

Item 1. Cover Page



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## FORM ADV PART 2

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**This brochure provides information about the qualifications and business practices of 12<sup>th</sup> Avenue Management, L.P. If you have any questions about the contents of this brochure, please contact Eric L. Ross, Senior Managing Director and Chief Compliance Officer, at (212) 878-3520 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 12<sup>th</sup> Avenue 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 first time we have used the SEC's new Form ADV Part 2. Much of the information called for by the Form is new and many of our responses, therefore, differ from those in previous versions of our Form ADV. The last version of our Form ADV Part 2 was released in December of 2010. This brochure, because it is on the new Form, should be reviewed in its entirety.

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## **Item 4. Advisory Business**

### **Structure; History and Ownership**

12<sup>th</sup> Avenue Management, L.P. (the “firm”) is an investment adviser with its principal place of business in New York City. The firm provides investment advisory services to private investment funds.

12<sup>th</sup> Avenue Management, L.P. commenced business in 2007. The firm has been registered as an investment adviser with the Securities and Exchange Commission (“SEC”) since August 9, 2007.

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, 12<sup>th</sup> Avenue Management GenPar, LLC. Robert G. Russel is a Senior Portfolio Manager and is responsible for the firm’s strategy.

The firm is part of Avenue Capital Group (“Avenue”, “Avenue Capital” or “we”), an established global alternative investment firm founded in 1995. Avenue Capital has approximately 300 employees worldwide, including 102 investment professionals. Avenue Capital maintains an institutional infrastructure with extensive accounting, operations, legal, investor relations, risk management, compliance and information technology teams.

Our primary investment advisory service is to provide discretionary investment advice to private investment funds.

Avenue Capital’s primary focus is investing in distressed debt and other special situations investments in the United States, Europe and Asia. The Senior Principals and the portfolio managers of the investment funds managed by the firm have spent virtually their entire careers in this space.

The firm’s primary investment strategy is a Multi-Manager strategy, pursuant to which we invest in a diverse group of private collective investment pools, commonly known as hedge funds, that are focused on investing primarily in distressed, special situations and deep-value or event-driven strategies. Using our Multi-Manager strategy, we allocate assets to a portfolio of funds that invest in a wide variety of instruments, across asset classes and sectors. We seek to invest with managers that have proven expertise investing in distressed opportunities throughout the distressed cycle. The Multi-Manager strategy generally targets managers focused on:

- distressed securities;
- bank debt;
- high yield debt;
- restructured and post-reorganization equities;
- event-driven situations;
- private lending;
- hedged strategies; and
- trade claims.

Prospective investors in any fund are advised to review the fund's private placement memorandum, explanatory memorandum, or confidential offering circular for a more in-depth description of that fund's investment strategy and objectives and related risk factors.

Some of the private funds we advise are feeder funds to or parallel funds of other funds.

A list of the funds we manage can be found below at Item 10.

## **Types of Advisory Services**

As described above, we provide advisory services to private funds. The advisory services we provide to investment funds are provided on a discretionary basis.

The investment strategies we employ on behalf of the funds, including, as applicable, restrictions on permissible investments and/or investment guidelines, are described below at Item 8.

## **Assets Under Management**

As of February 28, 2011, we managed approximately \$232,000,000 of client assets, all on a discretionary basis.

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

### **Fees**

Detailed information regarding fees is included in each fund's confidential offering memorandum. Because this brochure will only be delivered 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.

Some of our funds pay a management fee and an incentive allocation or performance fee and some of our funds only pay a management fee. The funds that only pay a management fee are dedicated feeder funds that invest substantially all of their assets into investing funds formed to carry out the investment program. The investing funds pay both a management fee and an incentive allocation or performance fee. The dedicated feeder funds do not bear any management fee, or any incentive allocation or performance fee, at the level of the investing funds into which they invest.

In the event that our investment management agreement with a fund is terminated, management fees are *pro rated* for partial periods.

Incentive allocations and performance fees are calculated as a percentage of profits of the applicable funds. The investing funds pay incentive allocations or performance fees, in whole or in part, on mark-to-market performance at the end of a period (year-end or upon a partial or full withdrawal), subject to a high watermark.

Management fees are paid to us directly by the funds. Incentive allocations and performance fees are allocated to our account with the relevant fund.

Management fees, incentive allocations and performance fees may be negotiable.

## Expenses

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

Detailed information regarding the expenses to which each fund is subject is set out in the offering documents with respect to the particular fund.

All funds will pay their out-of-pocket operating expenses, including:

- organizational expenses;
- administrative fees and expenses payable to an administrator;
- professional fees and expenses of auditors and legal counsel;
- government filing and registration fees;
- insurance (including director's and officer's insurance and errors and omissions insurance);
- costs of communications with limited partners; and
- such other expenses as are set forth in the fund's private placement memorandum and/or organizational documents.

Each dedicated feeder fund will also pay its *pro rata* share of the expenses of any investing fund into which its assets are invested, including:

- organizational expenses;
- investment expenses; and
- any extraordinary expenses incurred.

Each investing fund will pay the following additional expenses relating to its ongoing operations:

- expenses of purchasing, carrying and disposing of portfolio positions, such as:
  - brokerage commissions;
  - interest and commitment fees on borrowings; and
  - withholding and transfer taxes;
- professional fees and expenses of attorneys, accountants, appraisers and other third-party consultants in connection with researching and implementing investment opportunities;
- transaction costs associated with making investments in portfolio funds;
- a *pro rata* share of the expenses of portfolio funds in which the master funds invests, including:
  - such portfolio funds' organizational, operating and investment expenses; and
  - any extraordinary expenses incurred by such portfolio funds;
- fees payable to advisors of portfolio funds.

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

We receive part of our compensation from certain of the funds we advise (the investing funds described in Item 5, above) in the form of incentive allocations or performance fees from the accounts of the investors in the fund to our account in the fund. Incentive allocations and performance fees are calculated as a percentage of certain net capital appreciation during a period (subject to high watermarks), and allocated at the end of each fiscal year of the relevant fund. Other funds we advise (the dedicated feeder funds described in Item 5, above) do not pay an incentive allocation or performance fee. As discussed in Item 5, above, the dedicated feeder funds invest substantially all of their assets in the investing funds and do not bear any management fee, or any incentive allocation or performance fee, at the level of the investing funds into which they invest. Because the dedicated feeder funds that do not pay an incentive allocation or performance fee invest substantially all of their assets in the investing funds, which do pay an incentive allocation or performance fee, we do not believe the difference in fee structure creates a conflict of interest. Management fees, incentive allocations and performance fees are negotiable.

