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DEFAULT OF FUTURES CONTRACTS FOR MAINE POTATOES

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HEARING

BEFORE THE

SUBCOMMITTEE ON
AGRICULTURAL PRODUCTION, MARKETING,
AND STABILIZATION OF PRICES

OF THE

COMMITTEE ON
AGRICULTURE AND FORESTRY

UNITED STATES SENATE

NINETY-FOURTH CONGRESS

SECOND SESSION

JUNE 21, 1976

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DEFAULT OF FUTURES CONTRACTS FOR MAINE POTATOES

MONDAY, JUNE 21, 1976

U.S. SENATE,
SUBCOMMITTEE ON AGRICULTURAL PRODUCTION,
MARKETING, AND STABILIZATION OF PRICES OF THE
COMMITTEE ON AGRICULTURE AND FORESTRY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:13 a.m., in room 324, Russell Senate Office Building, Hon. Walter D. Huddleston (chairman of the subcommittee), presiding.

Present: Senators Huddleston, Clark, Young, and Dole.

Also present: Senator Muskie.

STATEMENT OF HON. WALTER D. HUDDLESTON, A U.S. SENATOR FROM KENTUCKY

Senator HUDDLESTON. The subcommittee will come to order.

As chairman of the Subcommittee on Agricultural Production, Marketing, and Stabilization of Prices of the Senate Agriculture and Forestry Committee, I have great interest in the efficient functioning of the futures market as a basic element in the process of orderly marketing of agricultural commodities.

This is so since it is usually the farmer who pays most heavily for any failures in the market mechanisms for his product.

Irresponsible trading and lack of effective market regulation not only stir farm resentment and opposition to futures trading but are costly to the economy as a whole.

A fundamental purpose of the Commodity Futures Trading Commission Act of 1974 is to insure fair practice and honest dealing on the commodity exchanges and to provide a measure of control over those forms of speculative activity which tend to demoralize the markets to the injury of producers and consumers and the exchanges themselves.

I have therefore called this oversight hearing today to determine the facts as they relate to the failure of the shorts in the May 1976 potato futures contracts, either to liquidate their positions or to deliver in accordance with the terms of the contracts.

The committee will want to know from the exchange when first they noticed the peculiar situation developing; what steps were then taken; the responsibilities of the exchange and clearing members; and what has been done to enforce its own rules.

We want to know from the Commodity Futures Trading Commission its total activity in this unprecedented default; the specific actions it has taken and those it expects to take.

Also there is the question as to whether the CFTC, as it was created a year ago, has the legal authority and resources to carry out its responsibilities.

We believe this is a very serious matter and one that cannot be permitted to happen again.

For that reason, we have called witnesses today who are most closely connected with these particular activities and are seeking from them testimony as to precisely what happened and why it happened.

At this point, I will insert a statement by Senator Dole.
[The prepared statement of Senator Dole follows:]

STATEMENT OF HON. ROBERT DOLE, A U.S. SENATOR FROM KANSAS

Mr. Chairman, I commend you for scheduling this oversight hearing on potato futures trading. Certainly, all of us are concerned about last month's massive default by sellers of potato futures contracts. But, perhaps more important, this situation needs to be explored fully to prevent such tragedies from occurring in the future, either in potatoes or other commodities.

It is my hope that those testifying at this hearing will provide answers to the following types of questions:

1. Why did the default occur? Were the New York Mercantile Exchange and the Commodity Futures Trading Commission aware of the developing problem before the default actually occurred?

2. Has the potato futures contract been serving any useful economic purpose or has the contract been used only for speculation?

3. What corrective action has the Commodity Futures Trading Commission taken? Has the Commission responded to the responsibility given it by Congressional mandate? I look forward to the testimony.

Senator HUDDLESTON. Our first witness will be Mr. Richard B. Levine, president of the New York Mercantile Exchange in New York.

Mr. Levine, if you will proceed.

STATEMENT OF RICHARD B. LEVINE, PRESIDENT, NEW YORK
MERCANTILE EXCHANGE, NEW YORK, N.Y.

Mr. LEVINE. Mr. Chairman and members of the committee:

I am grateful for the opportunity to present these comments to this subcommittee.

I am Richard B. Levine, president of the New York Mercantile Exchange. The exchange has been designated by the Commodity Futures Trading Commission as a contract market for futures trading in platinum, palladium, fresh frozen imported boneless beef, U.S. silver coins, gold, heating oil, industrial fuel oil and, of course, Maine potatoes. The exchange also conducts a spot market in silver dollars and butter.

The exchange is a 104-year-old institution, and futures trading in Maine potatoes has been carried on since 1941.

On May 25th of this year, three clearing member firms of the exchange failed to tender delivery notices involving 997 Maine potato contracts. The subsequent failure of three contract lots to meet delivery inspection standards and the failure of the delivering firm to replace them within the allowable time raised the total number of defaults to 1,000 contracts.

The exchange can well appreciate the subcommittee's concern over this default in view of the subcommittee's interest in the activities of the Commodity Futures Trading Commission.

Therefore, I am pleased to have the opportunity to increase your awareness of how the exchange is dealing with the situation, demonstrating its self-regulatory responsibilities, responding to the regulatory interests of the Commission and planning for the future with an expansion of its potato futures contract to embrace additional growing areas.

The fact of the default is simple to understand: A failure to deliver and a failure to fulfill futures contract obligations by three firms.

The issues involved, however, are complex and in the case of many factors, are still in the process of discovery by investigation and verification.

The exchange audits and investigations staff has already compiled a mass of data and evidence for presentation to our business conduct committee.

This committee will bring charges against any exchange member or member firm found to have violated exchange bylaws or rules. The exchange's adjudication committee will pass upon these charges and the board of governors will impose penalties if the charges are sustained.

The procedures for dealing with the default are no less complex than the issues. A fair market value for the undelivered potatoes has been determined by a special committee appointed for that purpose.

Our board of governors has already held hearings on the value determined by the committee and, upon request of member firms involved, has continued those hearings until June 22.

Upon their conclusion, the board will decide whether to change the fair market value determined by the committee and after its decision, the three defaulting firms will pay to the 14-member firms who did not receive delivery the difference between the contract settlement price on the last day of trading and any higher fair market value.

If this value is unchanged from the committee's figure of \$10.66 per hundredweight, or \$5,330 per contract, present holders of long positions will receive \$980 per contract.

The exchange clearinghouse committee will also hold hearings to determine whether any additional payments should be made to any individual contract holders who can prove special damages not compensated by the ordinary settlement.

This opportunity to receive fair compensation, by the way, is specifically provided under the default provisions of the contract.

The clearinghouse committee has already held lengthy hearings on prospective penalties to be assessed against the defaulting firms by reason of the default.

These hearings will be continued on June 25, June 29, and June 30, also upon request of the firms involved.

The committee's recommended penalties will be the subject of additional hearings before the board of governors which will make the final determination.

The exchange is thus affording due process to all parties. Needless to say, the procedures and the issues have been the recent pre-

occupation of almost as many attorneys as there are actual customers involved.

The public, the exchange community, the Commission and this subcommittee await the resolution to this situation while due process is served.

And served it will be, in an effort to afford fairness and equity and opportunity or mitigating comment by exchange members or member firms facing penalties for their actions.

Once served, however, due process will result in appropriate and responsible exchange action. The exchange is fully aware that its credibility and self-regulatory responsibility will be demonstrated by the manner of its disposition of the matter.

At the same time, the exchange is accountable to the Commission which, as you know, is pursuing its own investigation. I can testify that this investigation is being conducted intensively. However, inasmuch as the Commission's investigation and the exchange's activities are pending, I am sure the subcommittee will agree that this is neither the time nor the forum for the discussion of the complex details involved in this matter.

Moreover, the exchange would seriously compromise its efforts and procedures to deal effectively with the default, the penalties resulting from it, and the disciplinary proceedings resulting from exchange rule violations if more than a general overview of the situation were provided here.

Nevertheless, subject to these constraints, at the conclusion of my statement, I shall try to be as responsive to questions as the circumstances permit.

On May 27, 2 days following the default, the Commission urged the exchange to limit trading to liquidation only in the Maine potato contract for next May's delivery.

The exchange complied on the following day, requesting and receiving authority to limit trading to liquidation only in this delivery month.

The Commission has requested that the exchange submit for its approval a revised contract which would increase the supply available for delivery.

Under our revised contract, the exchange believes it has the basis to persuade the Commission that a May delivery option is feasible.

A large number of varietal types of potatoes will be deliverable from virtually all Eastern potato-growing areas. Delivery will be required by truck rather than rail, although rail delivery will be possible, pursuant to action by the board of governors, should delivery exclusively by truck be impractical at any time.

The broader geographical potato-producing areas covered by the contract will create a more useful hedging vehicle. Comments of potato industry representatives to date indicate a high probability of success for the new contract.

Finally, while the subcommittee's interest in this default is understandable, its members and staff should keep in mind the capability with which Congress endowed the Commission to deal with events even so unlikely and unpleasant as this.

The Commission's power to regulate futures trading is more than adequate. In fact, it is awesome.

I have no doubt the Commission views this situation as a test of its own capability, just as the New York Mercantile Exchange is being tested as a responsible public institution.

I am confident that both the exchange and the Commission will emerge the stronger for this test.

I ask that you share this confidence and defer both formal inquiry and judgment until the record of performance has been established.

The board and administration of the exchange are totally immersed in this task, and have no doubt of its importance. The Commission, as well, has made the exchange keenly aware that its own views and actions are based on the same understanding.

Senator HUDDLESTON. Thank you very much, Mr. Levine.

I appreciate the specific and detailed explanation of what the exchange has proposed and is attempting to do after the fact of the default.

It seems to me that an important part of this inquiry is what the actions of the exchange were, when concerns were expressed that default might occur.

Certainly, questions were raised about the deliverability of the short contracts. They were raised by members of the Commodity Futures Trading Commission staff; your staff was aware and had some concern.

Can you tell me specifically what that concern was early in April.

Mr. LEVINE. The exchange is always concerned, Mr. Chairman, with the development of large customer positions. Late in March, the exchange first asked for customer positions from its clearing member firms.

The exchange was aware of the existence of the short positions and went back to the clearing member firms involved on numerous occasions to indicate the exchange's concern that the member firms assure themselves of their customers' capability of performance, and that, in turn, the exchange would look to its clearing member firms for demonstration of responsible performance under exchange rules.

Senator HUDDLESTON. Did you have an actual meeting with the traders to advise them of their responsibility to avoid creating a disorderly market?

Mr. LEVINE. Mr. Chairman, the exchange recognizes and deals with its clearing members. It does not effectively know their customers.

The exchange can know who the customers are but it does not deal with them nor can it regulate them; it does not deal with nor can it regulate the customers' market activities. It can regulate the activities of the member firms carrying those customers' accounts.

Mr. Chairman, the record should show that at no time was there ever a worry that there would be a default. There was a concern about the available supply of potatoes which was determined to exist in adequate supply for the shorts to continue in satisfaction. There was never a suspicion that there could have been a default.

Senator HUDDLESTON. Well, of course, the deliverable supply is the thing that would lead to a default. It certainly ought to be a red flag that you should have expressed a good deal of concern about and investigation into it.

As a matter of fact, on several occasions, the acting regional CFTC Administrator discussed with officials of your exchange the possibility of substantially increasing the margin requirements for large

traders who were not liquidating their positions and this was not done.

Was there any specific reason why it was not done?

Mr. LEVINE. Senator, the exchange made a determination prior to the end of trading—and I might add that all of this is part of the exchange's responsibility to make its report to the Commission.

Without getting into a great deal of detail, let me assure you that the exchange did determine that prior to the end of trading in the May contract, a sufficient supply of potatoes existed relative to the expected quantity to be delivered many fold.

The liquidation pattern of the market was not inconsistent with prior history.

The option that the clearing members on the short side of the market and their customers have to get out of the market should not be overlooked. Should these customers and the clearing members have determined that the risk of nondeliverability was so great, they had the option of not delivering the potatoes.

They chose to obligate themselves to deliver.

That obligation, the exchange looked to these member firms to perform. The exchange has normal additional margin requirements on the first of each delivery month and these were fulfilled. We were aware of the substantial financial sufficiency that the customers had demonstrated to the clearing member firms carrying their accounts.

Senator HUDDLESTON. Well, are you saying that the number of open contracts on May 7—1,911 I believe—was not uncommon, not unusual, that being the last day of trading?

Mr. LEVINE. That was very unusual, Mr. Chairman. What was not unusual was the decline in the commitment pattern during the 10 days prior to the last day.

Now, at the beginning of the last day of trading, the commitment was 3,422 contracts. That figure was 16 percent less than the average commitment at the beginning of the last trading day during the prior 10 years.

Second, historically, on the average over the past 10 years, 93 percent of the exchange's commitment is liquidated on the last day. That would have indicated to the exchange, had the exchange been concerned with a default, had the Commission been concerned with a default, had anyone been concerned with a default, that the likelihood existed for no more than 250 contracts to remain open after trading on the last trading day.

The 1,911 cars that remained open came as a shock to everybody concerned. The pattern of liquidation prior to the last trading day was more than normal.

Senator HUDDLESTON. So the pattern was not unusual except as you say, it was even better maybe under normal circumstances but by the end of trading that day you had 997 default contracts?

Mr. LEVINE. No, sir; between the end of trading on—

Senator HUDDLESTON. May 25?

Mr. LEVINE. That is right; on May 25 there were 997 contracts in default.

Senator HUDDLESTON. Well, if this were so normal and the exchange had such little concern about it, why do you suppose that representatives of the Commission were in such constant and persistent contact with the exchange, requesting that they, No. 1, en-

force their own rules and that they show some concern about the situation that was developing?

Mr. LEVINE. Well, indeed the Commission was concerned. The exchange was equally, if not more concerned. The exchange, I think, will be able to show to the Commission, a responsible pattern of surveillance, a responsible prior effort to assure the orderly liquidation of the May potato futures contract and ample evidence of circumstances and events which in highly improbable combination caused the exchange to be a victim.

The exchange was not passive in terms of market surveillance, demonstrating its self-regulatory ability, in my opinion.

The exchange felt that its clearing member firms, whom it asked prior to May 7, subsequent to May 7, all the way through the last day of the period of time during which tender notices could be delivered, would act responsibly. The exchange looked to its member firms, actively, for performance under exchange rules and demonstrated on the occasion of many conversations with the representatives of these member firms, the exchange's concern and expectations.

Senator HUDDLESTON. Well, were the member firms giving you inaccurate or misleading information?

Mr. LEVINE. It would appear, Mr. Chairman, that the member firms were giving to the exchange the assurances which in turn were given to them by their customers.

The member firms apparently felt more obliged by their customers' desire and wishes, than by exchange rules.

Senator HUDDLESTON. You were admonished on several occasions, both orally and in writing from the Commodity Futures Trading Commission to "enforce your own rules relating to this matter."

Now, specifically, what were they asking you to do?

Mr. LEVINE. Specifically, what was the Commission asking the exchange to do?

Senator HUDDLESTON. Right, in enforcing your own rules relating to this particular trading incident?

Mr. LEVINE. On April 30, at a meeting between exchange officials and the Commission, the subject of the meeting was the large shorts position built up by certain customers and the possibility that their activities might conceivably be involved in market manipulation.

The market performance was examined and it became clear to both the Commission and the exchange that at that time and up to that time there was no evidence of market manipulation by shorts, which would have been a downward pressure on the market.

I cannot speak for the Commission in terms of how they expected the exchange to enforce its rules. I think the Commission left to the exchange the decision as to what courses of action were available to be taken. Certainly that cannot be disputed.

The exchange consulted with the Commission at virtually every turn it took in taking action and again, Mr. Chairman, the exchange assured itself that the clearing member firms carrying customer short positions were aware that the exchange has a rule which requires that no later than 5 minutes before the end of trading, on the last trading day, those firms which are not in a position to make delivery must have liquidating orders on the floor of the exchange. That rule, or the application of that rule, Mr. Chairman, is the subject of disciplinary investigations by the exchange's audit investigation staff;

and if there are found to have been violations of that rule, there will be disciplinary proceedings brought against member firms.

There was no lack of assurance on the exchange's part that the clearing member firms involved in this default were aware of the position of their customers on their books, that these firms were aware that their customers' positions on those books represented a small portion of the total position those customers had on the books of the total number of firms with which they were dealing and that this rule of the exchange, which these firms are typically reminded of at the beginning of every delivery month, was indeed a matter of concern to the exchange in this instance.

Senator HUDDLESTON. Well, you took the position then that the members knew the rules and you assumed that they were going to abide by the rules. The assurances that they presumably received from the traders to them and from them to you, were adequate as far as you were concerned, as the final trading day purposes; is that accurate?

Mr. LEVINE. Yes, Mr. Chairman, it is accurate.

Senator HUDDLESTON. The Commission was apparently not quite so confident, however, because they kept insisting that you get additional information even from the traders themselves; is that correct?

In the April 20 meeting, did you not suggest to the representatives of the Commission that they themselves might want to contact the traders?

Mr. LEVINE. Exactly, sir.

Senator HUDDLESTON. And ascertain from them what their specific position and intentions were; is that correct?

Mr. LEVINE. Exactly so; and the reason for that suggestion, Mr. Chairman, was the inability of the exchange to reach out to the customers on the books of the clearing members' firms and the capability of the Commission in doing so.

We suggested to the Commission that their contact with the customers, with a copy of a telegram to the clearing member firms carrying those customer accounts might go a long way toward making sure that the customers were reminded of the severity of the penalties which might result from any proved market manipulation.

I am not aware, Mr. Chairman, of any conversation with any staff member of the Commission or members of the Commission itself with regard to the possibility of default.

Senator HUDDLESTON. What would have been their concern about this situation? The obvious long position of a number of large traders, slowness in liquidating those positions.

Mr. LEVINE. Their concern, Mr. Chairman, I believe, is based on the availability of potatoes for delivery in comparison with the size of the total position attributed to these large trade interests and I underline "trade interests." These are not speculators, by their own characterization.

These customers are in the potato business and are expected or would normally be expected to be able to perform an obligation connected with the industry in which they were involved.

Senator HUDDLESTON. After the last trading day, it did become apparent, did it not, to the exchange, that something was amiss and that something needed to be done to expedite the possible liquidation?

Did you not make some suggestions as to changing the contract? Incidentally, I think at this point it might be well if you described the factors of the contract in the Maine potatoes futures for the record.

Mr. LEVINE. Let me briefly describe, Mr. Chairman, then, the contract as it was traded on May 7, and still is traded.

This is a contract for one freight, or 50,000 pounds of Maine potatoes, packed in 50-pound sacks. The more commonly known varieties of Maine potatoes are deliverable under the contract; they are inspected at origin; they are inspected at destination.

The months in which deliveries have been made typically are November, March, April and May. And I have forgotten your former question.

Senator HUDDLESTON. They must be delivered by rail also?

Mr. LEVINE. Rail delivery is required.

Senator HUDDLESTON. Only Maine potatoes? For the record, and for the Chairman's own edification, why were those particular requirements imposed?

Mr. LEVINE. Delivery by rail, sir?

Senator HUDDLESTON. Delivery by rail, no substitute of similar product.

Are these unduly restrictive delivery requirements?

Mr. LEVINE. In the judgment of the exchange, over the past number of years, no, sir. Let me deal with substitution first.

A less desirable grade of potato, known as commercials, as opposed to U.S. No. 1 potatoes, which are the contract specification, are deliverable at a discount, an escape valve, if you will, so that in the event of a shortness of supply, a broader base of supply could be tapped for delivery. The use of rail facilities is still no problem, provided the number of deliveries is itself no problem.

