

**COMMENT**

**BALCH & BINGHAM LLP**

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

COMMODITY FUTURES  
TRADING COMMISSION  
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MEMBER

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BIRMINGHAM OFFICE:  
710 SIXTH AVENUE NORTH  
BIRMINGHAM, ALABAMA 35203  
FACSIMILE (205) 226-8798

DIRECT DIAL TELEPHONE:

Lyle D. Larson

(205) 226-3441

E-Mail: llarson@balch.com

April 17, 1998

**BY HAND DELIVERY**

Ms. Jean A. Webb, Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, D.C. 20581

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COMMODITY FUTURES  
TRADING COMMISSION  
FILED FOR  
PUBLIC RECORD

*Re: Comments on Application of the Chicago Board of Trade for Designation as a Contract Market in TVA Hub Electricity Futures and Options, Submitted Under 45-Day Fast Track Procedures*

Dear Ms. Webb:

By notice in the Federal Register, published on April 2, 1998, the Commodity Futures Trading Commission ("Commission") invited persons interested in the above-referenced application to submit views and comments on or before April 17, 1998. In response to the Commission's invitation, TVA Watch, a coalition of American Electric Power, Carolina Power & Light, Duke Energy, Entergy Corporation, Kentucky Utilities, SCANA Corp., and Southern Company, hereby tenders its views and comments on the proposed designation as a contract market in TVA Hub futures and options.<sup>1</sup> The original and five conformed copies are attached for filing. TVA Watch appreciates greatly the opportunity to provide written views and comments on the above-referenced application, and remains available to the Commission for any conference, dialogue or discussion that may be deemed appropriate or helpful under the circumstances.

The following person is designated by TVA Watch to receive service of any documents filed in the above-referenced matter:

Lyle D. Larson, Esq.  
Balch & Bingham LLP  
P.O. Box 306  
Birmingham, Alabama 35201

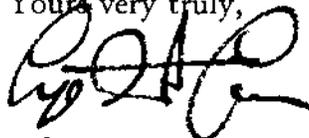
<sup>1</sup> TVA Watch has no comments on the application of The Chicago Board of Trade for designation as a contract market in ComEd Hub electricity futures and options.

BALCH & BINGHAM LLP

April 17, 1998  
Page 2

Two copies of the enclosed comments, complete with exhibits, have been deposited in first-class mail to the Chicago Board of Trade.

Yours very truly,

A handwritten signature in black ink, appearing to read "Lyle D. Larson". The signature is stylized and cursive, with a large initial "L" and "D".

Lyle D. Larson  
Attorney for TVA Watch

Enclosures  
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UNITED STATES OF AMERICA  
BEFORE THE COMMODITY FUTURES TRADING COMMISSION

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Applications of the )  
Chicago Board of Trade )  
for Designation as a Contract )  
Market in TVA Hub Electricity ) Docket No. \_\_\_\_\_  
Futures and Options, )  
Submitted Under ) Ref. File 1829.01  
45-Day Fast Track Procedures )

COMMENTS OF TVA WATCH

In response to the Commodity Futures Trading Commission's ("CFTC") "Notice of Availability of Proposed Terms and Conditions for Applications for Contract Market Designation," published in the Federal Register on April 2, 1998, TVA Watch respectfully submits these comments regarding the proposed TVA Hub Contract market. TVA Watch has no comments on the application of The Chicago Board of Trade for designation as a contract market in ComEd Hub electricity futures and options.

TVA WATCH

TVA Watch is composed of several investor-owned electric utilities, most of whom are directly interconnected with TVA. TVA Watch members include: American Electric Power Co., Carolina Power & Light Co., Duke Energy Corp., Entergy Corp., Kentucky Utilities Co., SCANA Corp., and Southern Company. The member companies of TVA Watch are united in their desire to educate Congress, the courts and regulatory agencies as to: (i) TVA's immunity from independent regulation

of its transmission system and access policies; (ii) TVA's freedom from accountability for violation of antitrust and related consumer protection laws and regulations; and (iii) the various legal restrictions on the terms and conditions under which TVA may make contracts to sell power. TVA Watch encourages the CFTC to exercise extreme caution and to carefully evaluate the proposed TVA Hub Contract market. The proposal by the CBT raises a set of truly novel and difficult issues that have yet to be confronted by the CFTC. Careful deliberation is justified and required under the circumstances.

#### BACKGROUND

On April 2, 1998, the CFTC published in the Federal Register Notice of the Chicago Board of Trade's ("CBT") application for designation as a contract market in TVA Hub Electricity Futures and Options ("TVA Hub Contracts"). The Notice specified that the proposed TVA Hub Contract has been tendered under the CFTC's 45-day "Fast Track" procedures. The Notice stated that interested persons could obtain a copy of the proposed TVA Hub Contract from the CFTC's World Wide Web page or from the CFTC itself. The stated deadline for the filing of comments on this proposal was identified as April 17, 1998.

