# SM124 | 6.3.2023
# Days of Futures Past | Episode 4
## Michel Marks, Former Chairman, NYMEX

**We continue our *Days of Futures Past* series with Michel Marks, the former chairman of the New York Mercantile Exchange (NYMEX). SmarterMarkets™ host David Greely sits down with Michel to discuss the creation of the modern energy futures markets.**

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**Michel Marks** (00s):
As an example, if we do get markets that are like the seventies again with hyperinflation and prices that are substantially higher, what will that mean for the marketplace and for government involvement? And it will be up to the exchanges if they want to maintain their markets and their position to manage that. And that is a challenge of significant proportion.

**Announcer** (25s):
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**David Greely** (01m 04s):
Welcome back to our series Days of Futures Past on Smarter Markets. I'm Dave Greely, Chief Economist at Abaxx Technologies. Our guest today is Michel Marks, Former Chairman of the New York Mercantile Exchange, the NYMEX. We'll be discussing the creation of the modern energy futures markets. Hello, Michel. Welcome to SmarterMarkets.

**Michel Marks** (01m 26s):
Hello, Dave. Thank you.

**David Greely** (01m 28s):
Well, thank you for joining us today. I truly appreciate the opportunity to get to talk with you about the creation of the modern Energy futures markets at the New York Mercantile Exchange. These markets in heating oil, gasoline, crude oil and natural gas are at the center of our economic life and these were markets that were built during your time as the chairman of the NYMEX. But interestingly, the story of the creation of the modern energy futures markets doesn't start with oil and natural gas. The story starts with potatoes, and that's because the default on the May, 1976 main potatoes futures contract on the NYMEX nearly ruined the exchange creating a crisis that you turned into an opportunity. Could you start us off today by telling us what happened and why it happened?

**Michel Marks** (02m 15s):
Well, Dave, the short version is that some shorts in the May 76 contract decided not to meet their obligations rather than covering their short position or making delivery, they defaulted on the contract that, as far as I know, was the only default in the history of commodities on a futures exchange and the CFTC took action against the exchange that nearly closed the exchange. There were various penalties and whatnot, and one of those was that the exchange was not allowed to trade any or apply for any new commodity contracts. Some of the fallout was that the price of the seats went down. Traders who could afford to leave the exchange left and went to COMEX or other, other exchanges. Members of the main potato community are retreated and potato trading did continue, but the credibility of the exchange and the contract took a big hit.

**Michel Marks** (03m 26s):
The story was that two potato producers from the West, Jack Simplot from Idaho, and Pete Garris from Washington, for reasons that we can only speculate about, decided that there were enough potatoes in the country and therefore the price of the potatoes shouldn't be any higher than what it was. The contract, however, called only for delivery of main potatoes and with a supply shortage that was apparently clear to everyone in Maine and New York the bet was that the price in May, which was the end of the crop year, so to speak,


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the end of the storage year, that the price would have to go up. So most of the players who were involved from the East Coast were long and betting, if you will, that the shorts were gonna have to cover, which of course would drive the market up in the last, in the last days of the contract.

**Michel Marks** (04m 25s):
And they'd get rich. But Simplot and Garris decided not to the tune of about 2000 contracts. Now that, just to put it in dollar terms, was about $8 million only and of course that was in 76 terms, it would've been more now, but still not a lot of money. But the sanctity of any futures exchanges the contract and the expectation is that the terms of the contract will be met and that the exchange stands behind those contracts in whatever way it may and so the fallout started, and this was front page, New York Times, Wall Street Journal, Washington Post stuff. The CFTC was relatively new in the game. I think it was in 74, that the CFTC was born to replace the former regulator, which was a division of the Department of Agriculture, something called the CEA and the CFTC I suspect, had something to prove and they were being tested in the early days and so as I said, they imposed sanctions on the exchange and the word on the street generally was, well, we're not gonna trade on the New York Market till exchange again. So that was the setup.

