

CFTC Letter No. 00-57**February 29, 2000****Interpretation****Division of Trading & Markets**

Re: Rule 4.13(a)(1) - Request for confirmation of availability of CPO registration exemption for managing members of an LLC formed as an investment vehicle for partners and key employees of a law firm

Rule 4.13(b)(2)(i)(A) and (B) - Request for exemption to permit substitute compliance with periodic reporting requirements where a pool does not directly trade commodity interests and investee vehicles do not timely provide the pool's CPO with information necessary to permit compliance with the reporting requirements applicable to CPOs claiming registration exemption under Rule 4.13(a)(1)

Rule 4.7(a)(1)(ii)(B)(2)(xi) - Request for exemption from the ten percent restriction on assets committed to commodity interest trading applicable to a pool in which not all participants are QEPs.

Dear :

This is in response to your letter dated December 11, 1998, to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by your letter dated February 9, 1999 and by telephone conversations with Division staff. By your correspondence, you request on behalf of your clients "X" a Delaware limited liability company (the "Fund") and "Y", a law firm organized as a Massachusetts general partnership (the "Partnership"), the following: (1) confirmation that the Managing Members of the Fund may claim exemption from registration as commodity pool operators ("CPOs") under Commission Rule 4.13(a)(1); ¹ (2) exemptive relief from the requirements of Rules 4.13(b)(2)(i)(A) and 4.13(b)(2)(i)(B) permitting substitute compliance with those provisions by the Managing Members; and (3) exemptive relief permitting the CPOs of Rule 4.7(a) exempt pools to treat the Fund as a qualified eligible participant ("QEP") as defined in Rule 4.7(a), notwithstanding that not all of the Fund's participants will themselves be QEPs, such that more than ten percent of the Fund's assets may be invested in entities that trade commodity interests.

Based upon the representations made in your correspondence, we understand the facts to be as follows. The Fund was begun July 29, 1996 as an investment vehicle for partners and certain key employees of the Partnership (and for the Partnership itself). The Fund is managed by the Managing Members, who are four of the Partnership's partners.² The assets of the Fund currently are invested in: (1) hedge funds, one of which may from time to time trade commodity interests; (2) leveraged buy-out funds; and (3) venture capital funds. The Fund may also invest in companies that are partially owned or controlled by leveraged buy-out, hedge or other funds. The Fund was not formed for the specific purpose of participating in Rule 4.7(a) exempt pools.

The Fund was established in connection with the adoption by the Partnership of a policy regarding investing with or in Partnership clients to promote compensation-related objectives. Pursuant to the policy, investment opportunities arising from relationships with Partnership clients are deemed to be (and are treated as) Partnership assets. Investment in the Fund, then, is a voluntary "fringe benefit" afforded to partners of the Partnership and certain key-employee non-partners.

Request for Confirmation of the Availability of Rule 4.13(a)(1).

None of the Managing Members is registered with the Commission in any capacity or affiliated with anyone who is required to register. Nor does any Managing Member engage in any activity (aside from managing the Fund) that would subject him to the requirement to register with the Commission. The Fund is the only commodity pool that any of the Managing Members is engaged in operating. Neither the Managing Members, the Fund nor the Partnership receives any compensation or other payment, directly or indirectly, for operating the Fund, except that the Managing Members receive profit allocations proportionate to their respective investments in the Fund. To date, no administrative expenses have been incurred. No advertising or solicitation is conducted in connection with the Fund. Information and documentation concerning the Fund are delivered to participants via interoffice mail at the Partnership in envelopes marked "Confidential."

Based upon representations in your correspondence, it appears that the Managing Members may claim exemption from the requirement to register as CPOs under Rule 4.13(a)(1) with respect to the operation of the Fund. The Fund is the only pool they operate, they do not receive compensation for operating it, they are not (nor are they otherwise required to be) Commission registrants or affiliated with persons required to register with the Commission, and interests in the Fund are not advertised. We remind you that, to claim this exemption, the Managing Members must deliver to participants and file with the National Futures Association and the Commission the written statement required by Rule 4.13(b).

Request for Exemption To Permit Substitute Compliance with Rule 4.13(b)(2)(i)(A) and (B).

The Fund does not trade commodity interests directly. On the contrary, its assets are invested in other funds (the "Investee Funds"). Thus, the Fund will not receive monthly account statements from any futures commission merchant ("FCM"). Moreover, most of the Investee Funds do not provide reports to participants on a monthly basis. Accordingly, you state that it will be impossible for the Managing

Members to comply strictly with the requirements of Rules 4.13(b)(2)(i)(A) and (B) to provide participants with copies of the monthly statements received from FCMs and to show clearly the net profit or loss on all commodity interests closed since the date of the previous monthly statement. You request exemption to permit the Managing Members to satisfy Rules 4.13(b)(2)(i)(A) and (B) by circulating regularly to participants any communications from the Investee Funds and by sending statements of the net profit or loss of the Fund to participants on an annual basis (collectively, the "Financial Information").