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

We serve as the investment manager and provide investment advisory services to private funds. Investment advice is provided directly to the funds and not individually to each of the funds' limited partners or shareholders, as applicable.

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

Each fund investor 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 meet such other eligibility requirements as we determine on a case by case basis.

There is no minimum size for the funds we advise. The funds have minimum investment amounts ranging from \$250,000 to \$500,000. These minimums may be reduced or waived by the general partners 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.

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

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

The firm's primary investment strategy is a Multi-Manager strategy, pursuant to which we invest in a diverse group of private collective investment pools, commonly known as hedge funds, that are focused on investing primarily in distressed, special situations and deep-value or event-driven strategies. These funds are sometimes referred to herein as portfolio funds. Using our Multi-Manager strategy, we allocate assets to a portfolio of funds that invest in a wide variety of instruments, across asset classes and sectors. We seek to invest with managers that have proven expertise investing in distressed opportunities throughout the distressed cycle. The Multi-Manager strategy generally targets managers focused on:

- distressed securities;



- bank debt;
- high yield debt;
- restructured and post-reorganization equities;
- event-driven situations;
- private lending;
- hedged strategies; and
- trade claims.

As a general matter, we do not use leverage as part of our Multi-Manager strategy, although we may in the future, and the managers to whom we allocate assets may use leverage as part of their 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 for a more in-depth description of that fund's investment strategy and objectives and related risk factors.

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

The investment strategies described above that we use for the funds cover a wide range of investment types. Material risks involved in our investment strategies are described below. Prospective investors in any fund are advised to review the fund's private placement memorandum, explanatory memorandum, or confidential offering circular for a more in-depth description of that fund's investment strategy and objectives and related risk factors.

#### **Conflicts of Interest**

An investment in a fund involves certain potential conflicts of interest, including those described below.

**Other Clients.** In addition to responsibilities with respect to the management and investment activities of any particular fund, 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 accounts necessarily creates a number of potential conflicts of interest.

**Combined Orders.** If the firm has determined to invest at the same time for one or more Other Clients, the firm will generally place combined orders for all such accounts simultaneously and if all such orders are not filled at the same price, it will generally average the prices paid. Similarly, if an order on behalf of more than one vehicle or account cannot be fully executed under prevailing market conditions, the firm will allocate the investments among the different vehicles or accounts on a basis that it considers equitable. Situations may occur where a client could be disadvantaged because of the investment activities conducted by investment managers for other clients.

**Time Commitment.** The firm and its principals and their respective affiliates are not obligated to devote any specific amount of time to the affairs of any fund. The principals and their respective affiliates spend substantial time on other business activities, including those related to the other Avenue 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.

**Transactions with Affiliates.** A client may engage in transactions with the firm or its affiliates. The firm may cause a fund to engage in cross trades. 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 the other investment managers that make up Avenue 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 Avenue 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 Avenue managers conflict with the interests of certain of Avenue'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.

**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 unaffiliated 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 Allocation.** The investment management fees and the incentive 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 allocations, generally reflect prevailing market terms. The existence of an incentive 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. In addition, the investment management fees will be charged on capital contributions that have not yet been returned or redeemed.

Although an incentive allocation, such as is paid to the general partners of certain of our private funds, has largely become a customary standard for private investment funds, this type of relative allocation of profits and losses can be characterized as creating an incentive to the general partner for speculative investment and thus a potential conflict with the interests of the limited partners. In addition, since the incentive allocation of certain of our private funds is based upon portfolio gains, both realized and unrealized (net of realized and unrealized losses), it is possible that the general partner may receive an incentive allocation based upon unrealized appreciation in particular positions that was not in fact achieved upon disposition of such positions. Further, while the general partner is entitled to receive an incentive allocation based upon the realized and unrealized net profits initially allocated to each limited partner, 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 Group.** In the ordinary course of a fund's investment activities, from time to time the fund may enter into transactions with parties related to the Morgan Stanley, which is an affiliate of Avenue. Such transactions may include, among other things, the fund purchasing securities from, or settling trades with, a party related to Morgan Stanley.

#### Risks Related to Our Investment Strategies

**Investment and Trading Risks in General.** All investments made by the firm or by the portfolio funds selected by the firm face the risk of loss of capital. Managers may utilize investment techniques such as trading on margin, short sales, substantial leverage, investments in non-marketable securities, foreign currency transactions, highly concentrated portfolios, options trading and the purchase or sale of forward and futures contracts. These techniques and financial instruments can, in certain circumstances, maximize the adverse impact to which a fund may be subject. No guarantee or representation is made that any fund's program will be successful, and investment results may vary substantially over time.

**General Economic Conditions and Recent Events.** Various sectors of the global financial markets have been experiencing an extended period of adverse conditions. Recently, market uncertainty in the United States has increased dramatically, and adverse market conditions have expanded to other markets. These conditions have resulted in reduced liquidity, greater volatility, general widening of credit spreads and a lack of price transparency. These difficult global credit market conditions have 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 funds are expected to be sensitive to the performance of the overall economy and any 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 funds and these or similar events may affect the ability of the funds and the portfolio funds they invest in to execute their investment strategies.

**Low Credit Quality Securities.** The funds may invest in portfolio funds that may make particularly risky investments and may also offer the potential for correspondingly high returns. As a result, a portfolio fund may lose all or substantially all of its investment in any particular instance. In addition, there is no minimum credit standard that is a prerequisite to a portfolio fund's investment in any security. The debt securities in which a portfolio fund invests may be rated lower than investment grade and hence may be considered to be "junk bonds" or distressed securities.

**Distressed Credits.** The portfolio funds may invest in securities of U.S. and non-U.S. issuers in weak financial condition, experiencing poor operating results, having substantial capital needs or negative net worth, facing special competitive or product obsolescence problems, or that are involved in bankruptcy or reorganization proceedings. Investments of this type may involve substantial financial and business risks that can result in substantial or at times even total losses. Among the risks inherent in investments in troubled entities is the fact that it frequently may be difficult to obtain information as to the true condition of such issuers. Such investments also may be adversely affected by U.S. state and federal laws relating to, among other things, fraudulent transfers and other voidable transfers or payments, lender liability and the U.S. bankruptcy courts' power to disallow, reduce, subordinate or disenfranchise particular claims.

