VANDENBERG & FELIU LLP

ATTORNEYS AT LAW

Robert B. Bernstein
TELEPHONE: 212-763-6804
rbernstein@vanfeliu.com

March 28, 2011

The Honorable Gary Gensler
The Honorable Michael Dunn
The Honorable Jill E. Sommers
The Honorable Bart Chilton
The Honorable Scott D. O'Malia
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Dear Members of the Commission:

These comments are submitted by the law firm of Vandenberg & Feliu in response to the Notice of Proposed Rulemaking, Position Limits for Derivatives ("Position Limits NOPR"), 76 Fed. Reg. 4752 (Jan. 26, 2011).[1]

As a threshold matter, we commend the CFTC for its willingness to consider exercising its statutory and rulemaking authority under the Commodity Exchange Act (CEA), as recently expanded by the Dodd-Frank Act, to establish position limits and limit formulas for certain physical commodity futures and options contracts, as well as aggregate position limits that would apply across trading venues to contracts based on the same underlying commodity.

We are concerned, however, about the existence of regulatory gaps in the CFTC's proposal which would allow for the acquisition of large positions in markets for metal-based commodities which would, in turn, facilitate artificially high prices at the least and intentional price manipulation at the worst. This concern applies most directly to metals as to which there is insufficient supply to counter sudden, investor-driven spikes in demand. Such metals would include, for example, palladium and platinum.[2] An even better example would be copper, recognized by financial analysts as a metal with a wide range of industrial uses but insufficient supply – exacerbated by old mines and delay-ridden mining processes – to keep up with increased demand.

---

[1] These comments are submitted on behalf of a large international copper merchant with offices in New York and London that relies on the LME and Comex for the traditional purpose of hedging the price risks it incurs in the purchase and sale of copper cathode throughout the world, including sales made directly to U.S. manufacturers.

[2] See Request for Comment on Options for a Proposed Exemptive Order Relating to the Trading and Clearing of Precious Metal Commodity-Based Exchange-Traded Funds, 75 Fed. Reg. 60411 (Sept. 30, 2010).

To be sure, the Position Limits NOPR offers position limits on already-regulated copper futures markets, as well as a spot market limit based on 25% of the copper available for immediate delivery. However, we note the following:

First, it is not clear that the proposed position limits would apply to purchases made on the London Metals Exchange (LME), which is where 95% of all copper is traded. We submit, however, that it is well within the CFTC's authority under Section 738 of the Dodd-Frank Act, and the proposed new 17 CFR Part 48, for the CFTC to condition the LME's registration as a Foreign Board of Trade on its agreement to comply with (or to independently adopt) all position limits and related requirements set forth in the Position Limits NOPR that would apply to the LME if it were a national exchange.

Second, the Position Limits NOPR does not propose any limits whatsoever on copper or other metal-based exchange-traded funds (ETFs). Thus, if trading in copper-based ETFs becomes legal (the result currently being urged by at least two investment banks), it would be far too easy for copper-related position limits to be circumvented by buying up copper available for immediate delivery through copper ETFs. Accordingly, we urge that the CFTC take all steps necessary to prevent such circumvention, including but not limited to the following: (1) Establishing combined position limits (Comex, LME and ETFs) for any investor holding more 5% or more of any copper ETF traded in the United States; and (2) Making it clear that any copper trader required to disclose its physical holdings under the Position Limits NOPR also be required to disclose its copper ETF holdings.

We also note that the position limit in the prompt months is set for copper at 25% of copper available for immediate delivery. As we understand it, copper ETFs will operate by purchasing available supply for immediate delivery from LME and Comex warehouses (or their sources of supply) and such copper will be held indefinitely in storage, meaning it will no longer be available for immediate delivery. Thus, copper held by copper ETFs is not copper available for immediate delivery. If there is no speculative limit on the amount of shares of a copper ETF a speculator may acquire, speculators seeking to avoid position limits on the Comex (and the LME as well) will purchase shares of copper ETFs which, in turn, will result in copper being drawn from the LME and Comex warehouses. Because copper is in demand worldwide for industrial uses and the supply of copper is generally inelastic -- i.e., increased prices will not generally lead to increased supply from copper mines -- investors in copper ETFs will be able to both avoid the CFTC's proposed position limits in the prompt months and, at the same time, drive up the price of copper available for immediate delivery. That is precisely the type of result that we understand Congress intended to avoid by granting additional rulemaking authority to the CFTC under Dodd-Frank. What is worse, as more speculators seek to avoid the position limits, more copper will be drawn into copper ETFs, thereby reducing the position limit of 25% because the amount of copper available for immediate delivery will be reduced. That, in turn, will make the effect that Congress was seeking to avoid when it enacted Dodd-Frank even worse.

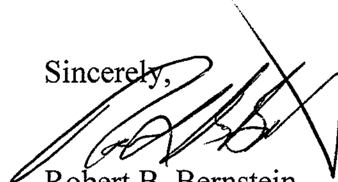
Equally flawed for the same reasons are the CFTC's proposed "visibility" requirements. The purpose of the "visibility" requirements is to prevent manipulation by large holders. Contracts on the LME and Comex are less likely to be susceptible to manipulation if, among other things, they are subject to measures to reduce the ability of any party to disrupt

pricing – e.g., position limits or ample deliverable supply or flexibility in the contract (alternative delivery mechanisms). However, if the "visibility" requirements are not extended to holdings of LME positions and holdings by investors of copper ETFs then, as supplies of copper available for immediate delivery from LME and Comex warehouses shrink -- which is the inevitable result of allowing copper ETFs to be marketed for sale in this country -- one or more parties could easily manipulate the price of copper available for immediate delivery by purchasing enough warrants for delivery of copper from LME and/or Comex warehouses to become the seller of last resort to near-term shorts on the LME and Comex, thereby effectively squeezing the market.

Finally, if there is any reluctance to extend position limits to the cash side of commodity markets, such as copper-based ETFs, we note that the CFTC's authority to do so is not limited to Section 738 of the Dodd-Frank Act. To the contrary, in Section 753 of the Dodd-Frank Act, Congress amended Section 6(c) of the CEA in a manner which "provided a direct statutory prohibition on manipulation of prices of . . . commodities." Notice of Proposed Rulemaking re Prohibition of Market Manipulation, 75 Fed. Reg. 67657, 67658 (Nov. 3, 2010). This expansion of the CFTC's anti-manipulation authority over cash markets includes rulemaking authority, as the Commission recognized by proposing (in its recent NOPR) to revise 17 CFR 180 to include rules which broadly prohibit fraud-based and other manipulation (pursuant to CEA Sections 6(c)(1) and 6(c)(3), as amended). Significantly, these new rules expressly apply to the direct or indirect manipulation of the price of any commodity in interstate commerce.

The foregoing comments are consistent with the fundamental rationale of position limits in commodity markets -- that such limits should function as a prophylaxis against price manipulation and the creation of artificial prices (even absent direct proof of manipulative intent).

Sincerely,



Robert B. Bernstein
Vandenberg & Feliu LLP