[I.D. 121796A]

Marine Mammals; Scientific Research Permit No. 1021 (P532C)

AGENCY: National Marine Fisheries Service (NMFS), National Oceanic and Atmospheric Administration (NOAA), Commerce.

ACTION: Issuance of permit.

SUMMARY: Notice is hereby given that Texas A&M University at Galveston, P.O. Box 1675, Galveston, TX 77551 (Principal Investigator: Dr. Randall W. Davis, Co-investigators: Dr. William E. Evans, Dr. Robert Benson, Dr. Bernd Würsig, Mr. Troy S. Sparks and Mr. Spencer Lynn), has been issued a permit to tag, biopsy dart, capture/release various cetacean species for purposes of scientific research. The NMFS decision on project 1 involving low frequency sounds on sperm whales was deferred pending an environmental review.

ADDRESSES: The permit and related documents are available for review upon written request or by appointment in the following office(s):

Permits Division, Office of Protected Resources, NMFS, 1315 East-West Highway, Room 13130, Silver Spring, MD 20910 (301/713–2289); and

Regional Administrator, Southeast Region, NMFS, 9721 Executive Center Drive North, St. Petersburg, FL 33702–2532.

SUPPLEMENTARY INFORMATION: On August 26, 1996, notice was published in the Federal Register (61 FR 43737) that a request for a scientific research permit to take various cetacean species had been submitted by the above-named organization. The requested permit has been issued under the authority of the Marine Mammal Protection Act of 1972, as amended (16 U.S.C. 1361 *et seq.*), the Regulations Governing the Taking and Importing of Marine Mammals (50 CFR part 216), the Endangered Species Act of 1973, as amended (ESA; 16 U.S.C. 1531 *et seq.*), and the regulations governing the taking, importing, and exporting of endangered fish and wildlife (50 CFR 222.25).

Issuance of this permit as required by the ESA was based on a finding that such permit: (1) Was applied for in good faith; (2) will not operate to the disadvantage of the endangered species which is the subject of this permit; and (3) is consistent with the purposes and policies set forth in section 2 of the ESA.

Dated: December 17, 1996.

Ann D. Terbush,

Chief, Permits and Documentation Division, Office of Protected Resources, National Marine Fisheries Service.

[FR Doc. 96–32753 Filed 12–24–96; 8:45 am]

BILLING CODE 3510–22–F

COMMODITY FUTURES TRADING COMMISSION

Chicago Board of Trade Futures Contracts in Corn and Soybeans; Notice That Delivery Point Specifications Must Be Amended

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of, and request for public comment on, Notification to chicago board of trade to amend delivery specifications.

SUMMARY: The Commodity Futures Trading Commission (''Commission'') has notified the Board of Trade of the City of Chicago (''CBT''), under Section 5a(a)(10) of the Commodity Exchange Act (''Act''), 7 U.S.C. 7a(a)(10), that the delivery terms of the CBT corn and soybean futures contracts no longer accomplish the objectives of that section of the Act; and that the CBT has seventy-five days from the date of this notice to submit proposed amendments to those contracts which will accomplish the objectives of that section.

The Commission has determined that publication of the notification to the CBT for public comment is in the public interest, will assist the Commission in considering the views of interested persons, and is consistent with the purposes of the Commodity Exchange Act.

DATES: Comments must be received by February 24, 1997.

ADDRESSES: Comments should be mailed to the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581, attention: Office of the Secretariat; transmitted by facsimile at (202) 418–5521; or transmitted electronically at [secretary@cftc.gov]. Reference should be made to ''Corn and Soybean Delivery Points.''

FOR FURTHER INFORMATION CONTACT: Blake Imel, Acting Director, or Paul M. Architzel, Chief Counsel, Division of Economic Analysis, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581, (202) 418–5260, or electronically, Mr. Architzel at [PArchitzel@cftc.gov].

SUPPLEMENTARY INFORMATION: Section 5a(a)(10) of the Act provides that as a condition of contract market designation, boards of trade are required to:

> permit the delivery of any commodity, on contracts of sale thereof for future delivery, of such grade or grades, at such point or points and at such quality and locational price differentials as will tend to prevent or diminish price manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce. If the Commission after investigation finds that the rules and regulations adopted by a contract market permitting delivery of any commodity on contracts of sale thereof for future delivery, do not accomplish the objectives of this subsection, then the Commission shall notify the contract market of its finding and afford the contract market an opportunity to make appropriate changes in such rules and regulations.

The Commission, by letter dated December 19, 1996, notified the CBT under Section 5a(a)(10) of the Act, that its futures contracts for corn and soybeans no longer were in compliance with the requirements of that section of the Act. The text of that notification is set-forth below.

December 19, 1996.

Patrick Arbor

Chairman, Chicago Board of Trade, 141 W. Jackson Blvd., Chicago, Illinois 60604

Re: Delivery Point Specifications of the Corn and Soybean Futures Contracts.

Dear Chairman Arbor: The Commodity Futures Trading Commission (''CFTC'' or ''Commission'') hereby notifies the Board of Trade of the City of Chicago (''CBT or Exchange'') under Section 5a(a)(10) of the Commodity Exchange Act (''Act''), 7 U.S.C. 7a(a)(10), that the delivery terms of the CBT corn and soybean futures contracts no longer accomplish the statutory objectives of ''permit[ting] the delivery of any commodity * * * at such point or points and at such quality and locational price differentials as will tend to prevent or diminish price manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce.'' [1]

The Commission, as detailed below, bases this finding on the following: (1) the continuing diminution of the role of terminal markets in the cash market for grain; (2) the increasing shift of the locus of the main channels of commodity flows away from the delivery points on the contracts, particularly the par-delivery point of Chicago; (3) the continuing decline in cash market activity generally at the contracts' delivery points, particularly Chicago; and (4) the serious, precipitous drop in regular warehouse storage capacity at the Chicago delivery point

[1] The full text of Section 5a(a)(10) of the Commodity Exchange Act is appended to this letter.

over the past fourteen months. These conclusions are supported by a number of CFTC staff inquiries into these issues and by four separate, comprehensive studies of these issues completed in 1991 (one of which was sponsored by the CBT). Each of these inquiries and studies identified the above trends and indicated that deliverable supplies on the subject contracts were not available in normal cash market channels in amounts sufficient to tend to prevent or to diminish price manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce.

Although the CBT has attempted previously to respond to these problems by amending the contracts, those steps, such as the addition of St. Louis as a delivery point, have proven to be ineffective. With the recent precipitous drop in warehouse capacity in Chicago, the problem has reached a critical juncture. Recognizing this, the CBT convened a Task Force to consider changes to the grain contracts. More than a year after the Task Force began its deliberations, the Exchange membership rejected the modifications to the terms of the corn and soybean contracts recommended by the CBT's Board of Directors.

And, as provided under section 5a(a)(10) of the Act, the Commission hereby notifies the CBT that the Exchange is afforded the opportunity to submit for Commission approval proposed amendments to the delivery terms of the corn and soybean futures contracts that will accomplish the statutory objectives by March 4, 1997, a period of seventy-five days from the date of this letter. In determining whether its proposal is adequate to accomplish the objectives of section 5a(a)(10) of the Act, the CBT should be guided by a number of illustrative alternatives provided below. Failure to respond in a manner which in the Commission's judgment is ''necessary to accomplish the objectives'' of this section of the Act will result in further proceedings under section 5a(a)(10).

In light of the Commission's determination that the CBT's futures contracts in corn and soybeans no longer comply with the requirements of section 5a(a)(10) of the Act, the CBT should refrain from listing additional months for trading in those contracts during the pendency of these proceedings.

By limiting this notification under Section 5a(a)(10) of the Act to the CBT's futures contracts for corn and soybeans, the Commission is not thereby making any determination regarding any other CBT futures contract. The Commission notes, however, that the delivery specifications for the CBT wheat futures contract are also subject to many of the same trends which have affected adversely the corn and soybean contracts. In light of the importance of these issues, the Commission determined to limit this Section 5a(a)(10) notification to the corn and soybean contracts, which have been fully considered by the CBT in the first instance. The Commission believes that such a full consideration by the CBT of the delivery specifications of its wheat contract is also warranted and should be undertaken immediately. The Commission is of the view that this reconsideration should be completed within 120 days.

In notifying the CBT of the Commission's finding that the terms of the corn and soybean futures contracts do not accomplish the objectives of Section 5a(a)(10) of the Act, the Commission is not questioning the continued utility of the contracts for hedging or price basing under ordinary conditions or their role as the world's premiere futures contracts for corn and soybeans. Rather, the Commission's action, as explained in greater detail below, is predicated upon its finding that bringing the delivery terms of the contracts into closer alignment with an otherwise broad and active cash market is necessary to meet the requirements of Section 5a(a)(10), tending to prevent or to diminish price manipulation, market congestion, or the abnormal movement of such commodities in interstate commerce.

I. Background.

The CBT's corn and soybean futures contracts are major United States (U.S.) futures markets and principal vehicles for hedging and pricing by U.S. firms with commercial interests in these two important agricultural commodities. They rank among the most actively traded commodity futures contracts in the world and are used extensively by foreign commercial interests. In this regard, for the 1995/96 crop year, the average daily open interest was nearly two billion bushels for CBT corn futures and approached one billion bushels for CBT soybean futures. The total trading volume over the same period was approximately 95 billion bushels for corn futures and 70 billion bushels for soybean futures.

