

**CONFIDENTIAL PRIVATE OFFERING MEMORANDUM**

**LIMITED PARTNERSHIP INTERESTS**

**OF**

**ETOLIAN CAPITAL CREDIT FUND, LP**

(a Delaware limited partnership)

February 2005

THIS CONFIDENTIAL PRIVATE OFFERING MEMORANDUM (“MEMORANDUM”) IS SUBMITTED TO YOU ON A CONFIDENTIAL BASIS SOLELY IN CONNECTION WITH YOUR CONSIDERATION OF AN INVESTMENT IN LIMITED PARTNERSHIP INTERESTS IN ETOLIAN CAPITAL CREDIT FUND, LP, A DELAWARE LIMITED PARTNERSHIP. DUE TO THE CONFIDENTIAL NATURE OF THIS MEMORANDUM, ITS USE FOR ANY OTHER PURPOSE MIGHT INVOLVE SERIOUS LEGAL CONSEQUENCES. CONSEQUENTLY, THIS MEMORANDUM MAY NOT BE REPRODUCED IN WHOLE OR IN PART, AND MAY NOT BE DELIVERED TO ANY PERSON (OTHER THAN YOUR FINANCIAL ADVISOR) WITHOUT THE PRIOR WRITTEN CONSENT OF THE GENERAL PARTNER.

THE PARTNERSHIP IS OPERATING PURSUANT TO AN EXEMPTION FROM THE REGULATIONS OF THE UNITED STATES COMMODITY FUTURES TRADING COMMISSION (“CFTC”) IN CONNECTION WITH POOLS WHOSE PARTICIPANTS ARE LIMITED TO “QUALIFIED ELIGIBLE PERSONS.” ACCORDINGLY, THIS MEMORANDUM IS NOT REQUIRED TO BE, AND HAS NOT BEEN, FILED WITH THE CFTC. THE CFTC WILL NOT PASS UPON THE MERITS OF PARTICIPATING IN A POOL OR UPON THE ADEQUACY OR ACCURACY OF AN OFFERING MEMORANDUM. CONSEQUENTLY, THE CFTC HAS NOT REVIEWED OR APPROVED THIS OFFERING OR ANY OFFERING MEMORANDUM FOR THIS POOL.

Memorandum Copy Number: \_\_\_\_\_

THE LIMITED PARTNERSHIP INTERESTS OFFERED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), SINCE THEY WILL BE OFFERED ONLY TO A LIMITED NUMBER OF QUALIFIED INVESTORS. IT IS ANTICIPATED THAT THE OFFERING AND SALE OF SUCH INTERESTS WILL BE EXEMPT FROM REGISTRATION PURSUANT TO REGULATION D OF THE ACT.

THESE INTERESTS HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION, NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION OR OTHER REGULATORY AUTHORITY PASSED UPON THE ACCURACY OR ADEQUACY OF THESE OFFERING MATERIALS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

IN MAKING AN INVESTMENT DECISION, INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE ISSUER AND THE TERMS OF THE OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED. THESE SECURITIES HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THESE OFFERING MATERIALS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

THESE SECURITIES ARE SUBJECT TO RESTRICTIONS ON TRANSFERABILITY AND RESALE AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED UNDER THE ACT, AND THE APPLICABLE STATE SECURITIES LAWS, PURSUANT TO REGISTRATION OR EXEMPTION THEREFROM. INVESTORS SHOULD BE AWARE THAT THEY WILL BE REQUIRED TO BEAR THE FINANCIAL RISKS OF THIS INVESTMENT FOR AN INDEFINITE PERIOD OF TIME.

THIS MEMORANDUM DOES NOT CONSTITUTE AN OFFER OR SOLICITATION IN ANY STATE OR OTHER JURISDICTION IN WHICH AN OFFER OR SOLICITATION IS NOT AUTHORIZED.

NO REPRESENTATIONS OR WARRANTIES OF ANY KIND ARE INTENDED OR SHOULD BE INFERRED WITH RESPECT TO THE ECONOMIC RETURN OR THE TAX CONSEQUENCES FROM AN INVESTMENT IN THE PARTNERSHIP. NO ASSURANCE CAN BE GIVEN THAT EXISTING LAWS WILL NOT BE CHANGED OR INTERPRETED ADVERSELY TO THE PARTNERSHIP OR THE PARTNERS. PROSPECTIVE INVESTORS ARE NOT TO CONSTRUE THIS MEMORANDUM AS LEGAL OR TAX ADVICE. EACH INVESTOR SHOULD CONSULT HIS OR HER OWN COUNSEL AND ACCOUNTANT FOR ADVICE CONCERNING THE VARIOUS LEGAL, TAX AND ECONOMIC CONSIDERATIONS RELATING TO HIS OR HER INVESTMENT.

NO PERSON OTHER THAN THE GENERAL PARTNER HAS BEEN AUTHORIZED TO MAKE REPRESENTATIONS, OR GIVE ANY INFORMATION, WITH RESPECT TO THESE LIMITED PARTNERSHIP INTERESTS, EXCEPT THE INFORMATION CONTAINED HEREIN, AND ANY INFORMATION OR REPRESENTATION NOT CONTAINED HEREIN OR OTHERWISE SUPPLIED BY THE GENERAL PARTNER IN WRITING MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY THE PARTNERSHIP OR ANY OF ITS PARTNERS. ANY FURTHER DISTRIBUTION OR REPRODUCTION OF THIS MEMORANDUM, IN WHOLE OR IN PART, OR THE DIVULGENCE OF ANY OF ITS CONTENTS, IS PROHIBITED.

A PROSPECTIVE INVESTOR SHOULD NOT SUBSCRIBE FOR LIMITED PARTNERSHIP INTERESTS UNLESS SATISFIED THAT THE PROSPECTIVE INVESTOR ALONE OR TOGETHER WITH HIS OR HER INVESTMENT REPRESENTATIVE HAVE ASKED FOR AND RECEIVED ALL INFORMATION WHICH WOULD ENABLE THE INVESTOR OR BOTH OF THEM TO EVALUATE THE MERITS AND RISKS OF THE PROPOSED INVESTMENT.

THE PARTNERSHIP WILL MAKE AVAILABLE TO EACH INVESTOR OR HIS OR HER AGENT, DURING THIS OFFERING AND PRIOR TO THE SALE OF ANY INTERESTS, THE OPPORTUNITY TO ASK QUESTIONS OF AND RECEIVE ANSWERS FROM REPRESENTATIVES OF THE GENERAL PARTNER

CONCERNING ANY ASPECT OF THE PARTNERSHIP AND ITS PROPOSED BUSINESS AND TO OBTAIN ANY ADDITIONAL RELATED INFORMATION TO THE EXTENT THE PARTNERSHIP POSSESSES SUCH INFORMATION OR CAN ACQUIRE IT WITHOUT UNREASONABLE EFFORT OR EXPENSE.

WHENEVER THE MASCULINE OR FEMININE GENDER IS USED IN THIS MEMORANDUM, IT SHALL EQUALLY, WHERE THE CONTEXT PERMITS, INCLUDE THE OTHER, AS WELL AS INCLUDE ENTITIES.

**SPECIAL NOTICE TO FLORIDA INVESTORS:**

UPON THE ACCEPTANCE OF FIVE (5) OR MORE FLORIDA INVESTORS, AND IF THE FLORIDA INVESTOR IS NOT A BANK, A TRUST COMPANY, A SAVINGS INSTITUTION, AN INSURANCE COMPANY, A DEALER, AN INVESTMENT COMPANY AS DEFINED IN THE INVESTMENT COMPANY ACT OF 1940, A PENSION OR PROFIT-SHARING TRUST, OR A QUALIFIED INSTITUTIONAL BUYER (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT OF 1933), THE FLORIDA INVESTOR ACKNOWLEDGES THAT ANY SALE OF AN INTEREST TO THE FLORIDA INVESTOR IS VOIDABLE BY THE FLORIDA INVESTOR EITHER WITHIN THREE DAYS AFTER THE FIRST TENDER OF CONSIDERATION IS MADE BY THE FLORIDA INVESTOR TO THE ISSUER, OR AN AGENT OF THE ISSUER, OR WITHIN THREE DAYS AFTER THE AVAILABILITY OF THAT PRIVILEGE IS COMMUNICATED TO THE FLORIDA INVESTOR, WHICHEVER OCCURS LATER.

**Table of Contents**

	<b><u>Page</u></b>
1. SUMMARY .....	1
2. INTRODUCTION .....	5
3. INVESTMENT PROGRAM.....	5
4. MANAGEMENT .....	10
5. MANAGEMENT FEE; EXPENSES .....	11
6. ALLOCATION OF NET PROFITS AND NET LOSSES; INCENTIVE ALLOCATION TO THE GENERAL PARTNER; PURCHASE OF "NEW ISSUES"; PRIOR FISCAL PERIOD ITEMS .....	11
7. RISK FACTORS .....	12
8. ADMISSION OF PARTNERS; ADDITIONAL CAPITAL CONTRIBUTIONS.....	20
9. WITHDRAWALS; RETIREMENT; DISTRIBUTIONS.....	20
10. BROKERAGE AND CUSTODY .....	23
11. TAXATION.....	23
12. ERISA MATTERS .....	28
13. OTHER PROVISIONS OF THE LIMITED PARTNERSHIP AGREEMENT .....	28
14. PROCEDURES FOR BECOMING A LIMITED PARTNER.....	30

## 1. SUMMARY

The following is a summary of the more detailed information contained elsewhere in this Confidential Private Offering Memorandum (the "Memorandum") and is qualified in its entirety by reference to such information and to the Limited Partnership Agreement of the Partnership.

### **The Partnership**

Etolian Capital Credit Fund, LP (the "Partnership") is a Delaware limited partnership designed for sophisticated investors. The Partnership invests substantially all of its assets in and is a shareholder of Etolian Capital Offshore Master Fund, Ltd., a Cayman Islands exempted company that has elected to be treated as a partnership for U.S. tax purposes (the "Master Fund"). References herein to the Partnership shall, to the extent appropriate, refer to both the Partnership and the Master Fund.

### **Investment Objective**

The Partnership's investment objective, through its investment in the Master Fund, is to provide stable and superior returns that are uncorrelated with the equity and fixed income markets, by establishing both long and short positions in the credit fixed income obligations of companies based in North America. The Investment Manager (as defined below) utilizes a quantitative methodology that relies on input from the credit fixed income, equity and equity options markets to assess relative value among the various parts of the capital structure of such companies. The application of state-of-the-art risk management techniques enables the Investment Manager to focus on differences in the relative valuation of companies' obligations, and generate its investment objectives through a careful selection of long and short positions in such obligations.

### **The General Partner**

The general partner of the Partnership is Etolian Capital Partners, LLC, a Delaware limited liability company (the "General Partner"). George Handjinicolaou, Larry Hirshik and Yiannis Tsiounis are the managing members and portfolio managers of the General Partner. The General Partner's principal office is at 67 Wall Street, 10<sup>th</sup> Floor, New York, NY 10005, telephone: 212-659-2430. Since the Partnership utilizes futures to hedge the portfolio, the General Partner is registered as a "commodity pool operator" with the Commodity Futures Trading Commission (the "CFTC").

### **The Management Company; Investment Manager to the Master Fund**

Etolian Capital Group, LP, a Delaware limited partnership (the "Management Company"), is responsible for certain administrative matters for the Partnership and also serves as investment manager (the "Investment Manager") to the Master Fund. The general partner of the Management Company is Etolian Capital Management, LLC, a Delaware limited liability company. Mr. Handjinicolaou, Mr. Hirshik and Mr. Tsiounis are the managing members of Etolian Capital Management, LLC. Since the Master Fund utilizes futures to hedge the portfolio, the Management Company is also registered as a "commodity pool operator" with the Commodity Futures Trading Commission (the "CFTC").

### **Investment by General Partner**

Mr. Handjinicolaou, Mr. Hirshik and Mr. Tsiounis have invested a substantial portion of their liquid net worths in the Partnership and/or its affiliates. The General Partner will at all times maintain a capital account equal to at least the lesser of \$100,000 or 1% of

the capital accounts of the Partners.

**Minimum Initial Investment**

The minimum initial investment is \$1,000,000, subject to waiver at the discretion of the General Partner.

