

CFTC Letter No. 00-89**September 11, 2000****Interpretation****Division of Trading & Markets**

Re: Rule 4.10(d)(1): Request for Interpretation that Limited Partnership
Engaged in Pork Production is Not a Commodity Pool

Dear :

This is in response to your letter dated April 17, 1997 to the Division of Trading and Markets (“Division”) of the Commodity Futures Trading Commission (“Commission”), as supplemented by letter dated August 11, 2000, and telephone conversations with Division staff. By this correspondence, you request an interpretation that “V”, a limited partnership that is a client of your company, “W”, would not be considered a commodity “pool” as defined in Commission Rule 4.10(d)(1), ¹ such that “V’s” general partner would not be required to register as a commodity pool operator (“CPO”) under Section 4m(1) of the Commodity Exchange Act (the “Act”).²

Facts

Based upon the representations made in your correspondence, we understand the facts to be as follows. “W” is registered as an introducing broker (“IB”) and is guaranteed by “Z”. You are the president, sole principal and a registered associated person (“AP”) of “W”. In connection with an audit of “W” by the National Futures Association (“NFA”), NFA staff informed “W” that one of its clients, “V”, may be a commodity pool as defined in Rule 4.10(d)(1) and, thus, that “V’s” general partner, “X”, might be required to register as the CPO thereof. NFA staff advised you to seek the Division’s opinion concerning the status of “V”.

“V” is an Iowa limited partnership engaged in the business of pork production. “V” has forty-two investors, the majority of which are Iowa farmers. “X”, the sole general partner, and the limited partners contributed cash and property in return for ownership interests in “V”.³ “X” owns sixty-eight percent of “V”. “V’s” primary function is hog production. Approximately ninety-five percent of “V’s” revenues results from the sale of hogs. According to “V’s” 1999 annual report, “V” sold nearly \$27 million worth of hogs in 1999.⁴ “V” also earns income from consulting activities, involving matters related to hog nutrition and production, and from the sale of feed, recordkeeping services, and breeding stock. “V”

engages in commodity futures and options transactions solely to hedge its hog production and related feed costs. As such, “V’s” commodity futures and options transactions are restricted to the hog, corn and soymeal markets.⁵

Originally, the general partner of “V” was “Y”. “Y” was formed specifically to serve as the general partner of “V”, and its only business activity was serving as the general partner of “V”. In 1994, for tax reasons, “Y” reorganized as a Subchapter S corporation, and changed its name to “X”. The sole employee of “X” is “A”. “A” and his wife own 61.5 percent of “X”. The remaining shareholders consist of local farmers and employees of “V”.⁶

“X’s” only business activity is serving as the general partner of “V”. “X” does not serve as a general partner of any other partnerships or provide any management services to any person or entity other than “V”. As the sole general partner, “X” directs “V’s” production and cash marketing of its hogs and feed, including any commodity interest trading undertaken to hedge its hog production and feed input costs, and manages “V’s” building sites and personnel. “X” receives a management fee of \$1.50 for each hog sold by “V” in addition to any distributions that “X” receives based upon its ownership interest in “V”.

Analysis

Rule 4.10(d)(1) defines the term commodity “pool” as “an investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests.” The term commodity “pool” is not defined in the Act. Rather, it was taken from the language of the term “commodity pool operator” in Section 1a(4) of the Act.⁷ In adding the CPO definition to the Act, and the corresponding registration requirement in Section 4m(1) of the Act, Congress intended to establish the foundation for eliminating certain undesirable practices by unscrupulous operators and advisors who had “enticed unsuspecting traders into the markets with, far too often, substantial loss of funds.”⁸ However, Congress vested discretion in the Commission “to exempt from registration those persons who would otherwise meet the criteria for registration ... if, in the opinion of the Commission, there is no substantial public interest served by such registration.”⁹

In light of this discretion, and in connection with its adoption of Rule 4.10(d), the predecessor of Rule 4.10(d)(1), the Commission stated that “[w]hether a particular entity is operated ‘for the purpose’ of trading commodity interests, and thus is a pool within the scope of Rule 4.10(d), depends on an evaluation of all the facts relevant to the entity’s operation.”¹⁰ The Commission then recognized that in the past its staff had issued interpretations of the Part 4 rules and, consistent with that practice, the Commission invited interested persons “to seek such staff interpretations of Rule 4.10(d) and of all other Part 4 rules.”¹¹

Based upon the representations made by you and “A”, and in particular the representations that: (1) “V” is engaged in the business of producing and marketing hogs; (2) approximately ninety-five percent of

“V’s” revenue derives from the sale of hogs; (3) “V’s” commodity interest trading is solely for the purpose of hedging its hog production and related feed costs; (4) “X’s” sole business purpose is to act as the general partner of “V”; and (5) neither “X” nor any of its principals are otherwise involved in the commodity futures business, it does not appear that “V” is an “investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests.” Rather, it appears that “V” is a business engaged in the production of pork that uses commodity interests to hedge the price risks associated with that business. Accordingly, the Division believes that “V” is not a commodity “pool” within the meaning and intent of Rule 4.10(d)(1), and consequently, that “X” is not a CPO of “V” and is not required to register as such under Section 4m(1) of the Act.

This letter does not excuse “V” or “X” 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 of the antifraud provisions of the Act and the Commission’s regulations and to the reporting requirements for traders set forth in Parts 15, 18 and 19.

This letter and the interpretation provided herein are based upon the representations you have made to us. Any different, changed or omitted material facts or circumstances might render this interpretation void. You must notify us immediately in the event that the operations or activities of “X” or “V” change in any material way from those represented to us. Further, the interpretation provided herein applies solely: (1) to “V” as to whether it is a commodity pool; and (2) to “X” as to whether it is the CPO of “V”.

This letter represents the views of this 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 correspondence, please contact Ky Tran-Trong, an attorney on my staff, at (202) 418-5450.

Very truly yours,

John C. Lawton
Acting Director

1 Commission rules referred to herein are found at 17 C.F.R. Ch. I (2000).

2 7 U.S.C. §6m(1) (1994).

3 By letter dated October 27, 1997, “A”, the Chief Executive Officer and majority shareholder of “X”, indicated that most of the property contributed to “V” consisted of hogs, although some land also was contributed.

4 You supplemented your letter with copies of “V’s” 1999 audited annual report and the Closing Memorandum (dated October 1, 1993) to the Confidential Private Placement Memorandum (dated October 17, 1992) for SGE.

5 In this regard, by letter dated August 27, 1997, “A” represented that “V” “is a bona fide hedge account” and that it is “operating within the hedging guidelines set forth in rule 1.3(z).”

6 The only other person to own more than ten percent of “X” is “B”. “B” and her husband were partners in “Y” with “A”. Neither “A”, his wife nor “B” are involved in the commodity futures business. Nor do any of these persons offer services related to the commodity futures business.

7 Section 1a(4) defines the term “commodity pool operator” to mean:

any person engaged in a business that is of the nature of an investment trust, syndicate or similar form of enterprise, and who, in connection therewith, solicits, accepts or receives from others, funds, securities or property . . . for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market

8 H.R. Rep. No. 93-975, 93d Cong., 2d Sess. 79 (1974).

9 *Id.* at 29.

10 46 Fed. Reg. 26004, 26006 (May 8, 1981). The Commission was responding to arguments that, for example, limited partnerships registered as broker-dealers would not be pools if they occasionally traded commodity interests, committed a limited amount of assets to such trading, and traded commodity interests for hedging as opposed to speculative purposes.

11 *Id.*