2.4 Billion in the 2024 Presidential Election*, OSF, June 10, 2026,

this data is not that sometimes the less-favored outcome occurs. Instead, it is that a quoted point estimate does not eliminate the dispersion of possible outcomes surrounding it. In short, the value of a book of event contracts (and by extension of a firm holding them or even offering them) poses a valuation problem akin to that identified by critics of relative priority, *but does so even under absolute priority!*

At any given moment, valuing the bundle of event contracts implicated in a prediction market platform insolvency would require "the range of potential value outcomes surrounding [the event contract price-based point estimate] and the probability of each of those outcomes eventuating."[233] Thus, prediction markets allow us to supplement the critiques brought by scholars in favor of absolute priority with the observation that the comparative difficulty of different priority systems should not be entirely abstracted from the firms to be resolved under those systems. Relative priority is even less appropriate for firms with inherently high-variance assets where valuation will necessitate more assumptions about future states of the world. This could be true of prediction markets, providers of catastrophic insurance, opportunistic investment firms, startups with uncertain prospects, or other firms that engage in high-variance activities.[234] The debate between absolute and relative priority sheds light on the precise ways that efficient recovery in bankruptcy is dependent upon reducing valuation uncertainty. Prediction markets add a new dimension to this literature by suggesting that a full account of the merits of absolute priority should also consider the nature of the firm and its assets. Relative priority may be suboptimal because of valuation difficulties, but these valuation difficulties are themselves unevenly distributed, with certain firms being even more difficult to value regardless of the type of priority scheme used.

3. Insufficient Disclosure and Divergent Prices

One final point relates to the role of insufficient disclosure in valuing event contracts. Some scholars have argued that deficient bankruptcy disclosures will lead to insufficient market information and therefore inaccurate bankruptcy valuations.[235] In many cases studied by

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https://osf.io/preprints/socarxiv/d5yx2_v5.

[233] Roe & Simkovic, *supra* note 14, at 417-18.

[234] *Cf.* Barry E. Adler, *A Theory of Corporate Insolvency*, 72 N.Y.U. L. REV. 343, 367-70 (1997) (discussing a firm's desire to change bankruptcy rules when it has a high-variance business); Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE L.J. 1807, 1822-24 (similar).

[235] Dick, *supra* note 8, at 1489–95; *see also* Lynn M. LoPucki, *Chapter 11's Descent into Lawlessness*, 96 AM. BANKR. L.J. 247, 290-300 (2022).

scholars, disclosure inadequacy can be laid at the feet of companies that do not follow the rules set forth in the Bankruptcy Code and judges who ignore or overlook such lapses. But for prediction markets the problem of disclosure is more fundamental. In today's evolving regulatory environment, prediction market platforms have fewer disclosure obligations with respect to the event contracts they list than issuers of publicly-traded securities. Moreover, any disclosures primarily relate to the rules governing the event contract itself, rather than information relevant to determining the likelihood of the (non)occurrence of the event to which the event contract relates. Thus, platforms currently self-certify compliance with applicable CFTC rules and must identify the sources of data upon which the settlement of event contracts will depend.[236] However, event contracts are not subject to a material information disclosure regime equivalent to that maintained by the SEC. In addition, the existence of an event contract related to an SEC-regulated public firm does not necessarily trigger additional disclosure obligations on the part of the public firm. Under this regime a platform can specify precisely how an event contract will resolve without possessing—or requiring anyone else to produce—the information necessary to determine how likely that resolution is. As a result, prices reflected in event contracts could diverge from prices of relevant securities on traditional markets, reducing the usefulness of publicly listed prices.

To see how (non)disclosure could affect values, consider a hypothetical public company that is considering a spinoff of one of its major divisions. Once sufficiently advanced, this may need to be disclosed in its securities filings, and would likely affect its stock price. But a third party with no special information can list an event contract on whether the spinoff will occur without itself creating a disclosure duty for the issuer.[237] In addition, if the platform found out material information about the proposed spinoff, it would have no obligation to disclose this to the market.[238] Until the company's own disclosure obligation arises, the event contract trades in a thinner information environment than the corresponding public securities. If a prediction market platform became insolvent in the time between the listing of the event contract and the public company's securities disclosures, the information available to the market may well be insufficient to value the company, despite the seemingly objective market value of the event contract price. A court turning to the price of that event

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[236] *See* 17 C.F.R. §§ 40.2(a), (d); *Self-Certification of an Event Contract Series*, CFTC Letter No. 26-22, CFTC, July 24, 2026, https://www.cftc.gov/csl/26-22/download.

[237] *See Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, 601 U.S. 257, 265 (2024) (silence without a duty to disclose is not misleading, and "a duty to disclose . . . does not automatically render silence misleading . . . .").

[238] *See* 17 C.F.R. § 180.1(b).

contract as a metric by which to ascertain its value would be doing so without the information infrastructure normally associated with public market prices.

