



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and
Intermediary Oversight

Matthew B. Kulkin
Director

CFTC Letter No. 19-02
No-Action
February 14, 2019
Division of Swap Dealer and Intermediary Oversight

**Re: No-action Relief from Registration as a CPO and/or a CTA for
“A”, the manager of “B”**

Dear :

This letter is in response to your letter dated September 26, 2018, to the Division of Swap Dealer and Intermediary Oversight (the “Division”) of the Commodity Futures Trading Commission (the “Commission”). You request on behalf of “A” (“Manager”), the manager of “B” (“Affiliate”) confirmation that the Division would not recommend enforcement action against Manager for failure to register as either a commodity pool operator (“CPO”) or commodity trading advisor (“CTA”) with respect to its activities managing Affiliate.

Based upon the representations in your letter, we understand the relevant facts to be as follows. Affiliate owns mineral interests and overriding royalty interests in crude oil and natural gas producing and non-producing properties. The majority of Affiliate’s revenues are derived from sales of crude oil and natural gas. As part of those activities it only conducts business that is reasonably incidental to its ownership of those revenue producing interests, such as signing leases that produce royalty income and revenue from holding surface rights and easements associated with their properties. In connection with the ownership of crude oil and natural gas interests, Affiliate will enter into commodity interest transactions, such as futures, options or swaps, with the intention of hedging its exposure to commodity price risk.

Because of the inclusion of commodity interests within the definition of a commodity pool under Section 1a(10) of the Commodity Exchange Act, Affiliate and/or its Subsidiaries may meet the definition of a commodity pool.

You state that Affiliate’s commodity interests generally have a notional value of approximately 80 percent of proved producing reserves and are intended to reduce the risk posed to Affiliate by fluctuations in crude oil and natural gas pricing. You further state that the terms and conditions of the commodity interests are consistent with those generally available in the traditional swaps market or listed derivatives markets and that Manager and Affiliate do not

“C”

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intend to trade in and out of the commodity interests to generate profits or mitigate losses. You represent that the commodity interests will not introduce any new risks to Affiliate other than counterparty credit risk associated with the commodity interests. You state that all commodity interests will be held by Affiliate.

With respect to Manager, you state that the advisory activities of Manager are limited to the commodity interests that are intended to hedge the commodity price risk of Affiliate. You state that both Manager and Affiliate will implement risk management policies and procedures reasonably designed to ensure compliance with the terms of the relief provided by this letter and that such policies and procedures will also be consistent with the restrictions on Affiliate's commodity interest-related activities in credit agreements with its lenders.

Based on your representations, the Division believes that Affiliate's commodity trading as described is determined by its primary business activities, the majority of which are comprised of sales of crude oil and natural gas. As represented in your correspondence, Affiliate is using commodity interests to more effectively hedge risks that are created as a byproduct of its primary business activities. Moreover, Manager limits its advice and management regarding commodity interests to acting on behalf of Affiliate and does not otherwise offer such services. As such, the Division believes that the typical regulatory concern associated with customer protection inherent in operating a commodity pool is not as significant.

Based on the representations in your correspondence, the Division will not recommend that the Commission take enforcement action against Manager for engaging in commodity interest transactions for Affiliate and for failure to register as a CPO with regard to those activities. Nor will it recommend that the Commission take enforcement action against Manager for failure to register as a CTA with respect to the commodity trading advice that it provides to Affiliate provided that Affiliate's use of commodity interests satisfies the following conditions:

1. The commodity interests will have the effect of reducing risk relative to the risk of the unhedged position;
2. The commodity interests cannot be established, held, altered or terminated for the purpose of speculation or trading;
3. The commodity interests will only hedge risks inherent in the physical assets of Affiliate, and not risks arising from the arrangement by which the assets are held or financed;
4. The commodity interests will not introduce any new risks to Affiliate other than counterparty risk;
5. The terms and conditions of the commodity interests are consistent with those generally available in the traditional swaps market or listed derivatives markets; and

“C”

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6. Manager and Affiliate will have employed reasonable risk management policies and procedures to reasonably ensure compliance with the terms of this letter including periodic testing to confirm ongoing compliance with respect to any amendments to the commodity interests or the structure.

This letter, and the positions taken herein, represent the view of this Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse the affected persons from compliance with any other applicable requirements contained in the Act or in the Commission’s regulations issued thereunder. This letter does not create or confer any rights for or obligations on any person or persons subject to compliance with the Commodity Exchange Act that bind the Commission or any of its other offices or divisions. Further, this letter, and the relief contained herein, is based upon the representations made to the Division. Any different, changed or omitted material facts or circumstances might render this letter void. The Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the relief provided in this letter, in its discretion.

Should you have any questions, please do not hesitate to contact Amanda Olear, Associate Director, at 202-418-5283, or aolear@cftc.gov, or Peter Sanchez, Special Counsel, at 202-418-5237, or psanchez@cftc.gov.

Very truly yours,

Matthew B. Kulkin
Director
Division of Swap Dealer and Intermediary
Oversight