

BALCH & BINGHAM LLP

ATTORNEYS AND COUNSELORS
POST OFFICE BOX 306
BIRMINGHAM, ALABAMA 35201
(205) 251-8100

WRITER'S OFFICE:
1710 SIXTH AVENUE NORTH
BIRMINGHAM, ALABAMA 35203
FACSIMILE (205) 226-8798

Lyle D. Larson

DIRECT DIAL TELEPHONE:
(205) 226-3441
E-Mail: llarson@balch.com

May 7, 1998

COMMENT

BY HAND DELIVERY

Hon. Brooksley E. Born, Chairperson
Hon. Barbara Pedersen Holum
Hon. David D. Spears
Hon. John E. Tull, Jr.
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, Northwest
Washington, D.C. 20581

Re: Application of Chicago Board of Trade for Contract Market
Designation for TVA Hub Contract Futures and Options,
Tendered Under Fast-Track Procedure

Dear Commissioners:

On April 2, 1998, the Commodity Futures Trading Commission ("CFTC" or "Commission") issued public notice of an application for contract market designation filed by the Chicago Board of Trade ("CBT"). The application appears to constitute CBT's formal request for designation as a contract market for Tennessee Valley Authority ("TVA") Hub contracts. In response to the CFTC's request for comments, TVA Watch, a coalition of investor-owned utilities, filed comments. Comments expressing concern about various aspects of the CBT application also were filed by the New York Mercantile Exchange, CINergy Corporation and Tennessee Power Company.

TVA Watch's comments sought to inform the CFTC and its staff about: (i) a number of material deficiencies in the CBT's application rendering it ineligible for "fast-track" review; (ii) disparities between the proposed contract terms and conditions and the underlying cash market; and (iii) other general concerns about the Commission's and CBT's ability to discharge certain regulatory duties with regard to TVA.

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The last of these concerns arises out of a complicated and novel aspect of CBT's application – the proposed delivery hub for the underlying commodity is exclusively controlled by the TVA. The central issue here is that the CBT's application contains no substantive discussion of the unique regulatory immunities enjoyed by TVA and thus contains no discussion of the impact, if any, TVA's unique legal status may have on the susceptibility of the market to manipulation or exploitation. The proposed terms and conditions of the proposed TVA Hub contract contain several provisions that appear targeted at addressing some of the unique problems inherent in a TVA hub contract, but CBT's application does not address the details of why certain provisions are included, what legal situation is sought to be addressed, and how the proffered remedy will work in practice to alleviate the problem(s). In short, CBT does not appear to have provided sufficient support for the Commission to base a reasoned decision on whether to grant designated contract market status.

Commission staff has provided a facsimile of what appears to be a "redlined" draft of an amended TVA Hub contract. The source of this redlined draft is unidentified. If amendments have been offered in an attempt to address infirmities identified by TVA Watch or other commenters, there has been no public notice of the amendments and certainly no opportunity for concerned parties to offer additional comment thereon. It would be expected further, that if any such amendments have been or will be offered, that CBT would also amend its application to discuss the purpose and effect of the amendments. There has been no public notice that any such application amendments have been offered nor has the public been invited to comment on any amendments.

TVA Watch respectfully asks the CFTC to take affirmative action to prevent the CBT's application from being deemed granted tomorrow, May 8, 1998. The public simply needs time to: (i) learn whether amendments have been offered by the CBT; (ii) if so, to review the amendments and have the opportunity to comment further; and (iii) if material amendments have been made, to review and comment upon the amended application's discussion of the reason for and the effect of the contract amendments. If amendments have been filed, fast-track review and approval may be inappropriate. Moreover, there is a serious question as to the nature and extent of CFTC's jurisdiction over TVA in connection with trading and physical delivery aspects of the proposed TVA Hub market.

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Until such time as the Commission resolves those issues, approval of the CBT's application appears premature. The enclosed background paper sets forth additional discussion on these concerns.

Thank you for your consideration.

