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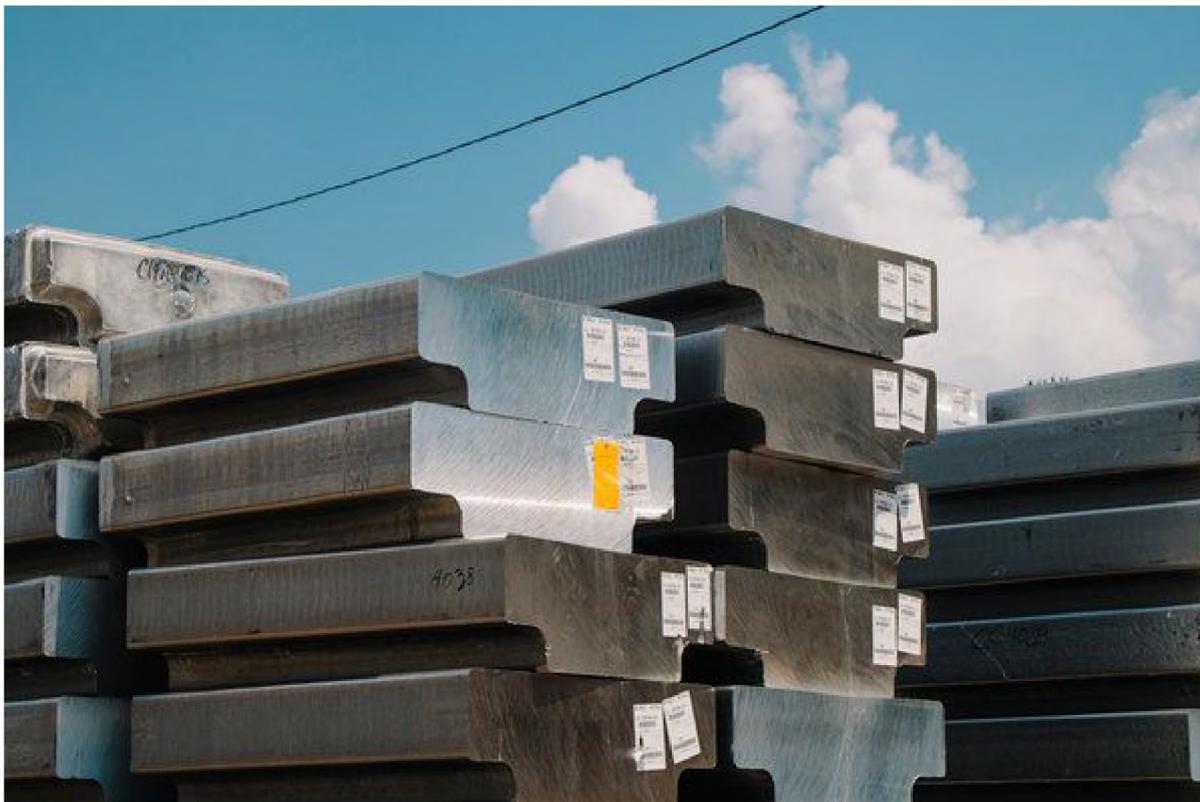
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Subject: ED LS: Very interesting story to manufacturers

THE HOUSE EDGE

## A Shuffle of Aluminum, but to Banks, Pure Gold



David Walter Banks for The New York Times

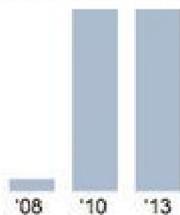
Aluminum ingots waiting to be shipped from a processor. Financial institutions like Goldman Sachs have used industry pricing regulations to earn millions of dollars each year.

By DAVID KOCIENIEWSKI

MOUNT CLEMENS, Mich. — Hundreds of millions of times a day, thirsty Americans open a can of soda, beer or juice. And every time they do it, they pay a fraction of a penny more because of a shrewd maneuver by Goldman Sachs and other financial players that ultimately costs consumers billions of dollars.

### The House Edge

Articles in this series will examine the challenges posed by Wall Street's influence over markets and the prices consumers pay.



Graphic

Profit from Commodities

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Fabrizio Costantini for The New York Times

One of Metro International's 27 warehouses near Detroit.

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Fabrizio Costantini for The New York Times

Another Metro International warehouse. Two or three times a day, sometimes more, drivers make the same circuits between warehouses.

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Tyler Clay

Aluminum at a Metro International warehouse in Michigan.

