Glencore: the monster has landed!

UK's largest listing raises numerous questions

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As we go to press, the world's biggest commodities' trader has "gone public" on the London and Hong Kong Stock Exchanges, following the conditional issue of shares to its so-called "cornerstone investors" over the previous week.

Glencore has leaped straight into the FTSE 100 list of the UK's largest companies and - with a market value likely to be at around £36 billion - will become the fourth or fifth biggest mining company traded on the London Stock Exchange's premium main market *.

And make no mistake, although Glencore's trading in foodstuffs is a key part of its global business (attracting a wealth of criticism in recent years), its main profits are derived from the exploitation of oil and minerals (*see below*).

The company's IPO (Initial Public Offering) on 24 May will milk the pockets of many investors, including so-called Tracker and Pension Funds, whose portfolio managers will argue they are duty-bound to take a stake on behalf of their worker clients.

Nonetheless, the hoo-hah, the investor road-shows, and the glut of press articles preceding this unique listing (the largest of its kind ever made in Britain), haven't all worked in Glencore's favour.

Far from it.

While this notoriously secretive enterprise will certainly now enjoy access to large chunks of new capital, it has also been forced to open its books to greater scrutiny than ever before.

Indeed, by having to publish an obligatory prospectus (accompanied by so-called "competent person" reports on four of its mining ventures) the firm has unwittingly exposed itself to a raft of criticisms and condemnation .

But it's difficult to tell whether some of the light, recently shed on the darker corners of the Swiss-based firm, has served to significantly deflate the enthusiasm of investors.

Don't invest!

On 20 May, *The Times* Business Editor, Ian King, expressed no doubt that taking stakes in this particular golden calf wouldn't be wise.

In a remarkably robust comment, King damned Glencore as "...a business with dubious morals. It trades grain amid food riots and has been accused of profiteering and environmental offences in numerous poor and war-torn countries.

"Most of those signing up to buy shares in Glencore's floatation are major Middle Eastern and Far Eastern investors. Few of the traditional City institutions will touch the shares with a bargepole. The question is, should you?"

King's optimism might have been a little premature. According to Reuter's IFR, on 19 May some nine hundred different accounts participated in the initial market offering:

"Orders were received from around the world including the UK, US, Asia, Middle East and Brazil.

"About 10% went to high-net worth individuals and private banking clients, about a third to hedge funds and the rest to institutions and sovereign wealth funds. Hong Kong retail took just 2.67% of the offering".

Nonetheless, a day later, Glencore's share price slipped, and marked scepticism was evinced by some investors.

The fund manager on the UK equities' team at

Schroders Bank, and Aviva Investors' UK equity manager, both warned investors to look to other mining companies with a long history as listed businesses.

Aviva's Chris Murphy said: "If we want exposure to the mining space we can buy Rio Tinto, where we know its track record and have visibility on management. We feel there is more value there than the likes of Glencore." [Reuters 23 May 2011].

Glencore's core agenda

"Why would a giant secret society like Glencore, with a dark past, want to come into the light of day and relinquish the private, backroom-dealing business model that made its partners and founder fabulously wealthy?"

That was the question raised by *Money Morning* contributing editor, Shah Gilani, on May 18th, and his answer was a terse one:

"Because the old game is over and commodities prices are about to break down - and in a big way.

"By utilizing its newly tapped source of capital - its own stock - the [Glencore] partners will eventually be able to cash out (they have a lockup provision of four years to five years).

"Not only that, the company will also be able to withstand the coming crash in commodity prices and then be perfectly positioned to buy at the bottom, which is what it is planning to do."

Maybe so (and, indeed, the market price of copper and other base metals did turnd downwards on Monday - just a day before the Glencore IPO).

But the fundamental question is whether the firm's move on London and Hong Kong isn't motivated by a more radical intent: to reduce its overall dependence on commodities trading *per se*, while increasing vertical integration in extractive companies.

As we commented recently on this website: "For sure Glencore will now put more money into acquiring and operating mines than it has to date. Metal output and trading is the company's second biggest money-spinner (next to oil)".

See: Greedy Glencore doesn't plan to change its ways

Stephen Bartholomeusz, of Australia's *Business Spectator*, agrees. On 17 May he wrote :

"What has changed within Glencore in recent years has been the size and contribution of [its] industrial assets - its interests in mines, oil wells, logistics businesses and port facilities".

Bartholomeusz thus forsees Glencore transforming itself "from a trader with some resource production to a mining house with some trading activities".

