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Issued to: Great Lakes Capital Partners

**CONFIDENTIAL PRIVATE PLACEMENT MEMORANDUM**

**MDL ACTIVE DURATION FUND, LTD.**

*(An exempted mutual fund company  
incorporated with limited liability under the laws of Bermuda)*

**Offering of Non-Voting, Redeemable, Participating Shares**

**Minimum Subscription Per Investor: U.S. \$1,000,000**

**MDL CAPITAL MANAGEMENT, INC.**

*Investment Adviser*

**OLYMPIA CAPITAL INTERNATIONAL, INC.**

*Administrator*

**THESE SECURITIES ARE SUBJECT TO RESTRICTIONS ON TRANSFERABILITY  
AND RESALE AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED  
UNDER APPLICABLE LAW AND UNDER THE PROVISIONS OF THE FUND'S GOVERNING  
DOCUMENTS.**

**THE DATE OF THIS MEMORANDUM IS JANUARY 15, 2003**

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**CONFIDENTIAL TREATMENT**

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## LEGENDS

PROSPECTIVE SUBSCRIBERS IN THE FUND SHOULD INFORM THEMSELVES AS TO THE LEGAL REQUIREMENTS AND TAX CONSEQUENCES WITHIN THE COUNTRIES OF THEIR RESIDENCE AND DOMICILE FOR THE ACQUISITION, HOLDING OR DISPOSAL OF SHARES AND ANY FOREIGN EXCHANGE RESTRICTIONS WHICH MAY BE RELEVANT TO THEM. IF YOU ARE IN ANY DOUBT ABOUT THE CONTENTS OF THIS MEMORANDUM, YOU SHOULD CONSULT YOUR STOCKBROKER, SOLICITOR, ACCOUNTANT OR OTHER FINANCIAL ADVISER.

NEITHER MDL ACTIVE DURATION FUND, LTD. (THE "FUND") NOR THE PARTICIPATING SHARES OF THE FUND (THE "SHARES") DESCRIBED IN THIS MEMORANDUM (THIS "MEMORANDUM") HAVE BEEN OR WILL BE REGISTERED OR QUALIFIED UNDER THE SECURITIES LAWS OF THE UNITED STATES ("U.S.") OR ANY OTHER JURISDICTION. THIS MEMORANDUM SHALL NOT CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY, NOR SHALL THERE BE ANY SALE OF SHARES IN ANY JURISDICTION IN WHICH SUCH OFFER, SOLICITATION OR SALE IS NOT AUTHORIZED OR TO ANY PERSON TO WHOM IT IS UNLAWFUL TO MAKE SUCH OFFER, SOLICITATION OR SALE. THE DIRECT OR INDIRECT OWNERSHIP OF SHARES BY "RESTRICTED PERSONS" AS DEFINED IN THIS MEMORANDUM IS PROHIBITED. NO PERSON HAS BEEN AUTHORIZED TO MAKE ANY REPRESENTATIONS CONCERNING THE FUND OR THE SHARES WHICH ARE INCONSISTENT WITH THOSE CONTAINED IN THIS MEMORANDUM, AND ANY SUCH REPRESENTATIONS SHOULD ACCORDINGLY BE TREATED AS UNAUTHORIZED AND MAY NOT BE RELIED UPON BY THE RECIPIENT.

UPON THE INVESTMENT ADVISER'S REGISTRATION WITH THE UNITED STATES COMMODITY FUTURES TRADING COMMISSION, THIS FUND WILL TRADE IN FUTURES. PURSUANT TO AN EXEMPTION FROM THE COMMODITY FUTURES TRADING COMMISSION IN CONNECTION WITH POOLS WHOSE PARTICIPANTS ARE LIMITED TO QUALIFIED ELIGIBLE PARTICIPANTS, A CONFIDENTIAL PRIVATE PLACEMENT MEMORANDUM FOR THIS POOL IS NOT REQUIRED TO BE, AND HAS NOT BEEN, FILED WITH THE COMMISSION. THE COMMODITY FUTURES TRADING COMMISSION DOES NOT PASS UPON THE MERITS OF PARTICIPATING IN A POOL OR UPON THE ADEQUACY OR ACCURACY OF A CONFIDENTIAL PRIVATE PLACEMENT MEMORANDUM. CONSEQUENTLY, THE COMMODITY FUTURES TRADING COMMISSION HAS NOT REVIEWED OR APPROVED AND IS NOT EXPECTED TO REVIEW OR APPROVE THIS CONFIDENTIAL PRIVATE PLACEMENT MEMORANDUM.

CERTAIN TRANSACTIONS IN FINANCIAL FUTURES AND RELATED OPTIONS AND THE INVESTMENT AND/OR HEDGING STRATEGIES ASSOCIATED THEREWITH WILL NOT BE AVAILABLE TO THE FUND UNLESS AND UNTIL CERTAIN REGISTRATIONS ARE OBTAINED. THE INVESTMENT ADVISER IS SUBMITTING APPLICATIONS FOR SUCH REGISTRATIONS BUT IS NOT OBLIGATED TO PURSUE OR OBTAIN ANY SUCH REGISTRATIONS.

THE PURCHASE OF SHARES IS SPECULATIVE AND INVOLVES A HIGH DEGREE OF RISK. THERE IS NO ASSURANCE THAT THE FUND WILL BE PROFITABLE. SEE THE SECTION ENTITLED "RISK FACTORS" WITHIN THIS MEMORANDUM FOR A DESCRIPTION OF CERTAIN RISKS INVOLVED IN THE PURCHASE OF SHARES.

THIS MEMORANDUM IS INTENDED SOLELY FOR THE USE OF THE PERSON TO WHOM IT HAS BEEN DELIVERED BY THE FUND FOR THE PURPOSE OF EVALUATING A POSSIBLE INVESTMENT BY THE RECIPIENT IN THE SHARES DESCRIBED HEREIN, AND IT IS NOT TO BE REPRODUCED OR DISTRIBUTED TO ANY OTHER PERSONS (OTHER THAN PROFESSIONAL ADVISERS OF THE PROSPECTIVE INVESTOR RECEIVING THIS DOCUMENT FROM THE FUND).

