

**Item 1. Cover Page**



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**FORM ADV PART 2**

January 1, 2014

**This brochure provides information about the qualifications and business practices of Artus Management, L.P. If you have any questions about the contents of this brochure, please contact Eric Ross, Senior Managing Director and Chief Compliance Officer of Avenue Capital Group, at (212) 878-3500 or [eross@avenuecapital.com](mailto:eross@avenuecapital.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority. Registration as an investment adviser with the SEC does not imply a certain level of skill or training.**

**Additional information about Artus Management, L.P. is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).**

**Item 2. Material Changes**

This brochure represents the firm's first Form ADV Part 2A. As a result, this brochure should be reviewed in its entirety.

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## Item 4. Advisory Business

### Structure; History and Ownership

Artus Management, L.P. (the “firm”) is an investment adviser organized in November 2013, with its principal place of business in New York City. The firm provides investment advisory services to private investment funds (“private funds”), registered investment companies (“public funds,” and together with private funds, “funds”) and separately managed accounts.

The firm expects to commence business on or about January 1, 2014.

The firm is part of Avenue Capital Group (“Avenue” or “Avenue Capital”), an established global alternative investment firm founded in 1995. As of September 30, 2013, Avenue Capital had approximately 206 employees worldwide, including 65 investment professionals. Avenue Capital maintains a well-developed infrastructure with extensive accounting, operations, legal, investor relations, risk management, compliance and information technology teams.

Marc Lasry (Chairman, Chief Executive Officer and Co-Founder) and Sonia E. Gardner (President, Managing Partner and Co-Founder) are the Senior Principals of the firm and together control the general partner of the firm, Artus Management GenPar, LLC. As of March 2013, Richard Furst is the Chief Investment Officer of Avenue Capital and spends a portion of his time providing high level investment oversight globally.

Avenue Capital’s primary focus is investing in credit obligations (public and private), including without limitation, distressed debt and equity opportunities, other special situations and high yield investments in the United States, Europe and Asia. Avenue Capital’s primary advisory service is to provide discretionary investment advice to private funds and public funds. The Senior Principals and the portfolio managers of the investment funds managed by the firm have spent virtually their entire careers in this space.

In contrast to the other investment advisers that comprise Avenue Capital, the firm’s primary investment strategies are a Relative Value Strategy and an Option Overlay Strategy. The firm expects to provide investment advisory services to private funds, a public fund and separately managed accounts, including option overlay accounts. The public and private funds and separately managed accounts, including option overlay accounts, that we provide services to are sometimes referred to collectively as the “accounts.” When managing the assets of these funds and accounts, the firm strives to provide equity investors with a favorable alternative to passive index investing.

- *Relative Value Strategy:* With respect to funds and separately managed accounts, stocks are selected using a quantitatively-driven value model, and this investment portfolio is then hedged against a blended mix of index call options, which, as a whole, are highly correlated to the investment portfolio determined by a proprietary quantitatively-driven value model.
- *Option Overlay Strategy:* With respect to option overlay accounts, the goal is to hedge the investor’s existing investment portfolio against a blended mix of index call options, which, as a whole, are highly correlated to that existing investment portfolio.

In each case, the options positions are continually monitored, and adjusted as needed, so as to maintain the combination of stocks and options within a targeted range of market exposure. Details regarding the investment strategies we employ on behalf of the accounts are described below at Item 8.

## **Types of Advisory Services**

As described above, we provide advisory services through a Relative Value Strategy with respect to private funds, a public fund and separately managed accounts, and an Option Overlay Strategy for institutional investors. Neither the firm nor any of our affiliates is acting as an investment adviser or otherwise making any recommendation as to an investor's decision to invest in the accounts that employ the Relative Value Strategy, or to engage the firm in respect of the Option Overlay Strategy. The advisory services we expect to provide to accounts will be on a discretionary basis. The firm does not participate in wrap fee programs.

In regards to our Option Overlay Strategy, we will collaborate with each client to determine its specific objectives. In doing so, the firm works with the client to (i) understand its investment objectives, (ii) determine appropriate hedging strategies for achieving the client's goals and (iii) analyze the client's investment portfolio to determine optimal mix of equity indexes to achieve proper correlation.

## **Assets Under Management**

As of December 6, 2013, we do not have any assets under management.

## **Item 5. Fees and Compensation**

### **Fees**

Detailed information regarding fees is included in each fund's confidential offering memorandum or registration statement, as applicable. Because this brochure will be delivered only to qualified purchasers as defined in section 2(a)(51) of the Investment Company Act of 1940, a complete description of our compensation arrangements is not required to be included in this brochure. Fees paid for services provided to managed accounts are determined on a client-by-client basis and may, but are not required to, be substantially similar to those paid by funds.

### ***Private Funds and Separately Managed Accounts***

Regardless of whether an investor invests directly in an investing fund or indirectly through a dedicated feeder fund that invests substantially all of its assets into an investing fund formed to carry out the investment program, only one layer of management fees and incentive fees or allocations will be assessed with respect to that investor.

The private funds and separately managed accounts we expect to advise will generally pay management fees and incentive fees or allocations. Management fees, calculated as a percentage of the asset value of the private fund attributable to each investor or managed account, will generally be paid monthly in arrears. The management fee will be payable whether or not the private fund or managed account is profitable in a given month. If a client withdraws all or a portion of its account other than at a calendar month-end, the management fee for such partial month will be prorated. Incentive fees and allocations will be calculated as a percentage of profits of the private funds and managed accounts. Incentive fees or allocations are deducted or allocated, as applicable, at the end of a period (year-end or upon a partial or full withdrawal), subject to a high watermark. All management fees will be deducted monthly directly from each applicable private fund. All fees will be deducted on an investor-by-investor basis.

### ***Public Funds***

The public fund we expect to sub-advise will generally pay management fees. In relation to the firm's role as a sub-adviser to the public fund, the firm will be paid monthly in arrears a fee based upon the net assets managed by the firm. Such fee will be paid by the investment adviser of the public fund to the firm. The public fund will not be responsible for paying this fee to the firm. The public fund will charge retail investors and institutional investors different management fees.

### ***Option Overlay Accounts***

When providing option overlay services to clients, the firm will be paid a management fee as of the last day of each calendar month equal to a percentage of the net asset value of the designated stock hedge amount (as set forth in each client's investment management agreement) of the client account. The management fee is to be paid within five days after receipt by the client of the firm's invoice.

The firm's fees are generally not negotiable, although the firm reserves the right to negotiate. Furthermore, the formative documents of the private funds will allow the firm or its affiliates to waive or reduce fees in their sole and absolute discretion.

The firm will not charge fees in advance.

The firm will not accept compensation for the sale of securities or other investment products.

## **Expenses**

### ***Funds***

The funds will generally be responsible for their own operating expenses. The payment of these expenses by a fund will reduce the value of each investor's investment in the fund.

### ***Private Funds***

Detailed information regarding the expenses to which each private fund is subject will be set out in the offering documents with respect to the particular private fund. Generally, each feeder fund will bear its own expenses and its *pro rata* share of the expenses of any master fund. Private fund expenses may include, without limitation, the following categories of expenses:

- brokerage commissions and other transaction-based charges (including interest and stock loan expenses);
- accounting, tax and auditing expenses;
- all administrative expenses (including reporting expenses, custodial fees and expenses, and governmental, registration, license and membership fees payable to regulatory as well as self-regulatory organizations) incurred by the private fund;
- all costs and expenses of computers, software, licenses and computer services utilized on behalf of the private fund;
- the fees and expenses of the private fund's attorneys, accountants and other advisers in connection with advice relating to the legal affairs of the private fund (including fees incurred in connection with transactions engaged in by the private fund);

- all extraordinary expenses relating to the private fund and its investments (including, without limitation, expenses of litigation);
- federal, state and local taxes; and
- such other expenses as are set forth in the private fund's private placement memorandum and/or organizational documents.