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David Walter Banks for The New York Times

A furnace at a Novelis aluminum processing plant in Greensboro, Ga. The company is one of the largest buyers of aluminum in the country.

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Nick Madden, chief procurement officer for Novelis. He said the London Metal Exchange had for years tolerated delays and high premiums, so its proposal, while encouraging, was still a long way from a solution.

## Readers' Comments

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The story of how this works begins in 27 industrial warehouses in the Detroit area where a Goldman subsidiary stores customers' aluminum. Each day, a fleet of trucks shuffles 1,500-pound bars of the metal among the warehouses. Two or three times a day, sometimes more, the drivers make the same circuits. They load in one warehouse. They unload in another. And then they do it again.

This industrial dance has been choreographed by Goldman to exploit pricing regulations set up by an overseas commodities exchange, an investigation by The New York Times has found. The back-and-forth lengthens the storage time. And that adds many millions a year to the coffers of Goldman, which owns the warehouses and charges rent to store the metal. It also increases prices paid by manufacturers and consumers across the country.

Tyler Clay, a forklift driver who worked at the Goldman warehouses until early this year, called the process "a merry-go-round of metal."

Only a tenth of a cent or so of an aluminum can's purchase price can be traced back to the strategy. But multiply that amount by the 90 billion aluminum cans consumed in the United States each year — and add the tons of aluminum used in things like cars, electronics and house siding — and the efforts by Goldman and other financial players has cost American consumers more than \$5 billion over the last three years, say former industry executives, analysts and consultants.

The inflated aluminum pricing is just one way that Wall Street is flexing its financial muscle and capitalizing on loosened federal regulations to sway a variety of commodities markets, according to financial records, regulatory documents and interviews with people involved in the activities.

The maneuvering in markets for oil, wheat, cotton, coffee and more have brought billions in profits to investment banks like Goldman, JPMorgan Chase and Morgan Stanley, while forcing consumers to pay more every time they fill up a gas tank, flick on a light switch, open a beer or buy a cellphone. In the last year, federal authorities have accused three banks, including JPMorgan, of rigging electricity prices, and last week JPMorgan was [trying to reach a settlement](#) that could cost it \$500 million.

Using special exemptions granted by the Federal Reserve Bank and relaxed regulations approved by Congress, the banks have bought huge swaths of infrastructure used to store commodities and deliver them to consumers — from pipelines and refineries in Oklahoma, Louisiana and Texas; to fleets of more than 100 double-hulled oil tankers at sea around the globe; to companies that control operations at major ports like Oakland, Calif., and Seattle.

In the case of aluminum, [Goldman bought Metro International Trade Services](#), one of the country's biggest storers of the metal. More than a quarter of the supply of aluminum available on the market is [kept in the company's Detroit-area warehouses](#).

Before Goldman bought Metro International three years ago, warehouse customers used to wait an

average of six weeks for their purchases to be located, retrieved by forklift and delivered to factories. But now that Goldman owns the company, the wait has grown more than tenfold — to more than 16 months, according to industry records.

Longer waits might be written off as an aggravation, but they also make aluminum more expensive nearly everywhere in the country because of the arcane formula used to determine the cost of the metal on the spot market. The delays are so acute that Coca-Cola and many other manufacturers avoid buying aluminum stored here. Nonetheless, they still pay the higher price.

Goldman Sachs says it complies with all industry standards, which are set by the London Metal Exchange, and there is no suggestion that these activities violate any laws or regulations. Metro International, which declined to comment for this article, in the past has attributed the delays to logistical problems, including a shortage of trucks and forklift drivers, and the administrative complications of tracking so much metal. But interviews with several current and former Metro employees, as well as someone with direct knowledge of the company's business plan, suggest the longer waiting times are part of the company's strategy and help Goldman increase its profits from the warehouses.

Metro International holds nearly 1.5 million tons of aluminum in its Detroit facilities, but industry rules require that all that metal cannot simply sit in a warehouse forever. At least 3,000 tons of that metal must be moved out each day. But nearly all of the metal that Metro moves is not delivered to customers, according to the interviews. Instead, it is shuttled from one warehouse to another.

Because Metro International charges rent each day for the stored metal, the long queues caused by shifting aluminum among its facilities means larger profits for Goldman. And because storage cost is a major component of the "premium" added to the price of all aluminum sold on the spot market, the delays mean higher prices for nearly everyone, even though most of the metal never passes through one of Goldman's warehouses.