**Risk Factors**

An investment in the Partnership involves significant risks and is suitable only for those persons who can bear the economic risk of the loss of their investment and who have limited need for liquidity in their investment. There can be no assurance that the Partnership will achieve its investment objective. An investment in the Partnership carries with it the inherent risks associated with investments in fixed income securities, short sales, options and other financial instruments. See "Risk Factors" - Section 7. Each prospective limited partner ("Limited Partner") should carefully review this Memorandum and the agreements referred to herein before deciding to invest in the Partnership.

**Management Fee**

The Management Company will receive a quarterly management fee calculated at the annual rate of 1.5% of each Limited Partner's capital account (the "Management Fee"). The Management Fee will be paid quarterly in advance, based on the value of each Limited Partner's capital account, as of the beginning of the quarter. The Management Fee will be prorated for any period that is less than a full quarter and will be adjusted for contributions during the quarter. There will be no Management Fee charged at the Master Fund level.

**Allocation of Net Profits and Losses; Incentive Allocation**

Except for "new issues," the net profit or net loss of the Partnership (including realized and unrealized gains and losses) will be allocated to each Limited Partner and the General Partner in accordance with the ratio of their respective capital account balances.

For each fiscal year there will be reallocated to the capital account of the General Partner from the capital account of each Limited Partner 20% of each Limited Partner's share of net profits, if any, subject to a loss carryforward provision. There will be no incentive allocation charged at the Master Fund level.

**Expenses**

The Management Company is responsible for and pays or causes to be paid the following overhead expenses of the Partnership: office rent; furniture and fixtures; stationery; secretarial/internal administrative services; salaries; entertainment expenses; employee insurance and payroll taxes. All other expenses are paid by the Partnership and include: the Management Fee; legal, audit and accounting expenses (including third party accounting services); administrator fees and expenses; organizational expenses; investment expenses such as commissions, research fees and expenses (including research-related travel); interest on margin accounts and other indebtedness; borrowing charges on securities sold short; custodial fees; the Partnership's pro rata share of the Master Fund's expenses and any other expenses reasonably related to the purchase, sale or transmittal of Partnership assets. Organizational expenses of the Partnership have been amortized over a period of 60 months from the

commencement of the Partnership's operations.

**The Offering**

The Partnership is offering limited partnership interests to certain qualified investors as described herein and in the Subscription Agreement. Admission as a Limited Partner in the Partnership is not open to the general public and interests in the Partnership are privately offered pursuant to Regulation D under the Securities Act of 1933, as amended. The Partnership generally accepts capital contributions on a monthly basis; however, the General Partner reserves the right, in its sole discretion, to accept capital contributions at other times.

**Withdrawals**

A Limited Partner may, upon at least 30 days' prior written notice, withdraw all or any part of its capital account as of the last day of the month occurring on or after the three-month anniversary of its initial investment in the Partnership and on the last day of each month thereafter.

If as of any withdrawal date, withdrawal requests by Limited Partners exceed 20% of the total capital accounts of all Limited Partners, the amount permitted to be withdrawn by each Limited Partner will be prorated on the basis of the relative size of the capital accounts of each Limited Partner requesting a withdrawal on such date.

**Valuation**

Partnership investments will generally be valued at their last traded price.

**Reports**

Each Limited Partner will receive unaudited reports of the performance of the Partnership monthly and will receive audited year-end financial statements annually.

**Tax Matters**

The Partnership will be treated as a partnership for Federal income tax purposes. Prospective Limited Partners should consult their own tax advisors with specific reference to their own situation as it relates to an investment in the Partnership.

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## 2. INTRODUCTION

Etolian Capital Credit Fund, LP is a Delaware limited partnership (the "Partnership") formed primarily for the purpose of investing its assets in and becoming a shareholder of Etolian Capital Offshore Master Fund, Ltd., a Cayman Islands exempted company that has elected to be treated as a partnership for U.S. tax purposes (the "Master Fund"). Etolian Capital Partners, LLC, a Delaware limited liability company, is the general partner of the Partnership (the "General Partner") and is responsible for managing the business and investments of the Partnership. Etolian Capital Group, LP, a Delaware limited partnership, is responsible for certain administrative matters for the Partnership (the "Management Company") and also serves as the investment manager ("Investment Manager") of the Master Fund. The general partner of the Management Company is Etolian Capital Management, LLC, a Delaware limited liability company. The General Partner's principal office is at 67 Wall Street, 10<sup>th</sup> Floor, New York, New York 10005, telephone no.: 212-659-2430. The managing members of the General Partner and Etolian Capital Management, LLC and the portfolio managers are George Handjinicolaou, Larry Hirshik and Yiannis Tsiounis (the "Managing Members"). References herein to the Partnership may, to the extent appropriate, also refer to the Master Fund. The General Partner of the Partnership and the Investment Manager to the Master Fund are registered with the Commodity Futures Trading Commission (the "CFTC") as "commodity pool operators" ("CPO").

This Memorandum sets forth the investment objective and method of operation of the Partnership, the principal terms of the Partnership Agreement and certain other pertinent information. However, the Memorandum does not set forth all the provisions and distinctions of the Partnership Agreement that may be significant to a particular prospective Limited Partner. Each prospective Limited Partner should examine this Memorandum, the Partnership Agreement and the Subscription Agreement accompanying this Memorandum in order to assure itself that the terms of the Partnership Agreement and the Partnership's investment program is satisfactory to it.

Prospective Limited Partners are invited to review any materials available to the General Partner relating to the Partnership, the operations of the Partnership and any other matters regarding this Memorandum. All such materials are available at the office of the Partnership, at any reasonable hour, after reasonable prior notice. The General Partner will afford prospective Limited Partners the opportunity to ask questions of and receive answers from its representatives concerning the terms and conditions of the offering and to obtain any additional information to the extent that the General Partner or the Partnership possesses such information or can acquire it without unreasonable effort or expense.

## 3. INVESTMENT PROGRAM

### Investment Objective

The Partnership's investment objective, through its investment in the Master Fund, is to provide stable and superior returns that are uncorrelated with the equity and fixed income markets, primarily by establishing both long and short positions in the credit fixed income obligations of companies based in North America. The Investment Manager utilizes a quantitative methodology that relies on input from the equity markets and equity options markets to assess relative value. The application of state-of-the-art risk management techniques enables the Investment Manager to focus on credit spreads (i.e., the difference between the yield offered by a particular credit and LIBOR), and generate its investment objectives through a careful selection of long and short positions.

### Investment Universe

The instruments in which the Partnership, through its investment in the Master Fund, generally invests can be grouped into the following broad categories:

- **Cash Fixed Income Obligations Issued by Companies:** The emphasis is on US dollar denominated obligations issued by US companies. However, the Investment Manager may consider

investing in either US dollar denominated obligations of non-US companies, and/or non-US dollar denominated obligations of US and non-US companies.

- **Credit Default Derivatives**: These are off-balance sheet instruments (e.g., credit default swaps, credit spread options, and cash bond options) that are designed to replicate the economic profile of the above-described bonds and may be used after taking into account the comparative economics, liquidity, and availability of credit lines.
- **Equity, Preferred Stock and Convertible Bond Obligations Issued by Companies**: The Investment Manager may consider the use of all of the above obligations either for expressing a view on a credit or for hedging purposes. Preferred stock obligations, although they are considered equity obligations, behave similarly to fixed income obligations and may represent an alternative for expressing a view on the credit of a particular company. Equities and convertible bonds may be used by the Investment Manager for hedging purposes.
- **Options on the Underlying Equity Stock Issued by Companies**: The Investment Manager may use equity puts and calls for hedging purposes.

In addition, because the focus of the Partnership's investment strategy is on credit spreads, it uses cash fixed income, interest rate futures and/or interest rate swaps to hedge various portfolio risks – interest rate risk in particular. Furthermore, it may occasionally use other fixed income derivatives such as credit derivatives on baskets of fixed income obligations and/or options (puts and calls) on such instruments, as well as cash equities index and equity index derivatives for hedging purposes.

### **Investment Opportunity**

The Investment Manager believes that there exists a great opportunity in the credit fixed income markets due to a number of trends:

- Over the last decade investors deployed large amounts of capital to equity capital markets, at the expense of fixed income markets, leading to portfolios that have been overrepresented with equity investments. Over the past couple of years, we have witnessed a shift back to fixed income investments. Yet, portfolios continue to be overweight with equities creating the possibility for further significant flows to the fixed income market through portfolio rebalancing.
- Investors have been disillusioned with market directional, index-based, investment returns that have failed to prevent capital erosion and are looking for investment opportunities that generate sustainable above average absolute returns that are not market direction sensitive, exhibit relatively low volatility, provide protection of capital, and produce alpha.
- The credit fixed income market comprises the largest market sector in fixed income, after governments and mortgages. Despite its size, it continues to be highly fragmented and opaque with, often times, poor price discovery. It is one of the few remaining markets where arbitrage opportunities still exist. Moreover, this market is in the midst of a major remake under the influence of new innovative products and techniques (such as credit derivatives and collateralized debt obligations) and new entrants to the market. Moreover, these techniques enable investors to create exposure to credit without exposing themselves to interest rate risks. Traditionally, investors wishing to hold credit fixed income instruments were exposed to both interest rate risk and credit risk.
- Pricing in the credit fixed income market continues to be driven by traditional credit analysis which relies heavily on detailed analysis of balance sheet and income statement information. As such, credit evaluation continues to be viewed as an “art”, not a science, and is driven by a wide range of subjective views about the various credits. The dramatic credit events of 2001 and 2002 (e.g., Enron, Kmart, WorldCom, Tyco) have demonstrated that these analytical tools have been inadequate in

anticipating major credit deterioration. Increasingly, market participants are looking for new, objective ways to assess and evaluate credit risk.

The Investment Manager believes that the offered product addresses such market needs at this time by offering an opportunity to invest in credit fixed income markets, without being exposed to interest rate risk, and in a manner that is consistent with preserving capital (by being hedged, i.e., having both long and short positions), while generating stable, above average annual returns that are uncorrelated with the equity and fixed income markets. More specifically,

- Unlike most other credit fixed income managers who utilize subjective traditional credit analysis for credit selection, the Investment Manager utilizes an objective approach to credit valuation which is based on a well established body of Finance theory – an options valuation framework. This approach (dating back to the seminal papers by Black & Scholes (1973) and Robert Merton (1974)), views credit (and risky bond valuation) as a claim on the assets of a company. The value of these options can be objectively obtained and estimated on the basis of market variables. The Investment Manager utilizes an options based methodology and relies on inputs from the credit fixed income, equity and equity options markets to determine which credits are overvalued and/or undervalued. This methodology drives the Investment Manager's selection process.
- The Investment Manager views the asymmetric nature of credit fixed income investments (the best outcome possible is the return of capital and interest, while losses can amount to the total invested), as a requirement for preserving capital and as an opportunity to create excess returns. The Investment Manager's approach aims at preserving capital and generating returns by taking advantage of credit deteriorating events. This is accomplished by going short on credits that are expected to deteriorate according to certain selection criteria. The combination of long and short positions reduces the likelihood of disastrous events, contributes to capital preservation, and creates potential upside.
- The Investment Manager seeks to generate stable and above average investment performance (alpha) by utilizing a blend of quantitative and qualitative selection methodology to select the individual credits, create the long and short portfolios, managing the long/short ratio, and by applying rigorous risk management techniques to control and manage risk.

### **Overview of the Investment Process**

Driven by the above considerations, the investment procedure followed by the Investment Manager will involve a four-step process.

The first step in the investment process is a quantitative screening of the corporate fixed income universe. The second step, the credit selection process, involves a rigorous research and analysis of the various alternative short and long investment candidates that are available for inclusion in the portfolios. The third step involves the portfolio construction and management, including the daily review of the whole portfolio construction process where each position in the portfolio is re-evaluated in light of the new candidates. Finally, in the fourth step, there is on-going risk management aimed at focusing on credit spread risk by hedging away other market risks, and controlling the Partnership's risk exposure in line with the stated objectives.

### **Step One: Quantitative Screening**

The Investment Manager's quantitative screening methodology is based on the insight, first outlined by Black & Scholes, and Merton, that the obligations of a firm (such as equity, preferred, loans, senior bonds, junior bonds, convertibles, etc.) represent claims on its assets. As such, they can be viewed as options that can be priced as a function of the assets of the firm. Moreover, such valuations have to be consistent. That is, all these instruments being options on the same underlying asset (the value of the assets of the firm) have to be priced in a consistent manner. The reality is that all these

securities are traded in different markets (the equity of a firm in the equity market, its bonds in the fixed income market, and so on), and it is likely that such valuations may not be consistent with each other.