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A market price is most probative of value when the legal rights being priced are stable, the relevant information can reach market participants, and the market mechanism itself is operating independently of the distress being valued. Prediction markets unsettle all three conditions simultaneously. Prediction markets therefore present a useful hard case for modern bankruptcy valuation, not because event contracts are difficult to price but because this constantly-quoted price can coexist with uncertainty about value. They underscore that valuation difficulty can vary with the nature of the firm, and that direct market evidence may only be most useful once the factual and legal predicates for the price have been settled.

B. Can Prediction Markets Be Treated Like Broker-Dealers, Futures Markets, or Banks?

If Chapter 11's model of the debtor fits prediction markets poorly, an obvious response is to look to the specialized resolution regimes that American law already maintains for financial intermediaries. SIPA, the CFTC's Part 190 rules, and bank receivership differ in important respects, but each privileges some combination of customer protection, speed, portability, and systemic stability. Yet upon further inspection each is inadequate for resolving prediction market insolvencies.

1. SIPA

The first comparison, in some ways the most institutionally revealing, comes from the treatment of failed broker-dealers under the Securities Investor Protection Act ("SIPA").[239] Under SIPA, broker-dealers do not ordinarily proceed through an ordinary Chapter 11 reorganization. Instead, they enter a specialized liquidation regime (overseen by a bankruptcy court but in practice run outside of a traditional bankruptcy proceeding)[240] designed to protect customers whose assets are held or mediated by the failed intermediary.[241] The funds of customers are given

[239] 15 U.S.C. § 78eee.

[240] *See* 11 U.S.C. § 742 (a filing under SIPA "stays all proceedings in the case under [the Bankruptcy Code]").

[241] *See* Jerry W. Markham, *Custodial Requirements for Customer Funds*, 8 BROOK. J.

priority over the other general creditors of an insolvent broker-dealer.[242] In addition, to ensure that customer funds are repaid in full, the Securities Investor Protection Corporation maintains an industry-funded insurance fund that covers any shortfall in repayment following liquidation unrelated to typical market movements.[243] That framework reflects a clear policy judgment that when a financial intermediary fails, the law should distinguish customer property from the general estate, and accord greater repayment priority to customer claims than would be available under the Bankruptcy Code.

The literature understands that this statutory scheme exists for several reasons. First, Congress implemented this framework "for much the same reason that it has adopted all securities statutes: to protect investors and maintain their confidence in the securities markets."[244] Thus, SIPA mandates insurance to protect investors against broker-dealer misuse, failure, or insolvency, not market movements or poor investment decisions.[245] Relatedly, bolstering consumer confidence in these markets prevents the risk that the failure of an individual brokerage will pull down the entire securities markets or harm the economy more broadly.[246] Finally, the administrative process is meant to be quicker, less costly, and more certain than a court-administered bankruptcy.[247] There is less opportunity to argue over claim priorities, and frequently customer accounts are simply transferred in bulk to a competing broker-dealer over a period of a few days.[248]

At first glance, prediction-market platforms bear some resemblance to broker-dealers and exchange-like intermediaries. They maintain customer-facing accounts, intermediate trades, and often hold or control user funds pending settlement. That similarity might suggest that a customer-protective framework akin to SIPA or SIPC-backed liquidation could provide a useful model. But the analogy quickly breaks down because these claims are more uncertain, there is less justification for consumer

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CORP. FIN. & COM. L. 92, 100-01 (2013).

[242] 15 U.S.C. § 78fff-2(c)(1); *Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258, 261 n.1 (1992).

[243] *See* Cheston, *supra* note 17, at 72-73; Krug, *supra* note 18, at 1227-28.

[244] Krug, *supra* note 18, at 1228; *see also* Joo, *supra* note 17, at 49.

[245] *See* Markham, *supra* note 241, at 100.

[246] Krug, *supra* note 18, at 1228 n.91; *see generally* Onnig H. Dombalagian, *Substance and Semblance in Investor Protection*, 40 J. CORP. L. 599 (2015) (discussing the tension between promoting confidence to reduce systemic risk and making liquidation more efficient).

[247] *But see* Joo, *supra* note 17, at 56 ("[t]he costs of administering a SIPC liquidation can be steep," but not providing a comparison to alternatives).

[248] Cheston, *supra* note 17, at 87; Dombalagian, *supra* note 246, at 603-06.

protection, and the risk of contagion is smaller.

The most important difference is the nature of the claims. A SIPA liquidation principally identifies and returns customer property which gains (or loses) value based on its performance in a market managed independently of the failed broker-dealer. A prediction market platform may instead mediate the creation and settlement of probabilistic entitlements whose value depends on unresolved events, contested inputs, and platform-defined rules. There may therefore be no comparably stable pool of customer property to return. In addition, a bulk transfer to a different platform is less feasible if the new platform uses a different settlement mechanism. As a result, the analogy to SIPA is valuable not because it supplies a ready-made solution, but because it reveals the absence of one. Prediction markets may look like customer-facing financial intermediaries, yet they lack the legal architecture that would allow courts to separate customers from the estate with the same confidence. This inherent uncertainty perhaps militates in favor of a *more* adversarial insolvency process, one that enhances dispute and investigation rights rather than limiting them. Such a process could be used to uncover the truth behind an event contract, whether there was any manipulation involved in that transaction, and the appropriate legal principles to apply.

