



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and  
Intermediary Oversight

James L. Carley  
Director

CFTC letter No. 05-11  
June 28, 2005  
No-Action  
Division of Clearing and Intermediary Oversight

Re: Section 4m(1); "X" – Request for CPO  
Registration Relief for Co-Manager of a Commodity Pool

Dear:

This is in response to your letter dated May 17, 2005 to the Division of Clearing and Intermediary Oversight (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by your e-mail messages dated May 20, 2005, June 8, 2005 and June 9, 2005, and by telephone conversations with Division staff (collectively, the "correspondence"). By your correspondence, you seek relief on behalf of "X" from the requirement to register with the Commission as a commodity pool operator ("CPO") under Section 4m(1) of the Commodity Exchange Act (the "Act")<sup>1</sup> in connection with acting as co-manager of the "Pool".<sup>2</sup>

Based upon the representations set forth in your correspondence, we understand the facts to be as follows: The Pool is a manager-managed limited liability company operated by your client "A", a registered CPO and floor broker, who is currently the Pool's sole manager. The Pool's private placement memorandum provides that "A" is to receive a management fee and an incentive allocation of profits from the Pool in return for his services. He may also receive a portion of the brokerage commissions generated by the Pool's trading account.<sup>3</sup> The management fee, incentive allocation and any brokerage commissions are collectively referred to herein as "Fees."

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<sup>1</sup> 7 U.S.C. §6m(1) (2000).

<sup>2</sup> You also request relief from the requirement to register as an introducing broker ("IB") under Section 4d of the Act (7 U.S.C. §6d) but under the facts you present, we do not believe that it is necessary to address the question of IB registration.

<sup>3</sup> You represent, however, that the private placement memorandum provides that "A" will not act as a floor broker with respect to the orders placed for the Pool's account.

“A” is the sole shareholder, director and officer of “X”. “X” initially was formed, in part for the purpose of receiving floor brokerage commissions resulting from customer orders executed by “A” on the floor of the Chicago Mercantile Exchange (“CME”).<sup>4</sup> “X” also may be used as a vehicle for “A’s” proprietary trading.

“A” now proposes to have the Pool’s Articles of Organization amended to designate “X” as a co-manager of the Pool, and to have the Fees to which “A” is entitled in connection with operating the Pool be paid to “X”, rather than directly to “A”. You represent that the purpose of this structure is to obtain favorable tax treatment of the Fees for “A”.<sup>5</sup>

“X” does not solicit customers or customer orders. It does not solicit, accept or receive funds for the purpose of trading in commodity interests. “X” is a passive entity and does not propose to engage in any activity requiring registration as a CPO.

In support of your request, you represent the following:

1. “A” will remain the sole shareholder and director of “X”;
2. “X” will refrain from any activities requiring registration, and will remain a passive entity accepting payments resulting from “A’s” activities, including floor brokerage fees for order execution and Fees in connection with operating the Pool;
3. In the event that trading accounts are opened in the name of “X”, such accounts will be funded and traded exclusively by “A”;

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<sup>4</sup> “A” participates in the CME’s Automatic Transfer of Money payment system whereby CME acts as collection agent with respect to floor brokerage fees and transfers the fees to accounts opened and maintained by floor brokers, which accounts can be in the name of the floor broker, or in the name of an entity formed by the floor broker, such as “X”.

<sup>5</sup> You represent that, for his personal tax planning reasons, “A” prefers that the compensation to which he is entitled be paid to his wholly-owned corporation (“X”) rather than to him directly. Currently, the portion of compensation that “A” receives himself that represents allocation of Pool profits is taxed at a lower rate under Section 1256 than the other two compensation components, the management fee and commissions. “A” would like to retain the favorable tax treatment of the allocation of Pool profits if such profits are paid to “X” rather than to him personally, so that there is no net increase in tax burden. You further represent that, because of the provisions of Section 1256 of the Internal Revenue Code, if “X” is designated a manager of the Pool, the incentive-based portion of the Fees, when made to “X”, will continue to be treated as an allocation of profits to a manager and to be taxed at a lower rate than if they were treated as a fee to a contractor or outside service provider.

4. "A" will remain registered as a CPO and will continue to be a member of NFA for as long as "X" continues to receive Fees;
5. "A" will act as the Pool's sole CPO for as long as "X" continues to receive Fees; and
6. "X" will receive brokerage commissions only from Pool accounts directed by "A".

Furthermore, "A" and "X" have submitted to the Division written cross acknowledgments, agreeing to be jointly and severally liable for violations of the Act and Commission rules in connection with the operation of the Pool.

Based upon the representations made in your correspondence, and consistent with prior practice in this area,<sup>6</sup> the Division will not recommend that the Commission commence any enforcement action against "X" or "A" for the failure of "X" to register as a CPO under Section 4m(1) of the Act in connection with serving as a co-managing member of the Pool.

The no-action position taken in this letter does not excuse "X" or "A" from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, each remains subject to all antifraud provisions of the Act<sup>7</sup> and the Commission's regulations, to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations, and to all applicable provisions of Part 4, including Rules 4.20 and 4.41.<sup>8</sup>

This letter, and the no-action position taken herein, are based upon the representations made to us. Any different, changed or omitted material facts or circumstances might render this position void. You must notify the Division immediately in the event that the operations or activities of "X", "A" or the Pool change in any material respect from those as represented to us. Further, this letter and the position taken herein represent the views of this Division only and do not necessarily represent the views of the Commission or of any other office or division of the Commission.

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<sup>6</sup> See, e.g., CFTC Staff Letter 04-20 [2003-2004 Transfer Binder] Comm. L. Fut. Rep (CCH) ¶29,818 (July 12, 2004); and CFTC Staff Letter 02-87 [2002-2003 Transfer Binder] Comm. L. Fut. Rep (CCH) ¶29,124 (July 1, 2002) (CPO registration no-action position where performance of CPO activities was restricted to another (registered) co-CPO, the unregistered co-CPO was not involved in commodity interest trading, the co-CPOs were affiliated and each co-CPO acknowledged joint and several liability for each other's violations of the Act).

<sup>7</sup> See, e.g., Sections 4b and 4o, 7 U.S.C. §§6b and 6o (2000).

<sup>8</sup> Commission regulations referred to herein are found at 17 C.F.R. Ch. I (2005).

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If you have any questions concerning this correspondence, please contact me or Christopher W. Cummings, Special Counsel, at (202) 418-5445.

Very truly yours,

James L. Carley  
Director