

CFTC Letter No. 99-41**August 27, 1999****Exemption****Division of Trading & Markets**

Re: Request for Exemption from the \$200,000 Limitation of Rule 4.13(a)(2)(i).

Dear :

This is in response to your letter to the Division of Trading and Markets (Division) of the Commodity Futures Trading Commission (Commission) dated December 9, 1998, as supplemented by your letter dated December 14, 1998 and telephone conversations with Division staff, whereby you request exemption from Rule 4.13(a)(2) in connection with the operation of the X by A and you. Specifically, you request exemption from the criterion in Rule 4.13(a)(2)(i) that the total gross capital contributions that a person seeking to claim relief from registration as a commodity pool operator (CPO) under Rule 4.13(a)(2) may receive for all the pools that it operates or intends to operate do not in the aggregate exceed \$200,000 (the \$200,000 Limitation).

Based upon the representations you have made to us in your correspondence, we understand the facts to be as follows. X is a California general partnership that was formed by A in April, 1989 as a trading vehicle for himself and his close relatives and friends to invest together in commodity interests pursuant to certain methodologies A devised. A and you are the managing general partners of X¹ and you operate X pursuant to the exemption from CPO registration in Rule 4.13(a)(1).² X is the only pool that A and you operate. A also conducts all of the trading activity of X³ The partners of X are: you; A ; B , who is A s spouse and a qualified eligible participant (QEP) as that term is defined in Rule 4.7; C , A s brother; a long-term (fourteen years) friend of A , who is a QEP with a net worth of approximately nine million dollars, and the friend s spouse (Couple #1), who hold their interests as tenants-in-common; and another long-term (ten years) friend of A and that friend s spouse (Couple #2), who also hold their interests as tenants-in-common. The amount of each partner s gross capital contribution to X and the percentage that amount represents of the aggregate gross capital contributions to X are as follows:

<u>Partner</u>	<u>Amount of Gross Capital Contribution</u>	<u>Percentage of Total Gross Capital Contributions</u>
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You	\$579,000	43.8%
A	521,000	39.4
B	120,000	9.1
C	4,000	.3
Couple #1	84,000	6.3
Couple #2	<u>15,000</u>	<u>1.1</u>
Total:	\$1,323,000	100%

You represent that, in part due to X s success, the partners of X recently have agreed that:

It would make business sense for [A] to leave his full-time employment and begin trading full-time for X . Since [X] is an experienced and seasoned professional who is highly compensated by his present employer (an entity which provides legal services), the other Partners of X believe that it is only fair that [A] be compensated by one or more of the other current Partners over and above the return earned on [A s] interest in X . Accordingly, the Partners of X have asked [A] to trade the capital of X on a full-time basis in exchange for payment of compensation. At no time has [X] solicited or otherwise asked any other Partners to compensate him for trading the capital of X .

As you acknowledge, because A will be receiving compensation in connection with his operation of X , he will no longer be able to comply with the criteria for exemption from CPO registration in Rule 4.13(a)(1).⁴ However, you ask that, under the circumstances, he be exempt from registration based on the policies behind Rule 4.13(a)(2). In support of your position, you claim that: (1) excluding the gross capital contributions to X from you, A and B , the total gross capital contributions to X do not exceed \$200,000; and (2) inasmuch as X has eight natural persons as investors, X does not have more than fifteen participants.

Rule 4.13 provides an exemption from CPO registration for persons who operate family, club and small pools, as follows:

(a) A person is not required to register under the Act as a commodity pool operator 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 (for purposes of this section, advertising includes the systematic solicitation of prospective participants by telephone or seminar presentation); or

(2)(i) The total gross capital contributions it receives for units of participation in all of the pools that it operates or that it intends to operate do not in the aggregate exceed \$200,000; and

(ii) None of the pools operated by it has more than 15 participants at any time. For purposes of computing the number of participants for paragraph (a)(2)(ii) of this section, the following participants shall be excluded:

(A) The pool's operator, commodity trading advisor, and the principals thereof; and

(B) Any relative, spouse or relative of such spouse living in the same household as such participants.

