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COMMODITY FUTURES TRADING COMMISSION RECEIVED FOR PUBLIC RECORD

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May 15, 1998

VIA FACSIMILE & REGULAR MAIL

Ms. Jean A. Webb
Secretary of the Commission
Office of the Secretariat
Commodity Futures Trading Commission
1155 21st Street, NW, Room 9106
Washington, DC 20581

Re: Chicago Board of Trade Application for Designation as a Contract Market in TVA Hub Electricity Futures and Options, 63 Fed. Reg. 16250 (April 2, 1998)

Dear Ms. Webb:

Morgan Stanley Capital Group Inc. ("MSCG") appreciates the opportunity to comment on the application of the Chicago Board of Trade ("CBOT") for designation as a contract market in Tennessee Valley Authority ("TVA") Hub electricity futures and options. We understand that on May 7, 1998, the Commodity Futures Trading Commission ("CFTC") extended its fast track review of the CBOT's application for 30 days until June 8, 1998.

MSCG, a wholly owned subsidiary of Morgan Stanley Dean Witter & Co., is licensed as a power marketer under the Federal Power Act. It is a leading dealer and market maker in power as well as other commodities. MSCG strongly supports the CBOT's application for designation as a contract market in TVA Hub electricity futures and options (hereinafter "TVA Hub futures contract").

I. THE CBOT'S PROPOSED TVA HUB FUTURES CONTRACT WILL INCREASE LIQUIDITY AND IMPROVE PRICE DISCOVERY IN THE CASH MARKET FOR ELECTRICITY CENTERED AROUND THE TVA HUB.

MSCG believes that the CBOT's proposed TVA Hub futures contract will increase liquidity and improve price discovery in the existing cash market centered around the TVA Hub. Our review of the CBOT's proposed terms for the TVA Hub futures contract, the CBOT's Cash Market Study and our own experience indicate that the proposed contract closely parallels commercial activity in the cash market for electricity.

As demonstrated in the CBOT's Cash Market Study, the TVA Hub is the most active cash market in the Southeastern Electric Reliability Counsel ("SERC"). *See* Application for Designation as a Contract Market, TVA Hub Electricity Futures and Options on Futures Contracts ("CBOT Application"), Chapter One: Cash Market Study ("Cash Market Study") at 5. In addition to being a large seller of wholesale power, TVA provides transmission facilities to adjacent utilities and power marketers who deliver power through the TVA Hub. *See* CBOT Application, Attachment 14. In order to integrate with the cash market around the TVA Hub, the CBOT has designated as delivery points for the TVA Hub futures contract the interconnection points between the TVA control area and adjacent utilities. *See* CBOT Application, Chapter 2: TVA Hub Electricity Futures Contract Terms ("Proposed Rules") 5436.01 and 5443.06(B).

MSCG is among the many power marketers that are active participants in the cash market centered around the TVA Hub. MSCG has a Transmission Service Agreement with TVA and delivers power to many of its clients through the TVA Hub. The CBOT Application provides the CFTC with additional evidence of the significant activities of power marketers in the TVA Hub market. *See* CBOT Application, Attachments 17, 18 and19.

MSCG believes that the proposed TVA Hub futures contract will provide many benefits to cash market participants in the TVA Hub. The exchange clearing house, by acting as a principal to, and guaranteeing the performance of, each electricity futures and option contract, will provide credit protection not currently available for cash market transactions. In addition, like other futures contracts, the proposed contract will provide competitively determined, publicly available reference prices for cash market transactions.

Furthermore, in our experience and as demonstrated by the CBOT Cash Market Study, cash market prices in the TVA Hub area are characterized by high volatility. *See* Cash Market Study at 11 and Attachments 21 and 22. The proposed futures contract will provide power marketers and other cash market participants with the opportunity to hedge against the risk of adverse price movements in the cash market. Moreover, the proposed futures contract will increase liquidity in the market generally by enabling parties that do not have an interest in or the facilities to make or take delivery to hedge against or assume the risk of changes in the price of electricity.

II. THE CBOT'S PROPOSED FUTURES CONTRACT DOES NOT CONFLICT WITH STATUTORY RESTRICTIONS ON THE SALE OF POWER BY TVA.

The proposed terms of the TVA Hub futures contract are entirely consistent with the restrictions in the Tennessee Valley Authority Act of 1933, as amended (the "TVA Act"). Section 15d of the TVA Act, "Bonds for financing power program," grants TVA the authority to self-finance through the issuance of bonds. 16 U.S.C. 831n-4(a). In exchange for granting TVA the authority to issue bonds, Congress restricted TVA's ability to sell power outside of a specific geographic area in the Tennessee Valley region. Section 15d(a) of the TVA Act provides:

> [TVA] shall make no contracts for the sale or delivery of power which would have the effect of making [TVA] or its distributors, directly or indirectly, a source of power outside the area for which [TVA] or its distributors were the primary source of power supply on July 1, 1957.