The market prices of such securities are also subject to abrupt and erratic market movements and above average price volatility, and the spread between the bid and ask prices of such securities may be greater than those prevailing in other securities markets. It may take a number of years for the market price of such securities to reflect their intrinsic value. In liquidation (both in and out of bankruptcy) and other forms of corporate reorganization, there exists the risk that the reorganization either will be unsuccessful

(due to, for example, failure to obtain requisite approvals), will be delayed (i.e., until various liabilities, actual or contingent, have been satisfied), or will result in a distribution of cash or a new security, the value of which will be less than the purchase price paid by the portfolio fund of the security in respect to which such distribution was made.

**Derivatives.** Certain portfolio funds may invest in complex derivative instruments that seek to modify or replicate the investment performance of particular securities, commodities, currencies, interest rates, indices or markets on a leveraged or unleveraged basis. These instruments generally have counterparty risk and may not perform in the manner expected by the counterparties, thereby resulting in greater loss or gain to the investor. These investments are all subject to additional risks that can result in a loss of all or part of an investment; in particular, interest rate and credit risk volatility, world and local market prices and demand, and general economic factors and activity. Derivatives may have very high leverage embedded in them, which can substantially magnify market movements and result in losses greater than the amount of the investment. Some of the markets in which a portfolio fund may effect derivative transactions are “over-the-counter” or “interdealer” markets. In addition, derivative instruments that may be purchased or sold by a portfolio fund are expected to regularly consist of instruments that are not traded on an exchange. The participants in such markets are typically not subject to the same credit evaluation and regulatory oversight as are members of “exchange-based” markets. This exposes the portfolio fund to the risk that a counterparty will not settle a transaction in accordance with its terms and conditions because of a credit or liquidity problem with the counterparty. Delays in settlement may also result from disputes over the terms of the contract (whether or not bona fide) since such markets may lack the established rules and procedures for swift settlement of disputes among market participants found in “exchange-based” markets. These factors may cause a portfolio fund to suffer a loss due to adverse market movements while replacement transactions are executed or otherwise. Such “counterparty risk” is present in all swaps and other over-the-counter derivatives, and is accentuated for contracts with longer maturities where events may intervene to prevent settlement, or where a portfolio fund has concentrated its transactions with a single or small group of counterparties. A portfolio fund generally is not restricted from dealing with any particular counterparty or from concentrating any or all of its transactions with one counterparty. In addition, any investments in complex derivative instruments must comply with, or be exempt from, applicable laws and regulations. These laws, regulations and exemptions may change and regulators may impose additional requirements with respect to trading complex derivative instruments or restrict currently available exemptions. Transactions in certain derivatives may be subject to clearance on a U.S. national exchange and to regulatory oversight. Derivative instruments contain much greater leverage than do non-margined purchases of the underlying instrument in as much as only a very small portion of the value of the underlying instrument is required to be paid in order to effect such investments.

Other risks may include market risk, liquidity risk, legal risk and operations risk. Special risks may apply to instruments which are invested in by portfolio funds in the future which cannot be determined at this time or until such instruments are developed or invested in by a portfolio fund.

For example, such derivative instruments are expected to be highly illiquid and it is possible that a portfolio fund will not be able to terminate such derivative instruments prior to their expiration date or that the penalties associated with such a termination might impact the portfolio fund’s performance in a material adverse manner. If a portfolio fund seeks to participate through the use of such derivative instruments, the portfolio fund will not acquire any voting interests or other shareholder rights that would be acquired with a direct investment in the underlying securities or financial instruments. Accordingly, the portfolio fund will not participate in matters submitted to a vote of the shareholders. In addition, a portfolio fund may not receive all of the information and reports to shareholders that the portfolio fund would receive with a direct investment. Further, a portfolio fund will pay the counterparty to any such derivative instrument structuring fees and ongoing transaction fees, which will reduce the investment performance of the portfolio fund. Finally, certain aspects of the appropriate U.S. federal income tax

treatment of such derivative instruments are uncertain and, if a portfolio fund's U.S. federal income tax treatment of such instruments proves to be inappropriate, the Fund's after tax return from its investment in such portfolio fund may be adversely affected.

**Hedging Transactions.** The portfolio funds may engage in hedging transactions. Hedging against a decline in the value of a portfolio position does not eliminate fluctuations in the values of portfolio positions or prevent losses if the values of such positions decline, but establishes other positions designed to gain from those same developments, thus moderating the decline in the portfolio positions' value. Such hedging transactions also limit the opportunity for gain if the value of the portfolio position should increase. Moreover, it may not be possible for the portfolio funds to hedge against an exchange rate, interest rate or security price fluctuation that is so generally anticipated that such portfolio fund is not able to enter into hedging transactions at a price sufficient to protect its assets from the decline in value of the portfolio positions anticipated as a result of such fluctuations.

The portfolio funds are not required to attempt to hedge portfolio positions and, for various reasons, may determine not to do so. Furthermore, success is also dependent upon the portfolio funds' ability to correctly predict movements in the direction of currency and interest rates. Therefore, while a portfolio fund may enter into such transactions to seek to reduce risks, such transactions may result in a poorer overall performance for such portfolio funds than if it had not engaged in any such hedging transaction. In addition, the degree of correlation between price movements of the instruments used in a hedging strategy and price movements in the portfolio position being hedged may vary.

Moreover, for a variety of reasons, the portfolio funds may not seek to establish a perfect correlation between such hedging instruments and the portfolio holdings being hedged. The successful utilization of hedging and risk management transactions requires skills complementary to those needed in the selection of the portfolio funds' holdings. Moreover, it should be noted that a portfolio will always be exposed to certain risks that cannot be hedged, such as credit risk (relating both to particular securities and counterparties), liquidity risk and "widening" risk.

**Stock Index Options.** The portfolio funds may purchase and sell call and put options on stock indices listed on exchanges or traded in the over-the-counter market for the purpose of realizing its investment objective or for the purpose of hedging its portfolio. Successful use by a portfolio fund of options on stock indices is subject to the portfolio fund's ability to correctly predict movements in the direction of a relevant stock market generally or of a particular industry or market segment. This requires different skills and techniques than predicting changes in the price of individual stocks.

**Options Trading.** Options trading involves certain additional risks. Specific market movements of the option and the instruments underlying an option cannot be predicted. No assurance can be given that a liquid offset market will exist for any particular option or at any particular time. If no liquid offset market exists, a portfolio fund might not be able to effect an offsetting transaction in a particular option. To realize any profit in the case of an option, therefore, the option holder would need to exercise the option and comply with margin requirements for the underlying instrument. A writer could not terminate the obligation until the option expired or the writer was assigned an exercise notice. The purchaser of an option is subject to the risk of losing the entire purchase price of the option. The writer of an option is subject to the risk of loss resulting from the difference between the premium received for the option and the price of the futures contract underlying the option that the writer must purchase or deliver upon exercise of the option. The writer of a naked option may have to purchase the underlying contract in the market for substantially more than the exercise price of the option in order to satisfy his delivery obligations. This could result in a large net loss.