Aluminum industry analysts say that the lengthy delays at Metro International since Goldman took over are a major reason the premium on all aluminum sold in the spot market has doubled since 2010. The result is an additional cost of about \$2 for the 35 pounds of aluminum used to manufacture 1,000 beverage cans, investment analysts say, and about \$12 for the 200 pounds of aluminum in the average American-made car.

"It's a totally artificial cost," said one of them, [Jorge Vazquez, managing director at Harbor Aluminum Intelligence](#), a commodities consulting firm. "It's a drag on the economy. Everyone pays for it."

Metro officials have said they are simply reacting to market forces, and on the [company Web site](#) describe their role as "bringing together metal producers, traders and end users," and helping the exchange "create and maintain stability."

But the London Metal Exchange, which oversees 719 warehouses around the globe, has not always been an impartial arbiter — it receives 1 percent of the rent collected by its warehouses worldwide. Until last year, it was owned by members, including Goldman, Barclays and Citigroup. Many of its regulations were drawn up by the exchange's warehouse committee, which is made up of executives of various banks, trading companies and storage companies — including the president of Goldman's Metro International —

as well as representatives of powerful trading firms in Europe. The exchange was sold last year to a group of Hong Kong investors and this month it proposed regulations that would take effect in April 2014 intended to reduce the bottlenecks at Metro.

All of this could come to an end if the Federal Reserve Board declines to extend the exemptions that allowed Goldman and Morgan Stanley to make major investments in nonfinancial businesses — although there are indications in Washington that the Fed will let the arrangement stand. Wall Street banks, meanwhile, have focused their attention on another commodity. After a sustained lobbying effort, the Securities and Exchange Commission late last year approved a plan that will allow JPMorgan Chase, Goldman and BlackRock to buy up to 80 percent of the copper available on the market.

In filings with the S.E.C., Goldman has said it plans by early next year to store copper in the same Detroit-area warehouses where it now stockpiles aluminum. On Saturday, however, Michael DuVally, a Goldman spokesman, said the company had decided not to participate in the copper venture, though it had not disclosed that publicly. He declined to elaborate.

### **Banks as Traders**

For much of the last century, Congress tried to keep a wall between banking and commerce. Banks were forbidden from owning nonfinancial businesses (and vice versa) to minimize the risks they take and, ultimately, to protect depositors. Congress strengthened those regulations in the 1950s, but by the 1980s, a wave of deregulation began to build and banks have in some cases been transformed into merchants, according to Saule T. Omarova, a law professor at the University of North Carolina and expert in regulation of financial institutions. Goldman and other firms won regulatory approval to buy companies that traded in oil and other commodities. Other restrictions were weakened or eliminated during the 1990s, when some banks were allowed to expand into storing and transporting commodities.

Over the past decade, a handful of bank holding companies have sought and received approval from the Federal Reserve to buy physical commodity trading assets.

According to public documents in an application filed by JPMorgan Chase, the Fed said such arrangements would be approved only if they posed no risk to the banking system and could “reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices.”

By controlling warehouses, pipelines and ports, banks gain valuable market intelligence, investment analysts say. That, in turn, can give them an edge when trading commodities. In the stock market, such an arrangement might be seen as a conflict of interest — or even insider trading. But in the commodities market, it is perfectly legal.

“Information is worth money in the trading world and in commodities, the only way you get it is by being in the physical market,” said Jason Schenker, president and chief economist at Prestige Economics in Austin, Tex. “So financial institutions that engage in commodities trading have a huge advantage because their ownership of physical assets gives them insight in physical flows of commodities.”

Some investors and analysts say that the banks have helped consumers by spurring investment and

making markets more efficient. But even banks have, at times, acknowledged that Wall Street's activities in the commodities market during the last decade have contributed to some price increases.

In 2011, for instance, an internal Goldman memo suggested that speculation by investors accounted for about a third of the price of a barrel of oil. A [commissioner at the Commodity Futures Trading Commission](#), the federal regulator, subsequently used that estimate to calculate that speculation added about \$10 per fill-up for the average American driver. Other experts have put the total, combined cost at \$200 billion a year.

## High Premiums

The entrance to one of Metro International's main aluminum warehouses here in suburban Detroit is unmarked except for one toppling sign that displays two words: Mount Clemens, the town's name.

Most days, there are just a handful of cars in the parking lot during the day shift, and by 5 p.m., both the parking lot and guard station often appear empty, neighbors say. Yet inside the two cavernous blue warehouses are rows and rows of huge metal bars, weighing more than half a ton each, stacked 15 feet high.

