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April 17, 1998

VIA FACSIMILE, FEDERAL EXPRESS AND ELECTRONIC MAIL

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

COMMENTS
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COMMODITY FUTURES
TRADING COMMISSION
RECORDS FOR
FILE RECORD

Re: Chicago Board of Trade Applications for Designation as a Contract
Market in TVA Hub Electricity Futures and Options and ComEd
Electricity Futures and Options 63 FR 16250 (April 2, 1998)

Dear Ms. Webb:

The New York Mercantile Exchange ("NYMEX" or the "Exchange") appreciates the opportunity to comment, on its own behalf and on behalf of its wholly-owned subsidiary, Commodity Exchange, Inc., to the Commodity Futures Trading Commission ("CFTC" or the "Commission") on the Chicago Board of Trade's ("CBOT") applications for designation as a contract market in Tennessee Valley Authority ("TVA") electric power system Hub Electricity Futures and Options and in Commonwealth Edison ("ComEd") system Electricity Futures and Options contracts.

NYMEX is a not-for-profit corporation organized under the laws of the state of New York. It has been designated by the Commission as a contract market for the trading of numerous commodity futures and commodity futures option contracts. NYMEX is the largest exchange in the world for the trading of futures and option contracts based on physical commodities. Public investors in our markets include institutional and commercial producers, processors, marketers and users of energy and metals products.

Introduction

In general, NYMEX, which has pioneered the introduction of electricity futures and options contracts, is excited about the potential for new electricity contract introductions to increase overall liquidity in NYMEX's electricity complex through spread trading and arbitrage. However, NYMEX has tempered its excitement with a sobering review of CBOT's proposed contracts and believes there are several material deficiencies in each of their proposed contracts that need to be remedied before they are introduced. One

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The New York Mercantile Exchange is composed of two divisions. The NYMEX Division offers trading in crude oil, heating oil, unleaded gasoline, natural gas, electricity, propane, platinum, and palladium. The COMEX Division offers trading in gold, silver, copper, and the Eurotop 100 index.

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of these issues is that fundamental delivery obligations under both of these contracts have not been adequately defined, leaving gaping ambiguity in what would constitute delivery. A second issue is that provisions in each contract place such heavy restrictions on who is eligible for delivery that convergence between futures prices and cash prices would not only be seriously threatened, but may only be possible by happenstance. A third issue is a mismatch between the price for trading these contracts and the implied price related to delivery.

NYMEX believes that each of these issues can be remedied. We explain each issue in greater detail below, and, in the constructive spirit of this comment letter, suggest actions that could remedy the problems identified with the application.

Definition of Delivery Obligation

Rules 5309.01 and 5409.01 Last Day of Trading

Rules 5336.01 and 5436.01 Standards

Rules 5343.06 and 5443.06 Time of Delivery, Payment, Delivery Procedures

The above contract rules collectively convey an ambiguous and incomplete standard delivery obligation. Subsection (B) (1) of the "Last Day of Trading" rules require the short and long standard delivery participants to provide copies of transmission or enabling agreements **into**/from the ComEd (or TVA) Control Area to its clearing members. If the transmission is not firm, the short and long are required to provide appropriate alternative arrangements **to**/from the ComEd (or TVA) Control Area. Since "into" and "to" have different definitions in the electricity cash market, the seller's and buyer's obligations are unclear.

No contract rule establishes clear responsibility for transmission service inside the host utility (ComEd, TVA). Altogether, there is, at best, an incomplete assignment of responsibilities if there is any assignment at all. The "Standards" rule lists some assignments, but they do not add up to those necessary to complete delivery. The "Time of Delivery..." rule refers to confirmation on OASIS, but that does not constitute a material assignment of obligation for reliable delivery. In short, the rules establish an affirmative obligation for delivery, but this obligation regrettably has not been appropriately defined, and the provisions relating to assignment of delivery responsibilities are materially incomplete.

The consequence of these ambiguous and incomplete assignments is that delivery is neither completely nor adequately defined. An action plan that would remedy this deficiency would include identifying complete delivery obligations and assigning them accordingly within the contract and also including a thoughtful explanation, which demonstrates a command of both the delivery process and of the meaning of terms and

expressions commonly relied upon in electricity cash market commerce.

Restrictions on Delivery

Rule 5309.01 and 5409.01 Last Day of Trading

Subsection (B) (2) (a) of these rules requires the short to certify that it is not restricted by law to which parties it may sell electric energy. This restriction raises a number of issues of concern and these are identified in turn immediately below.

The restriction is sweeping in scope. Indeed, this restriction is so sweeping that it probably eliminates virtually everyone from going to delivery as a seller. Every participant in the U.S. electricity market has some legal restriction on sales- if nothing else, then on retail sales to someone, somewhere. Currently, there are a number of categories of regulatory (or other legal) restrictions that attach to sellers of electricity in the U.S. Without being exhaustive, these include restrictions on affiliate sales, restrictions on sales in specified service areas or reliability regions, restrictions on sales to specific customers in certain areas (as mentioned parenthetically above), restrictions on sales to retail customers, and other restrictions. Clearly, eliminating everyone from being an eligible selling party to a delivery constitutes a serious problem. NYMEX presumes that this was not the intent of the CBOT. Nonetheless, as currently provided for, that is the result.

