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UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

2033 K Street, N.W.
Washington, D.C. 20581



May 18, 1994

Mr. R. Patrick Thompson
President
New York Mercantile Exchange
Four World Trade Center
New York, New York 10048

Re: Channel 4 System

Dear Mr. Thompson:

By letters dated March 3, 1994, as modified on April 6, 1994, and supplemented on May 5, 1994, the New York Mercantile Exchange ("NYMEX" or "Exchange") submitted information regarding the proposed "Channel 4" automated system for the purchase and sale of natural gas for the review of the Off-Exchange Task Force of the Commodity Futures Trading Commission ("Commission"). Based upon the representations made in the letter and oral presentations by the NYMEX staff, we understand the facts to be as follows.

The proposed Channel 4 system is the result of a cooperative effort between NYMEX and EnerSoft, a subsidiary of New York State Electric and Gas Corporation, which has significant experience in formatting, displaying, and communicating information to cash market participants about the production, transportation, and supply of energy. NYMEX and EnerSoft have developed the Channel 4 system in response to Federal Energy Regulatory Commission Order No. 636 under which natural gas pipelines will be required to make transportation and capacity information available through the use of electronic bulletin boards to cash market participants.

The Channel 4 system will provide three basic services to the natural gas physicals industry: information services, a communications network, and purchase and sale facilities. To address information services needs, the system will operate as a bulletin board enabling participants to access natural gas market information such as price, transportation charges, and storage capacity. The communications services will link participants directly with participating pipelines, storage facility operators, and other market participants. The system will also provide three means for effecting purchases and sales: Electronic Auction, Trader Match, and Market Match. Each of these will allow parties to enter into binding agreements to buy and sell natural gas. The first two will also permit contracting for transportation services and storage capacity. The first two contemplate bilateral negotiations between known or knowable

counterparties; the third will match counterparties allocated by the system anonymously.

As described in more detail below, all purchase and sales matches using the Channel 4 system will be

- (1) principal-to-principal transactions,
- (2) between qualified commercial parties,
- (3) establishing binding physical delivery obligations,
- (4) for delivery within customary cash market time frames,
- (5) not subject to reversal bilaterally or multilaterally through the system,
- (6) not cleared or guaranteed by NYMEX, any affiliate of NYMEX, or any other entity, and
- (7) not margined or marked-to-market by NYMEX, any affiliate of NYMEX, or any other entity.

Any purchases or sales of natural gas, pipeline capacity, or transportation service on the Channel 4 system will be principal-to-principal transactions between commercial parties, who must qualify to obtain access to the system, and will establish an obligation for physical delivery. Delivery will be permitted no more than twelve months forward. The Exchange represents that this is consistent with existing cash market practices.

Channel 4 transactions will only be able to be established in the system. There will be no mechanism for offset of transactions in the system. Thus all positions established through the system will be gross, not net.

The Exchange has represented that it is possible that the parties to a transaction conducted through the Channel 4 system might subsequently enter into a separate agreement outside the Channel 4 system to modify their delivery obligations. Specifically, the Exchange has represented that:

[I]t is our understanding that the use of a payment-of-differences to offset positions may happen in the natural gas markets, but it is not used in most cases. In the course of entering into such contracts, situations may arise where counterparties have multiple offsetting positions as a result of the effectuation of multiple, independent commercial transactions. In such circumstances, rather than effecting multiple redundant

deliveries, the parties may terminate their contracts and instead negotiate payment-of-differences. Such a payment may occur subject to individualized case-by-case negotiations. Similarly, in the event that purchasers and sellers may find themselves purchasing and selling gas more than once in a delivery chain, it is possible that participants attempt to negotiate separate cancellation agreements among themselves to extinguish redundant delivery obligations. Such cancellation agreements would be individually negotiated which could only be effected through agreement by all parties. It is our understanding that while such a practice is possible, its use does not happen in most cases in the cash markets for natural gas.

In sum, the Exchange has represented that agreements to modify delivery obligations are not the norm in the current cash market. Insofar as Channel 4 participants engage in such activity we are making no comment hereunder.