**David Greely** (05m 48s):
It's fascinating because it, that story there, there's seems like it echoes into some of what we saw on the LME over the past year or two where you have a producer of one specification, in this case, western potatoes, you know, being short, not being able to deliver those against a main potato contract and not being able to meet its obligations. It's interesting that still happens all these years later. So what did this episode teach you about the importance of the physical delivery mechanism now in particular, what are some of the key elements that are required to make it work?

**Michel Marks** (06m 21s):
Well, there are many difficult to enumerate, but it became clear at that time that the holders of the contracts when trading expired, had to meet their obligations and that it was up to the exchange to enforce that. So without any knowledge of what was happening in the boardrooms, even if Simplot and to Garris decided that they were not going to deliver it was still the exchange's responsibility to ensure that they did or liquidate. Now, as I said earlier, regulation, if you will, was still in an early stage of development and the regulation that the exchanges in the marketplace has now is significantly different and it's been tested and tried and edited and modified and developed to a point where for the most part something like this would not happen or could not happen and the apparatus now is and I've been out for 30 years, so I'm really talking from that time, I'm not sure how exactly it operates today, but we developed the exchange an apparatus and a mechanism to monitor positions in the last month leading up to the actual delivery through the clearing members.

**Michel Marks** (07m 46s):
And the exchange then could and would jaw bone positions down. They would assess if a holder had the commodity to deliver, if a holder had the money to pay to accept delivery, if there was anything that could have distorted prices and been manipulative in the making or taking of delivery and if anything came up on the radar screen that could cause some distortion going into that delivery mechanism. The exchange then learned how to act in advance. So, I think it was two years ago when oil prices went negative and I'm only talking from my experience and from afar, there was a code, if you will, that I followed which was that it was the exchange's responsibility to maintain a fair and orderly market. That may well have been a CFTC phrase, but that was something that I remember well. So when oil prices went negative to me, that was not a fair and orderly market because it did not represent what was actually happening in the physical market.

**Michel Marks** (08m 57s):
And one of the requirements of any futures marketplace is that it mirrors physical market conditions. So oil prices even though there was a glut of oil and a shortage of storage of oil for NYMEX, WTI that didn't necessarily, that doesn't equate to a negative oil price. So CME according to what I read had knowledge of the supply and demand situation and had predicted that prices could go negative, to me, that would have been a time to intervene and to jawbone positions down rather than to let the remaining holders in the contract determine what the price was. I think there's a lawsuit now against some of the shorts who forced the price down in the last few minutes of trading. But you could also say that, well all obligations were met. The shorts and the longs all got their money or they got the product and that that was sufficient.



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**Michel Marks** (10m 04s):
But from my experience, anything like that that can damage the credibility of the marketplace require some intervention. So going back to the 76 potato situation, the exchange probably at the time did not have the tools and the experience to jawbone and force those positions down the way they would today. So we had another situation in 79 with a potato contract that put the exchange to the test again, however, whether it was from the 76 experience or who knows what, my antennas went up immediately in March of 79 when I learned that during the delivery process, potatoes were failing, inspection and without any explanation and this was in the first day of a five day window for deliveries. Well, it turned out that according to the contract, potatoes, when they left Maine and were loaded onto a truck, had to be inspected by the USDA.

**Michel Marks** (11m 14s):
The potatoes were passing those in inspections and then the 24 hour ride down to Hunts Point Market in New York, according to the contract, they had to be inspected again when they were loaded off the truck and they were failing USDA inspection when they hit New York. So within 24 hours, the quality of the potatoes had changed. How do you explain that, well, there were all kinds of rumors and allegations and the inspectors were getting paid off and whatnot. Well, what are we gonna do about this. So the word spread quickly, and there were also April and May contracts and what do you think happened, well, the price of April and May started to get bid up because the guys on the floor and some of the, you know, specs said, well, if they're not making good delivery in March, what the hell's gonna happen in April and May.

**Michel Marks** (12m 08s):
So that was day one, day two more contracts failed inspection, and we sent a couple of exchange employees out to the Hunts Point market to watch the inspectors. What did they know. They were clearinghouse employees and they reported back and said, well, everything looks all right. So then we called down, we had a an exchange staffer who was our representative up in Maine. He was reporting in, we called the executive committee together for the next two or three days. We invited some of the main growers and whatnot to come down. Why is this happening, well, if the quality of the potatoes is in any good, can we substitute another grade of potatoes to make delivery. We were kicking the tigers in every way we could without any solution. Well, every day that went by and more contracts failed the price of the April and may contracts were going higher, even bid up the limit.