THIS DOES NOT CONSTITUTE AN OFFERING TO ANY MEMBER OF THE GENERAL PUBLIC OF BERMUDA.

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All monetary amounts for Shares set forth herein are expressed in U.S. dollars.

## INTRODUCTION

MDL Active Duration Fund, Ltd. (the "Company" or the "Fund"), is an exempted open ended mutual fund company incorporated under Bermuda law with limited liability and with unlimited duration. The Fund has been formed specifically for the purpose of providing an investment vehicle through which United States tax-exempt institutional investors and non-U.S. persons ("Investors") can invest in a portfolio consisting primarily of U.S. Treasury notes and bonds, U.S. agency notes and bonds and corporate and mortgage-backed fixed income securities. The Fund's duration, maturity structure and overall quality rating will be adjusted periodically based on an assessment of certain macro-economic factors. The Fund will seek to capture significant gains during periods when interest rates are generally declining and will seek to protect principal during periods when rates are generally rising.

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 a registered as an investment adviser with the U.S. Securities and Exchange Commission (the "SEC") under the Investment Advisers Act of 1940 (the "Advisers Act").

The Fund's investment objective is to profit by investing in U.S. Treasury, U.S. government agency, corporate and mortgage-backed fixed income securities, currencies, short-term equity positions, futures and option contracts. The Fund's investment strategy will include the use of leverage. *The Investment Adviser, in its sole and absolute discretion and authority as investment advisor to the Fund will ultimately identify and select investments for the Fund.* The Fund is designed primarily for U.S. tax-exempt institutional investors and non-U.S. investors. There can be no assurance that the Fund will achieve its objectives.

The Fund is offering (the "Offering") its non-voting, redeemable, participating shares (the "Shares"), subject to prior subscription and other conditions. The Fund has a target equity capitalization of \$300 million (which may be increased or decreased in the discretion of the board of directors of the Company (the "Board of Directors")). The minimum initial subscription per Investor is U.S. \$1,000,000, subject to reduction in the discretion of the Board of Directors of the Company. Initially, Shares will be offered at U.S. \$1,000.00 per Share. After commencement of investing activities, Shares will be offered for sale at the Net Asset Value per share as of the close of business on the last business day of each quarter (and any other date approved by the Board of Directors).

The Shares are offered only to non-United States persons and certain U.S. tax-exempt investors which meet the definitions of "qualified purchaser" as defined in the Investment Company Act of 1940, as amended (the "Investment Company Act") and Qualified Eligible Purchaser as defined in Regulation 4.7 of the Commodity Futures Trading Commission. The Fund reserves the right to reject any subscription in whole or in part.

The initial offering period shall commence on the date of the filing of this Memorandum with the Registrar of Companies in Bermuda on January 15, 2003 and will end on the earlier to occur of the acceptance of subscriptions in the aggregate amount of \$3,000,000 or May 15, 2003 (the "Initial Closing Date").

TABLE OF CONTENTS

SUMMARY ..... 1

SUMMARY OF THE TERMS OF THE OFFERING AND THE FUND ..... 1

DIRECTORY OF NAMES AND ADDRESSES ..... 10

INVESTMENT OBJECTIVE AND STRATEGY OF THE FUND ..... 11

SPECIAL INFORMATION ON THE MASTER FUND/FEEDER  
FUND INVESTMENT STRUCTURE ..... 12

MANAGEMENT AND ADMINISTRATION ..... 13

DESCRIPTION OF THE ADVISORY AGREEMENT ..... 16

CONFLICTS OF INTEREST ..... 16

RISK FACTORS ..... 17

DETERMINATION OF NET ASSET VALUE ..... 24

CHARGES TO THE FUND ..... 26

SERIES OF SHARES ..... 28

REDEMPTIONS AND DIVIDENDS ..... 29

REGISTRATION AND TRANSFERS ..... 31

TAX CONSIDERATIONS ..... 31

EMPLOYEE BENEFIT PLAN CONSIDERATIONS ..... 33

PLAN OF DISTRIBUTION ..... 35

ELIGIBLE SUBSCRIBERS ..... 36

STATUTORY AND GENERAL INFORMATION ..... 37

DEFINITIONS ..... 40

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CONFIDENTIAL TREATMENT

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SUMMARY

SUMMARY OF THE TERMS OF THE OFFERING AND THE FUND

The following is a summary of certain information about the Fund and the offering of Shares made by means of this Confidential Private Placement Memorandum (the "Memorandum"). The summary is qualified in its entirety by the more complete information appearing elsewhere in the Memorandum, and is subject to the detailed provisions of the Fund's Governing Documents and the Subscription Agreement attached hereto as Exhibit A. The Offering is subject to prior sale, modification and withdrawal.

FUND OVERVIEW

The Fund

The Fund is a Bermuda exempted, open ended mutual fund company incorporated on May 20, 2002 with limited liability in Bermuda. The operation and management of the Fund are governed by its Memorandum of Association and Bye-Laws, copies of which are available from the Administrator (the "Governing Documents"). The Registered Office and principal place of business of the Fund is Williams House, 20 Reid Street, Hamilton, HM11, Bermuda. The Fund has been classified as a Bermuda Institutional Scheme under the Bermuda Monetary Authority Collective Investment Scheme Regulations of 1998, as amended (the "Regulations"), and will be subject to the provisions of such law.

[REDACTED]

The Investment Adviser of the Fund is MDL Capital Management, Inc., a Pennsylvania corporation. The Investment Adviser's principal shareholders are Mark D. Lay, Steven L. Sanders, Edward Adatepe and Safeguard Scientific, Inc. The Investment Adviser is registered with the U.S. Securities and Exchange Commission as an investment adviser. The Investment Adviser is registering to become licensed as a commodity pool operator ("CPO") with the Commodity Futures Trading Commission ("CFTC"). Upon receipt of such licenses, the Investment Adviser will be the pool operator of the Fund.