However, the exchange has grown increasingly concerned about the deterioration of the rail facilities in the Northeast: The incapability of the railroads to keep on tap for occasional substantial deliveries, refrigerated cars, facilities for loading, facilities for unloading. While these conditions have grown worse, they have not yet worsened to a point where they became critical until a delivery condition arose requiring the use of these facilities beyond their capacities.

If there had been only 250 cars of potatoes delivered, Mr. Chairman, there would have been no default. There would have been no concern, and yet the exchange would have pursued as it has for the past 31½ years, the revision of its contract.

I know from prior visits of my own to Maine, in conversation with the Maine Potato Association, in conversations with the Maine Potato Council, the Maine Potato Commission, we have asked for input, suggestions, as to the feasibility of a truck delivery.

We are not unaware of the substantial number of potatoes shipped by truck in comparison with those shipped by rail.

Senator HUDDLESTON. Have you not made proposals that futures contracts be changed to permit truck deliveries?

Mr. LEVINE. Indeed we have, sir.

Senator HUDDLESTON. What is the status of that proposal at the present time?

Mr. LEVINE. The status of that proposal is two progress reports to the Commission, Mr. Chairman, in the first of which the exchange responded to the suggested areas of alteration, of amendment of the contract, that the Commission suggested would be appropriate.

The second response late last week was one in which two contract drafts were sent to the Commission, along with a letter explaining that the mechanics of inspection and delivery, particularly in regard to procedures at destination had not been finally determined; that it seemed appropriate to the exchange to obtain additional reactions from members of the potato industry and that the members of the drafting committee had been working diligently, long and hard to develop a draft in response to the Commission's urgings and the necessity of doing so under very severe time frames.

Senator HUDDLESTON. Now, the exchange had procedures and rules to follow.

In the case of a default of this nature the exchange itself would purchase potatoes at whatever price necessary and deliver the potatoes to those holding long position and short sellers would then be charged with the increased price plus a penalty of \$100.

Why was this procedure not followed? Why is it not being followed?

Mr. LEVINE. Mr. Chairman, the exchange has in its contract a rule which deals with defaults. That rule, I believe, was written years ago and had in mind some condition, let us hope, different from the one that exists today.

The rule requires in the case of the potato contract, it is exchange rule 51.14—that the president obtain, purchase, as you suggested, potatoes for the account of those who did not receive them, in the quantity equal to those in default, purchase potatoes in the quantity equal to that in default; deliver those potatoes to the buyer.

That rule further provides that any buyer who has suffered extraordinary damages as a result of failure of the shorts to deliver, may claim them and be reimbursed for them and, thirdly, that at least a \$100 penalty will be assessed against those firms failing to deliver.

The exchange believes that it has diligently followed that rule, Mr. Chairman. As a result of the inoperability of the first portion of it, the inability of the president to purchase potatoes equivalent in a quantity equal to that in default, the exchange has created a special committee.

Senator HUDDLESTON. You cannot purchase the potatoes because they are not available?

Mr. LEVINE. Apparently not, sir.

As a result of my own efforts and a canvas, a canvas of dealers and typical sources of potatoes in the State, I reported to our board of governors the inability to purchase more than a few cars of potatoes.

The board looked at the rule and determined that the rule specifically required the purchase of a quantity of potatoes equal to those in default. Since that was impossible performance, a substitution for that provision of the rule made under the exchange's emergency powers. A special committee was created to determine a fair market value for those undelivered potatoes. That fair market value is currently the subject of hearings before the board to deter-

mine whether that value should be changed prior to longs receiving the difference between it and the contract settlement price of \$8.70 established on the last trading day.

Senator HUDDLESTON. You are looking for a way of compensating money without the necessity of—

Mr. LEVINE. That is correct. That is correct, sir.

Senator HUDDLESTON. Mr. Levine, it has been suggested that it might be motive, this may be an area that you have to be careful with in both parts, of the sellers and the buyers, to attempt in some way to discredit the futures trading of potatoes.

Have you seen any evidence of this or are you concerned about this possibility?

Is this part of the subject of inquiry that you are making?

Mr. LEVINE. Mr. Chairman, the exchange is extremely concerned and is working not only diligently on its own behalf, but in cooperation with the Commission to determine whether any of these allegations are true.

Should they be true, we would hope that, in areas in which the exchange cannot reach out and penalize those found to have broken the exchange rules, the Commission will surely do so.

Senator HUDDLESTON. Have you filed, or do you anticipate filing, any legal action against any persons involved?

Mr. LEVINE. The entire posture of the exchange's position with regard to any potential legal action, sir, is under very, very close study.

Senator HUDDLESTON. No decisions have been made at this time?

Mr. LEVINE. No, sir.

Senator HUDDLESTON. Senator Dole—

Senator Young, any questions?

Senator YOUNG. Just two or three.

As a result of this default in trading, what relief do the longs have?

Does the exchange—will the exchange be paying them?

Mr. LEVINE. Senator, the question is extremely appropriate, because under the default rules of the exchange, any long who has suffered damages in excess of the ordinary damages, for which he will be compensated, may file a claim. If he can prove that claim, he will be paid by the shorts through the exchange's clearinghouse to the extent that his claim is verifiable.

Had any other procedure been utilized that equity, that fairness, that due process for the long, that compensation for injury, would not have been so easy to provide, sir.

Senator YOUNG. You mentioned a penalty of \$100.

Mr. LEVINE. At least \$100 per contract, sir.

Senator YOUNG. To whom?

Mr. LEVINE. The penalty of at least \$100 per contract, Senator, is assessed by the exchange on the clearing members in default, on the member firms themselves, sir.

Senator YOUNG. That is not much of a penalty, is it?

Mr. LEVINE. Not \$100, sir. At least \$100 per contract.

It would appear that this rule on the exchange books was written in contemplation of a condition somewhat different from what exists today.

The rule, however, does provide a certain flexibility in terms of describing the penalty as at least \$100.

Senator YOUNG. I would think it would be more than that.

But another question or two.

Do your contracts deal only with Maine potatoes, or do they include potatoes from any other area?

Mr. LEVINE. The contract as currently traded is concerned with potatoes grown only in the State of Maine. The contract, as it will be amended and which has been the subject of a great deal of effort on the part of the exchange in consultation with the Commission, will include potatoes which could be characterized as round white as opposed to russets.

The contract will not include so-called western grown varieties, sir.

Senator YOUNG. Why not include all potatoes of good quality, like Idahos? In the Red River Valley where I come from we have very good potatoes; why are they not included?

Mr. LEVINE. Sir, Senator, we are not excluding other varieties purposely.

As a matter of fact, one of the chief frustrations of the exchange is its inability to write a contract which encompasses the delivery of all potatoes grown in the country.

Apparently, as I understand the situation, the reason for this inability is a lack of interchangeability in end use between the so-called russets and the round white potatoes.

The round white potato is a baking potato and a potato essentially for table use and for some processing. The russet potato is particularly used in processing.

I know that we bake both potatoes but the interchangeability is not as great as it would have to be for a buyer to hedge or seller to hedge on a contract that would provide for delivery of any variety grown in the country.

Senator YOUNG. I would think you could have about the same exchangeability as they have on the grain exchanges. Certainly you could have more flexibility than you have now.

All right; that is all I have.

Thank you.

Senator HUDDLESTON. Senator Dole?

Senator DOLE. On page 2 in the second paragraph, I want to be certain that I understand it.

You say, "The exchange audits and investigations staff has already compiled a mass of data and evidence for presentation to our business conduct committee." And then you state, "This committee will bring charges against any exchange member or member firm found to have violated exchange bylaws or rules."

Is that the \$100 or more that you are talking about in that paragraph?

Mr. LEVINE. No. Senator, it is not. I meant specifically to differentiate between the disciplinary proceedings the exchange will bring for rule infractions and the issues that we are dealing with in terms of the default itself and the equity that we are providing for all parties.

The \$100 penalty is specifically at least the minimum penalty provided for in the rule that deals with defaults.

Senator DOLE. Have you imposed such a penalty in the past? Has the exchange, prior to this problem ever had occasion to impose any penalty because of default?

Mr. LEVINE. Yes, sir.

Senator DOLE. And what were the penalties? Just give me some examples.

Mr. LEVINE. Senator, I do not have those numbers fixed in my mind at the moment. They were so long ago that I really have not paid much attention because I thought they—

Senator DOLE. I just want to determine in my own mind if there was a vigorous enforcement of defaults. If you have any information, we would appreciate having it for the record.

Mr. LEVINE. I would be delighted to provide the subcommittee with information in exactly the areas in which you expressed an interest, sir.

[The following excerpt was subsequently received by the committee:]

[Excerpt from pages 92 through 94 of publication entitled "Futures Trading in Potatoes 1954-1955" dated November 1955, Commodity Exchange Authority, U.S. Department of Agriculture.]

INVESTIGATION OF THE MAY FUTURES

The next CEA investigation was concerned with the New York potato futures operations of a group consisting of six individuals and six corporations of which these individuals were officers. In April and the first part of May this group made large short sales in the May future. On May 6, this group held short positions of over 1,000 carlots, approximately one-half of the total open contracts. Between May 6 and May 18, the short positions were reduced substantially, but the group still held approximately one-half of the total open contracts.

Shortly before the close of trading on May 19, next to the last trading day in the May future, the group gave one of its brokers an order to sell 400 carlots. This very large order was given at a time and under circumstances which appear to have been designed to cause a decrease in the price of the May future. However, there were strong traders who were willing to buy any contracts which were offered for sale; so the selling order did not have the price effect apparently desired.

On May 19, the group increased its short position to over 1,000 carlots, which represented approximately three-fourths of the total open contracts. This increase in its short position was made in the face of the fact that the group did not have potatoes to deliver on a major portion of its commitments. On May 20, the last trading day in the May future, the group covered a portion of its short position, but at the close of trading still held a short position of 734 carlots.

On May 17, a representative of the group requested the U.S. Department of Agriculture to have inspectors available to inspect 400 to 450 cars of potatoes which he stated would arrive in the Harlem River Yards on the weekend of May 28 through May 30. This was an extremely large number, and an unusual request. On May 19, at a time when the group had a short position in excess of 1,000 carlots, its broker was told that it intended to deliver potatoes in satisfaction of its position. The group circulated on the exchange this information regarding its request for inspections and regarding its supposed plan to ship large quantities of potatoes into New York City for delivery.

During the period from May 2 through May 20, the group delivered 184 cars of potatoes in satisfaction of its short contracts in the May future, and after the close of trading, despite its stated plans for shipping potatoes to New York, the group delivered only an additional 128 cars, and defaulted on 606 contracts. This was the largest number of defaults ever recorded on the exchange. Surprisingly, in the face of its need for potatoes to deliver on its own short contracts and the growing certainty of default, the group sold 50 cars of deliverable potatoes to a Chicago trader who also held a sizable short position in the May future.

A large portion of deliveries made by the group consisted of potatoes originally shipped from Maine in 50-pound bags which were repacked in 100-pound bags after arrival in New York City to meet the delivery requirements of the

New York Mercantile Exchange. The cost of these potatoes, including charges for repacking, was substantially in excess of the price at which the May future expired.

On June 6, 1955, the grocery chain and eleven others in the group concerned were named respondents in an administrative complaint under the Commodity Exchange Act, charging attempted manipulation of potato futures prices in May 1955, and transmission of false and misleading information in violation of the act. (CEA Docket No. 68.) The respondents waived hearing and consented to the entry of an order denying trading privileges on all contract markets until further notice to 11 of the 12 respondents.

Senator DOLE. Is there any maximum number of contracts that an individual customer may hold at one time?

Mr. LEVINE. Yes, sir.

These are so-called speculative limits. "Speculative limits," as I understand the term, Senator, prevents the accumulation of substantial positions in the market on the part of people who are not involved in hedging; that is, not seeking price protection as a result of being in the industry which the futures contract serves.

There is obviously some question raised by this default, which the Commission is certainly diligently looking into, with regard to whether speculative limits have been violated.

Senator DOLE. Now, I know you have done it in your statement in a rather lengthy way, but I am wondering, just for my information and the others present, if you could just recap briefly step-by-step accounts of the action the exchange took since this problem developed and since the default occurred?

Mr. LEVINE. Without referring to my statement, Senator, let me try to summarize.

Since the default occurred, apart from meetings of our board of governors, virtually every day, the exchange first made an attempt to purchase potatoes for the account of the defaulting of sellers to deliver to the buyers.

After failing to do so, pursuant to resolutions of the exchange's board of governors, the exchange rule 51.14 was amended to provide for the appointment of a special committee by the chairman to establish a fair market value for these undelivered potatoes.

That committee has delivered to the board its recommended price of \$10.66 per hundredweight or, \$5,330 per contract, or \$980 more than the settlement price of the contract on the last trading day. The settlement price is that which the seller would have received from the buyer in the event of delivery.

The board is currently holding hearings among all parties concerned to determine whether or not to change that fair market price of \$10.66.

Second, let me back up—

Should that price not be changed, the sellers will pay, through the exchange clearinghouse, to the buyers the \$980 per contract, which represents the difference between the settlement price and the suggested fair market value.

Second, the exchange clearinghouse committee is currently holding hearings on penalties. These hearings, at the request of the clearing members involved, have been continued. They have been continued to as late a date as June 30.

There has been no continuance that I am aware of later than that date.

The clearinghouse committee's determination from its hearings on penalty will be referred to the board. The board, in turn, will hold hearings on those recommended penalties. The penalties will then be assessed by the board against the sellers.

Further, the exchange is preparing its disciplinary proceedings against any members found to have violated exchange rules based on this mass of data and evidence that the exchange audits and investigations staff has been in the process of accumulating.

Fourth, the exchange is responding to the regulatory interests of the Commission in providing the data the Commission is interested in knowing in regard to our own investigation, the penalties that we will assess which it has asked to be informed about and with regard to contract changes which the Commission and the exchange feel are appropriate.

The contract is being revised, Senator, amended. The default procedure, the procedures for dealing with the default are very much in operation and the disciplinary proceedings that will result from the events leading up to and including the delivery period which resulted in a default will be started momentarily.

Senator DOLE. That is all since the default?

Mr. LEVINE. Yes, sir.

Senator DOLE. What about before?

The reason I ask that question, I looked ahead and I have read the statement of Mr. Paul, who will be a witness later—and I cannot be here then—but he states on page 8 of his statement:

However, 1976 was an unusual year. Maine storage stocks of potatoes on April 1 (the last date for which stock reports are issued) were reported as only 7.4 million hundredweight, as compared to 13.0 millionweight in 1975, 9.3 millionweight in 1974, and 10.8 millionweight in 1973.

Hence, it seems likely that deliverable supplies to satisfy May futures contracts in 1976 were also significantly lower than usual. Each one millionweight shortfall is equivalent to 2,000 futures contracts (at 50,000 pounds per contract).

Now, I am just curious, if there was not some way to foresee you were going to have some problems and what you did as an exchange. I hope to find out from the Commission what they did.

I think one thing this proves is that you just do not create some new agency and solve all the problems. Others are trying to do that with regard to grain inspection. I think this is an example where we created an independent agency which had no impact on the problem but perhaps we can convince some of our colleagues that establishing another agency just does not solve all the problems.

But with this apparently common knowledge, what did the exchange do prior to default to head off the problems?

Mr. LEVINE. Senator, prior to the end of trading, not simply prior to the default—because obviously this kind of thought process was very much going on between the end of trading and the end of the delivery period, May 25—the exchange made its own analysis based on the same USDA starting figure that you offered in terms of stocks on hand as of April 1.

The exchange came to the conclusion that the available supply, while tight, was available in sufficient quantity to the shorts who had obligated themselves to deliver. They had every opportunity to come to the conclusions, on their own analysis that the potatoes they thought were sufficient enough supply were not in fact available. So,

they could have concluded they had better get out of the market on the last trading day, at least, if not before. They did not do so. They obligated themselves, sir, to deliver.

The exchange expressed this concern over short supply to the clearing members. The clearing members, in turn, assured the exchange of their awareness of their responsibility, of their intentions and their capability to perform and their customers' capability to perform.

Senator, it is an unfortunate event that has occurred. However, it should be borne in mind with regard to the exchange and the Commission, that however successful deterrents and discouragements might be to prevent a crime, these deterrents and discouragements cannot eliminate crime per se.

Senator HUDDLESTON. Are you suggesting that a crime has been committed here?

Mr. LEVINE. No, sir; that was a euphemism, a matter of speech.

Senator HUDDLESTON. It is not impossible?

Mr. LEVINE. It is not impossible, sir.

I am simply saying it is impossible to prevent that which is impossible to prevent.

Senator DOLE. I will vote for that. I will take it under advisement, or we will appoint a committee, as you have done.

What role did the Commodity Futures Commission play? Did they have any contact with the exchange prior to May 27, 1976, or are they on top of the thing?

We are just anxious to find out how this new agency is coming along.

Mr. LEVINE. Senator—

Senator DOLE. Or going along; I do not know which.

Mr. LEVINE. I do not offer these comments gratuitously about the Commission, simply as a result of its being the regulatory body that controls the future of the exchange, in effect.

But there is no question that the record speaks for itself. The Commission demonstrates, insofar as the exchange is concerned, its own ample concern, and its awareness of the exchange's concern.

On April 30, a meeting was held in my office with representatives of the Commission and the exchange in which meeting there was a sharing of information, a sharing of concerns.

Senator DOLE. When was this meeting?

Mr. LEVINE. April 30, sir. One week—the Friday before the end of trading.

The exchange had been involved in watching a short position held by certain customers from mid-March.

Similarly, the Commission was aware that these customers were in the market. The Commission looked to the exchange to enforce its self-regulatory responsibilities, and the exchange looked to its clearing members to demonstrate their self-regulatory responsibility.

Senator DOLE. But did you encourage the Commission to stay out of it.

Mr. LEVINE. On the contrary, sir. On the contrary.

Senator DOLE. Are there minutes of that meeting that we could have made part of the record?

Mr. LEVINE. Senator, there are no minutes. There are some summarizations that I have and notes at my office, which I would be

happy to give to the subcommittee if the subcommittee requests them; but they are—I would say to you, Senator, these are part of the issues that are pending and I would say if I am not inappropriately—

Senator DOLE. No; I do not particularly—I just thought you had a public record.

Mr. LEVINE. No, sir; we really have to report first to the Commission.

Senator HUDDLESTON. I would say here that they have submitted to the staff a summary—

Senator DOLE. Memorandum?

Senator HUDDLESTON. Memorandum of that meeting and others.

If Mr. Levine thought it might not be too difficult, I think his version would be helpful to the committee. I have not noted any conflict in what you said and what they said.

Mr. LEVINE. I would not want to deprive you on the subcommittee of any information. I am a little unsure as to our obligation to the regulatory body to which we are responsible and with which we have not formally sat down to compare notes on this. I would say it seems a little premature to me at this point.

Senator DOLE. I do not want to compromise anything you might be doing but if it can be done without any prejudice in an effort to find out what has happened, it would be helpful to the committee, I think.

[The following information was subsequently received by the committee:]

NOTES OF MEETING WITH REPRESENTATIVES OF NEW YORK MERCANTILE EXCHANGE AND CFTC—APRIL 30, 1976

On Friday morning, April 30, 1976, a meeting took place in the office of the President of the Exchange, the participants in which were Messrs. John Schobel and Howard Bodenhamer of the CFTC and Messrs. Levine and Gabler of the New York Mercantile Exchange. (Mr. Howard Gabler is the Exchange's Executive Vice President and Controller. He is also the officer in charge of the Audits and Investigations activities of the Exchange.)