**Michel Marks** (13m 02s):
And this was another thing that I learned, that on the final day of trading for a futures contract, the price of the futures contract and the price of the physical market have to converge. In other words, leading up to the last day, the futures price is always gonna be different than the physical price because it's the futures. But as you get closer and closer, two should start to come closer and closer together so that on that day when the futures contract becomes a physical contract, that price matches what's happening in the physical market. Well, that's not what was happening because the futures prices were diverging from the physical price because nobody wanted the potatoes that were going bad, the price of the, they were getting dumped, the price was going lower, and the price of the future's market was going higher. So another lesson convergence.

**Michel Marks** (13m 55s):
So Gary Sievers, who was, the new Chairman of the CFTC, called, I think it was on a Wednesday, and said maybe it was even on a Thursday. He said, I hope you're doing something about this. You know, what he didn't say was, my asses on the line here, and if you guys screw up again, I'm out of a job and the CFTC is gonna have mud all over its face. Well, I didn't need, I didn't need a prompt to know that we had already called the board meeting for that night. It started about four in the afternoon and by four in the morning. The only solution we could come up to was this is an act of god. It's not a matter of who's right or wrong. It's not that the longs are right or the shorts are right, or the producers. So there's only one thing to do. We have to shut down the market. So that was it. We close the market, settled everything in the previous days price, and gave everybody their money back and if they thought that 76 was the end of the exchange, 79, they were sure that was the end of the exchange.

**David Greely** (14m 52s):
Wow. It's really fascinating how there's so much more of an active role for the exchange than I think a lot of people realize in making sure that it reflects the physical market and that the delivery, that there's integrity behind it and I would love to turn now to talk about how some of those lessons from the potato market made their way into the oil market, because out of this crisis, the 76 and 79, now the NYMEX executed what has to be one of the great pivots or turnarounds in the history of American business by launching energy futures contracts and you did this after becoming the acting chairman of the exchange. I believe you were only 28 years old


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**Michel Marks** (15m 34s):
Yes.

**David Greely** (15m 34s):
At the time that's amazing and the first contract was for New York Harbor Heating Oil in 1978. How did you decide to launch futures for that market?

**Michel Marks** (15m 48s):
Luck, and I say that not in jest. It was a matter of circumstance the CFTC had in its sanctions because of, you know, from the 76 default, had prevented the exchange from applying for any new contract. So by default, pardon the pun, the exchange had to list or trade only its existing contracts and because potatoes was pretty much a done deal, I remember leafing through the Exchange manual to see what the possibilities were and there were only two that stood out. One was currencies, foreign exchange contracts, and the other was a heating oil contract. The exchange had in 1974 I believe, listed two oil product contracts. One was heating oil and one was residual fuel oil. Those failed miserably, did not even trade and were for a delivery in Rotterdam. So the exchange rewrote those contracts for delivery in the US and while that rewrite was going on we took a half a stab at currency contracts which were already traded on the IMM on the Chicago Mercantile Exchange successfully.

**Michel Marks** (17m 06s):
But at least that gave us something to do while we were waiting for that rewrite. That was, that was the setup really. It was simply a matter of circumstance at that point in time, we got to find something here to bail us out. There was no great foresight, and clearly at the time there was no interest. None of the other exchanges had I take it back, the Cotton Exchange had listed a crude oil contract maybe around the same time that NYMEX had, and that was untreated. The Chicago exchanges did not. The OPEC cartel started a few years prior and had taken control of the marketplace away from the seven sisters, the seven major oil companies, and they met in a tent somewhere in the Middle East every couple of months and came out and proclaimed what the new price of crude oil would be and that was how prices were set. So I mean, I suppose I had a sense of some kind that this had a lot of potential and there was an opportunity, but I think the prevailing wisdom was NYMEX was dead oils under the control of OPEC and who cares what you're doing.

