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PRIVATE INVESTMENT FUNDS

CFTC Rescinds CPO Registration Exemption; Adopts Additional Reporting Obligations

On February 9, the Commodity Futures Trading Commission adopted by a vote of 4 to 1 final rules amending its part 4 regulations governing commodity pool operators (CPOs) and commodity trading advisors (CTAs). The amendments:

- Rescind the exemption from CPO registration under CFTC Rule 4.13(a)(4) for CPOs of commodity pools offered privately only to certain qualified eligible persons and institutional investors;
- Modify the annual disclosure relief to registered CPOs claiming exemption under CFTC Rule 4.7 to require that commodity pool annual financial statements be audited;
- Require additional risk disclosures regarding swaps transactions in the CFTC disclosure documents that are required to be provided by registered CPOs and CTAs that are not relying on the disclosure exemptions provided by CFTC Rule 4.7;
- Adopt additional reporting obligations for registered CPOs and CTAs under CFTC Rule 4.27 and new Forms CPO-PQR and CTA-PR;
- Add limitations on futures and swaps trading by investment companies that are registered under the Investment Company Act of 1940 but that are exempt from CPO registration under CFTC Rule 4.5 (for more information on this, see the entry under **Investment Companies and Investment Advisors** below); and
- Require annual affirmation of eligibility for exemptions from CPO and CTA registration.

Effectiveness and Compliance Deadlines

Except as noted below, the general effective date of the amended rules will be 60 days after publication in the Federal Register.

- The data reporting rules in revised Section 4.27 will become effective on July 2, 2012. The first reports will be due within 60 days after September 30 for CPOs having at least $5 billion in commodity pool assets under management as of June 30, and will be due within 90 days after December 31 for all other registered CPOs and CTAs.
- The deadline for CPOs currently relying on the Rule 4.13(a)(4) (or claiming the exemption before it is repealed) is December 31, 2012. Affected CPOs must be registered and otherwise comply with the Part 4 rules applicable to CPOs on or before that date.
- Compliance by registered investment companies with the requirements of amended Rule 4.5 will be required by the later of December 31, 2012 or 60 days after the date on which CFTC regulations defining the term "swap" become effective. Funds that are required to register as a result of those amendments will become subject to

compliance with the CFTC's recordkeeping, reporting and disclosure requirements no later than 60 days after the CFTC implements as-yet-unspecified final rules harmonizing the CFTC and Securities and Exchange Commission requirements.

- Compliance with all other amendments is required by December 31, 2012.

Highlights of Changes from the Proposed Rules

Changes to the original proposals include:

- Maintaining the exemption from CPO registration for CPOs of pools offered privately to accredited investors that engaged in limited futures and swaps trading pursuant to CFTC Rule 4.13(a)(3);

- Requiring annual reaffirmations of exemption eligibility on a calendar year-end basis rather than on the anniversary of the filing date;

- Revising the substance and filing timelines for Forms CPO-PQR and CTA-PR. Notably:

  - CPOs that are registered as investment advisers with the SEC and report pool information on Form PF will only have to complete Schedule A of Form CPO-PQR containing general identifying information for any pool that is covered on Form PF. If the CPO chooses not to file Form PF with respect to commodity pools that are not private funds, it will have to file the full form CPO-PQR with respect to those pools.

  - Form CTA-PR will require only demographic data and the names of pools advised by the CTA.

  - The level of commodity pool assets under management required to be a large CPO required to report quarterly within 60 days of quarter end (rather than 15 days, as originally proposed) was raised from $1 billion to $1.5 billion.

  - CPOs with at least $150 million in commodity pool assets under management will be required to file Schedules A and B annually within 90 days of year-end but CPOs with less than that amount under management will not have to file Schedule B.

To review the full CFTC release adopting the rules, please click here.

INVESTMENT COMPANIES AND INVESTMENT ADVISORS

CFTC Revision of Rule 4.5 Requires Advisers to Certain Registered Investment Companies to Register with the CFTC; CFTC Separately Proposes to Harmonize Investment Company Rules with SEC Requirements

Rule 4.5 Amendment. On February 9, the Commodity Futures Trading Commission (CFTC) adopted final amendments to its Part 4 Rules, which set out the registration and compliance obligations for commodity pool operators (CPOs) and commodity trading advisors (CTAs). CFTC Rule 4.5 formerly provided a blanket exemption from CFTC registration and associated regulatory requirements for registered investment companies and their advisers. Amended Rule 4.5 is a step back to the rule as it existed before 2003, with certain modifications, where an adviser of a registered fund that trades over a *de minimis* amount of futures contracts, options on futures or swaps (Derivatives) or otherwise markets the fund as a commodity fund will be required to register as a CPO.