The policy case for SIPC-style insurance is also weaker. Prediction markets do not play the same central role in savings or capital formation as securities markets. As noted above, Congress itself has considered banning some or all prediction markets—something unimaginable for securities markets, and suggestive of the dispensability of prediction markets. Moreover, creating an insurance fund to protect consumers from losses on markets that are largely locations for sports betting necessarily creates moral hazard that encourages risky betting, makes it less likely that authorities will prosecute fraud and manipulation in markets,[249] and may be an inappropriate policy response. Finally, SIPA insurance merely protects against losses due to broker-dealer failure, *not* due to market movements or whether an investment was inappropriate or even fraudulent. Thus, porting such protections to prediction markets would not protect against the types of losses that most concern consumer protection advocates.

Finally, contagion appears to be a low risk today. As described above, prediction markets are relatively small and are not deeply intertwined with the rest of the financial system. If a prediction market platform failed tomorrow, it would result in a major bankruptcy case and many very upset customers, but would be unlikely to bring down the world economy. Thus, the need to bolster confidence in prediction markets

[249] Dombalagian, *supra* note 246, at 600-01.

through the provision of insurance and the application of higher priority for customer payments makes less sense than it does for broker-dealers and securities markets generally.

2. CFTC

A second specialized regime, and the one prediction market operators would most likely invoke under the current presidential administration, is the framework Congress and the CFTC have built for the failure of futures commission merchants and derivatives clearing organizations.[250] If event contracts are derivatives, the argument runs, their platforms resemble the intermediaries that regime was designed to resolve, and its customer-protective machinery should apply. The analogy is superficially attractive but ultimately misleading.

Futures commission merchants ("FCMs") play a role in CFTC-regulated markets akin to the role of broker-dealers in securities markets.[251] As such, Congress similarly required FCMs to use a specialized process under the Bankruptcy Code rather than the general provisions that apply to other companies that is quite similar to the liquidation process used for broker-dealers.[252] As with broker-dealers, scholars understand that the goal of this specialized process was to protect the assets of customers, not from decreases in market value but from misuse of customer funds by the FCM.[253] The same rationales as justify the SIPA framework—customer protection, lower administrative costs, and reduced risk of contagion—underlies this treatment.[254]

To further these goals, the CFTC, in turn, supplemented the Congressionally-mandated bankruptcy process with its "Part 190" rules that increased the protections available to FCM customers in bankruptcy.[255] Like SIPA, the Part 190 rules were designed to modernize the treatment of futures commission merchant bankruptcies to minimize market disruption and protect customer interests.[256] To do this, Part 190 requires that positions

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[250] *See* Lynn A. Stout, *Risk, Speculation, and OTC Derivatives: An Inaugural Essay for Convivium,* 1 ACCT., ECON. & L. 1 (2011) (describing the CFTC's adaptation to novel derivatives over substantial industry resistance).

[251] *See* Krug, *supra* note 18, at 1214.

[252] 11 U.S.C. §§ 761-767; Krug, *supra* note 18, at 1234.

[253] *See* Krug, *supra* note 18, at 1214; Markham, *supra* note 241, at 97.

[254] *See* Markham, *supra* note 241, at 96-97; Krug, *supra* note 18, at 1236, 1236 n.136.

[255] *See* Krug, *supra* note 18, at 1234-35.

[256] *See* Kathryn M. Trkla & Geoffrey S. Goodman, *190 Across the Finish Line: CFTC Adopts New Bankruptcy Rules for FCMs and DCOs*, 41 Futures & Derivatives L. Rep. (Apr. 2021) (explaining that the revised Part 190 framework prioritizes the transfer of customer accounts and margin to reduce systemic disruption); Bankruptcy of Commodity

either be rapidly transferred to another FCM[257] or liquidated if a transfer is not possible[258] or if the relevant account is in deficit or would be after marking open contracts held in the account to market.[259]

In tandem with the special bankruptcy provisions discussed above, the Part 190 rules give customer claims payment priority over the claims of other creditors of an insolvent FCM.[260] Rather than relying on an insurance fund like with SIPA, the Part 190 rules protect customers in two other ways. FCMs are required to segregate individual customer funds to facilitate their return in case of insolvency.[261] In addition, the Part 190 rules provide customers with a contingent security interest in the general property of the FCM to the extent that the FCM is unable to satisfy customer claims from its segregated funds.[262]

Despite the apparent similarities between prediction market platforms and FCMs and the federal government's desire to regulate event contracts as derivatives, Part 190 may be a poor fit for prediction market platforms. First, the customer protection rationale is less compelling for a market still dominated by speculative bets and largely isolated from the rest of the financial system. Granting prediction market users who made speculative bets payment priority or a contingent secured claim would depart from ordinary bankruptcy practice without the same systemic justification that supports those protections for FCM customers.