**David Greely** (18m 23s):
And I wanted to ask you before getting back into that broader macro landscape, you know, unlike many other commodity futurist contracts, you didn't use a warehouse model for delivery and I'm curious, why did you not choose to use a warehouse model and were there difficulties in making delivery work without a warehouse or a terminal?

**Michel Marks** (18m 41s):
Well, there was a terminal for oil products for heating oil, and then gasoline, which, which we listed a couple of years after heating oil. Crude oil was a different animal and even so there even though most oil was moved by pipeline, you still had storage terminals of some kind, why it was any different from other commodities in terms of the delivery mechanism. I don't have a clue, but we had the good fortune of a fellow named Arnold Safer coming in. He was an oil economist at Irving Bank in New York, and he was the guru and he said this, he, he wrote the contracts, all three of them with support and assistance from the exchange staff, but he said, this is how it's gonna be. and I trusted in Arnold and I wish I could tell you more about how it actually worked, but he said, and I forget with heat, oil and gasoline, but with the crude oil, he said, this is what you should trade WTI with a cushing delivery.

**Michel Marks** (19m 48s):
And the Chicago Board of Trade, after seeing what heating oil and gasoline were doing, decided to write a contract of a crude contract of their own, which wasn't in another grade of crude called light Louisiana Suite LLS and theirs was a waterborne delivery rather than a pipeline delivery And safer said from the beginning, it'll never work and in the first delivery month, they had delivery problems and that was the end of it. So Dave, that's about as much as I can tell you about the, the, the mechanics of those kinds of nuances to me.

**David Greely** (20m 24s):
Well, that's plenty and I wanted to ask you, because you've also told me in the past that energy futures markets were inevitable, but not inevitable that they would be on the NYMEX and so I was curious what was happening. You've alluded to a little bit of this, what was happening in the late 1970s and early 1980s that made energy futurist markets inevitable in your view?



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**Michel Marks** (20m 46s):
The big picture, this goes back to the sixties, before Nixon took the US off the gold standard markets were managed by cartels, by governments, by producers. Foreign exchange rates were fixed cartels and producers would have posted prices for oil or coffee or sugar or platinum and would change those twice a year. The price of gold was fixed. So that was the state of the world of many markets up until the gold standard collapsed and in the wake of that, so did the pendulum start to swing away from managed markets and you could probably have a great debate about why that happened and will it happen again and what the circumstances were. But as I see it, that was the nature of markets going into the 70s and then this started to erode, and that opened the door for innovators in the futures marketplace for one, to start trying futures markets that would create price discovery in a different way.

**Michel Marks** (22m 03s):
So gold futures were listed in, I think December 31st of 74 and that just started a cascade of new contract proliferation for all the exchanges. There were lots of financial or interest rate contracts, 90 day, two year, five year euro dollar. The exchanges were all competing with each other. I think there were five different gold futures contracts on different exchanges. So the setup was for whatever reasons that the government influence over prices and markets also affected the oil market and the seven sisters, and there are people in the oil industry I've spoken to who argue with me about this, but they set product oil, product prices with some kind of formula, and oil was plentiful. There was no concern about supply and that created outsized demand maybe before your time. But we had the gas guzzling cars, I remember they were getting eight miles a gallon, you know, so when the oil producing OPEC countries decided to take back their oil, so to speak, it wasn't just a matter of taking control of the supply, but because demand was so outsized, any reduction in supply created this enormous move up in price.

**Michel Marks** (23m 32s):
And from what gasoline being $0.25 cents a gallon, it went up to four or five, who knows and crude went from, from two to 35, however, curiously, that sewed the seeds of their demise because at $35, they opened the door for new production and exploration and in fact, they propped the price up OPEC that is propped the price up at $35 for an extended period of time, which then reduced demand as well as increasing supply and that eroded their control over the marketplace. So that was the setup for oil, leaving this controlled environment of how it flowed and who got what. There was always this concern of security of supply, heating, oil, and gasoline. Distributors would say, I don't care what the price is, just make sure that I get the oil. So security of supply was more important than security of price but then as oil started to come to the market from other sources, you developed a whole marketplace of oil traders.

