CBOT® Ethanol Futures

THE DELIVERY PROCESS

BACKGROUND

The predominant economic function of the Chicago Board of Trade Ethanol futures contract will be risk transfer and price basing, rather than merchandising or title transfer for the underlying ethanol. Consistent with the CBOT's grain contracts, it is anticipated that the majority of futures positions established in the ethanol market will be liquidated through the purchase or sale of offsetting futures contracts, rather than through making or taking delivery. Nonetheless, an effective delivery process ensuring the orderly convergence of futures prices and cash values is essential to the contract's risk-transfer and price-discovery functions and eventually its success.

Delivery, or the possibility of delivery, promotes convergence of the spot price and the futures price at the delivery point at expiration. This convergence is what makes hedging a viable risk management strategy. As a result, it is essential that the delivery specifications of this contract effectively link futures trading to a substantial segment of the underlying cash markets. The terms of delivery are critical in determining the effectiveness of arbitrage between cash and futures markets and the strength of the linkage between cash and futures prices.

The CBOT's Ethanol futures contract was designed to provide as much flexibility as possible for market participants throughout the delivery process. Although the contract does allow for delivery at any buyer's location, the CBOT anticipates that the bulk of physical ethanol delivery will take place in-store at the buyer's terminal in the Chicago area. Since buyers and sellers are likely to assume Chicago delivery, the CBOT expects that the Ethanol futures contract will price CIF Chicago.

Specifically, the Ethanol contract delivery specifications call for physical delivery by tank car, on track, at shipping origin with seller responsible for transporting product to buyer's destination. Once matched, the buyer and seller will have 48 hours to privately negotiate a freight rate. Should private negotiations fail, the seller shall deliver in-tank at the buyer's Chicago terminal. In other words, if it is economically viable, both parties will agree on a freight rate and ethanol will be shipped directly from seller to buyer. If either the buyer or seller fail to negotiate freight, the seller is required to deliver in-tank at the buyer's Chicago terminal. Thus, anyone participating in the delivery system should anticipate the default delivery location will be in Chicago.

DELIVERY INSTRUMENT — SHIPPING CERTIFICATE

As with the CBOT's Corn contract, the delivery instrument for the Ethanol contract will be a shipping certificate, which gives the buyer the right, but not the obligation to demand load-out of physical ethanol from the firm that issued the certificate. One of the key benefits of a shipping certificate delivery instrument is that trading in the underlying futures contract continues into the delivery month. Shipping certificates also offer the buyer or taker of delivery a great deal of flexibility — there is not a specified timeframe in which the buyer and seller must exchange physical ethanol. This facilitates arbitrage between the futures and cash markets while providing the flexibility that would allow the ethanol behind the shipping certificates to be moved to any one of several domestic markets.

Shipping certificates are only issued by firms that are approved to be regular for delivery by the Chicago Board of Trade. In order to be regular for delivery, ethanol facilities must meet several financial and operational requirements. All firms approved as regular along with their load-out capacity will be listed in the Ethanol Appendix of the CBOT Rulebook. If you would like to know more about the requirements for becoming a regular delivery facility for the CBOT Ethanol contract, please contact the CBOT Registrar's Office at 312-435-3592.

HOW THE DELIVERY SYSTEM WORKS

The delivery process is a moving three-day cycle that begins with:

First Position Day:
Two business days prior to the first calendar day of the delivery month

First Notice Day:
One business day prior to the first calendar day of the delivery month

First Delivery Day:
First business day of the delivery month

The futures contract will stop trading on the 3rd business day of the delivery month. However, this 3 day cycle is repeated for each delivery day in the delivery month until the last day of delivery which is the second business day following the last trading day of the delivery month.

If a firm decides to make or take delivery against a futures position, the following procedure takes place to convert a futures position into a shipping certificate:

Day 1 *(Position Day)*
The holder of a short futures position (the short) initiates delivery by notifying the Chicago Board of Trade Clearing Service Provider before 4:00 p.m. (Chicago time) of its intention to make delivery. After 8:00 p.m. (Chicago time), holders of long futures positions (the longs) are ranked according to the date on which they purchased their long futures positions (oldest is ranked first).

The holders of the long futures positions must report their positions to the Clearing Services Provider by 8:00 p.m. (Chicago time).

Day 2 *(Notice Day)*
The oldest long position holder is notified by 7:00 a.m. (Chicago time) by the Clearing Services Provider that delivery will take place; the Clearing Services Provider also notifies the short position holder of the identity of the long position holder which it has been matched with. The short invoices the long by 10:00 a.m. (Chicago time).

Day 3 *(Delivery Day)*
The short delivers the shipping certificate to the long; the long makes payment via the electronic delivery system at 6:45 a.m. (Chicago time) (or 6:45 a.m. the next banking day if it is a bank holiday).

