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COMMODITY FUTURES TRADING COMMISSION
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COMMODITY FUTURES TRADING COMMISSION
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DIVISION OF TRADING AND MARKETS

March 3, 1993

Re: Registration Inquiry

Dear :

This is in response to your letters dated October 4, 1991 and March 18, 1992 to the Division of Trading and Markets ("Division"), as supplemented by your telephone conversations with Division staff, wherein you request confirmation that ("Company") is not required to register under the Commodity Exchange Act (the "Act").[1/]

Based upon your representations, we understand the facts to be as follows. Company is in the cotton warehousing business in .[2/] Company's competitors are warehouses located in rural communities. To attract cotton to Company's facilities, Company will represent to producers and ginners that they can realize more money per bale by delivering cotton on the New York Cotton Exchange ("NYCE") than by marketing cotton in the traditional way.[3/] Since cotton cannot be delivered on the Exchange in rural warehouses, this is a way for Company to exploit the value of the location of its facilities. In connec-

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1/ 7 U.S.C. § 1 et seq. (1988), as amended by the Futures Trading Practices Act of 1992, Pub. L. No. 102-546, 106 Stat. 3590.

2/ Company also has a freight forwarding division, a trucking division, a general merchandise warehousing division, and two cotton and general merchandising transloading operations. Company may occasionally compress bales of cotton, although typically the bales arrive at the warehouse already compressed at the gin. Company also provides bagging and sampling services.

3/ The Division believes that this program could provide a reasonable marketing alternative but has not made an independent assessment of the economic viability of this proposal for any particular producer. You should be cautious to ensure that any sales representations are accurate.

tion therewith, Company will offer a program under which it will deliver producers' cotton against short cotton contracts executed on the NYCE (generally, the "Delivery Program").[4/] Company's futures-related activities will be limited to customers of the Delivery Program, and futures transactions for its own account as discussed below.

To participate in the Delivery Program, Company and the producer will sign an agreement with a futures commission merchant ("FCM") providing for the opening of an account. The account will not be a joint account. The account will belong solely to the producer. The agreement will provide for the FCM's disposition of the proceeds of the producer's futures account such that the producer will receive the proceeds less charges, advances and fees owed by the producer to Company, as explained more fully below. The producer may select the particular FCM at which the account is to be opened provided that, in Company's opinion, the FCM will be able to handle the business in a competent manner such that the deliveries will not incur any performance penalties as prescribed in the NYCE rules. Company represents that, for producers who do not specify an FCM, Company will select whichever FCM is believed by Company to be competent and which charges the lowest fees and commissions.[5/]

In addition, the producer will execute a limited power of attorney in favor of Company. The limited power of attorney will be on file with the FCM. The limited power of attorney will be revocable by the producer at any time. Under the limited power of attorney, the producer will grant Company complete authority with respect to the producer's account, except for two limitations. The first limitation is that Company may not buy or sell futures contracts on behalf of the producer unless explicitly authorized to do so by the producer. The second limitation is that Company will not be authorized to receive payment of any funds from the FCM with respect to the account, whether in

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4/ You represent that it is possible that cotton merchants who store their cotton at Company's facilities may also wish to use the Delivery Program under the same terms and conditions as discussed herein with respect to cotton producers. The conclusions set forth in this letter obtain regardless of whether the customer participating in the Delivery Program is a cotton producer or a cotton merchant, so long as all your other representations set forth in this letter apply and all other conditions set forth herein are met.

5/ In certain instances, we understand that Company may wish to use an introducing broker ("IB") in connection with these accounts. Of course, all transfers of funds described herein will occur between Company and the FCM carrying a particular account.

connection with gains in the account or in connection with the closing out of a contract through delivery of cotton or otherwise, except in accordance with the agreement described above.

Once the producer's cotton arrives at Company's warehouse, the producer will be updated regularly as to the current futures price. Lots of certificated bales will be created by Company and the producer will be notified as to the quantity of completed lots so that he can know how many futures contracts to sell. If the producer so chooses, he may elect not to sell futures at all. Company only will sell a futures contract when the producer determines the price. Company will never express any advice of its own on market conditions other than, as mentioned above, advice regarding the possibility of realizing more money per bale by delivering cotton on the NYCE than by marketing cotton in the traditional way.