The Notice stated further that the CBT's application and detailed information required by the CFTC's rules and regulations were available only if not otherwise confidential and only after filing a Freedom of Information Act request. By letter dated April 3, 1998, the undersigned counsel for TVA Watch requested the CBT's

application and other materials under the Freedom of Information Act. On April 9, 1998, TVA Watch received the CFTC's response. Thus, TVA Watch has had a little over two weeks to review the proposed terms of the contract and little over a week to review and digest the CBT's application and supporting materials. Given the relatively short time frame under which TVA Watch has been required to respond, these comments are necessarily general and likely fail to identify and address all shortcomings and items of concern. TVA Watch invites and encourages the CFTC to make further inquiry of interested parties and to engage in a dialogue with the electric power industry with regard to this important matter.

#### DISCUSSION

TVA Watch has two basic observations and concerns. First, the proposed TVA Hub Contract market appears prone to manipulation because a single, self-interested, unregulated, and largely unaccountable entity -- the Tennessee Valley Authority -- controls the circumstances and terms of physical delivery of the underlying commodity. Second, the proposed standard terms and conditions of the TVA Hub Contract do not appear to reflect normal lawful trading practices and, actually, may authorize and encourage transactions that in some circumstances would be unlawful.

TVA Watch emphasizes that it is not here attempting to cast aspersions upon TVA or CBT. TVA Watch has respect for both TVA and CBT and has no reason to believe that TVA has any present design or intent to exploit or manipulate the proposed TVA Hub Contract market. However, when a regulatory agency is

considering proposals to erect market institutions in an emerging market, every precaution should be taken to ensure the institutions are not subject to exploitation — under any set of reasonably anticipated circumstances.

## **I. The Proposed TVA Hub Contract Market Appears Subject to Uncontrollable Manipulation and Abuse**

TVA may not lawfully supply electricity to satisfy physical delivery obligations in the proposed contract market. This limitation, derived from the Tennessee Valley Authority Act of 1933 ("TVA Act") and known as the "Fence," appears to greatly limit market clearing ability and market liquidity. Because the underlying physical commodity may not be supplied lawfully from within the delivery hub, any contract that will be taken to physical delivery requires the counter-parties to have rights to transmission service into and out of TVA's power system.<sup>1</sup>

TVA, however, is not subject to any form of independent regulation of its transmission system or any of its trading practices. TVA has sole rate-making authority over its transmission tariffs with no oversight to ensure the validity of rates charged or, that indeed, TVA is charging themselves the same rates others are required by TVA to pay. TVA is not subject to the antitrust laws which would otherwise

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<sup>1</sup> Unlike other commodities traded on futures markets, electricity "cannot be stored, and consumer demand for it varies widely from season-to-season, from day-to-day, and from hour-to-hour." Ex. 1, pp. 4-5. Department of Justice, Statement of A. Douglas Melamed, Principal Deputy Assistant Attorney General, Antitrust Division, U.S. Dept. of Justice, "Legislative and Oversight Hearing on Antitrust Aspects of Electricity Deregulation," Testimony before the U.S. House of Representatives Committee on the Judiciary (June 4, 1997). The inability to store electricity, taken together with TVA's inability to provide an effective clearing mechanism, suggests physical delivery and receipt must occur via instantaneous entry and exit from TVA's unregulated and unaccountable transmission system.

apply to its operational practices relating to third-party access and use of its transmission system. Accordingly, unlike any hub already sanctioned by the CFTC as the locus of electricity futures contract trading, a TVA Hub is truly unique and warrants heightened scrutiny.

**A. TVA May Not Lawfully Be The Source Of Power Delivered To Satisfy Any TVA Hub Contract**

TVA is not a typical utility, nor a typical governmental unit. It operates under a special set of legal rules that are unique in the industry and present special challenges in evaluating the proposed TVA Hub Contract.

As established by Congress, TVA's primary purposes are flood control, river navigation, and regional economic development. 16 U.S.C. § 831. So long as consistent with these purposes, it is allowed to generate, transmit and sell electricity which is surplus to its own needs. 16 U.S.C. § 831h-1. In its disposal of surplus electricity, TVA is required to give preference to non-profit cooperative and municipal utilities (its "distributors"). 16 U.S.C. §§ 831i, 831j & 831k.

Whenever TVA makes a contract with "private companies or individuals for the sale of power," and the power will be resold for a profit, TVA is required to include in the contract a provision "authorizing the [TVA] Board to cancel said contract upon five years' notice in writing, if the Board needs said power to supply the demands of States, counties, or municipalities." 16 U.S.C. § 831i. Moreover, TVA is not allowed to sell power to a for-profit wholesale customer unless it requires that customer to:

. . . agree that any resale of such electric power by said person or corporation shall be made to the ultimate consumer of such electric power at prices that shall not exceed a schedule fixed by the Board from time to time as reasonable, just and fair; and in case of any such sale, if an amount is charged the ultimate consumer which is in excess of the price so deemed to be just, reasonable, and fair by the Board, the contract for such sale between the Board and such distributor of electricity shall be voidable at the election of the Board. . . .