"In fact", he says, "it would look very much like a BHP Billiton, which might be the point."

If many observers didn't see this crucial point before Glencore's pre-IPO prospectus was published, they have little excuse for failing to do so now, nor for ignoring the implications of what the London listing will mean in practice.

Damage, dirt and deception

On May 19th and 20th the London *Times* lashed into Glencore with two unprecedented exposes of the company's current operations while The *Guardian* followed suit with additional indictments.

The allegations included that:

- a Glencore subsidiary had procured lucrative market-sensitive information from a European Union "mole" which threatens to undermine the EU's Common agricultural policy
- Glencore's Colombian subsidiary is operating on government-owned land that was forcibly taken from its previous residents by paramilitaries; at least 18 people were murdered in a six month "campaign of terror" at El Prado, northern Colombia
- The company has been guilty of causing river pollution at its operations in Bolivia
- Members of the Wutha Native Title Climants Group in Australia had been cheated of an agreement made with Glencore in 1996, under which the company guaranteed to employ some of them in return for mining nickel on their

land. (The case was settled only recently out of court)

- Century Aluminum of the USA, 44% owned by Glencore, is being pursued for damages caused by its operations, in a string of cases brought by environmental agencies, local residents and other companies.

Mopani plea goes unheeded

It's Glencore's mining and smelting operations at Mopani in Zambia which seem to have provoked the strongest anger.

In an article ,entitled "Billionaire ignored children's pleas to stop toxic pollution from mine", *The Times* Environment Editor, Ben Webster reported on 20 May that Glencore's CEO, Ivan Glasenberg had, a full year ago, "received a bundle of letters from children at a school exposed on a daily basis to sulphur dioxide pollution from the nearby Mopani Copper Mines (MCM) complex.

"In the letters, obtained by *The Times*, the children described how clouds of toxic particles made them choke, burnt their throats, poisoned the school's fruit trees and forced teachers to close windows, leaving them sweltering in their classrooms".

In 2009, The Environmental Council of Zambia also reported that sulphur dioxide emissions from parts of the plant had reached up to 70 times the maximum health limit set by the World Health Organisation.

Says Webster: "A mineral expert's report, published in Glencore's prospectus also confirmed that "sulphur dioxide emissions from MCM were "consistently exceeding" environmental limits.

"It said that the breaches were a 'significant risk' because MCM had missed even the extended deadline for reducing the pollution. Three monitoring stations outside the plant repeatedly recorded breaches of air pollution limits".

The report "described various illegal discharges of hazardous fluids into rivers, including an acid leak that had contaminated the town's water supply and resulted in 'hospitalisation and treatment of a number of people'".

So far, however, Mr Glasenberg has ignored the childrens' plea, and his company has done virtually nothing to introduce stringent anti-pollution measures to the area.

Those choosing to buy Glencore stock this week may blithely hope that this monstrous enterprise will now be forced to clean up its numerous dubious acts.

But they certainly shouldn't bank on it.

* *Editorial note*: As of 23 May 2011, BHP Billiton's market capitalisation was £127 billion; that of Rio Tinto, £78.76 billion; that of Xstrata, £40 billion; that of Anglo American was set at £34 billion.

Is the Glencore IPO signallying a crash in commodity prices?

By Shah Gilani, Contributing Editor, Money Morning

18 May 2011

Super-secretive Swiss-based commodities trading giant Glencore International AG is going public. The Glencore IPO shares will be priced today (Wednesday) and could begin "conditional trading" in London tomorrow (Thursday).

ore has a 73% stake in the Mopani copper mine in ern ia. Photograph: Jean-Claude Coutausse/Bloomberg News

As currently planned, unconditional trading will begin in London on May 24 and in Hong Kong on May 25.

In spite of all the pre-IPO hoopla, there's actually probably quite a lot that you don't know about Glencore.

If that's the case, don't worry - you're not alone: Columnists and market pundits alike routinely describe the company as "mysterious." To be sure, the Glencore story is a colorful one, and is one of those tales that seems to raise at least as many questions as it answers (For instance, billionaire founder Marc Rich once owned 50% of 20th Century Fox, spent years as a "wanted" man, and was actually pardoned by a U.S. president).

So it's no surprise at all that the Glencore IPO deal raises a whole host of new questions - these two key among them:

- Why is Glencore going public right now?
- And precisely what does the largest IPO in the history of the United Kingdom means for global commodity prices?