If a producer elects to participate in the Delivery Program, Company will advance funds on behalf of the producer in connection with the required inspection and certification by NYCE and classification by the United States Department of Agriculture of the producer's cotton. Company also will advance and cover all initial and maintenance margin calls on behalf of the producer and will not charge interest on such loans. A fee of is charged by Company to participants in the Delivery Program for the provision of services by Company, including the use of a computer program developed by Company to perform the various calculations necessary for delivery on the NYCE.[6/] You represent that you believe that Company has a lien on the producer's cotton stored by Company in its warehouse, securing repayment of any moneys so advanced.[7/]

Notice and delivery will be performed in accordance with the rules of the NYCE by the FCM using information supplied by Company. Company will work closely with the FCM to assure that all NYCE delivery rules are followed.

Company intends to recover any amounts due to it from the producer from the proceeds of the sale of the cotton and any

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6/ No additional fees are charged by Company for participation in the Delivery Program other than the normal warehouse fees charged to all Company customers.

7/ The Division expresses no opinion as to the existence or effectiveness of, or the relative priority of, Company's purported "lien" on the cotton, the futures account, proceeds thereof, or any other property of the producer whether pursuant to statute, security agreement, or otherwise. The Division recommends that Company seek the advice of its counsel with respect to these issues.

monies remaining in the futures account following delivery of the cotton. You represent that it will be important, in most cases, for the amounts owed to Company to come directly to Company from the FCM so that Company is assured of recovering any amounts due to it from the producer (whom you state is typically a poor credit risk). The agreement among Company, the FCM and the producer will specify that Company is to provide the producer and the FCM with a written statement listing the amounts owed by the producer to Company. The FCM will pay to Company from the proceeds of the sale of the cotton and any monies remaining in the futures account following delivery of the cotton the amounts Company specifies are owed to it by the producer pursuant to the agreement among Company, the producer and the FCM. The FCM will pay the balance of such funds directly to the producer.

Company will not take title to the cotton, except to compile odd-lots for the purpose of forming a remaining whole lot of cotton for delivery. In that case Company will purchase the bales from the producers at the then existing futures price and sell a futures contract for its own account in anticipation of closing it out by delivery. In this event, both the cotton and the futures account will belong to Company itself and the account will be in Company's name only. Company will not do any futures trading for its own account under any other circumstances.

You represented that the purpose of the Delivery Program is to attract cotton from small producers to Company and to benefit the small producer by enabling him to deliver cotton through the NYCE and thus avoid discounts that would apply in other cash market channels. Company contemplates that all futures contracts executed in connection with the Delivery Program will be closed out by delivery. Additionally, Company will not receive fees from any IB through whom the accounts may be introduced or any FCM which may carry the accounts.

You have requested guidance from Division staff concerning in what capacity, if any, Company is required to register under the Act in connection with its Delivery Program described above.

1. Futures Commission Merchant/Introducing Broker

Section 1a(12) of the Act defines the term futures commission merchant as:

> an individual, association, partnership, corporation or trust that --
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> (A) is engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market; and

> (B) in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom.

Section 1a(14) of the Act defines the term introducing broker as:

> any person (except an individual who elects to be and is registered as an associated person of a futures commission merchant) engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market who does not accept any money, securities or property (or extend credit in lieu thereof) to margin, guarantee or secure any trades or contracts that result or may result therefrom.

Based upon your representations, it would appear that Company will solicit and accept orders for the sale of futures contracts and, further, that it will extend credit in connection with the solicitation or acceptance of orders to margin trades or contracts. Consequently, Company's activities under the Delivery Program are more appropriately considered in light of the FCM definition rather than the IB definition. Section 4d of the Act generally requires registration of each person who comes within the statutory definition of an FCM.