Respectfully submitted,



Lyle D. Larson
Attorney for TVA Watch

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cc: Ms. Jean A. Webb, Secretary

BACKGROUND PAPER
IN SUPPORT OF REQUEST TO STAY AUTOMATIC GRANT OF APPLICATION

Automatic fast-track approval is unwarranted and a deliberate evaluation of the novel and complex issues raised by the application should be undertaken. Several salient points merit the Commission's attention:

- ◆ Fast-track review is inappropriate when a board of trade files a materially deficient application, then without any public notice or opportunity for comment amends the terms and conditions of the proposed contract to remedy serious flaws and various deficiencies identified by comments.¹
- ◆ There are serious concerns as to whether the CBT and the Commission have sufficient authority and jurisdiction effectively to monitor, supervise or to even investigate the commodity delivery function underlying the proposed contract market. These concerns have not been addressed by CBT in its application or its proposed contract terms and conditions.
- ◆ The Commission and the CBT are at substantial risk of being unable to properly discharge their duties under the Commodity Exchange Act ("CEA") because of the unique posture of the TVA in the electric power industry. Generally, TVA is considered "government" and not a "person" for purposes of statutory construction. See, e.g., Webster Cty. Coal v. TVA, 476 F. Supp. 529, 531-32 (W.D. Ky. 1979).² The CEA's substantive provisions outlawing manipulation and fraud, however, apply to "persons." Therefore, it is at best unclear whether TVA is subject to the CEA's substantive provisions and would be available for prosecution or sanction by the CFTC.³

¹ See 7 CFR § 5.1(b)(5); see also Revised Procedures for Commission Review and Approval of Applications for Contract Market Designation and of Exchange Rules Relating to Contract Terms and Conditions, 62 Fed. Reg. 10434-01, 10435 (CFTC, March 7, 1997) ["Fast-Track Final Rule"] ("The fast-track review periods would be available only for applications for designation that are complete and not substantively amended after filing, except as requested by the Commission.").

² In that case, TVA argued and prevailed on the view that it, as "government," should benefit from a rule of statutory construction that laws that are made applicable generally to "persons" exclude application to government. Quoting the Court: "The TVA also argues that the antitrust laws are not expressly applicable to the federal government and so it along with its instrumentalities and agencies are protected from such action according to the rule of construction which holds that a 'general statute imposing restrictions does not impose them upon the Government itself without a clear expression or implication to that effect.'" Id.

³ See also Hancock v. Train, 426 U.S. 167 (1976); United States v. Wittek, 337 U.S. 346 (1949).

- ◆ The potential inability to discharge investigative, supervisory and/or prosecutorial authority over TVA also lies in the judicially constructed "nonliability doctrine" that has immunized TVA from certain lawsuits. See, e.g., Peoples National Bank of Huntsville, Alabama v. Meredith, 812 F.2d 682, 684 (11th Cir. 1987).
- ◆ In contrast to an electric utility that hosts a hub for electricity futures market approved by the Commission, TVA is not subject to full scale regulation of its transmission system operations and wholesale marketing practices by the Federal Energy Regulatory Commission pursuant to the Federal Power Act. TVA also is not subject to prosecution or private action for violation of antitrust and related consumer protection statutes. Under the Tennessee Valley Authority Act, as well, TVA is statutorily protected from payment of punitive damages or prejudgment interest -- under any set of circumstances. As a buyer of a large quantity of power in the spot market, TVA may be in a position to benefit from price fluctuation on the futures market that are driven by the prospects and risks of future physical delivery capability.
- ◆ The Supreme Court has noted that public corporations, like their counterparts in private enterprise, are capable of competitive mischief:

...the economic choices made by public corporations in the conduct of their business affairs, designed as they are to assure maximum benefits for the community constituency, are not inherently more likely to comport with the broader interests of national economic well-being than are those of private corporations acting in furtherance of the interests of the organization and its shareholders...

When [governments] act as owners and providers of services, they are fully capable of aggrandizing other economic units with which they interrelate, with the potential of serious distortion of the rational and efficient allocation of resources, and the efficiency of free markets which the regime of competition embodied in the antitrust laws is thought to engender.

City of Lafayette v. Louisiana Power & Light Co., 435 U.S. 389, 403, 408 (1978).

- ◆ Under the CEA, the TVA is not subject to substantive prohibitions against violating statutory and CFTC imposed restrictions on excessive speculation and prohibitions on trading or positions in excess of CFTC fixed limits. See generally, e.g., 7 U.S.C. § 6a(d) ("This section shall not apply to transactions made by, or on behalf of, or at the direction of, the United States, or a duly authorized agency thereof."). The CBT's application has not addressed the impact of this exemption on the ability to prevent and police manipulation in the proposed market. As such, the application is deficient and fails to justify contract market designation.

CBT's application and the issues it raises dictate the need for caution. Unless the Commission acts affirmatively by May 8, 1998, the CBT's application will be deemed approved. TVA Watch respectfully requests the Commission to take the appropriate affirmative steps to ensure that the novel and complex issues raised associated with the filing may be carefully and deliberately evaluated.

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