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January 9, 2013

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: File Number SR-NYSEArca-2012-28

Dear Ms. Murphy:

We are writing on behalf of RK Capital LLC, an international copper merchant, and four U.S. end-users of copper: Southwire Company, Encore Wire Corporation, Luvata and AmRod, in response to the "Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule change as Modified by Amendment No. 1 to List and Trade Shares of the JPM XF Physical Copper Trust Pursuant to NYSE Arca Equities Rule 8.201," dated December 14, 2012, and in particular in response to Section IV thereof, at page 73, entitled, "Solicitation of Comments," in which the Commission states that "[i]nterested persons are invited to submit written data, views and arguments concerning the foregoing, including whether Amendment No. 1 to the proposed rule change is consistent with the Act."

<u>The Relevant Legal Considerations</u>

Under *Netcoalition v. Securities and Exchange Commission*, 615 F.3d 525, 533 (D.C. Cir. 2010, the Commission is required in reviewing a proposed rule-change involving a self-regulating organization such as NYSE Arca to "examine the relevant data and articulate a

satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" In addition, the SEC's factual findings will not be deemed conclusive unless they are "supported by substantial evidence." Id.

As the Court of Appeals further explained, "[n]ot only must an agency's decreed result be within the scope of its lawful authority, but the process by which it reaches that result must be logical and rational. [Citations omitted]. While we have long held that agency determinations based upon highly complex and technical matters are entitled to greater deference, [citation omitted], we do not defer to the agency's conclusory or unsupported suppositions. In addition, an agency may not shirk a statutory responsibility simply because it may be difficult. [citation omitted]." Id. at 538-539.

For the reasons set forth below, we believe the Commission's findings that the listing and trading of shares in the JPM Physical Copper Trust will not have a material impact on the supply of physical copper available for immediate delivery is not based on substantial evidence and is therefore arbitrary and capricious. There is no evidence in the record that any non-warranted copper, including non-warranted copper in China, will in fact be available to authorized participants to purchase in order to obtain shares, that the creation of shares will therefore result in the removal from LME and Comex warehouses of a substantial amount of warranted copper, that such removal will obviously drive up the price of copper available for immediate delivery and create shortages of such supply, and that, because of the uncontradicted evidence in the record of growing warehouse queues at LME warehouses worldwide, there is no substantial evidence to support the SEC's supposition that industrial users need not worry about price and supply problems because "arbitrage" will result in the exercise of redemption rights that would return such copper to the market. Indeed, there is no evidence in the record that arbitrage under

such circumstances will even occur, must less than it would make copper otherwise removed from the market suddenly available again for immediate delivery.

Yet even though there is no evidence in the record that arbitrage and resulting redemption exercise could ever occur in the copper market such as it is today, it appears the Commission categorically rejected all of the substantial evidence presented as to the catastrophic damage that the proposed rule change could have for industrial users of copper, and particularly those industrial users of copper in the United States, all based on the speculative assumption that arbitrage and the putative exercise of redemption rights would ipso facto offset any problems industrial users might have related to price and supply. Such conclusions therefore clearly appear to demonstrate that the agency's conclusions were in fact arbitrary and capricious.

Indeed, so determined was the Commission in its order to support the proposed rule change even in the teeth of representations in the draft prospectus that the proposed offering might, if successful enough, actually remove enough copper from the market to cause prices to rise sufficiently to cover the monthly cost to store such copper, the Commission appears even to have ignored evidence of the history of past corners and squeezes of the copper market, including the most famous such squeeze in the 1990s in which a trader for Sumitomo Corporation conspired with a trader in the United States to remove all or substantially all of the copper available for immediate delivery at the LME warehouse in Long Beach, California, which created one of the largest artificial price spikes and artificial backwardations in the entire history of the copper market. Thus, even though, just as was the case in Sumitomo, the listing and trading of the Shares will almost certainly result in the removal of substantial quantities of warranted copper from the LME and Comex warehouses in the United States, the Commission simply assumes without substantial evidence, throughout its 75-page order, that "arbitrage" will

somehow return such copper to the market so as to offset any price and supply problems. Even explicit warnings by industrial users and traders that the listing and trading of the Shares will lead to increased fraud and manipulation simply because, if the proposed offerings of JPM and iShares are successful, it will become much less costly to remove all or substantially all of the warranted copper from the market, were dismissed as unsubstantiated and speculative based entirely on the Commission's own speculative assumption that arbitrage will result in the "market" allowing such copper to be placed back on warrant.

Accordingly, because of the huge damage to the U.S. economy that almost certainly occur if the Commission's speculative assumptions about the impact of the listing and trading of the Shares prove to be wrong, we respectfully submit that for these reasons, and for the reasons set forth more particularly in the balance of these comments, and in the written submissions and data that we have previously furnished to the Commission, including empirical evidence linking the removal of warranted copper from LME and Comex warehouses to spikes in price and backwardation, the Commission should use this opportunity to reconsider and withdraw its ruling approving the proposed rule change.

The SEC's Order is Flawed

The Commission tries to create the impression that the listing and trading of the Shares will lead to the creation of a new market for the trading of physical copper, and that such new market would be beneficial because it will allow more people to invest in copper. Thus, for example, at page 7, the Commission states, "[o]nly eligible organizations or members are able to participate directly in trading on the LME." In fact, only "open outcry" trading on the LME is limited to eligible organizations or members; most trading on the LME, however, takes place not in "open outcry" but in inter-office trading which takes place 24 hours a day, and unlike LME's

"open outcry" regime, is open to just about anyone who has a telephone and a computer screen. SEC's characterization, which supports its conclusion that allowing sale of copper backed ETFs as an alternative to direct trading on the LME would be precompetitive, is not supported by substantial evidence. Indeed, it is based on a misreading of the facts. See MG v. Sumitomo (describing how trading on the LME works).