**Use of Swap Agreements.** The portfolio funds may use equity, interest rate, index and currency swap agreements. Swap agreements are two-party contracts entered into primarily by institutional investors for

periods ranging from a few weeks to more than one year. In a standard swap transaction, two parties agree to exchange the returns earned on specified assets, such as the return on, or increase in value of, a particular dollar amount invested at a particular interest rate, in a particular foreign currency, or in a “basket” of securities representing a particular index. The use of swaps is a highly specialized activity that involves investment techniques and risks different from those associated with ordinary securities transactions. Interest rate swaps, for example, do not typically involve the delivery of securities, other underlying assets or principal. Accordingly, the market risk of loss with respect to an interest rate swap is often limited to the amount of interest payments that the portfolio fund is contractually obliged to make on a net basis.

There are risks relating to the financial soundness and creditworthiness of the counterparty to swap agreements. If the other party to an interest rate swap defaults, the portfolio fund’s risk of credit loss may be the amount of interest payments that the portfolio fund is contractually obliged to receive on a net basis. However, where swap agreements require one party’s payments to be “up-front” and timed differently than the other party’s payments (such as is often the case with currency swaps), the entire principal value of the swap may be subject to the risk that the other party to the swap will default on its contractual delivery obligations. If there is a default by the counterparty, the portfolio fund may have contractual remedies pursuant to the agreements related to the transaction. The swap market has grown substantially in recent years, and has become relatively more liquid, with a large number of banks and investment banking firms acting both as principals and as agents utilizing standardized swap documentation. The investment performance of the portfolio fund, however, may be adversely affected by the use of swaps if the portfolio fund’s forecasts of market values, interest rates or currency exchange rates are inaccurate.

**Counterparty Risk.** Some of the markets in which the portfolio funds 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 portfolio funds 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 portfolio fund to suffer a loss. Such “counterparty risk” is accentuated for contracts with longer maturities where events may intervene to prevent settlement, or where the portfolio fund has concentrated its transactions with a single or small group of counterparties. The portfolio funds may not be restricted from dealing with any particular counterparty or from concentrating any or all of its transactions with one counterparty. Moreover, a portfolio fund’s internal credit function which evaluates the creditworthiness of its counterparties may prove insufficient. The lack of a complete and “foolproof” evaluation of the financial capabilities of the portfolio funds’ counterparties and the absence of a regulated market to facilitate settlement may increase the potential for losses by the portfolio funds and, therefore, by the funds.

**Leverage.** The underlying portfolio funds may be able to borrow without limitation and may utilize various lines of credit and other forms of leverage, including swaps and repurchase agreements. While leverage presents opportunities for increasing a portfolio fund’s total return, it has the effect of potentially increasing losses as well. If income and appreciation on investments made with borrowed funds are less than the required interest payments on the borrowings, the value of the portfolio fund will decrease. Additionally, any event that adversely affects the value of an investment by a portfolio fund would be magnified to the extent such portfolio fund is leveraged. The cumulative effect of the use of leverage by a portfolio fund in a market that moves adversely to such portfolio fund’s investments could result in a substantial loss to the portfolio fund which would be greater than if the portfolio fund were not leveraged. In addition, leverage may be used by the funds in order to fund redemptions or for short term bridging purposes. Such leverage may be provided to the funds by the firm or its affiliates, or from unaffiliated third parties in each case, at prevailing market rates.

**Illiquid Investments.** Certain portfolio funds may make investments that are subject to legal or other restrictions on transfer or for which no liquid market exists such as private placements. The Fund may co-invest in similar illiquid investments. The market prices, if any, of such investments tend to be more volatile and it may be impossible to sell such investments when desired or to realize their fair value in the event of a sale. Moreover, securities in which portfolio funds may invest include those that are not listed on a stock exchange or traded in an over-the-counter market. As a result of the absence of a public trading market for these securities, they may be less liquid than publicly traded securities. There may be substantial delays in attempting to sell non-publicly traded securities. Although these securities may be resold in privately negotiated transactions, the prices realized from these sales could be less than those originally paid. Further, companies whose securities are not publicly traded are not registered or subject to the disclosure and other investor protection requirements that would be applicable if their securities were registered or publicly traded. In addition, the funds' investments in portfolio funds, or co-investments with portfolio funds, may also be subject to lock-up periods that differ from the funds' lockup periods, various withdrawal limits and fees and varying notice periods.

**Corporate Debt Obligations.** Certain portfolio funds may invest in corporate debt obligations and other forms of indebtedness, including commercial paper. Corporate debt obligations are subject to the risk of an issuer's inability to meet principal and interest payments on the obligations (credit risk).

**Portfolio Fund Compensation.** A portfolio fund typically provides for a performance fee or allocation to its manager or person serving in an equivalent capacity over and above a basic advisory fee. Performance fees or allocations could create an incentive for a portfolio fund manager to choose riskier or more speculative underlying investments than would otherwise be the case.

**"Soft Dollar" Payments.** In selecting brokers, banks and dealers to effect portfolio transactions, portfolio fund managers may consider such factors as price, the ability of the brokers, banks and dealers to effect transactions, their facilities, reliability, and financial responsibility, as well as any products or services provided, or expenses paid, by such brokers, banks, and dealers. Products and services may include research items used by the portfolio fund manager in making investment decisions, and any other lawful expenses of the portfolio fund manager. Such "soft dollar" benefits may cause a portfolio fund manager to execute a transaction with a specific broker, bank or dealer even though it may not offer the lowest transaction fees. Any such soft dollar benefits may or may not fall within the "safe harbor" of Section 28(e) of the United States Securities Exchange Act of 1934, as amended.

**Highly Volatile Markets.** The prices of commodities contracts and all derivative instruments, including futures and options prices, are highly volatile. Price movements of forward contracts, futures contracts, and other derivative contracts in which portfolio funds may invest are influenced by, among other things, interest rates, changing supply and demand relationships, trade, fiscal, monetary and exchange control programs and policies of governments, and U.S. and international political and economic events and policies. In addition, governments from time to time intervene, directly and by regulation, in certain markets, particularly those in currencies and interest rate related futures and options. Such intervention often is intended directly to influence prices and may, together with other factors, cause all of such markets to move rapidly in the same direction because of, among other things, interest rate fluctuations. Portfolio funds are also subject to the risk of the failure of any of the exchanges on which their positions trade or failure of their clearinghouses.

