89-17

COMMODITY FUTURES TRADING COMMISSION
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OFFICE OF
THE GENERAL COUNSEL

November 2, 1988

Dear ... :

By letters dated September 16 and 30, 1988, and in subsequent telephone conversations you have requested, on behalf of your client, ... ["the company"], that the staff of the Commodity Futures Trading Commission ("Commission") confirm that it will not recommend to the Commission that any enforcement action be taken against the company in connection with its issuance of certain notes which will offer a return in part indexed to the prices of copper, gold or silver.

In your letters, you represent that the company is currently the ... copper producer in the United States, engaged in both mining and smelting operations. The company produces gold and silver as by-products of its copper production. In connection with a refinancing, the company proposes to issue to the public certain notes, a portion of the return of which will be indexed to the prices of copper, gold or silver.

Specifically, you represent that the company proposes the issuance of three types of notes: Copper Indexed Senior Subordinated Notes ("Copper Notes"), Gold Indexed Senior Subordinated Notes ("Gold Notes"), and Silver Indexed Senior Subordinated Notes ("Silver Notes"). (These notes are hereinafter collectively referred to as the "Notes".) The company expects to issue between $... and $... of the Notes denominated in units of $1,000. The company currently intends to issue equal aggregate face amounts of each of the Copper Notes, the Gold Notes, and the Silver Notes. Each Note will mature approximately ten years from its issuance and pay interest semi-annually at an interest rate to be determined at issuance, but which will in no event be less than 35 percent of the market rate of interest on comparable pure debt instruments issued by the company. 1/ Fifteen percent of the original amount of Notes

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1/ You represent that the interest rate for comparable pure-debt
(Footnote Continued)

outstanding may be redeemed at the option of the holders beginning at the end of the fourth year after issuance and at the end of each year thereafter.

You further represent that the Copper Notes will pay their principal amount at maturity or upon redemption and an additional amount at the time of maturity or redemption based upon the settlement prices for a copper futures contract in the near month for the 20 days prior to the calculation (the "Copper Price"). The exchange and contract will be designated by the company prior to the issuance of the Notes and will probably be the Comex Grade 1 copper futures contract. Specifically, each $1,000 Copper Note will pay at maturity or upon redemption $1,000 plus, if the Copper Price at the time exceeds a reference price to be determined at the time of issuance, currently expected to be between $.90 and $1.00, an additional amount equal to the lesser of (a) the increase over $1,000 in the value of the number of pounds of copper which, valued at the reference price, would be worth $1,000 and (b) an amount that would result in a 20 percent compounded annual rate of return on $1,000 to the date of maturity or redemption from the commodity feature.2/

The Gold Notes and Silver Notes will be identically structured, with the Gold Notes currently expected to be based on two troy ounces of gold valued initially at $500 per troy ounce per $1,000 Note, and the Silver Notes currently expected to be based on 133.33 ounces of silver valued initially at $7.50 per ounce per $1,000 Note. Each Note will therefore return its

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(Footnote Continued)
securities issued by the company is currently estimated at 14 percent. Under these circumstances, the company envisions the effective interest rate on the Copper Notes, Gold Notes and Silver Notes, excluding the commodity-based component, to be 10 percent, 7.75 percent and 8.75 percent, respectively.

2/ In this regard, you have provided the following example: Assume that the Copper Price at the time of maturity or redemption is $1.50 per pound and $.95 is selected as the reference price. The reference copper amount would be 1,000 divided by .95 or 1,052.63. The holder would receive 1,052.63 times $.55 or $578.95 as the commodity-related component plus $1,000, _i.e._, $1,578.95 in respect of his $1,000 principal amount Note. The maximum payment a holder may receive will vary depending upon the year the principal payment is made. The maximum commodity-related payment upon redemption in year 4 would be $1,074 (which implies a $1.97 per pound Copper Price at the time) and the maximum commodity-related payment at maturity in year ten would be $5,192 (which implies a $5.88 per pound Copper Price).

original principal amount with interest without regard to prevailing commodities prices. Each Note will pay an additional amount, which in all events will not exceed an annualized, compounded 20% rate of return, in the event that commodity prices at the time of maturity or redemption exceed the initial reference prices noted above.

