87-90 CCH ¶ 23,973

87-8

November 9, 1987

Re: CPO Registration No-Action Position Where Investors Have 20-Year History

Dear :

This is in response to your letter dated September 25, 1987, as supplemented by your telephone conversation with Division staff held on October 20, 1987, wherein you requested confirmation that the Division will not recommend that the Commission take any enforcement action for failure to register as a commodity pool operator ("CPO") against the General Partners of the Partnership. 1/

Based upon the representations made in your letter, as supplemented, we understand the facts to be as follows:

> Although the Partnership was formed on January 22, 1987, it may claim an indirect affiliation with two corporations no longer in existence. "X" was formed in the early 1900s to engage in the wholesale distribution of certain products . . . . "X's" assets were sold in 1966 to an unrelated company, for cash and stock. However, the cash and stock

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1/ Alternatively, you requested an opinion that the Partnership would not be deemed to be a commodity "pool" within the meaning and intent of Rule 4.10(d), 17 C.F.R. §4.10(d) (1987). Among other reasons, because the Partnership is not a registered investment company we are unable to provide such an opinion. See Rule 4.5, 17 C.F.R. §4.5 (1987); see also n. 4, infra.

received in the transaction were not distributed to "X's" shareholders, but rather were left in the company, which was renamed "Y". In 1968 "Y" changed its state of incorporation to Delaware by merging into "Z", a corporation formed for that purpose. Neither "Y" nor "Z" ever sold additional shares of its stock. Shareholders in "Z" were in all instances former shareholders of "X" or the successors-in-interest to former shareholders of "X". 2/

During its existence, "Z" invested the proceeds of the sale of "X" in stocks, bonds, and other securities . . . . To assist it in these transactions, "Z" engaged a registered investment advisor . . . . At no time during their respective existence did "Y" or "Z" ever engage in the purchase or sale of commodities, the trading of commodity options, or the purchase or sale of commodity futures contracts.

In 1986, in response to adverse tax law changes contained in the Tax Reform Act of 1986, "Z's" directors recommended and the shareholders approved a dissolution of the corporation. At the request of a number of major shareholders of "Z", the directors of "Z" agreed to form a limited partnership which would be engaged in essentially the same investment activities as "Z". Former shareholders of "Z" were encouraged, though not required, to invest the liquidation proceeds (after deducting approximately 20% for federal income taxes) in this partnership.

"Z" was dissolved on December 30, 1986, and a private placement of limited partnership interests in the Partnership was commenced in January 1987. . . .

Out of approximately $15.5 million distributed among the 44 former shareholders

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2/ In your telephone conversation you explained that the term "successors-in-interest" refers to the heirs of the former shareholders.

> of "Z" at liquidation, 12 former shareholders chose to invest approximately $6.7 million in the Partnership. In addition, two other investors who were not former shareholders chose to invest in the Partnership. The first of these is a stockbroker with E.F. Hutton, the company which had handled many of the trades for "Z" during its existence. This person's investment amounted to $6,000. The other investor is [your] minor son . . ., whose investment amounted to $8,000. Each of the Partnership's six general partners is a former director of "Z". Furthermore, the investment advisor for the Partnership's Growth Fund . . . is the investment advisor which had been used by "Z".
>
> The only major operational differences between the Partnership and "Z" reflect the general partners' decision to use this opportunity to correct some problems which had plagued "Z". Easily the most significant of these problems was a dispute over whether the corporation's assets should be invested to yield current income or for capital appreciation. The Partnership sought to address this conflict by creating two funds, an Income Fund whose twin purposes were preservation of capital and maintenance of a high but consistent level of current income, and a Growth Fund whose purpose was capital appreciation. Each limited partner was offered the opportunity to allocate his investment between these Funds and to reallocate his investment at the end of each calendar year.

Your letter further explains that, consistent with the Partnership's investment philosophy, neither fund ever contemplated trading in commodity interests. In fact, your letter notes several provisions in the Partnership's Agreement which specifically prohibit such trading.