16 U.S.C. § 831k.

Whether TVA is selling power to a non-profit cooperative, a municipal utility, a large industrial customer or an investor-owned utility, the area where TVA power may be delivered and consumed is statutorily limited. Under Section 15d(a) of the TVA Act, TVA cannot make a contract that has the effect -- directly or indirectly -- of making it a source of power supply outside of a fixed area consisting of approximately 80,000 square miles and encompassing all of the state of Tennessee, and parts of Alabama, North Carolina, Virginia, Georgia, Mississippi and Kentucky. 16 U.S.C. § 8331n-4. The specific language of the restriction merits quotation:

Unless otherwise specifically authorized by Act of Congress the Corporation [TVA] **shall make no contracts** for the sale or delivery of power which would have the effect of making the Corporation or its distributors, directly or indirectly, a source of power supply outside the area for which the Corporation or its distributors were the primary source of power supply on July 1, 1957, and such additional area extending not more than five miles around the periphery of such area as may be necessary to care for the growth of the Corporation and its distributors within said area. . . .

Id. (emphasis added).

This area has been identified over the years in the electricity industry as the TVA "Fence." TVA has referred to the Fence as both a "straight-jacket"<sup>2</sup> and as its "main competitive disadvantage."<sup>3</sup> Attempts by TVA in recent years to supply power outside the Fence unlawfully have been challenged successfully in Court by several members of TVA Watch.<sup>4</sup>

There is an exception to the general prohibition which permits TVA to engage in a strictly limited set of transactions under which it may supply power for use outside the Fence. Section 15d(a) of the TVA Act authorizes TVA to engage in limited "exchange power arrangements" with neighboring power generating organizations with whom TVA had such arrangements in place as of July 1, 1957. The Courts have distinguished the "exchange" of power, which has a limited purpose and is limited to physical power trades, and the "sale" of power by TVA. The former is limited to certain types of trades with a finite array of counter-parties, while the latter is limited

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<sup>2</sup> TVA's current Chairman, Craven Crowell, spoke to the Public Power Association in 1995 and said: "[t]he fence around TVA's service area was put up at the insistence of private power companies when the TVA power system became self-financing. The Fence was intended to be a bulletproof vest for our competitors. It has become a straight-jacket for TVA." Ex. 2, Remarks of Craven Crowell, "Unleashing Potential: TVA in Free-Market Competition," addressing the American Public Power Association Board of Directors (February 2, 1995) (emphasis added).

<sup>3</sup> TVA's Chairman, Craven Crowell, has stated: "[o]ur strategy also takes into account our main competitive disadvantage, and that is a territorial restriction we call 'The Fence.'" Ex. 3, Remarks of Craven Crowell, "Tailoring the Seamless Enterprise: An Integrated Approach to the Challenge of Deregulation," addressing Conference on Building the Seamless Enterprise, Chicago, Illinois at 7 (Sep. 19, 1995).

<sup>4</sup> See Alabama Power Co., et al. v. TVA, 948 F. Supp. 1010 (N.D. Ala. 1996) [attached hereto as Ex. 4]; Alabama Power Co., et al. v. TVA, Docket No. CV-97-C-0885-S (N.D. Ala. 1997) (Consent Judgment Entered by Judge U. W. Clemon) [attached hereto as Ex. 5].

as set forth in the preceding paragraphs (as to counter-party, preferences, and geographic location of use).<sup>5</sup>

TVA's authority to engage in "exchange power arrangements" is limited in scope as to both counter-party and type of power transacted. The permissible scope of TVA's exchange power transactions is tightly regulated and is the subject of a Court Order. TVA may supply exchange power under an exchange power arrangement only to the following entities:

Alabama Power Company  
Georgia Power Company  
Gulf Power Company  
Mississippi Power Company  
Savannah Electric and Power Company

Entergy Mississippi, Inc.  
Entergy Arkansas, Inc.  
Entergy Louisiana, Inc.  
Entergy New Orleans, Inc.  
Entergy Gulf States, Inc.

Appalachian Power Company  
Columbus Southern Power Company  
Ohio Power Company  
Indiana Michigan Power Company  
Kentucky Power Company  
Kingsport Power Company  
Michigan Power Company

Carolina Power & Light Company

Nantahala Power and Light Company  
Duke Energy Corp.

Kentucky Utilities Company

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<sup>5</sup> See generally, Alabama Power Co. v. TVA, 948 F. Supp. at 1028-1029 (explaining difference between "sale" and "exchange" of power by TVA).

Cincinnati Gas & Electric Company

Aluminum Company of America through Tapoco, Inc.

Louisville Gas and Electric Company

East Kentucky Power Cooperative, Inc.

Electric Energy, Inc.