The Investment Manager utilizes information available in the credit fixed income, equity and equity options markets to determine the extent to which the outstanding debt of a company is fairly priced, that is, whether the equity and equity options markets are pricing the firm's debt consistently with the way the credit fixed income market does. This enables the Investment Manager to determine whether credit fixed income securities of a particular company are overvalued or undervalued relative to its equity and equity options. The Investment Manager believes that a rigorous analysis of credit via this methodology uncovers arbitrage opportunities by exposing information available from the other liquid markets which trade identical business risk. Information from these markets may or may not be adequately reflected in the credit fixed income market, giving rise to relative value opportunities and thus providing the basis for the investment strategy.

The U.S. credit fixed income universe consists of over U.S. \$5.5 trillion notional amount outstanding as of December 2003, representing over 30% of the outstanding size of the U.S. bond market and more than 50% of the global credit fixed income market. Moreover, there is an emerging market for credit default swaps, estimated to be about \$3 trillion of outstanding notional contracts. The Investment Manager believes that its methodology enables it to sort through the universe of companies whose obligations trade in the above markets, in a highly efficient manner. Rather than going through an intensive credit research process where historical balance sheet and income statements are rigorously analyzed, this process allows for a quick screening and identification of the most promising opportunities throughout the corporate universe.

### **Step Two: Credit Selection Process**

The screening process typically results in large pools of company names, the debt of which is either undervalued or overvalued in relation to the companies' equity and equity options valuations. During the second step of the investment process, a series of additional screenings are performed in order to come to a determination as to the source of the misalignment in the value of identical business risk among these three markets and narrow down the pools of credits to the best candidates for long positions and short positions. During this step, the Investment Manager incorporates in the selection process views about the state of the economy as well as the desirability of individual sectors/industries. Moreover, the Investment Manager reviews and assesses all information available on the candidate companies, and evaluates the feasibility of executing the conceived strategies in the market place at the desired levels. The end result of this process is to achieve the objective of segregating the credits which have the best prospects of retaining (or even narrowing) the yield compensation while minimizing spread widening risk (candidates for the long portfolio), and those credits which have the greatest potential to experience price erosion due to spread widening (candidates for the short portfolio).

In order to do this, the Investment Manager uses a number of filtering techniques to reduce the candidates. Such filters include conducting input validation tests (to discard spurious results caused by input errors); picking only the top prospects from the pools (judged by statistical techniques); picking the best instrument for each credit; analyzing the statistical properties of the variables underlying the credit, equity and equity option valuations; factoring in carry costs, liquidity and ability to short and ascertaining whether the trades are feasible in the market place. The tangible output of this step is a universe of about 50 – 70 credits from which the portfolios in Step Three are constructed.

### **Step Three: Portfolio Construction and Management**

The next step in the investment process involves subjecting the universe of credits that result from Step Two, to additional considerations aimed at improving the portfolio efficiency in terms of risk and return. Specifically, considerations such as ***correlation analysis*** (aimed at diversifying credit selection by analyzing the correlations among credit candidates); ***controlling industry exposure*** (limiting the entire portfolio's exposure generally to a maximum of 15% of its risk adjusted positions either long or short in any one industry (measured at the time of investment)); ***controlling individual company***

**exposure** (limiting the entire portfolio's exposure generally to a maximum of 5% of its risk adjusted positions either long or short in any one company (measured at the time of investment)); and by **balancing overall long and short positions in order to achieve a credit market neutral stance** (although the selection process is a "bottoms up" approach, an important portfolio consideration is whether the overall position is "long or short" credit spreads. Because the nature of the credit risk, such balancing may imply that the ratio of long positions to short positions can vary over time. The Investment Manager's intent is to maintain a balanced portfolio with respect to credit risk by maintaining an optimal portfolio of 40 to 60 credits, (total long and short).

#### **Step Four: Risk Management**

The Investment Manager seeks to produce excess returns (alpha) through the selection criteria discussed above, and by its ability to determine relative value which is predicated on the inconsistencies of valuation within the credit market universe relative to valuations prevailing in the equity and equity options markets. Therefore, it is critical to isolate these "spread" inefficiencies, and mitigate all other portfolio risks, the most important being interest rate risk. Where necessary, the Investment Manager will hedge the interest rate risk generally by using interest rate (fixed-floating) swaps, exchange traded Eurodollar futures, and/or other cash fixed income, interest rate futures and options. The result of this hedging exercise is that each credit position is expressed as a calculated spread over LIBOR.

A critical part of risk management is the continuous portfolio review and rebalancing of the portfolios. Individual company credits are, de facto, reviewed daily by being subjected to the selection process on a daily basis. This process identifies credits to be rotated out of the portfolios and indicates better choices for positioning. Rather than determining arbitrary spread objectives to take profits, this procedure ensures that the portfolio is consistently comprised of the best possible credit candidates, eliminating from the portfolios those credits for which theoretical and actual credit spreads converge. Furthermore, the manager has strict stop losses designed to address potentially wrong signals from the selection process and to preserve capital gains.

#### **Risk Management Limits**

The Investment Manager has made a significant investment in risk management technology. At any point in time, the Investment Manager is in a position to monitor and manage the dynamics of the Partnership's portfolio. The goal is to focus on credit spreads and control all other risks within very tight tolerances. Specifically, the Investment Manager can monitor and manage the efficiency of the hedging strategies (i.e., the process of eliminating interest rate risk). In addition, there is on going monitoring and management of the long and short positions with ability to represent them on the basis of many criteria (i.e., by long and short portfolios, by maturity, by credit rating, by industry, and by individual company or credit instrument). Finally, the whole portfolio is subjected to standard value-at-risk methodologies in order to identify potential exposures and scenarios that can lead to large losses.

#### **Flexibility**

The Investment Manager intends to pursue the investment objective described above and will generally follow the outlined investment program as long as such program is in accord with the Partnership's overall investment objective. In addition, it may also formulate new approaches to carry out the overall investment objective of the Partnership.

While it is anticipated that the Partnership will invest primarily in fixed income securities, the Partnership has broad and flexible investment authority. Accordingly, the Partnership's investments may at any time include long or short positions in U.S. or non-U.S. publicly traded or privately issued or negotiated common stocks, preferred stocks, stock warrants and rights, corporate debt, bonds, notes or other debentures or debt participations, convertible securities, fixed income securities, swaps, options (purchased or written), futures contracts, commodities, forward contracts and other derivative instruments, partnership interests and other securities or financial instruments including those of investment companies. The Partnership may also invest in new issues of securities ("new issues"),

provided that the Partnership first complies with all of the rules and regulations pertaining to such investments, including the Conduct Rules of the National Association of Securities Dealers, Inc. (the "NASD"). The Partnership intends to utilize financial futures as part of its hedging strategy and, in this regard, the General Partner and the Investment Manager have registered with the CFTC.

#### **Master-Feeder Structure**

As discussed above, rather than make portfolio investments directly, the Partnership invests substantially all of its assets in a "Master-Feeder" structure in the Master Fund. All portfolio investments are held at the Master Fund level. See "Risk Factors" below for a discussion of certain risks associated with this structure.

THE PARTNERSHIP MAY BE DEEMED TO BE A HIGHLY SPECULATIVE INVESTMENT AND IS NOT INTENDED AS A COMPLETE INVESTMENT PROGRAM. IT IS DESIGNED ONLY FOR SOPHISTICATED PERSONS WHO CAN BEAR THE ECONOMIC RISK OF THE LOSS OF THEIR INVESTMENT IN THE PARTNERSHIP AND WHO HAVE A LIMITED NEED FOR LIQUIDITY IN THEIR INVESTMENT. THERE CAN BE NO ASSURANCE THAT THE PARTNERSHIP WILL ACHIEVE ITS INVESTMENT OBJECTIVE.

#### **4. MANAGEMENT**

The Partnership is managed by its General Partner, Etolian Capital Partners, LLC, a Delaware limited liability company, and the Investment Manager to the Master Fund is responsible for the investment decisions of the Master Fund, in which the Partnership invests substantially all of its assets. Etolian Capital Group, LP, a Delaware limited partnership, is responsible for certain administrative matters for the Partnership and also serves as the Investment Manager of the Master Fund. The general partner of the Management Company is Etolian Capital Management, LLC, a Delaware limited liability company. The principals and Managing Members of the General Partner and Etolian Capital Management, LLC are George Handjinicolaou, Larry Hirshik and Yiannis Tsiounis. Set forth below are the biographies of the key personnel of the General Partner and the Investment Manager.

**George Handjinicolaou.** *Managing Member and Co-Chief Investment Officer.* Mr. Handjinicolaou has over 25 years of experience in trading and managing risk across several asset classes. Prior to forming the Etolian Capital Partners, LLC, Etolian Capital Group, LP and Etolian Capital Management, LLC, Mr. Handjinicolaou was Managing Director at Merrill Lynch with responsibility for Global Fixed Income Emerging Markets (2000-2002). From 1998 to 2000, he was Executive Vice President and Head of Fixed Income for the Americas at Dresdner Kleinwort Benson. From 1986 to 1998, George was involved with the fixed income derivatives trading in a variety of functions, including Head of Global Swaps Group at Security Pacific/Bank of America, and Head of Fixed Income Derivatives for the Americas at UBS. In the early eighties (1983 to 1986) and for a brief period in the nineties (1994-1995), he was with the World Bank Group, including serving as the Treasurer of the IFC. Over the years, Mr. Handjinicolaou has been an active member of the financial community, has served on the Board of Directors of ISDA and Brokertek, and is on the Advisory Boards of Polytechnic University, and the International Association of Financial Engineers (IAFE). He has taught at N.Y.U. and Baruch College and has published several articles. George has a Ph.D (1983) and an MBA (1978) in Finance from N.Y.U., and a BA in Economics from the University of Athens (1975).

**Larry Hirshik.** *Managing Member and Co-Chief Investment Officer.* Mr. Hirshik has more than 20 years of capital markets experience concentrating in the structuring, trading, and risk management of fixed income derivatives. From 1999 to 2002, Larry was CEO of Derivatives Exchange Network, an Internet start-up. From 1993 to 1999, he was Managing Director and Head of Derivatives Trading with First Union, where he headed a team of 8 traders with responsibility for pricing, trading, hedging and managing the risk of fixed income swaps, options, and municipals derivatives portfolios. From 1984 to 1993, he was with Security Pacific/Bank of America and Manufacturers Hanover in a variety of fixed income derivatives trading functions. Throughout his career, Larry has proven to be a profitable

and consistent trader. Larry has an MBA in Finance from UCLA (1983) and a BA in Mathematics and Computer Science from the University of New Hampshire (1980).

**Yiannis Tsiounis. Managing Member and Chief Operating Officer.** Yiannis Tsiounis brings to Etolian Capital a wealth of analytical, quantitative and entrepreneurial skills gathered from his experience as an academic and an entrepreneur. Prior to Etolian Capital, he was principal and co-founder of Ecleide (2001-2003), a company consulting for the banking industry and the Government, and of Internet Cash (1999-2001), an internet venture focusing on secured payments and communications. From 1995 to 1999, he was a scientist with GTE (now Verizon) Laboratories focusing on cryptography and from 1992 to 1995 he taught at Northeastern University, while getting his Ph.D. (1997) and Master's degrees (1992), in Cryptography and Computer Science, respectively. Yiannis also holds a BA in Applied Mathematics (1990) from the University of Athens.

## **5. MANAGEMENT FEE; EXPENSES**

### **Management Fee**

The Management Company will receive a quarterly management fee calculated at the annual rate of 1.5% of each Limited Partner's capital account (the "Management Fee"). The Management Fee will be paid quarterly in advance based on the value of each Limited Partner's capital account as of the first day of each calendar quarter (adjusted for contributions made during the quarter). The Management Fee will be prorated for any period that is less than a full fiscal quarter and will be deducted in calculating the net profit or net loss of the Partnership. The General Partner, with the consent of the Management Company, may waive or modify the Management Fee for Limited Partners that are members, employees or affiliates of the General Partner or the Management Company, relatives of such persons, and for certain large or strategic investors. There will be no Management Fee charged at the Master Fund level.