These activity levels for corn represent a greater than eight-fold increase in the levels of volume and open interest experienced in these markets in the early 1970s. For soybeans, these current levels are more than four times the levels experienced in the early 1970s. This increased overall level of trading activity can be attributed to an approximate 80 percent increase in the combined U.S. annual production of corn and soybeans over the last 25 years; a steadily decreasing level of federal crop price support activities, which has led to increased commercial uncertainty and need for hedging; and an increased internationalization of cash markets for feed grains and soybeans, which has also led to increased foreign participation in these futures markets for purposes of hedging and price-basing.

The preponderant use of these markets is commercial in nature. For example, in mid-November of this year, reportable commercial traders held 60 and 70 percent of the reportable long and short sides, respectively, of the soybean futures market and 85 and 64 percent of the reportable long and short sides, respectively, of the corn market.[2] Presumably, commercial traders also held a substantial proportion of the non-reportable positions.

The predominant economic function of the CBT corn and soybean futures markets is risk-transfer and price-basing, rather than merchandising or title transfer for the underlying commodity. Consistent with this, the preponderance of positions established in these markets are liquidated through the purchase or sale of offsetting futures contracts, rather than through making or taking delivery of the commodity. Nonetheless, the orderly convergence of futures prices and cash market merchandising values is essential to these contracts' risk-transfer and price-basing functions, and this convergence is dependent on the unimpeded opportunity of market participants to conduct arbitrage between the cash and futures markets. As a result, it is essential that the delivery specifications of these contracts effectively link futures trading to a substantial segment of the underlying cash markets.

The manner in which cash and futures prices are linked through the delivery mechanism is straightforward. If, at contract expiration, short position holders believe that expiring futures prices are higher than the current value of the commodity, they can satisfy their contractual obligations by acquisition and delivery of the physical commodity, rather than through the purchase of offsetting futures contracts. Likewise, if long position holders believe that

[2] Reportable traders are individuals or firms that hold futures positions of 500,000 bushels or more in soybeans or 750,000 bushels or more in corn in any one contract month through any U.S. or foreign broker.

expiring futures prices are lower than the current merchandising value of the commodity, they can require delivery in lieu of selling offsetting contracts in the futures market. To the extent that this arbitrage process is not impeded, convergence of cash and futures prices at contract expiration is assured.

The terms of delivery are critical in determining the degree of arbitrage between cash and futures markets and the strength of the linkage between cash and futures prices. When contract delivery terms do not correspond to a substantial segment of the cash market, the strength of the arbitrage linkage is diminished. In particular, when the futures market requires delivery at a location or of grades for which the commodity is not sufficiently available, short position holders may not be able to acquire the commodity or gain access to the delivery facilities in the event they believe that cash and futures prices are misaligned. Long position holders, seeking to profit from their positions, have no incentive to liquidate their positions through offset, and futures prices may take a course that is independent of the cash market. The resulting market congestion, or distortion of prices, is disruptive to proper functioning of the futures market, because prices no longer reflect cash market fundamentals. Thus, the nature of the delivery terms is critical to use of the CBT's corn and soybean futures contracts throughout the U.S. and abroad in the hedging and pricing of corn and soybean transactions and directly determines the degree to which the prices of the futures markets may be manipulated or otherwise become independent of fundamental conditions in those cash markets.

As discussed in detail below, the CBT's corn and soybean contracts currently specify delivery through the use of warehouse receipts for stocks held in specified facilities at Chicago, Toledo, and St. Louis. It is the location of these delivery points, as well as the nature of the delivery instrument, that is the subject of the Commission's analysis regarding the CBT's compliance with the provisions of Section 5a(a)(10) of the Act.

II. General Cash Market Trends

Chicago and Toledo, the primary delivery points of the CBT's corn and soybean futures contracts, are now situated at the periphery of current major cash market channels for these commodities. Their declining importance as cash market centers is the result of long-term trends in the storage, transportation, and processing of grains. As discussed below, these trends include: (1) increasing shipment of corn and soybeans from production areas directly to domestic users or export locations, bypassing intermediate locations such as terminal markets; (2) increasing processor use of corn and soybeans in production areas, to produce food, feed, and other products, thereby reducing the relative quantity of corn and soybeans shipped to locations outside of production areas including terminal markets; (3) substantially declining export activity from the Great Lakes relative to the growth of exports from Gulf of Mexico and Pacific Northwest ports; and (4) increasing decentralization in grain storage capacity, with marked increases in both on-farm and commercial storage capacity in production areas.

1. Changes in Transportation Patterns

The increasing shipment of corn and soybeans directly from production areas to domestic users or export locations, bypassing the traditional terminal markets, is related, in large part, to the deregulation of railroad freight rates. Prior to rail freight-rate deregulation in 1980, a practice called ''transit'' or ''proportional billing'' permitted grain to be shipped from production areas to an intermediate point for storage, such as a traditional terminal market, and then to the final destination at a single, fixed rate. After 1980, negotiated point-to-point rates replaced transit billing, favoring direct shipments of corn and soybeans to domestic users or export locations, to the detriment of traditional terminal markets located at major railroad centers such as Chicago.

2. Processing Trends

Substantial increases in corn and soybean processing at new and existing locations within the major production areas has further reduced the role of traditional terminal markets. According to U. S. Department of Agriculture (USDA) data, the quantity of corn processed into corn sweeteners, ethanol, and other products quadrupled between 1970 and 1995 (from about 400 million bushels to over 1.6 billion bushels) and the quantity of soybeans crushed in the U.S. approximately doubled over the same time period (from about 760 million bushels to about 1.34 billion bushels). Most of these new or expanded facilities are located in production areas, in which the processors obtain their supplies of corn and soybeans directly from nearby grain warehouses or producers. Moreover, even processing facilities located at terminal markets now purchase the majority of their supply directly from lower-cost production-area locations rather than from terminal market elevators. The inability to participate in this growth sector of the cash market has further eroded the relative importance of traditional terminal-market elevators.

3. Export Marketing Channel Changes

Over the past 25 years, corn and soybean exports have grown dramatically. However, the trends favor the all-year export facilities of the lower Mississippi River. In addition, the growth in exports to Asia has favored export facilities at Pacific Northwest ports. The growth in exports from these two areas has relatively disadvantaged the third major export route—the Great Lakes. More fundamentally, corn and soybean exports from the Great Lakes have declined absolutely, as well. This decline is, in part, attributable to the fall in exports to Northern European countries where Great Lakes ports sometimes have a cost advantage relative to other U.S. ports. In addition, exports from the Great Lakes are limited by the relatively high cost of shipping corn and soybeans by vessel from Great Lakes ports. This is partially due to the fact that the St. Lawrence Seaway, through which all vessels from Great Lakes ports must pass, can accommodate only relatively small vessels, which tend to charge higher freight rates for grain shipments than those assessed by larger vessels. In view of this consideration, corn and soybeans frequently are transferred from such smaller ships to larger vessels at Canadian ports.

These changes have significantly eroded the role, and general business activity, of the Great Lakes ports and the traditional terminal markets located there. For example, USDA data indicate that average annual exports of corn from Chicago and Toledo combined fell by 33 percent between 1968–70 and 1993–95. Average annual soybean exports from Toledo and Chicago over this same period fell by 53 percent. In addition, the percentage of total U.S. exports of corn and soybeans accounted for by Chicago and Toledo combined declined from an average of about 17 percent in the 1968–70 period to an average of about four percent in the 1993–95 period.

As the following charts indicate, the decline in the export role of Chicago and Toledo has been associated with, and is in contrast to, the increasing importance of corn and soybean exports through ports on the Gulf of Mexico and on the Pacific Coast.[3]