Central Illinois Public Service Company

Illinois Power Company

Union Electric Company<sup>6</sup>

Not only is TVA restricted to supplying "exchange" power to the foregoing entities, there are strict rules on what constitutes "exchange" power. For power to qualify as "exchange" power, the power must be physically delivered to the system of the authorized recipient for integration onto that system, and must be surplus to the needs of the area served by TVA. See id. at ¶¶ 1.07, 1.10, and 2.03. Moreover, TVA is obligated by Court Order to refrain from making any contract, or even offering to make a contract, to supply power except under these limited circumstances:

- ◆ It may only offer for sale Exchange Power to an Authorized Exchange Company. Id. at ¶ 2.01; and
- ◆ Other than for sales to its distributors and to retail customers inside the Fence, TVA shall not offer to sell any power to any power marketer or public utility or any other entity that is not an Authorized Exchange Power Company. Id. at ¶ 2.02.<sup>7</sup>

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<sup>6</sup> Ex. 5, Consent Judgement, Exhibit A, pp. 2-3.

<sup>7</sup> This restriction essentially forbids TVA from selling a TVA Hub Contract on the proposed market.

Judge U. W. Clemon of the United States District Court for the Northern District of Alabama has retained continuing jurisdiction over the interpretation, effectuation and implementation of the foregoing restrictions on TVA's power program operations. *Id.* at ¶ 3.10.<sup>8</sup>

As a practical matter, therefore, TVA may not lawfully enter into any agreement as a seller of a TVA Hub Contract. Further, because of the legal implications that attach to power sold by TVA, any party that purchases power from TVA will be forbidden to from reselling or delivering that power in satisfaction of a TVA Hub Contract. The only parties that might be in a position to sell TVA Hub Contracts lawfully will be parties other than TVA who do not use TVA as a source of power physically delivered thereunder.

TVA Watch has not had the benefit of time to review in detail the materials tendered by CBT in support of its application. As a result, TVA Watch is not able to comment specifically on the analysis contained therein. It is obvious, however, that CBT's application materials make no meaningful reference to the myriad legal restrictions on TVA's ability to offer or make contracts to supply power. CBT has

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<sup>8</sup> Any violation of Judge Clemon's Order would subject TVA to a civil contempt citation. *See, e.g., Shillitani v. U.S.*, 384 U.S. 364, 370 (1966); *Jove Engineering, Inc. v. I.R.S.*, 92 F.3d 1539, 1557 (11th Cir. 1996). Additionally, any person or entity acting in concert with TVA to violate Judge Clemon's Order would likewise be subject to a contempt citation. *See United States v. Board of Educ. of the City of Chicago*, 11 F.3d 668, 673 (7th Cir. 1993)(acknowledging that a nonparty to a consent decree may be liable for violating the decree when he or she "takes steps deliberately to thwart the enforcement of a judicial decree"). Nonparties also are held liable for violating decrees "should they aid or abet the named parties in a concerted attempt to subvert those prescriptions." *Rockwell Graphic System, Inc. v. Dev Industries, Inc.*, 91 F.3d 914, 919 (7th Cir. 1996).

failed to relate those restrictions to the elements required for a finding by the CFTC that the requirements of the Commodity Exchange Act are satisfied.<sup>9</sup>

**B. The Proposed TVA Hub Contract Market Is Prepared For Manipulation Because Physical Delivery is Controlled by An Unregulated, Unaccountable and Self-interested Market Participant.**

Because TVA itself may not be the source of power, directly or indirectly, that is physically delivered in connection with a TVA Hub Contract, all physical delivery will require transmission access to and from TVA's bulk power transmission grid. TVA's grid, therefore, appears to be an essential facility to the physical delivery of the commodity underlying the proposed contract market. However, unlike other "essential facilities," which are subject to independent regulation and antitrust laws, TVA operates its transmission system free of independent regulation, the antitrust laws or judicial accountability. As such, TVA would have untethered discretion to dictate and control the availability of the spot commodity and, thus, the ability to exploit the market.

TVA is not regulated as to how it operates its transmission system or power sales programs, it is not subject to antitrust laws, it is not subject to securities or fraud laws, and it is not subject to regulatory or judicial oversight of any sort with regard to

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<sup>9</sup> Among other shortcomings, CBT's application appears in several respects to fall short of the requirements of Guideline No. 1, 17 CFR Part 5, Appendix A. For example, CBT's description of the cash market is overly simplistic and does not reflect the various restrictions on TVA's power sales. Further, CBT has not, as appears required by Appendix A(a)(2)(i), explained how its proposed contract terms will provide for a "deliverable supply which will not be conducive to price manipulation or distribution," particularly in light of the unique legal status of TVA as the hub's host. Among other additional shortcomings, CBT's application appears also to ignore the required showings of Appendix A(a)(3)(ii)(B).

operation of its transmission system.<sup>10</sup> TVA is not a disinterested, dispassionate player in this market. Instead, it is an unregulated, interested economic actor and active market participant.

