No. 10-695

In the Supreme Court of the United States

MARK D. LAY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether, in a prosecution for investment adviser fraud under 15 U.S.C. 80b-6, the jury permissibly found, on the facts of this case, that a hedge fund adviser owed fiduciary duties to the sole investor in his hedge fund.

2. Whether the evidence was sufficient to support petitioner's convictions for mail fraud (18 U.S.C. 1341) and conspiracy to commit mail and wire fraud (18 U.S.C. 1349).

3. Whether, in permitting the rereading to the jury of petitioner's deposition testimony from a civil case, the district court gave an adequate cautionary instruction.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B1-B27) is reported at 612 F.3d 440. The opinion of the district court denying petitioner's motion for acquittal or for a new trial is reported at 566 F. Supp. 2d 652.

JURISDICTION

The judgment of the court of appeals was entered on July 14, 2010. A petition for rehearing was denied on August 25, 2010 (Pet. App. A1-A2). The petition for a writ of certiorari was filed on November 23, 2010. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Following a jury trial in the United States District Court for the Northern District of Ohio, petitioner was convicted of one count of investment adviser fraud, in violation of 15 U.S.C. 80b-6; one count of conspiracy to commit or attempt mail and wire fraud, in violation of 18 U.S.C. 1349; and two counts of mail fraud, in violation of 18 U.S.C. 1341 and 2. Pet. App. C2. He was sentenced to 144 months of imprisonment, to be followed by three years of supervised release. *Id.* at C4-C5. He was also ordered to forfeit \$590,526 and to pay \$212,967,084 in restitution. *Id.* at C9. The court of appeals affirmed. *Id*. at B1-B27.

1. Petitioner was the chairman of an investment advisory firm that was hired in the 1990s by the Ohio Bureau of Workers' Compensation (Bureau), a state agency that assists employers with expenses related to workplace injuries. *United States* v. *Lay*, 566 F. Supp. 2d 652, 655-656 (N.D. Ohio 2008). The firm was initially retained to manage the Bureau's investment in a long-term bond fund known as the "Long Fund." *Id.* at 656.

Petitioner later founded the "Active Duration Fund," a hedge fund that consisted primarily of government, corporate, and mortgage-backed securities. *Lay*, 566 F. Supp. 2d at 656. In 2003, he successfully solicited the Bureau to transfer \$100 million from the Long Fund to the Active Duration Fund. *Id.* at 657. The Bureau believed that the Active Duration Fund was "very conservative" and "low risk," and it intended its investment in that fund as a "hedge" that would "diversify[]" its Long Fund investment. Pet. App. B6. During the relevant time period, the Bureau was the Active Duration Fund's sole investor and paid petitioner's firm nearly $2 million in fees for services related to that investment. *Lay*, 566 F. Supp. 2d at 656-657.

The agreement governing the Active Duration Fund set a non-binding "leveraging guideline"—a guideline reflecting the extent to which the fund would take financial positions, through borrowing or otherwise, in excess of its actual assets—of 150%. Pet. App. B3, D13. In practice, petitioner routinely leveraged fund assets much more than that: two-thirds of the trades involved leveraging over 150%; over one-fifth involved leveraging over 1000%; and some trades involved leveraging over 10,000%. *Id.* at B3, B13. Petitioner concealed and misrepresented to the Bureau his true leveraging practices, the magnitude of losses that the fund began to experience, and the magnification of losses caused by his leveraging beyond 150%. *Lay*, 566 F. Supp. 2d at 657.

In 2004, the Bureau, believing that the Active Duration Fund had lost only $7 million when in fact it had lost $32 million, transferred another $100 million to that fund from the Long Fund. Pet. App. B3-B4; *Lay*, 566 F. Supp. 2d at 657. Later that year, the Bureau discovered petitioner's leveraging practices; it invested another $25 million in an attempt to avoid a complete loss of the $200 million it had already invested. Pet. App. B3; *Lay*, 566 F. Supp. 2d at 658. It ultimately recovered only $9 million of the total $225 million. Pet. App. B4.