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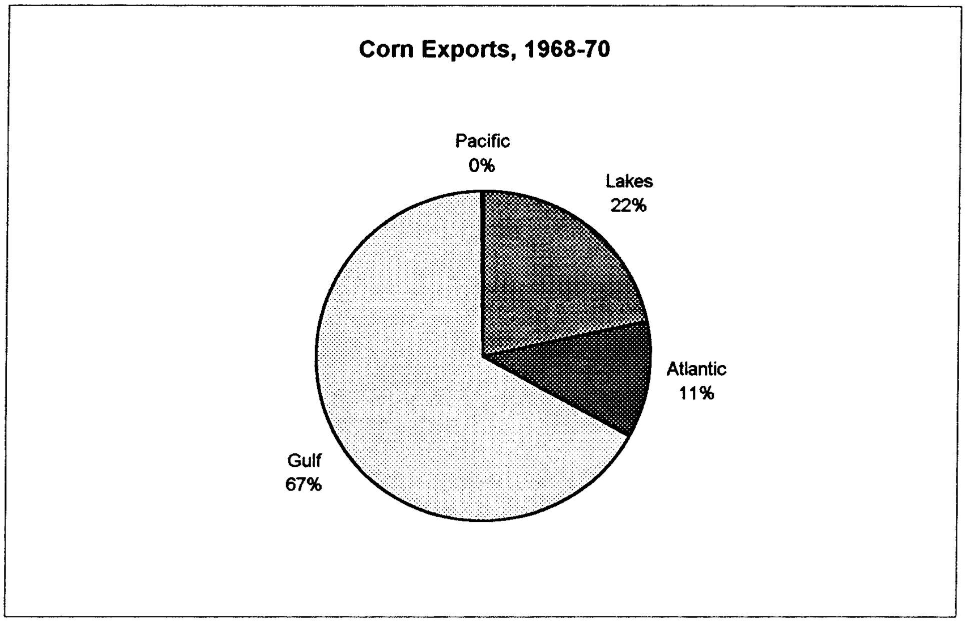
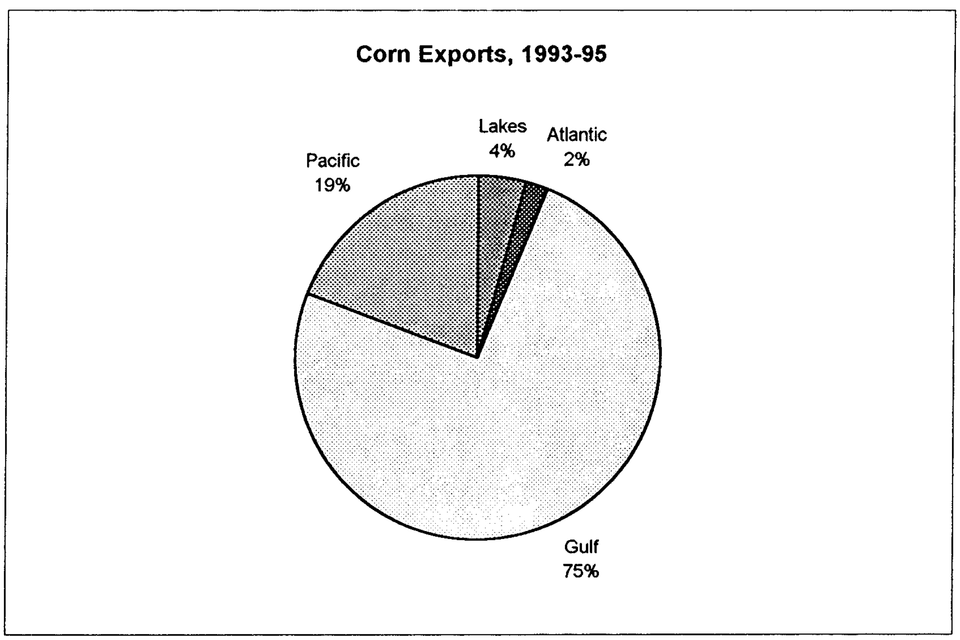
[3] Ports located on the lower Mississippi River accounted for about 93 percent of average annual soybean and corn exports from Gulf of Mexico ports over the period 1993–95. Virtually all Pacific Coast exports of corn and soybeans move through Pacific Northwest ports located on the Columbia River and Puget Sound.

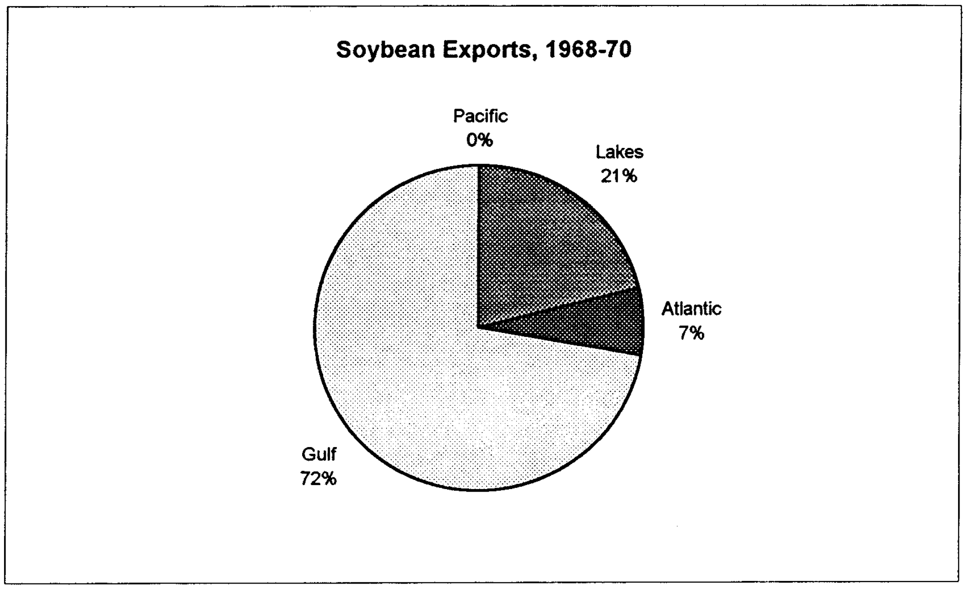
Chart 1. Percentage Distribution of Average Annual U.S. Corn Exports Among Port Areas, 1968-70 and 1993-95

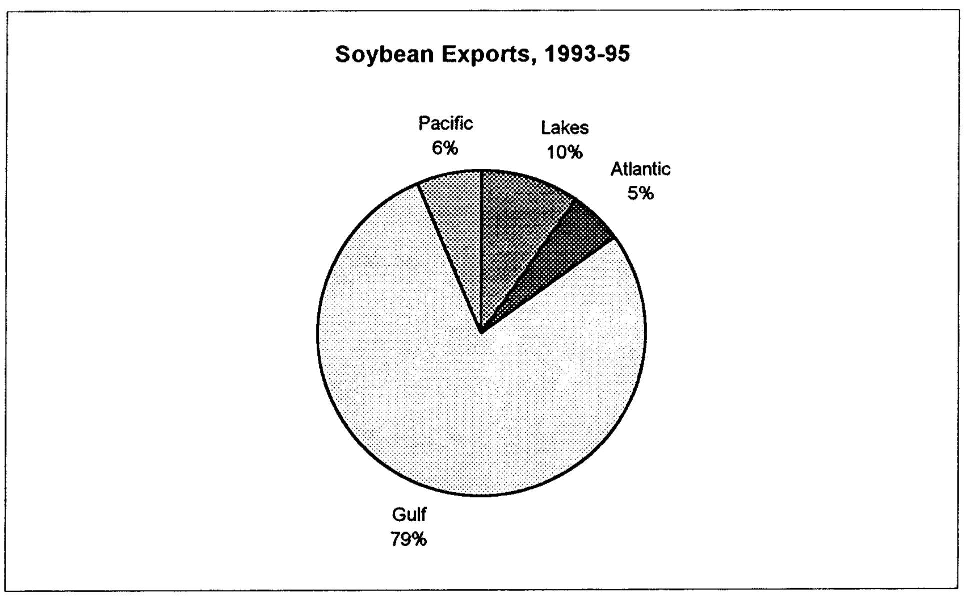




Sources: Federal Grain Inspection Service and CBT Annual Reports

Chart 2. Percentage Distribution of Average Annual U.S. Soybean Exports Among Port Areas, 1968-70 and 1993-95.





Sources: Federal Grain Inspection Service, CBT Annual Reports

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4. Geographic Changes in Storage Capacity Location

Finally, the role of some terminal markets as grain storage centers has declined as increasing storage capacity has been constructed in production areas, both off-farm and on-farm. Increases in off-farm storage capacity in production areas is due, in part, to the deregulation of rail freight rates, increased processing activity in production areas, and the need for additional storage capacity due to the significant growth in corn and soybean production in recent decades. In addition, on-farm storage capacity has increased significantly over the past 25 years to allow producers to maintain harvesting efficiency and access to lower cost storage. As a result, the role of terminal markets as storage centers has greatly diminished.

III. Cash Market Conditions at CBT Delivery Points.

As indicated above, general cash market trends disfavor traditional terminal markets such as Chicago. Moreover, cash market activity in Chicago and Toledo, the primary delivery locations for the CBT's corn and soybean futures contracts, has declined substantially, both on an absolute and relative basis, in recent decades. USDA production data and CBT data on grain receipts by elevators and processors at the primary delivery locations indicate that, despite U.S. corn production nearly doubling from 1970 to 1995, total corn receipts at Chicago and Toledo combined increased only by about 26 percent from 1970 to 1995, representing a mere 2.5 percent of total U.S. corn production in 1995. These data also indicate that, while U.S. soybean production also nearly doubled over this period, total soybean receipts in these locations actually fell by about 64 percent during the 1970–95 period, representing less than 2 percent of total 1995 U.S. soybean production. These trends illustrate the peripheral nature of the delivery points of the CBT's corn and soybean futures contracts to the cash market for these commodities.

The decline in the importance of the primary CBT delivery locations relative to the cash market is further illustrated by the trends in storage capacity at these locations in relation to changes in storage capacity in states which contain primary production areas for corn and soybeans. In particular, USDA data indicate that, from January 1, 1970, to December 1, 1995, total off-farm storage capacity in Illinois more than doubled, whereas CBT data for the same period indicate that the registered storage capacity of regular elevators at Chicago remained essentially constant until 1995, when it fell by about 58 percent. Similarly, during the period January 1, 1978, through December 1, 1995, total off-farm storage capacity in Illinois, Indiana and Ohio combined increased by about 42 percent, whereas total regular storage capacity in Chicago and Toledo combined declined by about 15 percent. This decline includes the 25 percent decrease in total regular storage capacity during 1995.

The decline in the cash market importance of the primary CBT delivery points has not been uniform. Rather, the declining cash-market importance of Chicago, the par delivery point, has recently been particularly acute.

1. Cash Market Trends at Chicago

Chicago's decreasing cash market role has been reflected over the years in a gradual loss in regular elevator storage capacity and in the number of firms operating such elevators. As discussed in more detail below, this loss has recently become precipitous. According to CBT data, in 1970, five firms operated seven regular elevators with a total registered storage capacity of about 52.4 million bushels. Currently, there are only three firms operating three regular elevators, with a total registered storage capacity of 22.8 million bushels. Further, one of the three remaining regular elevators, representing about 8.1 million bushels of storage capacity, recently ceased accepting grain and soybeans and appears to be closing down its operations, leaving total registered storage capacity at 14.7 million bushels.