It was suggested early in the meeting that Exchange Counsel, Mr. Mound, and in the absence of the Exchange Chairman, Jacob Stern, the Vice Chairman, Benjamin Pressner, sit in. The entire group was assembled at approximately 11 o'clock. At that time the CFTC reiterated their concern with the concentration of customer short positions in the May contract and offered cooperation to the Exchange in helping the Exchange to fulfill its responsibilities in maintaining an orderly market. The variety of potential actions available to the Exchange were explored, as was the nature of the customer short positions. Emphasis was placed on the fact that the customers were in the potato business, had substantial financial resources, had met the individual requirements of Clearing Members more than adequately, and were intimately familiar with the operations of the futures market.

It was suggested to the CFTC that of all the appropriate courses of action, the most appropriate, in the view of the Exchange, seemed to be through intervention by the CFTC and direct contact by the CFTC with customers in the form of a telegram, with copies to the Clearing Members involved, indicating the CFTC's concern and explaining the circumstances that might be described as market manipulation and the penalty for it. The Exchange expressed the belief that no condition existed which gave it adequate basis for taking any emergency action and, therefore, that CFTC involvement might well be suggested. The price action of the market, additionally, offered no basis for allegations of manipulation and no evidence of irregular market behavior.

The meeting concluded around noontime with the promise of the reaction of the CFTC after consultation with Washington.

Senator DOLE. Is anyone going to lose any money when this is all over, or are you just going to lose potatoes?

Mr. LEVINE. I think, Senator, the exchange's procedures for dealing fairly with those who failed to receive potatoes are sufficient to compensate for any losses they may have incurred.

I cannot comment on whether speculators have lost money. I am sure, statistically, we can find speculators who have lost and who have made money.

Senator DOLE. That is all I have.

Senator HUDDLESTON. Just a couple more questions, Mr. Levine.

Are you making any communication between persons in the short position and clearing member firms in which clearing member firms were specifically instructed not to liquidate on the last day of the trading?

Mr. LEVINE. Mr. Chairman, I am aware of communications between the clearing member firms and their customers, which communications are very much a part of the proceedings that are pending before exchange committees at the moment.

Senator HUDDLESTON. You cannot say specifically whether there was a deliberate understanding that there would not be a liquidation of shorts and therefore there would be default?

Mr. LEVINE. I think, Mr. Chairman, it might be premature for me to comment in specific terms at this point; but I think that it stands to reason that responsible member firms of the exchange felt more obliged by their customers' desires than by exchange rules.

Senator HUDDLESTON. Is this an area that is being investigated now?

Mr. LEVINE. Absolutely.

Senator HUDDLESTON. Would it be a serious matter to find that there had been collaboration here in violating the exchange rules?

Mr. LEVINE. That customers desire to deliver, per se, Mr. Chairman, does not disturb me. If a customer of a clearing member firm desires not to have his position liquidated, then he desires at the same time to make delivery. If he should choose to make delivery later, rather than liquidate his position, that is his choice.

It is also, Senator, his obligation.

Senator HUDDLESTON. In doing that, he accepts the obligation to deliver?

Mr. LEVINE. Yes, Mr. Chairman.

Senator HUDDLESTON. And the question then would be whether or not he knew at the time that the supply of potatoes was such that he could not in fact deliver. Which means that he would be deliberately going into a default position; is that right?

Mr. LEVINE. What went through the minds of the customers who obliged to deliver, Mr. Chairman, I really do not know. Perhaps the subcommittee would find out by asking them directly. I can only restate the exchange's conclusions on the basis of its own research, that a sufficient supply of potatoes existed.

Senator HUDDLESTON. On May 7?

Mr. LEVINE. On May 7, for that delivery obligation to be fulfilled.

Senator HUDDLESTON. Let me ask you one question that may be of particular concern to this committee.

How is the interest of the potato grower met? Is it enhanced by the futures trading process or is there danger that it is detrimental.

Mr. LEVINE. Well, Mr. Chairman, if this default shows one thing, it shows that the potato grower in Maine or anywhere else needs a

futures contract to protect his own interests. He cannot afford to permit those interests to be dictated by those large enough to make an impact on the trade in the international marketplace. The price discovery qualities, the price protection qualities of the futures contract offered to potato growers are some of the most precious tools he has, next to his capability of growing potatoes with the right kind of seed and fertilizer and God willing, rainfall.

Senator HUDDLESTON. Of course, the process has to operate with integrity?

Mr. LEVINE. It does, indeed, sir.

Senator HUDDLESTON. It must assure that obligations will be met in order for the whole system to work?

Mr. LEVINE. Very much so.

Senator HUDDLESTON. That is the reason why the exchange must meet its responsibilities and the Commission must see that procedures are in effect which are adequate and are carried out in complete detail.

Senator MUSKIE, we are glad to have you join the subcommittee at this point. I was just ready, Senator, to put your statement in the record.

I will do that, or you might deliver it, or certainly you are welcome to ask any questions that you might want to at this particular time.

Senator MUSKIE. I appreciate that, Mr. Chairman.

I think that nothing will be lost in the public interest if my statement is put in the record.*

Senator HUDDLESTON. It will be placed in the record.

STATEMENT OF HON. EDMUND S. MUSKIE, A U.S. SENATOR FROM MAINE

Senator MUSKIE. I suspect that the points that I have made in the statement have already been made and I have never found repetition to be that valuable in these hearings.

Senator DOLE. It is a good statement. I have read it. It is almost as good as mine.

Senator MUSKIE. Last night I had—the reason I wanted particularly to get in here this morning, was that last night I talked to representatives of at least one group of the Maine Potato Growers, who are very much concerned, of course.

I might say at the outset that not all potato growers in Maine share the same view about the Mercantile.

Senator HUDDLESTON. No group of farmers ever share the same views, Senator.

Senator MUSKIE. They do, but I think they appreciate the opportunity, any opportunity they might have to protect themselves against the fluctuations of futures markets.

But unfortunately there is the feeling that the Mercantile with respect to Maine potatoes has been too heavily weighted on the side of the speculators and not sufficiently on the side of those who benefit from stable prices and the stable market.

So over the years, I have introduced legislation to abolish trading,

*See p. 53 for the prepared statement of Senator Muskie.

the futures trading in Maine potatoes. I think we have managed to get it enacted by the Senate once, maybe twice; and I know Senator Hathaway, when he was a member of the House, I think he had similar success on the House side.

But we never were able to get the two bodies together, which is not unusual.

But in any case, the fears that have been expressed by those who had reservations about trading in Maine potatoes futures seem to have been borne out by this year's experience. There are a lot of questions I think that need to be raised and answered; but the immediate one that is of concern to those who called me last night, is the question of what price is now to be paid for the potatoes that are purchased by the Mercantile for the purpose of filling out these contracts?

How is that price arrived at? And if the potato growers in Maine feel that the price is unreasonable or unfair, what recourse is available to them to challenge the finding with respect to price?

Now, that is the most emotional issue right now.

The second one is—and it is longer term, perhaps, in its implications—is who is behind this mess of this year? The shorts seem to have been concentrating pretty much behind three major interests and the headlines refer to west coast traders and west coast speculators; and west coast potato interests have not always been consistent with the interests of east coast potato growers and there is the feeling that somebody has got evil designs on the Maine crop and in the viability of the Maine market and the Maine farmer, Maine potato farmer. This is another very emotional issue.

So these are the two central questions.

To the extent that Mr. Levine and later Mr. Bagley could throw light on these two questions, I would be most appreciative. I have stated them at some length in order to get them before you.

I am sure you know the principal questions I would put in any case, but I would like to get responses if you have not already covered it in your testimony and maybe I could follow it up with some more specific questions.

Senator HUDDLESTON. Mr. Levine has touched on both those areas but I think it might be well if he briefly summarized them for you.

Mr. LEVINE. Well, Senator, I am certainly aware of the concerns of your constituents in terms of the issues you mentioned and I would like to try to respond as directly as I can to what I heard to be three points you made; that the fears of the potato industry in Maine with regard to the contract were borne out by this year's experience, that there were some concerns as to how the price of the fair market value of potatoes was determined; and that there is some question as to who is behind all these unfortunate events.

I would submit, Senator, that the fears of the Maine potato industry are not justified in terms of the action of the potato futures contract this year. On the contrary, this was the year that proved the value of the contract in terms of providing a hedge. Maine potato farmers had an opportunity to hedge potatoes this year at prices which were extremely, extremely conducive to the profitability of the grower.

If any Maine potato grower did not fully understand how to use

this price protection vehicle and, in fact compounded his risk by misusing it, this is unfortunate.

This is also the subject of continued exchange educational efforts in Maine where we have maintained for some years an information office in Presque Isle. This is the subject of continued visits on my part to Maine to talk with growers, the Maine Potato Sales Association, Maine Potato Council, and Maine Potato Commission.

If I may be immodest enough to say so, Senator, it has been a personal crusade on my part to develop a closer relationship with that organization which most represents the growers, the Maine Potato Council, so that now we have a representative of the Maine Potato Council on the exchange's potato committee itself.

We have direct input from the grower community to the exchange in terms of the contract viability. The former acrimony, the former lack of communication has apparently become history and I am delighted about that.

This was the year that proved the value of the contract hedge, in spite of the volatility of the market.

Your second point, Senator, concerns—

Senator MUSKIE. Well, with respect to that, so that we do not depart from it, as I recall, the fluctuation in prices over the life of the 1976 contract, it ranged from just under \$6 a hundredweight, to over \$19 a hundredweight; settled down to under \$9 a hundredweight at about the time that there was no movement, or appeared to be no movement, on the part of the shorts to buy potatoes to meet their requirements.

Now, our Maine growers feel very much that that action was taken for the purpose of keeping the price depressed; that is, relative to the high point, or whatever the trend was at that point; and I do not know whether it is possible for anybody to fix the trend at that point, because of the action of the three dominant shorts in the business.

Now, if that is the case, if they were using dominant position to hold the price down relative to what it might otherwise have been, would your judgment still be that this was the year that trading was useful?

Mr. LEVINE. Oh, indeed, sir; because I think we are talking about two different kinds of events.

One occurred close to or on the last day of trading, if it is indeed proved that there was some effort to depress the market, by which time, Senator, the typical hedger should have been long gone from the market. The other time frame that we are discussing or that I am alluding to is—

Senator MUSKIE. By that do you mean that all growers by that time should have disposed of all their potatoes?

Mr. LEVINE. No, sir.

The typical hedge is a situation wherein the grower sells futures contracts early in the year. Later in the year he sells his potatoes through normal marketing channels and liquidates his futures market position and provides in the meantime for an effective means of price protection.

He does not subject himself to the fluctuations of the cash market alone.

Typically, by the last day of trading the growers are long gone from the futures market, or theoretically should be.

Senator MUSKIE. How about the potatoes on hand?

Mr. LEVINE. Potatoes on hand, sir—

Senator MUSKIE. Do you know what that is, by the way? Do you know the volume of potatoes on hand?

Mr. LEVINE. On the last day of trading, sir?

Senator MUSKIE. Then and now.

Mr. LEVINE. The exchange undertook a careful analysis of the cash market in Maine and as a matter of fact, Mr. Chipman Bull, who is the executive secretary of the Maine Potato Commission, himself was quoted as saying that there was sufficient supplies of potatoes available for shorts to buy to fulfill their delivery obligations, which is consistent with the exchange's own analysis.

Senator MUSKIE. Why did they not buy?

Mr. LEVINE. Yes, sir, why did they not buy?

Senator MUSKIE. And the fact that they did not buy, did not that inevitably have the effect of keeping the price down?

Mr. LEVINE. It depends on what period of time we are talking about, Senator. The lack of purchase between the time they obligated themselves to deliver, which was May 7 and May 25, would not have had an impact on the price prior to May 7 when they had an option not to deliver and could have gotten out of the market by buying back their futures contracts.

Senator MUSKIE. Was the situation at that point cumulative such that actually the shorts had concentrated in three dominant hands?

Was not that situation pretty visible before May 7, and was not the question of what was motivating those three dominant interests, now bound to be taken into account by anybody who had any potatoes?

Mr. LEVINE. Senator, the short position was concentrated in five, not three, hands. And of the five—

Senator MUSKIE. Can you identify them?

Mr. LEVINE. Of the five clearing members, Senator, who were obliged to deliver, two, in fact, fulfilled their delivery obligations, and the question that you have raised is well put: In the case of the other three clearing members, why did they not fulfill their own obligations? And that, Senator, is very much the subject of exchange hearings at the moment.

I cannot answer you because those hearings are still pending; but I can assure you that nobody wants to know the answer to that question more than I.

Senator MUSKIE. Could I ask you one question?

Would you be receptive to holding a hearing in Aroostook?

Mr. LEVINE. I am sorry, Senator?

Senator MUSKIE. Would you be receptive to holding such a hearing in Aroostook County, the northern Maine county?

Mr. LEVINE. As to what, sir?

Senator MUSKIE. As to these questions.

Mr. LEVINE. At the moment, Senator, the exchange, in dealing with the clearing members and not the customers, is holding hearings in New York so that those who must sit in judgment or in a position to collect the information are not unnecessarily inconvenienced.

These hearings have been going on for days. They are literally as time-consuming as any of those that you yourself attend.

Senator MUSKIE. I am sure they are.

Mr. LEVINE. The exchange has had representatives in the county talking with the representatives of industry, determining their attitudes, how they feel, getting their reactions to what is going on; so that the exchange is not without input from the county.

Senator MUSKIE. There is nothing like being there to get the feel of that county.

Mr. LEVINE. That is why we have sent people to the country, sir.

Senator MUSKIE. Well, the people I talked to last night are pretty prominent members of the industry and they did not mention the fact that this kind of activity is going on. It is a big county geographically, as you know. It is as large as the State of Massachusetts.

How many people have you sent up there?

Mr. LEVINE. In the past 2 weeks there have been two visits that I know of. The exchange's vice president for research and education, Dr. Allen Abrahams, was in the county as late as last Thursday.

Senator MUSKIE. Well, I have been in the county, as you know, as a Senator, and left only to learn later that nobody knew that he was there. I mean there is nothing like a public hearing to get attention.

Mr. LEVINE. Well, he was on the television.

Senator MUSKIE. Well, a lot of people do not watch it.

In any event, what the people want is a chance to speak up and I do not know who he talked to. I raise the question now without trying to nail it down. I simply want to send it up as a trial balloon because they are upset; and when those people are upset they like to have a chance to talk to the people who are upsetting them, as I have learned over 20 years; and I think Mr. Bagley would confirm that.

Mr. LEVINE. I am a New Englander myself, Senator.

Senator MUSKIE. Senator Huddleston, I interrupted a question of yours.

Senator HUDDLESTON. I just wanted to interject a question.

Mr. Levine, regarding the supply of potatoes, in your opinion what happened to the markets between the time that you received assurances that there was a sufficient supply for all of the short sellers to fulfill their obligations and the time that the exchange determined it was impossible to meet those short obligations because the supply was not sufficient.

Mr. LEVINE. That is certainly an appropriate question, Mr. Chairman, the answer to which I cannot give you. I really do not know.

I know that in fact there was an analysis done by the exchange prior to May 7 indicating the availability of a sufficient supply of the shorts to meet their delivery obligations.

I also know, based on personal effort, and telephone calls to acknowledged sources of good market understanding and potato availability in Maine, that I could not buy quantities of potatoes sufficient to meet the number in default, sir.

Senator HUDDLESTON. What was the price differential between those two periods?

Mr. LEVINE. The cash market price, sir?

Senator HUDDLESTON. Yes, sir.

Mr. LEVINE. I think the cash market price is a matter of interpretation, Mr. Chairman.

The cash market price as quoted by the Government Price Reporting Service, the USDA Price Reporting Service in Maine, as Senator

Muskie probably knows, is an indication of typical shipments that take place in the cash market on a daily basis.

These typical shipments are not characterized as to quality or variety and it is generally acknowledged, by the CEA and now by the CFTC, that you are talking of a difference between the cash market price as quoted and the cash market price for deliverable potatoes under the New York Mercantile Futures contracts.

There is some additional quality requirement and difficulty that is perceived in the loading of cars by the Maine farmers who demand a premium for those potatoes.

Senator HUDDLESTON. Well, was there any evidence, or do you have any knowledge of any producer or selling agent that might have withheld his potatoes from the market during that period of time?

Mr. LEVINE. These areas of inquiry, Mr. Chairman, are very much being undertaken by the exchange and comment in direct answer to that question on my part would be, I think, premature at the moment.

But be assured, please, that that possibility has crossed our minds and we are pursuing this and are assured that the Commission is also pursuing this line of inquiry.

Senator HUDDLESTON. Now, just for the record, let us get the specific time frame we are talking about.

On May 7, there were indications that there was a sufficient supply of potatoes to meet all of the short obligations at that time. Now, what date was it that you were not able to meet the requirements of the contract and the obligations of the exchange in the case of default because the potatoes were not available?

Mr. LEVINE. My report to the board, Mr. Chairman, is dated the 27th of May, 2 days after the default.

The difference between May 25 and May 27, represents a period of time in which the exchange diligently tried to, and at this point wishes very much it had been able to purchase potatoes in the quantity equal to that in default.

Senator HUDDLESTON. And you contacted all the normal sources of supply and found that you could not make a purchase?

Mr. LEVINE. Indeed we did, sir.

Senator HUDDLESTON. Two of the defaulting or potentially defaulting shorts did make purchases.

Is it possible that they could have exhausted the supply?

Mr. LEVINE. Your question, Mr. Chairman, I believe refers to the fact of the five clearing members obligated to make delivery, two in fact did, and three in fact did not.

Senator HUDDLESTON. Thank you.

Mr. LEVINE. Delivery can be accomplished under the contract in one of two ways:

Through the normal delivery of Maine potatoes and through the delivery of potatoes either grown or not grown in Maine and/or delivered in some different form. By "form," I mean payment terms or means of transportation or types of potatoes other than what the contract requirements are for the delivery of potatoes grown inside of the State of Maine, provided the buyer is willing to receive them. These deliveries are called exchanges of futures for product, in which case the delivery of a product other than that required by contract

specification is substituted for the obligation to deliver strictly pursuant to contract specifications.

A number of deliveries were made in this manner through the delivery of Western potatoes. A number of deliveries of Maine potatoes in truck, bulk, in some form acceptable to the buyer, but not specified in the contract, were also made.

Two of the five firms obligated to deliver, fulfilled their delivery obligations in one of these ways.

It should be said also that part of the delivery obligations of the other three firms were fulfilled in this manner as well.

I cannot comment on whether those efforts to fulfill delivery obligations exhausted the supply. I am led to believe, Mr. Chairman, that had a willingness been demonstrated on the part of those obliged to deliver, to pay whatever it took to purchase potatoes that would otherwise be planted as seed, that as one source of potatoes in Maine described to me, farmers would sell their seed potatoes and, rather than plant, would go fishing because they would already have built in a profit they expected to get on the next year's crop.

Senator MUSKIE. What price was offered by the exchange in an effort to get potatoes?

Mr. LEVINE. The exchange offered to pay any price, Senator, to buy potatoes and was totally unsuccessful in obtaining any, but indications for a very few number of cars.

Senator MUSKIE. How was that offer communicated?

Mr. LEVINE. By phone through me to individuals in the county.

Senator MUSKIE. And those times you just gave them a blank check?

Mr. LEVINE. Senator, the potatoes were not there to buy. I asked specifically.

Senator MUSKIE. What has happened to them?

Mr. LEVINE. Pardon me?

Senator MUSKIE. What has happened to them if they were there on the 7th of May?

Mr. LEVINE. That was the chairman's question, which I simply have no answer to. I really do not know.

Senator HUDDLESTON. The information on the 7th of May could have been faulty.

