

CFTC Letter No. 01-41

April 23, 2001

No-Action

Division of Trading and Markets

Re: Section 4m(1); "A"; Request for CPO Registration No-Action Position to Permit Registered IB to Operate or Affiliate with a Marketing Club Established to Assist Local Farmers in Learning How to Hedge Crop Price Risks

Dear:

This is in response to your electronic mail message dated August 4, 2000 to the Commodity Futures Trading Commission ("Commission"), as supplemented by electronic mail messages dated August 18, 2000, August 29, 2000, August 31, 2000, September 18, 2000, September 19, 2000, September 21, 2000 and October 23, 2000; facsimile transmissions dated September 20, 2000 and September 28, 2000; and telephone conversations with staff of the Division of Trading and Markets ("Division"). By your correspondence, you request, on behalf of "A", a registered introducing broker ("IB") and commodity trading advisor ("CTA"), that the Division not recommend that the Commission commence any enforcement action against "A" for failure to register as a commodity pool operator ("CPO") under Section 4m(1) of the Commodity Exchange Act ("Act"),^[1] if "A" operates a marketing club in North Dakota ("Z", or the "Club") that trades commodity interests.^[2] You are the compliance manager for "Y", the futures commission merchant that will be carrying the commodity interest trading account of the Club.

The Formation of the Club

Based upon your and "A's" representations, we understand the facts to be as follows. "A" is a farmer who resides in North Dakota. In or about February, 1999, "A" sponsored a meeting for local farmers and agricultural-related businesses to determine if there was any interest in forming a marketing club that would provide club members with the opportunity to learn about the different tools available to them for managing the risks associated with marketing their grain. "A" and 27 other local farmers who expressed an interest in participating in such a club thereafter formed the Club. It is a general partnership in which each farmer shares equal responsibility for operating the Club. There are currently 28 partners, and the Club will have no more than 30 partners. An agricultural extension agent helps with education and discusses management questions related to agricultural production.

North Dakota State University Cooperative Extension Service Grant Program

In June of 2000, the Club received a grant from the state of North Dakota under a grant program administered by the North Dakota State University Cooperative Extension Service (“NDCES”). NDCES grants provide recipients with a yearly payment in the amount of \$750. Because they are specifically intended to encourage the creation of marketing clubs. Grants are provided to marketing clubs for the first two years.^[3] While grant monies may be used to pay the operational costs of a marketing club, they may not be used for trading commodity interests or to pay commissions. As a condition for receiving a grant, a marketing club must have a facilitator, *e.g.*, an extension agent who attends meetings, assists with education and discusses management questions related to agricultural production.

The Club would like to trade commodity interest as one tool to assist club members in learning how to manage their marketing risks. The Club’s current facilitator, an NDCES agricultural extension agent, will continue to serve as the Club’s facilitator even after the Club becomes ineligible for grants from the NDCES.

The Operation of the Club

Each growing season, each Club member will contribute 1000 bushels of hard red spring wheat and 500 bushels of soybeans to the Club. These amounts of wheat and soybeans constitute less than 10% of the total wheat and soybeans, respectively, that are anticipated to be harvested on a yearly basis by the Club member. Club members will discuss and implement tools for managing the risks associated with marketing this grain. Accordingly, the Club may engage in short sales of hard red spring wheat or soybean futures contracts on the Minneapolis Grain Exchange and the Chicago Board of Trade, respectively. The Club may purchase commodity put options, or it may sell grain contracts on a deferred delivery basis. Generally speaking, the Club will trade commodity interests for the purposes of hedging against the risks of price fluctuations in the cash price of the grain.

Each member of the Club will be assessed a one-time initiation fee of \$100. Thereafter, each member will pay annual dues in the amount of \$100. Approximately one-half of the fees and annual dues collected will be used to pay the expenses for operating the Club. The remaining one-half of the fees and dues will be used to fund the Club’s commodity interest trading activities. If additional funds are needed to meet margin requirements, the members will be required to contribute such additional funds.

The Club will hold meetings on a biweekly basis. During these meetings, the members will discuss and vote upon strategies for managing the risks associated with marketing the grain. Pursuant to the partnership agreement among Club members, decisions require a majority vote of the members present at a meeting, provided a quorum exists.^[4] The Club also may invite guest speakers, such as an NDCES extension agent, who can provide advice relative to production or marketing issues. No partner of the Club will receive a salary.

The Club has elected a president, secretary and treasurer from among the participants in the Club. The president presides over the meetings of the Club. The president also is responsible for placing any

futures or option orders that the members agree to place.

The president of the Club is "A". "A", however, does not receive any compensation for operating the Club. Nor will he receive compensation for introducing the Club's trading account to "Y".

If any individual Club member expresses an interest in opening a commodity interest trading account, however, "A" may introduce that account to "Y", serve as a CTA for such individual account, and receive compensation for advising and introducing that account to "Y". Nevertheless, you represent that if any such individual account is opened, all commodity interest trading will be conducted strictly for hedging purposes.

Until the grain contributed by Club members is actually sold, the Club will hold an equitable interest in that grain. Club members who contributed the grain will retain legal title and will pay applicable carrying costs, if any, until the grain is sold. Once the grain is sold, all monies associated with the sale and the use of any marketing tool or technique, such as a short sale of a futures contract, will become the property of the Club and will be shared equally among the members of the Club.