At page 9, the Commission tries to create the impression that the listing and trading of the Shares will not put industrial users and traders at risk of increased fraud and manipulation, stating that "The CFTC is authorized under the CEA to monitor, investigate, and take actions with respect to activities that may have a material impact on the markets for physical commodities and "[s]pecifically, the CFTC has jurisdiction over manipulation and attempted manipulation of the cash commodity markets." In fact, there is no evidence in the record that the CFTC has ever exercised any such authority absent a direct immediate and reasonably foreseeable impact on the commodity derivative markets under its direct regulatory control, such as the COMEX; nor is there any evidence in the record that the CFTC has in fact weighed in on whether it has here the means and manpower to "monitor, investigate and take actions with respect to activities" involving the proposed listing and trading of shares in a physical copper backed ETF that could have a material impact on the market for physical copper. Thus, the SEC's conclusion that the CFTC will be able to monitor, investigate and take actions with respect to activities involving the listing and trading of JPM's shares of physical copper backed ETFs that may have a material impact on the market for physical copper available for immediate delivery is not supported by substantial evidence.

At page 11, the Commission introduces its discussion of its reliance on arbitrage as proof that redemption rights would be exercised so as to return to the market any copper that will be removed by the creation of the Shares. Thus, the Commission states that "[T]he Trust will hold Grade A copper in physical form, and the Trust's investment objective is for the value of the Shares to reflect, at any given time, the value of the copper owned by the Trust at that time, less the Trust's expenses and liabilities at that time," that JPM will determine value of its copper holdings by factoring in locational premia; i.e., copper stored in a location that is low in supply and high in demand carries a higher premium that copper that is stored in a location where supply is high and demand is low, and that "The Trust will store its copper in both LME approved warehouse and non LME approved warehouses that are maintained by the Warehouse keeper, but none of the copper held by the Trust will be on LME warrant, and therefore will not be subject to regulation by the LME."

The Commission, however, nowhere assesses the significance of not being subject to LME regulation. The LME regulates holdings of such copper if they reach more than 50% of the total held in LME warehouse stocks by requiring that they be returned to the market at gradually reduced levels of premia above spot price so as to discourage anyone from attempting to engineer a corner or squeeze. Therefore, to the extent the ETF would effectively acquire 50% or more of the LME warehouse stocks, it's not being subject to regulation by the LME thereby prevents the LME from blocking a corner or squeeze. The SEC failed to analyze why that would not be a problem; assuming, instead, that exercise of redemption rights would keep the threshold below that which would otherwise have been triggered if the copper had been subject to LME regulation. Yet, as we show, there is no substantial evidence to support the SEC's conclusion in this regard.

At page 12, the SEC assumes the redemption procedures will be exercised. Thus, SEC states, "the locations at which copper actually is held will depend on the warehouse locations at which authorized participants have actually delivered copper to the Trust and the warehouse locations from which copper is or has been delivered pursuant to the Trust's redemption procedures." However, no substantial evidence exists in the record that there will be any exercise of the Trust's redemption procedures.

At page 13, the Commission describes the redemption procedure, but never addresses the issue of whether and under what circumstances it will ever be exercised. At pages 13 and 14, the Commission states, "Because the copper held by the Trust in different locations may vary in value based on the applicable locational premium, the value of the copper actually received by the authorized participant will depend on the location of the specific whole lot(s) and fractional lots, if any, of the copper transferred to the authorized participant." For this reason, why then is redemption likely to occur at all? The Commission nowhere explains under what circumstances the price of such copper will so exceed the value of the shares that such risk would ever be worth taking. There is, in short, no substantial evidence in the record to support the conclusion that any such redemption would take place and plenty of evidence to suggest it will not.

On Page 14, note 42, the Commission discusses the First Out IIV as being "designed to facilitate arbitrate activity" by authorized participants by indicating whether the Shares are trading at a discount or premium during the trading day. If the Shares are trading at a discount to the price of copper, the inference is that authorized participants would be incentivized to redeem shares to sell the copper – but how can such discount be relied upon as an indication of relative value where (1) there is uncertainty as to the value of such copper to be received and (2) there is

uncertainty as to when such copper would actually be delivered and uncertainty as to whether the brand of copper delivered will have been de-registered and thus not good delivery to an LME warehouse to be placed on warrant. SEC never tested the assumption that redemption would actually occur.

At pages 15-16, the SEC emphasized the availability of information on copper prices directly from market participants, but nowhere discusses how such information will result in exercise of redemption.

At page 17, the Commission states that "NYSE Arca represents that its surveillance procedures are adequate to properly monitor Exchange trading of the Shares in all trading sessions and to deter and detect violations of NYSE Arca rules and applicable federal securities laws." However, there is no such representation that NYSE Arca's procedures are adequate to properly monitor, deter and detect violations of the CEA or the U.S. antitrust laws in the event of a corner or squeeze on copper traded on the LME and/or Comex. SEC then represents that "[t]o support this, the Exchange states that . . . it is able to obtain information regarding trading in the shares, physical copper, copper futures contracts, options on copper futures, or any other copper derivative *from ETP Holders acting as registered market makers, in connection with their proprietary or customer trades.*" (emphasis added).

An ETP Holder is any individual or entity that has been issued an Equity Trading Permit by the Exchange. Here, however, the Exchange recognizes it cannot obtain such information if it is held by persons or entities *other than ETP Holders acting as registered market makers in connection with their proprietary or customer trades.* Thus, persons or entities seeking to corner or squeeze the copper market by acquiring all or most of the copper on warrant in the LME

warehouses can escape detection by the Exchange simply by purchasing copper without using ETP Holders who may be acting as registered market makers in connection with their proprietary or customer trades. NYSE Arca tries to address this concern by representing (at 18) that "it has regulatory jurisdiction over its ETP Holders and their associated persons, which include any person or entity controlling an ETP Holder, as well as a subsidiary or affiliate of an ETP Holder that is in the securities business." Here, too, the Exchange recognizes that unless the person or entity is an ETP Holder, or otherwise legally affiliated with one, its surveillance procedures will be of no use in preventing a corner or squeeze on the physical market.