Currently, soybean cash market activity in the Chicago area is limited to the merchandising by regular elevators of soybeans received from production locations, generally at harvest time. In this regard, total annual soybean receipts by regular CBT elevators declined by about 86 percent from 1970 to 1995, to about 8 million bushels. The merchandising role played by CBT regular elevators essentially is limited to shipping soybeans into export channels, either by barge to lower Mississippi River export points or via vessels through the Great Lakes and the St. Lawrence Seaway.

The existing corn cash market in the Chicago area primarily consists of purchases of corn by two local processing facilities and the merchandising by regular elevators of corn received from production locations. Annual receipts of corn in Chicago in 1995 totaled 112 million bushels, remaining relatively unchanged since 1970. CBT data indicate that a very small share of these receipts is received by regular elevators, with these elevators accounting for only about 14 percent of total corn receipts in 1995. Further, corn processing facilities in Chicago purchase essentially all of their annual corn requirements directly from production areas rather than from regular elevators. As with soybeans, regular elevators merchandise the limited quantities of corn they receive primarily into export channels.

USDA data indicate that average corn exports via the Great Lakes, during the period 1993–95, declined in absolute terms by over 60 percent relative to the average levels observed in 1968–70 and, as a percentage of total U.S. exports, from about 11.3 to 1.2 percent.[4] These data also indicate that average soybean exports via the Great Lakes declined by approximately 70 percent between these same two time periods and, as a percentage of total U.S. exports, from about 7.3 to about 1.1 percent.

2. Cash Market at Toledo

Corn and soybean cash market activity in Toledo has been less affected by these trends than the par delivery point of Chicago. Since Toledo was added as a delivery point for corn and soybeans in the mid- to late 1970s, the number of regular elevators in Toledo has remained relatively stable, although overall registered storage capacity has increased from about 36 million bushels in 1978 to about 57 million bushels today. Currently, there are seven regular elevators at the Toledo delivery point. The cash market for corn and soybeans at Toledo consists exclusively of the merchandising activities of the regular elevators; there are no processing facilities for these commodities at this location.

From 1970 to 1995, annual receipts of corn at Toledo doubled, increasing to an average of about 65 million bushels during 1994–95. Despite the overall doubling of receipts, however, average corn exports via the Great Lakes, during the period 1993–95, exceeded by only about 20 percent the average levels observed in 1968–70. In contrast, soybean receipts at Toledo declined in absolute amount by about 30 percent over this same period to an average of about 30 million bushels during 1994–95. Average soybean exports from Toledo declined by an even greater amount—approximately 47 percent between these same two time periods. Thus, while these data indicate that

[4] These data actually overstate the level of corn and soybean exports from Chicago, because the USDA's export data for Chicago also include exports from Milwaukee.

Toledo, unlike Chicago, has retained a larger measure of cash market activity, it is of a decidedly mixed nature.

3. Cash Market Conditions at St. Louis

Cash market activity at the contracts' St. Louis delivery point is of a substantially different nature than at the contracts' two primary delivery points. This location primarily serves as a barge loading area for corn and soybeans for shipment to the lower Mississippi River export market. The four regular elevators currently at St. Louis have a registered storage capacity of 12.2 million bushels. CBT data indicate that these elevators handle relatively large quantities of corn and soybeans. Specifically, receipts of corn averaged 52 million bushels during the period 1994–95, while receipts of soybeans averaged 23 million bushels over this same period. Similar quantities of corn and soybeans were shipped (almost exclusively by barge) during these two years. However, regular elevators at this location do not store significant quantities of corn or soybeans for extended periods of time due to the need to keep storage space unencumbered in order efficiently to conduct the unloading/loading process. Accordingly, because delivery on the CBT's corn and soybean contracts calls for the issuance of warehouse receipts that require regular elevators to store the commodity until the receipt is redeemed, there have been only a token number of futures deliveries at St. Louis.

IV. History of Revisions to the CBT Corn and Soybean Futures Delivery Point Specifications—1973 to 1993

The trends discussed above are long-term in nature. There has been an equally long history of modest attempts, made only in response to the urging of the federal regulator, to address the effect of these trends on the continued viability of the delivery terms of these futures contracts, while retaining the primacy of Chicago. Until the 1970's, Chicago was the sole delivery point on the CBT's corn and soybean futures contracts. At that time, a number of problem liquidations and price manipulation investigations in these futures markets focused attention on the inadequacy of Chicago as a delivery point and the need for additional delivery points. In particular, in the summer of 1973, both futures markets experienced problem liquidations, due, in part, to a general tightness in supplies associated with large Soviet grain purchases. Later that year, Congressional hearings were held in response to these problems. Ultimately, as part of far-reaching amendments to the Act, Section 5a(a)(10) was added, providing for new federal authority to address directly the delivery point provisions of futures contracts.

1. Proposals to Add Toledo and St. Louis

In 1974, the CBT submitted proposals to the USDA's Commodity Exchange Authority, the Commission's predecessor agency, to add Toledo and St. Louis as delivery points on the corn and soybean contracts at a discount of 5 cents per bushel to Chicago.[5] The CBT never placed these amendments into effect, because the proposed discounts were thought to be too great relative to cash market pricing relationships between Chicago and the proposed delivery points. In 1975, these same amendments were resubmitted to the newly formed CFTC for its approval. The Commission approved the proposal for corn (effective with the December 1976 contract month); and the CBT withdrew the soybean proposal. In 1978, the CBT resubmitted the proposal to add Toledo (but not St. Louis) as a delivery point for the soybean contract at a discount of 8 cents per bushel. The Commission approved those amendments, effective with the November 1979 contract month.

2. Proposal to Add St. Louis as a Soybean Futures Delivery Point

In July 1989, a commercial long trader held large long positions that exceeded the amount of soybeans that short traders were able to deliver at the contract's then existing delivery points and indicated that it would stand for delivery on its positions. This prompted the CBT to declare a market emergency, taking action to ensure an orderly liquidation of that futures contract month. In response to the outpouring of concerns over the adequacy of the contract's delivery provisions expressed by market participants after this incident, the CBT in 1990 proposed a number of changes to its soybean and grain futures contracts. These included adding St. Louis as a delivery point for soybeans at a discount of 4 cents per bushel to Chicago. Based upon evidence that the proposed discount for St. Louis delivery was too great relative to cash market pricing relationships, the Commission returned this submission for further justification under Commission Rule 1.41(b). The Commission also reiterated its view that the CBT should consider more substantive changes to its soybean and grain futures contracts in order to ensure adequate deliverable supplies.

In response to the heightened concerns over the adequacy of the CBT grain and soybean delivery points renewed by the July 1989 market emergency, the National Grain and Feed Association, the CBT, the General Accounting Office, and the Commission all conducted or sponsored studies on the delivery terms of the soybean and grain futures contracts. These separate studies were all completed in 1991. They generally found that long-term trends in the structure of the grain industry had affected adversely the viability of the cash markets at Chicago and Toledo. Their specific conclusions are summarized below.

a. MidAmerica Institute

The CBT commissioned the MidAmerica Institute to conduct a study of its corn and soybean futures contracts. The study concluded that, based on an analysis of cash and futures price data for the 1984–89 period, the delivery process for these contracts effectively resulted in the convergence of futures prices and cash prices at the contracts' Chicago and Toledo delivery points. The study noted, however, that the Chicago-Great Lakes-East Coast cash market for grains and soybeans had declined markedly in importance relative to the Mississippi-Gulf of Mexico area. The study concluded that this decline had reduced the benefits of retaining Chicago as the primary delivery point and of relying upon Toledo as the alternative delivery point. In this respect, the study concluded that Chicago had become a relatively low price point because it is located near the origin, rather than at the destination, of grain and soybean flows for most of the year. The study indicated that this feature enhances the potential for manipulation, since deliverable supplies may only be increased to address a manipulation attempt by drawing these commodities from higher value locations. The study noted that such an action to increase deliverable supplies is costly and that a manipulator can profitably exploit this cost to inflate futures prices artificially under conditions that recur periodically in grain markets. The study also noted that the decline in Chicago's tributary area means that more hedgers must bear additional basis risk when Chicago is the primary delivery point.

This increased susceptibility to manipulation and basis risk, the study concluded, could be ameliorated by improving the alignment of the contracts' delivery mechanisms with

[5] Toledo was established by the CBT as a delivery point for its wheat futures contract in the early 1970s.

prevailing cash market conditions and pricing relationships. In particular, the addition of an effective Mississippi River delivery point, such as St. Louis, and the establishment of price differentials for all delivery locations at levels reflecting typical cash price relationships, was recommended. The addition of a delivery point at an active cash market location such as St. Louis, the Institute noted, would enhance the futures contracts' hedging performance by improving the extent to which their prices reflect prices in primary cash market channels. In this regard, however, the MidAmerica Institute cautioned that, because of their limited storage capacity and throughput nature, the addition of St. Louis warehouses would only modestly enhance deterrence of manipulative activity.[6]

b. Food Research Institute

The Food Research Institute of Stanford University was commissioned by the National Grain and Feed Association to study these issues as well. This study concluded that deliverable stocks at the contracts' delivery points were, in the years preceding the study's completion in 1991, too low relative to the size of positions normally held by the largest traders. It concluded that, in this respect, positions held by the largest traders were of such a size relative to deliverable stocks that neither delivery nor the threat of delivery was a credible alternative. Moreover, this limited level of deliverable stocks was not due to any warehouse capacity constraints existing at that time, but rather to the general inexorable decline of cash market activity at grain terminal markets—Chicago, in particular.