The instant request arose, then, out of the need to protect the Income Fund -- which had been invested in tax-exempt municipal bonds -- from a decline in value. As your letter states:

> Accordingly, in August 1987, the general partners interviewed four investment counsel and selected one of them. Among the reasons for selecting this counsel was this counsel's

program for using "hedging" to protect the asset values of conservative portfolios. 3/ By investing the Income Fund's assets in bonds which are included in the Bond Buyer Municipal Bond Index and then selling futures contracts covering bonds owned by the Income Fund, this program offers substantially increased protection against portfolio losses. Of course, this investment strategy minimizes the potential gain which could be realized by the Income Fund from asset appreciation, such as would occur in connection with a drop in prevailing interest rates. However, since the Partnership offers a Growth Fund for those partners seeking capital appreciation, the general partners concluded that this was an acceptable price to pay . . . .

[T]he Partnership must amend both its private placement memorandum and its Limited Partnership Agreement to permit its investment counsel to engage even in the limited "hedging" strategy outlined by the investment counsel. The general partners propose to condition the adoption of the strategy upon obtaining the consent to the necessary amendments to the Limited Partnership Agreement from 100% of those limited partners with investments in the Income Fund. . . .[T]hese proposed amendments . . . will be as narrow as possible. They will permit the Income Fund to engage in commodity trading activities, but only to the extent deemed necessary by its investment counsel to permit "bona fide hedging transactions" and then only subject to the further limitation that the Income Fund will not enter into commodity futures and commodity options contracts for which the aggregate initial margin and premiums exceed 5% of the fair market value of the Income Fund's assets. The private placement memorandum will be amended

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3/ You represent that this counsel has applied for registration as a commodity trading advisor.

consistent with these limitations and will contain the following representation:

> The Income Fund is not intended to be, nor it should be regarded by investors as, a commodity pool. Futures trading helps the Income Fund to achieve its goal of preserving capital assets while obtaining a high level of current income, but it is not the principal component of the Income Fund's investment program.

Based upon the foregoing representations, we believe that the relief you seek should be issued to the General Partners because of, among others, the facts that: (1) the general and limited partners (either directly or as successors-in-interest) have an investment affiliation that dates back to at least 1968, when "Z" was established; (2) the Partnership intends to trade commodity interests for hedging purposes; and (3) the Partnership will not commit more than 5% of that Fund's assets to initial margin or options premiums. Accordingly, based upon those representations, the Division will not recommend that the Commission take any enforcement action against any General Partner if he fails to register as a CPO in connection with his operation of the Partnership. 4/

You should be aware that the "no-action" position taken by this letter does not excuse any General Partner from compliance with any otherwise applicable requirements contained in the Act or in the Commission's regulations thereunder. For example, each remains subject to Section 4o of the Commodity Exchange Act, 7 U.S.C. §6o (1982), and to the reporting requirements for traders set forth in Parts 15 and 18 of the Commission's regulations, 17 C.F.R. Parts 15 and 18 (1985).

The position taken by this letter is based on the representations that have been made to us. Any different, changed or omitted facts or conditions

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4/ See Division of Trading and Markets Interpretative Letter No. 86-19, Comm. Fut. L. Rep. (CCH) ¶23,202 (July 3, 1986), wherein the Division issued similar relief based on similar facts. Compare Division Interpretative Letter Nos. 86-17, 86-10 and 83-9, Comm. Fut. L. Rep. (CCH) ¶23,200 (June 24, 1986), ¶23,016 (April 24, 1986) and ¶21,909 (Nov. 3, 1983), wherein we concluded that certain trading vehicles would not be pools within the meaning of Rule 4.10(d) because they were merely joint trading accounts comprised essentially of family members or long-time friends or business associates, not passive investors as in the instant case.

might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event the Partnership's operation, including its membership composition, changes in any way from that as represented in your letter and in your telephone conversation with Division staff.

Very truly yours,

Andrea M. Corcoran
Director

BSG/rv

cc: Daniel A. Driscoll, National Futures Association