Board of Directors

The Fund is governed by its board of directors (the "Directors" or "Board of Directors"). The members of the Board of Directors are Mark D. Lay, Steven L. Sanders and Edward Adatepe, who are the principals of the Investment Adviser, and Oskar P. Lewnowski and Raymond Morrison of Olympia Capital International, Inc., the Fund's administrator.

The Master Fund

The Fund may at some point in the future choose to invest all or some portion of its assets in a centralized investment company, commonly known as a "master fund" (the "Master Fund") (the Fund being a "feeder fund"). Such an investment would also be managed by the Investment Adviser at that level, but at all times in accordance with the investment style and strategies of the Fund as described in this Memorandum. The Master Fund would be a Bermuda limited liability entity of State of

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Delaware limited partnership or similar entity eligible to be treated as a "partnership" for U.S. income tax purposes. It is anticipated that the Master Fund, if established, would admit one or more additional Investor Members consisting of other investment funds organized by the Investment Adviser to participate in the portfolio of the Master Fund.

#### Investment Objectives

The investment objectives of the Fund shall be to concentrate on investments in U.S. Treasury notes and bonds, U.S. government agency notes and bonds and corporate and mortgage-backed fixed income securities to generate consistent positive returns and to achieve an investment return in excess of that from the investment grade, broad market debt securities reflected in the Lehman Brothers Government Credit Bond Index (the "Lehman Government Credit Index"). In particular, the Fund will seek to significantly outperform the Index during periods when interest rates are generally declining and will seek to protect principal during periods when rates are generally rising.

The Fund will seek to meet these objectives through an "active duration" approach, e.g., the Fund's portfolio will be constructed to take advantage of anticipated movements in yield curves as well as inter-sector spread relationships. The variation in the Fund's average duration will be based upon the Investment Adviser's projections as to overall trends in these variables based on analysis of U.S. and global macro-economic growth factors. The Fund's portfolio will include publicly-traded, United States-issued government agency, corporate and mortgage-backed fixed income securities and U.S. money market instruments and short-term investment funds, guaranteed investment contracts, forward contracts and, following the Investment Adviser's registration as a CPO with the CFTC, interest rate futures, financial futures and options thereon. The investments of the Fund will also involve the purchase of long and short positions of equity and investments and positions in foreign currencies. It is anticipated that the assets of the Fund will sometimes be pledged or otherwise collateralized to obtain a certain degree of leverage. The investments will be selected by the Investment Adviser in a manner consistent with the investment return objectives established by the Investment Adviser from time to time consistent with prudent standards of diversification, liquidity, quality, volatility and portfolio turnover. There is no assurance that the Fund will achieve its objectives.

#### Administrator

Olympia Capital International, Inc. (the "Administrator"), a British Virgin Islands corporation with a managing office in Bermuda, serves as administrator to the Fund. The Administrator will provide various administrative services to the Fund, including the calculation of the Fund's Net Asset Value and Net Asset Value per Share, processing Share subscriptions and redemptions and maintaining the Fund's principal books and records.

The Fund has appointed Winchester Fiduciary Services Limited, located in Hamilton, Bermuda, as registrar and transfer agent (the "Registrar and Transfer Agent"). The Registrar and Transfer Agent is wholly-owned by

Winchester Global Trust Company Limited, an affiliate of the Administrator

Custodian

The Fund has engaged Credit Suisse First Boston Corporation, a Massachusetts corporation, to serve as custodian of the Fund's assets (the "Custodian"). The Custodian will also act as the prime broker of the Fund.

Potential Advantages of the Fund

The Fund is designed to enable Investors to access investment and trading strategies that are not generally available to most investors; to participate in investment programs that differ from those of traditional portfolio management; to diversify their investment portfolios; and to benefit from the investment techniques and strategies of the Investment Adviser.

[REDACTED]

The Fund is expected to leverage the Fund's investment portfolio as a means to increase yield and enhance total return. Up to 150% of the Fund's assets, at the time of investment, may be leveraged (i.e., the combined value of borrowings and short positions). Leveraging will include, but is not limited to, short selling of securities, reverse repurchase agreements, certain option and futures transactions plus any borrowings to leverage the Fund's assets. Although the use of leverage may enhance returns on the Fund's portfolio and increase the number of investments that may be made by the Fund, it may also substantially increase the risk of loss. The percentage included above is intended as a guideline and may be changed from time to time at the sole discretion of the Board of Directors.

[REDACTED]

The Shares

The Fund is offering up to 10,000,000 non-voting, redeemable participating shares, U.S. \$0.001 par value (the "Shares"). The Fund's share capital consists of the Shares and 100 voting, non-participating, non-redeemable shares, U.S. \$0.01 par value each (the "Management Shares"), which are held by the MDL Active Duration Purpose Trust, a trust formed under the laws of Bermuda (the "Purpose Trust"). Harrington Trust Limited, a Bermuda company, is the sole trustee of the Purpose Trust. See "MANAGEMENT AND ADMINISTRATION—The Purpose Trust."