The Food Research Institute recommended that the CBT address this fundamental problem by rethinking its specifications requiring delivery of grain and soybeans in-store via warehouse receipts. Suggested alternatives included barge delivery, incorporating aspects of a call on production, or delivery at Mississippi River export facilities, with the receiver given the option as to when the product is loaded upon one month's notice.[7]

[6] Providing for emergency barge or rail delivery, or for some mechanism of ensuring access of throughput elevators in the vicinity of that city to the delivery process, would, according to the MidAmerica Institute, address these shortcomings in St. Louis as a potential additional delivery point.

[7] The Food Research Institute study suggested that the CBT consider adopting the delivery procedures used on the New York Mercantile Exchange's crude and heating oil futures contracts if the CBT selects a Gulf of Mexico delivery point system.

c. The CFTC

The Commission staff's study of the contracts' delivery terms reviewed and analyzed the general cash market trends and the specific cash market conditions at Chicago and Toledo during the period 1960 through 1990. The study found that Chicago and, to a lesser extent, Toledo had declined substantially as storage locations for corn and soybeans to be exported via the Great Lakes and shipped to other U.S. destinations for domestic consumption purposes. In addition, the study analyzed several potential alternative delivery-point specifications for the corn and soybean futures contracts, which would locate the contracts' delivery points within the commodities' primary cash market channels. These included delivering corn and soybeans in-store at Central Illinois warehouses via warehouse receipts; making delivery at Illinois River barge-loading, or Mississippi River vessel-loading export facilities via shipping certificates; and cash settlement. The study concluded that these alternatives, by aligning the contracts' terms more closely with the underlying cash markets for corn and soybeans, would thereby reduce the potential for market problems and concomitant regulatory interventions.

d. General Accounting Office (GAO)

At the request of the Chairman of the Agriculture Committee of the U.S. House of Representatives, the GAO completed a review of the CBT grain and soybean futures delivery-point issues in 1991. The GAO conducted interviews of interested parties, including CBT and Commission officials, and reviewed the above-noted studies prepared by the MidAmerica Institute and the Stanford University Food Research Institute.

In its study, the GAO noted that CBT officials believed that changing delivery points might interfere with the economic purposes of futures trading and that surveillance and disciplinary action programs rather than changing delivery points might be better suited to preventing potential market manipulation. The GAO noted that, in contrast, the Commission was reluctant not to alter futures contract terms that in its judgement resulted in an increased threat of manipulation and required an excessive level of regulatory intervention to prevent frequent market congestion, price distortions or manipulation. The GAO also noted that the MidAmerica and Food Research Institute studies supported the need for the CBT and the Commission to assess alternatives for improving how delivery points for grain and soybean futures contracts meet the economic purposes and anti-manipulation goals of the Act.

e. Symposium on CBT Grain and Soybean Delivery Point Issues

In conjunction with the completion of these studies, in September 1991, the Commission sponsored a symposium to discuss these issues. Attendees at that symposium represented a broad cross section of interested parties, including major grain companies, academic institutions, the CBT, and the Commission. Members of the grain industry generally agreed that the performance of the futures contracts under their current delivery specifications was not satisfactory in all respects, but disagreed on the degree of the problem and the nature of the possible solutions. Although acknowledging that Chicago was a declining cash market, a CBT representative nevertheless maintained that Chicago was still a viable delivery point based upon the variety of transportation alternatives available to long traders taking delivery at that location. The CBT representative further indicated that the CBT was continuing to study the situation and develop appropriate revisions to the contracts' delivery specifications.

f. Final CBT Proposals Responding to July 1989 Soybean Incident

In 1992, the CBT re-submitted its proposal to add St. Louis as a delivery point for soybeans, at a premium of 8 cents per bushel rather than at a discount of 4 cents per bushel as previously proposed in 1990. The CBT also proposed to revise the price differential for St. Louis corn futures deliveries to a premium of 7 cents per bushel from the then existing 4 cents per bushel discount and to reduce the discount for the delivery of corn in Toledo to 3 from 4 cents per bushel. Although approving these proposals in April 1992 for implementation beginning with the December 1993 corn contract month and the November 1993 soybean contract month, the Commission, in its approval letter, stated that it:

> understands that the addition of St. Louis as a delivery point for soybeans and wheat and revisions to locational differentials for corn were intended by the Exchange to provide additional deliverable supplies for these contracts. Nevertheless, the Commission is concerned that these changes may not be sufficiently responsive to the long run changes in the cash market, and therefore may not significantly alleviate concerns about the contracts' specifications in either the immediate future or the long run.

In particular, in view of the long term trends in the cash market, the Commission is concerned about the continued reliance on warehouse receipts in terminal markets as the sole source of deliverable supplies for each of these contracts. Further, the Commission notes that the limited warehouse space at St. Louis may be devoted primarily to ''through-put'' merchandising activities and, as a result, operators of these facilities may be reluctant to make significant space and/or receipts available for purposes of futures delivery.

The Commission concluded by again putting the CBT on notice that:

[i]n consideration of this, the Commission believes that the CBT should continue its efforts to develop comprehensive contract revisions that will enhance deliverable supply and reduce the need for formal and informal market intervention by the Exchange or the Commission. It is the Commission's belief that such revisions may require linking contract terms more directly to commodity flows or to decentralized storage. In the Commission's view, continued active consideration of this matter is particularly advisable in view of the possibility of further declines in the viability of the Chicago delivery area and the time necessary to develop and fully implement more substantive contract changes.

V. Recent Events—1995 to the Present

As predicted by the Commission in 1992, the CBT's response to the continuing deterioration of the cash market at its delivery points proved to be a solution of limited effect and short duration. In the fall of 1995, three of the existing six Chicago delivery warehouses ceased operations. As a result, Chicago delivery capacity was immediately reduced by more than half—from 53.9 to 22.8 million bushels. Significant as this drop in capacity is, it must be kept in mind that actual supplies available in those warehouses have been a fraction of the total capacity. Nevertheless, the precipitous drop in warehouse capacity served to reawaken concerns over the viability of the contracts' delivery points.[8]

Commission Chairman Mary Schapiro, in an October 11, 1995, letter to the CBT, expressed once again the Commission's concerns regarding the adequacy of the contracts' delivery provisions, stressing that the Commission's concerns were heightened by this further deterioration. Chairman Schapiro requested that the Exchange keep the Commission staff informed on a frequent basis of the progress of a Special Task Force established by the CBT to study the situation. Chairman Schapiro's letter further noted the Commission's recommendation that the Exchange not limit its consideration to short-term responses to the closure of the above-noted Chicago regular elevators. The letter noted, specifically, that the Exchange should consider, in the context of long-run cash market trends, comprehensive contract revisions that would enhance deliverable supply and provide a viable price-basing service for the international grain industry.

1. CBT Task Force.

As noted above, the halving of deliverable storage capacity at Chicago prompted the CBT to form a Special Task Force on September 25, 1995, to determine what changes, if any, were needed to be made to the contracts' delivery terms to ensure adequate deliverable supplies. The Special Task Force held numerous meetings from the date of its establishment through early June 1996. It invited a significant number of individuals, representing a broad cross section of the industry and other interests, to express their views. It considered in depth the merits of a number of suggested alternatives. The Special Task Force's Chairman also briefed the Commission on its progress.

On June 4, 1996, the CBT Special Task Force issued its final recommendations for changing the delivery provisions of the grain futures contracts. The Special Task Force recommended: (1) adding delivery points in East Central Illinois, Northern Illinois River locations, and Milwaukee, Wisconsin, for the corn and soybean contracts, with warehouse receipts continuing to serve as the delivery instrument; (2) reducing the locational price differentials for delivery of corn, soybeans, and wheat at Toledo, Ohio; (3) deleting St. Louis as a delivery point for the corn, soybean, and wheat futures contracts; (4) reducing the daily barge load-out requirement for Chicago elevators from 3 to 2 barges, but permitting the receivers of corn or soybeans to request up to 4 barges per day, which the Chicago warehouseman could provide either entirely from the Chicago elevator or through a combination of loadings at the Chicago elevator and a separate loading point along the Northern Illinois River; and (5) establishing higher minimum financial requirements for regular warehousemen.

2. March 1996 Wheat Expiration Problem

In the midst of the Special Task Force's deliberations, the March 1996 wheat futures contract experienced a problematic liquidation.[9] On the last trading day of this future, a major commercial trader maintained a significant long position against export sales contracts and a major commercial trader who did not own wheat in deliverable position maintained a significant short position until the final few minutes of trading. The commercial short trader and several other short position holders elected to offset their positions rather than make delivery. During the final minutes of trading, this buying interest was met by a lack of selling interest—the large commercial long trader had determined to stand for delivery and had not entered any orders on the close. As a result, wheat futures prices were bid sharply higher, from about $5.00 to over $7.00 per bushel during and after the close of trading. Although the Commission staff report[10] on this incident was not addressed to the causal links, if any, between the delivery specifications for the contract and the problem liquidation, the recent problem in the expiration of the March wheat futures contract may foreshadow similar problems for the corn and soybean futures contracts.