Id. (Emphasis added). The boundaries of the restricted area have come to be known as the TVA "Fence." Notwithstanding this restriction, Congress authorized TVA to engage in "exchange power arrangements" with power generating organizations ("Authorized Exchange Power Companies") with which TVA had such arrangements in place as of July 1, 1957. *Id.*

The assertion of TVA Watch that the proposed TVA Hub futures contract will enable TVA to circumvent the Fence is incorrect. The CBOT's Proposed Rules expressly prohibit any party that is restricted by law as to which parties it may sell electric energy from making delivery under a TVA Hub futures contract. Proposed Rules 5409.01(B) and (E). This prohibition, which plainly applies to TVA, requires that TVA offset any short futures contract position prior to the expiration of trading. *Id.* Thus, the proposed TVA Hub futures contract will not make TVA a "source of power" either inside or outside the Fence.

TVA Watch argues incorrectly that Section 15d(a) of the TVA Act prohibits TVA "from making any contract contemplating physical delivery for use outside of the Fence, whether or not that contract consummates in a physical trade." Comments of TVA Watch, April 17, 1998 at 19 (emphasis in original). TVA Watch's contention ignores the plain language of Section 15d(a). Section 15d(a) prohibits only those "contracts for the sale or delivery of power which would have the effect of making [TVA] or its distributors" a source of power outside the Fence. 16 U.S.C. 831n-4(a). Because TVA will be prohibited by the CBOT's Proposed Rules from settling a short futures position by delivery, the TVA Hub futures contract will not, under any circumstances, "have the effect of making TVA or its distributors" a source of power outside the Fence.[1]

Likewise, TVA Watch's contention that the settlement in *Alabama Power v. TVA* prohibits TVA from entering into a short futures contract that will be settled by offset rather than delivery is incorrect. The restrictions to which TVA agreed in the *Alabama Power* settlement are no broader than those in Section 15d(a) of the TVA Act, upon which the settlement was based. Thus, the settlement has no bearing on any contract to which TVA is a party that will not "have the effect" of making TVA a source of power outside the Fence. Entering into a futures contract that requires settlement by offset rather than delivery cannot reasonably be construed to have the effect of making TVA a source of power at any location.

III. THE PROPOSED TVA HUB FUTURES CONTRACT IS NOT INHERENTLY SUSCEPTIBLE TO MANIPULATION.

There is no basis for TVA Watch's contention that the TVA Hub futures contract will enable TVA to manipulate transmission or the price of electricity. As TVA points out in its comment letter, as a public corporate agency TVA is entitled to a presumption that it will conduct itself in a lawful manner. *See* TVA Comment Letter, April 27, 1998, at 4; *cf. FCC v. Schreiber,* 381 U.S. 279, 296 (1965) (courts presume that administrative agencies will act within the law). Moreover, TVA has no incentive to manipulate or deny access to its transmission facilities. The Federal Energy Regulation Commission requires TVA to provide reciprocal transmission access to adjacent utilities if it wants access to their transmission facilities. *See TVA Comment Letter, April 27, 1998*, at 5-6. Furthermore, TVA's transmission service guidelines contain dispute resolution procedures that are available to any party who has a dispute with TVA concerning transmission access. CBOT Application, Attachment 11, § 11 at 18.

Historical experience in the cash market centered around the TVA Hub also demonstrates that TVA Watch's allegations regarding the potential for price manipulation are unfounded. Although TVA Watch's contentions apply equally to the cash market, TVA Watch cites no evidence, and we are aware of none, that TVA has ever attempted to manipulate the cash market price of electricity. Based upon our

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[1] TVA's transmission service agreements similarly provide that nothing in the agreements shall be construed "to require TVA to take any action which would make TVA, directly or indirectly, a source of

experience with TVA, and the authority of the CFTC and the CBOT to address attempts by market users to manipulate the price of an exchange-traded commodity, MSCG is not concerned that the proposed TVA Hub futures contract is more susceptible to manipulation than any other currently approved futures contract.

For the foregoing reasons, we respectfully request that the CFTC approve CBOT's application for designation as a contract market in TVA Hub electricity futures and options.

Sincerely yours,

Simon T.W. Greenshields
Vice President
Morgan Stanley Capital Group Inc.

cc: Steven Manaster, Director
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power supply" to transmission customers. *See, e.g.*, CBOT Application, Attachment A to Attachment 11, Service Agreements for Firm Point-To-Point Transmission Service, at 67.

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