[REDACTED]

The Fund intends to sell Shares which will be denominated in U.S. Dollars. Each Share will be issued at a price of U.S. \$1,000.00 during the initial offering period (the "Initial Offering Period"), which shall commence on the date of the filing of this Memorandum with the Bermuda Registrar of Companies on January 15, 2003 and which shall end on the earlier of the acceptance of \$3,000,000 of subscriptions or May 15, 2003. There is no assurance that the Fund will receive and accept the minimum aggregate subscription amount necessary to commence investing. If subscriptions totaling at least \$3,000,000 are not

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period of time following a request of verification of identity, the Fund has not received satisfactory evidence as aforesaid, the Fund may refuse to admit the investor as a shareholder in which event any subscription proceeds received by the Fund will be returned without interest to the account of the relevant investors. Investors should note that if any of the Directors, the Investment Adviser, or the Administrator has a suspicion that a payment to the Fund (by way of subscription or otherwise) contains the proceeds of criminal conduct, it may be required under applicable anti-money laundering laws and regulations to report its suspicions to one or more enforcement or regulatory agencies, including various U.S. governmental agencies. For example, an individual may be required to produce a copy of a passport or identification card duly certified by a public authority such as a notary public, together with evidence of his address, such as a utility bill or bank statement, and date of birth. In the case of corporate investors, the Administrator can require, among other things, production of a certified copy of the certificate of incorporation (and any change of name), memorandum and articles of association (or equivalent), and the names, occupations, dates of birth and residential and business addresses of all directors and beneficial owners. The Administrator can request such information as is necessary to verify the identity of an investor. In the event of delay or failure by the applicant to produce any information required for verification purposes, the Administrator may refuse to accept the application and the subscription monies relating thereto, or may refuse to honor a redemption request until proper information has been provided.

If any person who is resident in Bermuda (including the Administrator) has a suspicion that a payment to the Fund (by way of subscription or otherwise) contains the proceeds of criminal conduct that person is required to report such suspicion pursuant to The Proceeds of Crime Act, 1997, Bermuda.

6. Shareholder Meetings.

In general, other than the Annual General Meeting, there will be no regularly scheduled meetings of Shareholders.

7. Directors' Interests.

None of the Directors has any ownership interest either direct or indirect in the Participating Shares or any options in respect of such Shares.

There are no existing or proposed service contracts between any of the Directors in their individual capacity and the Fund.

Except for the contract listed in paragraph (b) below, no Director is materially interested in any transactions subsisting at the date hereof which is unusual in its nature and conditions or significant in relation to the business of the Fund.

8. Reports and Accounts.

Interim and annual reports for the Fund, once listed, will be sent to Shareholders within four and six months, respectively, of the end of the period to which they relate.

9. Litigation.

The Fund is not engaged in any litigation or arbitration proceedings and the Directors are not aware of any litigation or claim pending or threatened by or against the Fund.

The following does not purport to be a comprehensive summary of all the risks associated with an investment in the Fund. Rather, the following are only certain particular risks to which the Fund is subject that the Investment Adviser wishes to encourage prospective investors to discuss in detail with their professional advisors:

*The Fund Has No Performance History.* The Fund has only recently been formed and has no performance history.

*Reliance on the Investment Adviser.* All decisions with respect to the Fund's assets and the general management of the Fund will be made by the Investment Adviser which relies on the services of several key employees, including without limitation, Mark D. Lay, Steven L. Sanders and Edward Adatepe. Shareholders will have no right or power to take part in the management of the Fund. As a result, the success of the Fund for the foreseeable future will depend largely upon the ability of the Investment Adviser and in particular Mark D. Lay, Steven L. Sanders and Edward Adatepe. Should any of these employees leave or become incapacitated for any period of time, profitability of the Fund's investments may suffer.

*Achievement of the Fund's Investment Objective.* No guarantee or representation is made that the Fund's Investment Objective will be successful. The Fund's investment program may include such investment techniques as short sales, leverage and limited diversification, which practices can, in certain circumstances, maximize the adverse impact to which the Fund's investments may be subject.

*Eligibility to Engage in Futures Transactions.* Certain transactions in commodity futures and options on futures and the investment and trading strategies associated with such transactions will not be available to the Fund unless and until the Investment Adviser has registered as a CPO with the CFTC. While the Investment Adviser has filed an application with the CFTC for licensing as a CPO, no assurance can be given that such license will be obtained and the Investment Adviser is not obligated to pursue or obtain any such license or registration.

*No Current Income.* The Fund's investment policies should be considered speculative, as there can be no assurance that the Investment Adviser's assessments of the short-term or long-term prospects of investments will generate a profit. In view of the fact that it is unlikely that the Fund will pay dividends, an investment in the Fund is not suitable for investors seeking current income for financial or tax planning purposes.

*Currency Risk.* Investments in securities of non-U.S. issuers will be denominated in currencies other than the U.S. Dollar, and hence the value of such investments will depend on the relative strength of the U.S. Dollar. The Fund may be affected favorably or unfavorably by exchange control regulation or changes in the exchange rate between foreign currencies and the U.S. Dollar. Changes in foreign currency exchange rates may also affect the value of dividends and interest earned, and the level of gains and losses realized on the sale of securities. The rate of exchange between the U.S. Dollar and other currencies is determined by forces of supply and demand in the foreign exchange markets. These prices are affected by the international balance of payments and other economic and financial conditions, government intervention, speculation and other factors. Additionally, because the Fund's Net Asset Value will be calculated, purchased and redeemed in U.S. Dollars, each shareholder, and not the Fund, will bear the risk of any currency exposure resulting from differences, if any, in the value of the U.S. Dollar relative to the shareholder's reference currency.

*Investment in a Master Fund.* An investment by the Fund in the Master Fund may be affected by an investment by other funds in the Master Fund. In view of the fact that all expenses of the Master Fund would be shared pro rata among its investors, if other investors in the Master Fund redeem their interests,

accepted by the Fund during the Initial Offering Period, the subscriptions will be returned with interest actually earned thereon.

**Continuous Offering Period**

If at least \$3,000,000 in subscriptions are accepted, the Fund will commence investing operations. Subsequent to the Initial Offering Period, Shares will be offered at the Net Asset Value per Share as of the last Business Day of each calendar quarter (each, a "Valuation Date"). Shares purchased after the Initial Offer Period will be issued as of the next Business Day after the relevant Valuation Date (the "Subscription Date"). A Business Day shall mean a day on which banks are open for business in Bermuda and New York, other than a Saturday or Sunday. Such proceeds will be invested in the Fund for the benefit of the Investor at the next Investment Date. Fractional Shares will be issued and carried out to three decimal places.