3. CBT Action on Proposals to Revise the Contracts

On September 18, 1996, the CBT's Board of Directors considered the Special Task Force's recommendations and approved for membership balloting all of the Special Task Force's recommended changes except the proposal to add East Central Illinois as a delivery area. On October 17, 1996, the Exchange membership voted to reject the recommended changes by a margin approximately of 2 to 1.

4. More Recent Developments

In the last week of October 1996, Commission staff were notified that one of the three remaining Chicago elevators, operated by Countrymark, has stopped accepting soybeans and grain for the indefinite future. Accordingly, at

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[8] Moreover, as also anticipated by the Commission in 1992, there have been few, if any, warehouse receipts registered for delivery on the soybean (or wheat) futures contracts at St. Louis, since it became a soybean (and wheat) delivery point in 1993. In addition, despite the substantial increase in the locational price differential applicable to St. Louis corn futures deliveries under the 1992 amendments, there continues to be very little futures delivery activity in corn at that location.

[9] As noted above, although this notification under section 5a(a)(10) of the Act applies only to the CBT corn and soybean futures contracts, many of the same trends affecting the corn and soybean futures contracts have affected the wheat futures contract, as well. The Commission is requesting the CBT to conduct an in-depth reconsideration of the delivery specifications for its wheat contract within the next 120 days, similar to that which it undertook for its corn and soybeans futures contracts.

[10] See, Report on Chicago Board of Trade March 1996 Wheat Future Expiration on March 20, 1996, (November 26, 1996).

present, there are only two functioning regular Chicago elevators. They have a combined rated storage capacity of 14.7 million bushels.[11]

VI. Requirements of Section 5a(a)(10) of the Act

The Commodity Exchange Act was extensively amended in 1974. Those amendments substantially expanded the Act's scope, created a regulatory system for the trading of all commodity futures contracts, and created the Commission as an independent regulatory agency to administer and to enforce the Act's provisions. Many of these amendments were designed to address apparent weaknesses in the prior statutory scheme. In this regard, the Commission's predecessor agency, charged with administering the Act, testified before the House Committee on Agriculture, that:

> For many years, the Department has been urging the exchanges to provide an adequate number of delivery points in the production areas and along the routes by which the various commodities move from the producer to the consumer. The need for such points is readily apparent. On July 20, 1973, the last trading day for July corn on the Chicago Board of Trade, the futures price rose $1.20 per bushel. * * * Transportation problems made it difficult to move corn into the Chicago area and warehouses in that area were either filled or reluctant to accept corn coming in for delivery on the futures contract. The result was that many who would have made delivery had there been provision for delivery at other points where supplies are ordinarily available * * * were * * * forced to buy futures contracts at an escalating price largely caused, not by an overall change in the supply or demand for corn, but an artificial shortage. * * *
>
> [T]he establishment of * * * additional delivery points * * * ought to be made by the exchanges in the first instance. Our concern here is simply making sure that if they do not do the job properly, adequate authority is present for the regulatory agency to take action should such be desirable.

H.R. Rep. No. 975, 93rd Cong. 2d Sess. 77 (1974).

In recognition of the crucial role played by adequate deliverable supplies in promoting orderly markets, Congress enacted Section 5a(a)(10) of the Act, which specifies, in part, that each contract market is required to:

> permit the delivery of any commodity, on contracts for sale thereof for future delivery of such grade or grades, at such point or points and at such quality and locational price differentials as will tend to prevent or diminish price manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce.

7 U.S.C. § 7a(a)(10).

Moreover, Congress granted the Commission authority under Section 5a(a)(10) of the Act to determine whether exchange rules regarding delivery terms fail to accomplish these objectives and to take appropriate remedial action.

As an aid to the exchanges in meeting the statutory requirements for designation, including the provisions of Section 5a(a)(10), the newly formed Commission published Guideline No. 1 (now codified at 17 CFR Part 5, Appendix A). As explained in Guideline No. 1, to demonstrate continuing compliance with the Act, exchanges must provide evidence that each individual contract term conforms with the underlying cash market and provides for a deliverable supply that will not be conducive to price manipulation or distortion and which can be expected to be available to the short trader, and saleable by the long trader at its cash market value in normal cash marketing channels.[12]

VII. Compliance of the CBT's Corn and Soybean Delivery Point Specifications with Section 5a(a)(10) of the Act

The Commission believes that the CBT's corn and soybean futures contracts currently do not meet the requirements of Section 5a(a)(10) of the Act that delivery terms be specified which "tend to diminish price manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce." As noted, the current level of total regular capacity in Chicago available for the storage of deliverable corn, soybeans, wheat, and oats has been reduced by about 60 percent since the fall of 1995, as three of the six regular Chicago warehouse operators closed operations. Moreover, effective regular storage capacity could decline to even lower levels (about 12 million bushels of effectively available storage capacity) in the very near future in view of the potential that another existing regular elevator may cease operations. With the withdrawal of three—and now, apparently four—elevators at the contracts' Chicago delivery point, the available deliverable supplies potentially have been reduced to levels which increase the futures contracts' susceptibility to price manipulation or distortion.

The recent closure of these elevators in Chicago greatly exacerbates a deliverable supply situation that is already severely limited due to the low levels of cash market activity in Chicago. These closures confirm that Chicago is at the periphery of normal cash market channels for corn and soybeans. The reduced number of regular warehouses, the frequently low levels of stocks available, and the lack of commodity flows to Chicago resulting from normal cash market activities increase the likelihood that futures prices may become distorted and that abnormal interstate movements of corn or soybeans may be required to meet futures delivery requirements.

Moreover, this situation is not confined to Chicago, the primary delivery point on the contracts. The inadequacy of the contracts' overall delivery point specifications is suggested by the very low deliverable supply conditions frequently observed at season-end for the corn and soybean futures contracts during recent years. As shown in Chart 3, season-end deliverable stocks of corn at all CBT delivery points combined have often fallen to very low levels from 1980 to the present, independent of the recent precipitous decline in regular storage capacity in Chicago. In particular, deliverable stocks of corn fell to as low as 2 million bushels (400 contracts) on September 1, 1990. As shown in Chart 4, since 1980, deliverable stocks of soybeans at all delivery points combined also have declined to levels as low as 1.2 million bushels (240 contracts) in 1985 and 1.05 million bushels (210 contracts) in 1996.[13]

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[11] Trade sources indicate that, if the latest elevator to stop accepting grain and soybeans closes, the effective regular storage capacity in Chicago which is available to hold grain and soybeans will be reduced to an even lower level, to about 12.0 to 12.5 million bushels. These lower effective capacity estimates reflect the fact that a certain proportion of storage within an elevator must be kept empty to allow blending of the stored grain and soybeans and for the efficient movement of these commodities into and out of the facility.

[12] Specifically, with respect to delivery points, Guideline No. 1 provides that exchanges must consider: (1) the nature of the cash market at the delivery point; (2) the composition of the market at that point; (3) the normal commercial practice for establishing cash market values and the availability of published cash prices reflecting the value of the deliverable commodity; (4) the level of deliverable supplies normally available, including the seasonal distribution of such supplies; and (5) any locational price differentials that would be applicable to the delivery points, including the economic basis for discounts or premiums, or lack thereof, applying to delivery points. In addition, Guideline No. 1 specifies that contract markets must provide information which describes the delivery facilities, including: (1) the type of delivery facility at each delivery point; (2) the number and total capacity of facilities meeting contract requirements; (3) the proportions of such capacity expected to be available for traders who may wish to make delivery, and seasonal changes in such proportions; and (4) the extent to which ownership and control of such facilities is dispersed or concentrated.

[13] The low levels of corn and soybean stocks at the contracts' delivery points observed in September 1996 were associated with low stock levels throughout the U.S. Nevertheless, it is clear that low stocks at the contracts' delivery points are

Further, effective deliverable stocks of corn (stocks at Toledo and Chicago minus stocks at St. Louis) have declined to even lower levels on other occasions.[14] For instance, on September 1, 1996, effective corn stocks fell to about 1.1 million bushels (about 220 contracts).