**Michel Marks** (24m 46s):
And I think this was exaggerated, but someone said that there were several thousand oil trading companies or more that emerged, and they were buying oil from Saudi, for example, at their posted price. So oil traders were able to buy maybe through relationships or graft, who knows what, but they were able to buy oil at contract, posted prices from Saudi Arabia or other oil producing countries, and the price in the free market was higher. So it was a layup risk-free profit and so an alternative marketplace developed outside of the network of oil just trading between oil companies and that came out of the Iranian revolution at the time, prices doubled when the Shaw was overthrown, that created in the heating oil contract on NYMEX. We had price limits then, maybe a penny a day, but the price of on the spot market, maybe it was 20, had gone up $0.25 cents almost overnight.

**Michel Marks** (25m 55s):
And the expression we had then, and this, this is, this goes to what you would see if you looked at a chart and where you would draw a line between the high and the low and if the market was locked limit up and didn't and only traded at that price, all you would see was a dot on the chart rather than a, a line connect and so the expression was that the market just dotted the charts for about three weeks in a row, nothing but.one penny at a time. Exactly and the market didn't trade well, of course there's nothing like that to get floor traders salivating. So you can imagine that instead of one or two guys in the heating oil trading pit, now, there were, you know, 20 or 30 who would stand there bidding limit up, hoping that a stray order would come in where they would get a risk-free profit and be able to sell out the next day.

**Michel Marks** (26m 44s):
So that got us a little traction on the floor of the exchange and there were other things that helped create a somewhat freely trading physical market that the futures market then was able to parallel and I'd like to circle back to that a little bit later, but your question was about why I felt that this was inevitable, but not necessarily on the NYMEX and I felt it was inevitable because that seemed to be the trend in commodities generally, that producers and governments were losing their influence in setting price and I suppose it was


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just a gut feeling on my part that this, that oil would follow what I saw happening elsewhere. Now, most people didn't believe that, but it didn't really matter. We didn't have any choice. Even if I was wrong, what the hell. We're rolling the dice here, let's go for it.

**Michel Marks** (27:43):
And, and that's why I felt that it was not inevitable on NYMEX from the outside, you might say that creating the oil futures market was the real significant part of what the exchange did but to me, what was more difficult and more significant was resurrecting the exchange itself because as I said, after the potato default and 79 problem, when I went around to some of the Wall Street houses, the typical response was, we'll never trade anything on NYMEX and for good reason, the entire budget of the exchange, and with a million dollars, there were maybe only 25 traders on the floor and the only thing that kept it alive was that it had a platinum and palladium contract. It was on the same trading floor as COMEX and coffee and sugar, and then the cotton exchange. So traders could and had an opportunity to venture off, wander off to the other exchanges where there, where there was more action to make money.

**Michel Marks** (28m 43s):
And platinum at the time was going along with gold and silver and was having good moves. So there was enough there to keep a few traders in business and paying the bills, but that was it. So the exchange didn't have many resources and in what followed then was the 79 potato problem and more traders left and the pot then there was essentially no potato trading. Then the COMEX was exploding and running out of floor space. So they were trying to buy the NYMEX just to have more floor space. And then we replaced the president and no one wanted the job. So we won a year without a president. The COMEX had members who were on the NYMEX board, and they outmaneuvered me and got me to agree to, I didn't agree, but there was a joint committee of the two exchanges set up to write the terms of a merger, quote unquote, or a takeover.

**Michel Marks** (29m 50s):
Really, I opposed it because COMEX had no interest as far as I could tell in oil contracts or anything else. They just wanted the floor space. The NEX board voted in favor of the merger. The deal, I think, was that it would require five NYMEX seats to convert into one COMEX seat, something like that. So the NYMEX board and the COMEX board voted in favor of it, and I thought that that was the end of the line. And in their infinite wisdom, two months later, COMEX decided that they were giving away too much. They didn't like the terms of the deal, and they backed out. So there was that to contend with and finding a president. And then there was in 81 we had a problem with the heating oil contract and a delivery, and that heating oil delivery was resolved, but it's still, there was a week there where the contract itself was on the precipice.