### **Expenses**

The Management Company is responsible for and pays or causes to be paid the following overhead expenses of the Partnership: office rent; furniture and fixtures; stationery; secretarial/internal administrative services; salaries; entertainment expenses; employee insurance and payroll taxes. All other expenses are paid by the Partnership and include: the Management Fee; legal, audit and accounting expenses (including third party accounting services); administrator fees and expenses; organizational expenses; investment expenses such as commissions, research fees and expenses (including research related travel); interest on margin accounts and other indebtedness; borrowing charges on securities sold short; custodial fees; the Partnership's pro rata share of the Master Fund's expenses; and any other expenses reasonably related to the purchase, sale or transmittal of Partnership assets.

The organizational expenses of the Partnership (including expenses of the initial offer and sale of limited partnership interests) have been paid by the Partnership and are being amortized over a period of 60 months from the date the Partnership commenced operations. Accordingly, the auditor's opinion on the Partnership's financial statements may contain a qualification to reflect this treatment.

## **6. ALLOCATION OF NET PROFITS AND NET LOSSES; INCENTIVE ALLOCATION TO THE GENERAL PARTNER; PURCHASE OF "NEW ISSUES"; PRIOR FISCAL PERIOD ITEMS**

### **Allocation of Net Profits and Net Losses**

Except for "new issues" profits, the net profit or net loss of the Partnership as of the end of each fiscal period (as defined in Section 13 below) will be allocated to each Partner in the proportion that the balance of its capital account as of the beginning of that fiscal period bore to the aggregate of all the capital accounts as of the beginning of that fiscal period. Net profit and net loss of the Partnership will be determined on the accrual basis of accounting generally using GAAP as a guideline and will be deemed to include net unrealized profits or losses on investment positions as of the end of each fiscal period.

### **Incentive Allocation to the General Partner**

Subject to the "loss carryforward" provision discussed below, if for any fiscal year a Limited Partner has a net profit, an amount equal to 20% of such net profit (including realized and unrealized gains) will be deducted from the Limited Partner's capital account as of the end of such fiscal year and allocated to the capital account of the General Partner (the "Incentive Allocation"). In the event that a Partner withdraws capital or retires at any time other than at the end of a fiscal year, such deduction will be made with respect to such Partner as though it were being made at the end of a fiscal year. The General Partner, in its sole discretion, may waive or modify the Incentive Allocation for Limited Partners that are members, employees or affiliates of the General Partner or the Management Company, relatives of such persons, and for certain large or strategic investors. There will be no Incentive Allocation charged at the Master Fund level. The Partnership's fiscal year will end on December 31 of each year.

Under a loss carryforward provision contained in the Partnership Agreement, no Incentive Allocation will be made from the capital account of a particular Limited Partner with respect to a fiscal year until any net loss previously allocated to the capital account of such Limited Partner has been offset by subsequent net profits. Any such loss carryforward will be subject to reduction for withdrawals on a pro rata basis.

### **Purchase of "New Issues"**

From time to time, the Partnership may, to the extent permitted by the Rules of the National Association of Securities Dealers, Inc., as may be amended from time to time (the "Rules"), purchase equity securities that are part of an initial public offering (sometimes referred to as "IPOs" or "new issues"). Under the Rules, brokers may not sell such securities to a private investment fund, if the fund has investors who are "Restricted Persons", which category includes persons employed by or affiliated with a broker and portfolio managers of hedge funds and other registered and unregistered investment advisory firms. The profits and losses with respect to new issues will generally be allocated to investors in the Partnership that are not Restricted Persons. The Partnership may, however, avail itself of a "de minimis" exemption pursuant to which a portion of any new issue profits and losses may be allocated to Restricted Persons. The Partnership Agreement provides that the General Partner is authorized to determine, among other things: (i) the manner in which new issues are purchased, held, transferred and sold by the Partnership and any adjustments with respect thereto; (ii) the Partners who are eligible and ineligible to participate in new issues; (iii) the method by which profits and losses from new issues are to be allocated among Partners in a manner that is permitted under the Rules (including whether the Partnership will avail itself of the "de minimis" exemption or any other exemption); and (iv) the time at which new issues are no longer considered as such under the Rules.

### **Prior Fiscal Period Items**

In general, and notwithstanding any of the allocation rules discussed above, if the Partnership has a material item of income or loss (as defined in the Partnership Agreement) in any fiscal period which relates to a matter or transaction occurring during a prior fiscal period (e.g., if the Partnership wins a cash settlement in a case it began in a prior year) the item of income or loss may, in the sole discretion of the General Partner, be shared among the Partners (including persons who have ceased to be Partners) in accordance with their interest in the Partnership during the prior period. A person who has ceased to be a Partner will be liable for his proportionate share of prior fiscal period items and will pay such share on demand, but the amount to be paid will not exceed the amount of such Partner's capital account at the time such prior fiscal period item arose.

## **7. RISK FACTORS**

The Partnership may be deemed to be a highly speculative investment and is not intended as a complete investment program. It is designed only for sophisticated persons who are able to bear the economic risk of the loss of their investment in the Partnership and who have a limited need for liquidity in their investment. The following risks should be carefully evaluated before making an investment in the Partnership:



## **Risks of Trading Strategies**

The Partnership's performance may be adversely affected by unforeseen events involving such matters as political crises, economic or market conditions, changes in currency rates or interest rates or forced redemptions of securities. Certain of the portfolio strategies employed by the Partnership are based on historical trends in, and relationships between, asset prices. There can be no assurance that such historical trends or relationships will continue, and no representation is made by the Investment Manager as to what results the Partnership will or is likely to achieve based on such trends and relationships.

## **Nature of Investments**

The Investment Manager has broad discretion in making investments for the Partnership. Investments generally consist of credit fixed income obligations of companies and other assets that may be affected by business, financial market or legal uncertainties. There can be no assurance that the Investment Manager will correctly evaluate the nature and magnitude of the various factors that could affect the value of and return on investments. Prices of investments may be volatile, and a variety of factors that are inherently difficult to predict, such as domestic or international economic and political developments, may significantly affect the results of the Partnership's activities and the value of its investments. In addition, the value of the Partnership's portfolio may fluctuate as the general level of interest rates fluctuates. No guarantee or representation is made that the Partnership's investment objective will be achieved.

## **Convertible Securities**

Convertible securities are securities that may be exchanged or converted into a predetermined number of the issuer's underlying shares or the shares of another company or that are indexed to an unmanaged market index at the option of the holder during a specified time period. Convertible securities may take the form of convertible preferred stock, convertible bonds or debentures, stock purchase warrants, zero-coupon bonds or liquid-yield option notes, stock index notes, mandatories, or a combination of the features of these securities. Prior to conversion, convertible securities have the same general characteristics as non-convertible debt securities. As with all debt securities, the market value of convertible securities tends to decline as interest rates increase and conversely, increase as interest rates decline. Convertible securities, however, also appreciate when the underlying common stock appreciates, and conversely, depreciate when the underlying common stock depreciates.

## **Lower-Rated Securities**

At any given time, the Partnership may invest in fixed income securities rated lower than Baa by Moody's or lower than BBB by S&P (or, if not rated, deemed by the Investment Manager to be of comparable quality). Securities rated lower than Baa by Moody's or lower than BBB by S&P are sometimes referred to as "high yield" or "junk" bonds. Securities rated Baa are considered by Moody's to have some speculative characteristics. Lower-rated securities may include securities that have the lowest rating or are in default. Investing in lower-rated securities involves special risks in addition to the risks associated with investments in higher-rated fixed income securities, including a high degree of credit risk. Lower-rated securities may be regarded as predominately speculative with respect to the issuer's continuing ability to meet principal and interest payments. Analysis of the creditworthiness of issuers/issues of lower-rated securities may be more complex than for issuers/issues of higher quality debt securities. Lower-rated securities may be more susceptible to losses and real or perceived adverse economic and competitive industry conditions than higher-grade securities. Securities that are in the lowest rating category are considered to have extremely poor prospects of ever attaining any real investment standing, to have a current identifiable vulnerability to default, and to be unlikely to have the capacity to pay interest and repay principal. The secondary markets on which lower-rated securities are traded may be less liquid than the market for higher-grade securities. Less liquidity in the secondary trading markets could adversely affect and cause large fluctuations in the value of the Partnership's portfolio. Adverse publicity and investor perceptions, whether or not based on fundamental analysis, may

decrease the values and liquidity of lower-rated securities, especially in a thinly traded market. Furthermore, with respect to certain residential and commercial mortgage-backed securities, it is difficult to obtain current reliable information regarding delinquency rates, prepayment rates, servicing records, as well as updated cash flows.

The use of credit ratings as the sole method of evaluating lower-rated securities can involve certain risks. For example, credit ratings evaluate the safety of principal and interest payments, not the market value risk of lower-rated securities. In addition, credit rating agencies may fail to change credit ratings in a timely fashion to reflect events since the security was rated.

### **Interest Rate Risk**

The Partnership is subject to interest rate risk. Generally, the value of fixed income securities will change inversely with changes in interest rates. As interest rates rise, the market value of fixed income securities tends to decrease. Conversely, as interest rates fall, the market value of fixed income securities tends to increase. This risk will be greater for long-term securities than for short-term securities. The Partnership intends to minimize the exposure of the portfolios to interest rate changes through the use of interest rate swaps, interest rate futures and/or interest rate options. However, there can be no guarantee that the Investment Manager will be successful in fully mitigating the impact of interest rate changes on the portfolios.

### **Corporate Debt Obligations**

The Partnership invests in corporate debt obligations, 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). The Investment Manager intends to actively expose the portfolios to credit risk. The Partnership's investment objective is to provide stable and superior returns that are uncorrelated with the equity and fixed income markets, primarily by establishing both long and short positions in the credit fixed income obligations of companies based in developed countries. However, there can no guarantee that the Investment Manager will be successful in making the right selections and thus fully mitigating the impact of credit risk changes on the portfolios.

### **U.S. Government Securities**

The Partnership 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. The Partnership 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.

### **Leverage**

The Investment Manager may borrow funds from brokerage firms, banks and other institutions on behalf of the Partnership in order to be able to increase the amount of capital available for marketable securities investments. In addition, the Partnership may in effect borrow funds through entering into repurchase agreements, and may "leverage" its investment return with options, commodity futures contracts, swaps, forwards and other derivative instruments. The amount of borrowings that the Partnership may have outstanding at any time may be large in relation to its capital. Consequently, the

level of interest rates, generally, and the rates at which the Partnership can borrow, in particular, will affect the operating results of the Partnership.

The use of leverage will increase investor returns if the Partnership earns a greater return on leveraged investments than the Partnership's cost of such leverage. However, the use of leverage exposes the Partnership to additional levels of risk, such as: (i) should the securities pledged to brokers to secure the Partnership's margin accounts decline in value, the Partnership could be subject to a "margin call", pursuant to which the Partnership will be required to either deposit additional funds with the lender or suffer mandatory liquidation of the pledged securities to compensate for the decline in the securities' value; (ii) greater losses from investments than would otherwise have been the case had the Partnership not borrowed to make the investments; and (iii) losses on investments where the investment fails to earn a return that equals or exceeds the Partnership's cost of leverage related to such investments.

### **Counterparty Credit Risk**

Transactions entered into by the Partnership involve credit risk to the extent that its market counterparties are unable or unwilling to fulfill their contractual obligations. In an effort to limit counterparty credit risk the Partnership will be subject to credit concentration limits. Counterparties will generally be expected to fulfill certain criteria as to creditworthiness. It is the Investment Manager's policy generally not to expose the Partnership to any counterparty that, at the time of entering into a transaction, has a long-term senior debt rating (or, if it has no rating, is deemed by the Investment Manager to merit a rating) below A- by Standard & Poor's Ratings Services, a division of McGraw Hill Companies, Inc., or A3 by Moody's Investors Service, Inc.

### **Custody Risk**

While UBS Securities LLC serves as the Partnership's cash custodian (the "Custodian"), as noted in Section 14 below, the majority of the Partnership's assets will be invested in fixed income instruments and related derivatives instruments many of which are not capable of being "custodied" in the traditional sense. Accordingly, at any given time the Partnership's account at the Custodian may only contain a small amount of cash and/or direct investments, with the majority of the Partnership's assets posted as collateral or otherwise held at the various banks, brokerage firms and other financial institutions with whom it has effected investment transactions. It is expected that all securities and other assets deposited with custodians or brokers will be clearly identified as being assets of the Partnership and hence the Partnership should not be exposed to a credit risk with respect to such parties. However, it may not always be possible to achieve this segregation and there may be practical or timing problems associated with enforcing the Partnership's rights to its assets in the case of an insolvency of any such party, particularly in regard to parties located in non-U.S. jurisdictions.