Recognizing the limitations of its authority, the Exchange further represents that "[w]ith respect to a subsidiary or affiliate of an ETP Holder that does business only in commodities or futures contracts, the Exchange . . . can obtain information regarding the activities of such subsidiary or affiliate through surveillance sharing agreements with regulatory organizations of which such subsidiary or affiliate is a member." Thus, if the person or entity does business only in commodities or futures contracts, but is not a subsidiary or affiliate or an ETP Holder, it would appear the Exchange cannot get any such information through surveillance sharing agreements. Likewise, it cannot get any such information if the person or entity is not a member of the regulatory organizations with which the Exchange has such surveillance sharing agreements. Yet, the SEC assumes, without explanation, that such oversight is sufficient to protect against the risk of a corner or squeeze on the physical copper markets. Finally, the Exchange represents that "it may obtain trading information via the Intermarket Surveillance Group ("ISG") from other exchanges that are members of the ISG, including the COMEX, and that it has entered into a comprehensive surveillance sharing agreement with the LME that applies with respect to trading in copper and copper derivatives. However, all this purports to

show is that the Exchange may obtain the same information the LME or Comex would have concerning who may own warehouse stocks or have dominant positions in the copper derivative markets. Squeezes and corners are historically engineered by persons or entities acting secretly in concert to acquire all or most of a physical commodity available for immediate delivery, and who similarly act in concert to drive up the price of available derivative positions. Such actions in concert, because they are illegal, are not intended to be detected by the LME or Comex regulatory bodies. Thus, no amount of surveillance sharing will be able to deter and detect such corners or squeezes, which are far more likely to occur as the ETF shrinks the supply of copper available for immediate delivery.

At page 22, the Commission claims the purpose of its analysis is to examine the extent to which the listing and trading of the Shares may (1) impact the supply of copper available for immediate delivery and ability of market participants to manipulate the price of copper and (2) be susceptible to manipulation.

A. Trust's Impact on the Supply of Copper Available for Immediate Delivery

At page 23, the SEC says opponents assume that (1) copper held by the Trust would not be available for immediate delivery; (2) global supply of copper available for immediate delivery that could be used to create Shares consists almost exclusively of copper already under LME or Comex warrant; and (3) the Trust would acquire a substantial amount of copper within a short period of time, such that copper suppliers would not be able to adjust production to replace the copper removed from the market by the Trust. The Commission then states that the record does not support any of these beliefs, and thus, Commission "does not believe that the listing and trading of the Shares is likely to disrupt the supply of copper available for immediate delivery.

In fact, there is substantial evidence in the record which supports these "beliefs," but the Commission appears to have ignored it in favor of their own belief that because of "arbitrage," it must be assumed that redemption rights would be exercised – a belief that is itself lacking in substantial evidence to support it.

1. **Availability of the Trust's Copper**

At page 23, the Commission recites JPM's assertion that Trust would not remove immediately available copper inventory from the market. The SEC then assumes that the copper in the JPM Trust would be just as "liquid" as copper on warrant in LME warehouses. To support this assumption, SEC relies on the fact that a report cited by one of the commenter's defines inventories held in exchange traded funds as "liquid stocks." (page 24). However, the only such inventory held in exchange traded funds was the ETFS product which the SEC omits to mention consists exclusively of copper on LME warrant in LME warehouses. Consequently, such copper is by definition just as "liquid" because it consists of the same copper on LME warrant in LME warehouses. The SEC, however, drew no such conclusion. It assumed instead that, even though the copper in the Trust would be taken off warrant, it would still be just as "liquid" as copper on warrant in LME warehouses. That conclusion, however, is not supported by substantial evidence in the record.

The SEC states at 24 that it agrees with JPM that copper held by the Trust will remain "available to consumers and other participants in the physical copper market" because (1) The Trust will not "consume" copper; (2) Shares are redeemable (in size) for copper on every Business Day; and (3) redeeming authorized participants will receive "the right" to obtain their copper within three business days. However, the fact that the Trust's copper is not

being "consumed" overlooks the fact that such copper is being removed from the market subject only to the exercise of redemption rights. However, more importantly, there is no substantial evidence in the record to support the assumption that simply because the Trust's shares are redeemable, that redeeming authorized participants will in fact receive copper within three business days or indeed that redemption will take place at all, except when, as we contend, the Trust fails to continue to accumulate enough copper so as to move the price sufficiently upward in order to cover the monthly costs of storage, at which time the Shares would likely become unsalable, copper would flood the market, and prices would collapse.

The SEC's entire argument thus turns on its assumption that authorized participants will regularly seek to redeem the Trust's shares and that, rather than artificially hoarding greater and greater amounts of copper for the purpose or driving up its price and that of the Trust's shares, as the JPM prospectus represents but which the SEC never mentions -- the Trust's copper will instead be regularly and routinely returned to the market through "arbitrage." There is, in fact, no substantial evidence in the record to support this assumption.

First of all, the exercise of redemption does not in fact mean that anyone would get delivery. To the contrary, all the SEC is able to conclude is that the exercise of redemption gives the authorized participant the "right" to obtain copper within three business days. Thus, as explained in footnote 83 (but which the SEC nowhere mentioned elsewhere in its 75-page report), the Commission concedes that "[t]he record is unclear whether authorized participants that are redeeming the Shares will be able to physically remove copper from the warehouse in which it is stored within three business days, or whether this reference is to three business days in addition to the existing time it takes to remove copper from the

warehouses. The SEC then states in footnote that "for purposes of analyzing this proposed rule change, the Commission assumes that copper will be transferred to an authorized participant's book-entry account within three days, and that an authorized participant taking delivery of copper from an LM E warehouse will then have to wait in the queues described by [an Opposing Commenter] just like other owners withdrawing metal from that warehouse." The Commission further states that "waiting up to an extra business business days beyond the time required to take copper off of LME warrant is not a significant enough delay to consider the copper delivered from the Trust unavailable for immediate delivery." However, the point here is not that those exercising redemption rights would have to wait for delivery three days longer than those taking delivery of LME warrants; rather the point that we made, which the SEC ignored, is that the placement of additional copper in these very same warehouses may lead to substantially longer queues that will make it even more difficult for all consumer and other market participants to obtain physical copper that otherwise used to be available for immediate delivery. Thus, while the three day delay may not be material, the additional tonnage being stored may make it that much more difficult to get physical delivery – and factor that, because of the huge costs of storage that will have to be borne by anyone choosing to take delivery in this fashion, may itself discourage the exercise of redemption rights.

Rather than address these practical impediments to the exercise of a redemption right that is the basis for its conclusion that there will be no impact on the supply of copper available for immediate delivery, the SEC states (again in footnote 83) that "the Trust's copper may be held in both LME-approved warehouses and non-LME-approved warehouses and there is nothing in the record concerning the existence of unloading queues in non-LME

warehouses." However, there is no reason for the SEC to speculate that there would be no impediment to delivery if copper is stored in non-LME warehouses. Thus, all of the warehouses to be utilized here are warehouses owned by the Sponsor itself, JPM. Thus, JPM knows whether and where it will be using non-LME warehouses and whether there are likely to be queues at such locations. Yet even though the SEC could have simply asked for such information in order to obtain substantial evidence to support its conclusion that the exercise of redemption rights will mitigate any adverse impact on the supply of copper available for immediate delivery, the SEC chose not to do so. The failure to ask for information which the Commission could easily get is precisely the kind of failure that the Court of Appeals has pointed to in illustrating when the Commission's actions appear arbitrary and capricious.