Senator MUSKIE. That is the fastest move of Maine potatoes I have ever heard of.

Mr. LEVINE. I have conjectured that there could have been an unwillingness to sell the potatoes to the exchange. We are pursuing that, too.

Senator MUSKIE. At any price?

Mr. LEVINE. Yes, sir.

Senator MUSKIE. Now, you have aroused the curiosity of all of us.

Senator HUDDLESTON. Mr. Levine, one final question.

Are you confident, in what Mr. Bagley described as "the potato fiasco," that the exchange has done all that it could do and all that it should have done within the framework of its rules and regulations to prevent the loss to any individual through unlawful trading practices?

Mr. LEVINE. Mr. Chairman, that has to be the most important question of all, and the first that I, personally, and the exchange have to answer.

Of course, that is the subject of the Commission's investigation of the matter.

I have done a great deal of soul searching; our board has done a great deal of soul searching; the chairman of the exchange, likewise. Of course, that question has to be answered without the benefit of 20-20 hindsight. It is always easy to go back in theory, now that you know something has happened, and theoretically take action that might possibly have avoided it.

I think the answer to your question, Mr. Chairman, is that the exchange expects to be able to demonstrate to the Commission a reasonable market surveillance prior to the end of trading on May 7, a responsible effort after May 7 to avoid the kind of conditions with which we are now faced, a responsible kind of effort subsequent to May 25 to deal with the conditions that arose as a result of the default and a responsible view of the future with regard to an amendment of its futures contract in potatoes to create the kinds of conditions which will act as a further deterrent to another default.

Senator HUDDLESTON. Senator Dole, do you have any further questions?

Senator DOLE. No.

Senator HUDDLESTON. Senator Muskie?

Senator MUSKIE. Yes.

I am bothered by this price.

The people I talked to last night—and I was not aware that you were going to offer an open price—there was certainly nothing said to me to suggest that they were aware of it, because their concern was directed to the price that they understood was being set up under the procedures available to the exchange to set the price.

I mean how does that fit with what you have just said about May 27th.

Then you said you were offering any price.

Are you offering something different from that now or what price have you set and what is the relevance of it to this whole situation? I am puzzled, that is all.

You have a committee now that advises you?

Mr. LEVINE. That is right, sir.

The exchange has a rule which provides for certain procedures to be followed in the event of unlikely default.

The first procedure to be followed is for the president to purchase potatoes in a quantity sufficient to equal those in default and deliver them to the buyer. That was impossible. We tried and failed.

Senator MUSKIE. What then?

Mr. LEVINE. That rule then becomes inoperable.

Senator MUSKIE. How then do you compensate a buyer for the potatoes that he does not receive?

Mr. LEVINE. As a result, Senator, the exchange amended its rule under its emergency provisions, to provide for a procedure that would compensate for the inoperability of that first portion of its rule, and that procedure was the appointment of a special committee to determine a fair market value for potatoes that are undelivered. The difference is this: the exchange undertook to purchase potatoes and determined that potatoes were available for purchase. The exchange made an honest effort to purchase potatoes and indeed we did, and made no effort to restrict the price we would pay and nevertheless failed to

purchase potatoes. That is a condition different from one which sets the price of potatoes that are undeliverable, given all the factors the board asked the special committee to consider, and I would be happy to read you a part of a resolution instructing the committee as to what factors to consider.

These two prices are somewhat different.

One is an attempt to purchase actual potatoes. The other is a value in lieu of potatoes not purchased.

Senator MUSKIE. That value represents what the exchange will pay to the buyer?

Mr. LEVINE. That value represents, Senator, a figure which will be compared with the settlement price on the 7th of May, of \$8.70 per hundredweight. The shorts will pay, through the exchange clearinghouse, to the longs, the difference, based on whatever the fair market value is, and in this case it has been recommended as \$10.66. The shorts pay through the clearinghouse to the longs.

Senator DOLE. Could I interrupt?

I wonder, if Senator Muskie could now find a lot of potatoes in Maine, would you buy those?

Mr. LEVINE. I would have to find out how the availability of potatoes could be used to satisfy the current exchange rules in their amended form.

Senator DOLE. Are you just as willing to buy potatoes now?

Mr. LEVINE. It would be a lot easier if the exchange were able to have purchased potatoes. The committee would not have been constituted, nor would it have met, nor would the basis for its determination be questioned.

Senator HUDDLESTON. Let me interject one point here.

When the exchange purchases potatoes to fulfill their requirements, price is not much of a concern of yours; is that correct?

Mr. LEVINE. I would not say that, Mr. Chairman. The price of \$10.66 was considered by those on the short side to be confiscatory, and those on the long side consider it to be absolutely unfair.

I imagine, therefore, that its must be a fairly reasonable price. I would not characterize our attitude as cavalier about the price that was set; because obviously there are attorneys who would demonstrate their concern in different ways.

Senator MUSKIE. What impact, if any, would that \$10.70, which sounds like—sort of judgment against the—against the shorts—what effect would it have on the market price for potatoes at that point?

You were not trying to set a market price, I take it, when you set it at \$10.70?

Mr. LEVINE. No, sir.

Senator MUSKIE. It is a compensatory price?

Mr. LEVINE. It is a compensatory price in addition to which the longs will receive any special damages they claim and prove. That is a fair and equitable procedure.

In addition to that, the shorts will be penalized by the exchange for having defaulted.

Senator MUSKIE. That penalty is \$100?

Mr. LEVINE. A minimum of \$100. At least.

Senator MUSKIE. You have not reached that point or setting?

Mr. LEVINE. There are hearings now being conducted, Senator, by the clearinghouse committee to determine penalties against the shorts

and disciplinary proceedings may also be brought by the business conduct committee.

Senator HUDDLESTON. Thank you very much, Mr. Levine. You have almost been on the stand, if we can call it that, for almost 2 hours. We appreciate your testimony.

Mr. LEVINE. I appreciate the opportunity to have been here today. Thank you.

Senator HUDDLESTON. Incidentally, before you do leave, there may be other questions that the subcommittee members have and desire to submit to you in writing.

If it is agreeable to you to respond to those, the record will stay open 7 days.

Mr. LEVINE. Of course, to the extent that I can, I certainly shall.

Senator HUDDLESTON. Mr. Bagley, if you will identify yourself for the record and also your counsel who is accompanying you.

STATEMENT OF HON. WILLIAM T. BAGLEY, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION, ACCOMPANIED BY HOWARD SCHNEIDER, GENERAL COUNSEL

Mr. BAGLEY. William T. Bagley, chairman of the Commodity Futures Trading Commission, and Howard Schneider, general counsel of our Commission.

First of all, I admire your concern, Mr. Chairman and members, for doing an oversight job. I welcome it and I thank you for it.

Senator HUDDLESTON. Happy birthday. We are glad to have you here.

Senator DOLE. Is it his birthday?

Senator HUDDLESTON. The Commission is just over a year old.

Senator DOLE. Oh, right.

Mr. BAGLEY. I do want to tell Senator Muskie, to tell him again so I do not forget, we, the Commission, have been planning a public hearing or series thereof on the whole question of the economics of the potato contracts, not on the investigation—and certainly if Senator Muskie's staff and Senator Hathaway's staff want to work with us and put together some kind of a forum in Maine, the whole Commission or part thereof will be happy to attend and conduct such a hearing.

Just going backward a little bit, vis-a-vis our birthday, we were sworn into office on April 15, 1975, and that was a Tuesday.

By that Friday, we had to, by law, designate all of the marketplaces and all of the contracts and all of the commodities to be traded, so that on April 21, whatever we did designate trading could continue.

Obviously, in that kind of situation, we designated on more or less a carte blanche basis. Then subsequently, within 3 months, the date being July 18, 1975, again after a rather hectic 3-month review, we again designated—that is another word for “licensed”—we again designated exchanges and contracts to be traded, including, of course, the New York Mercantile Exchange as a contract market for the trading of futures in those commodities that Mr. Levine has mentioned, gold, platinum, heating oils and several international currencies.

Those later had theretofore been the unregulated commodities.

Then as a matter of our general assumption of authority from the CEA, we redesignated butter, boneless beef and of course the subject of today's hearing, Maine potatoes.

On that date—

Senator DOLE. Mr. Bagley, I know you are going to read your statement and I will not be here for the end of it.

You have heard Mr. Levine's statement and read it and been in contact with him.

Do you find any agreement or disagreement with what he has stated here this morning?

Mr. BAGLEY. Oh, I am sure that we will be in disparity as our mutual—not necessarily joint investigations proceed.

If we are not, it will be a miracle that all parties agree. I could not give you an exhaustive or even a superficial list of potential areas of disagreement.

One comes to mind only because it was just mentioned by Mr. Levine.

First of all, I am sure he cares as much as I do about the integrity of his exchange and of the futures market. The question of whether the exchange did all it could have done was asked just several minutes ago.

Again, hindsight is better than foresight. I think you would have to take that question and what I am saying is, there possibly will be a difference between us as to whether the exchange did all it could.

Senator DOLE. I think the same question could be asked, whether the Commission did all it could.

Mr. BAGLEY. Yes, sir.

Senator DOLE. And probably will be asked.

Mr. BAGLEY. Yes, sir; I will respond now or later, whichever you wish.

Senator DOLE. You may want to do it later in relation to your entire statement, but I think these are general areas that the chairman is interested in and other members of the subcommittee.

Mr. BAGLEY. I will try to go through this much more rapidly than if I were the lead witness.

Senator HUDDLESTON. If you want to summarize the entire statement will be made a part of the record.*

Mr. BAGLEY. In the statement, we first describe the background of the Commission coming into being.

I think it is important to just add one sentence here; on this July 18 date, we did designate, that is license; 81 contracts in 49 commodities on 11 exchanges.

After that initial 3-month period, it took us several months to get organized, to get into gear, to get our own focus going so that by December or so, we were ready to undertake a more elaborate and expansive and detailed indepth review of various of the contracts.

Some of them were more perfect than others, economically speaking.

In regard to this particular contract, we, a few months ago, say December, on a staff level—began discussions with the New York Mercantile Exchange as to the need for changing the terms and conditions of the contract and also we had discussions commencing this

*See p. 54 for complete statement of Mr. Bagley.

spring as to the need for changing some of the rules and regulations and trade practices on the floor of that exchange.

These were proceeding; and I am told by my staff that by July or so, had this default not occurred, we would have been the recipients of proposed changes in contract terms to broaden the source of supply, broaden the delivery points, to broaden the delivery mechanisms.

Well, the default occurred in May rather than giving us the couple of extra months. My point is we were proceeding under the authority of Congress, which the CEA did not have, speaking of toothless tigers. Congress gave us some teeth, some sharp teeth, some incisive teeth.

Senator DOLE. Maybe they are false teeth.

Mr. BAGLEY. They are sharper and no pun intended, more—incisive than Jimmy Carter's teeth, but we do have those teeth and we are going to use them and I do want to spend a little time on that subject.

But we were in the process of reviewing the entire economic feasibility and workability of not just the Maine potato contracts, but several others which have been sources of problems, have been susceptible of market distortions or attempted manipulations in the past and that review was proceeding and is proceeding in reference to other contracts also.

One of the key points here is that if you have a market situation where you have heavy trading and a diminishing deliverable supply, you are looking at an economically vulnerable situation and we knew that. That is why obviously we have spent more time working on this contract predefault, than we have probably in any other marketplace.

Without going through the statement per se, the trading on this contract started in February, I believe of 1975; and as a matter of general course, we monitor on a daily or weekly basis, as information comes in, what the pricing is, what the open interest is, who is doing what to whom; and we did this in this instance.

We intensified that routine surveillance activity in March and early April when it became apparent that deliverable supplies may have been tight.

We obviously review USDA reports, their so-called "stocks in all position" reports, and those reports confirmed that potato supplies from Maine in May would be tight. In the course of this routine investigation, obviously, we were in contact with the exchange and with the brokers, the futures commission merchants and, toward the end of the contract period, with the traders themselves.

Our first concern—and I think this is always the case—the greatest concern was the potential for unreasonable or unwarranted price activity.

Now, with the exchange, I think I can say that our people did not expect it to default. It is something that does not happen, quote, unquote, in this marketplace. We looked at the positions and found, as Mr. Levine has testified, that there was a normal pattern of closing out of the open interest, which is shown on a chart that is attached to my testimony.

Nonetheless, we were concerned about inordinate price activity. That price activity, inordinate activity, seemingly did not take place. In the next to the last week of trading, it became apparent that, although the open interest was decreasing at an acceptable rate, con-

sistent with historical patterns, the positions of the large shorts were not decreasing proportionately.

Our staff met with exchange officials to discuss the large short positions, the deliverable supplies, and possible actions the exchange might take to deal with the developing situation.

The staff and the exchange were in almost daily contact regarding these and other traders' positions, and the overall liquidation of the contract from April 28 through the last day of trading on May 7, 1976.

Of primary concern—and here again, Mr. Levine has referred to this rule—was an exchange rule; and it is almost sort of a basic—basically inherent precept of orderly futures trading, the rule and the carrying out of this rule, the rule requiring that each clearing member who has a customer with short positions to assure the exchange and to us, but this is an exchange rule, to assure that either his customer is in a position to deliver on his short position or that the position will be liquidated.

That is the basic precept of orderly futures trading, to either deliver or liquidate out.

The events, of course, have shown that positions were not liquidated and that delivery was not forthcoming.

This is despite the fact we received continual assurances from all concerned that exchange rules would be adhered to. Parenthetically, may I say—it is one thing we really learned; that is, we are getting our minds in gear for the future here also; it is not to accept the word of all such people in such situations.

I am not saying that the word of the industry is not good. I am saying in this kind of a market situation, I should have gone to the sources of supply. We should have perhaps in advance of the default, issued subpoenas, found bills of lading, if they existed, and export situations which were developing, found from the shorts themselves whether or not they had the potatoes or whether they had contracts to buy them. We took the word of the exchange.

Senator DOLE. What do you mean "We"? The full Commission or some staff?

Mr. BAGLEY. I would say the staff, but I am not going to blame them. After all, we, the Commission, have the final authority.

Senator DOLE. Did the Commission make a judgment on it?

Mr. BAGLEY. No, sir, the Commission never did.

Senator DOLE. Did the Commission ever meet on this problem?

Mr. BAGLEY. Let me answer one at a time.

The Commission met and received staff reports.

Senator DOLE. When was that meeting?

Mr. BAGLEY. Gee, I cannot give you dates. Ongoing.

By that I mean once a week or so during the course of the latter part of April and early part of May. The Commission, however, answering your other question, never posed to itself the question of should we go out and subpoena those records in advance.

Believe me, sir, the next time, if there ever were to be one, we would pose that question to ourselves.

Senator HUDDLESTON. Let me inquire here.

What was your source on this question of supply? Because obviously you were getting information contrary to what the exchange was getting.

Mr. BAGLEY. Not on supply. I do not know that we were getting contrary information. We perhaps had a little more sensitivity and I do not mean to demean Mr. Levine by any means, a little more sensitivity to the situation, a little more concern, because this was one of the first instances we were faced with with this type of problem.

Senator HUDDLESTON. All right, clarify that; because right up to May 7, Mr. Levine was getting information that indicated that there was sufficient supply to meet the delivery requirements.

Considerably prior to that, back in April, you were getting information that caused you concern. You were already contacting the exchange to determine whether or not they were staying on top of the situation and your concern was that those supplies may not be there; is that correct?

Mr. BAGLEY. That is correct; but we did not receive—

Senator HUDDLESTON. Well, where did you get your information?

Mr. BAGLEY. Okay.

We did not receive any vastly differing information. We got our information from USDA reports, which is obvious. We had an economist in Maine making sort of an informal survey of sources of supply and very frankly we got our information from the traders, from the brokers and from the exchange itself. We did not do an exhaustive independent survey of supply.

Senator HUDDLESTON. You are saying that the discrepancy was in the interpretation of the information that was given?

Mr. BAGLEY. I am not saying that there was a discrepancy in information. There may have been a difference in point of view.

We wanted to be very sure that the basic rule of the exchange was going to be carried out. I think we were more concerned with exchange action and floor action than we were source of potatoes in Maine.

Senator HUDDLESTON. And you say now, and you have said since, that the great lesson you have learned, or one of them, is, you ought to go beyond the obvious information that comes to you and check it out with the quantity of supply to make certain that you have accurate information; is that correct?

Mr. BAGLEY. Yes sir; and Congress gave us those tools. We have almost unlimited subpoena power. We have what has been termed "awesome power"—I hope it never gets termed "awful power."

Senator Dole. You said you had promises from the traders and brokers and you used the word "we". I am trying to nail down who the word "we" is, I guess.

Are there memoranda in writing or oral conversation?

Were you ever notified personally of the possibility of the problem or any of the other Commissioners?

Mr. BAGLEY. I am trying to put the questions in a sequence.

The word "we," generically really means our staff, who were working on the problem.

Senator DOLE. And the entire Commission?

Mr. BAGLEY. Yes; on a timely basis. I cannot nail it down. I said here a minute ago, maybe once a week or so. The Commission itself would get a report as we do from our various divisions, our staff people, in the meeting that they were following the situation and they believe that the situation was in control, under control, in the hands of the exchange.

Senator DOLE. I think it does a lot to dispel any criticism of the Commission if there are in fact, assuming to verify you had these assurances a month before or 2 weeks before and that they were reviewed and maybe the record reflects that, I do not know what the Commission record shows.

Mr. BAGLEY. We will have—I do not have with me, and again as Mr. Levine said, obviously we are in the process and in the course of an investigation within several months now, we, the Commission, will have to don our quasi-judicial hats and I have to be careful also in indicating, which I do not indicate at all, any prejudgment of any facts, but orally, by phone, I know Mr. Bodenhamer, our regional director in New York, was assured by the exchange, by clearing members thereof, that they either had deliverable supply or were prepared to liquidate.

Obviously they were telling us they were going to obey the rules.

Senator HUDDLESTON. But now, Mr. Bagley, at least your field representatives, if not the Commission itself, did not wholly accept the assurances from the exchange. Did you not continue to insist that they take some action, that they at least enforce their rules from a period of time in early April right up to May 7 and May 25?

Did you not on numerous occasions say that you must enforce those rules? And at one point, did you not even threaten to proceed with legal action if they did not?

Mr. BAGLEY. The answer to your question is, yes.

In addition, we had presence on the floor of the exchange for a full month of one or more people, watching, mind you, trade practices, with the idea in mind that some traders might take advantage of what was becoming a sensitive situation, pricewise.

I have to say that myself, just speaking for myself, I did not consider default as a reasonable end result. So we were looking at possible distortions. We were looking at possible market "Mickey Mouse" if you will, rather than the ultimate default.

Senator MUSKIE. Why did you not regard ultimate default as a reasonable possibility?

Mr. BAGLEY. Because I am told—and mind you I am new to the industry, but it is a fact that it is so rare; it is something that people who are major traders—forget the traders—people who are major commission houses, national commission house, simply would not do because of peer pressure, because of economic pressure, because of contractual obligations and because of, I hope, some concern on their part for the integrity of the futures market.

It so rarely happens, that was the fact as of May 6.

Senator MUSKIE. Could I ask first of all, shorts benefit from declining price, is not that right? That is what they want?

Mr. BAGLEY. Yes, sir.

Senator MUSKIE. So if by withholding any action in the market they can produce a decline in price, that is to their benefit; is that not right?

Mr. BAGLEY. Yes, sir.

Senator MUSKIE. What was the trend in the market prior to May 7 to May 25?

Senator HUDDLESTON. On May 7 it was \$25, was it not?

Mr. BAGLEY. It is hard to read this chart.