### **Special Situations**

The Partnership may invest in companies involved in (or the target of) acquisition attempts or tender offers or in companies involved in or undergoing work-outs, liquidations, spin-offs, reorganizations, bankruptcies or other catalytic changes or similar transactions. In any investment opportunity involving any such type of special situation, there exists the risk that the contemplated transaction either will be unsuccessful, will take considerable time or will result in a distribution of cash or a new security the value of which will be less than the purchase price to the Partnership of the security or other financial instrument in respect of which such distribution is received. Similarly, if an anticipated transaction does not in fact occur, the Partnership may be required to sell its investment at a loss. Because there is substantial uncertainty concerning the outcome of transactions involving financially troubled companies in which the Partnership may invest, there is a potential risk of loss by the Partnership of its entire investment in such companies.

## **Portfolio Turnover**

The investment strategy of the Partnership may involve the taking of frequent trading positions, and, as a result, turnover and brokerage commission expenses of the Partnership may significantly exceed those of other investment entities of comparable size.

## **Non-U.S. Securities**

The Partnership intends to invest primarily in U.S. securities, but may invest in non-U.S. securities. Investing in securities of non-U.S. governments and companies which are generally denominated in non-U.S. currencies and utilization of options on non-U.S. securities involves certain considerations comprising both risks and opportunities not typically associated with investing in securities of the United States Government or United States companies. These considerations include changes in exchange rates and exchange control regulations, political and social instability, expropriation, imposition of foreign taxes, less liquid markets and less available information than is generally the case in the United States, higher transaction costs, foreign government restrictions, less government supervision of exchanges, brokers and issuers, greater risks associated with counterparties and settlement, difficulty in enforcing contractual obligations, lack of uniform accounting and auditing standards and greater price volatility.

## **Currency Risks**

Investments that are denominated in a foreign currency are subject to the risk that the value of a particular currency will change in relation to one or more other currencies. Among the factors that may affect currency values are trade balances, the level of short-term interest rates, differences in relative values of similar assets in different currencies, long-term opportunities for investment, capital appreciation and political developments. The Investment Manager may try to hedge these risks, but there can be no assurance that it will implement a hedging strategy, or if it implements one, that it will be effective.

## **Lack of Diversification**

The Partnership's portfolio may not be as diversified among a wide range of types of securities or industry sectors as other investment vehicles. Accordingly, the investment portfolio of the Partnership may be subject to more rapid change in value than would be the case if the Partnership were required to maintain a wider diversification among types of sectors, securities and other instruments.

## **Options**

The purchase or sale of an option involves the payment or receipt of a premium by the investor and the corresponding right or obligation, as the case may be, either to purchase or sell the underlying security, commodity or other instrument for a specific price at a certain time or during a certain period. Purchasing options involves the risk that the underlying instrument will not change price in the manner expected, so that the investor loses its premium. Selling options involves potentially greater risk, because the investor is exposed to the extent of the actual price movement in the underlying security rather than only the premium payment received (which could result in a potentially unlimited loss). Over-the-counter options also involve counterparty solvency risk.

## **Derivatives**

To the extent that the Partnership invest in swaps, derivative or synthetic instruments, repurchase agreements or other over-the-counter transactions or, in certain circumstances, non-U.S. securities, the Partnership may take a credit risk with regard to parties with whom it trades and may also bear the risk of settlement default. These risks may differ materially from those entailed in exchange-traded transactions that generally are backed by clearing organization guarantees, daily marking-to-market and settlement, and segregation and minimum capital requirements applicable to intermediaries. Transactions entered

directly between two counterparties generally do not benefit from such protections and expose the parties to the risk of counterparty default. It is expected that all securities and other assets deposited with custodians or brokers will be clearly identified as being assets (directly or indirectly) of the Partnership, and hence the Partnership should not be exposed to a credit risk with regard to such parties. However, it may not always be possible to achieve this, and there may be practical or time problems associated with enforcing rights to its assets in the case of an insolvency of any such party.

### **Credit Derivatives**

Credit derivatives are contracts that transfer price, spread and/or default risks of debt and other instruments from one party to another. Such instruments may include one or more debtors. Payments under credit derivatives may be made during the exercise period of the contracts. Payments under many credit derivatives are triggered by credit events such as bankruptcy, default, restructuring, failure to pay, cross default or acceleration, etc. Such payments may be for notional amounts, actual losses or amounts determined by formula.

The market for credit derivatives is relatively illiquid, and there are considerable risks that may make it difficult either to buy or sell the contracts as needed or at reasonable prices. Sellers of credit derivatives carry the inherent price, spread and default risks of the debt instruments covered by the derivative instruments. Buyers of credit derivatives carry the risk of non-performance by the seller due to inability to pay. There are also risks with respect to credit derivatives in determining whether an event will trigger payment under the derivative and whether such payment will offset the loss or payment due under another instrument. In the past, buyers and sellers of credit derivatives have found that a trigger event in one contract may not match the trigger event in another contract, exposing the buyer or the seller to further risk.

### **Distressed Securities**

The Partnership may invest in "distressed securities" securities, private claims and obligations of domestic and foreign entities which are experiencing significant financial or business difficulties. Investments may include loans, commercial paper, loan participations, trade claims held by trade or other creditors, stocks, partnership interests and similar financial instruments, executory contracts and options or participations therein not publicly traded. Distressed securities may result in significant returns to the Partnership, but also involve a substantial degree of risk. The Partnership may lose a substantial portion or all of its investment in a distressed environment or may be required to accept cash or securities with a value less than the Partnership's investment. Among the risks inherent in investments in entities experiencing significant financial or business difficulties 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 state and federal laws relating to, among other things, fraudulent conveyances, voidable preferences, lender liability and the bankruptcy court's discretionary power to disallow, subordinate or disenfranchise particular claims. The market prices of such instruments are also subject to abrupt and erratic market movements and above average price volatility, and the spread between the bid and asked prices of such instruments may be greater than normally expected. In trading distressed securities, litigation is sometimes required. Such litigation can be time-consuming and expensive, and can frequently lead to unpredicted delays or losses.

### **Futures**

The prices of futures contracts and options used for hedging purposes may not correlate with price movements of the underlying securities being hedged. Although the Partnership intends to purchase or sell commodity futures contracts only if there is an active market for each such contract, no assurance can be given that a liquid market will exist for the contracts at any particular time. Futures exchanges and boards of trade limit the amount of fluctuation permitted in certain futures contract prices during a single trading day. Once the daily limit has been reached in a particular contract, no trades may be made that day at a price beyond that limit.

### **Short Sales**

Short sales can, in certain circumstances, substantially increase the impact of adverse price movements on the Partnership's portfolio. A short sale involves the risk of a theoretically unlimited increase in the market price of the particular investment sold short, which could result in an inability to cover the short position and a theoretically unlimited loss. There can be no assurance that securities necessary to cover a short position will be available for purchase.

### **Lack of Liquidity of Partnership Investments / Restricted or Non-Marketable Securities**

The Partnership's investments in restricted or non-marketable securities may involve a high degree of business and financial risk that can result in substantial losses. There may be no existing market for the purchase and sale of such investments, and the Partnership may not be able to readily sell such investments. In addition, Partnership assets may, at any given time, include securities and other financial instruments or obligations that are thinly-traded, making purchase or sale of such securities at desired prices or in desired quantities difficult or impossible. Furthermore, the sale of any such investments may be possible only at substantial discounts, and it may be extremely difficult to value any such investments accurately.

### **Limited Withdrawal and Transfer Rights**

A Limited Partner generally is permitted to withdraw all or any part of his or her capital account on a monthly basis following an initial three-month holding period. Transfers of the limited partnership interests are permitted only with the written consent of the General Partner. Accordingly, the limited partnership interests should only be acquired by investors willing and able to commit their funds for an appreciable period of time.

### **Incentive Allocation**

The reallocation of a percentage of the Partnership's net profits to the General Partner may create an incentive for the General Partner to cause the Partnership to make investments that are riskier or more speculative than would be the case if this reallocation were not made. Since the reallocation is calculated on a basis which includes unrealized appreciation of assets, such allocation may be greater than if it were based solely on realized gains.

### **Unrelated Business Taxable Income for Certain Tax-Exempt Investors**

Pension and profit-sharing plans, Keogh plans, individual retirement accounts and other tax-exempt investors may realize "unrelated business taxable income" as a result of an investment in the Partnership since the Partnership may employ leverage. See Section 11, "Taxation." Any tax-exempt investor should consult its own tax adviser with respect to the effect of an investment in the Partnership on its own tax situation.

### **Reliance on Managing Members of the General Partner of the Investment Manager**

If one or more of the Managing Members of the General Partner of the Investment Manager resigns from the General Partner or otherwise becomes unable to participate in the management of the Partnership, Limited Partners will generally have no special withdrawal rights. If one or more of the Managing Members no longer participates in the management of the Partnership, it is possible that a significant number of the Partnership's Limited Partners may exercise their right to withdraw their investment in the Partnership at the next applicable withdrawal date. There can be no assurance that the Partnership's portfolio could be liquidated in an efficient manner to accommodate such withdrawals, and Limited Partners could experience losses.

### **Limited Operating History**

Each of the General Partner, the Investment Manager, the Partnership and the Master Fund is a newly-formed entity and has only a limited operating history upon which investors can evaluate its likely performance. Accordingly, an investment in the Partnership entails a significant degree of risk.

### **No Separate Counsel**

Seward & Kissel LLP will act as counsel to the General Partner, the Investment Manager, the Partnership and the Master Fund. Neither the Partnership nor the Master Fund has counsel separate and independent from counsel to the General Partner and Investment Manager. No separate counsel has been retained to act on behalf of Limited Partners.

### **Absence of Regulatory Oversight**

While the Partnership may be considered similar to an investment company, it does not intend to register as such under the Investment Company Act of 1940, as amended, in reliance upon an exemption available to privately offered investment companies, and, accordingly, the provisions of that Act (which, among other matters, require investment companies to have disinterested directors, require securities held in custody to at all times be individually segregated from the securities of any other person and marked to clearly identify such securities as the property of such investment company and regulate the relationship between the adviser and the investment company) will not be afforded to the Partnership or the Limited Partners.

### **Potential Conflicts of Interest**

Each of the General Partner and the Management Company will use its best efforts in connection with the purposes and objectives of the Partnership and will devote so much of its time and effort to the affairs of the Partnership as may, in its judgment, be necessary to accomplish the purposes of the Partnership. Under the terms of the Partnership Agreement, the General Partner, the Management Company, each of their respective directors, members, partners, shareholders, officers, employees, agents and affiliates (hereinafter referred to as the "Affiliated Parties") may conduct any other business, including any business within the securities industry, whether or not such business is in competition with the Partnership. Without limiting the generality of the foregoing, the Affiliated Parties may act as investment adviser or investment manager for others, may manage funds, separate accounts or capital for others and may serve as an officer, director, consultant, partner or stockholder of one or more investment funds, partnerships, securities firms or advisory firms. In this regard, it should be noted that the Management Company acts as the investment manager to Etolian Capital Offshore Credit Fund, Ltd., an offshore fund that also invests substantially all of its assets in the Master Fund. Such other entities or accounts may have investment objectives or may implement investment strategies similar or different to those of the Partnership. In addition, the Affiliated Parties may, through other investments, including other investment funds, have interests in the securities in which the Partnership invests as well as interests in investments in which the Partnership does not invest. As a result of the foregoing, the Affiliated Parties may have conflicts of interest in allocating their time and activity between the Partnership and other entities, in allocating investments among the Partnership and other entities and in effecting transactions for the Partnership and other entities, including ones in which the Affiliated Parties may have a greater financial interest.

The Affiliated Parties may give advice or take action with respect to such other entities or accounts that differs from the advice given with respect to the Partnership. To the extent a particular investment is suitable for both the Partnership and other clients of the Affiliated Parties, such investments will be allocated between the Partnership and the other clients pro rata based on assets under management or in some other manner that the Affiliated Parties determine is fair and equitable under the circumstances to all clients, including the Partnership.

In addition, purchase and sale transactions (including swaps) may be effected between the Partnership and the other entities or accounts subject to the following guidelines: (i) such transactions shall be effected for cash consideration at the current market price of the particular securities, and (ii) no extraordinary brokerage commissions or fees (i.e., except for customary transfer fees or commissions) or other remuneration shall be paid in connection with any such transaction.