This failure to ask JPM itself is particularly troubling here given the published reports, which are in the record, that JPM is itself contributing to the creation and lengthening of queues by paying huge economic incentives in order to get delivery of even more metals to its warehouses. Thus, based on the evidence in the record thus far, it would appear that the sponsor is itself looking to create queues – and lock in monthly storage profits -- by both paying economic incentives to get delivery into its warehouses and by marketing a copper backed ETF which seeks to accomplish the same thing. Yet, the SEC did nothing to determine whether the listing and trading of the ETF shares are intended to make delivery of copper that would otherwise have been available for immediate delivery even more difficult to obtain. Indeed, the Commission didn't even bother to ask JPM about this.

Lastly, the Commission notes that "the LME appears to be attempting to address the unloading queue issue." Page 25 n. 93. However, there is no substantial evidence in the

record to show that the LME will be able to address the problem that the listing and trading of the Trust's shares will lead to warehouse delivery queues growing even longer.

In short, rather than address the aforementioned practical implications that the listing and trading of the Trust's Shares will have in terms of removing physical copper from the market for an indefinite period of time, the SEC merely concludes that "[g]iven the *structure* of the Trust, the Commission believes that the amount of copper accessible to industrial users will not meaningfully change as a result of the listing and trading of the Shares" and that, accordingly, "the Commission believes that the proposed rule change will not burden capital formation for users who acquire copper for industrial and other purposes." (Page 26). However, as we have shown, by focusing solely on the Trust's *structure*, and theoretical redemption rights, as opposed to the practical limitations of its operation, the SEC has failed to come up with substantial evidence to support its conclusion that the amount of copper accessible to industrial users will not meaningfully change or that the proposed rule change "will not burden capital formation for users who acquire copper for industrial and other purposes."

In fact, the evidence in the record does not demonstrate that authorized participants will exercise redemption rights at all, thus making it harder and harder for industrial suppliers to get copper that would otherwise have been available for immediate delivery, which will lead to higher prices and product shortages, both of which will burden capital formation.

The Commission acknowledges that the industrial end users who submitted comments say they would not acquire Shares for the purpose of redeeming them to acquire copper because the copper they would receive in exchange for Shares might be in a location far from

their plants or might be of brands that are not acceptable to their plants. However, the SEC dismisses these comments, stating that "regardless of the preferences of these consumers," the authorized participants "may redeem Shares for copper and the record does not contain any evidence that these or any other consumers of copper could not use the Shares to obtain copper through an authorized participant." Page 26. The problem though is that there is no substantial evidence in the record to suggest that these or other consumers could in fact use their Shares to ever obtain the copper they need. Rather than address this absence of substantial evidence, the SEC argues that industrial consumers would be no worse off because "the record supports that the same logistical issues exist and are regularly addressed by end-users of copper holding LME warrants." However, there is no substantial evidence in the record to suggest that the same logistical issues could regularly be addressed by holders of Shares who seek to exercise redemption right through authorized participants. The Commission states that currently a purchaser of an LME warrant does not know the location or brand of the underlying copper, and therefore warrant holders sometimes need to swap the warrants to acquire copper of a preferred brand in a convenient location, and that industrial users currently rely on copper merchants to obtain their desired brands of copper by aggregating the lots from copper on warrant at LME and Comex warehouses.

In fact, the SEC's understanding of the purchase and sale of LME warrants is wrong – and the role played by copper merchants in that regard – is wrong. The SEC assumes that "currently a purchaser of an LME warrant does not know the location or brand of the underlying copper." That is only true when the holder of a long position on the LME agrees to take physical delivery instead of cash-settling his position. In fact, all LME warrants indicating brand, lot size, and location are stored on a centralized computer system, known as

LME Sword. Anyone may purchase such warrants directly – without having to first purchase an LME long position -- and know exactly what he is getting. However, the purchase and sale of such warrants is usually at a negotiated premium reflecting the relative demand in that particular location. Thus, merchants who know what their customers need will sometimes take delivery of long positions and trade physical copper to get delivery of the particular brands they want, or they will simply purchase the warrants directly.

There is no comparable system in place for the purchase and sale of physical copper held by the Trust. Thus, even though the Trust intends to publish data indicating the amount and brand of each lot of copper held by the Trust in each of its warehouses around the world, unlike LME copper on warrant, none of that copper will actually be for sale unless and until it is redeemed. Thus, just as holders of long positions on the LME who take delivery do not know what copper they will be getting, the same is true of anyone who exercises redemption rights. The crucial difference is that because none of the rest of the copper in the Trust is available for sale, the only such copper that can conceivably be traded by merchants for desired brands is copper on warrant in LME warehouses. But if, as we fear, the Trust intends to issue Shares based on copper on warrant in these very same LME warehouses, which copper will then be taken off-warrant and unavailable for sale, there is a much greater likelihood of there not being copper of the desired brands in the desired locations available for copper merchants to trade.

Because of its apparent misunderstanding of how the physical market actually works, the SEC erroneously concludes that "[n]othing in the record indicates that copper merchants will not be able to perform the same function in connection with Share redemptions." Page 26.

However, the record shows that copper merchants will not be able to perform the same functions with Share redemptions. The SEC assumes that merchants will be able to perform the same functions with Share redemptions because "on a daily basis, the Trust will publish information on the location and brand of copper that will be delivered to the next redeeming authorized participant, and this may assist end users of copper and copper merchants to locate suitable copper." Page 27. The problem though is that if such copper to be redeemed is not suitable, which may well be the case, the end user and copper merchant may no longer be able to get the copper they need on warrant from the LME warehouse because such copper may have instead been acquired by the Trust and is thus no longer for sale. Even though the Commission could easily have done so, the SEC never took that into account.