**Michel Marks** (30m 43s):
Goldman Sachs was involved, and they had a customer who had accumulated a position of about 50% of the open interest short within five trading days and NYMEX was, wasn't able to catch it and limit the position and there was a, a group on the other side who got long and wanted to, like in in 76, they wanted to put the screws to the short and neither side would budge and fortunately they did budge by the end of that delivery period. So there were things like that and because there was so much action on the other exchanges, nobody wanted to come to NYMEX. So, to me it certainly was not inevitable on NYMEX and even two or three years in while I was there, even though I believed in the future of the contract and it was becoming more and more apparent to others too, that it may be, if not inevitable, at least possible, but there was still three years in so little volume and following that there was no, no reason to believe even then that it would happen on NYMEX.

**David Greely** (31m 51s):
And I wanted to ask you, there's a lot of powerful reasons for thinking it wouldn't happen on NYMEX at the time, and I think it's to say it's probably a bit surprising that energy Futures markets didn't develop in Chicago at the time. And I'm curious, why was Chicago at the time so successful in launching new futures contracts, and what did you do at NYMEX that did make it the exchange where those energy contracts would be launched?

**Michel Marks** (32m 16s):
Dave, I'd like to know why Chicago did not launch and again, when you asked earlier how we were able to succeed, and I said luck, it was luck that Chicago did not get in and by the time they did get in it was too late because there was enough liquidity on the NYMEX contracts and of course, safer had written a good contract there particularly good one accrued. So that locked it in maybe just being the first mover in today's vernacular, and it's been 30 or more years. So I've got to go back in my memory bank to create what the situation was then. Here, here are a couple of factors. One was that even though NYMEX name was mud on Wall Street in the oil patch, it had no image or reputation. So there was nothing to fight against. That was more a matter of education.



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**Michel Marks** (33m 06s):
And there was some guys who were committed in the brokerage community and on the exchange staff itself, who just went out pounding the pavement and knocking on doors and explaining how this new thing worked. So that was one, there's another factor and it's interesting you talk about why, you know, what's the difference Chicago, New York, and one thing that I had heard in my early days there was that the relationship between Chicago and the AG industry and grain farmers was not copacetic. That they did not see eye to eye and there was friction and maybe many viewed the relationship as adversarial and I think that must have played into my view of the world and of course, there was no different in New York, the exchanges created for the benefit of the members, and most of those are the guys on the floor and all we want is to create a contract where we can make lots of money.

**Michel Marks** (34m 00s):
And I just came to the notion and opinion that if we were going to succeed, we needed to have a collaborative relationship with other players with Wall Street and with the oil industry itself. So we set up committees and stacked them with people from the oil industry. I remember early on with heating oil, the contract specifically as futures contracts do, laid out how deliveries had to be made and the oil guys during one delivery period said wait a minute, you know, Joe over there who's taken delivery from me as a friend of mine, we'll work it out and Merrill Lynch may said, you can't do that and the contract says this and this wasn't just a one-off thing. This I heard more than once and so I said, all right, get all the Wall Street guys and get the oil guys and put them in a room and let them work it out and they did. So an example of how collaboration goes, and we actively cultivated relationship with the oil industry. Now, as time went on, I don't know how that evolved, but in the early days I think that that was a key ingredient.

**David Greely** (35m 07s):
Yeah, it sounds like the birth of the EFP the exchange for physical. That's great and I'm curious, when you do look back, what conditions do you see as the exchange needing to create, to make a new futures contract launch successful and how do you grow a new market from those first few trades to the large deep liquid markets that we have today?

**Michel Marks** (35m 30s):
Oh boy, there's so many elements to that. Dave, where do I start one thing that comes to mind, and I'll use the cryptocurrency as an example, it was clear to me that you had to have a viable commercial marketplace to be the foundation if you will for a futurist market to exist and that foundation in the essence of it, is that there is risk in that commercial marketplace that can be offset in a futures marketplace. So if you have a physical commodity and there are only two or three sellers and two or three buyers, how much risk is there and if you have a crude oil market where a cartel is controlling production and setting price and consumers aren't concerned about price then what risk is there. So to use crypto as an example, is there a commercial marketplace for crypto. I don't know for sure, but to me it seems like it's predominantly speculation.