From December 1976, you see a price of about \$8.20 and up to

January, February, to \$17, down in February to \$11, up to March to almost \$15, and from March forward, a decrease with a little whip there in the end of March and then April forward from \$12, down to \$8.70.

Senator MUSKIE. I think you said that everything seemed normal except for the few dominant shorts?

Mr. BAGLEY. The normalcy was the closing out of open positions. At one point—and I have got the figures in round figures—but almost exactly, there were on April 15, April 19, approximately 6,700 open positions; on May 6, 3,400.

So that—and that decrease was almost exactly—in fact, even a little better—than the 5-year average for closing out, for liquidation. That is what happens.

Senator HUDDLESTON. Is that on the basis though of numbers of contracts rather than total supply?

Mr. BAGLEY. That is on the basis of numbers of contracts, and then of course on May 7, 1911, what was occurring on the last several days is that the—what you might call the normal traders were trading out and the percentages, the inordinancy of the percentage of the large shorts remained so the large shorts were not getting out.

Obviously, the question is why? And that is what we are going to find out.

Senator MUSKIE. Could I ask this question?

I am just going to quote from this newspaper article and this paragraph refers to Mr. Jack Simplot.

According to those close to the event—first, of all, let me read this:

Last Thursday the first of what is expected to be a flood of lawsuits over the default, charged Mr. Simplot with manipulating the price of Maine potatoes downward because obviously he was a short. That is, he stood to profit from lower prices. According to those close to the event, Mr. Simplot has long wanted to have as much dominance in Maine potatoes as he now enjoys in the Idaho market.

Now, I do not ask you to dig into Simplot's motives, but would it be possible to use this kind of tactic or to achieve dominance or to break the Maine market or to achieve dominance over the market? Is that a possibility, in your judgment without necessarily attributing that motive to Mr. Simplot?

Mr. BAGLEY. I think it is. I heard probably as many rumors, other than perhaps Mr. Levine than anyone else, one of the rumors—and I report it as such without any judgment—is that some of the traders simply do not want the futures market to exist.

There is a little double edge here. Some of the Maine potato farmers do not want the futures market to exist. But taking the side, if you will, of the idea of the future of a contract market, if you do not have a futures market as an alternate pricing mechanism, then a major large cash market entity might have more power in the cash market because there is no place else to go.

Now, that kind of rumor I have heard attributed to several of the players without naming them.

Senator MUSKIE. I understand while I was gone, you indicated some receptiveness to holding a hearing in Maine.

Could we pursue that and maybe find a date?

Mr. BAGLEY. Yes, sir.

Senator MUSKIE. What time frame do both of you see us being involved in your investigations, your inquiries and the resolution of all these?

Mr. BAGLEY. There are two major things happening now:

The first, an investigative effort in four arenas. No. 1, the shorts; No. 2, the longs, possible manipulation by either or both; No. 3, the exchange, as to whether it did its job or whether it violated the act and, No. 4, the brokers, whether they did their job.

It is obvious, without passing judgment, that they defaulted; so there are four areas of investigation. The investigation may be in stages.

One stage may be concluded very shortly.

Other stages will go over a matter of months.

The second big area of activity where a hearing would be most appropriate—I do not think we would want to have a hearing on investigative aspects—is the economic aspect.

We now have an application, which we solicited, in no uncertain terms, on May 27, a day or two after the fact of default.

Let me go back one step to make this clear and then I will come to your hearing question.

We had been working with the exchange for a matter of months to try to upgrade the economics of the contract.

Parenthetically, the exchange was not too receptive, prior to the default.

Parenthetically, I think one of the problems, if I might defer just for a second, the smaller New York exchange, without castigating, but I am categorizing, I know that, the smaller New York exchanges perhaps do not have the breadth, do not have the independence of boards of directors, do not have the clout or the peer pressure that some of the other exchanges do. Hopefully, we will be able to upgrade them and upgrade the industry. That is a major reason that we are here, the reason that Congress wanted us here.

So we were pursuing with them, although the New York Mercantile Board was not responding immediately.

On May 27, we said we want to do 1., 2., 3., 4. No. 1, trade for liquidation only in May '77 contracts, just simply to stop any comparable event where the supply dwindles in May again.

No. 2, submit to us a modified contract. That was done and that is what Mr. Levine was testifying to, modified so that you broaden the area of supply from any State east of the Mississippi; No. 3, you would have delivery points in other States and you would have other means of transportation; and, No. 4, we would still then consider whether or not to continue at all for any year in the future, May trading again, because of the dwindling supply. That issue is now before the Commission.

Parenthetically, we have a comparably broadened contract proposal from the Chicago Mercantile Exchange on Idaho potatoes. These two contract proposals are now being analyzed by our economists.

Will the supplies from other States be adequate enough to really broaden the supply or is this a facade? What are the economics of other delivery points? Will the contract be a better mechanism?

That subject can be, will be, sir, the subject of a public hearing;

and I personally, and some of my other commissioners would be happy to come to Maine and have a day or so of hearings there in the next couple of months.

It is a long answer; I am sorry.

Senator MUSKIE. Yes; I appreciate that.

May I express my appreciation to you, Mr. Chairman, for pursuing this?

I will look at the whole record and it may well be that the questions have occurred to all of us to pursue, but I put the ones that have been brought to my attention by my constituents and see where we go from here.

Senator HUDDLESTON. Thank you, Senator.

Mr. BAGLEY. We will contact your staff, Senator.

Thank you.

Senator MUSKIE. All right.

Mr. BAGLEY. Perhaps I ought to simply just conclude about two pages of this statement. I have covered most of it.

Senator HUDDLESTON. Very well. Then there will be some other questions.

Mr. BAGLEY. I want to concentrate on the Commission and our job here because it is not my own sensitivity that concerns me. It is the perception of the public of whether or not we are going to do our job, not for our sake, but for the sake of the futures markets themselves.

We came to town a year ago and a few months ago. I said then and I have continued to say that Congress perceived our creation not as a new regulatory body to provide more onus to an industry, but instead through our now powers granted by Congress to be able to provide the feeling and the fact of more public protection and the feeling and the fact of more confidence and credibility in this marketplace, generally, collectively, totally, domestically.

I know from this last year's activity that Congress gave us the adequate tools to do that job. I know from this last year's activity that we are just beginning to make some public impression of the fact that we are here and overseeing these marketplaces, and I hope I know that within the next couple of years—and I mean 2 years—otherwise I would be kidding myself and you and the public—within the next couple of years, as we review the economics of some of the more vulnerable or susceptible contracts, as we review the rules, regulations and trade practices on some of the floors—and parenthetically, you know a lot of the floors were not regulated, were not accustomed to updating their practices. Some of them existed in sort of a circa 1890 atmosphere, at least that is the impression I am beginning to get.

Over the next couple of years, without overregulating, without being onerous or too awesome, I hope that we will be able to—and I state that is why I am here; that is why Congress wanted us to be here; that we will be able to show the general public, the trading public and the industry that this is a better, cleaner, more workable marketplace. We do have the power to do so.

Senator HUDDLESTON. I was just going to ask if you are confident that you do have that power under the present law.

Mr. BAGLEY. Yes, sir. Well, someone may ask under that concept, why did you not step in and do something on May 6?

Senator HUDDLESTON. I was just going to ask that.

Mr. BAGLEY. The answer, again, with the benefit of hindsight in this instance, I do not think that even with the benefit of hindsight, other than finding out about that supply and the immediate ability to perform, that we should have stepped into the market and, quote, unquote, shut it down. That would have been potentially disastrous because we would have prevented the possibility of the market working itself out.

Were we on May 4 or 5 to order trading for liquidation only, there is still a very large question in my mind as to how we would force a person to liquidate if a trader told his broker, "Do not sell. I want to default and take the consequences."

So in retrospect, even, I do not think we should have stepped in and in effect run the market. Then we would be setting the price of potatoes and I do not think Congress wanted us to do that. That is my response.

Senator HUDDLESTON. You kept insisting that the exchange itself take some action and enforce its own rules.

What specifically did you have in mind that it should have been doing during the period April through May?

Mr. BAGLEY. Two arenas: One, potential price distortion and two, as the delivery date got closer and closer, we said we were not mindful in the front of our minds of the prospect of a default but certainly it occurred to the exchange and it occurred to us.

The exchange should have—and it is easy for me to say this—should have had more internal clout. It should have been able to jawbone themselves as occurred in the pork belly market, as occurred in the corn market when there was a situation that looked like somebody had an inordinate position, the board of directors pounced on that person and said, "You get out of the market or you ain't going to trade here no more." That kind of peer pressure should be exercised by the marketplace. We do not have that kind of peer pressure.

We could have, in addition to finding out about supply, we could have done some heavier jawboning.

Senator HUDDLESTON. Apparently the exchange seemed reluctant to accept your suggestions; is that correct?

Mr. BAGLEY. I do not want to pass judgment at this point. I am mindful of that quasi-judicial function that we have.

Senator HUDDLESTON. Well, you did continue to insist on numerous occasions beginning in April and extending through May 25th, essentially the same thing, that they take action; that they enforce their own rules.

Mr. BAGLEY. Yes, sir.

Mr. HUDDLESTON. And even after May 25th, you suggested some specific things that they needed to do after the default occurred; is that correct?

Mr. BAGLEY. Yes, sir. I do not want to just sit here and place all of the blame on the exchange. I am not here to absolve us for not doing everything that we could have done.

Senator HUDDLESTON. What authority do you have to see that your suggestions are implemented other than revoking the designation?

Mr. BAGLEY. We could have gone to court. This would have been difficult.

We could have gone to court before the fact.

Senator HUDDLESTON. You suggested that possibility, I believe.

Mr. BAGLEY. To obtain a mandatory injunction to force something to happen; that is pretty hard to do before it happens.

Other than that, we would issue all kinds of orders. We could declare an emergency and, in effect, take over the market. Although we did not actually vote on the subject, I think we consciously decided not to do it.

The rest of the areas of activity would be more presence, more jawboning, more facts showing that we are there. We tried that unsuccessfully.

Then you come to the penalty phases. Cease-and-desist orders, \$100,000 per violation fines. All kind of trade suspension powers.

Senator HUDDLESTON. Are you saying in retrospect now that you do not believe that those measures would have been appropriate in this particular situation?

Mr. BAGLEY. Since in the whole context of the act it indicates that Congress conceived us to have a primary role of oversight, the primary role of the exchange is self-regulation.

We are mindful of that concept and that in one sense answers your question. We were not about to just jump in and take over the marketplace if there were a reasonable chance among reasonable men that the market would work itself out and mind you we were assured that that would happen.

Senator HUDDLESTON. In the first year of operation, have you found it somewhat difficult to get the attention of the exchanges? Are they taking you seriously?

Mr. BAGLEY. The answer to both questions is yes, initially.

Senator HUDDLESTON. In other words, when you do get their attention, they do take you seriously?

Mr. BAGLEY. Well said.

Initially there was.

Senator HUDDLESTON. You know what that fellow did with that mule, don't you?

Mr. BAGLEY. He hit him over the head—and I have been known to be a little outrageous at times and extreme perhaps in some of my statements in order to get the attention of the industry.

When we first came on board, we were looked at very much askance by the industry.

First of all, they thought perhaps we were going to put them out of business. We did not do that. So we proceeded in an atmosphere where we knew we had to be slow and deliberative, to at least have some mutuality of communication with the industry, not bellying up, but some mutuality of communication.

I think in the first 8 or 9 months of our existence we finally achieved that kind of communication so that they knew we were around and could use our powers; but at the same time we were not around to put them out of business. That is about the atmosphere that exists today.

Senator HUDDLESTON. Do you feel this incidence of the Maine potato futures has improved the prospect of your getting their attention and assuring the authority that you have?

Mr. BAGLEY. I honestly believe, and although I am not going to

thank the participants, that this occasion will provide us the occasion to indicate that Congress simply did not reshuffle the alphabet when it created the CFTC as an aftermath of the CEA.

We have, without talking too tough, we have clout and we are going to use it and therefore hopefully the marketplace is going to be better.

Senator HUDDLESTON. Back to the potato situation.

Is there any substantial advantage to a person who holds short contracts in defaulting rather than meeting those contracts?

Mr. BAGLEY. Again, one of the rumors or speculations as to why this occurred is just that. I have heard the rumor that had the shorts been forced to go out in the market and buy potatoes, the price of potatoes for cash delivery would have gone up commensurately with the futures price; and if you're a major buyer of potatoes, even though you are short, if you are a major buyer of potatoes, you don't want the price to go up. That is one quote, unquote, rumor as to the motivation involved that I have heard.

Senator HUDDLESTON. So if the supply were held by a few people, they could have either refused to sell or have held the price up high enough so that it would then become financially uncomfortable for the short seller to secure potatoes to meet his obligation?

Mr. BAGLEY. Absolutely; no question.

Senator HUDDLESTON. And you are investigating as to whether or not that happened?

Mr. BAGLEY. Yes, sir; we are.

May I just add a thought here?

We are talking about price, we are talking about some major players, and I think Mr. Levine alluded to this but I think it is worth saying again, sort of to put the potato fiasco into perspective, the situation did not involve many characteristics that typify other types of scandals in commodities and securities transactions; by that I mean no customer funds were endangered; no one absconded with money; there was no massive failure of brokerage firms; we do not expect any.

The rest of the financial community has not been shaken by the defaults and this one is important; prices to the consumer were not affected; we did not have a price distortion situation.

Senator Muskie could say, legitimately, that the price to the farmer did not go up, whereas, in a tight supply situation it should have. That is a fair comment.

With the defaults that occurred, in round figures, it amounts to \$5 million. That amount approximates one one hundred thousandth of the total annual transactional value, that is, \$598 or \$600 million of all domestic futures trading.

Senator HUDDLESTON. How does it relate to the total potato trading?

Mr. BAGLEY. That is a darned good question; and I do not have that answer now, but I will supply it.

[The following information was subsequently received by the committee:]

Figures supplied by the New York Mercantile Exchange and the Chicago Mercantile Exchange indicate that the total value of potato futures trading during calendar year 1975 was \$3,468,500,000 (3,452,900,000 on the NYME and 15,600,000 on the CME). \$5,000,000 would be 0.144 percent of this total value figure.

Mr. BAGLEY. The point is, though, I do not want—and this is my plea—the futures market generally to be tainted by this default which, arithmetically, in the overall picture is almost miniscule.

I am not saying that our function is miniscule. I am not saying that this committee's function should not focus on that function, but just from the standpoint of total dollars, it is worth noting.

Senator HUDDLESTON. Back in April, you issued a formal order of investigation of trade practices, for the May contract.

Has this investigation been completed?

Mr. BAGLEY. It is not completed. It is ongoing and the default situation sort of took our—not only got our attention, but in the creation of sort of a strike force that we created, took about 20 of our people looking into the default situation.

Senator HUDDLESTON. What specifically prompted that action back in April?

Mr. BAGLEY. That was part of an ongoing initiative by our trading and market division to look at and this is something that CEA did not have the power to do, to change market exchange rules and regulations and trade practices.

We are doing an overall investigation here of the economics of the contract; that is one thing we are doing; but also of rules and regulations of the exchange, floor practices.

We have completed at least the survey of the five New York exchanges. Our people were in Kansas City last week.

Senator HUDDLESTON. Are you saying this is just a routine action on your part and not prompted by any specific findings?

Mr. BAGLEY. It is more than routine in the sense that we intended to do and are doing a trade practice investigation of every exchange. It was part of a pattern.

But we started in New York and we started with the New York Merc, if I can call it that, because of our sort of inherent knowledge that there were trade practice problems on that floor.

Senator HUDDLESTON. You also began a study or an audit of the exchange's rule enforcement program.

What is the status of that?

Mr. BAGLEY. It is really the same thing: Trade practice rule enforcement; how is trading conducted; what does the exchange do to see that it is under control and totally on the up and up.

The status is that we are covering all of the exchanges, working our way to Chicago, in effect; and after we have looked at all of them, then we will be in a position to assess who needs to have what ordered, and by that I mean what rules have to be changed; we will suggest changes; if the exchanges do not make the changes and if we feel strongly enough about them we will order changes made.

Senator HUDDLESTON. Well, in the course of your inquiry in New York, you talked to a broker of the New York Mercantile Exchange, who alleged that there was high concentration on the long side of the May futures contract. Was that allegation investigated by the Commission?

Mr. BAGLEY. Again, if I may, that would be part of our investigation. I do not have, No. 1, all of the facts as to who found out what and; No. 2, if I had them I could not state them here as fact. That is part of the—

Senator HUDDLESTON. That is part of the information on which there possibly might be some legal action initiated.

Mr. BAGLEY. Yes, sir; that is the other side.

I repeated or reported a rumor that might be held against the shorts, although I have not made up my mind; I keep saying that we will not prejudice. Now I'll report a rumor on the other side.

The rumor on the other side had its genesis in what you just said; namely, that the shorts would not trade out for liquidation because they will allege that they were being held up by the longs.

Senator HUDDLESTON. Is it a specific violation of law that an individual does not act responsibly in liquidating his futures position?

Mr. BAGLEY. It is, No. 1, a violation of the rules of the exchange which we have the right and obligation to enforce; so he has broken the rules. That is sort of—the first simple answer.

No. 2, if there is a manipulation or an attempted manipulation or conspiracy to attempt a manipulation, that is a crime.

Senator HUDDLESTON. If he defaults to avoid his obligation, is that a crime?

Mr. BAGLEY. No, sir, not in the abstract. My general counsel will correct me if I am mistaken.

Mr. SCHNEIDER. No; I believe you are right.

Senator HUDDLESTON. So there must be some kind of conspiracy for a crime to have been committed.

Mr. BAGLEY. You have to find a manipulation in the abstract which would sort of prove itself by a dramatic market move to someone's advantage.

If you cannot find that, then you have to find an attempted manipulation with all of the facts and figures, all of our investigative power to do so, aiding and abetting a manipulation.

All of these are a whole spectrum of possibilities that we are looking into. It is not easy to prove a manipulation; but we are not going to give up, either.

Senator HUDDLESTON. Are you now then pursuing this particular case in Maine potato futures transactions from the standpoint of possible changes that may be necessary in the rules and regulations that the exchange itself operates under, the contracts that may be involved and the enforcement that you have at your disposal? And further the question of whether or not laws may have been violated that would lead to legal action by the Commission against persons that might have been involved?

Mr. BAGLEY. Absolutely; yes. I'll just add one thought.

We discussed contract changes; we discussed the apparent lack of clout in this particular marketplace when trying to exert peer pressure internally. I have not discussed this, but I am going to mention next—but I will throw it out—the subject of public members on the boards of directors might be an interesting avenue to pursue and we have by our rules, could insist that there be a broader representation on the boards.

Obviously we also can insist that additional rules, if they are needed, be passed by that board of directors. We are talking here about the whole elemental area of self-regulation, and if self-regulation means something to this industry, and I know it does, then the industry will be responsive in wanting to preserve their rights and duty of self-regulation. The whole question is open.

Senator HUDDLESTON. But your responsibility certainly goes beyond self-regulation.

Mr. BAGLEY. Yes, sir.

Senator HUDDLESTON. It goes to the point of providing regulation.

Mr. BAGLEY. There are two facets, though. It is rather obvious.

The act does specify a number of places that the primary obligation is upon the exchange and we have this oversight role, plus we have the power to change rules of the exchange.

You start in hopefully with a well-run and well-supervised self-regulatory system; otherwise, we might have to assign CFTC personnel to every licensee and follow him around and that obviously would be ungodly. So we have two areas to perfect; self regulation, give it a chance to be perfected. No. 2, to assert ourselves when need be.

Senator HUDDLESTON. Now, the same question again to you, in retrospect.