More fundamentally, Part 190 assumes that positions can be valued, closed out, or transferred based on market prices and contractual terms that remain meaningful even in distress. It also assumes that the infrastructure necessary to support porting, such as clearing relationships and account-level segregation, remains operational at the moment of insolvency.[263] Prediction market positions, by contrast, may depend on unresolved events, contested definitions, or disputed informational inputs. As a result, there may be no coherent way to port positions, no reliable basis for close-out valuation, and no stable benchmark against which exposures can be netted.

Brokers, 85 Fed. Reg. 78,162 (Dec. 3, 2020) (codified at 17 C.F.R. pt. 190).

[257] 17 C.F.R. § 190.04(a)(1).

[258] 17 C.F.R. § 190.04(d).

[259] 17 C.F.R. § 190.04(b)(4).

[260] *See* Krug, *supra* note 18, at 1234.

[261] Dombalagian, *supra* note 246, at 624. Customer funds held by broker-dealers do not need to be so segregated. *Id*.

[262] *See* Krug, *supra* note 18, at 1235, 1248; 17 C.F.R. § 190(a)(1)(ii)(J) (customer recourse rule).

[263] *See* Cadwalader, Wickersham & Taft LLP, *Effective and Compliance Dates Set for CFTC "Comprehensive Update" to Bankruptcy Regulation*s, LEXOLOGY, Apr. 13, 2021, https://www.lexology.com/library/detail.aspx?g=4195a312-7748-489c-bebb-ddaadb5569e5 (explaining that the updated rules aim to improve the portability of customer positions and enhance clarity in the treatment of cleared and uncleared swaps).

Since market participants may have incentives to influence those informational inputs, the premise of an exogenous and reliable pricing mechanism becomes unstable.

In that setting, the core tools of the Part 190 framework, including porting, netting, and rapid liquidation, may fail to stabilize the system and may instead embed distortions into the insolvency process. A forced liquidation may crystallize values that are disconnected from eventual outcomes. An attempted transfer of positions may replicate uncertainty rather than reduce it. In fact, the collision of mark-to-market and liquidation rules of Part 190 with the uncertain and unresolvable values of event contracts may make Part 190 even less helpful for addressing prediction market platform insolvency than the SIPA resolution process. Rather than imposing valuation methods appropriate for other asset classes, it may be better to allow an adversarial process where parties can defend valuations appropriate for this unique asset class.[264]

3. Banks

Banks are expressly barred from filing for bankruptcy.[265] Instead, banks are primarily resolved by the Federal Deposit Insurance Corporation ("FDIC") under the Federal Deposit Insurance Act.[266] Like resolution under SIPA or the CFTC's Part 190 rules, bank resolution is meant to protect depositors and operation of the payment system, operate expeditiously, and reduce the risk of contagion.[267] Rapid resolution is seen as essential for immediate and broader reasons. Most immediately, since the government through the FDIC is frequently the largest creditor and residual claimant on an insolvent bank, the FDIC tries to act quickly to maximize the value of its claims and lower its resolution costs.[268] More broadly, the FDIC's resolution regime "enhances the credibility of a bank's core commitment to its depositors: enabling them to deposit, transfer, and withdraw their money

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[264] Melinda Roth, *Prediction Markets: Creating a New Asset Class from Ballots to Box Scores,* __ CONN. L. REV. __ (forthcoming 2026) (arguing that prediction markets increasingly resemble a distinct financial asset class).

[265] 11 U.S.C. § 109(b)(2). On the other hand, bank holding companies can and do file for bankruptcy. *See* Hynes & Walt, *supra* note 16, at 1019 n.138.

[266] 12 U.S.C. §§ 1821(d) (receiver powers), 1823(c)(2) (purchase-and-assumption authority).

[267] *See* Bliss & Kaufman, *supra* note 16, at 145-49; Adam J. Levitin, *Bankruptcy's Lorelei: The Dangerous Allure of Financial Institution Bankruptcy*, 97 N.C. L. REV. 243, 249-50 (2019).