### ***Public Funds***

The public fund's expenses may include, without limitation, the following categories of expenses:

- transfer agent fees;
- custodian fees;
- administration fees;
- administrative servicing fees; and
- shareholder servicing fees.

### ***Separately Managed Accounts***

The expenses borne by separately managed accounts, including option overlay accounts, will be set forth in their agreements with us and generally may include all brokerage commissions, transfer taxes and other fees and expenses incurred in the purchase, sale or other disposition of assets.

For more information regarding our brokerage practices and brokerage expenses that may be incurred, please see Item 12.

## **Item 6. Performance-Based Fees and Side-by-Side Management**

As discussed in Item 5 above, the private funds and separately managed accounts will generally pay incentive fees or allocations. Incentive fees and allocations are calculated as a percentage of profits of the funds. The firm's incentive fees and allocations will generally not be negotiable, although the firm reserves the right to negotiate incentive fees and allocations.

We will also serve as the investment sub-adviser to a public fund, the investment adviser to which will pay us an asset-based fee and not a performance-based fee. As a result we have a conflict of interest, because we can potentially receive greater fees from accounts having a performance fee structure than from those accounts we charge asset-based fees only. We have an incentive to:

- direct the best investment ideas to, or allocate or sequence trades in favor of, the private funds and managed accounts that pay performance-based fees;
- use trades by the public fund that does not pay performance-based fees to benefit private funds and managed accounts that do pay performance-based fees, such as where the performance-based fee paying private funds sell short before a sale by the public fund that does not pay performance-based fees, or the performance-based fee paying private fund sells a security only after a public fund that does not pay performance-based fees has made a large purchase of the security; and



- benefit a private fund or managed account that pays performance-based fees over the public fund that does not pay performance-based fees and which has a different and potentially conflicting investment strategy.

We have a fiduciary duty to our clients not to favor the account of one client over that of another, without regard to the types and amounts of fees paid by those accounts. In light of the conflicts of interest described above, we have allocation and other policies and procedures in place to ensure that accounts are treated fairly.

The public fund we sub-advise is managed using an investment strategy that is similar to the investment strategy employed by some of the private funds, invests in securities that are similar to investments that may be held in our private funds, and does not pay a performance fee.

The firm acknowledges that this may cause a conflict of interest, since the firm, its affiliates and its supervised persons may have an incentive to favor accounts for which they receive a performance fee. To address this potential conflict of interest, the firm agrees, to the extent within its control, not to favor itself to any client's financial detriment. The firm agrees to keep complete records of all securities transactions, as required by SEC and/or state regulation.

## **Item 7. Types of Clients**

We will provide investment advisory services to investment funds, including private funds, a public fund and separately managed accounts, including option overlay accounts. Neither the firm nor any of our affiliates is acting as an investment adviser or otherwise making any recommendation as to an investor's decision to invest in a fund or establish a managed account. With respect to the funds, investment advice is provided directly to the funds and not individually to each of the funds' limited partners or shareholders, as applicable. With respect to the separately managed accounts, the investment objective and strategy of each account will not involve a recommendation or determination by us as to the appropriate investment program for such account nor due diligence by us as to such account's financial condition or risk profile.

The private funds' investors and the firm's separately managed account clients may consist of one or more of the following: individuals, pension and profit sharing plans, financial institutions (including funds of funds), trusts, endowments, charitable organizations and corporations or other business entities.

Each private fund investor is required:

- to be an "Accredited Investor" as such term is defined in Rule 501(a) of Regulation D under the Securities Act of 1933; and
- to be a "Qualified Purchaser" as such term is defined in Section 2(a)(51) of the Investment Company Act of 1940; and
- to meet such other eligibility requirements as we determine on a case by case basis.

Each separately managed account client is required:

- to be a "Qualified Client" as such term is defined in SEC Rule 205-3 under the Investment Advisers Act of 1940; and
- to meet such other eligibility requirements as we determine on a case by case basis.

There is no minimum size for the funds or managed accounts we will advise. The private funds will have minimum investment amounts of \$1,000,000. The public fund will have a minimum investment amount of \$1,000. These minimums may be reduced or waived by the general partner of the funds that are partnerships or the board of directors or trustees of the funds that are companies or trusts, subject in certain cases to applicable statutory minimums. The minimum account size for option overlay account services (*i.e.*, those accounts that the firm advises using its Option Overlay strategy, which is discussed in item 8 below) is an account in which the designated stocks to be hedged have a net asset value of \$100,000,000, a substantially smaller amount is expected to be allocated to the firm to manage on a discretionary basis.

## **Item 8. Methods of Analysis, Investment Strategies and Risk of Loss**

### **Methods of Analysis and Investment Strategies**

Our investment strategies and certain risks associated with our investment strategies are described in this Item 8. Prospective investors in any fund(s) are advised to review the respective funds' private placement memorandum, explanatory memorandum or confidential offering circular or, in the case of a public fund, the prospectus that is included in the registration statement that has been filed with the SEC, for a more in-depth description of that fund's investment strategy and objectives and related risk factors.

#### ***Relative Value Strategy***

Our primary investment advisory service is to provide discretionary investment advice to private investment funds. The firm also acts as a sub-adviser to a public fund, pursuant to a sub-advisory agreement with the public fund's investment adviser, and will manage the investments of the public fund in accordance with the public fund's investment objective, policies and limitations and any investment guidelines established by the public fund's investment adviser.

The assets of the funds will be managed by combining two investment strategies. First, the firm maintains a portfolio of medium- to large-capitalization "relative-value" stocks (the "investment portfolio") in an effort to achieve tax-advantaged long-term capital gains. Second, index call options are sold (the "options portfolio") against the investment portfolio in an effort to increase the funds' income, reduce the volatility of returns and, in general, improve the reward/risk of the investment portfolio.

Prospective investors in a fund are advised to review the fund's private placement memorandum, explanatory memorandum or confidential offering circular or, in the case of a public fund, the prospectus that is included in the registration statement that has been filed with the SEC, for a more in-depth description of that fund's investment strategy and objectives, types of assets to be invested in, and related risk factors.

Some of the private funds we advise may be feeder funds to other funds that we also advise.

#### ***Option Overlay Strategy***

The firm will also provide investment management services to clients through the use of an option overlay strategy for such clients' existing investment portfolios. The firm strives to produce results that enhance the risk / reward or income profile of each client's investment portfolio through the application of a constant-hedge option overlay program. The firm seeks to become a long-term collaborative "partner" with each client, providing custom services that utilize index options with the objective of both reducing risk and enhancing performance. In this regard, the firm works with the client to (i) understand its investment objectives, (ii) determine appropriate hedging strategies for achieving the client's goals and

(iii) analyze the client's investment portfolio to determine optimal mix of equity indexes to achieve proper correlation.

### **Risks Associated with the Firm's Investment Strategies**

Material risks involved in our investment strategies are described below.

**Investment and Trading Risks in General.** All investments selected by the firm face the risk of loss of capital. The firm may utilize investment techniques and financial instruments that can, in certain circumstances, maximize the adverse impact to which an account may be subject. No guarantee or representation is made that any account's program will be successful, and investment results may vary substantially over time. Investing in securities involves a risk of loss that clients should be prepared to bear.

**Market Risks.** The accounts' investment portfolios will be subject to market risk. Because the accounts invest a substantial portion of their assets in stocks, they are subject to stock market risk. Market risk involves the possibility that the value of the accounts' investments in stocks will decline due to drops in the stock market. In general, the value of the accounts will move in the same direction as the overall stock market in which the accounts invest, which will vary from day to day in response to the activities of individual companies, as well as general market, regulatory, political and economic conditions. There can be no guarantee that relative value investing in general or the accounts' investment portfolios in particular will be profitable.

