No. 10-695 DEC 29 2010

In The
Supreme Court of the United States

MARK D. LAY,
Petitioner,
v.

UNITED STATES OF AMERICA,
Respondent.

Petition For A Writ Of Certiorari To The United States Court of Appeals For The Sixth Circuit

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BRIEF OF THE *AMICUS CURIAE* OF GERALD SHERWIN, ERIC CARMICHAEL, PASCAL NARDELLI, TRACY FOSTER, BRUCE GOODE, LEROY THOMPSON, DR. CLAUD ANDERSON AND THE HARVEST INSTITUTE

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December, 2010

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STATEMENT OF INTEREST OF AMICUS[1]

The individuals who have joined in the filing of this amicus brief are investment, academic and business professionals who desire to bring to the Court's attention an unprecedented employment

[1]In accordance with the provisions of Supreme Court Rule 37.6, it is hereby disclosed that counsel for Petitioner provided input to this brief of *amicus curiae* and also made a monetary contribution to the cost of printing. Other than counsel for Petitioner,no person other than the *amicus curiae* or their counsel contributed to preparation or submission of the brief. Pursuant to Rule 37.2(a), counsel of record for both parties received timely notice of amici's intent to file this brief. Letters from the parties consenting to the filing of this brief are on file with the Court.

by the United States of federal criminal securities laws to reach conduct by an African American investment manager, that when engaged in by non African American investment advisers heretofore, was treated as purely tortious, if anything. The conviction of Petitioner, Mark Lay, implies that it is a criminal offense for an African American investment adviser to lose a large sum of money in the market, notwithstanding the absence of theft, embezzlement or any form whatsoever of personal gain.[2] Mr. Lay was prosecuted for his handling of an investment by the Ohio Bureau of Workers Compensation (OBWC), that it is questionable that Ohio officials were authorized to make. There is a widely held perception that Mr. Lay's prosecution was racially and politically motivated and that Mr. Lay has been made a scapegoat for the misdeeds of certain high level Ohio officials. Accordingly, we desire for the Court

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[2]It should be noted that Mr. Lay received fees for his activity as a hedge fund investment adviser, but these fees were paid by the fund, not the investors. There was no churning allegation against Mr. Lay. Fees paid to Long Fund Advisers greatly exceeded those paid by ADF.

to review Mr. Lay's conviction as a matter of racial justice and fairness.

Set forth below is an individual list of the signatories with a description of their credentials and relationships to Mr. Lay.

1. Eric Carmichael Eric Carmichael has been in the investment industry since 1985. During his career he has actively been involved in both the investment banking and institutional brokerage sectors of the industry. In 1990, he established the Columbus, Ohio office for a national minority-owned investment firm.

   He provided brokerage services to the OBWC since 1992. He met Mr. Lay during the early 2000's and built both a friendship and business relationship whereby Mr. Carmichael's firm provided brokerage to MDL Capital Management.

2. Gerry Sherwin graduated from Columbia College in 1955 with concentration in Humanities and Government (Political Science). He served in US Army for two years and is currently a Marketing and Communications Consultant. He was formerly Senior Partner in Charge of Professional Development for six years at Bozell Group, has forty-five years of experience in Communications and

Marketing, and has held senior positions with Grey Advertising, Block Drug Company, Lehn & Fink, Bozell, WINS Radio.

Mr. Sherwin has known Mark Lay since he entered Columbia in 1981 when he was President of the Columbia Men's Basketball team and Mr. Lay was an undergraduate, and Captain of the men's basketball team. They continued their friendship after Mr. Lay graduated and stayed in touch whenever Mr. Lay came back to New York on business and to visit old friends. Mark Lay is someone Mr. Sherwin feels he can truly rely on--considerate, intelligent, are words that describe him--a friend of the highest order.

