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Division of
Market Oversight

December 9, 2002

Mr. Ted Butler
1620 16th CT
Jupiter, FL 33477

Dear Mr. Butler:

I apologize for my delayed response to your correspondence of August 13. In your letter, you make several assertions, namely: that "there are no legitimate speculative silver position limits currently in place on the COMEX and that big concentrated shorts are speculators masquerading as dealers/hedgers": that legitimate short hedgers must "hold real silver or no more than 12-month production hedging agreements"; that the 7,500-contract "accountability rule"[1] is the equivalent of a "100mph school zone speed limit"; that large shifts in commercial positions, in this case decreases in commercial short positions, are illegitimate; and that "the number one premise of commodity law...[is] that speculators shouldn't influence prices." I believe your assertions are either wrong on their face or have been fully addressed in my July 26 letter to you. Nonetheless, I will briefly reiterate and clarify my earlier remarks with respect to these allegations.

First, although you are essentially correct that the COMEX does not have speculative position limits outside of the spot month, this is well within Commission rules and guidelines. In any event, since there are no limits on speculative positions outside the spot month, there is no restriction on any trader from accumulating large futures positions, there is no "hedger exemption" as you call it, and no motive for a speculator to masquerade as a dealer/hedger in order to evade position limits. Moreover, the *Commitments of Traders* (COT) data on large positions says nothing about any trader's net market exposure. Futures traders may classify themselves as "commercials" if positions are held as legitimate hedges or risk management against any combination of world market exposures, including physical silver, over-the-counter dealings, and other derivative instruments. This classification has no bearing on how large a futures position can be held because there are no speculative position limits outside the spot month.

With respect to the efficacy of accountability rules, for reasons outlined above, the Commission places an emphasis on spot-month position limits in physical-delivery markets. If, as you allege, the accountability rule is equivalent to a 100-mph speed limit, then the silver spot-month limit forces drivers to slow down to 20 mph, *i.e.*, 1/5 the size of the accountability level.

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[1] The exchange has established an "accountability" level of 7,500 net futures equivalent contracts in one month or all months combined. Traders may exceed that level, but are then "accountable" for an additional request for information from exchange staff.

It is inconsistent to allege that manipulation is facilitated by the lack of position limits outside the spot month, but that artificially-low prices are also present during the several months each year that are spot months, when the 1,500-contract position limit is in effect and traders are free to take or make physical delivery on the futures if they believe futures prices or too low or too high compared to other market values. It is entirely consistent with price theory -- and our data show -- that silver futures prices are in line with other markets for silver throughout the year based upon the indicators cited earlier.

Furthermore, a large reduction in short futures positions in the COT commercial-trader category is not necessarily an indication of illegitimacy or wrongdoing. Commercial traders are entitled to make substantial increases/decreases in their futures positions as their exposures to other markets change and/or their view of the market changes. In other words, commercial traders may choose to respond to changes in the market by increasing or decreasing the amount of futures they are holding as risk management, regardless of whether their exposures in other markets have changed.

Finally, the purpose of futures markets is for the transfer of commercial risk and for price discovery, and commercial traders tell us that silver futures serve that purpose. Nonetheless, it is well understood that **every** trade in a market, whether by a commercial or noncommercial, has the capacity to affect price, which is contrary to your assertion that "the number one premise of commodity law...[is] that speculators shouldn't influence prices." Moreover, we have found no evidence that trades by speculators or commercials in silver futures are illegitimate, or that speculators are any more influential in silver futures than in many other markets.

We do from time-to-time contact traders on both sides of any given market to examine the nature of large positions and various trading strategies. Although I am barred by law from disclosing the business dealings of any specific trader, I can repeat that we have examined the situation in silver and have thus far uncovered no evidence of illegal conduct or traders acting in collusion. Until such time as our ongoing surveillance efforts or you or anyone else provides specific, first-hand information concerning violations of the Commodity Exchange Act, I believe that your allegations have been fully addressed.

Sincerely,

Michael Gorham
Director

cc: James Newsome
Chairman