To qualify for the new Rule 4.5 CPO exception, an investment company's adviser must represent to the CFTC that the fund will only use Derivatives solely for "*bona fide* hedging purposes." That term is narrowly construed and does not include strategies that are commonly referred to as "risk management." The adviser to a registered fund that cannot qualify for the bona fide hedging exemption will be subject to CPO registration requirements unless the fund otherwise uses Derivatives within either of the following thresholds:

- the aggregate initial margin and option premiums for non-hedging Derivatives will not exceed 5% of the fund's liquidation value (excluding the in-the-money amount of any in-the-money option at the time of purchase); or

- the aggregate net notional value of non-hedging Derivatives, determined at the time the most recent position is established, does not exceed 100% of the fund's liquidation value.

The thresholds must be calculated after taking into account unrealized profits and losses on the non-hedging Derivatives already held. The final rule provides detailed instructions on determining net notional value that allow netting of futures positions in the same commodity across designated contract markets and foreign boards of trade while limiting netting of swaps only to those cleared by the same derivatives clearing organization.

Finally, the fund's adviser must represent to the CFTC that the fund has not been, and will not be, marketed as a commodity pool or as a vehicle for trading in the Derivatives markets. The claim for the new Rule 4.5 CPO exclusion must be filed with the CFTC by the compliance date or, for new funds created after the compliance date, before the inception of the fund. In either case, an affirmation must be filed within 30 days of each calendar year-end.

While the amendments to Rule 4.5 become effective on July 2, 2012, compliance is not required before the later of (1) December 31, 2012, or (2) 60 days after the CFTC adopts a final rule defining the term "swap." Advisers required to register as CPOs solely by virtue of Rule 4.5 will become subject to the Part 4 reporting, disclosure and recordkeeping requirements within 60 days of the adoption by the CFTC of final rules that implement a proposed CFTC initiative to harmonize certain of its rules with those of the Securities and Exchange Commission (SEC).

CFTC Proposed Harmonization Initiative. Also on February 9, the CFTC proposed amendments to certain CPO reporting, disclosure and recordkeeping rules to harmonize the obligations of registered investment companies that otherwise might be subject to duplicative, inconsistent, and possibly conflicting, SEC requirements under the Investment Company Act of 1940. The CFTC proposes to amend Rule 4.12(c) to offer relief from the disclosure document delivery and acknowledgement requirements under Rule 4.21, certain periodic financial reporting obligations under Rule 4.22 and the requirement that records be maintained at the CPO's main office under Rule 4.23. The CFTC is also soliciting comments as to, among other things, whether further relief is needed.

To review the full final rule release of the CFTC, please click here. For the proposed harmonizing release, please click here. For more information on the CFTC's rulemaking on February 9, please see the entry under **Private Investment Funds** (above).

LITIGATION

Incomplete and Unfinished Documents May Satisfy Statute of Frauds

The U.S. Court of Appeals for the Fifth Circuit recently held that documents referenced in an agreement may satisfy the statute of frauds even if those documents are not finalized. Preston Exploration Company entered into three agreements with Chesapeake Energy Corporation for the sale of certain oil and gas leases. The specific leases to be conveyed were not set forth in the body of the agreements, but rather were referenced in the agreements as being defined in the attached exhibits. Drafts of the exhibits were circulated with the draft agreements and, although it was clear that the exhibits were not finalized, the agreements were executed by Chesapeake without protest.

Chesapeake ultimately refused to close on the sale transaction, and Preston sued for specific performance. In response, Chesapeake argued that the agreements did not sufficiently identify the property as required by the statute of frauds because the exhibits listing the leases were never finalized. The trial court accepted Chesapeake's argument and Preston appealed.