On that last question, at least, I can spare you the suspense: Global commodity prices are going to crash before they rally to new highs.

Now I want to show you why...

A Profile of Glencore

When researching a difficult topic, the best place to start is usually right at the beginning.

So let's do precisely that: What is Glencore and what does it do?

Based in Baar, Switzerland, Glencore is a private company that has 485 partners, and employs 54,800 people in 30 countries at its industrial subsidiaries, which consist of mines, farms, production, processing, milling, refining, and storage and distribution facilities. It also employs 2,700 commodities traders in 40 countries around the world.

Glencore owns 34% of mining giant Xstrata PLC. It trades crude oil, oil products, copper, zinc, lead, alumina and aluminum, ferroalloys, nickel, cobalt, coal, coke and agricultural commodities.

Rich, the billionaire founder of Glencore, was also one of the founders of spot-market oil trading. In the early 1980s, Rich was indicted for tax fraud, and for illegally trading with Iran during the 1979 hostage crisis. He was wanted by the United States, but remained beyond its grasp, and refused to return to this country - and ultimately was famously pardoned by Bill Clinton on the 42nd president's last day in office. (The Website of the Marc Rich Group features a "frequently-asked question" (FAQ) section that notes that Rich "was never convicted, or even tried, for any criminal offense.")

If the Glencore IPO is as successful as expected, the resultant public company will have a market capitalization of more than $61 billion. That means that Glencore - despite its freshly minted status - will be instantly bigger than Nestle SA, Novartis AG and UBS AG. In fact, it will debut as one of the largest companies traded on the

London Stock Exchange and it will immediately be made part of the FTSE 100 Index, forcing institutional money managers and index funds to buy its shares as a component of the benchmarks they track.

In order to make Glencore's debut as a publically traded giant a total home run, the company solicited the interest of "cornerstone" investors to commit to purchasing some of its shares. The rich crowd drawn into the Glencore IPO is reported to include:

- Aabar Investments, an Abu Dhabi sovereign wealth fund that says it will invest $850 million as a "cornerstone" investor, and $150 million besides - bringing its total Glencore outlay to a cool $1 billion.
- The Government of Singapore Investment Corp. Pte. Ltd. - Singapore's sovereign wealth fund (SWF) that's more commonly referred to as GIC.
- Hedge fund Highbridge Capital Management LLC (owned by JPMorgan Chase & Co. (NYSE: JPM)).
- And BlackRock Inc. (NYSE: BLK), the world's largest money-management firm.

It seems that investors are lining up - and they weren't doing so in order to read the 1,300-plus page prospectus that Glencore had to use to disclose all the risks that it faced. These investors were trying to get in on the commodities boom that Glencore has navigated for maximum profit - and in which it can be expected to have its corporate hands for many, many years to come.

But are those investors being lured into the ultimate trader's "bear trap?"

Key Questions to Ask

First of all, the company has to come to market by its announced launch dates. If it fails to do so, Glencore will have to go back and crunch some more financials. Analysts and others seem to be ignoring the fact that the financials on which the company's valuations are based were last updated on Dec. 31 - meaning the first quarter is a mystery.

Call me cautious, but wouldn't it be more revealing to see how the company - which supposedly controls about 50% of the world's copper trading, 60% of the zinc market and huge amounts of other commodities that have been, shall we say, somewhat volatile in the most recent quarter - has fared in the face of the bursting commodities bubble.

In other words, is Glencore cashing in at the top? Isn't that what traders do? Sell high and buy low? Isn't selling at the top of its market the same thing that a few other notable (change that to "exceptionally brilliant") trading houses did not so long ago?

For instance:

- Didn't Goldman Sachs Group Inc. go public in 1999, right before the tech bubble popped? And isn't Goldman's stock price currently trading well below its high-water mark?
- Didn't hedge fund giant Fortress Investment Group LLC go public at $18.50 a share back in February 2007 - right before the markets crashed? And isn't that once-high-flying IPO stock now trading at less than $5.25 a share?
- And didn't Stephen A. Schwarzman take private-equity giant Blackstone Group LP public at $31 a share in 2007 - at the absolute apex of the LBO market cycle - and isn't that stock now trading at less than $17.00? (In another interesting parallel to the Glencore deal, Blackstone also landed a major investment from a sovereign-wealth fund - a $3 billion infusion from the China Investment Corp. (CIC) China. China profited handsomely when the stock surged nearly 18% on its first day of trading. But at yesterday's closing price of $16.87, Blackstone shares are down 43% from CIC's purchase price of $29.605 a share - meaning China's SWF is sitting on a loss of about $1.3 billion).