2. A grand jury returned a superseding indictment charging petitioner with one count of investment adviser fraud, in violation of 15 U.S.C. 80b-6 and 80b-17; one count of conspiracy to commit or attempt mail and wire fraud, in violation of 18 U.S.C. 1341, 1343, and 1349; and two counts of mail fraud, in violation of 18 U.S.C. 1341

and 2. *Lay*, 566 F. Supp. 2d at 679-689. The mail fraud charges (and, in part, the conspiracy charge) were based on "Trade Confirmation Statements," which documented fund transactions, that petitioner had mailed to the Bureau. *Id.* at 686-687.

Section 80b-6, which is part of the Investment Advisers Act of 1940, ch. 686, Tit. II, 54 Stat. 847 (15 U.S.C. 80b-1 *et seq.*), makes it unlawful for an "investment adviser" to use the mails or the instrumentalities of interstate commerce:

> (1) to employ any device, scheme, or artifice to defraud any client or prospective client;
>
> (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;
>
> * * * * *
>
> (4) to engage in any act, practice or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

15 U.S.C. 80b-6(1)-(2) and (4). At trial, over petitioner's objection, the district court instructed the jury that, assuming it found petitioner had committed a fraud, such fraud would violate Section 80b-6 if the jury found either that (a) the Bureau was petitioner's "client" with respect to the Active Duration Fund, see 15 U.S.C. 80b-6(1)-(2); or (b) that petitioner owed the Bureau a

fiduciary duty with respect to that fund, see 15 U.S.C. 80b-6(4). Pet. App. B9-B11.

During deliberations, the jury asked to rehear deposition testimony that petitioner had given in a previous civil case, which had been admitted into evidence over petitioner's objection. Pet. App. B20-B22. In that deposition, petitioner had repeatedly stated that the Bureau was his "client" with respect to the Bureau's investment in the Active Duration Fund. *Id.* at B21. The district court permitted the deposition to be reread in its entirety, but cautioned the jury "not to accord undue influence to that testimony." *Lay*, 566 F. Supp. 2d at 678; Pet. App. B21.

The jury found petitioner guilty on all four counts. Pet. App. B11. It also found, on a special verdict form, that petitioner obtained $590,526 in proceeds from his offenses. *Ibid.*

3. Petitioner moved for acquittal or for a new trial. The district court denied the motion. *Lay*, 566 F. Supp. 2d at 652.

Petitioner's primary argument was that, as a matter of law, he had neither a client relationship with, nor a fiduciary duty to, the Bureau with respect to the Active Duration Fund. *Lay*, 566 F. Supp. 2d at 668-671. Relying on *Goldstein* v. *SEC*, 451 F.3d 873 (D.C. Cir. 2006), petitioner asserted that he was the adviser to the fund itself, not the adviser to the Bureau. *Lay*, 566 F. Supp. 2d 668-671. The district court rejected petitioner's reading of *Goldstein*. It observed that although *Goldstein* had found the "characteristics defining an adviser-client relationship * * * to ordinarily be absent in hedge fund scenarios," in petitioner's particular case, "there is evidence in the record that the characteristics of an adviser-client relationship were present." *Id.* at 670. In reaching that record-based conclusion, the district court focused on petitioner's preexisting fiduciary relationship with the Bureau regarding the Long Fund; evidence that the Bureau was the sole shareholder in the Active Duration Fund; evidence that the purpose of the Active Duration Fund was to provide a hedge for the Bureau's Long Fund investment, which petitioner managed; and evidence of petitioner's "regular and direct communication" with the Bureau about his management of the Active Duration Fund. *Id.* at 670-671.

Petitioner raised a number of additional arguments, all of which the district court rejected. In particular, the district court rejected, based on the evidence, petitioner's assertion that there was "no evidence that the mails were used to exceed * * * the leverage guidelines." *Lay*, 566 F. Supp. 2d at 671 n.56. The district court also held that the limiting instruction it had given in connection with the rereading of petitioner's deposition had been sufficient. *Id.* at 677-678.