From the standpoint of the Partnership, simultaneous identical portfolio transactions for the Partnership and the other clients may tend to decrease the prices received, and increase the prices required to be paid, by the Partnership for its portfolio sales and purchases. Where less than the maximum desired number of shares of a particular security to be purchased is available at a favorable price, the shares purchased will be allocated among the Partnership and the other clients in an equitable manner as determined by the Affiliated Parties. Further, it may not always be possible or consistent with the investment objectives of the various persons or entities described above and of the Partnership for the same investment positions to be taken or liquidated at the same time or at the same price; however all transactions will be made on a "best execution" basis.

### **Master-Feeder Fund Structure**

As discussed above, rather than make portfolio investments directly, the Partnership invests substantially all of its assets in a "Master-Feeder" structure in the Master Fund. All portfolio investments are held at the Master Fund level. The master-feeder fund structure and, in particular, the existence of multiple investment vehicles (if applicable) investing in the same portfolio presents certain risks to investors, including the increased costs associated specifically with investing through the Master Fund (which are borne on a pro-rata basis by the various entities investing in the Master Fund). Similarly, the Master Fund may become less diverse due to withdrawal by a larger investment vehicle, resulting in increased portfolio risk.

## **8. ADMISSION OF PARTNERS; ADDITIONAL CAPITAL CONTRIBUTIONS**

Admission as a Limited Partner in the Partnership is not open to the general public. The Partnership is not intended as a complete investment program and is designed only for persons who are able to bear the economic risk of the loss of their investment in the Partnership and who have a limited need for liquidity in their investments. Limited partnership interests will generally be sold only to qualified investors who are "accredited investors" under Rule 501 of Regulation D of the Securities Act of 1933, as amended, "qualified clients" under Rule 205-3 of the Investment Advisers Act of 1940, and "qualified eligible persons" as defined in Rule 4.7 under the Commodity Exchange Act, as amended.

The minimum initial investment in the Partnership is \$1,000,000, subject to waiver in the sole discretion of the General Partner. In general, the Partnership will accept capital contributions monthly; however, the General Partner reserves the right, in its sole discretion, to accept capital contributions at other times. Capital contributions by Limited Partners will be made in cash or, in the General Partner's sole discretion, in securities or partly in cash and partly in securities.

The General Partner may admit additional or substitute general partners to the Partnership who are affiliates of the General Partner; provided, however, that the General Partner gives 75 days' prior written notice to the Limited Partners of the proposed admission of any additional or substitute general partner.

## **9. WITHDRAWALS; RETIREMENT; DISTRIBUTIONS**

### **Withdrawals of Capital and Retirement of Partners**

A Limited Partner may, upon at least 30 days' prior written notice, withdraw all or any portion of its capital account as of the last day of the month following the three-month anniversary of its initial investment in the Partnership and on the last day of each month thereafter. Notwithstanding anything to the contrary herein, if as of any withdrawal date, withdrawal requests by Limited Partners exceed 20% of the total



capital accounts of all Limited Partners, the amount permitted to be withdrawn by each Limited Partner will be prorated on the basis of the relative size of the capital accounts of each Limited Partner requesting a withdrawal on such date. To the extent a Limited Partner's withdrawal request is reduced in this manner, any excess will be paid as of the next quarter end and each subsequent quarter end thereafter until the withdrawal amount requested has been paid. Withdrawal requests which have been carried forward from an earlier period shall have priority over later requests. A notice of withdrawal must state the amount to be withdrawn or the basis on which such amount is to be determined. A Partner who elects to withdraw all of his capital account will be deemed to have retired as of the effective date of such withdrawal. A partially withdrawing Limited Partner will generally be paid within 30 days; provided, however, that if a Limited Partner withdraws at least 90% of its capital account, it will be paid in the same manner as a fully retiring Limited Partner (i.e., at least 90% of the withdrawal amount will be paid within 30 days with the balance to be paid after a final determination of the value of all of the capital accounts in the Partnership, which may be after the completion of the Partnership's annual audit). The General Partner, in its sole discretion, may waive or modify the conditions relating to withdrawals for Limited Partners that are members, employees or affiliates of the General Partner or the Management Company, relatives of such persons, and for certain large or strategic investors.

The General Partner may withdraw all or any portion of its capital account on the last day of each month; provided, however, that the amount withdrawn may not reduce its capital account below the lesser of \$100,000 or 1% of the capital accounts of all of the Partners; and provided, however, further that if the capital sought to be withdrawn by the General Partner would reduce its capital account (computed without regard to net losses) to less than 50% of its initial capital contribution, the General Partner must give 75 days' written notice of the proposed withdrawal to the Limited Partners.

The Sub-Administrator will process withdrawal requests which are initially received by facsimile, but no part of the redemption proceeds will be paid to withdrawing Partners until the Sub-Administrator has received the original withdrawal request signed by the withdrawing Partner or by an authorized signatory of the withdrawing Limited Partner. Neither the Partnership nor the Sub-Administrator shall be responsible for any mis-delivery or non-receipt of any facsimile. Facsimiles sent to the Partnership or the Sub-Administrator shall only be effective when actually received by the Partnership or the Sub-Administrator. Limited Partners who submit withdrawal requests initially by facsimile to the Sub-Administrator are advised to contact the Sub-Administrator by telephone on (212) 918-9782 to confirm that the Sub-Administrator has received the facsimile withdrawal request.

### **Mandatory Withdrawals**

The General Partner, in its sole discretion, may require any Limited Partner to withdraw all or any part of its capital account from the Partnership at any time on not less than 20 days' notice, such withdrawal to be effective on the date specified in such notice. If the General Partner, in its sole discretion, deems it to be in the best interests of the Partnership to do so because the continued participation of any Limited Partner in the Partnership might cause the Partnership to violate any law, rule or regulation or expose the Partnership to litigation, arbitration, administrative proceedings or any similar action or proceeding, the General Partner may require such Limited Partner to withdraw all or any part of its capital account from the Partnership at any time on not less than 5 days' notice, such withdrawal to be effective on the date specified in such notice.

### **Death, Bankruptcy or Legal Incapacity of a Partner**

In the event of the death, bankruptcy or legal incapacity of a Partner, the estate or legal representative of such Partner will succeed to the Partner's right to share in net profits or net losses of the Partnership and to receive distributions from the Partnership. The estate or representative may, in the sole discretion of the General Partner, be paid as of the end of the fiscal year during which the Partner died or became bankrupt or legally incapacitated, the value of such Partner's capital account as of the end of such year in liquidation of the Partner's interest in the Partnership. Alternatively, the General Partner may, in its sole discretion, admit the estate or representative to the Partnership as a Limited Partner. Notwithstanding anything to the contrary, if a Partner dies on a day other than the last day of a fiscal period, net profits or net

losses for such fiscal period allocable to the deceased Partner will be allocated between the deceased Partner and his estate for Federal income tax purposes.

### **Payments on Retirement**

A Partner retiring in accordance with the Partnership Agreement will be entitled to receive an amount equal to the value of his capital account as of the date of his retirement, and the estate or legal representative of any deceased, bankrupt or legally incapacitated Partner may, in the sole discretion of the General Partner, be paid the value of such Partner's capital account as of the end of the fiscal year during which such Partner died or became bankrupt or incapacitated.

The Partnership will distribute to a retiring Partner at least 90% of its capital account within 30 days after the date of such Partner's retirement or the end of the fiscal year, as the case may be. Promptly after the General Partner has determined the capital accounts of the Partners as of such date (which, in the General Partner's sole discretion, may be after the Partnership's annual audit), the Partnership will pay to the retiring Partner or his representative the excess, if any, of the amount to which such Partner is entitled over the amount previously paid, or such Partner will be obligated to pay to the Partnership the excess, if any, of the amount previously paid over the amount to which such Partner is entitled, in each case together with interest thereon, from the date of retirement or the last day of the fiscal year, as the case may be, to the date of the payment of the excess amount at an annual rate equal to the broker's call rate charged by the Partnership's prime broker. The payment to a retiring Partner of his capital account will be subject to the retention of a reserve for Partnership liabilities, as provided in Section 10.02 of the Partnership Agreement. If the reserve (or portion thereof) is later determined by the General Partner to have been in excess of the amount required, the proportionate amount of the excess will be returned to the retired Partner with interest thereon at an annual rate equal to the broker's call rate charged by the Partnership's prime broker.

### **Suspension of Withdrawals**

The General Partner may suspend the right of Limited Partners to make withdrawals during any period when:

(a) any stock exchange on which a substantial part of securities owned by the Partnership are traded is closed, otherwise than for ordinary holidays, or dealings thereon are restricted or suspended;

(b) there exists any state of affairs that constitute a state of emergency or period of extreme volatility or illiquidity as a result of which (i) disposal of investments of the Partnership would not be reasonably practicable or cannot be completed in a timely fashion to meet withdrawal requirements and might seriously prejudice the Limited Partners or (ii) it is not reasonably practicable for the Partnership to determine fairly the value of its net assets;

(c) there is a breakdown in the means of communication normally employed in determining the prices of a substantial part of the investments of the Partnership;

(d) the Master Fund suspends redemptions; or

(e) none of the requests for withdrawals that have been made may be lawfully satisfied by the Partnership in U.S. dollars.

### **Distributions in Cash or in Kind**

Distributions to a Limited Partner on withdrawal or retirement will be made in cash or, in the sole discretion of the General Partner, in securities selected by the General Partner, or partly in cash and partly in securities selected by the General Partner. In-kind distributions may be made directly to the withdrawing Partner or, alternatively, in certain limited circumstances, distributed into a liquidating trust or account and

sold for the benefit of such withdrawing Partner, in which case (i) payment to such Partner of that portion of his withdrawal attributable to such securities will be delayed until such time as such securities can be liquidated and (ii) the amount otherwise due such Partner will be increased or decreased to reflect the performance of such securities through the date on which the liquidation of such securities is effected.

## **10. BROKERAGE AND CUSTODY**

The Investment Manager is authorized to determine the broker or dealer to be used for each securities transaction for the Partnership. In placing orders, it is the Partnership's policy to obtain the best price and execution for its transactions. Where best price and execution may be obtained from more than one dealer, the Investment Manager may purchase and sell securities through dealers who provide research, statistical and other information, although the Partnership may not necessarily, in any particular instance, be the direct or indirect beneficiary of the research services provided. Research and related services furnished or paid for by brokers may include, but is not limited to, written information and analyses concerning specific securities, companies or sectors; market, financial and economic studies and forecasts; financial publications; statistic and pricing services, as well as discussions with research personnel, along with hardware, software, databases and other technological, technical and telecommunication services (including wireless services), lines and equipment utilized in the investment management process (including updates, modifications, improvements, maintenance, offsite or onsite backup, repairs and replacements), as well as research-related travel. Research and related services obtained by the use of commissions arising from the Partnership's portfolio transactions may be used by the Investment Manager in its other investment activities.

Services, other than research, obtained by the use of commissions arising from the Partnership's portfolio transactions will only be used for the benefit of the Partnership, and such services will be limited to services which would otherwise constitute an expense borne by the Partnership. It should be noted that certain of the foregoing commission arrangements are outside the parameters of Section 28(e) of the Securities Exchange Act of 1934, as amended, which permits use of commissions or "soft dollars" to obtain "research and execution" services.

Additionally, from time to time, the Partnership may request and receive cash rebates when there is a soft dollar commission credit built up at an executing broker.

In selecting brokers and negotiating commission rates, the Investment Manager will take into account the financial stability and reputation of brokerage firms and the brokerage and research services provided by such brokers, although the Partnership may not, in any particular instance, be the direct or indirect beneficiary of the research services provided. The Investment Manager may also consider the referral of investors, consistent with best execution.

The Investment Manager may also hire separate independent trading firms in order to obtain better prices and/or execution, and such trading firms will be paid through additional commissions to be borne by the Partnership.

The Partnership maintains accounts at UBS Securities LLC, which serves as the Partnership's prime broker and custodian. The Investment Manager reserves the right, in its sole discretion, to change or add prime brokers and/or custodians without further notice to the Limited Partners.

## **11. ADMINISTRATOR**

The Partnership, the Master Fund and Etolian Capital Offshore Credit Fund, Ltd (together for the purposes of this section, the "Funds") have entered into an administration agreement (the "Administration Agreement") with Citco Fund Services (Bermuda) Limited, a company incorporated under the laws of Bermuda, to perform certain financial, accounting, administrative and other services on behalf of the Funds. In respect of the Partnership, the Administrator has delegated all of its duties under the Administration Agreement to its affiliate, Citco Fund Services (USA), Inc. (the "Sub-Administrator").