The accounts' options portfolios also will be subject to market risk. While the price of options theoretically is derived from a number of factors—the price of the underlying index, the strike price, interest rates, time to expiration, dividends and volatility—the market's perception, particularly as to the future volatility of the index, may cause the price of options to move differently from how theory would predict. While most index options ultimately settle for cash on expiration in an amount equal to their intrinsic value (the amount by which the index, in the case of call options, exceeds the strike price, if at all), during the course of the month, the options will trade for more than their intrinsic value. (This excess is called "time premium.") Although in theory the time premium (after adjusting for other factors) should decline somewhat regularly as expiration approaches, in practice this may not be the case. Since time premium is a function of, among other things, the market's perception as to the future volatility of the index, as that perception changes, the time premium may, in effect, decay faster or slower than theory would predict. As a practical matter, the firm believes this means that, in a down market, the accounts' options portfolios will not appreciate in value by as much as theory would predict.

In addition, although the accounts' options portfolios are intended to hedge their investment portfolios, there is no guarantee that they will do so to the degree predicted by theory. In calculating the accounts' overall exposure to the market, the firm will make certain determinations, including the market's perception as to the future volatility of the indexes. If the market's perception were to be incorrect or if the firm were unable to forecast accurately any one or more of the components used to determine how best to hedge the accounts' investment portfolios or the amount of the hedge that the accounts' options portfolios will provide, the accounts could, in practice, find their net exposure to be longer (or shorter) than their portfolio model would predict.

Moreover, the accounts' options portfolios will, in general, consist of short index call options. As such, the total dollar hedge provided by the accounts' options portfolios cannot exceed the proceeds from the sale of those options. While the accounts' investment strategy includes intra-month adjustments of the accounts' options portfolios to keep the accounts within certain parameters, in the event that the market were to open significantly lower than the previous day's closing price, the hedge provided by the accounts' options portfolios would be limited to the aggregate value of those short index call options.

In a similar vein, for those accounts with a market-neutral portfolio, their options portfolios would suffer losses if the market were to open significantly higher than the previous day's closing price. Since these accounts' options portfolios will be designed to be, on an options-adjusted basis, the equivalent of "short" on a pre-determined and agreed upon percentage of the net asset value of the accounts, the "face value" of the index call options sold will typically equal or exceed between a multiple of the net asset value of the accounts. If the market were to open significantly higher than the previous day's closing price, assuming that these accounts' investment portfolios matched the market's performance, these accounts would lose an amount approximately equal to that rise less the proceeds received from the sale of the index call options.

Finally, since most options expire intra-month while performance is determined as at the end of every month, the change in the rate of decay of the options in the accounts' options portfolios may have the unintended effect of shifting profits or losses in the accounts' options portfolios between months.

**Early Exercise Risk.** In general, the accounts' options portfolios will consist of short index call options. In some cases, index options can be exercised prior to expiration. To the extent such options are utilized in the accounts' options portfolios, an account will be subject to the risk that the purchasers of those options may elect to exercise some or all of those options before the applicable expiration. Since most index options settle for cash, if some or all of an account's options were to be assigned, the account's options portfolios would not be as short as if those options had not been assigned and, accordingly, an account's net exposure would be longer the market than would have been the case had those options not been assigned. While the firm will adjust an account's options portfolios, if necessary, to bring an account's net exposure back within its risk parameters as soon as practicable following notification, there can be no guarantee that the market will not have declined prior to the opening or prior to an account's ability to adjust its options portfolios accordingly.

**Investments in Equity Securities.** The accounts will invest primarily in equity securities. Although investments in equity securities, such as stocks, historically have been a leading choice for long-term investors, the values of stocks rise and fall depending on many factors. The stock or other securities of a company may not perform as well as expected, and may decrease in value, because of factors related to the company (such as poorer than expected earnings or certain management decisions) or to the industry in which the company is engaged (such as a reduction in the demand for products or services in a particular industry). Market and economic factors may adversely affect securities markets generally, which could in turn adversely affect the value of the accounts' investments, regardless of the performance or expected performance of companies in which the accounts invest.

Common stock and similar equity securities generally represent the most junior position in an issuer's capital structure and, as such, generally entitle holders to an interest in the assets of the issuer, if any, remaining after all more senior claims to such assets have been satisfied. Holders of common stock generally are entitled to dividends only if and to the extent declared by the governing body of the issuer out of income or other assets available after making interest, dividend and any other required payments on more senior securities of the issuer.

**Varying Diversification Policies.** The firm is restricted as to the percentage of certain accounts' assets (at the time of purchase) that may be invested in any particular sub-industry, industry group or market sector. In addition, certain account's individual equity diversification guidelines relate only to the initiation of positions. These diversification policies, however, do not apply to all accounts managed by the firm.

**Options.** Accounts will expose investors to the risks inherent in trading options. These risks include, but are not limited to, volatile movements in the price of the underlying instrument and misjudgments as to the future prices of the options and/or the underlying instrument. Increased option volatility can increase both the profit potential and the risk of an account's trading. While volatility can be monitored and reacted to, there is no effective means of hedging against market volatility.

Selling options creates additional risks. The seller of a "naked" call option (or the seller of a put option who has a short position in the underlying instrument) is subject to the risk of a rise in the price in the underlying instrument above the strike price, which risk is reduced only by the premium received for selling the option. In exchange for the proceeds received from selling the option, the option seller gives up (or will not participate in) all of the potential gain resulting from a decrease in the price of the underlying instrument below the strike price when compared to a short seller of the underlying instrument.

The seller of a "naked" put option (or the seller of a call option who has a long position in the underlying instrument) is subject to the risk of a decline in price of the underlying instrument below the strike price, which risk is reduced only by the proceeds received from selling the option. In exchange for the premium received for selling the option, the option seller gives up (or will not participate in) all of the potential gain resulting from an increase in the price of the underlying instrument above the strike price when compared to a purchaser of the underlying instrument.

Due to the inherent leveraged nature of options, a relatively small adverse move in the price of the underlying instrument may result in immediate and substantial losses to an account. For example, if an in-the-money call (put) option is sold for its intrinsic value plus a premium representing the time value of that option, a 10% rise (drop) in the value of the underlying stock index does not create a loss equal to just 10% of the value of the option; rather it creates a loss approximately equal to 10% of the value of the underlying instrument, less the time value, which loss may be many times greater than the price for which an account sold the option. In addition, upon selling an option, an account is required only to deposit a percentage of the value of the option at the time of sale as margin, thereby leveraging the investment even further. Thus, like other leveraged investments, any purchase or sale of options may result in losses in excess of the amount invested.

**Exchange-Traded Funds.** Accounts also may invest in shares of exchange-traded funds ("ETFs"). Risks of investing in shares of an ETF that invest in equities are similar to those risks associated with investing in the equities directly. In addition to these risks, an investment in shares of certain ETFs also expose investors to the risk of errors in matching the ETF's underlying assets to an index and the risk that an ETF that is not actively managed cannot sell poorly performing stocks as long as they are represented in an index. These risks may affect the ability of the firm to implement its investment strategy effectively and reduce the accounts' profit potential.

Additionally, an ETF's return may not match the return of the index it is trying to replicate (the "replicated index") for a number of reasons. For example, an ETF incurs a number of operating expenses not applicable to the replicated index, and incurs costs in buying and selling securities, especially when rebalancing the ETF's securities holdings to reflect changes in the composition of the replicated index. The ETF may not be fully invested at times, either as a result of cash flows into the ETF or reserves of cash held by the ETF to meet redemptions and expenses.

Investors in ETFs generally bear all of their expenses, including fees of the investment adviser and custodian, brokerage commissions and legal and accounting fees. As a result, investors will be paying two levels of advisory fees: (i) the management fee and/or incentive fee or allocation payable to the firm and its affiliates; and (ii) the advisory fee charged by the investment adviser of any ETFs in an account's

portfolio. The foregoing fees and expenses may be expected to result in a higher cost of investment than would be the case if an investor were to invest directly in the ETFs in which the accounts invest. As a result, the returns realized by clients of the firm from the accounts' activities will be less than the returns such investors would realize from engaging in the same activities directly.

