U.S. COMMODITY FUTURES TRADING COMMISSION

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91-37

DIVISION OF
TRADING & MARKETS

May 7, 1996

Re: Request for Confirmation that "Newco" Would Not Be a Commodity Pool under Rule 4.10(d)(1) and its Managers Would Not Be Commodity Pool Operators under Section 1a(4) of the Act and Rule 1.3(cc)

Dear :

This is in response to your letter dated February 20, 1996, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by telephone conversations with Division staff and a facsimile dated February 28, 1996. By your correspondence, you request confirmation on behalf of "X", a corporation that is not registered with the Commission in any capacity, that a limited liability company it intends to form ("Newco") would not be a commodity pool as defined in Commission Rule 4.10(d)(1)[1/] and its managers, "A" and "B" ("Managers"), would not be commodity pool operators ("CPOs") as defined in Section 1a(4) of the Commodity Exchange Act ("the Act")[2/] and Commission Rule 1.3(cc).

Based upon the representations contained in your letter, as supplemented, we understand the relevant facts to be as follows. "X" proposes to form Newco and transfer certain of its existing investments to Newco for business and tax restructuring reasons, primarily due to disadvantageous multiple state income tax effects on "X's" owners. You represent that this transfer is "strictly a lateral inter-company movement of assets" and "a change in form and not in substance," with no intention to alter participation or ownership in "X", Newco or the portfolio of investments, or any liability with regard to the

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1/ Commission rules referred to herein are found at 17 C.F.R. Ch. I (1995), as amended by 60 Fed. Reg. 38,146 (July 25, 1995).

2/ 7 U.S.C. § 1a(4) (1994).

investments. Certain of these investments, many of which have been held for more than ten years, consist of commodity pool interests, hedge fund interests and managed accounts.[3/] Newco intends to continue to hold these interests and, possibly, make future investments in commodity interests.

All of Newco's members will be the same persons and entities who own "X", and each will own the same percentage of interests in both companies.[4/] "X's" shareholders are: the chairman of the board and chief executive officer, who is a Family Member (49 percent); trusts held by Family Members (24.15 percent); four Family Members (6.18 percent); the president, who is a Family Member (6 percent); the executive vice president, treasurer and chief financial officer (4 percent); nine senior vice presidents, two of whom are Family Members (8.9 percent); nine vice presidents (.82 percent); the secretary and general counsel (.12 percent); the assistant secretary, who also is a vice president (.14 percent); and three employees, middle management level and above, one of whom is a Family Member, who have worked at "X" for at least ten years (.41 percent). The Managers of Newco are shareholders, key executives and employees of "X". Although they will continue to monitor and make decisions regarding the investments, the Managers will not receive any management, performance or other fees or compensation for their services from Newco or its members.[5/]

As you note, absent the relief requested herein, Newco would be a commodity pool within the meaning and intent of Rule 4.10(d)(1) and the Managers, who appear to be analogous to general partners of a limited partnership, would be required to register as CPOs pursuant to Section 4m(1) of the Act.[6/] However, in light of your representations, we believe that the Manag-

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3/ Currently, eighteen percent of "X's" investment portfolio is in commodity interests.

4/ "C", "X's" founder and chairman, his children and his son-in-law (the "Family Members") collectively own almost ninety-two percent of "X" and will own almost ninety-two percent of Newco.

5/ "X" is the parent company of "Y", a registered CPO and futures commission merchant. Two of "X's" shareholders do hold positions at "Y", but "A" and "B" are not officers, directors or employees of "Y". "A" is not registered with the Commission in any capacity. "B" is an outside, non-executive director and listed principal of "Z", a registered CPO and CTA.

6/ See CFTC Interpretative Letter No. 75-16, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,104 (October 15, 1975).

ers may claim relief from CPO registration pursuant to Rule 4.13(a)(1) in connection with their serving as the managers of Newco. In this regard, it appears that they satisfy most of the requirements of the rule in that: (1) they will not receive any compensation for operating the pool; (2) they will operate only one commodity pool; and (3) the pool will not be advertised. They do not meet all of the criteria of Rule 4.13(a)(1) because they are business affiliates of persons required to register with the Commission. However, the Division will allow the Managers to rely on the registration exemption of the rule based upon their familial and long-standing business relationships with Newco's members.[7/] The Division therefore will not recommend that the Commission take any enforcement action against the Managers for failing to register as CPOs in connection with their serving as managers of Newco, provided that they comply with the provisions of Rule 4.13(b) through (d).[8/] We note, however, that the Division is not otherwise taking any position on the legality of the transfer of investments from "X" to Newco.

The position taken in this letter does not excuse the Managers or "X" from compliance with any other applicable requirements contained in the Act[9/] or the Commission's regulations issued thereunder. For example, they remain subject to the antifraud provisions of Sections 4b and 4o of the Act,[10/] the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations, and Rules 4.20 and 4.41, which apply to each person who comes within the CPO definition, regardless of registration status. Moreover, the position we have taken herein is applicable to the Managers solely in connection with their serving as the CPOs and managers of Newco.

This letter is based upon the representations that you have made to us. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. In

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7/ To claim the relief available under Rule 4.13, the Managers must deliver to each member the statement required by Rule 4.13(b), file the statement with the Commission and the National Futures Association, and operate Newco in compliance with Rule 4.13.

8/ In order to comply with the rule, the Managers must provide the Division with written notice of the actual name of "Newco" at such time as it is organized.

9/ See 7 U.S.C. § 1 et seq. (1994).

10/ 7 U.S.C. §§ 6b and 6o (1994).

this regard, we request that you notify us immediately in the event that the operations or activities of "X", Newco, including the composition of its membership, or the Managers change in any way from those as represented to us. Further, nothing in this letter should be construed as limiting in any way the Commission's ability to take enforcement or other action against "X" or any other person for any past violation of the Act or Commission regulations. Finally, this letter represents the position of this Division only. It 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 me or Natalie A. Markman, an attorney on my staff, at (202) 418-5450.

Very truly yours,

Susan C. Ervin
Chief Counsel