

CFTC Letter No. 01-21

March 23, 2001

No-Action

Division of Trading and Markets

Re: Rule 4.13(a)(1): -- Request for Continuation of Availability of CPO Registration Exemption

Dear :

This is in response to your letter dated December 13, 2000, to the Division of Trading and Markets (“Division”) of the Commodity Futures Trading Commission (“Commission”), as supplemented by e-mail dated January 9, 2001, February 2, 2001, and February 22, 2001, and telephone conversations with Division staff. By your correspondence you request that the Division confirm that it will not recommend that the Commission commence any enforcement action against “A”, based solely upon “A’s” continued reliance upon exemption from registration as a commodity pool operator (“CPO”) pursuant to Rule 4.13(a)(1),¹ notwithstanding “A’s” serving as the general partner of a second commodity pool. For the reasons set forth below, you believe that the two pools should be treated as a single pool for purposes of Rule 4.13(a)(1).²

Facts

Based upon your representations, we understand the facts to be as follows. “X”, an Illinois general partnership, together with its associated partnership, “Y”, a law firm organized under the laws of the United Kingdom (“U.K.”) (collectively, the “Firm”), is an international full-service business law firm with approximately ___ lawyers. The Firm is seeking to offer certain partners, key employees, and related entities and persons (collectively “Eligible Investors,” as further defined below) the opportunity to participate in collective investment vehicles in which they might not otherwise be able to invest individually. Among other things, through this participation, Eligible Investors will be able to diversify their investments by overcoming high minimum investment requirements.

To accomplish this, the Firm has formed the “Feeder Fund”, a Delaware limited liability company, and the “Investment Fund”, an Illinois general partnership. The Feeder Fund invests substantially all of its assets in the Investment Fund, and the Investment Fund’s only purpose is to act as an investment vehicle for the Feeder Fund. The Investment Fund will invest in primarily private equity, venture capital, and buy-out funds, but may invest up to 20% of its assets in hedge funds that primarily trade securities and also, to a lesser degree, trade commodity interests. While the Investment Fund may directly trade securities, it will not directly trade commodity interests. “A”, a partner in the Firm, is the manager of the Feeder Fund. Currently, the Feeder Fund and five other partners of the Firm are the general partners of

the Investment Fund.³ Three of these partners form the Investment Committee of the Investment Fund, which will make the day-to-day investment decisions for the Investment Fund.⁴ The dual structure of a Feeder Fund and an Investment Fund was established to minimize adverse treatment of investments in the Feeder Fund under the Illinois Income Tax Act.⁵

Similarly, in order to minimize adverse tax treatment of investments by Eligible Investors subject to U. K. tax, the “Proposed Fund”, a Delaware limited partnership, was established. Upon operation, the Proposed Fund will “function exactly as the Feeder Fund, only through a limited partnership structure,” and is being formed solely to allow Eligible Investors subject to U.K. tax to participate in the same investments as the Feeder Fund without adverse tax consequence.⁶ “A” will serve as the general partner of the Proposed Fund. The Proposed Fund will invest substantially all its assets in the Investment Fund, and will be admitted as a general partner of the Investment Fund.⁷ The assets of both the Feeder Fund and the Proposed Fund will be used to purchase general partnership interests in, and thereby make the same investments through, the Investment Fund.⁸

Persons eligible to invest in the Feeder Fund and the Proposed Fund are: (a) Eligible Employees; (b) a trust whose trustees, grantors, and/or beneficiaries are Eligible Employees or their immediate family members;⁹ (c) partnerships, corporations, limited liability companies, or other entities, the voting power of which is controlled by Eligible Employees; (d) spouses of Eligible Employees; and (e) the Firm. In order to be an Eligible Employee, an employee must be an “accredited investor” meeting the income requirements under Rule 501(a)(6) of Regulation D¹⁰ under the Securities Act of 1933,¹¹ or, if not an accredited investor, be employed as an attorney or key administrative employee, meet the sophistication requirements as set forth in Rule 506(b)(2)(ii) of Regulation D, have a minimum of five years professional legal experience (or managerial experience, in the case of key administrative employees), and have had compensation of at least \$150,000 in the prior year and a reasonable expectation of compensation of at least \$150,000 in each of the two immediately succeeding years. Participation in the Feeder Fund or the Proposed Fund is voluntary.

Analysis

Commission Rule 4.13(a)(1) provides that a person is exempt from registration as a CPO if:

- (1)(i) It does not receive any compensation or other payment, directly or indirectly, for operating the pool, except reimbursement for the ordinary administrative expenses of operating the pool;
- (ii) It operates only one commodity pool at any time;
- (iii) It is not otherwise required to register with the Commission and is not a business affiliate of any person required to register with the Commission; and

(iv) Neither the person nor any other person involved with the pool does any advertising in connection with the pool.