Given that "selling at the top" is what traders do best, the question to ask here is clear: Does the Glencore IPO signal the top of the commodities bubble? Are the insiders selling out at a perfect time? And, as we saw with Blackstone and CIC, are the new Glencore shareholders coming aboard at the absolute worst moment?

You bet.

Glencore's mystique (there's that word again) and legendary status as a global powerbroker and master trader is part of what the company insiders are selling. Their sales pitch is based more on the past than it is on the future.

After all, Glencore's past reads like a Hollywood script, if not a Tom Clancy novel.

It's a long and fabulous story.

Here's the short version.

Building the Mystique

A young Jewish émigré named Marc Rich escapes Belgium in 1940 - before Hitler's panzer-headed blitzkriegs rolled through - and ends up in America. By 1954, Rich is earning $60 a week at Philipp Brothers (now the Phibro LLC unit of Occidental Petroleum Corp., at the time a well-known commodity-trading house in New York.

Rich ends up trading oil, which isn't much of a business when he first gets involved. As it turns out, however, he's in the right place at the right time: By applying his unique genius, Rich basically creates the spot-trading market in crude oil.

In 1973, Rich "accidentally" bumps into his legendary Philipp Brothers boss, Ludwig "Jes" Jesselson, on the ski slopes of Switzerland. When Jesselson asks him what he's doing there, Rich replies "skiing." But in an exchange that's now part of Wall Street lore, Rich mentions his upcoming bonus and suggests that he's earned a $1 million payday. Jesselson reportedly retorted: "We've never paid a trader a million dollars and we never will."

Within 48 hours, Marc Rich & Co. was doing business out of its new offices in New York's swanky Piaget Building.

The timing couldn't have been any better. The 1973 Arab oil embargo was an oil traders dream. Rich's new company made millions. He had quite a run, too. But the fact that oil was the most precious commodity on the planet - coupled with the fact that the countries that controlled the biggest supplies were often at odds with the United States - forced Rich into a precarious high-wire act.

But he was game. Whether he was helping set up a secret oil pipeline that sent so much Iranian oil directly to Israel that the barren Jewish state actually became a net exporter of oil, or trading Iranian oil to apartheid-era South Africa for uranium, Rich wasn't afraid to mix it up with "rogue" states or to do business with dangerous operatives.

It eventually tripped him up, and Rich got caught "daisy chaining" oil for illicit profits. He had allegedly devised a complicated process through which he was able to buy domestic U.S. oil that was controlled to sell at only $6 a barrel and move it around on tankers and reclassify it to sell at the then-hefty price of $40 a barrel.

Despite the American embargo against Iran, that country would ultimately become Rich's key oil supplier for a decade and a half - and according to one source he reportedly earned billions of dollars selling oil for the Iranian ayatollahs.

Not only that, Rich was accused of tax evasion and of "trading with the enemy" by dealing extensively with the Ayatollah Khomeini's Iran during the 444-day Iranian Hostage Crisis. In 1983, Rich was indicted for the illegal oil deals and for evading more than $48 million in taxes, and he was also charged with 51 counts of tax fraud, according to a Time report.

Rather than face charges, Marc Rich fled to Zug, Switzerland, where the Swiss, Spanish and Israeli governments defended and protected him. Commodities trading had made him a powerful man with connections that reached the highest offices in many of the world's governments.

His wife Denise, heiress to the Florsheim fortune, divorced him in 1996 and collected a tidy $365 million. Denise, and it is rumored former Israeli Prime Minister Ehud Barak, lobbied then President Clinton to grant Rich a pardon. It was done on President Clinton's last day in office - an act that Time has included as one of the 10 "most notorious" presidential pardons in U.S. history.

(President Clinton also pardoned his half-brother Roger Clinton, and former business partner Susan McDougal. But it was the Rich pardon that seemed to spark the greatest ire from Republicans and Democrats alike. In fact, the uproar over the pardon was so intense that authorities launched an investigation into whether it had been "purchased" by the generous donations that Denise Rich had made to the Clintons and to the Democratic Party. It must be noted here that investigators failed to find enough evidence to indict Clinton, and the matter was dropped.)

But Rich so feared what might happen if he once again set foot on U.S. soil. So he's never returned.