The minimum initial subscription per Investor is \$1,000,000. The minimum subscription for additional investments by an Investor shall be \$500,000. Shares are offered directly by the Fund. The minimum subscription amount and the minimum additional subscription amount may be reduced by the Board in its sole discretion. To subscribe for Shares, an Investor must submit a Subscription Agreement (in the form attached hereto) to the Administrator. Subscription Agreements and consideration for the Shares subscribed to must be received by the Administrator at least five Business Days before the intended Subscription Date for the subscription. Upon acceptance of the subscription, capital contribution for the Shares subscribed must be transmitted immediately to the Fund's subscription account. Cleared funds must be in the Fund's account by 5 p.m. (Bermuda time) at least three Business Days before the Subscription Date. Consideration for Shares must be paid for in cash, although the Directors may in their absolute discretion accept other forms of payment.

**Eligible Subscribers**

Generally, except with respect to Qualified U.S. Persons (as defined in (b) below), the Shares will not be offered for sale in the U.S. or its territories or possessions or to nationals thereof, persons resident therein or entities established under the laws thereof. Shares will be offered from time to time on a private basis only to a select number of institutional and individual investors which meet applicable regulatory requirements. The Shares may be purchased only by (a) individuals that are not citizens or residents of the United States or entities that are not organized under the laws of the United States ("Non-U.S. Persons"), and (b) U.S. Persons within the meaning of the U.S. Internal Revenue Code of 1986, as amended (the "Code"), that are subject to the U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA"), or are otherwise exempt from payment of United States Federal income tax, or an entity substantially all of the ownership interests in which are held by entities exempt from payment of U.S. Federal income tax ("Qualified U.S. Persons"). Prospective shareholders who are Qualified U.S. Persons must also qualify as "qualified purchasers" under §2(a)(51) of the Investment Company Act and "qualified eligible participants" under

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CONFIDENTIAL TREATMENT

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CFTC Regulation 4.7. Non-U.S. Persons and Qualified U.S. Persons that are Qualified Purchasers and Qualified Eligible Participants are hereinafter referred to as "Qualified Holders." Shares may not be purchased or held by or for the account of Bermuda residents. The Board of Directors may reject any subscription for any reason, or for no reason, in their sole and absolute discretion.

Series of Shares

In order to ensure a more equitable allocation of the Incentive Fee (see "Fees and Expenses" below) among Investors investing in the Fund at different times during the calendar year, Shares issued as of separate Subscription Dates will be designated as Shares of separate series (each with its own Net Asset Value per Share) as follows: Shares issued on the first Subscription Date of a calendar year will be designated as Series 1 Shares. Shares issued on Subscription Dates that do not fall on the first Subscription Date of a calendar year will be designated as Shares of a consecutive series of Shares. To the extent that there is no Loss Carryforward with respect to a Series, such additional series of Shares will be converted into Series 1 Shares at the beginning of each calendar year as described in more detail under "FEES AND EXPENSES".

**FEES AND EXPENSES**

Organization and Offering Expenses

The aggregate initial organization and offering expenses will be advanced by the Investment Adviser and will be reimbursed by the Fund at such times and in such amounts as requested by the Investment Adviser. Provided that the Fund commences investing activities, the Fund may treat its organizational costs and expenses in accordance with U.S. Generally Accepted Accounting Principles, although it may elect to modify its treatment of such costs and expenses to accommodate its practical needs, including without limitation, by amortizing such organizational costs and expenses over a period of up to 60 months. Subsequent offering expenses will be direct expenses of the Fund.

[Redacted]

The Fund will bear its routine operational expenses, including legal, custodial, accounting, printing, and audit expenses, expenses related to the investments of the Fund's assets, including, without limitation, brokerage commissions, investment related travel expenses, interest expense and professional and consulting fees relating to particular investments, insurance premiums (if any), administrative, directors fees and expenses, expenses incurred with respect to furnishing the Shareholders with annual reports and other financial information, the Administrator's and the Registrar and Transfer Agent's fees and annual Bermuda government fees. The Investment Adviser will bear all of its general overhead expenses in connection with its services to the Fund (and the Master Fund), including employee salaries and office and equipment costs. The Fund will also, at such time as it becomes a member of the Master Fund, indirectly bear its allocable share of expenses incurred by the Master Fund, which will consist primarily of

brokerage commissions and other operating and investment expenses paid by the Master Fund.

**Investment Adviser  
Compensation**

The Investment Adviser will receive a quarterly management fee determined at a rate equal to 1% per annum of the Fund's Net Asset Value, accrued monthly and payable in arrears as of the end of each calendar quarter. It also will receive a quarterly incentive fee (the "Incentive Fee") equal, in the aggregate, to 20% of the increase in Net Asset Value of each series of Shares over the sum of (i) the Series' Net Asset Value as of the commencement of each calendar quarter plus (ii) the yield on the Fund's portfolio at a rate equal to the yield of the Lehman Government Credit Index for such period (the "Hurdle"). A Series of Shares will only be charged with an Incentive Fee if its Net Asset Value at the end of a quarter (prior to accrued Incentive Fees), if any, for the quarter is greater than (i) its Net Asset Value at the time of its initial subscription (or the Initial Closing Date, whichever is later) or (ii) its Net Asset Value at the time the last Incentive Fee was charged against such Series, whichever is higher, plus the Hurdle (the "High Water Mark"). In the event that the Fund invests in the Master Fund, the Investment Adviser will not be entitled to a separate management or investment advisory fee as manager of the Master Fund but will be entitled to reimbursement for expenses incurred on behalf of the Master Fund.

In order to ensure that the Incentive Fee is charged only to Shares that have appreciated in value since their acquisition and to make sure that all Shares have the same Net Asset Value, the Fund will issue different series of Shares to investors who invest at different times to ensure that the Incentive Fee is charged only to Shares that have appreciated in value. See "CHARGES TO THE FUND-Calculation of Investment Adviser Compensation."