Relief Requested

Most of the farmers with whom "A" is familiar market their grain soon after it is harvested. Very few of these farmers are aware of the tools available to them for managing the risks associated with marketing their cash commodities, and they do not use the futures markets to hedge against adverse cash price movements. You state that the Club, which is to be created under the auspices of the NDCES, will serve an important educational function in that it will provide the local agricultural producers with the opportunity to learn techniques for managing the risks and maximizing the revenue stream associated with marketing their grain. You further state that Club members will learn more from actually trading than they would if they simply discussed such marketing techniques with other Club members.

You are seeking a no-action position that would allow "A", as the president of the Club, to operate the Club without having to register with the Commission as a CPO.

Disposition

Rule 4.13(a) provides an exemption from registration as a CPO for certain persons operating commodity pools. Rule 4.13(a)(1) exempts the operator of a commodity pool where, among other things, the operator is not otherwise required to register with the Commission. "A's" registration as an IB and CTA precludes the availability of this exemption.

Rule 4.13(a)(2) exempts from registration as a CPO the operator of one or more pools where, among other things, none of the pools have more than 15 participants. This exemption also is unavailable to "A", inasmuch as the Club currently has 28 members.

Although the Division previously has issued CPO registration no-action positions in connection with the operation of marketing clubs that sought to trade commodity interests, these positions were issued in the context of universities that were offering students and producers the opportunity to learn about commodity interest trading through participation in university-sponsored trading clubs.^[5] In issuing these no-action positions, the Division emphasized the educational purpose of the trading clubs.

Given the representations that the Club operates under the auspices of the NDCES, Club members will share equal responsibility for operating the Club, and trading will correlate to the amount of grain contributed by members, it appears that granting your request would not be contrary to the public interest or the purposes of Section 4m(1) of the Act. In this regard, we note the educational purpose of the Club and your representations that: (1) "A" is registered as both an IB and a CTA; (2) the Club will have no more than 30 members; (3) the members of the Club will be local farmers who will contribute 1000 bushels of hard red spring wheat and 500 bushels of soybeans to the Club, which amounts are expected to be less than 10% of the total yearly anticipated harvest in each crop; (4) the trading of futures and options by the Club will be conducted principally for hedging purposes; and (5) no partner or other person, including "A", will receive compensation for operating the Club.

Accordingly, the Division will not recommend that the Commission commence any enforcement action against "A" for failure to register as a CPO under Section 4m(1) of the Act. This position, however, is subject to the following conditions: (1) a written copy of the statement prescribed by Rule 4.13(b) to the effect that the operator of the Club is not registered as a CPO, and, therefore, is not subject to disclosure document, periodic account statement and annual report requirements, must be distributed to each Club member; (2) "Y" will distribute to each Club member the risk disclosure statement required under Rule 1.55 and obtain the written acknowledgement required under paragraph (a)(1)(ii) of that Rule; (3) all material information concerning the Club will be disclosed to Club members; (4) the Club will have no more than 30 participants at any one time; (5) the Club will cease trading related to the current harvest within 12 months following the month in which that grain is harvested; (6) the commodity interest trading account for the Club will be opened and traded in the name of the Club; (7) any withdrawals from the commodity interest trading account of the Club must be requested in writing and signed by two members of the Club; (8) the FCM that carries the account of the Club must be informed in writing of the foregoing restriction regarding withdrawals; and (9) a cooperative extension agent will serve as a facilitator to the Club for so long as the Club is in operation.

This letter does not excuse "A" from compliance with any otherwise applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, he remains subject to all applicable antifraud provisions of the Act and the Commission's regulations and the reporting requirements for traders set forth in Parts 15, 18, and 19 of the regulations. Moreover, this letter is applicable to "A" solely in connection with his operation of the Club. It is not applicable to any of "A's" current IB and CTA activities, nor is it applicable to any individual commodity interest account of a Club member for which "A" may serve as an IB or a CTA.

This letter, and the no-action position provided herein, is based upon the representations you and "A"

have made to us and are subject to compliance with the conditions set forth above. Any different, changed or omitted material facts or circumstances might render this letter void. “A” must notify us immediately in the event that his activities or the activities of the Club change in any material way from those as represented to us. Further, this letter represents the position of the Division only. It does not necessarily reflect the views of the Commission or any other division or office of the Commission.

If you have any questions concerning this correspondence, please contact Helene D. Schroeder, an attorney on my staff, at (202) 418-5450.

Very truly yours,

John C. Lawton
Acting Director

^[1] 7 U.S.C. § 6m(1) (1994).

^[2] “A” authorized you to submit this request on his behalf. Further, he has knowledge of the representations made in support of this request and has certified, in accordance with Rule 140.99(c)(3), that the underlying facts set forth in this letter are true and complete to the best of his knowledge.

^[3] Grant recipients must comply with detailed criteria established by the NDCES. The criteria is set forth in a document entitled “Ag Marketing Club Project” (“Criteria”) and includes the following requirements, among others: (1) Clubs must meet a minimum of twelve times per year; (2) 24 hours per year must be used for presentation of approved curriculum; (3) Clubs must conduct post-testing of members upon completion of the instructional phase; and (4) a record of the post-test scores of members must be sent to the NDCES.

^[4] The partnership agreement provides that a quorum is defined as fifty percent of the paid membership of the partnership, and that a member must attend two-thirds of Club meetings or else his membership will be forfeited.

^[5] See, e.g., CFTC Staff Letter No. 00-10 [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,009 (Jan. 6, 2000); CFTC Staff Letter No. 87-5 [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23, 916 (Sept. 29, 1987).