The Key Takeaway From the Glencore IPO

That controversial chapter also closed the book on his tenure at Marc Rich & Co. In 1994, Rich was bought out of his interests in what would become Glencore International by its then managers for a reported $600 million. The rumor is that his partners forced him out after a $200 million loss on a bad Zinc trade.

There's little doubt that Glencore continued its secretive ways, while also maintaining the Central Intelligence Agency (CIA) and Mossad connections that Rich had always been famous for.

So, you have to ask yourself: Why would a giant secret society like Glencore, with a dark past, want to come into the light of day and relinquish the private, backroom-dealing business model that made its partners and founder fabulously wealthy?

I'll tell you why. Because the old game is over and commodities prices are about to break down - and in a big way. By utilizing its newly tapped source of capital - its own stock - the partners will eventually be able to cash out (they have a lockup provision of four years to five years). Not only that, the company will also be able to withstand the coming crash in commodity prices and then be perfectly positioned to buy at the bottom, which is what it is planning to do.

The whole Glencore story is amazing. And when you understand the game that's afoot, the story of the Glencore IPO is even more so.

As amazing as this tale is, however, I'm not touching the stock. I'm buying the timeframe the company insiders gave themselves - which is the four years it will take for commodities to fall and then to rise again.

That's when commodity prices will peak again and the partners will cash out, once again at the top. That's the prediction that the Glencore IPO is making for us: Use that insight to your own advantage.

Glencore's real IPO strategy

By Stephen Bartholomeusz

Business Spectator

17 May 2011

As the giant Glencore float enters its final days there are still those cynical about the motivation for the IPO and who see it as a mechanism for the Glencore partners and staff for cashing out at the peak of the commodity cycle. In fact the contrary is probably the case.

Apart from the fact that, as Glencore chief executive Ivan Glasenberg has pointed out, his senior executives will be locked into the group for up to five years, the changing nature of the Glencore business and its stated ambitions tends to point to a continuing bullish view of the outlook for commodities.

The suspicion in relation to Glencore's motives is understandable. When the owners of the world's largest commodities trader, a group with what is regarded as the world's best market intelligence, decide to sell it is logical to assume they are trying to cash out at the top of the market.

Glencore, however, isn't a conventional commodity trader and has certainly evolved dramatically from its trading house origins. If it were purely a commodity trader it would be predominantly a margin business and, while not indifferent to price, would still be able to collect its margin while profiting by trading in either direction against the volatility. As it says, the performance of its trading activities isn't as correlated to commodity prices as is the performance of what it calls its industrial assets.

What has changed within Glencore in recent years has been the size and contribution of those industrial assets - its interests in mines, oil wells, logistics businesses and port facilities - as the commodities boom has intensified. Last year they contributed about 55 per cent of its earnings and, given what's happened to prices and volumes for hard and soft commodities this year, the proportion will probably be higher.

Glasenberg has said Glencore wants to use the $US11 billion or so it will raise from the float to make larger acquisitions - he wants to expand the group's ownership of the commodities it trades - and has also made no secret of his desire to merge with Xstrata, in which Glencore has a 34.5 per cent stake.

That would complete the transformation of Glencore from a trader with some resource production to a mining house with some trading activities. In fact it would look very much like a BHP Billiton, which might be the point. If Glencore is bullish about commodity prices it would make compelling strategic sense to create a much bigger economic exposure to the physical commodities and to leverage the value of its trading skills by acquiring more production.

After the 2001 merger of BHP and Billiton that group created its own marketing group, with hubs in Singapore and Europe and organised along customer sector lines, to internalise the margin it was paying traders. It was able to create value from its own knowledge of what was happening on the demand side of the markets for its output as well as the supply side. Marius Kloppers was BHP Billiton's inaugural chief marketing officer.

Because there is no separate P&L for the marketing group its success can't be measured with any precision, although its executives did tell analysts during a 2007 presentation that they believed it had added value equivalent to more than 1 per cent of BHP's sales. If that still held true it would have generated value of more than $500 million last year.

Certainly it was the marketing division, having developed a far better understand of China's demand, that led the push within BHP to shift the pricing of its commodities away from annual benchmarking to market-related prices, which has delivered a bonanza to BHP and more recently, as they have belatedly joined in, Rio and Vale.

The development of internal marketing and trading businesses within the major miners would presumably have impacted the growth of Glencore's trading businesses and reduced the advantage it once had over them in the quality of its market intelligence,. This provides another reason for shifting the emphasis in its business from trading to resource ownership.