[268] Hynes & Walt, *supra* note 16, at 1015-25 (FDIC is largest and residual claimant); Bliss & Kaufman, *supra* note 16, at 154 (least cost resolution mandated by 12 U.S.C. § 1823(c)(4)).

on demand."[269]

The key principles underlying the bank resolution process are the importance of speed and certainty. An insolvent bank is typically wound down by the FDIC over a weekend.[270] Customer balances are protected by the FDIC's familiar deposit insurance, and the FDIC becomes subrogated to any customer claims.[271] Domestic deposits are also granted payment priority over foreign deposits and other general unsecured creditors.[272] Next, the insolvency process relies upon a simplified administrative proceeding in which the FDIC "unilaterally makes all decisions necessary to carry out the liquidation or reorganization" of a bank, and "claimants have no standing and very limited rights to appeal before decisions are executed."[273] Finally, almost 90% of bank failures are resolved through transfers of deposits and assets to another institution.[274] These aspects collectively sharply reduce the distributional uncertainty characteristic of ordinary bankruptcy.[275]

As with the other models, the FDIC model would not work well for prediction markets insolvencies. The most obvious reason why is the absence of FDIC-style insurance. But besides this, for the reasons described above contagion is a far smaller risk for prediction markets than for banks.[276] Moreover, bank deposits are easily insured and transferred from one bank to another in part because there is almost no uncertainty as to the value of the assets protected under this regime. Indeed, the value of deposit assets held at banks are so certain, while the risk of contagion is so great, that the law *requires* the FDIC to step in and wind down a bank that is solvent but is "critically undercapitalized."[277]

Finally, the FDIC model of over-the-weekend resolution and transfer to a solvent competitor may be particularly ill-suited to prediction market platform insolvency for two reasons. First, a rapid transfer not only does not address the uncertainty inherent to event contracts, but could

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[269] Dan Awrey, *Unbundling Banking, Money, and Payments*, 110 GEO. L.J. 715, 743-44 (2022).

[270] Hynes & Walt, *supra* note 16, at 989, 989 n.15.

[271] *Id*. at 1000.

[272] *Id*.

[273] Bliss & Kaufman, *supra* note 16, at 160.

[274] Hynes & Walt, *supra* note 16, at 1002.

[275] Bliss & Kaufman, *supra* note 16, at 164-65.

[276] This is true even though some portion of holdings at a prediction market platform may consist of cash (or crypto) not yet invested in event contracts. Withdrawal of these funds could have run-like consequences depending on the financial management practices of the platform and other factors. *See generally* Moran Ofir, & Tal Elmakiess, *Bank Runs in the Digital Era Technology, Psychology, and Regulation*, 2025 U. ILL. L. REV. 1747 (describing bank runs in the emerging technology era and the challenging risks they pose).

[277] Bliss & Kaufman, *supra* note 16, at 156.

actually exacerbate it.[278] This could be true if the volatility of the underlying event increases or remains high while the transfer is being undertaken, or if the transferee uses different settlement rules than the transferor. Second, and more practically, as of now there are really only two prediction market platforms of any size in the market: Kalshi and Polymarket. Were one to fail, the existence of only one possible transferee raises difficult questions about monopoly concentration in the industry.

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Taken together, these regimes point in the same direction a single direction. Each uses specialized rules to protect customers and preserve value when speed, portability, or systemic stability matters. Prediction markets claims may instead remain contingent, disputed, or dependent on unsettled factual predicates at the moment of failure. While specialized administrative solutions may be appropriate in some circumstances, here the nature of prediction markets and the unique risks they pose may weigh in favor of determining what the claims actually are before they are transferred, netted, or liquidated. In such circumstances, greater judicial involvement, including adversarial inquiry and case-by-case resolution of contested predicates, may be analytically justified.

IV. WHAT IF WE WANTED TO BET ON BANKRUPTCY?

As outlined in the preceding Parts, a prediction market platform insolvency would create difficult questions for bankruptcy law. But many of these difficulties would originate not with bankruptcy as such, but with antecedent regulatory and factual questions. Without a straightforward legal answer to the question of whether an event contract is a derivative, a wager, or something else, a bankruptcy court may be forced to provide a response and then determine how the Bankruptcy Code applies. Instead, policymakers should consider these insolvency consequences directly. This Part offers three principles: bankruptcy treatment should be considered alongside broader regulatory treatment, any prohibition should entail a well-considered offramp, and functional regulation is likely superior to formalistic regulation. Each responds to the uncertainty catalogued above and seeks to reduce the policy choices left to a court during collapse.

A. Design Regulation with Insolvency in Mind

[278] *Cf.* Levitin, *supra* note 267, at 264-66, 285 (successful asset transfers require the asset purchaser to be confident in the value of the purchased assets).

As Parts II and III have shown, bankruptcy treatment is downstream of regulatory treatment. The legal status applied to a prediction market transaction before insolvency can determine whether the automatic stay applies, whether parties are subject to an alternative resolution regime, or even whether bankruptcy is available at all. Although a policymaker may be focused on the scope of existing statutory authority, market integrity, consumer protection, or even the political whims of a particular presidential administration or Congressional actor, the policymaker's decision may determine the rights of customers and creditors after failure. To prevent this outcome, regulators should design prediction market regulations with insolvency in mind, rather than treating failure as a problem for bankruptcy courts to sort out later.