How do you rate the performance of the Commission and the New York Mercantile Exchange at the various steps in efforts to protect all parties involved in the trading of futures?

Mr. BAGLEY. Let me start with the last part of your question first.

All parties involved, rather happily in this instance, were a relatively few number of parties and they were, I think, all professionals. Perhaps one reason we did not step in as we have for example in a number of instances where you have ongoing allegations of fraud by fly-by-night option operators; we step in and enjoin. That is a different world.

Here we have professional traders who apparently did not affect the marketplace from a consumer standpoint. So we looked at the situation in that context, appraising ourselves—I would be repetitive—I will say quickly, we should have, No. 1, investigative—

Senator HUDDLESTON. Let me interrupt you.

There is a vote going on that I almost overlooked. I am going to have to leave.

I would like to come back and complete your testimony before we break for lunch and save our final witness for after lunch.

[A short recess was taken.]

Senator HUDDLESTON. The subcommittee will come back to order. Mr. Bagley, we interrupted you right in the middle of responding as to whether or not the Commission used the power available to it to the fullest extent as it relates to the Maine futures trading actions.

Mr. BAGLEY. Without running on at great length, in the abstract, the answer to your question is no, in the sense that we had other clout, most of which I have already testified to, the power literally to close down the market and the power to provide trading for liquidation only and the power to declare an emergency.

For the reasons testified to, it was felt, with the assurances that we already had, that it would be better to allow the market to give that marketplace a chance to work out its own problems as happens in 999 times and the percentage is even better than that, out of 1,000; more specifically, what we could have done more realistically rather than close down the market, because again we cannot force somebody to trade if he will not trade out—there is no way of doing that.

But we could have delved into the supply situation to a greater extent.

In retrospect, it might not have made any difference because if it was the motivation of the parties to play chicken with each other, stare each other down, and that last day, it did not matter if there was a supply.

No. 2, perhaps more importantly, we could have—I could have personally—which I did not—inserted myself to do a lot more heavy jawboning.

Senator HUDDLESTON. The strike force that you ordered into action May 27, I believe 2 days after the actual default, is it still proceeding?

Mr. BAGLEY. Yes, sir.

Senator HUDDLESTON. It is part of the investigation that you have referred to?

Mr. BAGLEY. Yes, sir.

Very quickly, we have three major operating divisions: division of economics, division of trading and markets, which works on rules and practices and, division of enforcement.

Mr. Schief is in charge of the overall strike force but he is borrowing people from the economics division and the trading and marketing division, I would estimate, although certainly not all of them all the time; we probably have about 20 people involved from Washington, New York, and Chicago offices in the investigation.

Senator HUDDLESTON. Can you keep the committee informed on the progress of this investigation?

Mr. BAGLEY. We will logistically. I do not think you want us to specifically, from the standpoint of our preliminary findings.

Senator HUDDLESTON. That is correct.

Mr. BAGLEY. Yes, sir.

Senator HUDDLESTON. And what actions may be indicated by the investigation?

Mr. BAGLEY. Yes, sir.

Senator HUDDLESTON. There is one meeting that you have referred to and Mr. Levine referred to on April 30 at which a discussion was held as to what actions should be taken I believe I am correct in saying that your representatives were urging the exchange to take more specific action, even to the extent of contacting the traders themselves in trying to ascertain what their intentions were.

They made the same suggestion of you. Is this a buckpassing situation or is it just simply that the Commission was more able to carry out this kind of function?

Mr. BAGLEY. I think—I am sure it was the latter.

The exchange, as Mr. Levine testified, has no direct hook on the trader; the exchange may not even know who the actual customer is. The exchange has an order from a broker.

We have much more pervasive jurisdiction. We, for example, can bar a given trader, a customer, somebody out there in the real world, from trading. The exchange does not have that power. They only have power by virtue of their rules, by virtue of contract with their members.

So we had to take over that obligation and did.

Senator HUDDLESTON. Do you have reports from the traders to give you some idea of what their position is?

Mr. BAGLEY. Yes, sir.

Senator HUDDLESTON. You do that on a regular basis.

Mr. BAGLEY. Yes, sir.

Senator HUDDLESTON. Are you looking into any possible conflict of interest? Are there any brokers in May of 1976 potato contracts who are also executives or members of enforcement committees of the exchange?

Mr. BAGLEY. The answer is yes.

Senator HUDDLESTON. Are there also producers involved that may be members of the exchange?

Mr. BAGLEY. I am trying to remember whether there are any producers; and I personally do not know; but answering your question, we are certainly looking into that.

Senator HUDDLESTON. That is an area?

Mr. BAGLEY. That is an area of inquiry and also as I raised here a moment ago, it is perhaps an area of more broad collective action that we might want to take in the future to at least assure you, the Congress and the public, that there will be some independence of these boards that are constituted as self-regulatory entities.

Senator HUDDLESTON. Mr. Bagley, I believe that completes our questioning.

I again welcome you before this subcommittee for your first appearance since the Agriculture Committee passed the CFTC legislation and confirmed you.

Mr. BAGLEY. I have got to say that Dick Clark has had me up here a couple of times.

Senator HUDDLESTON. We hope—

Mr. BAGLEY. Which I welcome and enjoy.

Senator HUDDLESTON. We hope as you do that this instance will prove to be a catalyst for the kind of activity that the CFTC was empowered to perform and that it will result in improvements in the entire process of futures trading.

The record will remain open for 7 days and we may very well submit to you further questions and request that they be answered in writing.

Mr. BAGLEY. Yes, sir.

Let me just respond by first of all obviously thanking you for your concern and then adding one thought.

The fact that I have been talking about exchange practices and about some of the deficiencies in these marketplaces should not be interpreted by anyone—I'm really talking to the public—interpreted as a broad allegation of deficiencies in these marketplaces; because from my first year's perspective, that is not the case, nor should the industry, the other exchanges, interpret my remarks as indicating that I do not want to continue some cooperative effort to bring better self-regulation into play.

I do not mean to lean on that, but without that cooperative self regulation, we would have to increase our capacity 20-fold and I do not know that we are going to be authorized to do that.

Senator HUDDLESTON. Thank you very much, Mr. Bagley, and the subcommittee now will adjourn until 2 o'clock, at which time the witness will be Dr. Paul.

[Whereupon, at 1:13 p.m., the hearing recessed, to reconvene at 2 p.m.]

AFTERNOON SESSION

Senator HUDDLESTON. The subcommittee will come to order and we will resume our hearing.

Dr. Paul, identify yourself and your associate for the record and then please proceed.

STATEMENT OF DR. ALLEN B. PAUL, PROGRAM LEADER FOR PRICING, POLICY, AND PROGRAM ANALYSIS, NATIONAL ECONOMIC ANALYSIS DIVISION, ECONOMIC RESEARCH SERVICE, U.S. DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY JAMES V. FAHEY, HEAD, PROGRAM ANALYSIS SECTION, VEGETABLE BRANCH, FRUIT AND VEGETABLE DIVISION, AGRICULTURAL MARKETING SERVICE, USDA

Dr. PAUL. I am Allen B. Paul, program leader, pricing, policy, and program analysis, Economic Research Service, U.S. Department of Agriculture.

I am accompanied by James V. Fahey, who is in the Fruit and Vegetable Branch—or is it division?

Mr. FAHEY. Fruit and Vegetable Division and that is the branch, the Agricultural Marketing Service, USDA.

Dr. PAUL. It would be most expeditious to read the statement, or is it too long?

Senator HUDDLESTON. Just proceed as you choose. Generally, I find reading is quicker than to summarize.

Dr. PAUL. Right.

Mr. Chairman and members of the committee:

In the last 18 years, I have been employed by the Department and have specialized, among other things, in the economics of futures trading.

A number of my studies have appeared in professional journals, in departmental bulletins and elsewhere. I am not a commodity specialist but I do try to maintain a working acquaintance with pertinent features of different commodities as they bear on the organization and functioning of exchange processes.

I have followed, along with others, recent newspaper accounts of the resolution of the May 1976, contract in Maine potatoes.

The episode appears to be a particular manifestation of the general problems associated with all organized futures trading, namely, how to achieve an orderly liquidation of maturing futures contracts.

The problem in any seasonally produced commodity becomes aggravated toward the end of the shortage year when stocks are normally depleted. I will return to this important matter shortly.

Any well-functioning futures market invites wide participation. It provides low-cost access of buyers to sellers through its highly standardized terms and procedures, and security of contract through customer margin requirements and clearinghouse guarantees.

These sophisticated institutional arrangements evolved over many decades of trial and error and were in use about the turn of the century. Such trading devices result in a large structure of commodity debts, all of which need to be settled by their due dates.

The liquidation normally is done by entering offsetting contracts before the time one must deliver or accept delivery on his commodity debt.

Usually, neither party that wants to obtain or dispose of the commodity would find it suitable to do so in the futures market.

Standardized methods do not give each participant precisely what he wants. Yet, if someone wants to make or take delivery on futures, he is fully entitled to do so and the machinery usually does this expeditiously.

Invariably, some commodity debts are settled by delivery. All in all, there usually is little or no problem of achieving an orderly liquidation of all futures contracts despite their large numbers.

Thus organized futures trading takes on the characteristics of a purely financial institution, wherein there is a large structure of debt claims against commodity reserves to settle them. The issuance, sale and extinction of standardized claims occur relatively smoothly.

The economic role of futures trading in commodities is to facilitate choice of asset holdings: The important point is that it facilitates the separation of responsibility for owning claims to commodities from the responsibility for owning claims to inputs required to physically transform the commodity in form, place or time, i.e., to grow, assemble, store, process or distribute the commodity.

Presumably each participant tries to increase his net worth by appropriate shifts in his asset-liability holdings.

For example, whether a claim to a commodity, or claim to the use of facilities to transform the commodity in some manner is a reasonably good addition to one's portfolio depends on all his other holdings, including the value of his personal skills.

Intelligent use of futures, whether used directly or indirectly, enables many businessmen to discriminate in their enterprise selections and thus concentrate their commitments of equity to particular endeavors.

This usually results in more specialized, more modern, and lower cost physical operations than otherwise—be this enterprise the growing, assembly, distribution, processing or warehousing of the commodity.

The alternative of allocating one's equity both to ownership of the commodity and to what it takes to conduct physical operations will suffer for lack of capital, or that he will have to take in partners to enlarge the equity fund in order to assume both kinds of responsibility.

The latter move is in the direction of the corporate business unit.

On the other hand those who choose to own (or owe) commodities and let someone else perform the physical transformation on them, engage in forecasting the future price of the commodity.

They judge that the worth of these commodities will rise or fall relative to the worth of other things they might own. The result is the discounting of new information, arising from various quarters, into price.

It results in guiding production along lines of the forecast, be it the carrying of more or less stocks from periods of harvest forward, increased or decreased acreages planted, increased or decreased rates of feeding, or some other such change in the rate of physical transformation.

Beyond these two fundamental and interrelated roles of futures trading, another service is provided; namely, the bringing of prices into the open for all to see. It is an integral part of the information role whose nature and importance is only now receiving wider appreciation and understanding.

The problem of liquidation in the delivery month—as suggested above, a unique feature of organized futures trading in seasonally produced commodities as a financial institution is the difficulty of achieving an orderly liquidation when deliverable supplies are particularly short.

It can result in a type of distortion that is a strong form of the delivery month squeeze. The nature of the problem and possible remedies were examined at length in a recent department publication entitled "Treatment of Hedging in Commodity Market Regulation." This is the document that I brought; here are a few copies. USDA Technical Bulletin No. 1538, Economic Research Service, April 1976.

Senator HUDDLESTON. Thank you. We will receive that for the committee's use.*

Dr. PAUL. The study was made at the request of the administrator of the Commodity Exchange Authority and it has been made available to the successor agency—the Commodity Futures Trading Commission.

I will summarize parts of this report that seem pertinent for the analysis of May potato futures in eight brief points:

One: All commodity futures contracts have a squeeze potential because there are positive costs of making and taking delivery. These costs may or may not present serious problems, depending on the nature of the commodity stored and on the availability of stocks, storage, and transport services in relation to the number of contracts outstanding.

Large delivery costs tend to create a large squeeze potential. The problem becomes magnified when the costs are incurred for searching out, transporting and otherwise diverting supplies to satisfy futures delivery.

Two: The fewer the available supplies for delivery on a particular contract, or the more costly it is to make or take delivery of existing supplies, the more susceptible the contract is to distortion, i.e., futures prices get out of line with competitive values in cash trading.

Three: There are two routes to lessen the potential for distortion; namely, (a) modify contract terms to increase deliverability of supplies and/or (b) limit the size of positions that may be carried into the delivery month geared to the available supplies.

Four: Modification of contract terms is the most constructive direction to move. The better the design of futures contract terms, the larger the positions that can be sustained without distorting prices. However, the problem of specifying par types, grades and location for delivery, substitutions, and equitable premiums or discounts thereto, is among the most complex of economic problems—requiring reliable insight into the consequences of each suggested change. There is no substitute for studies of basic economic relations in form, place and time as applied to the commodity under study.

Five: The potentials for improving contracts may be limited by the underlying structural features of commodity markets. Markets differ widely in what structural improvements might be achieved.

*Retained in committee files.

Six: Speculative limits have been applied by both the exchanges and by the CFTC, formerly CEA, in order to achieve more orderly markets but bona fide hedges have generally been excluded from any such controls. It has become clear that it is often hard to distinguish between the two.

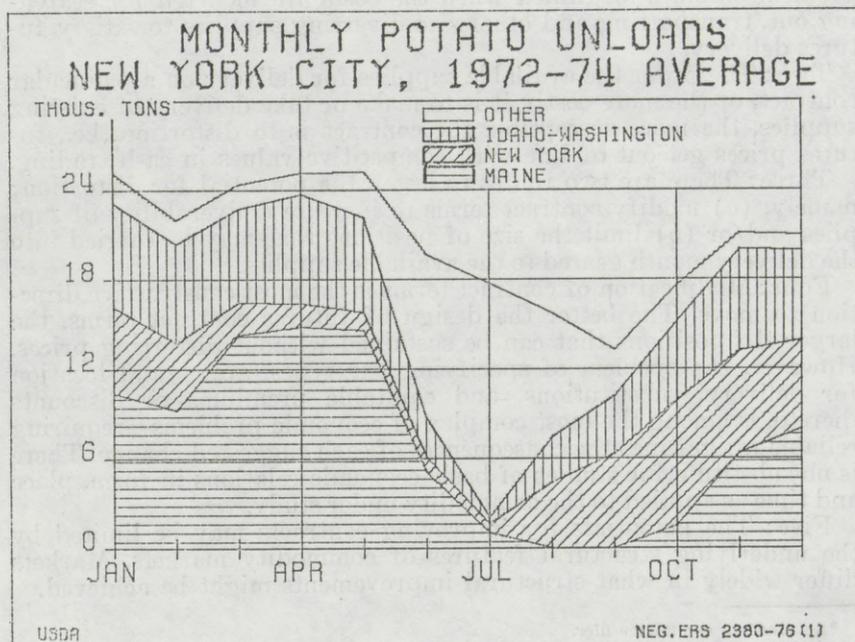
In any case, the need for orderly liquidation of contracts applies to all market participants, which fact argues for imposing a general constraint on positions carried into delivery month irrespective of their classification.

Seven: One way to mitigate distortion is to have a general constraint on total open positions of all traders in a contract during the delivery month, geared to the economically deliverable supply of commodity. Reasonably accurate estimates of deliverable supplies might allow positions limits to be adjusted in time to avoid difficulties.

Eight: In principle there is no particular need for any limits on size of positions before the delivery period. However, to achieve an orderly reduction in size of positions carried into the delivery month would require a positive means for reducing the size of individual positions as the delivery month approaches. One way to do this is with tapering limits applied to each contract. The taper would increase with increased distance to its delivery date.

Focus on Potatoes.—Maine-grown potatoes are stored in volume and fed into fresh and processing markets mostly in the East during the winter and early spring. Typically shipments during May are about as large as shipments during February and March, all peak periods.

This is shown in the accompanying figure, charting monthly potato unloads in New York City from all sources in the 1972-74 period, from "Vegetable Situation, Economic Research Service, February 1976."



Now, looking at the chart a moment, the lower line, the horizontal stripe, are unloads in New York during each month from the State of Maine. As you can see, beginning about October, Maine potatoe unloads start to rise and build up in November and December and continue into January and February—but the biggest shipments are March, April, and May. So that May is a substantial month for the cash movement of Maine potatoes into this large eastern market.

Another large source of potatoes—the diagonal line is harvested a little earlier. I am not a potato expert; I should defer to Mr. Fahey; but New York State potatoes supply the New York market earlier than Maine. The vertical line indicates the Idaho-Washington potatoes, which come a long distance into the New York market. They are in the market at about all times that the Maine potatoes are in the market. The upper line, represents potatoes from all other sources; these are largely new potatoes and come in from the South and from various other parts of the country.

However, 1976 was an unusual year. Maine storage stocks of potatoes on April 1—the last date from which stock reports are issued—were reported as only 7.4 million hundredweight, as compared to 13.0 million hundredweight in 1975, 9.3 million hundredweight in 1974, and 10.8 million hundredweight in 1973.

Hence, it seems likely that deliverable supplies to satisfy May futures contracts in 1976 were also significantly lower than usual. Each 1 million hundredweight shortfall is equivalent to 2,000 futures contracts, at 50,000 pounds per contract.

The above suggests that there is an economic rationale for trading in May potato futures. It is to facilitate carrying Maine potatoes into May and enable the various markets to be supplied in the interval before new crop potatoes arrive in volume in June or July.

However, there is also a potential problem of achieving orderly liquidation of the contract because of short supplies. Squeezes with noticeable price distortion are one result; defaults are another.

The 1976 episode was, of course, dramatic, but a 600-car default occurred in the May 1955, Maine potato contract, when one firm and its subsidiaries held a dominant position. This was over 20 years ago. It is a similar type of thing; it was rather dramatic too.

A constructive resolution to this problem would require a research effort. As noted, the change in contract terms to broaden the deliverable supply should be considered in terms of economic consequences of the various feasible adjustments. For example, should potatoes other than Maine grown be deliverable on May futures and if so, then at what premium or discount?

Constraints to limit size of positions in the May contract also merits examination. Both the New York Mercantile Exchange and the CFTC (CEA) placed limits on speculative positions. The Government's limit for the May contract is 150 contracts—cars of 50,000 pounds—net long or short.

The limit for November is 300. This amounts to a rough gearing of size of all positions except hedges to the distance of the delivery into the storage season.

Should this taper remain fixed, or should it be varied (a) with the distance of the month in which the trading takes place to the delivery month, and (b) with the outlook for remaining deliverable stocks as the season progresses?

Should hedges be allowed to exceed such limits? If so, should all potatoes held in store qualify as hedgeable cash positions in the Maine potato contract or should only those that, in principle, are deliverable on the contract be counted?

I wish to thank you gentlemen for the opportunity to present these few observations based on my general knowledge of futures trading. I will be glad to answer any questions you may have.

Senator HUDDLESTON. I think even though our time is extremely limited, we would like to get your opinion on specific transactions that we are talking about here.

First of all the last day of trading was May 7 for the May Maine potatoes contract. Is that an arbitrary date? How is it arrived at?

Dr. PAUL. I do not know, except that I believe in 1955, referring to the investigation that I read, the date was not that early. It was quite a bit later, but it changed.

Senator HUDDLESTON. Is that a date that is in the contract itself?

Dr. PAUL. Well, it is part of the rules which are in the by-laws governing the contract. They are written.

Senator HUDDLESTON. You heard this morning the indication by both Mr. Levine and Mr. Bagley, about their thinking about a new contract.