**Michel Marks** (36m 34s):
So to me, that is not a formation market that's gonna work in the long run unless or until you've got actual use of that currency. El Salvador, I think, announced that they were going to use crypto. Well, it's another thing that I learned. We had a heating oil. It was a New York Harbor delivery, and many of the majors came to us and said, the nexus of this business is in Houston and Texas it's not in New York Harbor. You should have a you know, contract delivered down here. Well, okay, we thought that they, you know, these are the big guys telling us the way it works. So we'll list one, it did not work and I can't explain for sure why, but I would venture to say that there wasn't any, wasn't enough risk in that marketplace relative to what there was in New York and so what I also learned was don't pay attention to what the guys with the big name and the clout are telling you that that doesn't necessarily mean that what they're saying is right or that they will use the marketplace.

**David Greely** (37m 41s):
Well, one thing I was interested in was the, the growing of liquidity. Like how do you start from zero and get people to begin to trade it?

**Michel Marks** (37m 50s):
Well, that's the secret sauce. That was the tour of the industry in Chicago, Leo Malamed, who seemed to have a the magic touch with doing that and I don't know how he did it, but when you start from zero, you've got maximum risk. If you go into a contract, you can get in, but how are you gonna get out if there isn't any liquidity, so it becomes a chicken and an egg game, and it's up to the exchange to create that initial liquidity and the exchange then is dependent upon floor traders and by and large floor traders don't like taking risk. They're watching the order flow and, and matching up orders behind the scenes or whatever it may be, at least at the time when it was



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open outcry. So it was potluck and I spent a lot of time and over the years trying to persuade traders from who had NYMEX badges from comics to come over and trade this.

**Michel Marks** (38m 43s):
I remember when the, the open interest in heating level was a thousand, I would go in there myself and just take the opposite side of every order and then try to lay it off and spread it off and I think I had 400 of the thousand contracts just to try to get the liquidity going. When we opened crude, I called 20 of the top floor traders together for, for a dinner, for a couple of dinners and I begged and pleaded and I said, all I could, all I could use as an incentive was that this thing is gonna be big and of course, nobody believed that, but I did ask for a commitment of an hour a day for two weeks from each of them, and for the most part, they gave it and that created enough liquidity to get some traction. If I was doing it again, now I would try something different and I think the idea occurred to me shortly after the fact, but why not pay market makers in the early stages to be market makers. I mean, that would've taken some doing to get the CFTC to approve that, but if I was doing it all over again now with any contract, to me that's a legitimate way to go about it, to create that and, and pay people who are going to take the risk until that risk is evaporated.

**David Greely** (39m 55s):
Yeah and bringing up the market makers, and you've brought up clearing members earlier. We've also talked with others on this podcast about the importance of the ecosystem within which in exchange operates, you know, the trading participants, the clearing members, the commercial industry, which forms the basis, and of course the regulators. How did that ecosystem change while you were at the NYMEX, and how did it affect the way the exchange operated?

**Michel Marks** (40m 20s):
Well, that's a new word to me, ecosystem. We had clearing members, we had floor traders, and we had oil industry players, and we had the platform and I suppose it was just a matter of cultivating the interests of each and having a sense of balance and of cooperation between the three. I mean, essentially their interests are not all aligned, and that's where the exchange's role in my mind came in to be sensitive to the needs and the interest of all the players, and then to be able to, to judge and balance that and in all kinds of market situations. So I think that's gotten much more sophisticated now than it was when I was there. We were still learning and growing and hopefully learning from our experiences as I've been out for a long time. But as I understand it now, things operate a lot differently.

**Michel Marks** (41m 19s):
I mean, one, one thing that's caught my attention is the use of indexes now rather than physical commodities and delivery as, as a basis and that's certainly doable if you have a reliable index and that depends on then price reporting agencies or others that are providing or scanning the physical market for those kinds of inputs to come up with something that is reliable and the whole, the crux of it all is that the future's market has to emulate what's happening in the physical market and not distort it, not be a distortion of it and in whatever way you do that and nothing is permanent. So in the crude oil market, for example, the, well, we'll go back to main potatoes, where, where the exchange could have prevented those kinds of delivery problems from happening would've been in modifying the contract or being sensitive to changes as supply of main potatoes was declining.