Glencore also got a wake-up call during the financial crisis about the risks of having a private entity reliant on debt to fund its trading and industrial businesses. It was forced into a sale and buy-back of its best coal asset to Xstrata in order to fund its share of Xstrata's mid-crisis equity raising.

Given the continuing fragile state of some of the distressed economies in Europe and elsewhere, and the massive public sector refinancing tasks that lie ahead even if those economies are able to continue muddling through, Glencore would also be conscious that a model without access to external capital is vulnerable and that in the current environment equity is preferable to debt.

When Glencore is listed -- its shares are expected to start trading on a conditional basis in London on Thursday, with full trading from next Tuesday -- Glasenberg will have raised a big lump ($US8 billion or $US9 billion) of equity, generated about $US2 billion of cash for his existing shareholders, and will have created both a currency for expansion and access to a more dependable source of capital.

Fear Companies Lurking in Dark Financial Shadows: Simon Johnson

By Simon Johnson

Bloomberg Opinion

16 May 2011

On the face of it, Glencore International AG doesn't look too scary. With about $80 billion in assets, the Swiss-based commodities trader is a lightweight in comparison to global megabanks like Goldman Sachs Group Inc. (GS), one of its trading rivals. Goldman has assets more than 10 times Glencore's, is more leveraged and has less capital.

So why do executives at Goldman, Citigroup and JPMorgan Chase argue that lightly regulated or unregulated companies operating "in the shadows" -- private equity firms, hedge funds and commodities traders like Glencore -- risk another financial calamity?

What Glencore's rivals are really worried about is competitive advantage. It's about to sell $11 billion in shares through an initial public offering in London and Hong Kong. That fresh capital will allow Glencore to expand at a time when its Wall Street competitors' hands are tied. Glencore doesn't face the same limits that banks do in proprietary trading, capital reserves, leverage and compensation.

This may be unfair, but it's not the right reason to subject Glencore to the same tough regulatory regime as banks, nor the right lesson to draw from our recent experiences.

The real question regulators should ask is this: How much of a risk would Glencore pose to the world's financial system? To use the terminology proposed by Mervyn King, governor of the Bank of England, is Glencore "too important to fail" -- meaning that its bankruptcy would bring down other significant parts of the financial system or real economy?

Marc Rich Connection

Glencore was founded by the secretive Marc Rich, who fled the U.S. for Switzerland in 1983 just before being indicted on tax evasion and other charges. He sold the company in a management-led buyout in 1994. President Bill Clinton pardoned Rich in 2001. Today Glencore trades and produces minerals and metals like zinc, aluminum, cobalt and coal, as well as grains, cotton and sugar. It owns refineries and drilling rigs and holds large stakes in other mining companies.

Glencore also has a large amount of capital and little leverage, judging by its shareholder equity, which is worth 25 percent of assets. Goldman claims equity worth about 14 percent of assets, counting only risk-weighted assets. But on an apples- to-apples basis (counting unweighted assets), Goldman's shareholder equity is closer to 7 percent.

Little Threat

There is little sign that a government would feel the need to save Glencore and protect its creditors if it were on the brink of collapse. A restructuring of its debts should not be disruptive to the world economy. Based on the limited information in Glencore's 2010 annual report, even its derivatives book seems unlikely to create system-wide risk.

Still, this could change quickly. Derivatives are the wild card. Glencore almost certainly will qualify for the so-called end-user exemption under the Dodd-Frank financial reform legislation, meaning that it may not have to follow new clearing and margin requirements (although these rules are still under discussion). It would be relatively easy for a firm with Glencore's balance sheet and insight into the physical side of commodity markets to ramp up its involvement in the financial side of commodities.

We do not want commodity traders like Glencore, Cargill Inc., Paris-based Louis Dreyfus & Cie., an oil major or any other nonfinancial company to be tempted to take financial risks that are big relative to the size of the system.

Even supposedly expert financial firms can destroy themselves with the mismanagement of risk -- a process made potentially even more devastating to everyone involved through derivatives.

Lehman's Lessons

Remember that Lehman Brothers Holdings Inc. (LEHMQ) was not a megabank -- its balance sheet was about one-fifth the size of Citigroup's and the largest European banks'. But Lehman's web of connections through derivative transactions turned out to pose a system-wide threat -- about which the Treasury Department and the Federal Reserve were completely unaware until the day after Lehman went bankrupt.