**Short Sales.** While accounts managed by the firm do not currently intend to sell equity securities short, they may do so in the future. Short selling, and especially short selling on margin, is considered a risky strategy. If an account were to sell equity securities short, it would be selling securities it did not own. To make delivery of those securities sold, an account would have to borrow those securities. The gain (loss) realized would be the difference between the price at which those securities were sold and the price at which those securities were subsequently re-purchased. In the event that the market price of the security were to increase, an account could be forced to cover the short position at a higher price and, if the interest earned on the proceeds of the short sale were insufficient to offset the price differential, a loss would result.

Furthermore, an account could be prematurely forced out of a position if the lender from which an account borrowed stock to effect the short sale were to recall such stock at a time when such stock could not be borrowed from other sources.

Since there is theoretically no limit on the price of a security, an unhedged short sale theoretically involves the unlimited risk of an increase in the market price of the securities involved (and unlimited loss).

**Suspensions of Trading.** Securities exchanges typically have the right to suspend or limit trading in any instrument traded on the exchange. A suspension would render an account temporarily or permanently unable to liquidate its positions and could thereby expose an account to losses.

**Dispersion Risk.** As part of the firm's investment strategy, the accounts sell index call options to hedge the investment portfolios. As such, there is the risk that the investment portfolios will under-perform the blended performance of the indices on which those options were sold. If the investment portfolios were to under-perform such indices sufficiently, the accounts could incur losses, even during times that the investment portfolios generate profits.

**Value Stock Risk.** Accounts that employ our Relative Value strategy invest in value stocks. When value investing is out of favor, the investment portfolio holdings may experience declines in value even though the companies these accounts hold have sound fundamentals.

**Medium Capitalization Company Risk.** Accounts that employ our Relative Value strategy may invest in the securities of companies that are considered "mid-cap" or medium capitalization. Such companies may be relatively newly formed or have limited product lines, distribution channels and financial and managerial resources. The risks associated with these investments are generally greater than those associated with investments in the securities of larger, more well-established companies. This may cause these accounts' share price to be more volatile when compared to investment funds that focus only on large capitalization companies. Securities of medium capitalization companies are more likely to experience sharper swings in market values, less liquid markets, in which it may be more difficult for the firm to sell at times and at prices that the firm believes appropriate. Compared to large capitalization companies, "mid-cap" or medium capitalization companies are more likely to have (i) less information publicly available, (ii) more limited product lines or markets and less mature businesses, (iii) fewer capital resources, (iv) limited management depth and (v) shorter operating histories. Further, the equity securities of smaller companies are often traded over-the-counter and generally experience a lower trading volume than is typical for securities that are traded on a national securities exchange.

Consequently, these accounts may be required to dispose of these securities over a longer period of time (and potentially at less favorable prices) than would be the case for securities of larger capitalization companies, offering greater potential for gains and losses and associated tax consequences.

**Portfolio Turnover Risk.** The accounts may engage in short-term trading strategies and securities may be sold without regard to the length of time held when, in the opinion of the firm, investment considerations warrant such action. These policies, together with the ability of the accounts to effect short sales of securities and to engage in transactions in options, may have the effect of increasing the annual rate of portfolio turnover of the accounts. A high portfolio turnover rate will result in greater brokerage commissions and transaction costs. It may also result in greater realization of gains, which may include short-term gains taxable at ordinary income tax rates.

**Management Risk.** The accounts will be subject to management risk, which means that the firm's security selections and other investment decisions might produce losses or cause the accounts to underperform when compared to other accounts with similar investment goals.

### **Risks Associated with Market Conditions and the Firm's Investments**

**General Economic Conditions and Current Events.** Various sectors of the global financial markets have been experiencing an extended period of adverse conditions. Over the past several years, market uncertainty has increased dramatically. These conditions have resulted in periods of reduced liquidity, greater volatility and a lack of price transparency. These difficult global credit market conditions have, at times, adversely affected the market values of equity, fixed-income and other securities and these circumstances may continue or even deteriorate further. The short- and longer-term impact of these events is uncertain, but could have a material effect on general economic conditions, consumer and business confidence and market liquidity. Investments made by the accounts are expected to be sensitive to the performance of the overall economy. A negative impact on economic fundamentals and consumer and business confidence would likely increase market volatility and reduce liquidity, both of which could have a material adverse effect on the performance of the accounts and these or similar events may affect the ability of the accounts to execute their investment strategies.

The SEC, the Commodity Futures Trading Commission ("CFTC") and Congress have devoted increased attention to the issue of whether hedge funds, fund of funds, and other private investment vehicles should be subject to increased or different modes of regulation. On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which, among other things, imposes registration requirements on many investment advisers to hedge funds, private equity funds and other private investment funds that were previously exempt from registration with either the SEC or the states, imposes new recordkeeping and reporting requirements on many fund advisers, and makes certain other changes to the regulatory landscape affecting investment advisers and private investment funds. As a consequence of amendments to the CFTC rules, the firm, its affiliates and its funds may be, but to date have not been, required to register with the CFTC as a commodity pool operator or commodity trading advisor in the future. Future changes in applicable securities laws or regulations could impose additional compliance or financial burdens upon the firm or its clients, including funds managed by the firm, or affect their operations in other respects.

**Hedging Transactions.** The market in which the accounts may invest is subject to fluctuations and the market value of any particular investment may be subject to substantial variation. The entire market or, particular securities traded on a market may decline even if earnings or other factors improve since the prices of debt securities and equity securities are subject to numerous economic, political, procedural and other factors that have little or no correlation to the performance of a particular company. The accounts may utilize a variety of financial instruments, such as derivatives, options, interest rate swaps, caps and

floors, futures and forward contracts, both for investment purposes and for risk management purposes. When used for hedging purposes, an imperfect or variable degree of correlation between price movements of the derivative instrument and the underlying investment sought to be hedged may prevent the accounts from achieving the intended hedging effect or expose the accounts to risk of loss. While the accounts may enter into hedging transactions to seek to reduce risk, such transactions may result in a poorer overall performance for the accounts than if they had not engaged in any such hedging transaction. We may determine not to hedge a position and may not identify appropriate risks to hedge. Moreover, it should be noted that the accounts' portfolios will always be exposed to certain risks that cannot be hedged.

In connection with a hedging transaction, the accounts' may be required to allocate funds or provide a credit line to be used as collateral for the margin capital of the hedge. Such a requirement would tie up a portion of the accounts' capital that could otherwise have been available for investment. This could cause an account to be less invested in its core investment strategy than it would have been absent such hedging transaction, and could possibly result in an adverse effect on the overall returns of the accounts.

Furthermore, the funds' ability to enter into hedging transactions may be limited by their compliance with CFTC Rule 4.13(a)(3)'s "de minimis" requirements with respect to the funds' commodity interest positions.

**Counterparty Risk.** Some of the markets in which the accounts may effect transactions are "over-the-counter" or "interdealer" markets. The participants in such markets are typically not subject to credit evaluation and regulatory oversight as are members of "exchange-based" markets. This exposes the accounts to the risk that a counterparty will not settle a transaction in accordance with its terms and conditions because of a dispute over the terms of the contract (whether or not *bona fide*) or because of a credit or liquidity problem, thus causing the relevant account to suffer a loss. Such "counterparty risk" is accentuated for contracts with longer maturities where events may intervene to prevent settlement, or where an account has concentrated its transactions with a single or small group of counterparties. The accounts are generally not restricted from dealing with any particular counterparty or from concentrating any or all of their transactions with one counterparty. Moreover, the accounts' internal counterparty review process, which evaluates the creditworthiness of their counterparties, may prove insufficient. The lack of a complete and "foolproof" evaluation of the financial capabilities of the accounts' counterparties and the absence of a regulated market to facilitate settlement may increase the potential for losses by the accounts. Changes in the credit quality of the companies that serve as the accounts' counterparties with respect to transactions supported by the counterparty's credit will affect the value of those instruments. Certain entities that have served as counterparties in the markets for these transactions have incurred significant financial hardships including bankruptcy and losses as a result of the credit crisis and making investments that have experienced recent defaults or otherwise suffered extreme credit deterioration. As a result, such hardships have reduced such entities' capital and called into question their continued ability to perform their obligations under such transactions. By using options, an account assumes the risk that its counterparties could experience similar financial hardships. In the event of default by, or the insolvency of, a counterparty, such account may sustain losses or be unable to liquidate a position.