*Deferral of Fees.* The Investment Adviser may elect, prior to the commencement of the Fund's trading activities with respect to its first calendar year of trading and prior to the commencement of each calendar year thereafter, to defer for a period of up to ten years payment of all or any portion of its Management Fees and/or Incentive Fees earned with respect to that subsequent period.

**Administration**

For its services as the Fund's Administrator, the Fund will pay the Administrator fees in accordance with the Administration Agreement.

**Registrar and  
Transfer Agent**

For its services, the Registrar and Transfer Agent will receive a fee of U.S. \$2,500 per annum and is entitled to reimbursement of actual out-of-pocket expenses incurred on behalf of the Fund.

**Directors' Fees**

Each Director who is not an officer or employee of the Investment Adviser receives a flat annual fee of U.S. \$2,000 for serving in such capacity. The Directors shall be entitled to reimbursement from the

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CONFIDENTIAL TREATMENT

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Fund for reasonable out-of-pocket expenses incurred by them on behalf of the Fund.

**Trustee Services**

The Trustee of the Purpose Trust holding the Management Shares will be entitled to an acceptance fee of \$1,500 and an annual trustee fee of \$1,500 payable by the Fund.

**Custody and Prime Brokerage Services**

For its services as custodian of the Fund's assets and prime broker of the Fund, the Fund will pay the Custodian in accordance with the Custody Agreement.

**SHAREHOLDER INFORMATION**

**Limited Liability**

Shareholders will purchase Shares in the Fund with limited liability and cannot lose more than the amount of their investment and profits thereon.

**Redemption of Shares**

Shares may be redeemed at a Shareholder's option at the Net Asset Value per Share of the relevant Series as of any Valuation Date upon at least 15 Business Days prior written notice to the Fund. The Fund may compulsorily redeem the Shares of any Shareholder on at least ten days' prior written notice to such Shareholder at the sole and absolute discretion of the Directors of the Company or where the holding of such Shares may result in regulatory, pecuniary, legal, taxation or material administrative disadvantage to the Fund or its Shareholders. There is no redemption charge or penalty. The Fund will generally pay 95% of the redemption price within 30 Business Days of the effective date of the redemption without interest, and the balance promptly at such time as the Fund shall determine, at the discretion of the Board of Directors.

The Fund expects to pay the entire redemption price in cash, although it has the right to distribute marketable securities. A redemption notice, once given, may not be cancelled or rescinded without the consent of the Directors in their sole discretion.

The Fund reserves the right to decrease, limit, delay or deny a redemption request, or any payment on a redemption request, if reasonably necessary in order to comply with the Fund's credit and other agreements, as well as for other reasons.

**Transfer of Shares**

There is no active secondary trading market for the Shares, nor is one expected to develop. Shares may not be sold, transferred or otherwise disposed of by a Shareholder in the United States or to any person, corporation or entity which is not a Qualified Holder without prior written consent of the Fund and compliance with all applicable laws.

**Favorable Tax Treatment**

Under existing legislation in Bermuda, there are no income, capital gains or withholding taxes payable by the Fund or its Shareholders, nor are there any Bermuda estate, succession, or inheritance taxes payable by the Shareholders with respect to their Shares.

There is, at present, no direct taxation in Bermuda and interest, dividends and gains payable to the Fund will be received free of all Bermuda taxes. ~~The Fund is an exempted company under Bermuda law~~ and the Fund has made application to the Minister of Finance of Bermuda for, and expects to receive, an assurance that no law hereafter enacted in Bermuda imposing any taxes or duty to be levied on income or capital assets, gains or appreciation will apply to any income or property of the Fund.

The Fund and its Shareholders should not be subject to United States taxation as a consequence of the Fund's trading activities.

**Dividends and Distributions**

The Fund is a capital appreciation fund and does not intend to distribute dividends. Any dividends declared will be in the sole discretion of the Directors and will be paid out of the Fund's accumulated net income plus the net of accumulated realized and unrealized capital gains and accumulated realized and unrealized capital losses. Any dividends declared will be paid in accordance with Bermuda law.

**Net Asset Value**

The Net Asset Value of the Fund and each Series will be calculated at each Valuation Date in U.S. Dollars (unless the calculation at such Valuation Date has, for any reason, been postponed or suspended). Shareholders may, at any time, obtain information from the Fund regarding the most recently available indication of Net Asset Value.

**ERISA Considerations**

Fiduciaries and other persons investing in Shares in the Fund on behalf of employee benefit plans, employee retirement plans, individual retirement arrangements, Keogh Plans and other plans (together, "Plans") subject to ERISA or the Code should be aware that the assets of the Fund may constitute "plan assets" for purposes of the reporting, disclosure, prohibited transaction and fiduciary responsibility provisions of ERISA and the Code. The Investment Adviser qualifies as a "qualified professional asset manager" under applicable regulations under ERISA and will take all appropriate steps to ensure that the Fund does not engage in any prohibited transactions under ERISA. The Investment Adviser will be a fiduciary of Plans investing in the Fund for purposes of ERISA. An investment in the Fund by Plan Investors requires special considerations, and fiduciaries of such Plans are encouraged to carefully review this Memorandum and the Section entitled "ERISA Considerations."

**Auditors**

Deloitte & Touche, Hamilton, Bermuda

**Legal Counsel**

Foley & Lardner, Milwaukee, Wisconsin, have counseled the Investment Adviser on various matters of United States law relating to the Fund. Appleby, Sparing & Kempe, Hamilton, Bermuda, have advised the Investment Adviser and the Fund on various matters of Bermudan law relating to the Fund.

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**Custody Arrangements**

The Fund is exempt under the Regulations from the requirement to appoint a Bermuda custodian of Fund Assets since the Fund is classified as a Bermuda Institutional Scheme. ~~The Custodian will serve as custodian of the assets of the Fund.~~

**Prime Broker**

The Custodian will also initially be engaged as prime broker for the Fund, will function as clearing agent and will provide margin leverage and certain valuation and reporting services to the Fund and the Administrator.