CBT's application fails to address TVA's near total lack of accountability with regard to its power system operations. Even worse, the CBT application suggests inaccurately that TVA's transmission service arrangements with various parties are "FERC approved."<sup>11</sup> TVA is self-interested and unregulated and CBT proposes no protections to check or mitigate the potential for abuse. As a result, TVA Watch submits that the proposed contract market designation should be rejected as failing to meet the requirements of the CFTC's Fast-Track application rules, incompatible with the public interest, and as establishing a market institution that appears to be inherently unpredictable and susceptible to manipulation.

**1. TVA Is Not Required to Provide "Open Access" and its Transmission Practices Are Not Subject to Independent Regulatory Authority**

TVA is not subject to regulation as a public utility by the Federal Energy Regulatory Commission ("FERC") under the Federal Power Act ("FPA") (16 U.S.C. § 824 *et seq.*). Specifically, the key jurisdictional term of "public utility," which triggers the full array of FERC regulatory jurisdiction over transmission services and wholesale

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<sup>10</sup> A slight exception applies to sales by TVA that violate the Fence restriction.

<sup>11</sup> See CBT Application, ¶ 1.3.7 (second paragraph). Contrary to CBT's suggestion in its application, the numerous service agreements TVA claims to have with power marketers and other entities for transmission service have not been reviewed or approved by the Federal Energy Regulatory Commission.

power transactions, excludes TVA.<sup>12</sup> Because it is not regulated as a public utility by FERC, TVA is not subject to the various FERC policies and regulations that prohibit the use and abuse of monopoly control over transmission facilities and other forms of market power.<sup>13</sup> Moreover, and perhaps most importantly for present purposes, TVA is not subject to FERC's Order Nos. 888, 888-A, 888-B and 888-C (collectively, "Order 888") that require public utilities to operate their transmission systems on an "open access" basis.<sup>14</sup> Order 888 and associated FERC policies and regulations apply to delivery mechanisms at the other electricity futures hubs that have previously been reviewed and approved by the CFTC.

Without FERC-mandated tariffs and oversight in place to prevent abuses before they occur, TVA could preempt delivery of any electricity traded on the proposed TVA Hub at its discretion without independent regulatory oversight.<sup>15</sup> An aggrieved

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<sup>12</sup> See 16 U.S.C. § 824(e) and (f); Southern Company Services, Inc., 60 FERC ¶ 61,273, 61,923 (1992).

<sup>13</sup> The rationale of FERC regulation through the years has been (i) to ensure that essential services are provided at just and reasonable rates and without unfair discrimination between customers or customer classes; and (ii) to replace competition with regulation where it is not possible for effective competition to exist (because of the natural monopoly characteristics of transmission service). As an adjunct to this regulatory approach, antitrust concepts have attained major significance. FERC uses antitrust principals to inform its policies for regulation of public utilities under the FPA. See generally Federal Power Commission v. Conway Corp., 426 U.S. 271 (1976); Otter Tail Power Co v. United States, 410 U.S. 366 (1973); Gulf States Utilities Co. v. Federal Power Commission, 411 U.S. 747 (1973).

<sup>14</sup>Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Service by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, FERC Stats. & Regs. ¶ 31,036, order on reh'g, Order No. 888-A, FERC Stats & Regs. ¶ 31,048, order on reh'g, Order No. 888-B, 81 FERC ¶ 61,248 (1997), order on reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998). Since it is not a "public utility," TVA is not required to file an open-access tariff under FERC's rules. See FERC Statutes and Regulations ¶ 31,036, at 31,858 (1996).

<sup>15</sup> Again, as detailed previously, TVA Watch is not making any allegation of current manipulative or fraudulent intent on the part of TVA. However, in establishing market institutions, the possibility of questionable conduct at some future time should be appreciated, and potential problems should be

parties' only recourse would be to file a complaint with FERC under Sections 211 and 212 of the Federal Power Act requesting transmission service in the future. This recourse, however, would always be "too little too late" in the context of a manipulation.

TVA Watch is familiar with TVA's claims to have established a set of Transmission Service Guidelines that are touted by it as substantially similar to the open-access tariffs required by FERC's Order 888. First, it is simply not true that TVA's Transmission Service Guidelines have been determined to satisfy FERC's requirements under Order 888.<sup>16</sup> Second, even if the "Guidelines" did substantially meet FERC's requirements, they may be changed by TVA at any time and for any reason (or no reason).<sup>17</sup> The ability to change transmission policies and access criteria without notice, without justification and without independent regulatory review is

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anticipated and precluded by the structure of the institution if at all possible.