The Commission also dismissed as "unsupported" the assertion that even if an industrial user wanted to redeem in order to acquire copper, he might not be able to do so because there might not be shares to purchase. (Page 27). The SEC states that "[t]here is no evidence in the record to suggest that investors holding the Shares will be unwilling to sell them, particularly in response to market movements or changes in investor needs." Id. In fact, the assertion was supported in the record by the representation in the draft prospectus that if enough copper can continue to be removed from the market each month to cause a rise in prices sufficient to cover the monthly cost of storage, the Shares will increase in value. In short, persons or entities who acquire the Shares will do so based on the belief that the value of copper will increase – and increase enough in value to cover the monthly cost of storage. Based on that premise, it stands to reason that holders of Shares will well be unlikely to sell them in the secondary market until such time as copper prices have increased substantially, which may

indeed make it difficult for an industrial user who intends to redeem such Shares to obtain delivery of copper to be able to acquire such shares.

The Commission further states, without substantial evidence, that "the listing and trading of the Shares could provide another way for market participants and investors to trade in copper, and could enhance competition among trading venues." Here, the SEC overlooked substantial evidence in the record to show that market participants and investors can trade in copper in a number of different ways without the need for an ETF that will siphon off copper needed by industrial users. Thus, for example, there are numerous ETFs based on managed copper derivatives. There are also ETFs based on baskets of copper mining stocks. Managed copper derivatives have the advantage of allowing the investor to benefit from trading strategies that favor a contango market when the market is in contango, and from a back warded market, when the market is in backwardation. There is no such advantage for a passive investment in a physically backed copper ETF. If the market is in backwardation, absent removal of enough copper in the near term to force prices up so as to cover the cost of monthly storage, the investment will almost certainly lose money. In short, there is no substantial evidence in the record show that allowing a copper backed ETF would in any way enhance competition among trading venues.

Nor is there any substantial evidence in the record to support the SEC's finding that "the listing and trading of the Shares will provide investors another investment alternative, *which could enhance a well diversified portfolio.*" All the SEC states here is that "[b]y broadening the securities investment alternatives available to investors, the Commission believes that trading in the Shares could increase competition among financial products and the efficiency

of financial investment." However, the SEC did not provide any data or analysis to support this conclusion. Thus, it identifies no financial products where such supposed competition exists or would increase; nor does it identify much less explain how trading in the Shares could increase the "efficiency of financial investment." In short, because there is no substantial evidence to support these findings, these are just words devoid of meaning.

2. Source of Copper Used to Create Shares

The Commission found that the record "supports the view that there are sufficient copper stockpiles such that up to 61,800 metric tons of copper could be deposited into the Trust without authorized participants taking copper off of either the LME or Comex warrant." Pages 30-31. However, there is no substantial evidence to show that any such copper outside of the LME or Comex warehouses is actually available for sale – indeed, even though the Commission could have easily done so, the SEC rejected suggestions that it ask for proof from the Sponsor that such copper is available for sale --- and that, accordingly, all such copper will have to come from copper on warrant in the warehouses.

The SEC thus dismissed comments suggesting that the supply of non-warranted copper belongs to producers, consumers and/or merchants and traders and is not otherwise in the supply pipeline, and that the only copper available for immediate delivery is in LME and Comex warehouses. Instead, even though it has no evidence to show that any of such copper is actually for sale, and refused even to ask for such proof, the SEC said it "believes" that it is "more plausible" that a "sufficient portion of the estimated 1.4 million metric tons of copper inventories cited by commenter's currently is available for authorized participants to use to create Shares."

All the SEC can point to, however, is anecdotal evidence that copper is available off-warrant. Thus, the Commission cites between 450,000 and 540,000 tons of copper stored in China "that may be deliverable to the Trust." However, that fact that such copper "may be deliverable," as the Commission speculates, does not mean that it in fact can or will be delivered, and there is no substantial evidence in the record to suggest that it can or will. To the contrary, the record shows that China, at 40%, is the largest copper consuming country in the world, that China's annual copper consumption is growing faster than any country in the world, and that there is no evidence that even with an apparent slackening in demand for Chinese copper last year, any such Chinese copper has ever been sold to any non-Chinese company for delivery outside of China. The Commission nevertheless concludes that such copper may be acquired by the Trust based on JPM's quoting a "Metal Bulletin" estimate that 80% of these bonded stocks in China are LME acceptable metal given the imported status of such metal and arbitrage activity between the LME and SHFE. Page 31. However, the fact that such metal in China may be "LME acceptable" does not mean that it is in fact being delivered to the LME. First of all, there are at present no LME warehouses in China. And even though, because there is currently so much of it, Chinese bonded copper generally trades at a premium far less than premiums for copper outside of China, which would logically incentivize Chinese producers and traders to export it, and thus make it available as a source of supply to the Trust, JPM produced no evidence that such exporting is taking place.

The reason, as has been publicly reported, see "Chinese Copper Export Ambitions," Financial Times, May 1, 2012, is that traders say that "much of the copper in bonded warehouses is locked up in 'financing deals,' in which companies import copper in order to

use it as collateral for bank loans" and that "[w]ith financing for such trades relatively plentiful, traders say that only a fraction of the metal in bonded warehouses is available for sale." The SEC, however, dismissed this evidence on the ground that, even though there was no evidence produced by the Exchange of the Sponsor showing how much, if any, of that copper has been exported at a time when its exports would appear to be financially attractive, no evidence was supplied showing how much of the copper is "so encumbered under financing arrangements" or "how long such copper would be restricted."

In short, the Commission summarily rejected evidence from knowledgeable global traders such as RK that such copper is not available in the market to be purchased and has not in fact been purchased by RK or by anyone else, while at the same token the SEC did not require any substantial evidence from JPM, which purchases and sells copper around the world every day, that such Chinese copper is indeed available for purchase because it has actually made such purchases. Instead, despite published reports that such copper is generally not available for sale because it is tied up in financing arrangements, the Commission merely accepted JPM's representation that such copper could be purchased – and thus wouldn't be taken from LME warehouse stocks on warrant -- because no statistics were furnished showing how much of such Chinese copper was actually encumbered and for how long. The SEC thus assumed such copper would be available to support the Trust without requiring any substantial evidence in the record that such copper would actually be available for sale when the Shares would first be listed and traded.

What is more, the Commission simply assumed – again without substantial evidence to support its assumption -- that such copper would be available to the Trust because "one of the Trust's initial permitted warehouse locations is Shanghai." P. 32.