The crypto winter presents a cautionary tale. Because no regulatory architecture existed to resolve failing crypto firms ex ante, their collapses were shunted into bankruptcy. Once there, unelected bankruptcy judges made consequential, system-wide policy choices—about the ownership of customer assets, the status of tokens, and the priority of claims—on an ex post, case-by-case basis. Prediction markets could find themselves on a similar path. For example, one of the first questions a judge would need to answer in a prediction market insolvency would be whether a bankruptcy filing is permissible at all, a question with significant consequences that should be thoughtfully decided before a crisis. The way to avoid this is to decide these hard questions before a platform fails, not during its collapse.

This principle—thinking through the insolvency consequences of regulation *before* insolvency occurs—strengthens the argument for national regulation, without being dispositive in that regard. From an insolvency perspective, a nationally uniform baseline has substantial advantages over a fragmented state-by-state regime, which are apparent when considering both the structure of prediction markets and the preconditions that would be needed for state-law regulations. Platforms currently operate across state lines, and face substantial compliance costs meeting the competing requirements of different jurisdictions.[279] As described above, in distress these conflicting rules may make a prediction market platform harder to finance, sell, reorganize, or unwind. In addition, as noted by the insurance company analogy, insolvency at a state level may be manageable, but only in the context of comprehensive regulations such as solvency monitoring, capital requirements, guaranty mechanisms, and state-level interventions in struggling firms. Without these features, a state-level insolvency regime may provide little assurance to market participants.[280] Following in the

[279] *See* notes 22 and 56, *supra*, and accompanying text.

[280] *See* Organek, *supra* note 12, at 262-66 (describing state-level insolvency proceedings for legal cannabis companies, and noting the many reasons for their limited

footsteps of some cannabis companies and decentralized autonomous organizations, prediction markets might even turn to offshore proceedings if the law is insufficiently settled in the United States, potentially weakening customer protections and shifting restructuring activity abroad.[281]

Considered in this light, the alternatives should be either a national regulatory framework, or comprehensive state-level frameworks undergirded by some form of national coordination. A national framework, whether housed at the CFTC, shared among agencies, or created from scratch might supply a common baseline for classification, customer treatment, and wind-down, even though some questions may involve federal, state, and even foreign law. Although state regulation may have some advantages, particularly as it relates to consumer protection, once insolvency (and the risks that inadequate insolvency planning poses to consumers) is taken seriously, we argue that the case for national uniformity is considerably stronger than the current debate acknowledges.

Regardless of which sovereign ultimately regulates prediction markets, we also believe that bankruptcy should ordinarily remain the presumptive resolution mechanism. As described in Part III, the existing specialized, administrative resolution mechanisms would not easily apply to the unique challenges posed by prediction market platform insolvency. Administrative speed, even at the expense of opportunities to challenge valuation, is useful when the claims being transferred or paid have a sufficiently stable value and the concern of contagion is deep. Yet prediction market failures would not have these features; instead, a court may need to determine value, priority, and even the nature of the claim itself. For untested claims like these, a more fulsome valuation process is important even when weighed against bankruptcy's own preference for speedy resolution.[282] This is especially true since a judge in a prediction market platform bankruptcy filing may face at least some of the doctrinal issues described in Part II, such as those related to valuation under section 365, regardless of which sovereign regulates event contracts.

In short, regulators should establish the legal architecture of the market, with due consideration for the ways that event contracts will be treated in the event of insolvency. Only then should bankruptcy courts

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use by the industry).

[281] *See* Ben Zigterman, *Cannabist Ch. 15 Wins Recognition in Pot Industry Test Case*, LAW360, May 11, 2026, https://www.law360.com/articles/2476160/cannabist-ch-15-wins-recognition-in-pot-industry-test-case (US recognition of Canadian cannabis insolvency proceeding); Jared A. Ellias & Narine Lalafaryan, *The Global Law of Debt*, 75 DUKE L.J. __ (forthcoming 2026), manuscript at 73-78.

[282] *See* William A. Organek, *Why Bankruptcy Will Keep Eating Mass Torts*, 28 U. PA. J. BUS. L. __ (forthcoming 2026), manuscript at 49-52 (discussing the importance of litigation for valuing immature claims in bankruptcy).

apply that architecture, rather than creating it during collapse.

B. Plan for Unwinding: Prohibition Is Not Self-Executing

Next, if policymakers decide that some event contracts should not be permitted at all, any such decision should only be made in connection with a plan to unwind the contracts that already exist. A prohibition silent on unwinding does not make outstanding positions—some of which may resolve days, months, or years in the future—disappear. Instead, it converts them into a mass of contingent, potentially unenforceable obligations whose holders have paid real money and expect real settlement, and it does so without telling courts, counterparties, or platforms how these obligations should be valued, netted, or discharged. A federal prohibition like that which exists for cannabis could leave creditors wholly without bankruptcy protection. On the other hand, a determination that state regulators should be the primary regulators may similarly leave creditors without remedy unless and until a corresponding state regulatory architecture is built. In either case, a regulatory decision intended to protect customers ex ante could end up making customers worse off ex post if it eliminates access to a collective insolvency resolution proceeding without offering an alternative.