However, under the facts and circumstances as you have represented them to us and subject to the conditions set forth below, the Division will not recommend that the Commission take any enforcement action against Company under Section 4d of the Act or Parts 1 and 3 of the Commission's regulations for failure to register as an FCM or to comply with the provisions of the Act or the Commission rules pertaining to FCMs in connection with its Delivery Program as described above.[8/]

This no-action position is based upon, among others, your representations that the accepting of orders for the purchase and sale of cotton futures contracts as part of Company's Delivery Program will be merely incidental to Company's cotton storage business, that margin will be deposited with registered FCMs in accounts belonging to the customer, and that the disposition of the proceeds of the futures account will occur as described

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8/ The Division notes that the capital, segregation and customer reporting duties applicable to FCMs will be fulfilled by the FCM carrying the accounts under the Delivery Program.

above. It is also based upon your representations that the solicitation of orders will not be made to the public at large but will be limited to cotton producers and merchants and will be incidental to Company's stated goal of attracting cotton to its storage facilities in , and that Company anticipates that all contracts under the Delivery Program will be closed out by delivery.

2. Commodity Trading Advisor

Section 1a(5)(A) of the Act defines the term "commodity trading advisor" ("CTA") generally as:

> any person who --
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> (i) for compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value of or the advisability of trading in . . . any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market . . . ; or
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> (ii) for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i).

CTAs are generally required to register under Section 4m(1) of the Act. However, Rule 4.14(a)(1)[9/] provides an exemption from registration as a CTA for any person who is "a dealer, processor, broker, or seller in cash market transactions or any commodity (or product thereof) and the person's commodity trading advice is solely incidental to the conduct of its cash market business."[10/]

Based upon the representations in your letter, as supplemented, the Division believes that the cash market activities of Company, referred to above, are comparable to those referred to in Rule 4.14(a)(1) cited above. Accordingly, subject to the following conditions, the Division will not recommend that the Commission take any enforcement action against Company in connec-

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9/ Commission rules referred to herein are found at 17 C.F.R. Ch. I (1992).

10/ See generally, 55 Fed. Reg. 3205, 3207 (Jan. 31, 1990) for application of the Rule 4.14(a)(1) exemption to feedlot operators.

tion with the Delivery Program you described for violations of Section 4m(1) of the Act or failure to comply with Part 4 of the Commission's regulations based solely upon the failure of Company to register as a CTA.

The no-action positions taken herein are subject to the conditions that (1) Company maintains a record containing the name and address of each producer and showing separately by purchaser the information set forth in Commission Rule 1.35(b)(2)(i); (2) Company maintains a record of any contract closed out other than by delivery if, contrary to your expectations, a contract is indeed closed out other than by delivery; (3) neither Company nor any director, officer or other principal of Company nor any employee of Company working in the Delivery Program would be subject to any disqualification from registration under Section 8a(2) or 8a(3) of the Act, if they were to apply for registration, and (4) all monthly and confirmation statements to be delivered by the FCM carrying the account are delivered both to the producer and to Company.

The positions taken herein are limited solely to the entering of orders and advancing of margin on behalf of, and the provision of commodity trading advice to, clients whose cotton is handled by Company as discussed above. You should be aware that the Division's position does not affect any other duties or responsibilities of Company under the Act and the regulations promulgated thereunder. For example, Company remains subject to the anti-fraud provisions of Sections 4b and 4o of the Act, and to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations. Also, since Company effectively will control the positions of its customers in the Delivery Program, those positions must be aggregated by Company with its own proprietary positions for purposes of compliance with the Commission's reporting regulations. Further, this relief applies only with respect to the sale of cotton futures contracts traded on the NYCE. It does not extend to the purchase of NYCE cotton futures contracts, to futures contracts traded on any other futures exchange, to any foreign futures contracts or to any options.

Further, the positions taken herein are based upon the representations that have been made to us and are subject to compliance with the conditions set forth above. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event that the operations or activities of Company and the Delivery Program change in any way from those as represented to us. In addition, we note that the opinions contained herein apply on a prospective basis only and in no way relate to any past conduct of Company, including engaging in conduct of the type described above without having been appropriately registered with the Commission. This letter

does not necessarily preclude the Commission from taking action against Company or any individual associated with Company for any violations of the Act or the Rules if the Commission determines that such action is appropriate. Moreover, this letter represents the position of the Division only and does not necessarily represent the views of the Commission or any other office or division of the Commission.

If you have any questions concerning this matter, please feel free to contact Susan Ervin, Chief Counsel, or Carla Behnfeldt, an attorney on my staff, at (202) 254-8955.

Very truly yours,

Andrea M. Corcoran
Director