Finally, the Commission concluded that even if authorized participants would need to remove copper from LME warrant to deposit the copper into the Trust, i.e., even if as much as 61,800 tons of the 240,000 tons on warrant or 25% were removed, "the Commission believes that the Trust's copper will remain available for immediate delivery to consumers and participants in the physical markets." P. 32. However, there is no substantial evidence in the record to support this "belief." Thus, as we have demonstrated, the supply of the particular brands of copper required by industrial users for immediate delivery, particularly in the United States, will be disrupted by the listing and trading of the Shares because (1) such copper will be taken off warrant and thus taken off market; (2) there is no assurance that such copper will be available for delivery when Shares are redeemed (even assuming redemption occurs) and (3) unlike warrants which can be purchased, sold and traded for acceptable brands at any time, here only the particular brands held by the Trust to be redeemed (assuming redemption even occurs) would ever be available for such trade. Accordingly, there is substantial evidence in the record to show that the listing and trading of the Shares is indeed likely to disrupt the supply of copper available for immediate delivery and, despite what the Commission has ruled, there is no substantial evidence in the record to the contrary.

3. <u>Growth of the Trust</u>

In concluding that the listing and trading of the Shares would not likely disrupt the supply of copper available for immediate delivery, the Commission rejected arguments that it was reasonable to expect that the Trust would sell all of the Shares covered by the Registration Statement in the three months after the registration becomes effective because of (1) the stated desire to have the Trust remove enough copper from the market each month to move prices upward to cover the costs of storage; (2) the very limited quantity of copper available for immediate delivery to accomplish the Trust's objective; (3) the increase in copper prices in the three months following October 2010, when the Trust, iShares and ETFS Physical Copper all announced plans to market copper backed ETFs, and (4) the generally inelastic copper supply which will be unlikely to increase fast enough to account for the increased demand that would be unleashed by the creation and growth of the Trust. As shown below, the Commission's rejection of these arguments was not based on substantial evidence.

First, the Commission argues that the full 61,800 tons represented by the number of Shares that will be registered will only be acquired if no redemptions take place and that "[b]ased on the existence of the arbitrate mechanism of the Trust, which is common to many exchange-traded vehicles, the Commission believes it is very unlikely that no Shares will be redeemed." Page 34. However, as has been demonstrated, there is no substantial evidence in the record to demonstrate that there will be any effective "arbitrate mechanism" resulting in redemptions being exercised. Arbitrage leading to redemption would normally occur when the value of the Shares is less than the value of the underlying metal in which case, the holder of Shares may contact an authorized participant to redeem the Shares and receive the higher valued metal in return. In theory,

the release of the metal to the market would lead to more supply of metal and thus the value of the Shares and the metal would begin to converge. However, while that mechanism may work for precious metals, where there is already an abundance of supply available for immediate delivery, it may not work for copper, where growing warehouse queues (which do not exist for precious metals) mean that LME spot prices for immediate delivery may bear little or no relationship to actual prices when such metal will be delivered. As a result, the entire assumption on which the SEC's conclusion about redemption being exercised as part of the "arbitrage mechanism" is untested, not supported by substantial evidence, and inherently speculative.

The Commission next expresses skepticism that there will be that much investor demand for the Shares. Thus, the Commission asserts that the amount of copper held by the Trust will depend on investor demand, that the extent to which authorized participants fulfill such demand by buying Creation Units and not redeeming issued Shares, and that such investor demand is "currently unknown." To substantiate that conclusion, the Commission states that "ETFS Physical Copper, shares of which are listed and traded on the London Stock Exchange and the Deutsche Boerse, has not grown to a substantial size since its inception." Page 35. But the Commission omits to mention that, unlike JPM's proposed ETF, ETFS Physical Copper is backed by copper on warrant in LME warehouses which means that, unlike JPM's proposed ETF, the copper it holds is subject to LME regulation and thus, in the event ETFS were to acquire 50% or more of the LME warehouse stocks of copper, it would be required to lend a portion of its inventory back into the market – thus preventing the very circumstance which JPM here seeks to avoid by not being subject to LME regulation. In other words, the Commission significantly

avoids mention of the very circumstance which would drive authorized participants to try to acquire as much LME warrant copper as they can – and as quickly as they can – in order to meet the Trust's stated objective of moving the price of copper high enough so as to cover the Trust's monthly costs of storage.

The Commission then asserts that even if the Trust's copper "will be unavailable for immediate delivery," those opposed to the rule change have "not supported their prediction that the Trust would grow so quickly that it would significantly disrupt the supply of copper for immediate delivery." However, those opposed to the listing and trading of the Shares have in fact come forward with substantial evidence to support its prediction from the Sponsor's draft prospectus that it (1) hopes to acquire enough copper quickly enough so as to move the price upward in order to cover cost monthly costs of storage and that, (2) to help achieve that end, unlike ETFS Physical Copper, it will not be subject to LME regulation requiring that its inventory be sold otherwise loaned back into the market. At the same time, the Commission has here not come forward with any substantial evidence its own contrary prediction that, despite these representations in the Sponsor's draft prospectus, the Trust would not grow so quickly as to significantly disrupt the supply of copper for immediate delivery.

4. <u>Other Physical Commodity Trusts</u>

The Commission also dismissed arguments that the performance of existing ETFs for the precious metals gold, silver, platinum and palladium should not be viewed as a model for an ETF based on an exclusively industrial metal in relatively short supply – because they have traditionally been held for investment purposes, currently are used as

currency, and that, as a result, there were ample stored sources available to supply ETFs backed by those metals. The SEC likewise rejected arguments that physical copper, by contrast, because it is sold in 25-ton lots which are very expensive to store, generally is not held as an investment, but rather is used exclusively for industrial purposes, with an annual demand generally exceeding the available supply, and that the introduction of the Trust would therefore impact supply.

The SEC rejected these arguments based on the Sponsor's representation that the "majority of the market for silver, platinum, and palladium is industrial in nature." Page 36. However, even if, unlike gold, the majority of the market for silver, platinum and palladium is indeed industrial in nature, the SEC overlooked substantial evidence showing that, unlike copper, because these precious metals have traditionally been held for investment purposes, there are ample stored sources of these precious metals available to supply industry whenever such metals are in short supply.