Once a long position holder takes delivery on delivery day, the long has the option to do one of four things with the ethanol shipping certificate:

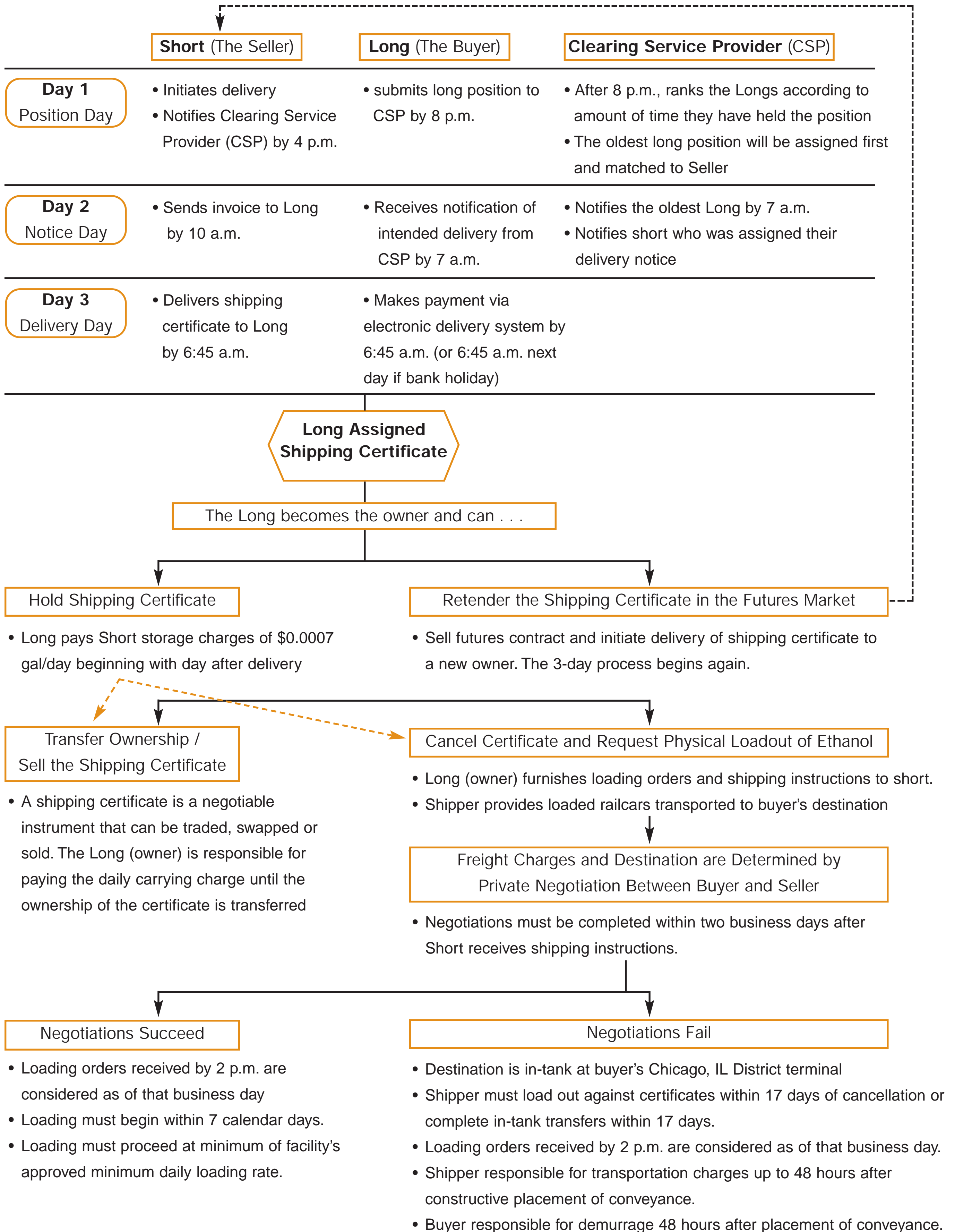
1. Hold onto the shipping certificate. In this situation, the buyer begins paying the seller a "carrying" charge of $0.0007 per gallon per day for the time the certificate is held.

2. Sell the shipping certificate to someone else at a negotiated price.

3. Re-tender (redeliver) the certificate in the futures market by selling a futures contract and initiating delivery of the shipping certificate to a new owner.

4. Cancel the shipping certificate and request physical load-out of ethanol.

FIGURE 1: CHICAGO BOARD OF TRADE DELIVERY PROCESS



Business Development
141 W. Jackson Boulevard
Chicago, IL 60604-2994
312-341-7955 • fax: 312-341-3027

New York Office
One Exchange Plaza
55 Broadway, Suite 2602
New York, NY 10006
212-943-0102 • fax: 212-943-0109

European Office
St. Michael's House
1 George Yard
London EC3V 9DH
United Kingdom
44-20-7929-0021 • fax: 44-20-7929-0558

Asian Market Contact
312-341-7955

Latin American Contact
52-55-5605-1136 • fax: 52-55-5605-4381

www.cbot.com

The information in this document is taken from sources believed to be reliable. However, it is intended for purposes of information and education only and is not guaranteed by the Chicago Board of Trade as to accuracy, completeness, nor any trading result and does not constitute trading advice or constitute a solicitation of the purchase or sale of any futures or options. The Rules and Regulations of the Chicago Board of Trade should be consulted as the authoritative source on all current contract specifications and regulations. EM17-7 06.05.300 05-03857

©2005 Board of Trade of the City of Chicago, Inc. All rights reserved.