3. Pascal M. Nardelli, Managing Member, Castlebrook Development Group, LLC, Principal

4. Tracy Foster is the owner of P & W Foreign Cars and South Hills Audi, both located in Pittsburgh, Pennsylvania. Ms. Foster also owns Woodson Motor Sports in Ft. Wayne, Indiana. Ms. Foster has been a business associate of Mr. Lay for nearly a decade.

5. Bruce Goode is an investment banker and owner of Goode Investments located in Cleveland, Ohio.

6. Leroy Thompson is President/Chief Manager, BDT Development & Management, LLC, a real estate development and construction management firm with offices located in Pittsburgh, Pennsylvania and Knoxville, Tennessee. Mr. Thompson has known Mr. Lay for several years both personally and professionally. In all of our interactions, I have found Mr. Lay to be of sound judgment and character with the highest regard to professionalism. It is impossible for me to believe that Mr. Lay could have knowingly committed the serious crimes that he was charged and ultimately convicted of in federal court.

7. The Harvest Institute is a non-profit, tax exempt research educational, policy and advocacy organization located in Washington, D.C. and founded in 1993. Its mission is to engage in activities that lead to a Black America that is self-sufficient and competitive as a group within the next decade. Its founder is Dr. Claud Anderson, author of *Black Labor, White Wealth: A Search for Power and Economic Justice and PowerNomics: The National Plan to Empower Black America.*

The signatories to this brief have longstanding personal relationships with Mr. Lay.

It has been established unequivocally that Mr. Lay did not realize personal gain from the conduct which resulted in his conviction. However, critical exculpatory information probative of the political dimension to Mr. Lay's prosecution was excluded from evidence, namely a memorandum from the Ohio Bureau of Worker's Compensation Chief Investment Officer indicating that a high level cover-up of losses from OBWC investments took place. See, Appendix A. Also, included in this brief at Appendix B is the investment guideline applicable to OBWC investment advisors, which establishes that the conduct for which Mr. Lay was prosecuted was not cognizable under the antifraud provisions of the Investment Advisers Act of 1940, 15 U.S.C. §80b-6, for the reason Mr. Lay was not an investment adviser to OBWC in relation to ADF and that Mr. Lay did not use the mails or wires in a scheme to defraud OBWC of money or property.

The signatories primary interest in this appeal is fairness. Losses in the marketplace, without more, historically have not resulted in criminal prosecutions and convictions in the financial industry. The Court should review Mr. Lay's case for the reason it stands out as an exception to the treatment ordinarily accorded to investment advisers.

Lastly, the signatories urge review by the United States Supreme Court for the reason Mr. Lay's conviction represents an unprecedented extension of the Investment Adviser's Fraud statute, 15 U.S.C. §80b-6, to include claims by hedge fund investors against hedge fund advisers, and has created a conflict among the circuit courts of appeal.

ARGUMENT

A. Mr. Lay's Relationship To The State Of Ohio Bureau Of Workers Compensation

MDL Capital Management, Inc. (hereinafter "MDL") became an investment adviser to the Ohio Bureau of Workers Compensation ("OBWC") on May 14, 1998. See, Appendix B. Petitioner Mark D. Lay, was the Chairman and Chief Executive Officer of MDL. The agreement at Appendix B is the only investment adviser agreement between "OBWC" and "MDL".

In 2002 Petitioner formed the MDL Active Duration Fund ("ADF"). A separate investment adviser agreement was entered into between MDL and ADF. See, Appendix C. Although OBWC invested in ADF, there was no investment advisers agreement between MDL and OBWC as it related to ADF for the reason it was known to both OBWC and MDL, that MDL would be ADF's investment advisor and that OBWC would merely be an investor in ADF. The investment advisers agreement between MDL and OBWC, Appendix B, specifically prohibited MDL, in its capacity as an investment adviser for OBWC, from investing OBWC funds in private placement securities such as ADF. In point of fact, the MDL-OBWC investment advisers agreement states, in pertinent part:

SCHEDULE A TO
INVESTMENT MANAGEMENT AGREEMENT

> Client: State of Ohio, Bureau of Workers' Compensation Investment Manager: MDL Capital Management
>
> **INVESTMENT GUIDELINES**
> **Active Duration Fixed Income Management**
>
> **Statement of Purpose**
> The purpose of these guidelines is to:
>
> - establish the investment objective and performance standards of the Investment Account,

- ensure that Investment Manager has the capability to evaluate the risk of all financial instruments in which the Investment Account is invested, and
- prevent Investment Manager from exposing the Investment Account to excessive overall levels of risk, exposure to inappropriate risk sources, or disproportionate exposure to any one risk source.

Investment Objective

The basic objective is to attain the highest total return consistent with a reasonable degree of risk by investing in fixed income securities. Success in achieving that objective will be measured by comparing the risk adjusted return and the after-fee return of the Investment Account to the Lehman Brothers Aggregate Bond Index...

<u>Prohibited Securities</u>

- Dollar denominated foreign debt securities such as Yankees and Brady Bonds are prohibited
- Securities denominated in currencies other than the U.S. dollar (non-dollar bonds) are prohibited
- <u>Private placements are prohibited except for 144A securities with registration</u>
- High yield securities are prohibited

- Use of inverse floaters, other exotic derivatives and reverse repurchase agreements is prohibited
- 144A securities without registration rights are prohibited
- Use of Eurodollar futures and options is prohibited
- Use of listed U.S. fixed income futures and options contracts is prohibited.

See, Schedule A, to Appendix B. (Emphasis added.)

Under the above guidelines Petitioner was not, in his capacity as an investment advisor for OBWC, permitted to invest OBWC funds into a private placement such as ADF. Accordingly, OBWC, a sophisticated investor, invested directly into ADF, in a series of separate and distinct investments that were not governed by Appendix B, but instead by the terms of a private placement memorandum ("PPM") and subscription agreement. It is clear from these documents, that MDL was not OBWC's investment advisor as it related to ADF and that OBWC knew it. OBWC, a sophisticated investor, had no investment advisor as it related to ADF, but wanted to take the risk of a hedge fund investment, on its own, as an overlay strategy.

The PPM that governed OBWC's investment into ADF made clear that MDL was not its investment adviser in relation to ADF. The PPM states:

> The Fund's investment adviser is MDL Capital Management, Inc. a Pennsylvania corporation ("MDL") or the "Investment Adviser"). The Investment Adviser will provide investment advisory services to the Fund and will be responsible for the overall management of the Fund's portfolio. The Investment Adviser is registered as an investment adviser with the U.S. Securities and Exchange Commission (the "SEC") under the Investment Advisors Act of 1940 (the "Advisers Act) | ")...
>
> **DESCRIPTION OF THE ADVISORY AGREEMENT**
> The Fund has entered into an Advisory Agreement with the Investment Advisor. The Advisory Agreement provides that the Investment Advisor shall have broad discretion to direct and manage the Fund's investments. Subject to the approval of the Directors, the Investment Advisor may allocate all or a portion of the Fund's assets to the Master Fund, although it

is not required to do so. The compensation terms are set forth in "Charges to the Fund." The Investment Advisor may elect in its sole discretion, to defer payment of all or a portion of its Management Fee and Incentive Fees for a period of up to 10 years from the date payment is due. The Advisory Agreement also provides that the Fund will indemnify the Investment Adviser and its officers, employees and controlling persons from any liabilities, damages costs or expenses relating to the business or activities undertaken on behalf of the Fund, provided that such conduct does not constitute fraud, gross negligence, bad faith, willful misconduct, a willful material breach of the Advisory Agreement or will full violation of any material law, and provided that such indemnification obligation shall not apply to any liabilities, costs or expenses imposed on the Investment Advisor or its affiliates under the Securities Act (to the extent such indemnification would be contrary to public policy) or under ERISA. The Advisory Agreement further provides that the indemnified parties shall not be liable to the Fund in connection with its services in the absence of