**Forward Trading.** Portfolio funds may engage in forward trading. Forward contracts and options thereon, unlike futures contracts, are not traded on exchanges and are not standardized; rather, banks and dealers act as principals in these markets, negotiating each transaction on an individual basis. Forward and "cash" trading is substantially unregulated; there is no limitation on daily price movements and speculative position limits are not applicable. The principals who deal in the forward markets are not

required to continue to make markets in the currencies or commodities they trade and these markets can experience periods of illiquidity, sometimes of significant duration. There have been periods during which certain participants in these markets have been unable to quote prices for certain currencies or commodities or have quoted prices with an unusually wide spread between the price at which they were prepared to buy and that at which they were prepared to sell. Disruptions can occur in any market traded by the portfolio funds due to unusually high trading volume, political intervention or other factors. Market illiquidity or disruption could result in major losses to a portfolio fund.

**Concentration.** Some of the portfolio funds in which the funds invest may concentrate their investments in only a few securities, industries or countries. Therefore, despite the dynamic portfolio composition of its underlying portfolio funds, the funds' overall portfolios may exhibit unbalanced or excessive investment biases from time to time. For instance, underlying portfolio funds may have collectively increased exposure to a certain geographic region or currency or an asset class that overstates the funds' view or exceeds value-at-risk parameters. Although the funds' overall investments may be diversified, concentration by individual portfolio funds may cause a proportionately greater loss than if their investments had been spread over a larger number of investments. In addition, concentration of the funds' investments in a limited number of portfolio funds may also cause a proportionately greater loss than if the funds' investments had been spread over a larger number of portfolio funds.

**Significant Positions.** Portfolio funds could have a relatively small aggregate number of outstanding shares, so that the portfolio fund may acquire (i) more than 5% of a class of securities of a single issuer which would require the filing of a Schedule 13D or 13G statement with the SEC or (ii) more than 10% of a class of securities of a single issuer (which would impose certain limitations on the ability of the portfolio fund manager to trade in such securities, including the restrictions of Section 16 of the U.S. Securities Exchange Act of 1934, as amended). The accumulation of such a significant position in the shares of a single issuer could lead to litigation or disputes in the event the portfolio fund desires to influence the issuer. The portfolio fund may also seek to challenge the management of a portfolio company through a proxy contest. Such litigation or proxy contest may result in substantial expense to the portfolio fund, thus reducing the value of a fund's investment in that portfolio fund. In addition, the portfolio fund manager may serve on the board of directors of one or more portfolio companies. As a result, such portfolio fund manager would become an insider and may have access to material non-public information affecting the portfolio company, which may preclude the portfolio fund from selling its position (or acquiring additional shares) at any time when the portfolio fund manager otherwise believes it would be appropriate to do so. Moreover, a portfolio fund's ability to realize value from certain of its investments may depend upon the ability of the portfolio fund manager to influence the management of a portfolio company to take certain actions, including, for example, a recapitalization, restructuring, spin off, sale of the business or change in management. If the portfolio fund is incorrect in its assessment of the impact such action will have on the value of a portfolio company, or if it is unsuccessful in persuading the portfolio company's management to take the desired action, the portfolio fund may sustain a loss on its investment in the portfolio company, resulting in a reduction of the value of the applicable fund's investment in the portfolio fund.

**Turnover.** The funds' activities involve investment in the portfolio funds, which may invest on the basis of certain short-term market considerations. The turnover rate within the portfolio funds may be significant, potentially involving substantial brokerage commissions, fees and other transaction costs. The funds have no control over this turnover. In addition, the withdrawal of a fund from a portfolio fund or termination of a separately managed account relationship could also involve expense to the fund under the terms of the fund's investment.

**Reliability of Valuations.** A fund's interest in a portfolio fund is valued at an amount equal to the fund's shares or capital account in the limited partnership or other entity that issued such interest. The funds



generally relies on valuations provided to them by the portfolio fund managers of the portfolio funds. As a general matter, the governing instruments of the portfolio funds in which the funds invest provide that any securities or investments that are illiquid, not traded on an exchange or in an established market or for which no value can be readily determined, are assigned such fair value as the respective portfolio fund managers may determine in their judgment based on various factors. Such factors include, but are not limited to, aggregate dealer quotes or independent appraisals. Such valuations may not be indicative of what actual fair value would be in an active, liquid or established market.

**Availability of Information.** Some of the portfolio funds may provide very limited information with respect to their operation and performance to the funds, thereby severely limiting the funds' ability to verify initially or on a continuing basis any representations made by the portfolio funds or the investment strategies being employed. This may result in significant losses to a fund based on investment strategies and positions employed by the portfolio funds or other actions of which the firm has limited or no knowledge.

**Momentum Investing Strategy.** Some of the portfolio funds in which the funds invest have portfolio fund managers whose investment strategies emphasize primarily "momentum investing". "Momentum investing" may not be based on fundamental economic analysis of companies or macro- or microeconomic analysis, but rather only on price movements, which may increase risk of loss, and should therefore be viewed as highly speculative. Since only a limited number of securities may be exhibiting significant momentum at any one time, the beneficial effects of diversification among portfolio fund managers may be significantly reduced if any of the underlying investment pools invest in the same securities at the same time. As the funds do not control the investment decisions of the portfolio funds, the firm has no way of preventing this situation from occurring.

**Proprietary Investment Strategies.** Portfolio funds may use proprietary investment strategies that are based on considerations and factors that are not fully disclosed to the firm or the funds. These strategies may involve risks under some market conditions that are not anticipated by the firm or the funds. The portfolio funds generally use investment strategies that are different than those typically employed by traditional managers of portfolios of stocks and bonds. The investment niche, arbitrage opportunity or market inefficiency exploited by a portfolio fund may become less profitable over time as the portfolio funds and competing asset managers or investors manage a larger group of assets in the same or similar manner (tending to arbitrage away the profit opportunities), or market conditions change. The strategies employed by the portfolio funds may involve significantly more risk and higher transaction costs than more traditional investment methods. It is possible that the performance of the portfolio funds may be closely correlated in some market conditions, resulting (if those returns are negative) in significant losses to the funds and investors.

**Short Selling.** A short sale involves the sale of a security that a portfolio fund does not own in the hope of purchasing the same security (or a security exchangeable therefor) at a later date at a lower price. To make delivery to the buyer, the portfolio fund must borrow the security, and is obligated to return the security to the lender which is accomplished by a later purchase of the security. The portfolio fund realizes a profit or a loss as a result of a short sale if the price of the security decreases or increases between the date of the short sale and the date on which the portfolio fund covers its short position, (e.g., purchases the security to replace the borrowed security). Certain market participants could accumulate such securities in a "short squeeze", which would reduce the available supply, and thus increase the cost of such securities. A short sale involves the theoretically unlimited risk of an increase in the market price of the security that would result in a theoretically unlimited loss. The extent to which a portfolio fund engages in short sales will depend upon its investment strategy and perception of market direction. There can be no assurance that the securities necessary to cover a short position will be available for purchase.