**Systemic Risk.** Credit risk may also arise through a default by one of several large institutions that are dependent on one another to meet their liquidity or operational needs, so that a default by one institution causes a series of defaults by the other institutions. This is sometimes referred to as a "systemic risk" and may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges, with which the accounts may interact on a daily basis.

**Legal Risks of Funds as Part of Larger Firm.** The firm is part of Avenue Capital, a larger corporate structure with multiple business lines in multiple jurisdictions that are governed by a multitude of legal systems and regulatory regimes, some of which are new and evolving. As a result, the funds, the firm



and/or their respective affiliates are subject to a number of unusual risks, including changing laws and regulations, developing interpretations of such laws and regulations and increased scrutiny by regulators. Some of this evolution may result in scrutiny or claims against the funds, the firm and/or their affiliates directly for actions taken or not taken by the funds, the firm or their affiliates. Thus, the funds, the firm and their respective affiliates face the continuing risk of pending and potential litigation and regulatory action. These risks are often difficult or impossible to predict, avoid or mitigate in advance. The effect on the funds, the firm or any affiliate of any such legal risk, litigation or regulatory action could be substantial and adverse.

## **Conflicts of Interest**

An investment in an account involves certain potential conflicts of interest, including those described below.

**Overlapping Proprietary Investments.** Affiliates and/or employees of the firm may hold interests in one or more accounts, and such interests may be significant from time to time.

**Other Clients.** In addition to responsibilities with respect to the management and investment activities of any particular account, the firm will have similar responsibilities with respect to various other existing and future pooled investment vehicles and clients. The existence of such multiple vehicles and clients necessarily creates a number of potential conflicts of interest.

**Time Commitment.** The firm, its principals and their respective affiliates are not obligated to devote any specific amount of time to the affairs of any account. The firm's principals and their respective affiliates spend substantial time on other business activities, including those related to affiliate clients. The firm's Senior Principals and their affiliates currently engage in and will be free to continue to engage in investment activities for their own accounts.

**Agreements with Certain Investors in Private Funds.** The funds, the firm and their respective affiliates have and may from time to time in the future enter into agreements with one or more investors in private funds whereby in consideration for agreeing to invest certain amounts in a fund and other consideration deemed material to the fund, such investors may be granted rights not otherwise afforded to other investors, including, without limitation, the right to receive reports from the fund on a more frequent basis or to receive reports that include information not provided to other investors, the right to pay a reduced investment management fee, the right to receive a share of the investment management fee earned by the firm or its affiliate and such other rights as may be negotiated between the funds, the firm and their respective affiliates, on the one hand, and such investor, on the other hand. Such agreements will have the effect of establishing rights under, or altering or supplementing the terms of, the funds' constituent documents with respect to such investors. To the extent that compliance with any of the provisions of any such agreements would cause the funds, the firm or any of their respective affiliates to violate their respective fiduciary duties or obligations or to violate any applicable laws, any non-compliance with any such provision will not be deemed to be a breach of such agreements.

**Transactions with Affiliates.** A client may engage in transactions with the firm or its affiliates. The firm presently does not engage in cross trades on behalf of its clients, but may in the future determine to do so. The value of any affiliated transactions or any cross trades with any affiliated funds will be determined in a manner that is consistent with the fair valuation methodologies that are used by the firm.

**Diverse Investment Management Firm.** The firm and its affiliates engage in a broad range of investment management activities, including sponsoring and managing other pooled investment vehicles, client accounts and other activities. Although the relationships and activities of the affiliate managers should enable these entities to offer attractive opportunities and services to their clients, such relationships

and activities, in the ordinary course of business, may also give rise to circumstances in which the interests of these entities and other affiliates of the affiliate managers conflict with the interests of certain of affiliate's clients, including, without limitation, competition with other investment vehicles (proprietary or third-party managed) in which clients may have an interest, purchasing and selling investments in entities in which clients may have an interest, or taking or advocating positions in certain transactions that may be considered adverse to the interests of certain clients. The affiliate managers effectively may engage in opposite transactions with respect to a particular investment (*e.g.*, one affiliate client may acquire a long position in a security on behalf of an affiliate client while one or more of the other affiliate clients sells or shorts the security).

**Other Activities.** None of the firm or any of its principals are required to manage the investments of any particular client as their sole and exclusive function and each may engage in other business ventures and other activities unrelated to the affairs of any client, including directly or indirectly purchasing, selling, holding or otherwise dealing with any securities for the account of other investment funds, for their own accounts or for the accounts of their family or other clients. Without limiting the foregoing, the firm's principals may invest in, participate on advisory boards of and/or provide other services to, funds that are and are not affiliated with the firm and its family of funds. The firm and/or its principals may become aware of business opportunities in which clients will not be given an opportunity to participate.

**Investment Management Fee; Incentive Fee / Allocation.** The investment management fees and the incentive fees and allocations borne by funds have generally not been established on the basis of an arm's-length negotiation between the fund, on the one hand, and the firm or its affiliates, on the other hand. However, the firm's principals believe that the investment management fees, and the terms of the incentive fees and allocations, generally reflect prevailing market terms. The existence of an incentive fee or allocation may create an incentive for the firm to cause a fund to make, more speculative investments than it would otherwise make in the absence of such performance-based compensation.

Although an incentive fee or allocation has largely become a customary standard for private investment funds, this type of fee and relative allocation of profits and losses can be characterized as creating an incentive to the firm for speculative investment and thus a potential conflict with the interests of the clients. In addition, since the incentive fee and allocation of certain of our accounts is based upon portfolio gains, both realized and unrealized (net of realized and unrealized losses), it is possible that the firm may receive an incentive fee and incentive allocation based upon unrealized appreciation in particular positions that was not in fact achieved upon disposition of such positions. Further, while the firm is entitled to receive an incentive allocation based upon the realized and unrealized net profits initially allocated to each client, it is allocated net losses solely on the basis of its invested capital.

**Diverse Investors.** Each fund's investors may include taxable and tax-exempt entities and persons or entities resident of or organized in various jurisdictions. As a result, conflicts of interest may arise in connection with decisions made by the firm or an affiliate that may be more beneficial for one type of investor. In making such decisions, the firm and its affiliates intend to consider the investment objectives of the fund as a whole, not the investment objectives of any investor individually.

**Minority Investor in Avenue Capital.** In the ordinary course of a fund's investment activities, from time to time the fund may enter into transactions with parties related to Morgan Stanley, which is a minority investor in certain entities that are part of Avenue Capital. Such transactions may include, among other things, the fund purchasing securities from, or settling trades with, a party related to Morgan Stanley.

**Valuation.** While an account does not intend to invest or trade in securities for which market quotations are not readily available, if it were to do so in the future, the determination of unrealized appreciation for such securities would be made by the firm. The use of outside appraisers or independent investment

advisers to determine the valuation of such securities is not contemplated, although the funds' administrator would be responsible for confirming such valuations.

## **Item 9. Disciplinary Information**

This Item is not applicable to us.

## **Item 10. Other Financial Industry Activities and Affiliations**

### **Material Financial Industry Affiliations of the Firm**

The firm currently has no direct relationships with any private funds.