The end-user exemption should be interpreted narrowly and applied evenly. If Glencore or a similar company wants to engage in financial speculation or market-making, those activities should be walled off from their physical operations and legitimate hedging needs, as my MIT colleague John Parsons has been arguing.

Regulators need as much visibility as possible into derivatives transactions around the world. The major players in these markets -- including firms like Goldman -- do not want transparency, primarily because they don't want their pricing structure to be widely known.

Open Secret

It was transactions between the big Wall Street firms and largely unregulated mortgage originators that brought us the subprime crisis. The open secret of Wall Street is that the "shadows" are often made possible and profitable by the big banks. One example: structured investment vehicles, the undercapitalized, off-balance-sheet entities that large banks created in 2007 and 2008 to house subprime mortgage investments.

The Treasury Department has been pressing hard to lighten the transparency requirements on derivatives markets, including most recently with its baffling decision to exempt foreign exchange swaps from clearing requirements. The best way to deal with potential shadows is to shine a bright light on all markets. Restricting who can avail themselves of the end-user exemption is one very good way to ensure that the shadows do not get too dark and that stand-alone commodity traders do not become too important to fail.

(Simon Johnson, co-author of "13 Bankers: The Wall Street Takeover and the Next Financial Meltdown" and a professor at MIT's Sloan School of Management, is a Bloomberg News columnist. The opinions expressed are his own.)

Glencore prepares to join FTSE amid scrutiny of Namibia court battle

Government of Namibia alleges commodity trader's high prices helped plunge state oil group Namcor into financial crisis

The Guardian

19 May 2011

Glencore performs well on grey market

As Glencore prepares to join the FTSE 100 index of blue-chip businesses next week, it is also battling the government of Namibia over claims it deceived the country, and covered up secret "ambitions to control the local oil industry".

The legal case is one of many beginning to attract attention as Glencore emerges on to the public markets with its £37bn valuation - making it bigger than Tesco - after enjoying years of relative obscurity operating as a private partnership from its Swiss base.

Namibia's high court is hearing proceedings which centre on a deal the commodity trading company struck to supply the state oil group, Namcor. That agreement is being blamed by the government for helping plunge the African company into financial crisis as it was locked into paying high prices for fuel.

A Namibia cabinet briefing paper on the case, alleged: "Glencore has been negotiating with Namcor in bad faith and seems to have undisclosed ambitions to control the local oil industry in future."

Glencore has defended the contract, saying the government knew prices would be likely to rise yet it failed to put in place procedures to deal with the increases.

The report is understood to have been sent to President Hifikepunye Pohamba's office and forms part of the documents filed in a high court application where Glencore opposed the government's decision to suspend its Namcor contract. That suspension was subsequently overturned by the courts as it had ignored the parties' constitutional right to fair procedure. The Namibia government has appealed.

The legal case follows a 2009 PricewaterhouseCoopers audit of Namcor, which observed that dealing with Glencore "forces Namcor to continue to purchase from its current suppliers even though other suppliers may potentially offer lower prices".

Both Glencore and the Ministry for Mines and Energy declined to comment.

The listing prospectus does reveal a Belgian criminal investigation in which Glencore's Dutch-based grain trading operation, a former employee and one current employee have all been charged with bribing European officials, but the company does not detail any further legal battles as it believes it has "meritorious" defences and that any rulings will not adversely affect its finances.

The document states: "Certain legal actions, other claims and unresolved disputes are pending against Glencore. Whilst Glencore cannot predict the results of any litigation, it believes it has meritorious defences against those actions or claims. Glencore believes the likelihood of any liability arising from these claims to be remote and the liability, if any, resulting from any litigation will not have a material adverse effect on its consolidated income, financial position or cash flows".

However, among piles of mundane commercial disagreements filed in the US, court documents detail how one Jeremiah Hunley is suing Glencore and other defendants for $100m, while asking for punitive damages of 10% of the defendants' net worth.

That case follows an accident when the plaintiff lost both of his "arms below the elbow" and suffered "severe injuries to his abdominal and internal organs". Glencore has filed a "motion to dismiss" saying that Hunley is seeking "to impose liability upon Glencore, derivatively, based solely upon the alleged torts of its alleged subsidiaries".

The wide collection of cases continues the company's controversial legal tradition.

Glencore was among dozens of companies accused of paying kickbacks to Iraq in 2005 by a commission that investigated the UN's Oil for Food programme. A preliminary judicial investigation found "a lack of culpable information". Meanwhile, in 2009, Glencore agreed to pay a cash settlement to Aluminium Bahrain to resolve a dispute over "controversial payments associated with a Glencore agent".