Instead, the SEC accepted merely the Sponsor's representation that any holding of physical copper inventories, or of a financial replicating position, is implicitly an investment in copper. Page 36. However, there was no evidence in the record of any physical copper inventories available to supply a short market. The only record of any physical copper inventories was a record showing copper that is being held temporary at a port, on rail, on a boat or in a warehouse for delivery to an actual customer. Nor is the holding of a "financial replicating position" – whatever that may be -- the same as holding physical copper that can supply a short market.

By contrast, there is a worldwide market for the private storage in vaults of silver, platinum and palladium bars. See e.g., goldmoney.com (offering silver for storage in Canada, Hong Kong, Singapore, Switzerland and the United Kingdom; platinum for storage in Switzerland and Hong Kong, and palladium for storage in Hong Kong). Thus, platinum bullion is available in 10-ounce bars of pure .9995 fine platinum for trading, storage or personal delivery. Similarly, palladium can be purchased in one-ounce and ten-ounce bullion bars. Because of the relative small size and weight of these precious metals in relation to their value, the storage costs involved in such an investment are not nearly as substantial as is the cost of storing 25-ton lots of copper. Consequently, there is nothing comparable for the private storage of LME grade copper anywhere in the world. Moreover, because of the market for privately held storage of silver, platinum and palladium, any surge in ETF holding of such metals leading to a shortage – and resulting spike in prices -- could be relieved by investors selling their holdings to industrial users. Because there is no such comparable storage of LME grade copper, there is no evidence of any copper held for investment that can be used to address a shortage of copper created by the Trust.

The SEC nevertheless concluded that "[g]iven the industrial usage of silver, platinum and palladium as compared to copper, the Commission believes that it is reasonable to project that any impact of the listing and trading of the Shares will not be meaningfully different than that of the listing and trading of shares of these other Commodity-Based Trusts due solely to the nature of the underlying commodity markets. As shown above, there is no substantial evidence in the record to support that belief.

Apparently recognizing that the market for LME copper is very different from the markets for silver, platinum and palladium, the Commission concluded that even if there were differences, it wouldn't matter because of the Commission's belief "that the listing and trading of the Shares is not likely to disrupt the supply of copper available for immediate delivery." However, as demonstrated earlier, there is no substantial evidence in the record to support that belief.

B. <u>The Trust's Impact on the Price of Copper</u>

The Commission also rejected arguments that the rapid growth of the Trust would remove a substantial portion of the supply of immediately available LME warranted copper, thus driving up the price of such copper. Specifically, the SEC rejected arguments that the Trust would hold up to 61,800 metric tons of copper, that the iShares Copper Trust would hold up to 121,200 metric tons of copper, that collectively, they would hold approximately 34% of the copper available for immediate delivery, and that the announcements about the proposed copper trusts in October 2010 coincided with a copper price run up that assumed as much as 120,000 metric tons were about to be removed from the market.

In so doing, the Commission accepted JPM's representation that there are a number of factors that affect the price of copper and that drawdown's of copper warrants by 10,000 metric tons or more – which is the amount JPM estimates its Trust will acquire initially -- are not that uncommon, i.e., they occur at least 25% of the time, and that due to the Trust's redemption mechanism and the related ability of authorized participants to exchange Shares for physical copper – its Shares would track rather than drive the price

of copper. However, there is no substantial evidence that the copper the Trust will take off market would be limited to 10,000 metric tons – indeed, the Commission ignores the fact that JPM itself represents in its prospectus that there is in fact no limit to the amount of copper that can be acquired by the Trust and related copper backed ETFs, such as the iShares Copper Trust. In addition, far from merely tracking the price of copper, JPM represents in its draft prospectus that if enough copper can be taken off market through its own ETF and others, they will together will drive the price of copper high enough to cover the monthly costs of storage. There is no substantial evidence in the record to demonstrate that these representations in JPM's prospectus are false. Indeed, based on these representations by the Sponsor itself, there is substantial evidence in the record to suggest that the Sponsor will succeed in achieving its objective – not fail as the Commission assumes.

The Commission further represents that "even if the supply of copper under LME warrant would decrease because previously warranted copper were transferred to the Trust . . . the Commission does not believe that lower LME inventory level by itself will increase the LME Settlement Price (or any other price of copper). Page 40. In support of this conclusion, the SEC relied on internal economic analysis that purports to show no relationship between movements in daily LME inventory levels and the settlement price. As demonstrated below, however, these analyses are sufficiently flawed and biased in favor of the conclusion that the SEC wanted to reach that they cannot reasonably be said to constitute substantial evidence in support of its position.

First, SEC staff performed a "linear regression" of daily copper price changes, using five years of data from 2007-2012, against changes in LME copper inventory reported from the previous day. However, LME traders price copper based on inventory changes in real time – not changes in inventory reported from the previous day. Thus, traders make it their business to know when there has been a large movement of copper in or out of the LME warehouses worldwide because such information informs the relative balance of supply and demand that day when copper is being priced. The SEC never explained why it felt the "lagged change in LME copper inventory" should have any statistical relevance and there is no reason why it should.

In response, the Commission does not attempt to justify why it felt that "lagged change in LME copper inventory" it relied upon are statistically relevant; instead, the Commission summarily rejected the suggestion by a professional trader that traders make pricing decisions based not on "lagged changes in LME copper inventory" but rather on contemporaneous reports of changes in inventory levels, stating, "[t]he Commission does not believe that such a concurrent analysis can isolate the effect of inventory changes on prices because such an analysis cannot distinguish whether price changes lead inventory changes or vice versa." Page 50-51. However, the Commission made no effort to test its speculative supposition that contemporary price changes cause LME inventory stocks to move up and down.

The Commission nevertheless summarily rejected evidence showing if instead of looking at lagged daily LME stock data, Commission staff looked at the 30 largest quarter-to-quarter LME inventory declines against changes in the LME cash price over

the same time periods, it would have found that for the 30-largest observations, the median stock decline was 28.6% and that the LME cash price rose in 25 out of 30 observations, for a median increase of 10.5%. These findings suggest if LME and Comex inventories were to decline by more than 50%, which could happen if the Trust and iShares were to sell all of the shares registered through their respective registration statements, prices could increase 20-60% in the quarter that the LME and Comex inventory decline occurs. Even though Commission staff could have easily determined whether the evidence presented was statistically significant, the Commission summarily rejected it on the ground that (i) it wasn't accompanied by an analysis demonstrating its statistic significance, (ii) it didn't accept what it characterized as a statistical reliance on contemporary price changes – preferring instead to look only at its study of day-to-day prices following the one-day lagged daily inventory report and (iii) it didn't believe the listing and trading of the Shares is likely in any event to disrupt the supply of copper available for immediate delivery Page 53.