Through affiliated entities, the firm currently has indirect relationships with the following additional private funds:

- Avenue Europe International, Ltd.
- Avenue Europe International Master, L.P.
- Avenue Europe Investments, L.P.
- Avenue Europe Special Situations Fund II (Euro), L.P.
- Avenue Europe Special Situations Fund II (U.S.), L.P.
- Avenue Europe Special Situations Fund, L.P.
- Avenue Europe Special Situation Fund (Parallel), L.P.
- Avenue Europe Special Situations Fund (Parallel II), L.P.
- Avenue-SLP European Opportunities Fund, L.P.
- Avenue Europe Opportunities Fund, L.P.
- Avenue Europe Opportunities Fund, Ltd.
- Avenue Europe Opportunities Intermediate Fund, L.P.
- Avenue Europe Opportunities Master Fund, L.P.
- Avenue Europe Private Opportunities Fund, L.P.
- Avenue Europe Private Opportunities Co-Investment Fund, L.P.
- Avenue Europe Capital Solutions Fund, L.P.
- Avenue Europe Capital Solutions Feeder, L.P.
- Avenue Europe Employee Participation Plan, LLC
- Avenue Special Situations Fund IV, L.P.
- Avenue Special Situations Fund IV (Parallel), L.P.
- Avenue Special Situations Fund V, L.P.
- Avenue Special Situations Fund VI (A), L.P.

- Avenue Special Situations Fund VI (B-Feeder), L.P.
- Avenue Special Situations Fund VI (B), L.P.
- Avenue Special Situations Fund VI (C-Feeder), L.P.
- Avenue Special Situations Fund VI (C), L.P.
- Avenue Special Situations Fund VI (Master), L.P.
- Avenue Investments, L.P.
- Avenue International, Ltd.
- Avenue International Master, L.P.
- Avenue CLO Fund, Ltd.
- Avenue CLO II, Ltd.
- Avenue CLO III, Ltd.
- Avenue Real Estate Fund LP
- Avenue Real Estate Fund Parallel LP
- Avenue-CDP Global Opportunities Fund, L.P.
- Avenue TC Fund, L.P.
- Avenue Blue TC Fund, L.P.
- Avenue Special Opportunities Fund I, L.P.
- Avenue Special Opportunities Co-Investment Fund I, L.P.
- Avenue Employee Participation Plan, LLC
- Avenue Real Estate Employee Participation Plan, LLC
- MAGS Capital, LLC
- MAGS Capital II, LLC
- MAGS Capital III, LLC
- MAGS Capital VI, LLC
- MAGS Capital VIII, LLC
- Avenue Asia Special Situations Fund II, L.P.
- Avenue Asia Capital Partners, L.P.
- Avenue Asia Special Situations Fund III, L.P.
- Avenue Asia Special Situations Fund III (Parallel), L.P.
- Avenue Asia Special Situations Fund IV, L.P.
- Avenue Asia Investments, L.P.
- Avenue Asia International, Ltd.
- Avenue Asia International Master, L.P.

- Avenue Asia Employee Participation Plan, LLC
- Avenue Strategic Partners Feeder, L.P.
- Avenue Strategic Partners, L.P.
- Avenue Strategic Partners Feeder, Ltd.
- Avenue Strategic Partners, Ltd.
- 12<sup>th</sup> Avenue Employee Participation Plan, LLC

An affiliate of the firm, Avenue Capital Management II, L.P., serves as adviser to Avenue funds that are public funds.

The firm also has relationships with the following entities that act as investment advisers:

- Avenue Capital Management II, L.P. (registered as an investment adviser with the SEC since 2000)
- Avenue Europe International Management, L.P. (registered as an investment adviser with the SEC since 2004)
- Avenue Asia Capital Management, L.P. (registered as an investment adviser with the SEC since 2001 and registered with the Securities Exchange Board of India as a Foreign Institutional Investor since 2008)
- 12<sup>th</sup> Avenue Management, L.P. (registered as an investment adviser with the SEC since 2007)

The firm has relationships with the following entities (the general partner of private funds that are advised by us) that is its “relying adviser”:

- Artus Management GenPar, L.L.C. (the “general partner”)

The firm has relationships with the following entities (general partners of private funds that are advised by our investment adviser affiliates and certain entities used to carry on the these affiliates’ businesses) that are “relying advisers” of certain of its investment adviser affiliates:

- Avenue Capital Partners IV, LLC
- Avenue Capital Partners V, LLC
- Avenue Capital Partners VI, LLC
- Avenue International Master GenPar, LLC
- Avenue Partners, LLC
- Avenue Real Estate GenPar, LLC
- Avenue Global Opportunities Fund GenPar, LLC
- Avenue TC GenPar, LLC
- Avenue Blue TC GenPar, LLC
- Avenue SO Capital Partners I, LLC
- Avenue Asia Capital Partners II, LLC
- Avenue Asia Capital Partners III, LLC

- Avenue Asia Capital Partners IV, Ltd.
- Avenue Asia International Master GenPar, Ltd.
- Avenue Asia Investments GenPar, LLC
- Avenue Europe Capital Partners II, LLC
- Avenue Europe Capital Partners, LLC
- Avenue Europe Capital Solutions Partners, LLC
- Avenue Europe International Master GenPar, Ltd.
- Avenue Europe Investments GenPar, LLC
- Avenue Europe Opportunities Fund GenPar, LLC
- Avenue-SLP European Opportunities Fund GenPar, LLC
- Avenue EPO Partners, LLC
- Avenue Europe Management, LLP (authorized by the U.K. Financial Services Authority since 2004)
- Avenue Germany Management GMBH
- Avenue Luxembourg S.A.R.L.
- Avenue Asia Services, LLC
- Avenue Asia Advisors Private Limited
- Avenue Asia Singapore Pte Ltd.
- GCF Services, Ltd.
- Ai Hua Consulting (Beijing) Co., Ltd.
- Bo Yuan Jun He Consulting (Beijing) Co., Ltd.
- IH Services HK Limited
- PT LGR Indonesia

In October 2006, Morgan Stanley became an indirect minority owner of Avenue. From time to time, certain funds may utilize Morgan Stanley for prime brokerage, consulting and other services.

Avenue is affiliated with Amroc Investments, LLC. Marc Lasry and Sonia Gardner, the Senior Principals of Avenue, own Amroc. As of January 1, 2008, all of Amroc's employees became employees of Avenue entities and there are no commissions or other fees paid to Amroc for sourcing investments. We do not believe that the firm's relationship with Amroc is material to our ongoing business activities.

A number of entities with which the firm is affiliated serve as the general partners of private funds whose investment programs are managed by the firm and/or by affiliates of the firm.

### **Other Activities**

None of Avenue, its principals, nor any of their affiliates (including the firm), or their respective affiliates, employees, officers, directors, principals, shareholders and members, or affiliates of any such persons or entities is required to manage any of the funds as its sole and exclusive function and each may engage in

other business ventures and other activities unrelated to the affairs of the funds. Any person may become aware of business opportunities in which any fund is not expected to be given an opportunity to participate.

Except as otherwise set forth in a fund's offering documents, no person is obligated to devote any specific amount of time to the affairs of the funds. Avenue persons spend substantial time on other business activities, including those related to various existing and future pooled investment vehicles and other client accounts sponsored, formed, offered and managed by Avenue and its affiliates.

Furthermore, the Senior Principals of Avenue, and other officers and employees of Avenue and its affiliates, may, from time to time, serve on the boards of directors, credit committees, or other committees, of one or more entities in which one or more of the Avenue funds has invested. In addition, certain Avenue persons may, from time to time, provide certain services to the firm, the funds, one or more of the firm's other affiliates, and/or one or more of the investments or companies in which the funds invest. As a result, there may be a number of conflicts of interest which may arise, which could adversely affect the funds. Please see the disclosure provided elsewhere in this brochure under Item 8 as well as in the offering documents of the applicable fund.

Avenue persons engage in a broad range of investment management activities, including sponsoring and managing other private funds and other activities. Certain Avenue persons also expect to sponsor and operate future pooled investment vehicles and other client accounts that pursue similar investment objectives or other lines of investment activity. Although the relationships and activities of Avenue persons should enable these entities to offer attractive opportunities and services to the funds and investors, such relationships and activities, in the ordinary course of business, may also give rise to circumstances in which the interests of these entities and other affiliates of the Avenue persons conflict with the interests of the funds and investors, including, by way of example but not limitation, competition with other investment vehicles (proprietary or third-party managed) in which investors may also have an interest, purchasing and investments in entities in which investors may have an interest, or taking or advocating positions in certain transactions that may be considered adverse to the interests of investors.