Pursuant to the Administration Agreement, the Administrator is responsible for the overall administration of the Funds and performs or supervises the performance of certain services necessary for the Partnership's operation and administration (other than making investment decisions), including administrative, accounting and investor relations services. The Administrator is also responsible for, among other things: (i) calculating the net asset value of the Partnership in accordance with this Memorandum and the Partnership's Limited Partnership Agreement; (ii) performing certain acts related to the subscription and withdrawal of interests; (iii) keeping such books and records for the proper conduct of the affairs of the Partnership; and (iv) performing other services necessary in connection with the administration of the Partnership.

In determining the net asset value of the Partnership, the Administrator will follow the valuation policies and procedures adopted by the Partnership as set out in the Limited Partnership Agreement. If and to the extent that the Investment Manager is responsible for or otherwise involved in the pricing of any of the Partnership's portfolio of securities or other assets, the Administrator may accept, use and rely on such prices in determining the Net Asset Value of the Partnership and shall not be liable to the Partnership, any investor in the Partnership, the General Partner, the Investment Manager or any other person in so doing. The Administrator will not be responsible or liable for the accuracy of information furnished by other persons to the Administrator and/or the Partnership. The Administrator in no way acts as guarantor or offeror of the Partnership's interests or any underlying investment, nor is it responsible for the actions of the Partnership's sales agents, the prime brokers, any other brokers or the Investment Manager. The Administrator will not be responsible for monitoring any investment restrictions or compliance with the investment restrictions and therefore will not be liable for any breach thereof.

Under the Administration Agreement, the Funds will indemnify and hold harmless the Administrator, its subsidiaries, affiliates, directors and other officers, shareholders, servants, employees, agents and permitted delegates (together "Indemnified Parties") against any liability, actions, proceedings, claims, demands, costs or expenses in connection therewith that may be incurred by the Administrator or any other Indemnified Party or which may be made against the Administrator or any other Indemnified Party in respect of the same sustained or suffered by any third party, except that no Indemnified Party will be indemnified against any liability to which it would be subject by reason of a material breach due to its gross negligence, bad faith, fraud or dishonesty. In the absence of material breach of the Administration Agreement by the Administrator due to the gross negligence, bad faith, fraud or dishonesty in the performance of its duties, neither the Administrator nor any other Indemnified Party will be liable to the Funds on account of anything done, omitted or suffered by the Administrator or any other Indemnified Party in good faith pursuant to the Administration Agreement in the performance of the services to be performed by the Administrator.

The fee payable to the Administrator is based on its standard schedule of fees charged by the Administrator for similar services. The Funds and the Administrator may terminate the Administration Agreement upon 90 days' written notice to the other party.

## **12. TAXATION**

The Partnership has been advised by its counsel, Seward & Kissel LLP, that, under present law, the Partnership will be treated as a partnership and will not be a taxable entity for Federal income tax purposes. Instead, each Limited Partner is required to take into account for each fiscal year, for purposes of computing his or her own income tax, his or her proportionate share of the various items of taxable income or loss allocated to him or her pursuant to the Partnership Agreement, whether or not any income is paid out to him or her. The manner in which such items of taxable income or loss are allocated among the Partners is set forth in Article VII of the Partnership Agreement. Such items of taxable income or loss will be required to be taken into account in the taxable year of the Limited Partner in which the fiscal year of the Partnership ends.

The Partnership invests substantially all of its assets through a "master-feeder" structure in the Master Fund, which is a Cayman Islands exempted company. Although the Master Fund is subject to a 30% Federal withholding tax with respect to dividends and certain interest income considered to be from

sources within the United States, the Partnership's share of such income should not be subject to this withholding tax. The Master Fund has elected to be treated as a partnership for U.S. Federal income tax purposes and, consequently, will not be a taxable entity for Federal income tax purposes. The Partnership will take into account for Federal income tax purposes its pro rata share of the Master Fund's income and loss.

The Master Fund has been advised by its Cayman Islands counsel, Ogier & Boxalls, that neither the Partnership nor the Master Fund will be subject to any income, withholding, capital gains or other taxes in the Cayman Islands. Further, Limited Partners will not be subject to any income, withholding, capital gains or other taxes in the Cayman Islands with respect to their interest in the Partnership, nor will they be subject to any estate duty or inheritance taxes in the Cayman Islands.

Income, gains, losses and deductions of the Partnership are not from a "passive activity" within the meaning of Section 469 of the Internal Revenue Code of 1986, as amended (the "Code"). Accordingly, (i) the deduction by a Limited Partner of his or her share of the losses or deductions of the Partnership will not be restricted under Section 469 of the Code, and (ii) a Limited Partner who is an individual will not be able to deduct losses from other "passive activities" against his or her share of income of the Partnership.

The Master Fund will be required each year to make the determination as to whether it will take the position for Federal income tax purposes that it is (i) a trader in securities or, alternatively, (ii) an investor in securities. This determination will be made separately each year based primarily on the level of the Master Fund's securities activities during the particular year. Accordingly, the Master Fund's status as a trader or an investor may vary from year to year and is difficult to predict in advance. If the Master Fund is characterized as a trader, each Limited Partner who is an individual may deduct his or her share of expenses of the Master Fund (other than interest expense) under Section 162 of the Code as business expenses. Alternatively, if the Master Fund is characterized as an investor, the expenses of the Master Fund (other than interest expense) will be investment expenses deductible under Section 212 of the Code, and accordingly, such expenses would be deductible by an individual only to the extent that his or her share of such expenses, when combined with his or her other "miscellaneous itemized deductions", exceeds 2% of his or her adjusted gross income. Further, the amount in excess of such 2% floor would be subject to the overall limitation on itemized deductions imposed by Section 68 of the Code. Also, the amount in excess of such 2% floor would be considered a tax preference item in computing the alternative minimum tax for an individual taxpayer. The Partnership also will be required to determine whether expenses it incurs directly (e.g., the Management Fee) are business expenses or investment expenses subject to the foregoing limitations on deductibility.

For Federal income tax purposes, interest expense attributed to the Partnership from the Master Fund generally will be considered "investment interest." Subject to certain limited exceptions, investment interest is deductible by an individual only to the extent of his or her net investment income (which for this purpose generally does not include net long-term capital gains or "qualified dividend income"). Investment interest that is not deductible in any taxable year because of this limitation may be carried forward to the succeeding taxable year.

Since the Master Fund may invest in the securities of foreign issuers, the Partnership's income may be subject to foreign income taxes, including withholding taxes. A Limited Partner may elect either to deduct his or her share of such foreign taxes in computing his or her Federal taxable income or treat his or her share of such foreign taxes as a credit against Federal income taxes, subject to certain limitations. No deduction for foreign taxes may be claimed by an individual who does not itemize deductions.

Under Section 988 of the Code, gains and losses from the disposition of foreign currencies, from the disposition of debt securities denominated in a foreign currency, or from the disposition of certain foreign currency contracts, which are attributable to fluctuations in the value of the foreign currency between the date of acquisition and the date of disposition are generally treated as ordinary income or loss. Similarly, gains or losses attributable to fluctuations in exchange rates between the time interest,

other receivables, expenses or other liabilities denominated in a foreign currency are accrued and the time such receivables or liabilities are collected or paid are treated as ordinary income or loss.

If the Master Fund invests in bonds issued with "original issue discount", the Master Fund generally will be required to accrue as taxable income a portion of the excess of the face value of the securities over their issue price for each year the securities are held, even though the Master Fund receives no payment with respect to such discount in such year. Gain derived by the Master Fund from the disposition of market discount bonds (i.e., bonds purchased subsequent to original issue at a price less than face value) generally will be taxed as ordinary income to the extent of the accrued market discount on the bonds, unless the Master Fund elects to include such discount in income as it accrues. Unless such an election is made, the deduction for some or all of the interest expense incurred to purchase or carry a market discount bond may be deferred.

The Master Fund generally will not realize gain or loss on a short sale of a security until the Master Fund purchases the security to be delivered to the lender to close the transaction (or, in the case of a loss, until the security is delivered to the lender). Gain arising from the closing of a short sale generally is treated as short-term capital gain.

A position entered into or held by the Master Fund in conjunction with any other position held by the Master Fund may constitute a "straddle" for Federal income tax purposes. In general, straddles are subject to certain rules that may affect the character and timing of the Master Fund's gains and losses with respect to straddle positions by requiring, among other things, that (i) loss realized on disposition of one position of a straddle not be recognized to the extent that the Master Fund has unrealized gains with respect to the other position in such straddle; (ii) the Master Fund's holding period in straddle positions be suspended while the straddle exists (possibly resulting in gain being treated as short-term capital gain rather than long-term capital gain); (iii) losses recognized with respect to certain straddle positions which would otherwise constitute short-term capital losses be treated as long-term capital losses; and (iv) the deduction of interest and carrying charges attributable to certain straddle positions be deferred.

The character and timing of the Partnership's taxable gains and losses may be affected by various Code provisions, including those applicable to Section 1256 contracts and wash sales.

If the Master Fund is a trader for Federal income tax purposes, the Master Fund may elect, pursuant to Section 475(f) of the Code, to "mark to market" its securities at the end of each taxable year. Pursuant to this election, the Master Fund's securities generally would be treated for Federal income tax purposes as though sold for fair market value on the last business day of the taxable year. This election would apply to all taxable years of the Master Fund unless revoked with the consent of the Internal Revenue Service. If this election were made, the Master Fund's gains and losses generally would be considered ordinary income or loss, rather than capital gain or loss. Since for Federal income tax purposes capital losses generally may be deducted only against capital gains, the ability of a Limited Partner to deduct capital losses realized from his or her other investments against his or her share of the Partnership's income would be limited if the Master Fund were to make this election.

As discussed in Section 3, the General Partner may utilize leverage in connection with the Partnership's investments. In this regard, a tax-exempt investor will generally be subject to tax on the portion of its share of the Partnership's profits attributable to the use of certain leverage. Such portion will be considered "debt-financed income" and will be taxable as "unrelated business taxable income" under the Federal income tax law. The law is not entirely clear, however, as to the proper way to determine what portion of a tax-exempt investor's share of the Partnership's profits is attributable to the use of leverage and therefore "debt-financed income." Accordingly, while the Partnership will compute each tax-exempt investor's share of "debt-financed income" from the Partnership in a manner which the Partnership determines is reasonable, there can be no assurance that the Internal Revenue Service (the "IRS") will accept the method of computation used by the Partnership.

In February 2003, the IRS released final Treasury Regulations expanding previously existing information reporting, record maintenance and investor list maintenance requirements with respect to

certain "tax shelter" transactions (the "Tax Shelter Regulations"). The Tax Shelter Regulations may potentially apply to a broad range of investments that would not typically be viewed as tax shelter transactions, including investments in investment partnerships and portfolio investments of investment partnerships. Under the Tax Shelter Regulations, if the Partnership or the Master Fund engages in a "reportable transaction," the Partnership and, under certain circumstances, a Limited Partner would be required to (i) retain all records material to such "reportable transaction"; (ii) complete and file IRS Form 8886, "Reportable Transaction Disclosure Statement" as part of its Federal income tax return for each year it participates in the "reportable transaction"; and (iii) send a copy of such form to the IRS Office of Tax Shelter Analysis at the time the first such tax return is filed. The scope of the Tax Shelter Regulations may be affected by further IRS guidance. Non-compliance with the Tax Shelter Regulations may involve significant penalties and other consequences. Each Limited Partner should consult his or her own tax advisers as to his or her obligations under the Tax Shelter Regulations.

Based on its investment program and on the basis of present law, the Partnership should not be subject to the New York City unincorporated business tax and individual Limited Partners who are not considered to be residents of New York State should not be subject to New York State personal income tax in respect of their share of the income from the Partnership.

If the Partnership were considered to have income from New York sources, the Partnership would be required to withhold New York State income tax with respect to income allocable to Limited Partners who are not residents of New York. Based on the anticipated activities of the Partnership, it is expected that little, if any, of the Partnership's income will be treated as New York source income. If the Partnership is required to pay such tax, a nonresident Limited Partner should be eligible for a credit equal to the portion of the tax on the Partnership attributable to such Limited Partner's share of the Partnership's income if such Limited Partner files a New York State income tax return.