In short, the Commission simply overlooked contrary evidence presented because it was contrary to the conclusions that the Commission had already reached. However, since those conclusions were not themselves based on substantial evidence, they cannot by definition support its conclusions here.

Moreover, the Commission similarly summarily rejected evidence showing that the relevant price from the perspective of a professional trader is not the LME Settlement Price at all, but rather the cash to three month time spread which, as SEC was shown, when compared with LME inventory changes, actually demonstrates a very strong

relationship. The Commission thus summarily rejected statistical evidence showing that if the Trust and iShares Copper Trust were to sell all of the shares registered through their respective registration statements, the cash to three month time spread "would blow out to a massive backwardation, potentially approaching record levels, making it impossible for copper consumers to finance their inventory." Such evidence is, of course, consistent with corners and squeezes in the copper market. Thus, in the mid-1990s, when the Japanese trader Sumitomo conspired with an American trader to remove all of the warranted copper from the LME warehouse in Long Beach, California, the result was a massive backwardation that forced up near term prices. Yet, the Commission rejected this statistical evidence, which yielded a conclusion diametrically opposed to the one the Commission staff reached, on the ground that the analysis "does not provide the significance level of any test statistics associated with these findings, which would provide an assessment of the likelihood that relations were observed in the data by statistical chance" and that "[w]ithout an assessment of statistical significance, it is difficult to conclude whether observed relations in the commenter's data are systematic or anecdotal." Page 50.

However, given the historical evidence of corners and squeezes in the physical copper market, and the resulting backwardation that is created, as demonstrated not only by what occurred with the infamous Sumitomo squeeze but by the statistical evidence showing a strong correlation between LME inventory levels and backwardation, it appears that the Commission simply chose to ignore substantial evidence that was contrary to the conclusion it wished to reach, while at the same time relying on statistical

evidence that was itself lacking substantial evidence showing why it was relevant or significant.

The Commission also summarily rejected evidence suggesting that if the Commission really wanted to determine whether the listing and trading of Shares in the Trust would result in higher prices, Commission staff should consider instead the impact on locational premia. Here, the argument was that the relationship between LME inventory and locational premia in the U.S. is strong, and data was provided showing that when inventories are at anemic levels, locational premia can be very high (above $200 per metric ton). The reason it was suggested that Commission staff itself examine the extent to which creation of the Trust would result in higher locational premia is that if the Trust results in the removal of inventory from LME and Comex warehouses, as was suggested, the associated market impact will be much higher locational premia.

The Commission, however, not only declined to ask commission staff to examine such data, as we suggested it do, it refused to consider the idea at all on the ground that the commenter himself didn't furnish its own analysis. Page 54. Instead, the Commission concluded without study that locational premium "appear to be no greater than 2%," that the degree to which premia can therefore be influenced is "limited" and that, in any event, "the Commission believes that the Trust's copper will remain available for immediate delivery to consumers and participants in the physical markets, which will limit the possible effect on locational premia." Page 54. However, since the Commission's conclusion is itself not based on any substantial evidence, it follows that its conclusions about not needing to examine the impact that removal of inventories from

the U.S. LME and Comex warehouses will have on locational premia that must be paid is likewise not supported by substantial evidence.

The Commission similarly and summarily rejected suggestions that Commission staff examine whether the listing and trading of the Shares could change the fundamental structure of the copper market on the ground that the SEC's reliance on a simplistic "ex-ante statistical analysis of LME/global inventories and LME settlement prices" does not address the possibility that the Trust will create the opportunity for the first time in history for "financial players to 'lock up' significant amounts of LME and Comex inventory in a short period of time and remove that copper from the market. The Commission dismissed that concern, as it dismissed other concerns, based on its conclusion that it "does not believe that the listing and trading of the Shares is likely to disrupt the supply of copper available for immediate delivery, and even assuming that copper was taken off LME warrant to be deposited into the Trust, the Commission believes that the Trust's copper will remain available for immediate delivery to consumers and participants in the physical markets." (Page 55-56). However, as has been demonstrated, because the Commission's overall conclusions are themselves not based on substantial evidence, its refusal to study whether the listing and trading of the Shares could change the fundamental structure of the copper market is likewise not based on substantial evidence.

The Commission also assumed without substantial evidence that arbitrage will mitigate any risk of a squeeze or corner of the supply of copper available for immediate delivery. Thus, the Commissions states (at page 65), "[d]epending on the size of the

Trust, though, it is possible that copper holdings may be dispersed across an additional market – i.e., less copper may be held under LME and/or Comex warrant and more copper may be held by the Trust." However, the Commission added, "the availability of inter-market arbitrage is expected to help mitigate any potential increase in the ability of market participants to engage in corners or squeezes as a result of any dispersion of copper holdings across markets (as distinguished from a reduction in the copper supply." Page 65-66. Thus, the Commission states that "[f]or example, if the Trust grows large relative to the market for warrants on the LME, LME market participants faced with a potential corner or squeeze may acquire Shares, redeem them (though an authorized participant) for LME warrantable copper, put the copper on LME warrant, and delivery the warrants." Id. However, as the Commission's own order demonstrates, at footnote 83, there is evidence in the record that redemption for "LME warrantable copper" would ever result in copper actually being delivered and put on warrant at any specific time. Indeed, depending on where the "LME warrantable copper" is being held by the Trust, it could be months before any such copper is actually delivered. During that time frame, of course, the price of copper could change dramatically and, as a result, what may have been a good trade might turn into a disastrous trade. Consequently, the SEC's assumption that the "availability of inter-market arbitrate" would mitigate any potential increase in the ability is market participants to engage in corners or squeezes is based not on substantial evidence, as the law requires, but nothing more than wishful thinking.

In sum, for all these reasons, and for all the reasons set forth in the many written submissions and data we have provided on behalf of our clients, RK, Southwire, Encore, Luvata, and AmRod, the latter four representing 50% of the copper fabricating capacity

in the United States, we respectfully submit that the Commission should reconsider its order and, upon further review, based on substantial evidence in the record, the Commission should reverse its decision and deny approval of the proposed rule change.

Respectfully,

Robert B. Bernstein