The Avenue persons, the funds, the general partners of such funds (if applicable) or their respective members, officers, directors, employees, principals or affiliates may come into possession of material, non-public information. The possession of such information may limit the ability of the accounts to buy or sell a security or otherwise to participate in an investment opportunity.

## **Item 11. Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

### **Code of Ethics; Personal Trading**

We have adopted a written code of ethics that applies to the firm, our employees and certain related persons. Our code of ethics is administered by our chief compliance officer or his designees. Employees are given training with respect to our code of ethics when they are hired and annually thereafter. Each client may obtain a copy of our code of ethics by submitting a written request to Eric Ross at 399 Park Avenue, 6th Floor, New York, New York 10022 or by contacting Mr. Ross at (212) 878-3500.

The following general principles and standards of conduct are established by our code of ethics:

- We must operate at the highest level of ethical standards in keeping with our fiduciary duties to clients, and in compliance with all applicable laws.

- We have a duty to place the interests of clients first and to avoid conflicts of interest.
- Information about our operations and investment strategies, as well as information about investors in our funds and our managed account clients (other than, possibly, their name), unless otherwise consented to by the investor, is strictly confidential and will not be disclosed to anyone outside the firm and its consultants and agents, unless required by law or a government agency and upon prior notice to the chief compliance officer.
- Our employees may not use any confidential information or otherwise take inappropriate advantage of their position for the purpose of furthering any private interest or as a means of making any personal gain.
- Our employees and their immediate families may not accept any benefit from a client, an investor in one or more of our funds or person who does business with us, except for normal business courtesies and non-cash gifts of nominal value, except as otherwise provided for by our code of ethics.
- Insider trading is prohibited and may expose an employee to stringent penalties.

Our code of ethics deals with a range of topics including, without limitation, the following:

- Categories of persons related to the firm who are covered by the code of ethics.
- Opening of personal securities accounts by covered persons.
- Pre-approval requirement for most personal securities transactions.
- Submission to the firm of information concerning personal securities holdings and transactions.
- Restrictions on trading in securities of particular issuers.
- Gifts, entertainment and investee company promotions (*i.e.*, any discounted or complimentary goods or services provided by an investee company to a firm employee, such as hotel rooms).
- Charitable contributions.
- Political contributions and payments.
- Reporting of violations and our whistle-blower policy.
- How the code of ethics is administered.
- How exceptions to the code of ethics may be granted by our chief compliance officer.

Each covered person is required to acknowledge that he or she has received and reviewed, and understands the Code of Ethics.

### **Participation or Interest in Client Transactions**

A principal transaction occurs when an investment adviser, acting for its own account (or the account of an affiliate) buys a security from, or sells a security to, a client's account. An agency cross trade occurs when a person acts as an investment adviser in relation to a transaction in which such investment adviser, or any person controlling, controlled by, or under common control with such investment adviser, acts as broker for both such advisory client and for another person on the other side of the transaction. The firm currently does not engage in principal transactions or agency cross trades.



The firm may, from time to time, recommend a security in which the firm, directly or indirectly, has an interest. For instance, it may be expected that one or more of the accounts may invest capital in securities of issuers in which one or more of the other accounts hold positions. In addition, the firm or its affiliates may invest their own capital in the accounts. Given the likely frequency of these occurrences, clients will not be provided with notification of them. This may represent a conflict of interest for the firm.

We will not be engaged as an investment adviser to advise investors as to the appropriateness of investing in the funds we manage or establishing a managed account with us. Although we will not receive any compensation for selling interests in the funds, we will receive compensation in our capacity as manager of these funds based in part upon the amount invested in the funds.

Accounts that are beneficially owned by the firm's employees, principals and affiliates may from time to time transact in securities. These transactions will be subject to our personal account trading policy.

## **Item 12. Brokerage Practices**

### **Selection of Brokers**

In effecting securities transactions, the firm generally seeks to negotiate with brokers a combination of the most favorable commission and the best price obtainable on each transaction. Consequently, brokers are selected primarily on the basis of their execution capability and trading expertise consistent with the effective execution of the transaction.

In determining the broker or dealer to be used and the commission rates to be paid, the firm considers the utility and reliability of brokerage services, including:

- execution capability and performance,
- financial responsibility and investment information,
- market insights, and
- other research provided by the brokers.

Accordingly, the commissions charged by brokers may be greater than the amount another broker might charge if the firm determines in good faith that the amount of these commissions is reasonable in relation to the value of the brokerage services and research information provided by the brokers. The firm's authority to select the broker or dealer to be used may be limited by legal restrictions such as those imposed under the U.S. Employee Retirement Income Security Act of 1974 (ERISA).

Consistent with the requirements of best execution, brokerage commissions may be directed to brokers in recognition of investment research and information furnished as well as for services rendered in the execution of orders by such brokers. By allocating transactions in this manner, the firm is able to supplement its research and analysis with the views and information of brokerage firms. The funds may also allocate a portion of their brokerage business to brokerage firms whose employees participate as brokers in the introduction of investors to the funds or who agree to bear the expense of capital introduction, marketing or related services by third parties.

The firm may effect securities transactions, to the extent permitted by law, with brokerage firms affiliated with the firm or with investment companies registered under the Investment Company Act of 1940 to which the firm provides advisory services, if it reasonably believes that the quality of execution and the commission are comparable to that available from other qualified firms. Certain broker-dealers, through

which the public fund we sub-advise may effect securities transactions, may be affiliated persons (as defined in the Investment Company Act) of the firm or the applicable public fund. Avenue has adopted certain policies incorporating the standards of Rule 17e-1 issued by the SEC under the Investment Company Act which require that the commissions paid to affiliates of the public funds be reasonable and fair compared to the commissions, fees or other remuneration received or to be received by other brokers in connection with comparable transactions involving similar securities during a comparable period of time. The rule and procedures also contain review requirements and require the firm to furnish reports to the trustees of the public funds and to maintain records in connection with these reviews.

### **Soft Dollar and Directed Brokerage Arrangements**

We do not presently intend to receive soft dollar items, but we do have the right to receive such items and may do so in the future, provided that such soft dollar items fall within the “safe harbor” of Section 28(e) of the U.S. Securities Exchange Act of 1934.

A client may direct the firm in writing to use a particular broker-dealer to execute some or all transactions for the client (“directed brokerage”). In that case, it will be the responsibility of the client to negotiate terms and arrangements for trade execution for the account with that broker-dealer, and the firm will disclose to the client that the firm will not seek best execution from other broker-dealers. The firm will also disclose to the client that as a result of the directed brokerage, the client may pay higher commissions or other transaction costs or greater spreads, or receive less favorable net prices, on transactions for the account than would otherwise be the case. Where the client has directed brokerage that would result in additional operational difficulties, the firm may choose to terminate the investment advisory relationship.

### **Aggregation of Orders**

The firm does not presently aggregate trades but may choose to do so in the future. If the firm so determines, client trades will be aggregated with affiliated accounts under the following conditions:

- Account trades are treated equally with those for affiliated accounts;
- Each participant in the trade will receive the average execution price and may receive discounted commissions;
- Securities will be allocated in a fair and equitable manner pursuant to the firm’s policies and procedures; and
- The practice of aggregating account trades with affiliated accounts will be disclosed in the firm’s disclosure documents, as necessary.

### **Allocation Procedures**

In addition to our responsibilities with respect to the management and investment activities of the funds and the option overlay accounts, we and our affiliates will have similar responsibilities with respect to various other existing pooled investment vehicles and managed accounts (such clients, together with clients of the firm, are referred to as “affiliate clients”). The existence of such multiple vehicles and accounts necessarily creates a number of potential conflicts of interest.

The public fund to which the firm serves as a sub-adviser may invest in securities that are similar to investments that may be held by the firm’s private funds and separately managed accounts.