> fraud, willful default, bad faith, gross negligence or reckless disregard of its obligations or duties under the agreement.
>
> In the Advisory Agreement, the Investment Advisor represents and acknowledges, among other things that (a) the Investment Advisor is a registered investment advisor, (b) that it is a fiduciary under ERISA with respect to ERISA plans investing in the Fund, (c) that it is a "Qualified Professional Asset Manager," (d) that it has complied and will continue to comply with applicable governmental regulations and (e) that it will not cause the Company to enter into any "prohibited transaction" under ERISA. Either party may terminate the Advisory Agreement on 90 days prior written notice to the other party.

Notwithstanding all of the above the Sixth Circuit, in conflict with every other court that has addressed this issue, most notably the District of Columbia Court of Appeals in Goldstein v. SEC, 451 F. 3d 873 (D.C. Cir. 2006) determined that Mr. Lay was the investment adviser to both ADF, a hedge fund, and OBWC, an investor in ADF. This finding is unprecedented and threatens to cause chaos and uncertainty in financial markets.

B. <u>Hedge Funds Are For Sophisticated Investors</u>

Hedge funds by design and nature are for sophisticated investors. Because they are unregulated and have limited investors they require investors to meet (and sign off on minimum) standards or criteria. <u>See</u>, Subscription Agreement. For example, they require investors to be institutions, meet certain minimum net worth requirements (usually $1 to 2.0 million) or annual income of $200,000.00 or more. Id.

By mandating that these investors in hedge funds are indeed sophisticated, the hedge fund cuts down on the questions, concerns or servicing that a publicly traded fund might require. Further, they invite less scrutiny from any regulators or overseers as everyone is assumed to be "a big boy" and can take care of themselves and their interests.

C. <u>The MDL Fund Was Designed To Be A Real "Hedge"</u>

In addition to MDL, the Ohio Bureau of Worker's Compensation (OBWC) had dozens of investment managers who managed fixed income (bond) portfolios. These managers could invest in bonds by buying them, collecting the interest payments, holding them to maturity or perhaps selling the bonds if they increased in value. These managers are referred to as "long only" managers.

ADF was designed to actually protect the OBWC bond portfolios as a hedge against falling bond prices which would therefore cause the bonds to lose principal value. It was a step OBWC took as a sophisticated investor however, not upon the advise of Mr. Lay.

Typically, when interest rates rise, the principal value (underlying value) of a bond would go down. Where a bond's interest rate is fixed (set) as other bonds yield more, they are worth more in the market.

ADF was by design allowed to use leverage (borrow money or securities) and allowed to go short (sell bonds which it did not own). With a short position, the investor is selling a security which he doesn't currently own; with the expectation that they will be able to buy the security back later at a lower price. As most people know, one of the best ways to make money as an investor is to "buy low and sell high." With a shorting strategy it is exactly the same except that the investor reverses the traditional order and "sells high" first, then seeks to "buy low."

As shorting and leverage was not allowed for the other fixed income managers, they were expected to have a tough time in the market; if interest rates were to rise their portfolios were expected to lose money (principal). The original design of ADF was that it would make money to balance or hedge losses in the other fixed income portfolios managed by the other firms.

D. <u>A Simple Bet On Interest Rates</u>

During the time of the establishment of ADF, the Federal Reserve (at the time, headed by Mr. Alan Greenspan) was expected to raise short term interest rates.

In a typical yield curve environment, the longer money is invested, the more interest an investor would demand. So a six month investment would be a much lower yielding instrument than a two year investment and they would both be significantly lower yielding than say, a ten year investment.

Given these mechanics, when the Federal Reserve raised short term rates, then the natural assumption would be that longer term rates would also rise in some proportion to these shorter term rates. Some market watchers would say they rose in sympathy to shorter rates.