Applying Texas law, the Fifth Circuit vacated the trial court's decision, holding that the general description of the property to be conveyed set forth in the agreements, along with the draft exhibits specifically identifying the leases, provided a sufficient basis for enforcing the agreements. In particular, the Court pointed out that the agreements reflected a clear meeting of the minds of the parties even though it was recognized "that there was still some title work to be done" with respect to the specific leases that would be conveyed. Moreover, the Court held that although the exhibits were not finalized, they contained sufficient information concerning the property to be conveyed to satisfy the statute of frauds.

Preston Exploration Company, L.P. v. GSF, L.L.C., No. 10-20599 (5th Cir. Feb. 1, 2012)

Courts Lack Jurisdiction To Review Determinations By Arbitration Panels Under the Railway Labor Act

The U.S. Court of Appeals for the Fifth Circuit recently held that collective bargaining agreements cannot provide for judicial review of the Railway Labor Act's (RLA) exclusive and mandatory dispute resolution process. Retired Continental Airline pilots alleged that Continental had breached the retirees' pension plan by improperly calculating their salaries when determining their pension benefits. The collective bargaining agreement (CBA) between the parties required that, for "minor disputes" involving the interpretation of the pension plan, the retirees must seek review through arbitration before a System Board composed of two representatives from the company and two representatives from the pilot's union. Although resolution of minor disputes through the System Board was required, the CBA also provided that, if the System Board's ruling was adverse to a retiree, the retiree could seek judicial review of the dispute under the Employee Retirement Income Security Act (ERISA).

The retirees received an adverse ruling from the System Board, and, as they were expressly permitted to do both by the CBA and the System Board's decision, commenced an action in federal court under ERISA challenging the ruling. The federal district court for the Southern District of Texas dismissed the action for lack of subject matter jurisdiction and the Fifth Circuit affirmed.

The Fifth Court acknowledged that, when drafting a collective bargaining agreement subject to the RLA, the parties may identify issues that are not subject to review by the System Board. Disputes involving issues that are not reviewable by the System Board are subject to ERISA and may be challenged in federal court. However, once the CBA provides for review of the dispute through arbitration before a System Board, that review is exclusive and the dispute cannot be said to be governed by ERISA. Since private parties cannot confer subject matter jurisdiction on the federal courts, the fact that the CBA provided for judicial review of the System Board's decision did not mandate a different result. In so holding, the Court noted that allowing judicial review of System Board determinations "would destroy the purposes of the RLA in promoting an efficient and comprehensive framework for resolving labor disputes."

Ballew v. Continental Airlines, Inc., No. 11-20279 (5th Cir. Jan. 31, 2012).

EU DEVELOPMENTS

France Proposes Financial Transaction Tax

On February 8, the French government released details of a proposed financial transaction tax (FTT). The proposal will be considered by the French parliament and, if passed, will impose taxes on certain transactions in shares and other financial instruments, as well as on high frequency trading (HFT).

The government has until the end of the current parliamentary session on March 22 to get legislative approval for the FTT. Given the tight legislative timeframe, it is possible that the bill will still be pending when the session ends, in which case it will be shelved until after France's presidential and parliamentary elections which will take place between April and June 2012.

France, supported by eight other European Union (EU) member states, has proposed that an FTT be implemented by the EU. This proposal will be considered at EU level later this year. These nine countries could, under the EU's "enhanced cooperation" rules, act collectively to impose an FTT across their economies, although they would not be able to impose an FTT on other EU member states.

The details of the French FTT proposal include:

- A tax of 0.1% on purchases of shares of listed companies headquartered in France which have a market capitalization of at least €1 billion (approximately $1.32 billion) and whose shares are listed on a "regulated market." In practice, the tax will affect the shares of about 60 French blue chip corporates. The tax will be payable by the buyer's financial intermediary, regardless of where the intermediary is situated. Where no financial intermediary is involved, payment of the FTT will be the custodian's responsibility.

- A tax of 0.01% on French tax resident companies undertaking HFT for their own account, based on the ratio of cancelled orders to completed orders. Market making activities by registered market makers and liquidity providers are excluded from the ambit of the proposed tax.

- A tax of 0.01% on the notional value of sovereign bond credit default swap (CDS) short transactions entered into by a French tax-resident company. There are exceptions for market making activities or where the CDS is bought to hedge an existing long position.

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