Participation on the system will be limited to entities which can demonstrate that they are active in the commercial natural gas industry. Participants will have a continuing obligation to show that they have either sold, purchased, produced, consumed, distributed, shipped, transported, stored, or processed at least 5 billion British Thermal Units of gas in each month over the last twelve-month period. (The system will have the right to waive this requirement in the event that the entity has been in existence for fewer than twelve months or that there have been other circumstances that affect this figure.) Thus, you represent that the system will not be available to individual speculators, commodity pools, passive collective investment vehicles or other non-commercial entities.

Participants also will be subject to certain financial requirements. Those who wish to participate in the basic information, communication, and trading services (except the Market Match functionality) will be required to demonstrate that they have maintained working capital equal to at least \$250,000 over the previous twelve months and/or net worth of at least \$1,000,000. Participants in the Market Match functionality will be required to demonstrate that they have maintained working capital equal to at least \$4,000,000 over the previous twelve months and/or net worth of at least \$10,000,000.

In addition, to these capital requirements, participants in Channel 4 will be required to make deposits to be applied toward penalties for failure to perform and/or arbitration awards. Market Match participants will be required to maintain a deposit

equal to at least \$500,000, payable in the form of cash, U.S. Government obligations of a duration of less than ten years, or a letter of credit payable to Channel 4. The first \$200,000 of such amount, will be cash or U.S. Government obligations. All other participants will be required to maintain with Channel 4 a deposit equal to at least \$250,000, payable in the form of cash, U.S. Government obligations of a duration of less than ten years, or a letter of credit. The first \$100,000 of such amount will be cash or U.S. Government obligations.

Participants will not be members of the Channel 4 system. They will have no equity interest in or control over this system. The operation of the Channel 4 system will be separate and distinct from the operation of NYMEX as a designated contract market. NYMEX members will have no special rights to participate on the Channel 4 system by virtue of being members of the Exchange. NYMEX members who participate will be subject to the same criteria as all other participants. Similarly, the Channel 4 system will have no connection to the NYMEX Access system (the Exchange's after hours automated trade execution system). All funds and all records relating to Channel 4 will be kept separately from funds and records relating to NYMEX trading. The Exchange has stated that the operation of Channel 4 should not present any unique intermarket trading issues not currently presented by existing cash markets. Nonetheless, NYMEX understands that the Commission has responsibilities relative to manipulation of cash markets and represents that it will have access to, and will use, as appropriate, in its market surveillance function, information relating to Channel 4 purchases and sales.

Purchases and sales on Channel 4 will not be cleared by NYMEX or any other entity. Nor will there be any margining or settlement procedures applicable to such trades. Payment obligations will be determined in accordance with current cash market conventions.

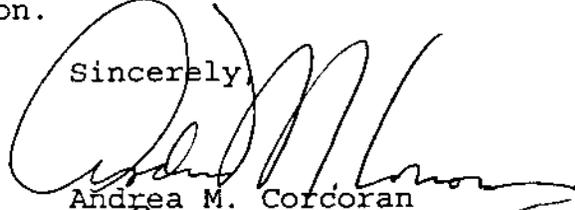
The Channel 4 system will establish procedures to assess penalties for failure to perform and to resolve disputes between parties to a trade. These procedures will be completely separate and distinct from disciplinary and arbitration proceedings conducted by NYMEX in its role as a self-regulatory organization.

Based on the representations set forth in your March 3, 1994 letter and oral presentations by NYMEX staff, the members of the Off-Exchange Task Force do not believe that NYMEX's participation in the Channel 4 system would require NYMEX or Channel 4 to be designated as contract markets for the purchases and sales of natural gas or natural gas transportation or storage services entered into using the Channel 4 system. Any different, omitted,

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or changed facts or conditions might require a different conclusion. In addition, the Commission may request information or reports concerning operation of the Channel 4 system as authorized under various provisions of the Commodity Exchange Act and Commission regulations. Finally, you should note that any views expressed in this letter are solely those of the staff and are not binding on the Commission.

Sincerely,



Andrea M. Corcoran



Pat G. Nicolette
Co-Chairmen
Off-Exchange Task Force