



COMMODITY FUTURES TRADING COMMISSION

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Wendy L. Gramm  
Chairman

June 20, 1988

The Honorable Joe Barton  
U.S. House of Representatives  
Washington, D.C. 20515

Dear Mr. Barton:

This letter responds to your recent inquiry concerning the status of the Commission's action on a proposed futures contract market in natural gas. In that regard, the New York Mercantile Exchange (NYMEX) submitted an application to trade a futures contract in natural gas on March 9, 1984, which is currently pending at the Commission. However, Commission staff review has been stayed until the NYMEX responds to certain questions concerning its application.

Section 5 of the Commodity Exchange Act directs the Commission to designate any board of trade or exchange as a market to trade a specific contract when, and only when, that exchange complies with the requirements of the Act. In this regard, the Commission has promulgated Guideline No. 1 which describes the criteria by which the Commission determines whether an exchange has complied with the economic and public interest requirements necessary for the market designation. Under Guideline No. 1, the exchanges furnish evidence that the terms and conditions of a proposed futures contract will provide for a deliverable supply (1) which will not be conducive to price manipulation or distortion and (2) that the supply can reasonably be expected to be available to the short trader and salable by the long trader at its market value through normal cash marketing channels.

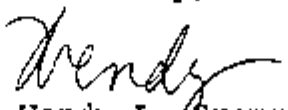
As part of the Commission's normal review process for the proposed natural gas contract, Commission staff discovered several apparent deficiencies related to deliverable supplies and the physical delivery process. In this regard, the staff asked the exchange on May 31, 1985 for additional information and justification as needed to meet the economic requirements for approval. To date, the exchange has not formally responded to these questions. Commission staff will not resume review of this proposed natural gas futures contract until the Commission receives a complete response to the issues discussed in the staff's letter of May 1985.

The issues raised in that letter include the availability of deliverable supplies for the proposed contract and the impact of recent changes in interstate natural gas regulation on the availability of pipeline space for traders who wish to make or take delivery through the futures market. In order to address the issues associated with the physical delivery of natural gas and to ensure the availability of adequate supplies, a filing has been made with the Federal Energy Regulatory Commission (FERC) by four national gas pipeline companies to establish a natural gas interchange service to be provided in the Katy, Texas area. In his letter to you dated January 21, 1988, Mr. John Watson noted that this filing constitutes a major step toward the creation of a natural gas futures market. It is our understanding that FERC approval of that interchange service is considered an integral part of NYMEX's completed application for futures trading in natural gas.

In his letter Mr. Watson also alluded to the level of speculative participation in the existing crude oil futures contract. Historically, total open interest, in the NYMEX's actively traded crude oil futures contract has been dominated by commercial, rather than speculative, traders. Open interest is the total number of futures contracts in a delivery month or market that have not been offset or fulfilled by delivery. For example, based on the Commission's Commitments of Traders in Commodity Futures data, as of March 31, 1988, positions classified as commercial represented about 66 percent of the long and 59 percent of the short open interest in that contract. However, regardless of these observations, please be assured that the concerns expressed by Mr. Watson, as well as all other concerns identified by Commission staff, will be considered by the Commission in its evaluation of the proposed natural gas contract.

We appreciate your comments and the comments of Mr. Watson on the NYMEX's proposed natural gas futures contract. His comments, as well as the comments of other knowledgeable trade sources contacted by the Commission staff, will assist the Commission in its analysis of the proposed contract.

Sincerely,

  
Wendy L. Gramm  
Chairman