As a general matter, the firm does not allocate trades between or among accounts. If the firm determines to do so in the future, the firm, in advance of placing a block trade, will:

- Disclose its aggregation policies in its disclosure documents;
- Obtain client's consent to aggregate their trades in the applicable investment advisory agreement, subscription agreement or by other means;
- Ensure that each account will be treated fairly and will not favor any account over another; and
- Ensure that the decision to aggregate a trade for a client is based on individual advice to that client.

Once the foregoing prerequisites have been performed, the firm will either:

- Designate on the trade order memorandum, the number of shares of the block trade to be allocated to each specific account prior to placing the order; or
- Make a *pro rata* allocation of the shares to each account based upon the size of the client's account.

Throughout the block trade, the firm will continue to:

- Seek best execution on such trades;
- Avoid holding cash and securities involved in an aggregated trade longer than necessary; and
- Avoid receiving additional compensation as a result of the aggregation.

In the event that the firm determines that a pro-rated allocation is not appropriate under the particular circumstances, the allocation will be made based upon other relevant factors, which may include:

- When only a small percentage of the order is executed, shares may be allocated to the account with the smallest order or the smallest position or to an account that is out of line with respect to security or sector weightings relative to other portfolios, with similar mandates;
- Allocations may be given to one account when that account has limitations in its investment guidelines which prohibit it from purchasing other securities which are expected to produce similar investment results and can be purchased by other accounts;
- With respect to sale allocations, allocations may be given to accounts relatively lower in cash;
- In cases when a *pro rata* allocation of a potential execution would result in a *de minimis* allocation in one or more accounts, the firm may exclude the account(s) from the allocation and the transactions may be executed on a *pro rata* basis among the remaining accounts; or
- With respect to allocation of limited investment opportunities, in the event that insufficient shares/securities are available to make a *pro rata* allocation to all accounts for which the opportunity is appropriate, the firm will select a random method for allocation that ensures no client is preferred over another.

## **Trade Errors**

We have adopted a policy for the purpose of addressing trade errors that may arise, from time to time, with respect to the securities transactions of the accounts. An example of a trade error is the sale of a security when it should have been purchased. Pursuant to the policy, we will seek to identify and correct any trade errors in an expeditious manner. Trade errors that result in losses for an account that are the result of our gross negligence or willful misconduct, as determined by us, will be reversed, and we will be responsible to make the affected accounts whole. Trade errors that result in losses for an account, other than a public fund, or managed account that are not the result of our gross negligence or willful misconduct, as determined by us, will be reversed and we may, but are not required to, bear such losses in whole or in part. Any such losses we do not bear will be borne by the affected accounts. Trade errors that result in losses for a public fund, whether or not they are the result of our gross negligence or willful misconduct, will be reversed, and we will be responsible to make the affected public fund whole. Gains from trade errors will be credited to the affected accounts. Gains from trade errors may not be used to offset losses from trade errors. “Soft dollars” or “client commissions” will not be used, either directly or indirectly, to correct trade errors. We document each trade error and maintain a trade error file. The determination of whether or not a trade error has occurred will be in our sole discretion.

## **Item 13. Review of Accounts**

Accounts are reviewed daily, and all accounts are monitored on a portfolio management system that provides current and comprehensive information concerning account performance, asset allocation, and the progress of individual positions in the portfolio. Account review is a routine firm function, but it can be triggered or intensified by unexpected performance, shifting market conditions, or changing client preferences or circumstances.

With respect to the private funds for which the firm serves as the investment manager and the public fund for which the firm serves as the sub-adviser, each investor receives annual audited financial balance and income statements of each such fund. In addition, investors in the public fund the firm sub-advises receive semi-annual unaudited reports, and investors in the various private funds receive additional financial statements and reports as described in the confidential offering memorandum for each private fund.

With respect to other clients for whom we serve as the investment manager on a managed account basis, we will provide such clients with monthly reports and statements.

## **Item 14. Client Referrals and Other Compensation**

### **Compensation for Client Referrals; Placement Agents for Funds**

The firm is one of five registered investment advisers that are part of Avenue Capital Group. Any one of our five registered advisers, or another member of Avenue Capital Group, may retain the services of one or more placement agents in connection with the solicitation of prospective investors. Avenue has retained Hightower Securities, LLC, Spoonhill Asset Management, Inc., J.P. Morgan Securities Inc., Morgan Stanley & Co., Jefferies & Co., Inc., Credit Suisse Securities (SA) LLC, Barclays, UBS, Lazard Freres & Co., Inc., ABAX Brokerage Services, LLC and Foreside Financial Group, LLC as placement agents. Typically, placement agents retained by Avenue are paid a fee based upon a percentage of the investor’s investment or of the applicable Avenue adviser’s management fee. These fees are borne by

Avenue. If an investor that is placed with Avenue by one of the placement agents we have retained has a brokerage or other relationship with that placement agent, that investor may pay additional fees to the placement agent if the terms of its relationship with the placement agent so provide. To the extent applicable, solicitations of prospective managed clients are made in accordance with SEC Rule 206(4)-3 adopted under the Investment Advisers Act of 1940.

## **Item 15. Custody**

We have custody, as defined in Rule 206(4)-2 under the Investment Advisers Act of 1940, of the assets of the private funds as a result of the service of the general partner of some of the private funds we manage and our ability to remove the independent directors of some of the private funds we manage. The private funds are audited annually and deliver audited financial statements to their investors within 120 days' of the applicable fiscal year-end.

## **Item 16. Investment Discretion**

Item 4 includes a description of the investment discretion that we exercise.

## **Item 17. Voting Client Securities**

We have policies and procedures in place for the voting of proxies and processing of corporate actions on behalf of the accounts we advise. The proxy policy is designed to ensure compliance with the proxy voting, disclosure and record keeping requirements under SEC Rules 206(4)-6 and 204-2 adopted under the Investment Advisers Act of 1940, as investment adviser to the accounts.

Our policies and procedures are also designed to ensure that all proxy and corporate action proposals are thoroughly reviewed voted in the best interest of each account, provide disclosure to fund investors and managed account clients and ensure that certain documentation is retained. As a general matter, fund investors and managed account clients may not direct our vote in a particular solicitation.

The firm's objective is to ensure that its proxy voting and corporate action activities on behalf of the accounts are conducted in a manner consistent, under all circumstances, with the best interest of the accounts.

### **Proxy Voting**

Each investor in a private fund and each managed account client may obtain a copy of our firm's proxy voting policies and procedures by submitting a written request to Eric Ross at 399 Park Avenue, 6th Floor, New York, New York 10022 or by contacting Mr. Ross at 212-878-3520.

### **Corporate Actions**

Avenue has adopted procedures to address and, in some cases, mitigate the conflicts of interest that may arise with respect to corporate actions where multiple accounts hold different securities of the same issuer. In cases where either a specific right, such as a vote with respect to a security or the grant of a waiver, or an ongoing right, such as an opportunity to serve on a creditor's committee or otherwise engage in discussions with an issuer, arises, and Avenue does not identify a conflict of interest, the following procedures will apply:

- Avenue will be responsible for determining whether the course of action that is in the best interest of the relevant account is clear;
- Avenue will exercise the right or ongoing right in the best interest of the relevant account(s); and
- The Chief Compliance Officer will be notified prior to the exercise of the right.

If Avenue identifies a conflict of interest with respect to such a situation, then Avenue will notify the Chief Compliance Officer and convene its Conflicts Committee to attempt to resolve the conflict. If the Conflicts Committee cannot do so, Avenue will follow the procedures set forth in each fund's organizational documents. The funds' organizational documents generally provide that:

- In the case of a public fund, the investment adviser (if the firm serves as the sub-adviser) or Board of Directors (or Trustees) of the public fund may direct the vote on behalf of the fund; and
- In the case of a private fund, an advisory committee established by the fund or independent representative appointed to handle such matters or, if permitted under the fund's organizational documents, an independent third-party, may vote on behalf of the fund.

## **Item 18. Financial Information**

We do not require or solicit prepayment of more than \$1,200 in fees from the funds, six months or more in advance, and therefore are not required to include a balance sheet for our most recent fiscal year.