**Michel Marks** (42m 21s):
And increase of western potatoes was you know, moving in parallel. They change could have made changes in the contract. The problem was though that there was no risk because most of the western potato production was controlled by a couple of people. So it may well be that if the exchange took a hard look at it, they would've said, there's no justification for this potato contract and could because there's not enough risk and there's not enough risk and there's not enough supply. So I don't know how relevant that is to your question about ecosystem, but, but to me that is the role of an exchange or platform in whatever product it may list.

**David Greely** (43m 02s):
Yeah, and I wanted to bring it back to another point you raised, which is you've got participants, it's an inherently competitive market. Their interests don't always align, but you need them to collaborate to a certain extent, to maintain the market itself and that sounds like kind of some secret sauce as well. How do you balance the tension between these different participants over time?

**Michel Marks** (43m 27s):
Well, I would say it's different now because the exchanges are public at the time when, when they were membership organizations, it was much more difficult and the floor members dominated and they felt that they had the right to make any decisions. They wanted who got in as members and who didn't, and how the rules were set and we had we had a business conduct committee, and if there,


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and, and that was the first place, if there was a violation on the floor of the exchange enforcement department would have to send it to the committee, but the committee would say, well, he didn't mean it. He's a nice guy, you know, let him, let him off the hook and that was the way business was done. The CFTC I maybe I shouldn't say this, but Leo bragged to one man who I knew well, who became chairman of the CFTC, and Leo bragged to him. He says, you know, and this probably, this was about eight or nine years into the CFTC's existence, Leo said, you know, you know, I've handpicked every CFTC commissioner up until now. So that's, that was the 70s and 80s and now that the exchange, and I always went.

**Michel Marks** (44m 46s):
Exchange and I always wondered if the exchanges go public, what's going to happen to this cabal and community and the way business is done, and can it be done. How can you regulate, exchange, you know, all of this when you're public and as it's turned out, they've done it very, very well. I at least on the surface, I don't know what's happening in the background. And of course, technology has changed everything too, where people don't know each other and it's all anonymous and maybe that's been a positive for it.

**David Greely** (45m 18s):
Michel, thank you for sharing your time and your experiences with us. As we wrap up. You know, you've shared a lot of great pieces of advice and wisdom and lessons from your time at the NYMEX. I was wondering, you know, just to kind of finish things off, are there any lessons or pieces of advice that you think are the most important to pass on from your experience to ensure that we continue to build futures exchanges and new futures markets that work?

**Michel Marks** (45m 44s):
Dave, all I would say is that nothing is permanent and to be sensitive to changes in the marketplace and if possible, to be ahead of the curve and not reactive. The risks are that markets will change faster than those who manage them and the pendulum is swinging. I believe, as I said earlier, up until the late 60s markets were managed and had more intervention and control over prices and then after we went off the gold standard, I believe the pendulum swung to the other extreme where markets had very little management and government intervention and almost entirely freely traded. Personally, I believe the pendulum is swinging back the other way and there will be more intervention and management. I mean, just an example if the price of beans goes to $70 a bushel, will the government stand by and allow a futures market to be the allocator of supply in that kind of situation and I would say no. As an example, if we do get markets that are like the 70s again with hyperinflation and prices that are, you know, substantially higher, what will that mean for the marketplace and for government involvement and it will be up to the exchanges if they want to maintain their markets and their position to, to manage that and that is a challenge of significant proportion.

**David Greely** (47m 22s):
Thanks again to Michel Marks, Former Chairman of the New York Mercantile Exchange. We hope you enjoyed the episode. Join us next week with our guest, Walt Lukken, President and CEO of the FIA and Former Acting Chairman of the US Commodity Futures Trading Commission. We'll be discussing the history and legacy of the Commodity Futures Modernization Act of 2000. We hope you'll join us.

**Announcer** (47m 45s):
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**Announcer** (48m 36s):
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