The advice from Seward & Kissel LLP on Federal, New York State and New York City tax matters is based on the assumption that the Partnership will be operated in the manner contemplated by the General Partner and as described in this Memorandum and the Partnership Agreement and under present provisions of the laws and regulations issued thereunder and the cases and rulings interpreting such laws and regulations. There can be no assurance that the positions the Partnership or the Master Fund takes on its tax returns, with respect to expenses or otherwise, will be accepted by the IRS or the New York taxing authorities.

As promptly as practicable after the end of each fiscal year, the Partnership will send to each Limited Partner a report indicating the amounts representing his or her respective share of net long-term capital gain or loss, net short-term capital gain or loss, operating profit or loss and other appropriate items of income and deduction for purposes of reporting such amounts for Federal income tax purposes.

The tax consequences of an investment in the Partnership may vary depending upon the particular circumstances of each prospective Limited Partner. Accordingly, each prospective Limited Partner should consult his or her own tax advisers with respect to the effect of an investment in the Partnership on his or her personal tax situation and, in particular, the state and local tax consequences to him or her of an investment in the Partnership.

Tax-exempt investors should review with their tax advisers the discussion above regarding unrelated business taxable income and debt-financed income and any tax and/or filing obligation they may have with respect to unrelated business taxable income. Tax-exempt investors should also consult their tax advisers with regard to the unrelated business taxable income issues that may arise upon the disposition of their interest in the Partnership. In a private ruling, the IRS has taken the position that a portion of the gain realized from the sale (e.g., withdrawal) of a partnership interest by a tax-exempt entity is debt-financed income when the partnership uses borrowed funds to purchase property even though the tax-exempt entity did not use borrowed funds to purchase its partnership interest.

A Limited Partner (and each employee, representative, or other agent of the Limited Partner) may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of an

investment in the Partnership and all materials of any kind (including opinions or other tax analyses) that are provided to the Limited Partner relating to such tax treatment and tax structure.

### **13. ERISA MATTERS**

The following is a summary of certain aspects of the laws and regulations applicable to retirement plan investments as in existence on the date hereof, all of which are subject to change. This summary is general in nature and does not address every issue under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") that may be applicable to the Partnership or a particular investor.

The Partnership may accept capital contributions from individual retirement accounts ("IRAs"), Keogh plans, pension or profit-sharing plans, governmental plans, entities that invest the assets of such accounts or plans and/or other benefit plan investors (all such entities are herein referred to as "Benefit Plan Investors"). The General Partner does not anticipate that the assets of the Partnership will be subject to ERISA, because the General Partner intends to limit the investments in the Partnership by Benefit Plan Investors to less than 25% of the value of any class of equity interests of the Partnership, excluding from this calculation any non-Benefit Plan Investor interest of that class held by the General Partner or the Management Company, persons affiliated with the General Partner or the Management Company, or their employees. No subscriptions for Partnership interests made by Benefit Plan Investors will be accepted and no transfers of Partnership interests will be permitted to the extent that the investment or transfer would result in the Partnership exceeding this 25% limit. In addition, because the 25% limit is to be calculated upon every contribution to or withdrawal (in whole or in part) from the Partnership, the General Partner has the authority to require the retirement or withdrawal (in whole or in part) of any Partnership interest if the continued holding of such interest, in the opinion of the General Partner, could result in the Partnership being subject to ERISA. See "Mandatory Withdrawals" – Section 9.

ERISA and the Code impose certain duties, obligations and responsibilities on persons who serve as fiduciaries with respect to employee benefit plans ("Plans") or IRAs and prohibit acts of fiduciary self-dealing and certain transactions between Plans or IRAs and "parties-in-interest" or "disqualified persons" (as such terms are defined in ERISA and the Code). In the Partnership's Subscription Agreement, each Plan and IRA will be required to represent that its fiduciary has independently made the decision to invest in the Partnership and has not relied as a primary basis for its investment decision on any advice from the General Partner, any placement agent associated with the Partnership or General Partner or any affiliate of either with respect to the investment in the Partnership. Accordingly, fiduciaries of Plans or IRAs should consult their own investment advisors regarding the prudence of the investment and their own legal counsel regarding the consequences under ERISA and the Code of the investment in the Partnership.

### **14. OTHER PROVISIONS OF THE LIMITED PARTNERSHIP AGREEMENT**

**Term of the Partnership.** The Partnership will continue until December 31, 2032 and thereafter from year to year unless dissolved as provided in Section 9.01 of the Partnership Agreement.

**Liability of Partners and Indemnification of the General Partner and Others.** The General Partner is liable to creditors for the debts of the Partnership. However, none of the General Partner, the Management Company or their respective directors, members, partners, shareholders, officers, employees, agents or affiliates, nor any person designated to wind up the affairs of the Partnership pursuant to the Partnership Agreement will be liable for any loss or cost arising out of, or in connection with, any activity undertaken (or omitted to be undertaken) in connection with the Partnership, except for any liability caused by his, her or its gross negligence, willful misconduct or violations of applicable laws.

The Partnership will, to the fullest extent legally permissible under the laws of the State of Delaware, indemnify the General Partner, the Management Company, each of their respective directors, members, partners, shareholders, officers, employees, agents and affiliates and any persons designated to wind up the affairs of the Partnership pursuant to the Partnership Agreement (each, an "Indemnitee")



against any and all loss, liability and expense (including, without limitation, judgments, fines, amounts paid or to be paid in settlement and reasonable attorney's fees and expenses) incurred or suffered by the Indemnitee in connection with the good faith performance by the Indemnitee of his, her or its responsibilities to the Partnership; provided, however, that an Indemnitee will not be indemnified for losses resulting from his, her or its gross negligence, willful misconduct or violation of applicable laws. To the extent legally permissible, the Partnership will, in the discretion of the General Partner, advance amounts and/or pay expenses as incurred in connection with the Partnership's indemnification obligation.

A Limited Partner who does not take part in the management or control of the business of the Partnership will not be personally liable for any debt or obligation of the Partnership in excess of his capital account. Under certain circumstances a Limited Partner may, under Delaware law, be required to return, for the benefit of creditors, amounts previously distributed to him.

**Amendment of the Partnership Agreement.** The Partnership Agreement may be amended by the General Partner, in its sole discretion, in any manner that does not adversely affect any Limited Partner. The Partnership Agreement may also be amended by action of both the General Partner and Limited Partners owning a majority-in-interest of the capital accounts of all the Limited Partners in any manner that does not discriminate among the Limited Partners.

**Dissolution of the Partnership.** The Partnership may be dissolved at any time by the General Partner, whereupon its affairs will be wound up by the General Partner. The retirement, dissolution, bankruptcy or insolvency of the General Partner will dissolve the Partnership unless (i) at such time there is another general partner who agrees to continue the business of the Partnership, or (ii) an entity controlled by George Handjinicolaou, Larry Hirshik and/or Yiannis Tsiounis is substituted as general partner to continue the business of the Partnership. If there is no remaining general partner who agrees to continue the business of the Partnership or an entity controlled by George Handjinicolaou, Larry Hirshik and/or Yiannis Tsiounis is not substituted as general partner, the affairs of the Partnership will be promptly wound up by the General Partner, or if the General Partner is unavailable, by the person previously designated by the General Partner, or if the General Partner has made no such designation, the person selected by a majority in interest of the capital accounts of the Limited Partners. Such person will take all steps necessary or appropriate to wind up the affairs of the Partnership as promptly as practicable.

Neither the admission of Limited Partners nor the retirement, bankruptcy, death, dissolution, or insanity of any Limited Partner will dissolve the Partnership.

**Assignability of Limited Partnership Interests.** Neither the interest of any Limited Partner in the Partnership nor any beneficial interest therein is assignable, in whole or in part, without the prior written consent of the General Partner.

**Power of Attorney.** The General Partner will be granted an irrevocable power of attorney to sign on behalf of each Limited Partner a Certificate of Limited Partnership and any amendments thereto or termination thereof, as well as any documents required by reason of the dissolution of the Partnership or any documents required to be submitted by the Partnership to any governmental or administrative agency, to any securities exchange, board of trade, clearing corporation or association or to any self-regulatory organization or trade association.

**Reports to Partners.** The Partners will be advised promptly following the end of each month as to the unaudited performance of the Partnership. The books and records of the Partnership will be audited at the end of each fiscal year by a firm of certified public accountants selected by the General Partner, and the Limited Partners will be furnished with audited year-end financial statements (within 90 days of the end of each fiscal year or as soon as practicable thereafter) including a statement of profit or loss for such fiscal year and of an unaudited status of such Limited Partner's capital account at such time. The Partnership's financial statements will be prepared using generally accepted accounting principles ("GAAP") as a guideline, unless otherwise deemed appropriate in the sole discretion of the General Partner. Organizational expenses are being amortized over a period of 60 months from the date the Partnership commenced operations because the Partnership believes that such treatment is more equitable than

expensing the entire amount during the first year of operations, as is required by GAAP. As a result, the Partnership's financial statements may contain a qualification reflecting this treatment. The Partnership's auditors are PricewaterhouseCoopers LLP. The General Partner reserves the right, in its sole discretion, to change the Partnership's auditors without further notice to the Limited Partners.

**Fiscal Year and Fiscal Periods.** The Partnership has adopted a fiscal year ending on December 31. Since Limited Partners may be admitted or required to retire and additional capital contributions or withdrawals may be made during the course of a fiscal year, the Partnership Agreement provides for fiscal periods, which are portions of a fiscal year, for the purpose of allocating net profits and net losses due to changes occurring in capital accounts at such times.

## **15. PROCEDURES FOR BECOMING A LIMITED PARTNER**

In order to become a Limited Partner, a prospective Limited Partner should: (i) complete and execute a copy of the Subscription Agreement, inserting the amount of his capital contribution, residence address and taxpayer identification or social security number; (ii) complete and execute the signature page of the Partnership Agreement, (iii) provide the verification information and documentation outlined in the Subscription and (iv) return all completed and executed documents referred above by facsimile to the Investor Relations Department, facsimile (212) 918-9411, ([investorrelations@citco.com](mailto:investorrelations@citco.com)), with originals to follow by mail to the Partnership c/o Citco Fund Services (USA) Inc., 350 Madison Avenue, 12<sup>th</sup> Floor, New York, New York 10017.

After receipt of the Subscription Agreement, the General Partner will notify each prospective Limited Partner of the date (the "Admission Date") by which, and the address to which, he or she will be required to transmit the amount of his capital contribution under the Subscription Agreement. Shortly after the Admission Date, the General Partner will return to each new Limited Partner copies of the Subscription Agreement and the signature page of the Partnership Agreement as executed by the General Partner.

In order to comply with United States and international laws aimed at the prevention of money laundering and terrorist financing, each prospective investor that is an individual will be required to represent in the Subscription Agreement that, among other things, he is not, nor is any person or entity controlling, controlled by or under common control with the prospective investor, a "Prohibited Person" as defined in the Subscription Agreement (generally, a person involved in money laundering or terrorist activities, including those persons or entities that are included on any relevant lists maintained by the U.S. Treasury Department's Office of Foreign Assets Control, any senior foreign political figures, their immediate family members and close associates, and any foreign shell bank). Further, each prospective investor which is an entity will be required to represent in the Subscription Agreement that, among other things, (i) it has carried out thorough due diligence to establish the identities of its beneficial owners, (ii) it reasonably believes that no beneficial owner is a "Prohibited Person", (iii) it holds the evidence of such identities and status and will maintain such information for at least five years from the date of its complete withdrawal from the Partnership, and (iv) it will make available such information and any additional information that the Partnership may require upon request that is required under applicable regulations.

The General Partner reserves the right to request such further information as it considers necessary to verify the identity of a prospective investor. In the event of delay or failure by the prospective investor to produce any information required for verification purposes, the General Partner may refuse to accept a capital contribution until proper information has been provided, and any funds received will be returned without interest to the account from which the monies were originally debited. Investors should note that the General Partner may refuse to accept a withdrawal request if it is not accompanied by such additional information as it, or the Administrator or its affiliates, on its behalf, may reasonably require.

It should be noted that the General Partner (or an entity designated by the General Partner) may pay fees to persons (whether or not affiliated with the General Partner) who are instrumental in the sale of interests in the Partnership. Any such fees will in no event be payable by or chargeable to the Partnership or any Limited Partner or prospective Limited Partner.

## **ETOLIAN CAPITAL CREDIT FUND, LP**

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