Paragraph (a)(2)(i) of Rule 4.13 does not address whether the gross capital contributions to a pool by its operator or advisor should be excluded from the \$200,000 limit in the rule, even though a pool's operator, advisor, and the principals thereof specifically are excluded from the no more than fifteen participants limit in paragraph (a)(2)(ii) of the rule. That paragraph provides that for the purposes of computing the number of participants allowable in a pool for which the operator thereof seeks to claim an exemption from registration under Rule 4.13(a)(2), the pool's operator, advisor and their principals are excluded. This provision was patterned after Rule 501(e)(1)(i) under the Securities Act of 1933 (the '33 Act⁵), which provides that for the purposes of computing the number of non-

accredited purchasers allowed to participate in an exempt offering under Rule 506 under the 33 Act,⁶ the following purchasers shall be excluded: any relative, spouse or relative of the spouse of a purchaser who has the same principal residence as the purchaser. Since Rule 506 provides an exemption from the registration of securities otherwise required under the 33 Act for limited offers and sales *without regard to the dollar amount of the offering*, the exemptive rules under the 33 Act need not, and do not, make any mention of excluding the capital contributions of persons who are excluded from the computation of non-accredited purchasers.

The Division believes that it would not be contrary to the public interest to grant the requested exemption, such that the capital contributions of A and B and you could be excluded from the \$200,000 Limitation. As written, Rule 4.13 could be interpreted such that the operator, advisor and their principals would not be participants for purposes of meeting the criterion of Rule 4.13(a)(2)(ii) but that their contributions would be included for purposes of meeting the other criterion of Rule 4.13(a)(2)(i). At least with respect to pools with relatively limited net asset value, this result is somewhat inconsistent.

Accordingly, by the authority delegated to it under Rule 140.93(a)(1), the Division hereby exempts A and you from the \$200,000 Limitation of Rule 4.13(a)(2)(i), such that you are permitted to claim the exemption from CPO registration in Rule 4.13(a)(2) in connection with your operation of X .

This letter, and the exemption granted herein, are based upon the representations you have made to us. Any different, changed or omitted material facts or circumstances might render this exemption void. You must notify us immediately in the event the activities or operations of A , you, or X change in any material way from those represented to us. Likewise, if the net asset value of X exceeds \$5,000,000, you must notify the Division immediately to confirm your continued eligibility for the exemption granted by this request.

This letter does not excuse A or you from compliance with any other applicable requirements contained in the Act or the Commission's rules issued thereunder. For example, you each remain subject to all antifraud provisions of the Act and the Commission's rules, to the reporting requirements for traders set forth in Parts 15, 18, and 19 and to all other applicable provisions of Part 4. Also, this letter is applicable to A and you solely in connection with the operation of X .

Finally, should the Commission revise Rule 4.13 in the future to address the issues raised by your exemptive request, you, A and B , and all the other participants, advisors or operators of X will be required to comply with any revised rule, and the exemption granted herein will be void.

If you have any questions concerning this letter, please contact Barbara S. Gold, Assistant Chief Counsel, at (202) 418-5450.

Very truly yours,

I. Michael Greenberger

Director

¹ Both A and you also are attorneys associated with major, national law firms.

² Commission records indicate that A filed a claim of exemption under Rule 4.13(a)(1) with respect to the operation of X on April 10, 1989.

³ Rule 4.14(a)(5) provides that a person is exempt from registration as a commodity trading advisor (CTA) if it provides commodity interest trading advice solely to, and for the sole use of, the pool or pools for which it is exempt from CPO registration. Unlike Rule 4.13, Rule 4.14(a)(5) is self-executing. No notice needs to be filed to claim exemption from CTA registration under Rule 4.14(a)(5).

⁴ Specifically, he will no longer be able to meet the criterion of Rule 4.13(a)(1)(i), stated above.

⁵ 230 C.F.R. §501(e)(1)(i)(1999).

⁶ 230 C.F.R. §506(1999).