After Goldman bought the company in 2010, Metro International began to attract a stockpile. It actually began paying a hefty incentive to traders who stored their aluminum in the warehouses. As the hoard of aluminum grew — from 50,000 tons in 2008 to 850,000 in 2010 to nearly 1.5 million currently — so did the wait times to retrieve metal and the premium added to the base price. By the summer of 2011, the price spikes prompted Coca-Cola to complain to the industry overseer, the London Metal Exchange, that Metro's delays were to blame.

Martin Abbott, the head of the exchange, said at the time that he did not believe that the warehouse delays were causing the problem. But the group tried to quiet the furor by imposing new regulations that doubled the amount of metal that the warehouses are required to ship each day — from 1,500 tons to 3,000 tons. But few metal traders or manufacturers believed that the move would settle the issue.

"The move is too little and too late to have a material effect in the near-term on an already very tight physical market, particularly in the U.S.," Morgan Stanley analysts said in a note to investors that summer.

Still, the wait times at Metro have grown, causing the premium to rise further. Current and former employees at Metro say those delays are by design.

Industry analysts and company insiders say that the vast majority of the aluminum being moved around Metro's warehouses is owned not by manufacturers or wholesalers, but by banks, hedge funds and traders. They buy caches of aluminum in financing deals. Once those deals end and their metal makes it through the queue, the owners can choose to renew them, a process known as rewarranting.

To encourage aluminum speculators to renew their leases, Metro offers some clients incentives of up to \$230 a ton, and usually moves their metal from one warehouse to another, according to industry analysts and current and former company employees.

To metal owners, the incentives mean cash upfront and the chance to make more profit if the premiums increase. To Metro, it keeps the delays long, allowing the company to continue charging a daily rent of 48 cents a ton. Goldman bought the company for \$550 million in 2010 and at current rates could collect about a quarter-billion dollars a year in rent.

Metro officials declined to discuss specifics about its lease renewals or incentive policies.

But metal analysts, like Mr. Vazquez at Harbor Aluminum Intelligence, estimate that 90 percent or more of the metal moved at Metro each day goes to another warehouse to play the same game. That figure was confirmed by current and former employees familiar with Metro's books, who spoke on condition of anonymity because of company policy.

Goldman Sachs declined to discuss details of its operations. Mr. DuVally, the Goldman spokesman, pointed out that the London Metal Exchange prohibits warehouse companies from owning metal, so all of the aluminum being loaded and unloaded by Metro was being stored and shipped for other owners.

"In fact," he said, "L.M.E. warehouses are actually prohibited from trading all L.M.E. products."

As the delays have grown, many manufacturers have turned elsewhere to buy their aluminum, often buying it directly from mining or refining companies and bypassing the warehouses completely. Even then, though, the warehouse delays add to manufacturers' costs, because they increase the premium that is added to the price of all aluminum sold on the open market.

## **The Warehouse Dance**

On the warehouse floor, the arrangement makes for a peculiar workday, employees say.

Despite the persistent backlogs, many Metro warehouses operate only one shift and usually sit idle 12 or more hours a day. In a town like Detroit, where factories routinely operate round the clock when necessary, warehouse workers say that low-key pace is uncommon.

When they do work, forklift drivers say, there is much more urgency moving aluminum into, and among, the warehouses than shipping it out. Mr. Clay, the forklift driver, who worked at the Mount Clemens warehouse until February, said that while aluminum was delivered in huge loads by rail car, it left in a relative trickle by truck.

"They'd keep loading up the warehouses and every now and then, when one was totally full they'd shut it down and send the drivers over here to try and fill another one up," said Mr. Clay, 23.

Because much of the aluminum is simply moved from one Metro facility to another, warehouse workers said they routinely saw the same truck drivers making three or more round trips each day. Anthony Stuart, a forklift team leader at the Mount Clemens warehouse until 2012, said he and his nephew — who worked at a Metro warehouse about six miles away in Chesterfield Township — occasionally asked drivers to pass messages back and forth between them.

"Sometimes I'd talk to my nephew on the weekend, and we'd joke about it," Mr. Stuart said. "I'd ask him 'Did you get all that metal we sent you?' And he'd tell me 'Yep. Did you get all that stuff we sent you?'"

Mr. Stuart said he also scoffed at Metro's contention that a major cause for the monthslong delays is the difficulty in locating each customer's store of metal and moving the other huge bars of aluminum to get at it. When he arrived at work each day, Mr. Stuart's job was to locate and retrieve specific batches of aluminum from the vast stores in the warehouse and set them out to be loaded onto trucks.