Did they seem reasonable to you?

Dr. PAUL. They certainly ought to be explored. If truck movement is a predominant movement, or even a substantial movement, it ought to be allowed. Other States produce round white potatoes, which are the same kind of potatoes as Maine produces. If they have some period of substantial stocks they ought to be allowed to make—

Senator HUDDLESTON. This flexibility would, in your judgment, reduce the probability of an incident like the current situation?

Dr. PAUL. Right.

Senator HUDDLESTON. How prevalent is the practice of roller cars in the potato industry?

Dr. PAUL. I would have to defer to Mr. Fahey.

Mr. FAHEY. Mr. Chairman, it is prevalent in the year of heavy supply, surplus supplies, when the shippers in the Far East will start a car roll and he hopes to sell it en route.

In a position of fairly tight supply, such as in the past spring, the transaction is usually consummated in the shipping points.

Senator HUDDLESTON. What about other perishable commodities?

Mr. FAHEY. It is across the board in produce, particularly California lettuce, if the market goes down to \$2.25 a carton. They will move it across the country.

Senator HUDDLESTON. Looking for better prices?

Mr. FAHEY. Right. But in recent years our supplies have tended to be better with demand. I think over the time the problem is diminishing.

Senator HUDDLESTON. Is it utilized in grain or mostly in perishables?

Mr. FAHEY. I would suggest it is mostly in perishables, where you have short-term supply.

Senator HUDDLESTON. Do you have any comment on the fact that was developed by our two earlier witnesses, that while both were seeking information about the available supply, they apparently

either received different information or interpreted it differently with the Commission coming to the conclusion that there was indeed a shortage of supply while on the other hand, the exchange was assured that there were adequate supplies to meet the need.

Mr. FAHEY. I think the basic supply of Maine potatoes was on the type and size but it would be surprising to most of us that the supply was so tight that a person wishing to consummate a contract could not find any.

Senator HUDDLESTON. If he had been willing to pay the price?

Mr. FAHEY. Yes. But the Maine production in 1975 was a small symptom of the 1940's, and by April 1, the last official date we have supplies reported, Maine potato supplies were 50 percent of the year earlier.

I would like to point out here that there were certain paradoxes this past winter which we had the extreme shortage on a per-capita basis of Maine potatoes. But we had a record supply in the Far West.

Admittedly, the supply in the East is the round white, which is not exactly a substitute for that grown in the Far West. But we did have that paradox. It was difficult, a difficult market for those of us who followed it.

What does it mean in terms of price?

At the same time we have the unusual export business from Eastern Europe, very unusual, because they say we have a quarantine; we do not need your potatoes. This year, they did.

At one time our potatoes left our Eastern shore and as they proceeded to their destination to Europe, they said, no, you cannot land your potatoes here. I am merely bringing the point up to point out if you have sold a whole boatload of potatoes to a foreign outlet and those potatoes do not find a home, it has an impact on domestic prices.

While we have a shortage in Maine, the heavy supply in the Far West, our new crop, such as in California, will prefer a large crop. That crop is now being marketed and potato supplies today are fairly heavy. So we have this—

Senator HUDDLESTON. That increased production out West would not help because of the delivery restrictions in the contract.

Mr. FAHEY. It would have some impact on price.

Senator HUDDLESTON. But the shortfall in production in Maine should have alerted nearly anybody observing the market to potential problems.

Mr. FAHEY. It should, anybody that followed the statistics.

I might point out that normally, after May 1—and I can go to the record for the exact date—approximately 15 percent of your crop was marketable, 100 percent moving.

Starting May 1, your supply thins out in May.

Senator HUDDLESTON. So there again, anyone who is maintaining their short positions beyond May 1, should be on notice that he is risking possibilities of not being able to find potatoes even in normal times.

Normally the liquidation rate really accelerates in those first few days of May.

Mr. FAHEY. It normally does.

Senator HUDDLESTON. Is May 7 a reasonable date for the last trading day?

What is your knowledge about that?

Mr. FAHEY. I might point out that all of the futures trading contracts by the 10th of the month, they try to consummate that particular contract. In my opinion, once you get into May, you are getting into a thin supply of these storage potatoes and you may have that situation—

Senator HUDDLESTON. Would an earlier date be more reasonable?

Mr. FAHEY. I think it would have a good concept; yes.

Senator HUDDLESTON. Excuse me just a second.

[Short pause.]

Senator HUDDLESTON. It is hard to be in two places at the same time; but we try.

We were talking about the closing date of trading.

It seems like being a little earlier might help you eliminate—

Mr. FAHEY. Right. As a personal opinion of mine.

Senator HUDDLESTON. How do you see the opportunity for manipulation in the Maine potato futures contracts on behalf of either the seller or the buyer?

Dr. PAUL. Well, there are the big positions of only two people, despite the larger number of clearing accounts that have these accounts as reported in the Wall Street Journal article. I do not know the composition on the long side, but I gather that one trader had rather a large position and there were some exporters. I take it also that some of these positions were put on rather late in the contract. So I think the unusual low stocks carried beyond April 1, which was information everyone had, presented more of an opportunity for them to manipulate.

If anyone were going to try to influence the price of this market, then it would be more likely than if you had large stocks. How much they did, I do not know, except for one point I would like to make. I do not understand, the open positions allowed under the law. The Federal limit on the amount any one person could have in May is 150 cars, at most.

Now, if one is a hedger, he can exceed that. So the question now is: Were these people bona fide hedgers? Maybe under the rules they are counted as bona fide hedgers; but the question is, should they be if they do not have the kind of potato that is deliverable on a contract?

Senator HUDDLESTON. That presumably is a matter to be investigated by the exchange and the Commission.

Does the staff have any other questions of these two witnesses?

[No response.]

Senator HUDDLESTON. Gentlemen, thank you very much for your testimony. We appreciate it.

That concludes this hearing by the subcommittee. The record will remain open for 7 days for any additional information that might be requested.

[Whereupon, at 2:47 p.m., the subcommittee adjourned subject to call of the Chair.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF HON. EDMUND S. MUSKIE, A U.S. SENATOR FROM MAINE

Mr. Chairman, and members of the Subcommittee, I would like to thank you for this opportunity to participate in your oversight hearing on commodity exchange trading of May Maine potato futures contracts. Your efforts today to determine what is being done to redress the difficulties recently caused by unusual and disruptive trading practices and defaults which developed in trading on the May Maine contract will be of great interest to my constituents who are broadly affected by these developments and deeply concerned about them.

The serious and large-scale violations of the rules of the New York Mercantile Exchange have created a crisis-in-confidence toward all commodity exchange trading. The developments show dangerous weaknesses in the ability of the Exchange to prevent futures trading from causing wild swings in price and disruptions in the market unrelated to true market forces.

As this Subcommittee knows, commodity exchanges are designed to assist in the orderly marketing of key products. They provide forums for commodity buying and selling months ahead of dates for delivery in order to help producers protect themselves against a drop in the market and to help processors and dealers plan inventories and gauge price pattern developments. These exchanges attract speculators, having no interest in the commodity, who seek profits when price patterns fluctuate wildly.

But many farmers in Maine have for years said that the trading of Maine potatoes for future delivery has been subject to manipulation and has created a market which does not fairly reflect the actual supply and demand picture. In years past, I have many times sought, and several times achieved, Senate passage of legislation to ban the trading of Maine potato futures. A similar ban has been passed on more than one occasion by the House of Representatives, at the urging of Bill Hathaway, then a Congressman. But a ban was never enacted into law.

So we were delighted to support the legislation establishing the Commodity Futures Trading Commission, which beefed up the regulatory authority of the former Commodity Exchange Authority. The new Commission was vested with strong authority to carefully monitor and in extreme cases to control futures trading to guard against manipulation of commodity markets. Passage of that measure, we hoped, would improve the operations of commodity exchanges and would provide for effective remedies against those who would seek to manipulate the boards of trade or violate the rules of trading.

The widespread violations of the rules of the New York Mercantile Exchange on the May Contract raise many questions about the Exchange and about this new Commission.

Therefore, today's hearing is important. We will seek to assure that an open and thorough investigation is conducted by the Commission and that the Exchange's house is put in order again. The actions taken by the Commodity Futures Trading Commission and the New York Mercantile Exchange in this unprecedented situation will be the benchmarks for us to judge their performance in protecting the market against manipulation and in redressing all damages and punishing all wrong-doers.

STATEMENT OF HON. WILLIAM D. HATHAWAY, A U.S. SENATOR FROM MAINE

Thank you Mr. Chairman for this opportunity to testify at this hearing on the state of affairs in the potato futures market.

I realize that the purpose of today's hearing is not so much to find a remedy for the recent problems which have befallen the trading of May potato futures' contracts, but is rather an overview or initial investigation of those problems and of recent events.

However, it behooves me to mention a few basic issues of great importance to my constituents in the potato raising part of Maine. It is the hope of farmers in Maine that as the CFTC, the New York Mercantile Exchange and even this committee consider changes in the standard contract that they put themselves in the boots of the farmer.

The first concern of the farmer is that, when he sells his potatoes, he is promptly paid. That means that when he sells to a broker or anyone else who may be involved in the futures market, the farmer is entitled to a quick settlement through prompt payment.

I am also persuaded that the farmer as well as the ultimate consignee at the point of destination could lend helpful advise as the CFTC and the New York Mercantile Exchange alter the contract to allow for shipment by truck. Some thought ought to be given to what is an appropriate contractual destination.

Finally, if the exchange and the CFTC determine that it will be advantageous to satisfy obligations with other round white potatoes, I hope that there will be enough lead time given for farmers in Maine to adapt to whatever changes in their circumstances this may entail. After all, we may have been forced quickly to recognize some shortcomings which have surfaced in the mercantile exchange this year, but it does not follow that we must therefore react with such haste that we catch Maine farmers unaware, or for that matter for the potato producers of other states.

And while I am on that note, I hope that any decisions include the farmers of other states and not be made unilaterally by the mercantile exchange or by the CFTC. The farmers of any areas ought to have a chance to express their views before they are committed to something which they might not desire.

And any such confusion will of course threaten the necessary integrity of and public confidence in the New York Mercantile Exchange.

Thus, I would suggest that the New York Mercantile Exchange and the CFTC consider holding rule-making type hearings in Maine, and elsewhere, prior to any final new contract. Farmers to be subject to this contract ought to have a chance to express their views on it and I have no doubt that the final product of such an exchange will be superior to a unilateral creation.

Thank you, Mr. Chairman, for allowing me to make these remarks. I am sure I speak for potato farmers everywhere when I thank you for your interest and conscientious attention to this vital issue.

STATEMENT OF WILLIAM T. BAGLEY, CHAIRMAN, COMMODITY FUTURES
TRADING COMMISSION

On July 18, 1975, the Commodity Futures Trading Commission designated the New York Mercantile Exchange as a contract market for trading in futures contracts of gold, platinum, palladium, U.S. silver coins, heating oil, and several international currencies. These had theretofore been unregulated commodities. As part of our general assumption of authority, the Commission assumed regulatory responsibility for three previously regulated contract markets on the New York Mercantile Exchange—butter, boneless beef, and of course, the subject of today's hearing, Maine potatoes.

The Maine potato contract currently traded on the New York Mercantile Exchange calls for delivery of 50,000 lbs. of certain varieties of Maine-grown potatoes. All potatoes delivered against the contract must be round, white, U.S. No. 1, Size A, 2 inch minimum and 3¼ maximum. The potatoes must be packed in 50 lb. paper bags, and loaded in railroad cars. A USDA Inspector certifies that the delivery lot meets contract specifications. Delivery is made FOB, a shipping point in Maine, with freight paid to New York City. Prices of Maine potatoes in both the cash and futures markets are quoted in dollars per hundredweight. The USDA quotes a daily cash price for potatoes in the State of Maine. To determine the value of Maine potatoes delivered in New York, freight and delivery costs of approximately \$1.40 per hundred weight must be added to the price quoted in Maine. A one cent per pound (one dollar per hundred weight) price change in the futures market represents \$500.00 per contract. The delivery months of the Maine potato contract have been November, March, April and May. These months coincide with the potato crop year and commercial practices, in that potatoes are harvested in the late fall, stored during the winter and merchandized in the spring. Because futures prices are

a function of potential supply and demand, throughout the life of any futures contract, prices will respond to different factors at different times. The May futures contract is the last contract of the expiring crop year. Traditionally, the availability of deliverable potatoes is the dominant consideration in the thinking of all market participants who trade in the May contracts.

The availability of deliverable supply is also an important consideration in our market surveillance program. We monitor all futures contracts on all commodity exchanges from the moment the first trade is initiated up through and including the day the last contract is liquidated whether by offset or delivery. We are particularly concerned with a contract as the period in which deliveries may be made approaches. The Commission routinely monitors the relationship of cash prices to futures prices, the total makeup of the open interest including the positions of large traders and, of course, deliverable supply. In addition, we routinely conduct any other surveillance that is necessary to assure an orderly liquidation. If it appears that an abnormal situation is developing, the staff takes any action which is appropriate in light of the circumstances, within the framework of the purposes and policies of the Commodity Exchange Act and CFTC regulations thereunder.

Our surveillance of the May 1976 Maine Potato Futures contract began in February of 1975 when it was listed for trading. As a result of that surveillance, it became apparent in March and early April, 1976, that deliverable supplies for the May contract were likely to be small. In mid-April, we intensified our routine surveillance activity, because we were concerned about a situation which could possibly result from a combination of several factors. One factor was the development of substantial export business. Another factor was the April USDA Stocks in All Positions Report which confirmed that potato supplies from Maine in May would be tight.

In the course of our routine surveillance there was always an element of concern respecting the price of the May contract. We were aware, as you may be, that the liquidation of the May potato futures contracts had in the past been subject to sudden, volatile price changes which the public and some members of Congress felt were unreasonable and unwarranted. We were particularly concerned that the conduct of the floor brokers during the final days of trading be within the rules of the Exchange. For this reason, we assigned a member of the staff to spend full time on the floor of the Exchange, to observe the trading and to look for abusive floor trading practices.

As a result of the foregoing concerns, on April 23, 1976, the Commission authorized a formal investigation of the May futures contract and the staff began a review of the Exchange's rule enforcement program. At this point, our greater concern was the potential for unreasonable or unwarranted price activity, as opposed to whether potato futures contracts would have to be settled by delivery. With respect to this latter consideration, we were aware of the positions of certain large traders who were short. However, at this time these positions did not represent a threatening percentage of the total open positions, and assuming the normal situation—that traders would adopt an orderly plan of liquidation—there would be no disruption of the market.

In the next to the last week of trading it became apparent that although the open interest was decreasing at an acceptable rate (consistent with historical patterns), the positions of the large shorts were not decreasing proportionately. The staff met with Exchange officials to discuss the large short positions, the deliverable supplies, and possible actions the Exchange might take to deal with the developing situation. The staff and the Exchange were in almost daily contact regarding these and other traders' positions and the overall liquidation of the contract from April 28 through the last day of trading on May 7, 1976. Of primary concern was an Exchange rule which requires each clearing member who has a customer with a short position to assure either that his customer is in a position to deliver on his short position or that the position will be liquidated. Events, of course, have shown that positions were not liquidated and that delivery was not forthcoming. This is despite the fact that we received continual assurances from all concerned that Exchange rules would be adhered to.

This was part of our normal routine in that the Act places the primary responsibility for orderly markets upon the Exchanges with the Commission having broad oversight authority. While we continuously emphasized to the Exchange that it had the first line of responsibility in dealing with the situation

(i.e., enforcing its rules), the Commission also contacted the short traders holding the large positions, warning them that they controlled a substantial portion of the open interest and that, under the Act, they had a responsibility to avoid disrupting the market, and would be held accountable for their actions.

Then, with only four trading days left, the other shoe dropped. New longs entered the market and began to build sizeable positions. The Exchange was advised of this development and again it was emphasized that the Commission expected the Exchange to take whatever steps were necessary to assure an orderly liquidation. In this final week of trading, the open interest continued to decline in a pattern consistent with the last ten years, and the price of the May futures contract relative to the cash market was well within acceptable tolerances.

The rest of the story has been well covered by the press. Despite the efforts of both the Commission and the Exchange, when trading in the May futures expired at 1:30 p.m., May 7, 1976, there were 1,911 contracts left open. The large shorts were still short and the large longs had more than doubled their positions in the last two trading days. Under Exchange rules, these contracts either had to be satisfied by actual delivery according to the contract specifications or exchanged for the cash commodity.

We remained in close contact with the Exchange during the delivery period which was May 10 through May 25. During this delivery period, we continued to remind the Exchange of its obligation to see that its rules were enforced. At the end of the delivery period, a total 914 of the open contracts had been settled in accordance with Exchange rules. However, as of the close of business May 25, 1976, 997 contracts had not been settled.

In response to these defaults the Commission met in an all day session on May 26, 1976, and took the following action on May 27 (see letters attached) :

(1) Demanded that the Exchange limit trading in the May 1977 contract to "liquidation only". We seriously questioned whether there is an adequate supply of potatoes generally available to justify the continuation of a May potato futures contract. With this action, we defused the time bomb which had the potential to explode again at the same time next year.

(2) Created an Investigative Strike Force under the direction of William Schief, Director of Enforcement, to investigate the situation.

The investigation is proceeding forthwith and the Strike Force is continuing to subpoena and interrogate witnesses and review records and documents concerning possible violations of the Commodity Exchange Act. The investigative force continues to work on an overtime basis and is inquiring into the broad responsibilities and activities of (a) the major longs, (b) the major shorts, (c) the Exchange and (d) the Exchange Clearing Members.

We expect the investigation to be thorough and expeditious, but at this early date we are unable to accurately assess when the investigation will be completed. Staff members from our New York and Chicago offices have joined the core of our Strike Force from Washington.

(3) Requested that the Exchange modify the terms and conditions of the potato contract to provide for an expansion in the deliverable supply, an increased number of delivery points, delivery by truck and improved inspection procedures. In addition, there are several other Exchange rules, which, in light of what has occurred, will require modification or substantial justification from the Exchange.

The Exchange is still sorting things out. In view of the Commission's responsibility to review all actions of the Exchange, it is inappropriate for me to comment on these proceedings at this time. The Exchange is keeping us informed of their progress.

This entire May potato situation is extremely serious, in that, the very integrity of a futures contract has been questioned. In addition, the whole concept of self-regulation will be re-examined. However, to keep things in perspective, this situation does *not* have many of the characteristics which typify past scandals involving securities and commodities transactions, some of which led to sweeping regulatory reform. For example, there are no customer funds in danger; no one has absconded with money; there has not been a massive failure of brokerage firms, nor do we expect any; the rest of the financial community has not been shaken by the defaults; prices to the consumer were not affected and, if we do our job rapidly, and effectively, the public will not have

lost confidence in these market places. As a matter of fact, these "defaults" of about \$5 million in the potato contract approximate 1/100,000th of the total annual transactional value (\$600 billion) of all domestic futures trading. Moreover, the daily volume of trading in futures contracts has been generally rising in the midst of this publicity, particularly at the Chicago Board of Trade.