**Reports**

The Fund will provide Investors with monthly unaudited performance reports and annual audited financial statements prepared by the Fund's auditors.

**Fiscal Year**

The Fund's fiscal year will be the calendar year ending December 31st.

**Conflicts of Interest**

The Fund will be subject to certain actual and potential conflicts of interest. For example, the Investment Adviser will not be required to devote all of its time to the management of the Fund and the Investment Adviser has provided and expects to continue to provide investment management and advice to clients other than the Fund. In addition, the terms of the Investment Adviser's compensation from the Fund was not established by arm's length negotiations. See "CONFLICTS OF INTEREST."

**Risks**

Investment in the Fund involves greater risks than certain other types of investments. Investors in the Fund should be able financially to bear a loss of their investment. There is no assurance that the Fund will be profitable or will avoid substantial losses. "See Risk Factors."

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**DIIRECTORY OF NAMES AND ADDRESSES**

**Registered Office**

MDL Active Duration Fund Ltd.  
 Williams House, 20 Reid Street  
 Hamilton, HM11, Bermuda

**Directors**

Mr. Mark D. Lay  
 c/o MDL Capital Management, Inc.  
 225 Ross Street, 3rd Floor  
 Pittsburgh, PA 15219

Mr. Edward Adatepe  
 c/o MDL Capital Management, Inc.  
 225 Ross Street, 3rd Floor  
 Pittsburgh, PA 15219

Mr. Raymond Morrison  
 c/o Olympia Capital International, Inc.  
 Williams House, 20 Reid Street  
 Hamilton, HM 11, Bermuda

**Administrator**

Olympia Capital International, Inc.  
 Williams House, 20 Reid Street  
 Hamilton HM 11, Bermuda

**U.S. Counsel to the Fund**

Foley & Lardner  
 777 East Wisconsin Avenue  
 Milwaukee, WI 53202-5367

**Secretary, Registrar and Transfer Agent**

Winchester Fiduciary Services, Limited  
 Williams House, 20 Reid Street  
 Hamilton HM 11, Bermuda

**Investment Adviser**

MDL Capital Management, Inc.  
 225 Ross Street, 3rd Floor  
 Pittsburgh, PA 15219

Mr. Steven L. Sanders  
 c/o MDL Capital Management, Inc.  
 225 Ross Street, 3rd Floor  
 Pittsburgh, PA 15219

Mr. Oskar P. Lewnowski  
 c/o Olympia Capital International, Inc.  
 Williams House, 20 Reid Street  
 Hamilton, HM 11, Bermuda

**Trustee of Purpose Trust**

Harrington Trust Limited  
 Cedar House, 41 Cedar Avenue  
 Hamilton HM12, Bermuda

**Auditors**

Deloitte & Touche  
 Corner House  
 Church and Parliament Streets  
 Hamilton, Bermuda

**Bermuda Counsel to the Fund**

Appleby Spurling & Kempe  
 Cedar House  
 41 Cedar Avenue  
 Hamilton HM12, Bermuda

**Custodian and Prime Broker**

Credit Suisse First Boston Corporation  
 Eleven Madison Avenue  
 New York, NY 10010-3629

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**INVESTMENT OBJECTIVE AND STRATEGY OF THE FUND**

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**Investment Objective and Strategy.**

The Fund aims to achieve consistent positive returns and to outperform the Lehman Government Credit Index over a full market cycle (*i.e.*, 3-5 years). In particular, the Fund seeks to significantly outperform the Index during periods when bond and/or stock markets experience relatively strong returns. Conversely, the Fund seeks to match or slightly exceed the Index return during periods when returns from financial assets are generally declining. The Fund will have a broad market style focusing on investments in U.S. Treasury and U.S. agency notes and bonds and corporate and mortgage-backed fixed income securities.

It is anticipated that the objectives of the Fund will largely be achieved through an active duration approach. This means that the Fund will be constructed so as to take advantage of anticipated movements in the U.S. Treasury yield curve as well as of changes in intersector spread relationships. The Investment Adviser's projections of these variables will be based on an analysis of domestic and foreign macro-economic factors including, but not limited to, economic growth, inflation trends, Federal Reserve policies, Federal budgetary considerations, exchange rate and trade policies and the performance of foreign economies.

The Investment Adviser will select individual securities so that the Fund will, on the whole, have the desired portfolio characteristics (*e.g.*, duration, maturity structure, sector allocation and quality). During this process, the Investment Adviser will take into consideration other related factors such as liquidity, coupon, on-the-run versus off-the-run, yield, call features and convexity.

Assets of the Fund will regularly be pledged or otherwise collateralized to obtain some degree of leverage.

**Investments of the Fund**

Investments of the Fund will consist primarily of long positions in U.S. Treasury notes and bonds, notes and bonds of U.S. government agencies, fixed income securities of U.S. corporations with a Standard & Poor's credit rating of B or better and mortgage-backed fixed income securities. The Fund's investments in mortgage-backed securities will be limited to simple pass-through securities such as Ginnie Mae's and Fannie Mae's. The Fund will also take positions from time to time in various currencies and in long and short positions and options in publicly-traded equity securities, both as a hedge against underlying credit and interest rate trends or as unhedged positions. The Fund will also enter into forward contracts, engage in interest rate swaps and hold commercial paper, certificates of deposit, repurchase agreements and short-term money market funds. The Fund will not take positions in convertible bonds.