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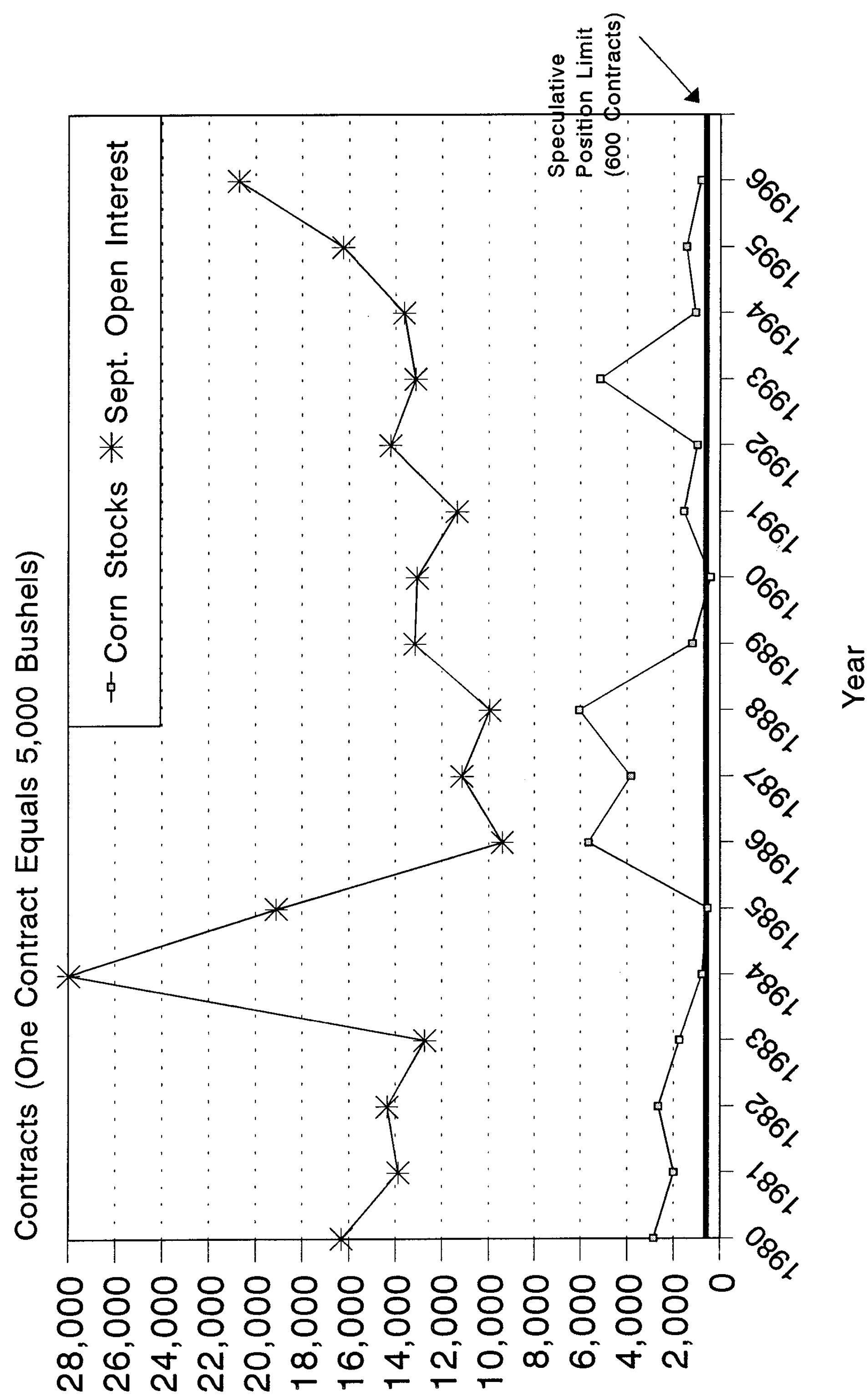
also a problem in years where U.S. stock levels are not at uniformly low levels.

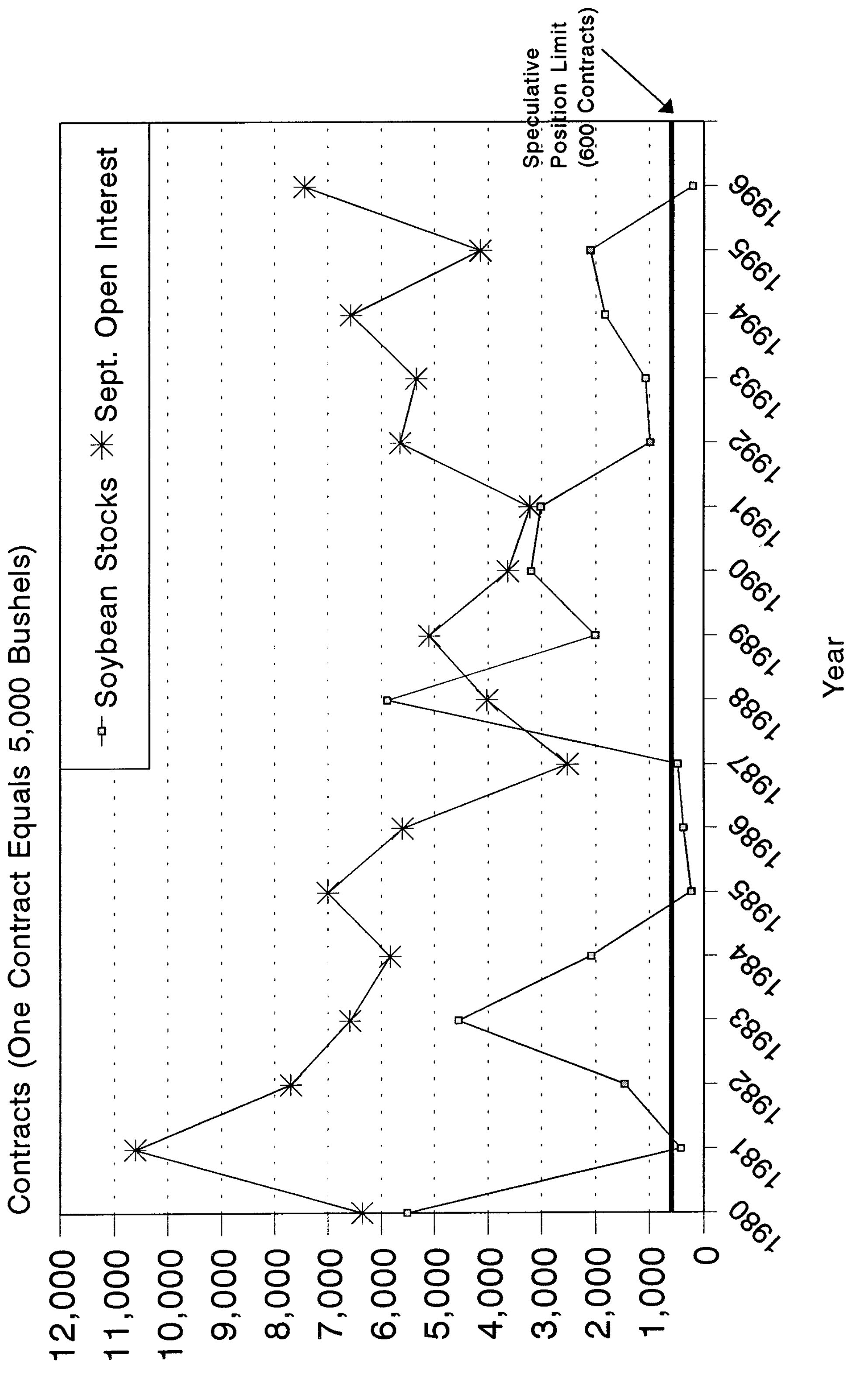
[14] As discussed above, there have been very few deliveries at St. Louis since this location became a delivery point in the 1970s. The lack of deliveries at this point reflects the fact that elevators in St. Louis, unlike the regular elevators in Chicago and Toledo, operate as barge-loading facilities rather than storage facilities. Corn and soybeans received at St. Louis elevators are stored only temporarily until they can be loaded into barges.

Chart 3 - Corn Stocks on First Friday of September in Deliverable Position at All CBT Regular Elevators vs. Total Open Interest for the September Contract and Spot Month Speculative Limit Level, 1980 Through 1996



Source: CBT and CFTC Stocks of Grain Reports. Footnotes: Stocks reported as of the First Friday in September for CBT Regular Elevators in Chicago, Toledo and St. Louis. September Futures Contract Open Interest on the Last Day of August.

Chart 4 - Soybean Stocks on First Friday of September in Deliverable Position at All CBT Regular Elevators vs. Total Open Interest for the September Contract and Spot Month Speculative Limit Level, 1980 through 1996



Source: CBT and CFTC Stocks of Grain Reports. Footnotes: Stocks reported as of the First Friday in September for CBT Regular Elevators in Chicago, Toledo and St. Louis. St. Louis became a soybean futures delivery point in 1993. September Futures Contract Open Interest on the Last Day of August.

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Charts 3 and 4 also indicate the comparative levels of open interest for the expiring September contract month and the spot month speculative position limits for the corn and soybean futures contracts. These figures indicate, for instance, that total stock levels frequently have fallen to levels near or below the maximum number of contracts a single speculative trader may hold during the delivery periods of expiring contract months (600 contracts). Moreover, commercial firms may have been granted exemptions from these limits for purposes of bona fide hedging. These comparisons show that the potential requirements for futures delivery frequently exceed, by a substantial degree, the level of deliverable stocks available for futures contracts. They thereby indicate the increased potential for market problems as well as the increased potential for regulatory intervention required to ensure that positions are liquidated in an orderly fashion.

Moreover, the recent loss of substantial regular warehouse capacity likely will cause further deterioration in the chronically low deliverable stock situation. The primary factor drawing deliverable supplies to Chicago has been the existence of warehouse capacity for futures contract deliveries at that location, rather than traditional cash market demand. Numerous trade sources and cash market experts have verified that the cash market flow of corn and soybeans to Chicago elevators for purposes other than futures delivery is weak or non-existent. Accordingly, the Commission believes that the recent decline in the number of grain merchandisers in Chicago will necessarily result in a further decline of stocks from the low levels depicted in the charts.

In such situations, where stocks are available for delivery only at chronically low-levels due to the location of a contract's delivery points at the periphery of cash market channels, futures prices can more become distorted relative to cash market prices. This results from the need to attract the necessary quantities of corn or soybeans, which are otherwise not normally available, to the contracts' delivery points to fulfill delivery requirements. Thus, when the delivery points for a futures contract are not located within active cash market channels for the underlying commodity, the likelihood increases that abnormal interstate movements of the commodity will be required to meet futures delivery requirements. In contrast, when a contract's delivery points are located within active cash market channels for a commodity, deliverable supplies readily can be made available for delivery from stocks at, or flows of the commodity through, the contract's delivery points at a price that is representative of prevailing cash market prices for the commodity.