Purchasing securities to close out the short position can itself cause the price of the securities to rise further, thereby exacerbating the loss.

In response to recent dislocations in the financial services industry and other market events, the SEC, the United Kingdom Financial Services Authority and securities regulators of many other jurisdictions have implemented certain prohibitions and disclosure requirements on short selling of securities. Limitations on the short selling of securities could interfere with the ability of a portfolio fund to execute certain aspects of its investment strategies, including its ability to hedge certain exposures and execute transactions to implement its risk management guidelines, and any such limitations may adversely affect the performance of such portfolio fund.

**Co-Investments.** In certain situations, portfolio fund managers may offer a fund an opportunity to make direct co-investments alongside portfolio funds. These opportunities may arise from contractual obligations for the benefit of the relevant fund in the fund agreements or otherwise as an investor in a portfolio fund. Co-investments are likely to be subject to lock-up or other contractual provisions that would prevent sales of such investments, except in limited circumstances that may not be in the relevant fund's control. The fund's inability to exercise control over co-investments may have an adverse impact on its liquidity and cash flow.

When a fund makes a co-investment with a portfolio fund manager, the firm will generally have limited access to information and may not undertake the same level of due diligence conducted by the portfolio fund manager that is making the primary investment. To the extent that a fund makes a co-investment that loses some or all of its value, the effect of the decline may be magnified, because the fund may have exposure both at the level of its co-investment and at the portfolio fund level.

A fund may make a co-investment in a portfolio fund with financial, strategic or other third party investors. Such investments will involve additional risks not present in investments where a third party is not involved, including the possibility that the co-investor may have interests or objectives that are inconsistent with those of the fund or may be in a position to take action contrary to the fund's investment objectives. A fund may in certain circumstances also be liable for actions of its third party co-ventures or partners. In addition, the fund's ability to exercise control or significant influence in connection with these arrangements may be limited and will depend on the nature of the relevant documentation.

**Commodities.** Commodity futures markets are highly volatile and are influenced by factors such as changing supply and demand relationships, governmental programs and policies, national and international political and economic events and changes in interest rates. In addition, because of the low margin deposits normally required in commodity futures trading, a high degree of leverage is typical of a commodity futures trading account. As a result, a relatively small price movement in a commodity futures contract may result in substantial losses to the trader. Moreover, commodity futures positions are marked to market each day and variation margin payments must be paid to or by a trader. To the extent that principal transactions are engaged in, including, but not limited to, swaps, forward foreign currency transactions and bonds, the investor must rely on the creditworthiness of a counterparty. Commodity futures trading may also be illiquid, and certain commodity exchanges do not permit trading in particular commodities at prices that represent a fluctuation in price during a single day's trading beyond certain set limits. If prices fluctuate during a single day's trading beyond those limits – which conditions have in the past sometimes lasted for several days with respect to certain contracts – a portfolio fund could be prevented from promptly liquidating unfavorable positions and thus be subjected to substantial losses. In addition, the CFTC and various exchanges impose speculative position limits on the number of positions that an investor may indirectly hold or control in particular commodities.

**U.S. Government Securities.** Certain portfolio funds may invest in U.S. government securities. Generally, these securities include U.S. Treasury obligations and obligations issued or guaranteed by U.S.

government agencies, instrumentalities or sponsored enterprises. U.S. government securities also include Treasury receipts and other stripped U.S. government securities, where the interest and principal components of stripped U.S. government securities are traded independently. These securities are subject to market and interest rate risk. A portfolio fund may also invest in zero coupon U.S. Treasury securities and in zero coupon securities issued by financial institutions, which represent a proportionate interest in underlying U.S. Treasury securities. A zero coupon security pays no interest to its holder during its life, and its value consists of the difference between its face value at maturity and its cost. The market prices of zero coupon securities generally are more volatile than the market prices of securities that pay interest periodically.

**Non-U.S. Investments.** Investments outside the United States or denominated in non-U.S. currencies pose currency exchange risks (including blockage, devaluation and non-exchangeability) as well as a range of other potential risks that could include, depending on the country involved, expropriation, confiscatory taxation, political or social instability, illiquidity, price volatility and market manipulation. In addition, less information may be available regarding non-U.S. issuers and non-U.S. companies which may not be subject to accounting, auditing and financial reporting standards and requirements comparable to or as uniform as those of U.S. companies. Further, non-U.S. securities markets may not be as liquid as U.S. markets. Transaction costs of investing outside the U.S. are generally higher than in the U.S. Higher costs result because of the cost of converting a non-U.S. currency to dollars, the payment of fixed brokerage commissions on some non-U.S. exchanges and the imposition of transfer taxes or transaction charges by non-U.S. exchanges. There is generally less government supervision and regulation of non-U.S. exchanges, brokers and issuers than there is in the U.S. and there is greater difficulty in taking appropriate legal action in non-U.S. courts. Non-U.S. markets also have different clearance and settlement procedures that in some markets have at times failed to keep pace with the volume of transactions, thereby creating substantial delays and settlement failures that could adversely affect the funds' performance.

**Emerging Market Investments.** The portfolio funds may invest in securities, including debt securities, of companies based in emerging markets or issued by the governments of such countries. Investing in securities of emerging countries and companies involves certain considerations not usually associated with investing in securities of developed countries or of companies located in developed countries, including political and economic considerations, such as greater risks of expropriation, confiscatory taxation, imposition of withholding or other taxes on dividends, interest, capital gains or other income, limitations on the removal of funds, nationalization and general social, political and economic instability; the small size of the securities markets in such countries and the low volume of trading, resulting in potential lack of liquidity and in price volatility; fluctuations in the rate of exchange between currencies and costs associated with currency conversion; or certain government policies that may restrict a portfolio fund's investment opportunities and problems that may arise in connection with the clearance and settlement of trades. In addition, accounting and financial reporting standards that prevail in certain of such countries generally are not equivalent to standards in more developed countries and, consequently, less information is available to investors in companies located in these countries than is available to investors in companies located in more developed countries. Further, emerging market debt securities are unrated or rated in lower rating categories by the various credit rating agencies. These securities are subject to greater risk of loss of principal and interest than higher-rated securities and are generally considered to be predominantly speculative with respect to the issuer's capacity to pay interest and repay principal. They are also generally subject to greater risk than securities with higher credit ratings in the case of deterioration of general economic conditions. Because investors generally perceive that there are greater risks associated with lower-rated securities, the yields or prices of such securities may tend to fluctuate more than those for higher-rated securities. The market for emerging market debt securities is thinner and less active than that for higher-rated securities, which can adversely affect the prices at which securities are sold. In addition, adverse publicity and investor perceptions about emerging market debt

securities, whether or not based on fundamental analysis, may be a contributing factor in a decrease in the value and liquidity of such securities. The sovereign debt obligations in which the portfolio funds may invest in many cases pertain to countries that are among the world's largest debtors to commercial banks, non-U.S. governments, international financial organizations and other financial institutions. In recent years, the governments of some of these countries have encountered difficulties in servicing their external debt obligations, which led to defaults on certain obligations and the restructuring of certain indebtedness.