Likely 90 to 95 percent of the time, this would make sense. As such, most investment firms and money managers made the same assessments and "bets" on the future directions of long term rates that Mr. Lay and ADF. Much like Mr. Lay and ADF, most of these firms on "The Street" lost money on the same trade, or with the same strategy.

Instead of rising significantly, or proportionally, the yield curve essentially "flattened" out, meaning that graphically, the spread or differences between short term and long term rates were smaller and the gap narrowed.

Even Alan Greenspan when asked by congressional questioners about this unusual interest rate movement lamented that he was as surprised and perplexed as every other market watcher was at the results.

E. <u>MDL One Of OBWC's Most Successful</u>

MDL had been one of OBWC's most successful fixed income advisers. MDL consistently out performed competitors in their asset class and out paced their assigned bench marks or comparable indices. The firm outperformed both larger and smaller investment managers and institutions from around the country.

To a large degree, MDL was known to have a good understanding of the fixed income markets and known to make more significant "bets" in interest rates and the fluctuating prices of bonds. Fortunately for the OBWC these bets usually paid off handsomely.

F. <u>Why Invest More Money?</u>

Initially, OBWC invested $100 million in ADF. Given market conditions and the leverage used, this initial investment was lost in the market quickly.

After losing the first $100 million then additional allocations were made of another $100 million and $25 million more. History has shown that the vast majority of these funds were lost as well with OBWC retaining only about $9 million of the total money invested in ADF.

Most intelligent/logical people would agree that one would not make the second and third investments, if they felt that they were wronged. This would be especially true for seasoned investment professionals.

G. Investment Advisor Or Not

The prosecution of Mr. Lay under the antifraud provisions of the Investment Advisors Act, required Mr. Lay to be the investment adviser for OBWC in relation to ADF. OBWC was merely an investor into ADF. The failure of the Sixth Circuit to acknowledge and enforce this critical distinction portends chaos for financial markets. The Sixth Circuit has basically determined that notwithstanding clear language in a PPM and subscription agreement and the lack of an investment advisors agreement, if there is any history of an investment advisor relationship between a hedge fund investment adviser and an investor into this hedge fund, a jury or court may find that the investor is entitled to treatment as a client with all of the protections and restrictions applicable under federal securities laws to nonexempt investments. This conclusion totally undermines the rationale for Congressional recognition of the class of exempt investments known as hedge funds. The Sixth Circuit has ruled that hedge fund investors may have their cake and eat it too. That is, seek high rewards from a risky exempt investment, but then fall back on nonexempt regulatory protection if the investment fails. The opinion of the Sixth Circuit in this connection is totally illogical. The Sixth Circuit opinion will create chaos in financial markets. It will cause investment advisors to be subjected to criminal liability for conduct in connection with exempt investment vehicles, specifically authorized by Congress to be formed for use by sophisticated investors capable of looking out for themselves. The Sixth Circuit opinion creates heretofore unknown criminal liability.

H. Mail And Wire Fraud

Petitioner's conviction should also be reversed for the simple reason OBWC did not part with money or property as a result of a use of the mail or wires in a scheme to defraud. OBWC parted with $225 Million dollars when it made three separate and distinct investments into ADF. Not when Mr. Lay conducted trades.

The prosecution of Mark Lay was nothing more than a means to make someone pay for the unfortunate losses that resulted from a failed investment strategy as far as ADF was concerned. OBWC's Long Fund continued to prosper and Mr. Lay continued as a Long Fund manager even after ADF was closed.

Given the allegations in the McLean memo at Appendix A and the Goldstein opinion, it is critical for the Court to accord further review to this case. It is unseemly for the securities law to be extended in the manner done here, where the defendant is a bright young African American, but the conduct that he is accused of engaging in never before resulted in prosecution.

CONCLUSION

The amicus curiae here respectfully request that the Court grant certiorari.

December 28, 2010.

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