Should the CBOT reduce the scope of this restriction, its proposal may very well still be problematic. Admittedly, permitting some sellers to be party to delivery is better than permitting none, but any such restrictions could have serious consequences for convergence between futures and cash prices. For instance, would the pool of eligible sellers be too small to effectuate convergence, or would its make-up have insufficient overlap with the make-up of the pool of typical cash market participants?

NYMEX has another concern regarding these provisions beyond its concerns with delivery eligibility and convergence. The electricity market is subject to substantial regulation at both the federal and state levels (sometimes at the local level as well). The CBOT's restriction provisions are a clever adaptation in response to that regulation, and NYMEX applauds the innovation. However, reliance on such an innovation, in the face of the enormous amount of applicable regulation, requires providing a detailed explanation of both the regulations that the provisions intend to address and the interaction of the provisions' effects with said regulations. This is more than simple courtesy to sibling regulators (or other governing bodies) to the Commission; it is also an assurance that the designated contract market operator is fluent in all relevant regulations that pertain to its products. Given that the electricity industry is going through the very sensitive process of dramatically reducing regulation (at the federal and state levels), this fluency is even more critical.

The consequence of the provisions, as currently written, is that delivery could not take

place. Even if the contract is modified to permit delivery, there could be serious implications regarding convergence between futures and cash prices. An action plan to remedy these issues would explicitly identify what restrictions apply on delivery in the respective contracts and would provide a thorough explanation of the regulatory (and other legal) restrictions the provisions intend to address, how they address it, and what the interaction would be between the effects of the contracts' provisions and the relevant regulatory (and other legal) restrictions. Such explanation should properly contain discussion of similar types of regulatory (and other legal) restrictions that the provisions do not intend to address, defining the boundary between these restrictions and the contracts' provisions. NYMEX appreciates the alacrity with which the CBOT is proceeding in bringing its contracts to market, but that alacrity is very likely responsible for the unintended consequences of the provisions the CBOT has filed with the Commission and the absence of any explanation as to what it really intended in its submission. The next round not only requires a sounder set of rules, but an informative explanation of their intent and justification.

Mismatch Between the Price for Trading and the Implied Price for Delivery

Rules 5304.01 and 5404.01 Unit of Trading

Rules 5343.06 and 5443.06 Time of Delivery, Payment, Delivery Procedures

The "Unit of Trading" rules define the unit of trading of the ComEd and TVA futures contracts as 1,680 MWh of firm electric energy. Rules 5343.06 (B) and 5443.06 (B) state that on every on-peak day of the delivery month, delivery shall be 5 MW during all on-peak hours (16 hours a day). During the next 5 years, the total number of on-peak days during calendar months will range from 19 to 23. Consequently, delivery volumes would range from 1,520 MWh to 1,840 MWh. During some months, the delivery volume would be 1,680 MWh, but most of the time it would be something different. It appears that during those months where delivery volumes would differ from 1,680 Mwh, the price quoted from trading these contracts (dollars and cents per Mwh) would not reflect the price for electricity delivered (for standard delivery) under the contract (calculated by dividing the price for a traded contract by the delivery volume). It is not at all clear what the purpose or economic justification is for having the trading price and imputed delivery price differ most of the time. NYMEX believes that this is problematic and, possibly, unintended.

The consequence of this mismatch between price for trading the contracts versus price for delivering the contracts is, at a minimum, the introduction of substantial unnecessary confusion into the trading of the contracts; this confusion could conceivably favor some classes of market participant over others. In addition, this confusion would very likely complicate the process of convergence between futures and cash prices; clearly

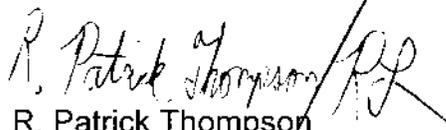
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it is the imputed delivery price that should converge rather than the quoted traded price. Based on the justification and explanation provided in the CBOT's accompanying submission, NYMEX suspects that the CBOT has not submitted these provisions with that intention. A plan of action to remedy this problem would be to more carefully construct provisions that better reflect what appears to be intended (based on the submitted explanation) and to increase the clarity of the explanation as to all intended related obligations that apply to market participants.

* * * *

NYMEX thanks the Commission for the opportunity to submit comments concerning the proposed applications and would be pleased to furnish additional information in this regard. If you have any questions, please do not hesitate to contact the undersigned.

Respectfully submitted,


R. Patrick Thompson
President

cc: Chairperson Brooksley Born
Commissioner Barbara P. Holum
Commissioner David D. Spears
Commissioner John E. Tull, Jr.