More recently, in Australia, lawyers have found plenty of work at Glencore's 71%-owned subsidiary Minara Resources - where Glencore's chief executive, Ivan Glasenberg, its former chairman, Willy Strothotte, and trader, Marc Ocskay, all sit on the board. Peter Coates, just installed as a new independent director of Glencore, was the Australian-listed company's chairman until last month.

Minara has just settled a long-running case with the Wutha Native Title Claimant Group, which alleged breaches of an agreement dating back to 1996 which was supposed to compel the company to employ certain numbers of the Wutha community in return for mining nickel on land which the plaintiffs claim. Last August, Wutha lodged a A$62m claim which Minara argued was "unfounded, grossly inflated and without merit" while promising to continue to "vigorously defend the proceedings". The company, which said the deal had been cancelled because of "non-performance", has just settled the claim out of court.

Elsewhere, Century Aluminum, which is 44% owned by Glencore, is being pursued in a string of cases by a combination of environmental agencies, local residents and other companies. In a US stock exchange filing last week, Century admitted: "At this time, it is not practicable to predict the ultimate outcome of these actions or to estimate a range of possible damage awards" but states that the actions will not materially affect its finances.

Glencore declined to comment on all legal cases.

Glencore 'is in dark ages' compared with rivals, says NGO boss

Glencore contests claims that it fails to measure up to other major mining firms on corporate responsibility, climate policy and CO2 emissions

The Guardian

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Extracting minerals, coal and oil from the earth is never a clean business, but Glencore's vast mining operations have left the company open to mounting criticism as it swaps its private Swiss partnership structure for public company status.

From Bolivia, where Glencore is accused of allowing harmful waste into local water supply, to Zambia, where Glencore is alleged to have inflated its operating costs to reduce its tax bill, Glencore's interests in some of the world's most remote regions and in countries where democratic institutions are feeble have raised questions over the company's ethical and environmental performance.

Andreas Missbach, managing director of Berne Declaration, an NGO in Switzerland where the commodities giant is based, said Glencore stood out against others in the sector. "In terms of corporate responsibility, climate policy, CO2 emissions, Glencore is still in the dark ages compared to other major mining firms."

Glencore has strongly contested these claims and is producing an annual sustainability report in an attempt to silence its critics. Although a spokesman said the company was legally limited in what it could say publicly because of the flotation, it has previously answered many of the claims against it. In the case of the Bolivian river pollution, the company has said it was an accidental pipe rupture that it immediately repaired. In Zambia, the company said when the complaint surfaced, it paid the correct amount of tax. It said claims it had not done so were based on "flawed analysis", carried out without visiting the mine.

The company has been accused of a string of failures, including taking advantage of the lack of governance in Democratic Republic of the Congo to exploit mining concessions, and failing to adhere to safety standards in mines there. Two years ago the commodities trader paid a cash settlement to Aluminium Bahrain to resolve what it called a "controversy" over allegations of improper payments, although Glencore denies it ever paid bribes.

A report last month based on publicly available negative news stories from sources including NGO websites and blogs listed more than 20 accusations against the company.

There are questions over whether Glencore benefits people in the countries where it operates. "Take Zambia," said Missbach. "Glencore has a 73% stake in the Mopani copper mine there, yet they pay royalties to Zambia of just 0.6%. Meanwhile, Zambia is number 150 out of 169 on the UN's Human Development Index. The scandal is that this is not a scandal."

Roger Moody, director of consultancy Nostromo Research, added the Mopani mine "raises serious questions in regards to its land use, safety record, and air and water pollution".

Glencore has admitted the mine had a poor environmental record when it was acquired, but is taking steps to clean up. It rejects claims by two Swiss NGOs questioning safety at its Congolese mines, saying the problems were with artisanal miners with whom it has no relationship.

The commodities giant is sensitive over charges of social and environmental failings. Oliver Classen, of Berne Declaration, recalls an unexpected phone call in 2008 from the famously low-profile chief executive, Ivan

Glasenberg, after the award of a satirical prize to the company for poor environmental and social responsibility. "I initially didn't believe it was him - he was the most invisible business figure in Switzerland, if not the world. He was thoroughly irritated by the award. He insisted Glencore behaved impeccably."

"There's a lot we don't know, and a great deal we ought to know that has not been revealed," said Moody. But he doubts whether being a public company will result in Glencore being more public about its operations.