You indicate that the company intends to register the Notes under the Securities Act of 1933, as amended, in connection with offering them to the public. The underwriter has informed the company that while the minimum permissible purchase will be $1,000, it anticipates that the overwhelming majority of sales in the initial public offering will be in blocks in excess of $200,000. The company intends to list the Notes for trading on either the New York Stock Exchange or the American Stock Exchange.

The Commission, in its Advance Notice of Proposed Rulemaking Relating to the Regulation of Certain Hybrid and Related Instruments ("Advance Notice"), 52 Fed. Reg. 47022 (December 11, 1987), sought comment on a proposed regulatory framework which would exempt from Commission regulation specified instruments having a commodity option-like component. In particular, the Commission proposed to establish an exemption for a class of hybrid instruments that are predominantly debt instruments and which possess only incidental commodity option elements. In view of the fact that the Advance Notice remains pending and that the Commission has not reached a final determination with respect to the proposals set forth therein, the staff believes that it is appropriate, in limited circumstances such as this, to address certain instruments on a case-by-case basis. In this regard, in your letter you compare the company and the Notes with regard to each of the following criteria set forth in the Commission's Advance Notice.

(1) Term to Maturity

Each Note will mature approximately 10 years from its date of issuance, and no portion thereof will be redeemable by its holder until four years from its issuance date. The commodity component of the Notes is not detachable from the Notes and therefore matures at the same time as the Notes. Accordingly, the minimum three-year term proposed by the Commission will be met.

(2) Commodity-Based Return

The Commission has proposed that any exemption based on incidental commodity-option elements be conditioned upon compliance with a requirement that the hybrid instrument have a minimum annual yield or return independent of its commodity-related component equal to at least 35 percent of the estimated annual yield at the time of issuance for a comparable pure debt or depository instrument and have no more than the maximum average potential return on its commodity-related component of 20 percent, on an annualized basis, of the total principal or face amount of a hybrid instrument.

You represent that the non-commodity based and commodity-related returns of the proposed Notes meet both of these tests. In particular, you represent that each Note will pay interest semi-annually at an annual rate significantly exceeding 35 percent of the estimated annual yield at the time of issuance for comparable pure-debt notes issued by the company. In the current market environment, the company envisions the gold Notes paying interest at 7.75 percent per year, the Copper Notes paying interest at 10 percent per year, and the Silver Notes paying interest at 8.75 percent per year. These rates translate roughly into 55 percent, 71 percent and 63 percent of the current estimated 14 percent yield on comparable pure-debt notes issued by the company. You also represent that the maximum potential return on the portion of each Note indexed to the price of gold, copper or silver is capped at 20 percent of the principal amount of the Note on an annualized basis with annual compounding.

(3) <u>Line of Business</u>

You represent that the principal line of business of the company is producing copper and, as by-products, gold and silver. The company has been in the business of producing copper, gold and silver for ... years and is currently the ... producer of copper in the United States. As a result, the commodity-based portion of the return on the Notes is related to the company's principal line of business.

(4) <u>Otherwise Regulated Standard</u>

You represent that both the company and the Notes will be regulated by the Securities and Exchange Commission ("SEC"). The company's common stock is registered under the Securities and Exchange Act of 1934 (the "1934 Act"). Therefore, the company is subject to the rules promulgated by the SEC under the 1934 Act including reporting rules, such as those requiring the filing of quarterly reports, annual reports and proxy material. The company's common stock is quoted on NASDAQ. Further, a Registration Statement on Form S-1 with respect to the offer and sale of the Notes will be filed with the SEC under the Securities Act of 1933 (the "1933 Act"). Each prospective purchaser of Notes will receive a prospectus that complies with the disclosure requirements of the 1933 Act and discloses, among other things, the risks related to the commodity-indexed portion of the Notes. Furthermore, the Notes will be offered by an underwriter that is registered with the SEC as a broker-dealer and is a member of the National Association of Securities Dealers Inc. and the New York

Stock Exchange. Finally, the company intends to seek a listing for the Notes on the New York Stock Exchange or the American Stock Exchange.