4. The court of appeals affirmed. Pet. App. B1-B27. It agreed with the district court that it was permissible, and consistent with *Goldstein*, for the jury to "determine the existence of a fiduciary relationship * * * on the facts of this case." *Id.* at B17. It explained that "*Goldstein* did not hold that *no* hedge fund adviser could create a client relationship with an investor, but rather held only that the SEC had 'not justified treating *all* investors in hedge funds as clients.'" *Ibid.* (quoting *Goldstein*, 451 F.3d at 883) (first emphasis added). The court of appeals concluded, essentially for the reasons stated by the district court, that "the relationship between the Bureau and [petitioner] as to the Active Dura-

tion Fund was not a typical hedge fund adviser-investor relationship" and that a finding of a fiduciary duty was supported by the evidence. *Id.* at B17-B18; see *id.* at B14-B15.

Petitioner raised several additional arguments, all of which the court of appeals rejected. Petitioner asserted that the 150% leverage limit for the fund "served only as a guideline rather than a binding limitation," but the court concluded that the contemplated leeway did "not permit leveraging over 150% in two-thirds of trades and leveraging over 1000% in one-fifth of trades." Pet. App. B18. Petitioner also argued that insufficient evidence supported the mail- and wire-fraud-related convictions, but the district court concluded (among other things) that the "trade confirmations, emails, and faxes through which [petitioner] conducted the fraud satisfy the mailing and wiring requirements because these documents were designed to lull the victims into a false sense of security, postpone their ultimate complaint to the authorities, and therefore make the apprehension of the defendants less likely than if no mailings had taken place." *Id.* at B19 (internal quotation marks and citation omitted). And petitioner additionally argued that the district court should have instructed the jury, when his deposition testimony was reread, not to take the testimony out of context; the court of appeals concluded that such an instruction was unnecessary because "the entirety of [petitioner's] deposition testimony was re-read to the jury." *Id.* at B21.

Judge Kethledge concurred in part and dissented in part. Pet. App. B24-B27. He disagreed with the majority's conclusion that sufficient evidence supported the mail-fraud convictions; in his view, the trade confirmation slips that petitioner mailed to the Bureau "were too remote from the antecedent fraud, and too speculative in their effects, to support a finding that they were designed to lull the victims into a false sense of security." *Id.* at B26 (internal quotation marks and citation omitted). Judge Kethledge recognized, however, that "even under [his] proposed disposition of this case, [petitioner's] sentence would remain the same." *Ibid.*

ARGUMENT

1. Petitioner first contends (Pet. 14-35) that the court of appeals' decision in this case conflicts with the D.C. Circuit's decision in *Goldstein* v. *SEC*, 451 F.3d 873 (2006). According to petitioner, *Goldstein* holds that, as a matter of law, a hedge-fund adviser can never have a client relationship or other fiduciary relationship with a hedge fund investor. As both lower courts correctly concluded, petitioner misreads *Goldstein*.

In *Goldstein*, the D.C. Circuit invalidated a Securities and Exchange Commission (SEC) regulation interpreting a section of the Investment Advisers Act of 1940 (Act) not directly at issue here, 15 U.S.C. 80b-3(b)(3), which exempts advisers with fewer than 15 "clients" from the requirement to register with the SEC. See 451 F.3d at 877, 884. The regulation had interpreted the term "client" in such a way that investors in hedge funds would generally be considered "clients" of a hedge fund adviser. *Id.* at 877.

The D.C. Circuit held that the SEC had "not adequately explained how the relationship between hedge fund investors and advisers justifies treating the former as clients of the latter." *Goldstein*, 451 F.3d at 882. The court observed that while the term "client" was not defined in the Act, the term drew meaning from the definition of "investment adviser," which is defined as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities." 15 U.S.C. 80b-2(a)(11); see *Goldstein*, 451 F.3d at 879. The D.C. Circuit stated that in hedge funds, an investor does not receive direct advice from an adviser about how to spend his money; instead, the investor purchases a share of the fund and allows its money to be controlled by the hedge fund adviser. *Ibid.* According to the court, the adviser "owes fiduciary duties only to the fund, not to the fund's investors" and "the adviser [would] inevitably face conflicts of interest" if fiduciary duties were owed to both. *Id.* at 881.