<sup>16</sup> FERC has never ruled, nor has any court, that TVA's Transmission Service Guidelines meet the stringent requirements of Order 888. Indeed, it appears that the guidelines do not satisfy FERC's requirements. Under the guidelines, for example: (i) TVA does not have to take transmission service itself in supplying its wholesale distributors, nor in making off-system sales and purchases, under the same tariff it provides such services to others; (ii) TVA may have improperly functionalized certain production-related expense items to the transmission function, which would increase transmission service costs unreasonably; and (iii) TVA has been alleged to have failed to functionally separate its marketing business from its transmission services unit and to otherwise comply with FERC rules as to codes of conduct and inter and intracompany communications of confidential information. The question of whether TVA's Transmission Service Guidelines satisfy the requirements of Order 888, therefore, is unresolved. Indeed, pending before FERC is a complaint against TVA with regard to its transmission service practices. See Tennessee Power Company, FERC Docket No. TX97-5-000 (notice issued March 31, 1997). A copy of the Complaint in that proceeding is attached hereto as Exhibit 6. As of this writing, FERC has issued no substantive order or decision in this proceeding.

<sup>17</sup> TVA's Transmission Service Guidelines reserve to TVA an unequivocal right to modify the Guidelines at will. TVA Transmission Service Guidelines ¶ 8.3, Orig. Sheet Nos. 16-17.

unique to TVA in the industry and seems to present a situation conducive to market manipulation.

## 2. TVA's Practices With Regard to Transmission Access Are Not Subject to Antitrust Scrutiny

TVA's transmission system appears to be a "bottleneck" or essential facility for delivery of the underlying commodity in the proposed contract market. This is because TVA's transmission facilities are in the control of a single party (TVA) and there is no ability to practically or economically duplicate the facility. Under normal circumstances, as with transmission systems constituting the delivery hubs for previously sanctioned electricity futures markets (*i.e.*, CINergy, Entergy, COB), the owners of the essential transmission facilities are subject to antitrust prosecution<sup>18</sup> and/or treble damage lawsuits if they refuse to share the facilities with their competitors on fair terms.<sup>19</sup>

The Department of Justice ("DOJ") has observed that the transmission segments of the industry "will likely retain their natural monopoly characteristics for the

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<sup>18</sup> "As the electric industry becomes increasingly deregulated, vigorous antitrust enforcement is absolutely essential to ensure that consumers benefit from competition. This case should send a wake-up call to electric utilities. We will not tolerate private agreements designed to thwart the introduction of competition into this important industry." Ex. 7, Remarks of Joel I. Klein, Announcing Suit Against Rochester Gas & Electric Co. (DOJ Press Release, Issued June 24, 1997), "Justice Department Sues New York's Rochester Gas & Electric Co. Over AntiCompetitive Agreement with the University of Rochester."

<sup>19</sup> The "essential facilities" doctrine requires that those in possession of facilities that cannot be duplicated must share those facilities with their competitors on fair terms. *See, e.g., Aspen Highlands Skiing Corp. v. Aspen Skiing Co.*, 738 F.2d 1509, 1519 (10th Cir. 1984), *aff'd*, 472 U.S. 585 (1985); *United States v. Otter Tail Power Co.*, 331 F. Supp. 54, 61 (D. Minn. 1971), *aff'd*, 410 U.S. 366 (1973).

foreseeable future."<sup>20</sup> As such, according to DOJ, aggressive enforcement of the antitrust laws and active FERC regulation of open access transmission is essential for a properly functioning competitive electricity industry.

Courts have recognized, however, that TVA is immune from liability under the antitrust laws. This immunity has been based on TVA's status as an instrumentality of the federal government.<sup>21</sup> Congressional silence also may have influenced decisions finding TVA immune from antitrust liability.<sup>22</sup> Therefore, TVA could restrict access to its essential facilities without regard to the antitrust laws and without a legitimate business justification.<sup>23</sup> This situation could lead to price distortion and is hostile to the public interest because it prepares the proposed TVA Hub Contract market for exploitation.

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<sup>20</sup> Ex 1, pp. 3-6. Department of Justice, Statement of A. Douglas Melamed, Principal Deputy Assistant Attorney General, Antitrust Division, U.S. Dept. of Justice, "Legislative and Oversight Hearing on Antitrust Aspects of Electricity Deregulation," Testimony before the U.S. House of Representatives Committee on the Judiciary (June 4, 1997).

<sup>21</sup> City of Loudon, Tenn. v. TVA, 585 F. Supp. 83 (E.D. Tenn. 1984), aff'd, 754 F.2d 372 (6th Cir. 1984); Webster County Coal Corp. v. TVA, 476 F. Supp. 529 (W.D. Ky. 1979).

<sup>22</sup> See City of Loudon, 585 F. Supp. at 87.

<sup>23</sup> It should be noted, however, that the Supreme Court has not ruled on the issue of TVA's antitrust immunity. Also, the changing nature of TVA's activities from "governmental" to primarily "commercial" may draw into question the bases of earlier decisions on this issue.