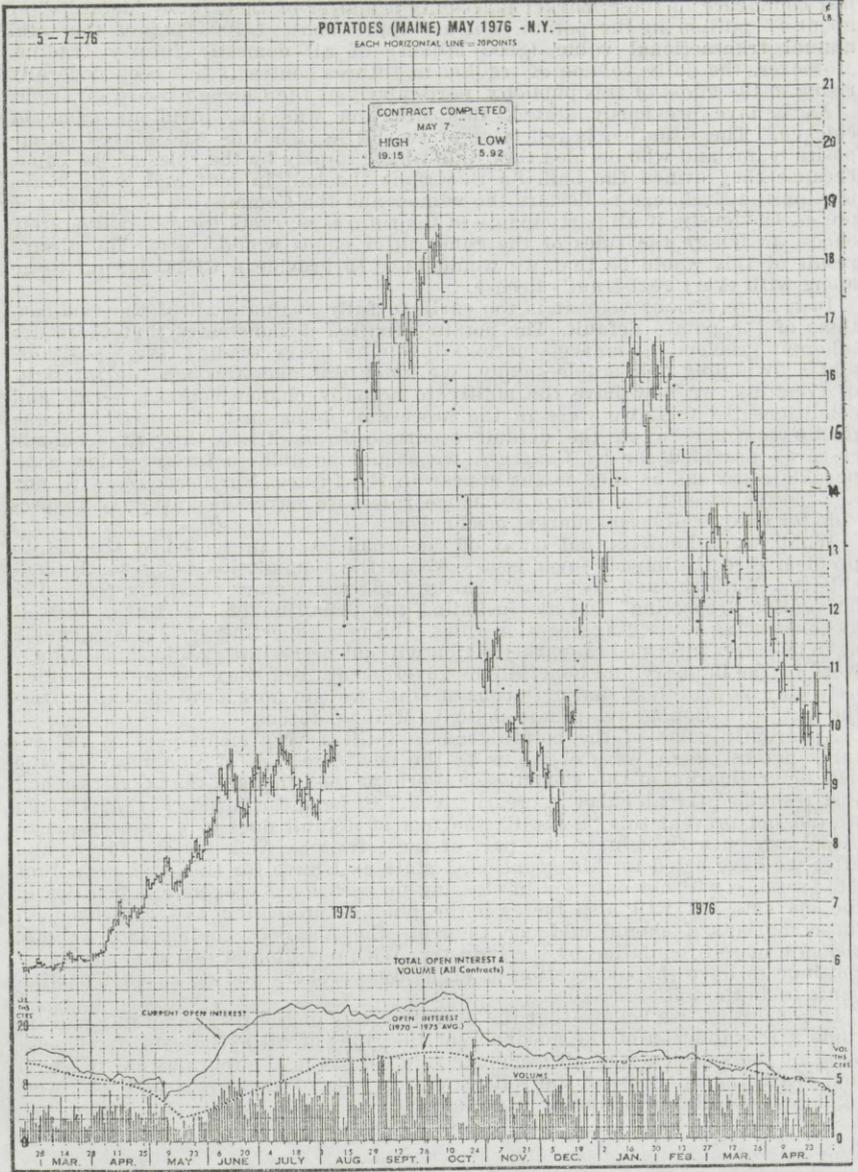
As I have previously stated, this situation was an "invidious game of chicken." The situation is reflective of two little rich kids who played on opposite teams and who decided they didn't have to play by the rules of the game, because they owned the ball. So they split the ball in half and went home, leaving the Exchange to declare the winner and the Commission to pick up the pieces. Obviously, if all participants in the futures markets were to deliberately choose to ignore the rules of the game, utter chaos would ensue. The absurd result of this would be that we would have to provide a CFTC official to go along with every registrant's license.

In a more serious vein, it is too early to fully evaluate all of the ramifications of the potato default. The potato situation demonstrates that there are inherent problems in market contexts involving heavy trading, large positions and a dwindling deliverable supply. We know this and, through the foresight of Congress, we now have the ability to actually change contract terms and conditions. In fact, we were in the process of doing just that to the Maine potato contract—when the default occurred. In addition, through economic research provided for by Congress, we should be able to foresee other comparable occasions as they might appear in the future. Furthermore, with our new power to actually change exchange rules, we have the authority to provide for an overall better market mechanism.

What we do know is that many of the broad issues presented by the potato problem directly impact upon issues which the Commission is presently considering. With the new focus provided by Congress, we are presently reforming our entire "reporting" system, including the definition of "hedging", as well as considering revised aggregation rules. The new reporting system will enable us to be better informed of market action without necessitating additional paperwork by the industry and hopefully by government. And since Congress provided us with a new professional enforcement staff, we can now move into an "after-the-fact" situation as we are now doing in Maine potatoes.

Apparently some of the potato traders (still a very small part of the futures marketplace) were oblivious to the new direction of Congress and the new determination of this Commission. Perhaps they thought that Congress had just reshuffled the alphabet in creating C.F.T.C. from the former C.E.A. Though we did not prevent this "default", the fact of default does give us occasion to dispel any such thought on the part of these traders. And, for the future and after we have acted in this situation, I state as I have for this past year, that our presence will not only aid in clearing up occasional economic difficulties in the markets but will also increase the public's protection and confidence in those markets. I should add one thought—the Act does contemplate a large measure of self-regulation by the industry. With our limited resources, we must continue to have the cooperation of exchanges, brokers and all market participants to do the job.

In conclusion, we believe that the overall effects of the potato default will include a reevaluation of the adequacy of the rules of all exchanges, a reassessment of the sufficiency of all exchange rule enforcement programs as well as a soul searching analysis of the self-regulatory role of exchanges and our oversight responsibilities in similar situations.



COMMODITY FUTURES TRADING COMMISSION,
Washington, D.C., May 27, 1976.

Mr. RICHARD B. LEVINE,
President, New York Mercantile Exchange,
New York, N.Y.

DEAR MR. LEVINE: As you are aware, the Commission is gravely concerned about defaults in the delivery of May Maine potatoes futures contracts on the New York Mercantile Exchange (the "Exchange"). Accordingly, the Commission has authorized an immediate, full scale investigation of all aspects of the events surrounding the default, including but not limited to, the activities of the Exchange and its officials in enforcing Exchange rules, the compliance by member firms of the Exchange with the Commodity Exchange Act, as amended (the "Act"), and the actions and alleged justifications of both the longs and shorts which brought about the situation.

The law requires, and the Commission expects, the Exchange to pursue its own independent investigation of the matter and forthwith to provide the Commission with a report of its findings and the actions to be taken by the Exchange to punish any persons found to have violated Exchange rules.

We wish to advise you that we regard this matter as one of the utmost importance; so much so that we have diverted investigators and economists from other pressing duties at the Commission to participate in this investigation. We expect and require the full cooperation of the Exchange, its officials and member firms. While we would like to be in a position promptly to take enforcement action which would place responsibility on those at fault (as well as take prompt regulatory action which would prevent a situation of this sort from occurring again), an investigation of this magnitude will, of necessity, take time to complete. Nonetheless, we will proceed expeditiously and hope to complete our investigation as soon as possible.

There are, however, two other aspects of the situation which also require your immediate attention—each involves the terms and conditions of the Maine potato futures contract and what must be done to prevent situations of this sort from occurring again:

1. The Commission believes that the May 1977 Maine potato futures contract (currently on the board for the 1976 crop year) should be traded for liquidation only. The May contract has traditionally presented a problem because of the inability of traders to ascertain deliverable supply at that time of year. The Commission strongly urges that the Exchange take appropriate action to remove the current May contract from trading; such trading ban to continue until such time as the other issues involving the contract terms and conditions (discussed below) can be resolved.¹ If the Exchange does not take the recommended action by June 2, 1976,² the Commission will promptly consider whether trading in all potato futures contracts on the Exchange should be halted under the Commission's emergency powers—Section 8a(9) of the Act—or, alternatively, whether the designation of the Exchange for trading in potato futures should be suspended or revoked—Sections 5b and 6(a) of the Act.

2. As you are aware, the Commission staff has for some time been concerned about the general terms and conditions of the Maine potato contract traded on the Exchange, and has discussed fundamental changes in those terms and conditions with Exchange officials continuously since the Commission granted designation to the Exchange as a contract market for potatoes (July 18, 1975). The Commission monitors the terms and conditions of contracts of sale to be executed on or subject to the rules of a designated contract market for purposes of ascertaining whether designation should continue in effect. Because of the current situation, such fundamental changes must now be implemented. Accordingly, at a minimum, the Commission hereby requests that the Exchange submit proposed changes in the terms and conditions of its potato contract³ with respect to such matters as:

A. *Deliverable supply.*—The deliverable supply must be expanded. It has been suggested that this can be accomplished by lifting the "Maine grown" provision and by increasing the number of varieties deliverable on the contract.

¹ Reference is made to item F on page 4 hereof. That item expresses the staff view that justification for continuation of a May contract in potato futures is necessary.

² Submission under Section 5a(12) of the Act of an Exchange plan to trade the May 1977 Maine potato futures contract for liquidation only will constitute the requisite action.

³ The Commission understands that members of the Exchange staff will meet on these matters with members of the Commission staff today and expects a response to the matters raised by June 2, 1976. Subsequently, submissions pursuant to section 5a(12) of the Act will, of course, be required.

B. *Delivery points.*—The adequacy of the number of delivery points and their individual and collective ability to handle sufficient deliveries to avoid price distortions must be improved.

C. *Transportation.*—The contract terms limiting deliveries to rail cars do not reflect the current shipping pattern in the cash market and should be expanded to allow truck delivery.

D. *Inspection procedures.*—The inspection procedures must be reviewed and improved to assure that they do not act as a restriction on supply or as an impediment to delivery.

E. *Delivery pack.*—The acceptability of the existing delivery pack provision is questionable. There is a very limited movement of potatoes in straight loads and a rapidly declining rate in 50 pound bags.

F. *Delivery months.*—There is a serious question as to whether there is an adequate supply of potatoes generally available to allow the continuation of a May contract.

Concurrent with the submission of the revised contract, a plan outlining how positions in the currently existing contracts will be liquidated or transferred to the new contract must be submitted.

If such changes are not promptly submitted to the Commission, the Commission will then either (i) institute proceedings to suspend or revoke the Exchange's designation for trading in potato futures under Section 5b and 6(a) of the Act, or (ii) specify to the Exchange, pursuant to Section 8a(7) of the Act, the changes to be effected, on the Exchange's behalf, in the terms and conditions of the contract of sale for potatoes to be executed on or subject to the rules of the Exchange. If alternative (ii) is adopted and such terms and conditions are not thereafter promptly implemented by appropriate submission to the Commission, the Commission will hold a hearing, as required by Section 8a(7) of the Act, to ascertain whether the changes specified by the Commission "are necessary or appropriate for the protection of persons producing, handling, processing or consuming . . . [potatoes] or for the protection of traders or to ensure fair dealing in . . ." potato futures traded on the Exchange.

Furthermore, in light of what has occurred, several other more general rules of the Exchange probably will require modification or change. You should discuss with Thomas A. Russo of our Trading and Markets Division what changes the Exchange deems appropriate. That Division will concurrently begin its own review and discuss with you what changes it deems appropriate.

Members of the staff of the Commission will be in direct contact with you with respect to our investigation. William R. Schief, the Director of the Commission's Division of Enforcement, will be in charge of the investigation. Dr. Mark Powers, the Director of the Commission's Division of Economics and Education, will be in charge of matters relating to contract terms and conditions.

Very truly yours,

WILLIAM T. BAGLEY,
Chairman.

COMMODITY FUTURES TRADING COMMISSION,
Washington, D.C., May 27, 1976.

Re New York Mercantile Exchange Rule 51.14.

Mr. RICHARD B. LEVINE,
President, New York Mercantile Exchange,
New York, N.Y.

DEAR MR. LEVINE: This is in response to a letter of May 24, 1976, to me from Mr. Maurice Mound, Counsel for the New York Mercantile Exchange ("NYME" or "Exchange"). Mr. Mound attached to that letter a resolution to be proposed to the Board of Directors of the NYME. This resolution would amend certain sections of Rule 51.14(b) of the NYME and implement certain other provisions of that Rule, and was submitted to the Commission for its approval pursuant to section 5a(12) of the Commodity Exchange Act, as amended ("Act").* It

*Rule 51.14(b) of the NYME currently states:
"When there is a default in delivery by a seller, the President, or a broker appointed by him, shall buy in the cash market for the account of the delinquent and deliver to the buyer an amount of potatoes equal to the quantity in default. If the cost of such purchase is in excess of the contract delivery price, the difference shall be paid by the delinquent through the Clearing House, and in all cases the delinquent shall pay to the Clearing House a penalty of at least \$100.00 per contract, as determined by the Clearing House Committee, plus any brokerage charge and/or expenses incurred by the Clearing House on the purchase and delivery plus a penalty to be paid to the buyer of an amount sufficient to reimburse him for any proven loss occasioned by the default."

is also my understanding that the Exchange is requesting expedited approval of the resolution as submitted.

Rule 51.14(b) presently provides that, in the instance where there is a default in delivery by a seller, the President of the NYME shall buy in the cash market for the account of the delinquent seller and deliver to the buyer an amount of potatoes equal to the quantity in default. In the proposed resolution forwarded by Mr. Mound, it was stated that Rule 51.14(b) has three elements of damages: . . . where a seller is in default in delivery he is required to make the following payments:

(1) Ordinary damage is payable to the buyer amounting to the excess of the cost of purchasing deliverable potatoes on the cash market plus the cost of delivering them to the buyer over the contract delivery price;

(2) Special damages to reimburse the buyer for any provable additional loss occasioned by the default;

(3) A penalty of at least \$100 per contract payable to the Clearing House. . .

Thus, a defaulting party would be subject, pursuant to the terms of Rule 51.14(b), to "ordinary damages," "special damages" and a "penalty." Under the present provisions of Rule 51.14(b), "ordinary damages" to be paid by the defaulting party would be that amount by which the cost of the purchase of potatoes by the President plus the cost of delivery "is in excess of the contract delivery price." Any "penalty" or "special damages" to be paid by the defaulting party would be determined by the Clearing House Committee of the Exchange.

The proposed resolution (1) would delete the requirement that the President purchase potatoes to satisfy contracts on which the seller has defaulted; (2) sets forth a settlement procedure as an alternate method of computing ordinary damages to be paid to the buyer by the seller since delivery cannot be made; and (3) sets forth certain procedures for implementing the "special damages" and "penalty" provisions of Rule 51.14(b)."

The Division has considered your request that the resolution submitted by the Exchange be recommended for expedited approval. The Division has determined that it will be unable to recommend that the Commission expedite approval of the resolution pursuant to section 5a(12) of the Act, since it is the Division's belief that the subject matter of the resolution is more appropriately within the emergency authority of the Exchange. This determination by the Division has been discussed with the Commission and the Commission has concurred in this determination. As you are aware, section 5a(12) of the Act requires the Commission to review each rule, including exchange resolutions, in order to determine that such rules are "not in violation of the provisions of the . . . [Commodity Exchange Act] or the regulations of the Commission thereunder . . ." The resolution as submitted presents three complex procedures to be implemented by the Exchange. Specifically the resolution sets forth procedures to be utilized by the Exchange in determining the amount of ordinary damages, special damages and penalty to be paid by the sellers defaulting on the recent May Maine potato contract. It is the Division's belief that a determination that the procedures outlined in the resolution as submitted were "not in violation" of the Commodity Exchange Act or the regulations thereunder would require a detailed study by the Commission's staff. Such a study should not be done hastily.

In considering whether to recommend to the Commission that the resolution submitted be treated expeditiously, the Division has also considered the power of the Exchange to take whatever action the Exchange deems necessary pursuant to its emergency authority.* In that connection, Rule 23.19(a)(1) of the Exchange provides that:

"Whenever as a result of any exceptional contingency not provided for in the By-laws or Rules, an extraordinary situation arises whereby the rigid enforcement of contracts or of the By-laws or Rules would be grossly at variance with just and equitable principles of trade or the public interest, the Board of Governors by a majority vote of the entire Board may accord relief in such manner as in its judgment the exigencies of the situation may demand, with due regard to the rights of both buyer and seller and to the best interests of the Exchange."

*In this connection, the proposed resolution submitted to the Commission stated that: ". . . the Board finds that the provisions of Rule 51.14(b) respecting the purchase of potatoes by the President and delivery thereof to the buyer cannot be performed with respect to the May 1976 potato futures contract and that an emergency exists which makes it necessary to . . . [provide] for another method of protecting the aggrieved party at the expense of the offending party."

It is the Division's belief that the Exchange could, either pursuant to Rule 23.19(a)(1) or the Exchange's broad general emergency powers, take whatever action the Exchange deems appropriate to remedy the situation outlined in the resolution submitted to the Commission.

This letter should be read in connection with the Commission's letter to you issued today.

Sincerely,

THOMAS A. RUSSO,
Director, Division of Trading and Markets.

[The following material was subsequently received for the record:]

COMMODITY FUTURES TRADING COMMISSION,
Washington, D.C., June 24, 1976.

Mr. WILLIAM SEALE,
Legislative Assistant, Office of Senator Walter Huddleston, Dirksen Senate
Office Building, Washington, D.C.

DEAR MR. SEALE: Enclosed is the data on the May 1976 Maine potato contract which you requested from John Mielke in your meeting last Friday, June 18. The listing gives you the volume, open interest, and settlement price for each day over the life of the contract.

Sincerely,

MARK J. POWERS,
Chief Economist.

Enclosure.

DAILY FUTURE MARKET DATA FOR 1976 MAY MAINE POTATOES TRADED ON THE NEW YORK MERCANTILE EXCHANGE

Maine, May 1976 potatoes contract	Volume of trading	Open interest	Settlement price
Mar. 1	3,324	7,980	\$12.63
Mar. 2	3,377	7,903	13.13
Mar. 3	1,857	7,706	13.63
Mar. 4	3,563	7,769	13.30
Mar. 5	2,937	7,803	13.40
Mar. 8	1,845	7,999	13.40
Mar. 9	1,423	7,866	12.90
Mar. 10	2,355	7,586	12.72
Mar. 11	2,432	7,713	12.65
Mar. 12	1,839	7,415	12.45
Mar. 15	158	7,377	11.95
Mar. 16	466	7,378	11.45
Mar. 17	3,571	7,440	11.95
Mar. 18	2,824	7,800	12.18
Mar. 19	1,493	7,957	12.68
Mar. 22	1,317	7,959	13.18
Mar. 23	4,335	8,242	13.10
Mar. 24	3,463	8,443	13.60
Mar. 25	227	8,442	14.10
Mar. 26	4,796	8,325	14.85
Mar. 29	2,762	8,561	13.85
Mar. 30	4,648	8,826	13.50
Mar. 31	2,762	8,422	13.22
Apr. 1	2,802	8,359	12.85
Apr. 2	3,999	7,927	12.36
Apr. 5	1,631	7,823	11.86
Apr. 6	3,808	7,471	11.48
Apr. 7	3,413	7,488	11.45
Apr. 8	462	7,478	10.95
Apr. 9	3,226	6,823	10.58
Apr. 12	1,273	6,854	11.08
Apr. 13	3,164	6,715	10.70
Apr. 14	14	6,722	11.20
Apr. 15	316	6,794	11.95
Apr. 16 (holiday)			
Apr. 19	3,565	6,660	10.95
Apr. 20	338	6,611	10.45
Apr. 21	3,859	5,634	10.15
Apr. 22	2,285	5,662	9.84
Apr. 23	2,254	5,586	10.34

Maine, May 1976 potatoes contract	Volume of trading	Open interest	Settlement price
May 26	2,145	5,698	\$9.85
May 27	1,800	5,622	9.90
May 28	1,709	5,416	10.40
May 29	2,187	5,254	10.38
May 30	1,684	5,100	10.15
June 3	555	4,843	9.65
June 4	3,275	3,849	9.00
June 5	1,238	3,687	9.20
June 6	1,605	3,422	9.70
June 7	3,505	1,911	8.70

NOTE.—May 7 last day of trading for May 1976 contract.

Source: New York Mercantile Exchange Daily Future Report and Wall Street Journal.

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