The D.C. Circuit did not, however, foreclose the possibility that a client or fiduciary relationship might exist in special cases, different from the general hedge fund operations it had described. The SEC pointed out that "a hedge fund adviser may not treat all of its hedge fund investors the same"; the court responded, in part, by stating that "[i]f there are certain characteristics present in some investor-adviser relationships that mark a 'client' relationship, then the [SEC] should have identified those characteristics and tailored the rule accordingly." *Goldstein*, 451 F.3d at 882-883. The rule the SEC had promulgated, however, "ha[d] not justified treating *all* investors in hedge funds as clients." *Id.* at 883; see *ibid.* (criticizing SEC for "painting with such a broad brush").

Goldstein accordingly leaves open the possibility that a narrower regulation, defining only some hedge fund investors as "clients" within the meaning of 15 U.S.C. 80b-3(b)(3), might be permissible. It necessarily follows that *Goldstein* does not preclude the possibility that, in a prosecution under a separate section of the Investment Advisers Act, 15 U.S.C. 80b-6, a jury might conclude that a client or fiduciary relationship existed on a particular fact pattern. In particular, *Goldstein* is silent on whether a fiduciary relationship could arise on facts like those in this case, which, as the court of appeals recognized, lie far afield from the generic hedge fund scenario contemplated in *Goldstein*.[1]

As the court of appeals concluded (Pet. App. B17-B18), unlike a typical hedge fund adviser, petitioner had an individualized, person-to-person relationship with the Bureau concerning its investment in the Active Duration Fund. Petitioner "has never disputed" his preexisting fiduciary relationship with the Bureau with respect to the Long Fund, and "evidence supports the conclusion that this relationship continued through the existence of the Active Duration Fund and encompassed the Bureau's Active Duration Fund investment," which was designed as a hedge for the Long Fund investment. Pet. App. B14. "Unlike a typical hedge fund investor," the Bureau played "an active role" in its investment. *Id.* at B15; cf. *Goldstein*, 451 F.3d at 880 (describing scenario where investor "fades into the background" once the investment is made). Also "[u]nlike a typical hedge fund investor, the Bureau was the only investor in the Active

[1] Petitioner raises (*e.g.*, Pet. 21-22, 29-34) a number of challenges to the jury's conclusion that a client or fiduciary relationship existed on this case. Those fact-bound arguments do not merit this Court's review.

Duration Fund at the relevant time," Pet. App. B15, eliminating the possibility of the sort of conflicts of interest that troubled the D.C. Circuit in *Goldstein*, see 451 F.3d at 881.

c. Further regulatory developments also render certiorari, based on petitioner's claim of tension between *Goldstein* and the result in this case, unwarranted. Shortly after *Goldstein*, the SEC promulgated a new rule clarifying that Section 80b-6(4) prohibits investment advisers from defrauding investors or prospective investors in pooled investment vehicles, including hedge funds, without regard to whether a fiduciary relationship exists. 17 C.F.R. 275.206(4)-8; see SEC, *Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles*, Release No. IA-2628, at 4-5 (Aug. 3, 2007) (SEC Rule) (intention of rule "is to prohibit all fraud on investors in pools managed by investment advisers" and rule applies to hedge fund advisers), http://www.sec.gov/rules/final/2007/ia-2628.pdf.[2] Because the new rule prospectively resolves the issue of whether an adviser's fraud on a hedge fund investor is criminalized by the Investment Advisers Act, the question presented has limited future importance.

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[2] Petitioner argues (Pet. 25) that the new rule *supports* review here, because the rule "does not create under the Advisers Act a fiduciary duty to investors or prospective investors in a pooled investment vehicle not otherwise imposed by law." SEC Rule 13. Petitioner misunderstands the import of the rule. Under the new rule, it *does not matter* whether a hedge fund adviser owes fiduciary duties to a hedge fund investor; defrauding such an investor will be illegal regardless. *Id.* at 14; see 17 C.F.R. 275.206(4)-8; see also 15 U.S.C. 80b-6(4) (permitting SEC to define investment adviser frauds without regard to whether they are committed against a "client").