### 3. Manipulative Transmission Access and Trading Patterns by TVA are Potentially Exempt From Any Form of Independent Regulatory Oversight or Judicial Accountability

TVA probably is not subject to any form of legal challenge or judicial (or regulatory) accountability when it is performing a "discretionary" function. TVA has long taken the position that its power program – fuel procurement, generation, transmission and sale of power – is "discretionary" and thus not subject to judicial challenge or accountability.<sup>24</sup> It is, therefore, highly questionable whether TVA is subject to the substantive provisions of the Commodity Exchange Act which prohibits manipulation.<sup>25</sup> (TVA surely would take the position that it is immune). For the same reasons, it is equally unclear whether TVA is subject to various other consumer protection statutes, including the securities laws and RICO.<sup>26</sup> If TVA is either immune from private or CFTC enforcement of the provisions of the Commodity Exchange Act, or is otherwise immune from prosecution for anticompetitive practices or other abuses, the proposed TVA Hub Contract seems suspect and vulnerable to

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<sup>24</sup> See TVA v. Welch, 327 U.S. 546, 553 (1945) (TVA given substantial discretion under TVA Act over its contracts and other operational decisions and practices); Hoke Co., Inc. v. TVA, 854 F.2d 820 (6th Cir. 1988) (coal procurement discretionary function); Queen v. TVA, 689 F.2d 80 (6th Cir. 1982) (giving TVA wide discretion to take actions relating to promotion of wider and better use of electricity to benefit regional customers), cert. denied, 460 U.S. 1082 (1983); 4-County Elec. Power Ass'n v. TVA, 930 F. Supp. 1132, 1137-38 (S.D. Miss. 1996) (wholesale power transactions discretionary function); Morris v. TVA, 345 F. Supp. 321, 323 (N.D. Ala. 1972) (hydroelectric power plant operations discretionary function); Pacific Nat'l Fire Ins. Co. v. TVA, 89 F. Supp. 978, 979 (W.D. Va. 1950) (hydroelectric power plant construction discretionary function).

<sup>25</sup> E.g., 7 U.S.C. §§ 9 & 13.

<sup>26</sup> See generally Peoples National Bank of Huntsville, Alabama v. Meredith, 812 F.2d 682, 684 (11th Cir. 1987) ("nonliability" doctrine applies to immunize TVA from claims of misrepresentation in connection with discretionary function).

manipulation by TVA and/or any party in conspiracy with TVA.<sup>27</sup> This situation is rather problematic and raises novel and complex issues deserving careful study and analysis.<sup>28</sup>

## **II. The Terms and Conditions of the TVA Hub Contract Contemplate Unlawful Transactions that Thwart the Public Interest**

The financial and market integrity of the proposed TVA Hub Contract is highly questionable. A second and independent reason for rejecting, or at least forestalling, CBT's application is that the proposed contract contemplates and envisions unlawful transactions. The terms and conditions of the proposed TVA Hub Contract do not reflect normal market flow and commercial trading practices. Any transaction on the proposed contract market that involves TVA as a seller of power or as the provider of the physical commodity that is taken to delivery by any party, whether generated by TVA or whether purchased and resold by TVA, likely would be unlawful, and (possibly) the subject of litigation.

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<sup>27</sup> Indeed, if TVA were at some future time to conduct a market manipulation and take the position that the manipulation was required or justified as a legitimate exercise of discretion under the TVA Act, it is questionable whether CFTC or any other party could bring an enforcement proceeding.

<sup>28</sup> Legal scholars have recently begun writing about some of the same legal problems created by the presence of government corporations in the economy as are discussed in these comments. See generally, A. Michael Froomkin, "Reinventing the Government Corporation," 1995 U. of Illinois L. Rev. 543, 632 (1995). ("The obscurity in which Federal government corporations operate allows them to have the best of both worlds and to avoid both the accountability mechanisms designed to reign in government and the laws and rules that regulate private firms.").

The proposed TVA Hub Contract (as well as CBT's application) fails to properly reflect (or describe) lawful trading practices and neglects to address the legal import of the various restrictions on TVA's power operations. There are several provisions of the TVA Hub Contract that appear to make an effort to limit the class of parties who may purchase and sell TVA Hub Contracts. These provisions, though, fall short of the mark.

**A. Section 5409.01(B)(2)**

Section 5409.01(B)(2) requires participants holding non-proprietary long (short) positions to make "written certification" as follows:

(a) if short, the participant has generation capacity or a purchase agreement for a quantity and quality of electric energy sufficient to meet such participant(s) obligations to make delivery as prescribed by these Rules, and is not restricted by law to which parties it may sell electric energy. . .