(5) Marketing and Disclosure

The company represents that the Notes will not be marketed to the public as having the beneficial characteristics of commodity options except as may be necessary to disclose fully the operation and financial consequences of the Notes.

(6) Special Calls

You represent that the company agrees to submit to special calls from the Commission for information relating to the issuance of the Notes, the matters addressed by your no-action request and compliance with the conditions upon which any no-action position is based.

(7) Net Worth and Cover

In the Commission's Advance Notice, the Commission proposed to condition any exemption on compliance with a requirement that the issuer have at least $100 million of net worth. That notice also proposed a cover requirement to ensure performance of the issuer's commodity-related obligations under a qualifying hybrid instrument.

You represent that the company's net worth is currently approximately $... and the refinancing of which the issuance of the Notes is a part is not expected to reduce the company's net worth. Moreover, the company intends to maintain a net worth of at least $... during the term of the Notes.

You also represent that the company will maintain cover for the commodity component of the Notes equal to the greater of its current obligations to pay the cash value of the commodity component of the Notes or the maximum average annual amount of such obligations. You indicate that such cover may be in the form of physical copper, gold or silver, including reserves or long-term tolling contracts or in the form of futures contracts or options on futures contracts. You represent that the company has current proven/probable copper reserves as of December 31, 1987 of ... billion tons of ore which, based on estimated grade and recovery rates which the company believes to be reasonable, would yield approximately ... billion pounds. You have calculated that ... pounds of copper would cover the $... million face amount of Copper Notes, assuming a $.95 per pound copper reference price.

The company represents that its copper reserves will yield copper concentrate from which approximately ... troy ounces of gold will be recovered in the smelting and refining process, and that over the next ... years it expects to recover approximately ... additional troy ounces of gold under a ... agreement with .... Gold Notes having a $... million face amount would require cover of ... troy ounces of gold, assuming a gold reference price of $500 per troy ounce. The company similarly represents that its copper reserves will yield copper concentrate from which approximately ... million ounces of silver will be recovered in the smelting and refining process, and that over the next ... years it expects to recover approximately ... million additional ounces of silver under the ... agreement with .... Silver Notes having a $... million face amount would require cover of ... ounces of silver, assuming a silver reference price of $7.50 per ounce.

(8) Minimum Unit Price

The Commission, in its Advance Notice, proposed a $20,000 minimum unit price for the sale of hybrid option instruments qualifying for exemptive treatment as a means of protecting customers in an off-exchange environment. However, you have indicated that the Notes will be denominated in $1,000 units in order to facilitate their trading on a national securities exchange. In this regard, the staff believes the listing and trading of the Notes on a national securities exchange and the registration, reporting and underwriting requirements of the securities laws, as noted above, adequately address the purpose of customer protection in the circumstances of this offering. Thus, the staff is of the view that in the circumstances presented by this offering, an exception to the minimum unit size requirement proposed in the Advance Notice is warranted.

Accordingly, based upon the representation in your letters and your conversations with the staff, the understanding that although denominated in units of $1,000 the Notes will be registered under the Securities Act of 1933 and initially offered pursuant to an underwriting under applicable law, and the significant net worth and reserves of copper, gold and silver owned by the company, the staff has concluded that the proposed offering is not inconsistent with the general conditions for granting exemptive relief articulated in the Advance Notice. Therefore, the staff will not recommend to the Commission any enforcement action under Section 4c of the Commodity Exchange Act based upon the issuance of the proposed Notes by the company.

This position does not excuse the company from complying with any otherwise applicable provisions of the Commodity Exchange Act nor does it address any other instrument or proposed instrument. Any different, omitted or changed facts or conditions might require a different conclusion. It should also be noted that this position is that of the staff and is not binding upon the Commission and that any subsequent determination by the Commission with regard to the rulemaking proceeding initiated by the Advance Notice may require a reconsideration of this staff position.

Sincerely,

Marshall E. Hanbury
Co-Chairman
Off-Exchange Task Force

Paula A. Tosini
Co-Chairman
Off-Exchange Task Force