“A”, as the manager of the Feeder Fund, filed a Statement of Exemption from Registration pursuant to Rule 4.13 with respect to the Feeder Fund, effective _____. However, and as you have acknowledged, once the Proposed Fund accepts investors, “A”, as the general partner of the Proposed Fund, would be operating two commodity pools. In such case, absent relief, the exemption he previously claimed from CPO registration in connection with his operation of the Feeder Fund would cease to be available.

In support of your request you note that “A” meets the criteria of Rule 4.13(a)(1)(i), (iii), and (iv). With respect to the remaining criteria under Rule 4.13(a)(1)(ii), the Division additionally notes your representations that the Proposed Fund was created solely to permit Eligible Investors subject to U.K. tax to participate in the same investments as the Feeder Fund without adverse tax consequences and that the Proposed Fund essentially will function exactly the same as the Feeder Fund, only in a limited partnership structure.

Based upon the representations you have made, the Division believes that “A”, and, as you have requested, any successor Firm partner or key administrative employee who operates both the Feeder Fund and the Proposed Fund (a “Successor”),¹² should be permitted to rely upon the exemption provided for under Rule 4.13(a)(1). Accordingly, the Division will not recommend that the Commission commence any enforcement action under Section 4m(1) of the Commodity Exchange Act (the “Act”)¹³ against “A” or a Successor, for failing to register as a CPO upon reliance of the exemption from registration in Rule 4.13(a)(1).

This letter does not excuse “A” or any Successor from compliance with any other applicable requirements contained in the Act¹⁴ or in the Commission’s regulations issued thereunder. For example, each remains subject to all antifraud provisions of the Act and to Rules 4.20 and 4.41, which apply to each person who comes within the CPO definition, regardless of registration status. Moreover, the position taken in this letter is applicable to “A”, and each Successor, solely in connection with his serving as the CPO of the Feeder Fund and the Proposed Fund.

The position taken herein is based upon the representations that have been made to us. Any different, changed, or omitted facts or conditions might render this position void. You must notify us immediately in the event the operations or activities of the Feeder Fund or the Proposed Fund change in any material way from those represented to us. Further, this letter represents the position of this Division only and does not necessarily represent the views of the Commission or any other division or office of the Commission.

If you have any questions concerning this correspondence, please contact Michael A. Piracci, an attorney on my staff, at (202) 418-5430.

Very truly yours,

John C. Lawton
Acting Director

¹ 17 C.F.R. § 4.13(a)(1). Commission rules referred to herein are found at 17 C.F.R. Ch. 1 (2000).

² You also request registration no-action positions for the two pools. It is not necessary for the Division to address this matter because CPOs, and not commodity pools, are required to register with the Commission.

³ These partners are: “B”, “C”, “D”, “E”, and “F”.

⁴ These general partners are “D”, “E”, and “F”. The Investment Committee intends to file a Statement of Exemption from Registration as a CPO pursuant to Rule 4.13 with respect to the Investment Fund.

⁵ For the purposes of this letter, the Division is accepting as correct, and is not making any independent finding as to, your assessment of the Illinois Income Tax Act.

⁶ For the purposes of this letter, the Division also is accepting as correct, and is not making any independent finding as to, your assessment of the tax consequences for Eligible Investors subject to U.K. tax.

⁷ However, the Proposed Fund will not be admitted as a general partner of the Investment Fund unless you receive the relief requested herein.

⁸ While the Proposed Fund will have as its limited partners U.K. investors, on rare occasion the Investment Fund may invest in trading vehicles that do not permit participation by non-United States investors. In response to staff inquiries you explained that:

The UK Proposed Fund's assets will not be used to satisfy the liabilities that may result from investments by the Investment Fund in which non-United States investors are not allowed to participate. First, all Investment Fund investments will be in funds that are limited liability vehicles, so the investors' total potential loss will be limited to the amount of their investment, and, therefore, there will be no need to look to the assets of any investor to satisfy the liabilities of any other investor. Second, at the Investment Fund level, all General Partners, including the Investment Fund, will receive their pro rata share

of profits and losses. Then, if there are profits or losses in which the UK investors cannot participate, those profits or losses will be debited/credited to those partners at the UK Proposed Fund level (and those UK investors will be paid interest on the capital that was invested in those investments in which they were not allowed to participate).

You also represented that the foregoing explanation of trading restrictions and their consequences will be provided to each prospective participant in the Proposed Fund.

⁹ Immediate family members of an Eligible Employee include spouses, parents, children, spouses of children, siblings, and grandchildren.

¹⁰ 17 C.F.R. §§ 230.501-230.508 (2000).

¹¹ 15 U.S.C. § 77a *et seq.*

¹² Of course, like “A”, any Successor must meet the criteria of Rule 4.13(a)(1)(i), (iii), and (iv) and may not serve as the CPO of any pool other than the Funds.

¹³ 7 U.S.C. § 6m(1).

¹⁴ 7 U.S.C. § 1 *et seq.* (1994), *as amended by* Pub. L. No. 106-554, 114 Stat. 2763.