**Other Trading Strategies.** Certain of the portfolio funds employ strategies for which no specific "risk factors" are provided. Nevertheless, such strategies should be considered to be speculative, volatile and, in general, no less risky than other strategies more fully described herein.

## **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 direct relationships with the following private funds:

- Avenue Strategic Partners Feeder, L.P.
- Avenue Strategic Partners, L.P.
- Avenue Strategic Partners Feeder, Ltd.
- Avenue Strategic Partners, Ltd.

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 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 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.

An affiliate of the firm, Avenue Europe International Management, L.P., serves as sub-adviser to an Invesco Van Kampen fund and an Avenue fund, both of which are registered investment companies (i.e., public funds).

An affiliate of the firm, Avenue Capital Management II, L.P., serves as adviser to the Avenue fund that is a registered investment company.

Avenue Asia Capital Management, L.P. also manages the assets of one or more liquidating trusts established to manage the liquidation of certain assets formerly held by Avenue Asia Investments, L.P., Avenue Asia International, Ltd., and Avenue Asia International Master, L.P.

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)
- Avenue Europe Management, LLP (authorized by the U.K. Financial Services Authority since 2004)
- Avenue Germany Management GMBH

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 Avenue 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 Avenue 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 funds 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 L. Ross at 399 Park Avenue, 6th Floor, New York, New York 10022 or by contacting Mr. Ross at (212) 878-3520.

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 our 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 or person who does business with us, except for normal business courtesies and non-cash gifts of nominal value.
- 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 and entertainment.
- 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. A cross transaction, or cross trade, occurs when an investment advisor arranges a transaction between two clients. The funds have different procedures with respect to completing principal and cross transactions that are set forth in each fund's operative documents. Accordingly, the portfolio managers are required to identify any potential principal transaction, and any potential cross trade between two or more funds, prior to effecting the transaction and to contact the firm's chief compliance officer. The chief compliance officer, in consultation with outside counsel (if necessary), will determine whether or not the trade would constitute a principal transaction or a cross trade, and if so, whether such transaction is permissible and what procedures must be followed to complete the transaction. The firm may cause the funds to engage in cross trades, including the purchase or acquisition of participations in originated investments, typically for purposes of rebalancing the portfolios of the funds or for other reasons consistent with the investment and operating guidelines of the funds. These rebalancing transactions may, or may not, be subject to commissions. Notwithstanding the foregoing, it is our more customary policy to rebalance funds and accounts by trading in the market rather than by effecting 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 funds may invest capital in another of the funds or in securities of issuers in which one or more of the other funds hold positions. In addition, the general partners of certain of the funds have invested their own capital in their funds. Given the likely frequency of these occurrences, clients and investors in the funds 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. 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 trade claims of distressed companies. 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, as amended (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 registered investment companies to which affiliates of the firm provide investment advisory services.

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

Research or brokerage services provided by brokers through which portfolio transactions for the funds are executed may include:

- research reports on particular industries and companies,
- economic surveys and analyses,
- recommendations as to specific securities,
- online quotations,

- news and research services,
- financial publications, and
- other products and services (*e.g.*, software based applications for market quotes and news and database programs providing portfolio company and industry data)

that prove lawful and appropriate assistance to the firm in the performance of its investment decision-making responsibilities on behalf of the funds and other accounts which its affiliates manage (these are all referred to collectively as “soft dollar items”). Avenue generally uses soft dollar items for the benefit of all of its clients.

Soft dollar items may be provided directly by brokers, by third parties at the direction of brokers or purchased by or on behalf of the funds with credits or rebates provided by brokers. Soft dollar items obtained in connection with portfolio transactions for the funds and are intended to fall within the “safe harbor” of Section 28(e) of the U.S. Securities Exchange Act of 1934, as amended. The commissions to be paid to the brokers providing soft dollar items 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 products and services provided by the brokers.

During the most recent fiscal year, the firm did not use any soft dollar items or engage in directed brokerage transactions.

### **Aggregation of Orders**

If the firm has determined to purchase (or sell) an investment at the same time for more than one investment vehicle or account, the firm will generally place combined orders for all such accounts simultaneously, and if all such orders are not filled at the same price, it will generally average the prices paid. Similarly, if an order on behalf of more than one vehicle or account cannot be fully executed under prevailing market conditions, the firm will allocate (or sell, as applicable) the investments among the different vehicles or accounts on a basis that it considers equitable. Situations may occur where the funds could be disadvantaged because of the investment activities conducted by the firm for other investment vehicles or accounts.

### **Allocation Procedures**

In addition to our responsibilities with respect to the management and investment activities of the funds, 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 “Avenue clients”). The existence of such multiple vehicles and accounts necessarily creates a number of potential conflicts of interest.

We expect that investments will be allocated between and among Avenue clients, particularly where the investment objectives and policies of the Avenue clients overlap (in whole or in part). There are, or are expected to be, differences between and among the Avenue clients with respect to, among other considerations:

- investment objectives,
- investment strategies,
- investment parameters and restrictions,
- portfolio management personnel,

- tax considerations,
- liquidity considerations,
- hedging considerations,
- legal and/or regulatory considerations,
- asset levels,
- timing and size of investor capital contributions and redemptions,
- cash flow considerations,
- market conditions,
- existing exposures to an investee company or security, and
- other criteria we deem relevant (the nature and extent of the differences will vary from client to client).