Moreover, these problems are likely to be most difficult for offshore or decentralized platforms and counterparties. A domestic prohibition cannot by itself unwind a position booked through a foreign entity or settled on a decentralized protocol beyond the reach of a US court—it can only strand it. Nor can one sovereign easily resolve a contract where another sovereign requires a conflicting result. The recent (entirely domestic) disputes between federal and state sovereigns illustrate the "impossible position"[283] that results when prohibition outruns a well-considered process.[284]

To prevent these unwanted outcomes, any decision prohibiting some or all event contracts should specify whether outstanding contracts may continue to settlement or be transferred. If settlement or transfer is

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[283] *See* notes 22 and 56, *supra*, and accompanying text; *see also* Rajveer Pardesi, *Prediction Market Operator Kalshi Hits Back at Nevada Regulator Over Geofencing Fine,* REUTERS, Aug. 15, 2026, https://www.reuters.com/legal/litigation/prediction-market-operator-kalshi-hits-back-nevada-regulator-over-geofencing-2026-08-15/ (Kalshi accuses Nevada of violating federal law by imposing $120,000/day fine for failure to comply with geofence order).

[284] *See generally See generally* Nizan Geslevich Packin, *Too-Big-To-Fail 2.0? Digital Service Providers,* 93 IND. L.J. 1211, 1214–22, 1245–62 (2018) (arguing that the growing economic and social dependence on large digital service providers creates potentially systemic consequences from their failure and proposing enhanced risk-management and supervisory mechanisms to address those risks before failure occurs).

permitted, the settlement rules in place at the time of the purchase of the event contract should govern even after a transfer. If settlement or transfer is not permitted, liquidation should proceed with a prescribed methodology for valuation. Finally, as such a process is quite likely to engender litigation, regulations should specify the appropriate forum (federal or state) and governing law to prevent inconsistent decisions on these fundamental issues. We do not take a position on which methodology, forum, or governing law would be best, other than to say that these decisions should align with consumer expectations at the time of purchase as best as possible. But the key lesson remains: prohibition is not self-executing. Whoever chooses it must also guide how the unwinding will occur.

C. Regulate Event Contracts by Function, Not Form

The final principle is perhaps the most important one: regulators should classify and regulate event contracts by function rather than by form. A recurring lessons of this Article is that "the prediction market" is not a single thing that can be placed in a single regulatory box. An event contract tied to an interest-rate announcement and one tied to whether a soldier will be rescued may both be "event contracts," yet they differ in economic function, in the risks they create, in their susceptibility to manipulation, and in the social interests they implicate. A regulatory regime that classifies every event contract as a derivative, a wager, or something else risks misclassifying a large proportion of the market and reinforcing precisely the doctrinal instability described in Parts II and III.

Here the emerging regulatory treatment of cryptocurrency offers a narrow but useful analogy. In their recent joint rulemaking, the SEC and CFTC moved away from asking what a crypto asset *is* in the abstract (i.e., is it a security or not?). Instead, it sought to investigate what *economic function* a particular transaction performs, allocating oversight accordingly and coordinating across agencies rather than competing for jurisdiction.[285] The rule created a taxonomy, "classify[ing] crypto assets into five categories based on their characteristics, uses, and functions."[286] It then explained which of these categories would be characterized as a security (and thus regulated by the SEC under existing standards), which would be a commodity (and thus regulated by the CFTC under existing standards), and which would fall outside of the purview of either of these regimes. While one can dispute the treatment of a particular item within the taxonomy or quibble over edge cases, the benefit of this functional approach is that it will coordinate treatment across agencies, avoid forcing every crypto asset or

[285] *See* note 23, *supra*.
[286] SEC and CFTC Joint Final Rule*, supra* note 23, at 13.

transaction into the same legal box, and take advantage of many well-established parts of existing legal architecture.[287]

A functional taxonomy for event contracts could build on that approach, focusing on the predominant economic function and the nature of the risks embodied in a given event contract. One useful distinction is between contracts that transfer *preexisting* risk and contracts that principally create *new* risk. At one end of this spectrum lies event contracts used to hedge weather, interest rate, regulatory, product, or other preexisting commercial or financial risk. Such contracts serve an insurance function just as derivatives do and could be regulated as such. This would include applying bankruptcy's safe harbors to such contracts, as well as appropriate consumer protection regulations. At the other end of the spectrum would lie event contracts for which no preexisting risk is hedged, but instead which creates new risk for the counterparties intrinsic to entering into the event contract and that would not exist without it. A sports wager, a bet on a mention market, or another event contract entered into without a meaningful corresponding extrinsic economic risk likely is materially equivalent to gambling, and should be regulated under (federal or state) consumer protection regimes built for that purpose.[288]