This provision appears designed to prevent only TVA from taking a short position to delivery. However, the laws restricting sale and resale of TVA-generated or marketed power take it an additional step. TVA is prohibited under Section 15d(a) of the TVA Act from making any contract contemplating physical delivery for use outside of the Fence, whether or not that contract consummates in a physical trade. 16 U.S.C. § 831n-4(a).<sup>29</sup> Moreover, under the terms of Judge Clemon's Consent Judgment, TVA appears prohibited from even offering a contract for exchange power that will not go

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<sup>29</sup> Under the statute, it is the "making" of an unlawful contract that is prohibited. The statute does not require physical delivery as a condition precedent to violation.

to physical delivery.<sup>30</sup> Finally, to the extent that any party purchases power from TVA, it is unlawful for that party to resell the TVA power to any third party. This is true regardless of whether the TVA Act applies directly to that party to restrict the class of consumers to whom it can supply power. Therefore, to the extent Section 5408.01(2) attempts to hard-wire unlawful transactions out of the process, it fails.

**B. Section 5409.01(E)**

Section 5409.01(E) attempts to preclude TVA or any party attempting to resell or redeliver TVA power from taking a short position to physical delivery:

Any party that is restricted by law to which parties it may sell electric energy, may not give notice for delivery, or participate in an exchange for physical transaction involving the sale of electric energy to parties to whom it is restricted to sell to, and must liquidate all short positions prior to the expiration of trading. Notwithstanding any provision of these Rules, the clearing member of a party subject to such a restriction shall liquidate all open short positions of that party prior to the close of trading on the last day of trading.

This provision suffers from the same basic flaw as Section 5409.01(B)(2). It is not just unlawful for TVA to take a short position in a TVA Hub Contract to physical delivery, it is unlawful for TVA to even "make" a contract for the sale of power for use outside the Fence or to exchange power with any entity for any purpose other than for physical delivery. Moreover, any entity that has plans to use TVA power to satisfy any delivery obligation is prohibited by law from doing so. Therefore, Section

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<sup>30</sup> Ex. 5, Consent Judgment, Exhibit A, ¶ 2.02.

5409.01(B)(2), does not extend far. Rather, it keeps the door open for unlawful transactions and even encourages them.

C. Section 5443.06(B)(1)

Section 5443.06(B)(1), concerning time of delivery, payment and delivery procedures, makes another unsuccessful attempt to conform the TVA Hub Contract to the requirements of the TVA Act and Court Orders. Like the others, Section 5443.06(B)(1) falls short of the mark. The provision reads (with emphasis provided):

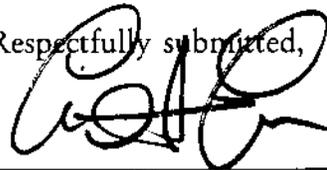
The Short shall notify the Long on a daily basis of the TVA Hub interface point in which the delivery for that day shall occur. The Long's confirmed transmission request recorded on TVA's Open Access Same Time Information System (OASIS) shall be the determination of transmission service reliability. The Long shall notify the Short of a confirmed transmission request on a timely basis. If the interface point designated by the Short is not available for the Long, then the Short shall notify the Long of (1) an alternative interface point for which transmission service is available to the Long, or (2) generation inside of the TVA Control Area.

The underlined clause sets up both the Short and the Long to participate in an unlawful transaction. No Short (not just TVA) has the legal right to violate the TVA Act. The subject matter of any contract to which the Short is a party wherein it will use TVA power to satisfy its delivery obligation to a Long appears unlawful. Likewise, if the Long is not authorized to purchase power from TVA directly (for its own end use and not for resale to a third party), it cannot take delivery of TVA indirectly through the Short's resale and delivery of TVA power.

## CONCLUSION

The proposed TVA Hub Contract presents a set of truly novel and complex issues in commodities regulation. What is proposed is a commodity futures market where the only delivery hub is controlled exclusively by a market participant that is not regulated, not subject to antitrust or related consumer-protection laws, and not subject to judicial challenges to its operational decisions or practices. This situation is troublesome because the entity with exclusive control over delivery is a self-interested, economic participant in the market. CBT's application is disappointing because it fails to bring this lack of oversight to the CFTC's attention. CBT's application appears to treat the proposed TVA Hub Contract market just like any other electricity hub market (*i.e.*, just like the proposed ComEd Hub contract market). However, TVA is unlike ComEd and unlike any other utility. The failure of the application to address the market manipulation prospects created by the unique and novel position of TVA in the proposed market requires its rejection.

Respectfully submitted,



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Lyle D. Larson  
Attorney for TVA Watch

### OF COUNSEL:

Lyle D. Larson  
BALCH & BINGHAM LLP  
1710 Sixth Avenue North  
Post Office Box 306  
Birmingham, Alabama 35201  
(205) 251-8100

Patrick J. McCormick, III  
BALCH & BINGHAM LLP  
1275 Pennsylvania Avenue N.W.  
Tenth Floor  
Washington, D.C. 20004  
(202) 347-6001

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the Comments of TVA  
Watch upon the Chicago Board of Trade by placing same in the United States Mail,  
First Class postage prepaid.

Done this the 17th day of April, 1998.

A handwritten signature in black ink, appearing to read 'Lyle D. Larson', written over a horizontal line.

Lyle D. Larson