In addition, certain investments may be purchased in odd lots, or there may exist stub amounts, either of which are not readily allocable to multiple clients. Notwithstanding the differences between and among Avenue clients, and the possible existence of hard to allocate investments, there may be circumstances where some or all of the Avenue clients participate in parallel investment transactions. If we deem it appropriate, taking into account the investment objectives and policies of the various clients, this participation will be on a *pro rata* basis (based on either an “available cash” or “net asset value” concept developed by Avenue), at the same time and on the same terms; this will be the case most commonly with respect to Avenue clients that have similar investment objectives and investment strategies.

However this will not always be the case. There will be circumstances where:

- only some of the Avenue clients participate in parallel investment transactions;
- the level of participation between and among the Avenue clients in parallel investment transactions is not on a *pro rata* basis;
- the terms of parallel investment transactions vary between and among one or more of the Avenue clients;
- one or more of the Avenue clients effectively engage in opposite transactions with respect to a particular investment (*e.g.*, an Avenue client acquires a long position in a security while one or more of the other Avenue clients sells or shorts the security); and/or
- investment transactions between and among the Avenue clients vary in other respects.

Such non-parallel and/or non-*pro rata* investment transactions between and among the Avenue clients will be made in the discretion of Avenue when deemed:

- appropriate given the differences between the clients involved,
- appropriate because the target holdings of the particular investment that Avenue has established with respect to the clients involved differ from client to client, and/or
- otherwise to be in the best interests of the clients involved.

It is our general policy that no Avenue client will receive inappropriate preferential treatment or otherwise be treated unfairly; and we will seek to uphold this policy when making decisions regarding investment allocations.

In certain cases, opportunities during a particular period and up to a certain size may be offered only to one or more funds and not to other Avenue clients.

## **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 funds. 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 a private fund that are the result of our gross negligence or willful misconduct will be reversed, and we will be responsible to make the affected funds whole. Trade errors that result in losses for a fund that are not the result of our gross negligence or willful misconduct 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 funds. Gains from trade errors will be credited to the affected funds. 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**

Each fund is maintained, supervised and reviewed on a regular basis by its respective investment principals. Matters reviewed include specific investments held, the percentage of assets in various types of asset classes and the relative and absolute performance of each account. The investment principals for each fund are listed in that fund’s confidential offering memorandum.

With respect to the private funds for which the firm serves as the investment manager, each investor receives annual audited financial statements of each such fund. In addition, investors in the 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 or sub-advisory basis, we will provide such clients with reports and statements, the content and frequency of which will be as agreed.

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

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

The firm is one of four registered investment advisers that are part of Avenue Capital Group. Any one of our four 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 Spoonhill Asset Management, Inc., J.P. Morgan Securities Inc., Morgan Stanley Smith Barney, Jefferies & Co., Inc., Credit Suisse, Aspen Capital Partners, Ltd. and Lazard Freres & Co., Inc 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 certain of our affiliates as general partners 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 funds we advise that are 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. Our policies and procedures are also designed to ensure that all corporate actions are voted in the best interest of each fund, provide disclosure to fund investors and ensure that certain documentation is retained. As a general matter, 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 funds are conducted in a manner consistent, under all circumstances, with the best interest of the Funds.

### **Proxy Voting**

With respect to certain proxy proposal issues, we vote in accordance with predetermined "for" or "against" designations, except when we determine the best interests of the client require a contrary vote. We vote other proxy proposals on a "case by case" analysis in the best interests of the client.

In the event that the firm votes contrary to the proxy voting guidelines, we will document the basis for our contrary voting decision.

In addition, the firm may choose not to vote proxies in certain situations or for certain funds, such as (i) where a fund has informed the firm that it wishes to retain the right to vote the proxy, (ii) where the firm deems the cost of voting would exceed any anticipated benefit to the fund, (iii) where the proxy is received for a fund that has been terminated, or (iv) where a proxy is received by the firm for a security it no longer manages on behalf of a fund. The firm will document the basis for the decision not to vote.

We may occasionally be subject to conflicts of interest in the voting of proxies. If at any time the firm becomes aware of an actual conflict of interest relating to a particular proxy proposal, the firm will handle the proposal as follows:

- If the proposal is designated in the proxy voting policies as "For" or "Against," the proposal will be voted by the firm in accordance with the proxy voting policies; or

- If the proposal is designated in the proxy voting policies above as “Case by Case” (or not addressed in the proxy voting policies), the firm will notify the fund of such conflict and will vote the fund’s shares in accordance with the fund’s instructions.

Each investor in a private fund may obtain information on how we voted with respect to the securities of such fund and obtain a copy of proxy voting policies and procedures by submitting a written request to Eric L. Ross at 399 Park Avenue, 6th Floor, New York, New York 10022 or by contacting Mr. Ross at 212-878-3520. With respect to any registered investment company, the firm shall promptly provide information to the registered investment company regarding how the registered investment company’s proxies and corporate actions were voted to enable the registered investment company to make the required disclosures regarding the proxy voting.

## **Corporate Actions**

Conflicts of interest may arise where multiple funds simultaneously hold securities representing different parts of the capital structure of a financially troubled or distressed issuer. Conflicts of interest may also arise where multiple funds simultaneously hold different investment positions with respect to the same issuer. Avenue has adopted procedures to address and, in some cases, mitigate the actual conflicts of interest that may arise. Any deviation from these procedures must be approved in advance by the firm’s Chief Compliance Officer.

Where multiple funds hold different securities of the same issuer and 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 exercise the right or ongoing right in the best interest of the relevant fund(s).
- Avenue will be responsible for determining whether the course of action that is in the best interest of the relevant fund is clear.
- The Chief Compliance Officer must be notified prior to the exercise of the right.

If Avenue does identify an unresolved conflict of interest, the following procedures will apply:

- If the course of action that is in the best interest of each fund is not clear, or if the course of action involves an ongoing right, then Avenue will designate an independent representative to make a recommendation with respect to, or assume responsibility for, the exercise of the right or undertaking the ongoing right for one or more of the funds.
- Avenue will be responsible for determining whether the course of action that is in the best interest of the relevant fund(s) is clear.
- The Chief Compliance Officer must be notified prior to the designation of an independent representative.
- In the case of a registered investment company, or RIC, the independent representative may be the manager, if Avenue is acting as sub-adviser, or Board of Directors (or Trustees) of the RIC.
- In the case of a private fund, the independent representative may be an advisory committee established by the fund to handle such matters or, if permitted under the fund’s organizational documents, a third-party advisor.

- If an independent representative is designated, Avenue employees who communicate with the independent representative must be careful not to disclose material non-public information to the independent representative unless the prior approval of the Chief Compliance Officer is obtained and such party has a duty of confidentiality with regard to such material non-public information (such as through the execution of a confidentiality agreement or service as a manager or board member of a RIC).

## **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.