2. Petitioner also raises challenges to the sufficiency of the evidence on his mail-fraud and conspiracy convictions. Pet. 35-48. These largely fact-bound challenges lack merit.

Petitioner first asserts (Pet. 36-37, 41) that there "was no evidence * * * that the [Bureau] parted with property by reason of a material misrepresentation." That assertion was rejected by the courts below. See Pet. App. B18-19 (petitioner's "misrepresentations of his leveraging activity caused the Bureau to part with money"); *Lay*, 566 F. Supp. 2d at 671 n.56 ("There is evidence in the record that the [Bureau] would not have transferred funds to the [Active Duration Fund] if aware of over-leveraging."). No further review is warranted.

Petitioner next challenges his mail-fraud convictions on the ground that the only mailings mentioned in the indictment—the trade confirmation statements—did not contain false information and were not themselves used to obtain the Bureau's property. Pet. 37-42. As this Court has made clear, however, "the use of the mails need not be an essential element of the scheme" in a mail-fraud prosecution, *Schmuck* v. *United States*, 489 U.S. 705, 710 (1989), and "routine mailings that are innocent in themselves" can supply the mailing element so long as they are "incident to an essential part of the scheme, or a step in the plot." *Id.* at 710-711, 714-715 (internal quotation marks, citation, and brackets omitted); see *id.* at 712 (mailing of title-registration forms in odometer-tampering scheme was necessary to passage of title and thus to the scheme, even though they "may not have contributed directly to the duping of either the retail dealers or the customers"). Here, the mailing of the confirmation statements was necessary to the settlement of the fund's trades, see Gov't C.A. Br. 51-52, and, as the court of appeals found, they served to lull the Bureau into a false sense of security and thereby postpone discovery of the fraud. Pet. App. B19. The Second Circuit cases cited by petitioner (Pet. 38) are consistent with that conclusion. See *United States* v. *Grossman*, 843 F.2d 78, 86 (1988) (confirmation slips furthered scheme in part because they "concealed the fraud by maintaining an appearance of normality"), cert. denied, 490 U.S. 1059 (1989); *United States* v. *Marando*, 504 F.2d 126, 130 (confirmation slips "ostensibly legitimatized the fraud and provided it with the appearance of normality"), cert. denied, 419 U.S. 1000 (1974).

Petitioner finally contends (Pet. 42-48) that the court of appeals' decision conflicts with this Court's decision in *Skilling* v. *United States*, 130 S. Ct. 2896 (2010). That contention lacks merit. *Skilling* did not address the definition of money or property fraud under the mail-fraud statute at issue here (18 U.S.C. 1341), but instead interpreted 18 U.S.C. 1346's prohibition against "honest services" mail or wire fraud. In explaining the historical development of the honest services doctrine, the Court noted that unlike traditional fraud cases—in which "the victim's loss of money or property supplied the defendant's gain, with one the mirror image of the other"—the defrauded party in an honest services scheme suffered no money or property deprivation. 130 S. Ct. at 2926. That observation has no bearing on this case. Notwithstanding petitioner's assertion to the contrary (*e.g.*, Pet. 43), he did in fact gain at the Bureau's expense: while the Bureau paid nearly $2 million in fees, the jury specifically found (and the court of appeals affirmed) that petitioner "obtained $590,526.23 in proceeds from his mail and wire fraud offenses." Pet. App. B11; *Lay*, 566 F. Supp. 2d at 654, 656-657.

3. Petitioner finally contends (Pet. 48-49) that a new trial is warranted because the district court declined to instruct the jury not to take his deposition testimony out of context when it was reread during deliberations. Petitioner fails to explain why it was necessary to give such an instruction when "the *entirety* of [petitioner's] deposition testimony was re-read to the jury." Pet. App. B21 (emphasis added); see *United States* v. *Rodgers*, 109 F.3d 1138, 1143 (6th Cir. 1997) (where jury heard the entire testimony of a witness, it could not have taken part of it out of context). He furthermore fails to assert that any other court of appeals would have required such an instruction. Further review is unwarranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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