"It's all in rows," he said. "You can find and get anything in a day if you want. And if you're in a hurry, a couple of hours at the very most."

When the London Metal Exchange was sold to a Hong Kong company for \$2.2 billion last year, its chief executive promised to take "a bazooka" to the problem of long wait times.

But the new owner of the exchange has balked at adopting a remedy raised by a consultant hired to study the problem in 2010: limit the rent warehouses can collect during the backlogs. The exchange receives 1 percent of the rent collected by the warehouses, so such a step would cost it millions in revenue.

Other aluminum users have pressed the exchange to prohibit warehouses from providing incentives to those that are simply stockpiling the metal, but the exchange has not done so.

Last month, however, after complaints by a consortium of beer brewers, the exchange proposed new rules that would require warehouses to ship more metal than they take in. But some financial firms have raised objections to those new regulations, which they contend may hurt traders and aluminum producers. The exchange board will vote on the proposal in October and, if approved, it would not take effect until April 2014.

Nick Madden, chief procurement officer for one of the nation's largest aluminum purchasers, Novelis, said the situation illustrated the perils of allowing industries to regulate themselves. Mr. Madden said that the exchange had for years tolerated delays and high premiums, so its new proposals, while encouraging, were still a long way from solving the problem. "We're relieved that the L.M.E. is finally taking an action that ultimately will help the market and normalize," he said. "However, we're going to take another year of inflated premiums and supply chain risk."

In the meantime, the Federal Reserve, which regulates Goldman Sachs, Morgan Stanley and other banks, is reviewing the exemptions that have let banks make major investments in commodities. Some of those exemptions are set to expire, but the Fed appears to have no plans to require the banks to sell their storage facilities and other commodity infrastructure assets, according to people briefed on the issue.

A Fed spokeswoman, Barbara Hagenbaugh, provided the following statement: "The Federal Reserve regularly monitors the commodity activities of supervised firms and is reviewing the 2003 determination that certain commodity activities are complementary to financial activities and thus permissible for bank holding companies."

Senator Sherrod Brown, who is sponsoring Congressional hearings on Tuesday on Wall Street's ownership of warehouses, pipelines and other commodity-related assets, says he hopes the Fed reins in the banks.

"Banks should be banks, not oil companies," said Mr. Brown, Democrat of Ohio. "They should make loans, not manipulate the markets to drive up prices for manufacturers and expose our entire financial

system to undue risk.”

## **Next Up: Copper**

As Goldman has benefited from its wildly lucrative foray into the aluminum market, JPMorgan has been moving ahead with plans to establish its own profit center involving an even more crucial metal: copper, an industrial commodity that is so widely used in homes, electronics, cars and other products that many economists track it as a barometer for the global economy.

In 2010, JPMorgan quietly embarked on a huge buying spree in the copper market. Within weeks — by the time it had been identified as the mystery buyer — the bank had amassed \$1.5 billion in copper, more than half of the available amount held in all of the warehouses on the exchange. Copper prices spiked in response.

At the same time, JPMorgan, which also controls metal warehouses, began seeking approval of a plan that would ultimately allow it, Goldman Sachs and BlackRock, a large money management firm, to buy 80 percent of the copper available on the market on behalf of investors and hold it in warehouses. The firms have told regulators that these stockpiles, which would be used to back new copper exchange-traded funds, would not affect copper prices. But manufacturers and copper wholesalers warned that the arrangement would squeeze the market and send prices soaring. They asked the S.E.C. to reject the proposal.

After an intensive lobbying campaign by the banks, Mary L. Schapiro, the S.E.C.'s chairwoman, [approved the new copper funds](#) last December, during her final days in office. S.E.C. officials said they believed the funds would track the price of copper, not propel it, and concurred with the firms' contention — disputed by some economists — that reducing the amount of copper on the market would not drive up prices.

Others now fear that Wall Street banks will repeat or revise the tactics that have run up prices in the aluminum market. Such an outcome, they caution, would ripple through the economy. Consumers would end up paying more for goods as varied as home plumbing equipment, autos, cellphones and flat-screen televisions.

Robert Bernstein, a lawyer at Eaton & Van Winkle, who represents companies that use copper, said that his clients were fearful of “an investor-financed squeeze” of the copper market. “We think the S.E.C. missed the evidence,” he said.

*Gretchen Morgenson contributed reporting from New York. Alain Delaquérière contributed research from New York.*

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