Other contracts likely land between these two poles. For example, economic, election, or policy markets may serve information-aggregation functions even when most individual participants are speculating. Such markets raise distinctive questions regarding manipulation and the possibility of interference with important democratic institutions.[289] As such, they should be treated differently from either of the two prior examples. Perhaps certain individuals who may have insider information should be banned from trading. In some circumstances, guardrails drawn from election law may be appropriate, such as limits on when such contracts can be listed, when they must be closed, how much money can be wagered by individuals and corporations, bans on foreign bettors, and other similar protections. Special rules may also be appropriate for event contracts

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[287] *Cf.* Frank H. Easterbrook, *Cyberspace and the Law of the Horse*, 1996 U. CHI. L. F. 207, 210-16 (counseling in favor of applying clear existing rules to new technologies rather than creating new architectures wholesale).

[288] For more on this distinction *see* John T. Holden, Matthew C. Turk & Marc Edelman, *Regulating Sports Prediction Markets*, __ U. ILL. L. REV. __ (forthcoming); *see also* J.J. McCorvey, *Kalshi Grilled by Massachusetts High Court Over What Gambling Is,* BLOOMBERG, May 4, 2026, https://www.bloomberg.com/news/articles/2026-05-04/kalshi-grilled-by-massachusetts-high-court-over-what-gambling-is.

[289] *See* Nizan Geslevich Packin, *Betting NYC's Democracy: When Prediction Becomes Persuasion*, FORBES, Oct. 31, 2025, https://www.forbes.com/sites/nizangpackin/2025/10/31/betting-nycs-democracy-when-prediction-becomes-persuasion/.

similar to the notorious ones about the fates of identifiable individuals, military events, or others where creating a financial reward tied to the underlying event produces unacceptable externalities, manipulation incentives, or moral costs.

A functional regulatory system need not capture every case ex ante—such a system would be impossible to create and would reinforce the very rigidity that the functional approach is meant to avoid. It is also possible that future event contracts may fit within more than one category, and it will be up to courts and regulators to identify the predominant function of such an event contract and apply the corresponding rules. Finally, classification for one regulatory purpose need not automatically answer every insolvency question, though any classification should track existing classifications and bankruptcy treatments as much as possible. As discussed above, insolvency consequences should be considered as part of a well-conceived regulatory framework, but especially for intermediate cases it may be appropriate to classify a particular event contract as one type of legal instrument for consumer protection purposes and another for bankruptcy purposes.

Even imperfect functional sorting would reduce many of the insolvency problems discussed above. Recall that much of the doctrinal uncertainty of a prediction market platform bankruptcy flows from classification uncertainty: whether a claim is a derivative determines whether the safe harbors strip the estate of the automatic stay and avoidance powers; whether a contract is lawful determines whether the platform can invoke bankruptcy at all; and whether a user is a customer, a counterparty, or a mere wagerer determines priority and recovery. Resolving function ex ante would leave a court with contracts largely assigned to legal categories carrying known insolvency consequences, rather than an entire order book whose regulatory status must be determined during collapse. Functional regulation therefore facilitates ex ante insolvency planning while removing from courts policy decisions that should be left to lawmakers and regulators.

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These three principles—designing for insolvency with the use of a national framework, planning the unwinding of prohibited contracts, and regulating by function rather than form—do not purport to answer every question prediction markets raise. However, each treats insolvency not as a remote contingency with decisions to be made improvisationally by a court, but as a design constraint to be accommodated at the beginning. Moreover, each is calibrated to the central theme of this Article: prediction markets

destabilize the factual, doctrinal, and jurisdictional foundations on which bankruptcy silently depends. A framework that internalizes this finding will not eliminate the risk of prediction market failure. But it can help ensure that if and when a prediction market platform does fail, its resolution is governed by rules chosen deliberately in advance by the appropriate policymakers, rather than by a bankruptcy judge forced to bet, under pressure and without a rule book, on answers it was never equipped to give.

CONCLUSION

What happens when a prediction market becomes insolvent? Prediction markets expose how much of bankruptcy law rests on foundations—identifiable debtors, determinable liabilities, and objective facts from which value can be inferred—that these markets systematically unsettle. A prediction market insolvency would ask a bankruptcy court not merely to allocate value, but to decide, contract by contested contract, whether the wager was lawful and who is entitled to be paid. Uncertainty over legal classification could also expand, curtail, or even eliminate bankruptcy's ordinary tools for resolving financial distress. The questions raised by a potential prediction market insolvency also point to fundamental assumptions made in bankruptcy literature about the nature of valuation and the appropriateness of specialized resolution regimes. We argue that to avoid the chaos, bankruptcy should not serve as a substitute for regulatory choices that ought to be made in advance. Whether or not one believes prediction markets can predict the future, no one should want to bet on how they will fail.

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