Based upon the representations in your correspondence, we do not believe that granting your request would be contrary to the public interest and the purposes of Rule 4.13(b)(2), because the Financial Information will apprise participants of the status of investments in the Investee Funds by containing whatever information the Managing Members receive from the Fund's direct investments. Accordingly, under the authority delegated to the Division by Rule 140.93(a)(1), we hereby exempt the Managing Members from the requirements of Rules 4.13(b)(2)(i)(A) and (B) with respect to the operation of the Fund. This exemption is subject to the following conditions: (1) that the Managing Members promptly provide the Financial Information to Fund participants; and (2) if at any time the Fund trades commodity interests directly, the Managing Members must comply with Rules 4.13(b)(2)(i)(A) and (B) with respect to such direct trading.

Request for Exemption To Permit the CPOs of Rule 4.7 Exempt Pools To Treat the Fund as a QEP.

As is stated above, not all of the participants in the Fund are QEPs. Rule 4.7(a)(1)(ii)(B)(2)(xi) provides that a pool in which not all of the participants are QEPs may itself be treated as a QEP if its total assets exceed \$5 million, it was not formed for the specific purpose of participating in Rule 4.7(a) exempt pools, its participation in Rule 4.7(a) exempt pools is directed by a QEP, and no more than ten percent of the fair market value of the pool's assets are used to purchase units in Rule 4.7(a) exempt pools. The Fund meets the total assets criterion, and each of the Managing Members is a QEP. It was not formed for the specific purpose of investment in Rule 4.7(a) exempt pools. However, you concede that the Fund does not meet the ten percent restriction on the amount of its assets that can be used to purchase units in Rule 4.7(a) exempt pools.³

In support of your request for QEP treatment of the Fund, you point to the sophistication of the non-QEP participants in the Fund as experienced attorneys (or allied professionals) in a nationally respected corporate law firm, and to the fact that they have all been well known to the Managing Members for a substantial period of time and are willing to consent to being treated as QEPs. In addition, you state that the Fund will invest on an indirect basis, and in accordance with CFTC Staff Letter No. 91-6, no more than ten percent of its committed capital to commodity interest trading.⁴

Based upon the representations made in your correspondence, we do not believe that granting your request would be contrary to the public interest or the purposes of Rule 4.7 in light of the nature of the participants in the Fund and the restrictions on the amount of the Fund's committed capital that

(indirectly) may be used to establish commodity interest trading positions. Accordingly, under the authority delegated by Rule 140.93(a)(1), we hereby grant to the registered CPOs of such Rule 4.7 exempt pools as may accept funds or property from the Fund exemption from the specific requirements of Rule 4.7(a) to the extent that such CPOs may treat the Fund as a QEP for purposes of Rule 4.7(a).

This letter, and the interpretation and exemption provided herein, do not excuse the Managing Members from compliance with any other applicable requirements contained in the Commodity Exchange Act (the "Act"),⁵ or in the Commission's regulations issued thereunder. For example, each remains subject to all antifraud provisions of the Act, to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's rules and to all otherwise applicable provisions of Part 4.

This letter is based upon the representations made to us. Any different, changed or omitted material facts or circumstances might render the interpretation and exemption provided herein void. In this connection, we request that you notify us immediately in the event that the operations or activities of the Fund or the Managing Members change in any material way from those represented to us. Further, the interpretation provided herein represents the position of the Division only. It does not necessarily reflect the views of the Commission or any office or other division of the Commission.

If you have any questions concerning this correspondence, please contact Chris Cummings, an attorney on my staff, at (202) 418-5445.

Very truly yours

John C. Lawton
Acting Director

1 Commission rules referred to herein are found at 17 C.F.R. Ch. I (1998).

2 The current Managing Members are "A", "B" and "C".

3 You state that as of December 31, 1998, 40% of the Fund's assets were committed to a hedge fund that may trade commodity interests. That hedge fund had less than one percent of its assets "invested in commodities."

4 [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,069 (June 13, 1991). In that letter, the Division permitted the CPO of a Rule 4.12(b) exempt pool to multiply the percentage of its assets invested in another Rule 4.12(b) exempt pool by the ten percent limitation on the amount of assets that the second pool was permitted to commit to establish commodity interest trading positions, for purposes of determining whether the first pool was in compliance with Rule 4.12(b). Thus, if the first pool had invested 25 percent of its assets in the second pool, under Letter 91-6 the first pool would treat that investment as though 2.5 percent of its assets were actually committed to establish commodity interest trading positions.

5 7 U.S.C. § 1 et seq. (1994)