These circumstances were clearly envisioned by the MidAmerica Institute study discussed above, which concluded that because Chicago had become a low price point, deliverable supplies required to respond to an attempted manipulation could only be drawn from higher value locations, thereby enhancing the potential for, and possible profitability of, market manipulations.[15]

The situation is critical in that, except for cash-settled contracts, the threat of delivery is the mechanism through which the market forces futures and cash prices to converge. To the extent that delivery is not a viable alternative because of inadequate deliverable supplies, trading will increasingly require regulatory intervention to remain orderly, particularly during contract month expirations.

Accordingly, the Commission has determined to notify the CBT under the provisions of Section 5a(a)(10) of the Act, that for the reasons discussed above, and in light of the CBT's failure to date to take appropriate corrective action, the Commission finds that the CBT rules specifying the terms of its corn and soybean futures contracts do not accomplish the Section 5a(a)(10) objectives of ''tend[ing] to prevent or diminish price manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce.''

Further, the Commission hereby notifies the CBT, under the provisions of Section 5a(a)(10) of the Act, that the CBT has until March 4, 1997 to adopt and submit for Commission approval ''appropriate changes'' to CBT rules.

VIII. Alternative Contract Specifications.

To avoid further proceedings under Section 5a(a)(10), the CBT must make changes to the contracts which, in the opinion of the Commission, are necessary to accomplish the objectives of this subsection of the Act. Although the Commission has not reached a conclusion as to the exact nature of the changes which are ''necessary to accomplish the objectives'' of providing delivery terms ''as will tend to prevent or diminish price manipulation,'' it is providing guidance to the CBT on a range of possibilities which could constitute ''appropriate changes'' by providing for the necessary, viable linkage with the cash market. By providing these alternatives, the Commission is not limiting the CBT's ability to respond to this Section 5a(a)(10) notification, nor is it specifying exact design criteria. Rather, these are examples of various means by which the Commission believes the objectives of the section could be met. In any event, the particular contract specifications proposed by the CBT in response to this notification, in order to meet the statutory requirement, should provide for a linkage with the cash market through specific terms which are in conformity with a substantial segment of that underlying market.

1. Modified CBT Special Task Force Proposal

The contract amendments recommended by the CBT Special Task Force, with certain modifications, could potentially provide for the necessary increase in deliverable supplies. Under the Special Task Force proposal, futures delivery would continue to be made at all locations by the transfer of a warehouse receipt for grain in store. Chicago and Toledo would continue as delivery points, with Chicago remaining the par delivery location, St. Louis being deleted, and existing discounts for Toledo delivery being reduced to 2 from 3 cents per bushel for corn and to 4 from 8 cents per bushel for soybeans.

The Special Task Force also proposed that delivery be permitted at regular warehouses in Milwaukee, in East Central Illinois (ECI), and on the Northern Illinois River (NIR).[16] Vessel deliveries of corn and soybeans in Milwaukee would be at par, with rail and barge deliveries subject to a discount of 8 cents per bushel. Corn and soybeans in store at regular ECI warehouses would be deliverable at discounts of 4 cents and 8 cents per bushel, respectively.[17] Futures delivery at NIR warehouses would be at par for corn and at a discount of 4 cents per bushel for soybeans.

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[15] The inclusion of Toledo does not cure this fundamental flaw because it, too, is on the periphery of the cash market.

[16] The ECI delivery area would encompass the counties of Champaign, Coles, Douglas, Ford, and Iroquois. The NIR delivery area would consist of that part of the Illinois River that lies between Creve Coeur and Chicago.

[17] The recommended changes also would permit delivery receivers to require ECI regular warehouses to load the delivery corn and soybeans into barges at NIR barge-loading facilities at a premium of 4 cents per bushel. This provision implies that corn would be deliverable in barges on the NIR at par, while soybeans would be deliverable on the NIR at a discount of 4 cents per bushel.

However, as to this proposal, the following changes would be necessary to provide for an economically effective linkage of the futures contracts with the cash market:

1. In view of the infrequent participation of St. Louis as a delivery point, as well as the similarly limited storage capacity and through-put nature of the barge-loading warehouses on the NIR, the Special Task Force proposal to permit delivery in NIR barge-loading warehouses must be modified to allow delivery at off-water warehouses located within a specified distance of this portion of the Illinois River, in order to make warehouses located on the NIR an effective source of deliverable supplies.[18] The specified area should encompass corn and soybean storage facilities that typically store these commodities on a seasonal basis and from which substantial deliverable supplies would be available.

2. The recommended locational price differentials for delivery in store at Toledo, the ECI, and warehouses located on or near the NIR should be modified so that they reflect commonly observed cash price relationships with the contracts' other delivery locations. Specifically, for deliveries at NIR barge-loading facilities, the price differential levels selected should reflect the fact that corn and soybeans become more highly valued the further south the delivery location is on the NIR.

2. Illinois River Shipping Certificate Delivery Alternative

An alternative specification that could also result in the necessary increase to deliverable supplies would replace the existing warehouse-receipt-delivery instrument with a shipping certificate and provide for delivery at Illinois River barge loading facilities, in addition to the contracts' existing Chicago, Toledo, and St. Louis delivery points.[19] The Illinois River delivery area could be specified to include all or a substantial part of that River. The contracts' par pricing location could be shifted to a delivery location/area that has an active cash market, with locational price discounts for other delivery points/areas set at levels that fall within the range of commonly observed cash price differences between the specified delivery locations.

[18] As recommended by the Special Task Force for deliveries at ECI warehouses, the receiver of corn and soybeans in an off-water warehouse could be given the option of taking delivery of corn and soybeans in barges from regular warehouses on the NIR or by rail from the off-water facility.

[19] The terms of the shipping certificate could be specified in several different ways. For example, the shipping certificate could require that the issuer ship corn or soybeans in rail cars or trucks to a location nominated by the buyer within the specified delivery areas, with the buyer having the option of requiring that the corn or soybeans be loaded into barges at a specified premium.

3. Lower Mississippi River Export Alternative

This alternative would eliminate the contracts' existing delivery locations and delivery instrument in favor of an export-oriented contract with a shipping certificate as the delivery instrument. The shipping certificate would call for delivery at export locations on the lower Mississippi River.[20]

4. Cash Settlement Alternative

This alternative would replace the contracts' existing delivery provisions with cash settlement provisions. The cash price index could be based on the USDA-quoted prices for corn and soybeans in the primary production or export market areas on the last day of trading or any other method of calculating a cash-settlement price consistent with Guideline No. 1.

Section 5a(a)(10) of the Act authorizes the Commission to change or supplement the terms and conditions of futures contracts. The Commission would prefer, however, not to take such an action. Rather, the Commission looks forward to receiving for its approval proposed modifications from the CBT to the delivery specifications for the CBT's corn and soybean futures contracts which satisfactorily address the issues discussed in this letter. In the event that the Commission fails to receive such proposed amendments by March 4, 1997, the Commission is prepared to take appropriate action under Section 5a(a)(10) of the Act to address the situation.

By the Commission,

Jean A. Webb,

Secretary of the Commission.

The Commission has determined that publication of the notification to the CBT for public comment will assist the Commission in its consideration of these issues, including in particular, the eventual response of the CBT. Accordingly, the Commission is requesting written data, views or arguments from interested members of the public. Commenters are specifically requested to address the following issues:

1. To what extent do the current CBT delivery specifications for corn and soybeans reflect the structure of the cash market for the underlying commodity? To the extent the terms of the contracts depart from commodity flows in the cash market, does this have any detrimental impact on the trading of these contracts?

2. What is the likely effect of failing to modify the current terms of the contract?

3. To what extent would the alternatives listed by the Commission increase deliverable supplies on the contracts, and would such increases be sufficient under the Act?

4. The Commission identified several changes to the CBT Task Force's recommendations necessary to provide "a meaningful increase in the level of economically deliverable supplies available for futures delivery." To what extent is it necessary to permit delivery in off-water warehouses if delivery on the contract continues to call for warehouse receipts at warehouses on the Illinois river, which largely tend to be through-put facilities? What is the range of discounts or premiums commonly observed in the cash market for corn and soybeans that would be deliverable in Toledo, East Central Illinois, or the Northern Illinois River, compared to Chicago?

5. Is modification of the contracts' delivery provisions likely to enhance or detract from their hedging or price-basing utility?

6. On a related issue, to what extent do the current CBT delivery specifications for the futures contract for wheat reflect the structure of the cash market for the underlying commodity? To the extent that the terms of the futures contract depart from commodity flows in the cash market, does this have any detrimental impact of the trading of futures contracts for wheat?

7. What is the likely effect of failing to modify the current delivery specifications of the wheat contract?

8. What alternatives to the current delivery specifications would increase deliverable supplies on the wheat contract, while maintaining its utility for hedging and price basing?

Issued in Washington, D.C., this 19th day of December, 1996, by the Commodity Futures Trading Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 96–32708 Filed 12–24–96; 8:45 am]

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[20] As in alternative 2, the shipping certificate's terms may be specified in different ways. In this case, for example, the shipping certificate could require the issuer to deliver corn or soybeans in barges or rail cars to an export location on the lower Mississippi River specified by the buyer, with provision for delivery corn and soybeans to be loaded into vessels at a specified premium.

DEPARTMENT OF DEFENSE

Office of the Secretary

Defense Partnership Council Meeting

AGENCY: Department of Defense.

ACTION: Notice of meeting.