In addition, subject to applicable regulatory requirements of the CFTC, including commodity pool operator registration requirements, the Fund may participate in commodities transactions in interest rate and financial futures including currency futures and options on the foregoing investment instruments. The Investment Adviser is applying to become licensed as a CPO with the CFTC and upon such licensing will apply for an exemption for the Fund from certain disclosure and reporting requirements of the CFTC that are applicable to certain commodity pools. As a condition to such an exemption, if granted, the Fund may have to commit to the CFTC, among other things, that it will restrict the percentage of its assets that may be committed to initial margin and option deposits in connection with commodity futures contracts and options thereof. In any event, the Fund does not plan to commit

more than 10% of its assets as initial margin and option deposits in connection with such commodities futures contracts and options thereon.

The trading of the Fund will consist primarily of long positions in fixed income securities. In addition, in order to augment or adjust the duration of the portfolio or to hedge certain positions, the Fund will from time to time take long and short positions in certain equities, engage in relative value trading (long and short positions in similar securities), fixed income arbitrage of mispricings in related fixed income securities and mortgage arbitrage (offsetting long positions in mortgage-backed securities with short positions in other fixed income securities of different durations) and acquire option positions, futures and options on futures.

#### Diversification and Concentration

The Fund will not be limited with respect to the amount of capital that may be committed to any particular sector, type of investment or securities of a particular issuer. It is anticipated that the Fund's portfolio will typically consist of debt securities of 10 to 30 issuers plus positions in other asset classes.

#### Portfolio Turnover

Purchases and sales will be made for the Fund whenever necessary, in the Investment Adviser's determination, to meet the Fund's objectives. The Fund's investment activities may involve numerous investments based on various short-term market considerations. The turnover rate of the Fund is expected to be significant.

#### SPECIAL INFORMATION ON THE MASTER FUND/FEEDER FUND INVESTMENT STRUCTURE

It is within the power of the Directors to direct that part or all of the assets of the Fund be invested in a Master Fund at some point in the future. In the event the Fund does make an investment in a Master Fund, the assets invested in the Master Fund would also be managed by the Investment Adviser at the Master Fund level, but at all times in accordance with the investment strategies of the Fund as set forth in this Memorandum. The Master Fund would be a Delaware limited partnership or a Bermuda limited liability entity or other entity exempt from U.S. income taxation. The use of the Master Fund may give the Fund added flexibility in its investing by increasing the equity base available for such investing.

In such arrangement, the Fund would be what is often referred to as a "Feeder Fund." In addition to selling an interest to the Fund, the Master Fund may sell interests to other affiliated and non-affiliated investment companies or institutional investors (i.e., other feeder funds). Such investors will invest in the Master Fund on the same terms and conditions and will pay a proportionate share of the Master Fund's expenses. However, the other investors investing in the Master Fund may not be required to redeem their shares at the same offering price as the Fund due to variations in sales commissions and other operating expenses. Therefore, investors in the Fund should be aware that these differences may result in differences in returns experienced by investors in the different funds that invest in the Master Fund. See "RISK FACTORS."

## MANAGEMENT AND ADMINISTRATION

## The Directors

The directors of the Fund are Mark D. Lay, Steven L. Sanders, Edward Adatepe, Oskar P. Lewnowski and Raymond Morrison. Directors are elected, and can be removed by a majority vote of the holders of the Management Shares. Additional directors may also be appointed by a majority vote of the holders of the Management Shares. The directors are ultimately responsible for all aspects of the operation of the Fund, although they have delegated investment authority to the Investment Adviser and certain administrative responsibilities to the Administrator.

For the biographies of Messrs. Lay, Sanders and Adatepe, please see the discussion under Investment Adviser. Biographies of Messrs. Lewnowski and Morrison are as follows:

Oskar P. Lewnowski has, since its inception, been Chairman and a director of Olympia Capital International, Inc. (the Fund's Administrator), a company he was instrumental in forming in 1990, and an officer and director of its affiliates, and the Chairman of the Board of Winchester Global Trust Company Limited, a licensed Bermuda trust company formed in 1995. For more than two decades, he has been a director of various international investment companies.

Raymond Morrison is a Chartered accountant and a Chartered Financial Analyst and has, since July 1993, been an officer of Olympia Capital (Bermuda) Limited and of various international investment companies. For three years prior thereto, he was a senior accountant at Ernst & Young, Hamilton, Bermuda.

Olympia Capital International, Inc. is the Administrator and is located at Williams House, 20 Reid Street, Hamilton, Bermuda.

Subject to the Bye-Laws of the Fund, the Fund shall indemnify its officers and directors for losses (including reasonable legal fees) which they may incur in connection with the performance or non-performance of their duties as directors of the Fund, provided the person seeking the indemnity acted in good faith and in a manner reasonably believed to be in, or not opposed to, the Fund's best interest, and that his actions did not involve fraud, willful or reckless misconduct, bad faith or gross negligence. Any such indemnification payments would reduce the Fund's assets.

## The Investment Adviser

MDL Capital Management, Inc. (the "Investment Adviser") is a business corporation which was incorporated in Pennsylvania. The equity of the Investment Adviser is owned by Mark D. Lay, Steven L. Sanders, Edward Adatepe and Safeguard Scientific, Inc. Its offices are located at 225 Ross Street, 3rd Floor, Pittsburgh, Pennsylvania 15219. The Investment Adviser's books and records are maintained at this address. The Investment Adviser is responsible for the management of the Fund's portfolio and will provide investment advice to the Fund and arrange for execution of the Fund's portfolio transactions.

The Investment Adviser is a registered investment adviser under the Advisers Act and is a "Qualified Professional Asset Manager" as defined in U.S. Department of Labor prohibited transaction class exemption 84-14. The Investment Adviser is applying to become licensed as a commodity pool operator with the CFTC.

MDL Advisers, Inc., a wholly-owned subsidiary of the Investment Adviser ("MDL"), is the investment adviser to the MDL Broad Market Fixed Income Fund, a mutual fund registered under the

Investment Company Act and established in 2001 (the "Affiliate Fund"). In 2001, the Affiliate Fund acquired all of the assets of the Advisors' Inner Circle MDL Broad Market fund, a registered mutual fund established by another affiliate of the Investment Adviser in 1987. MDL Advisers, Inc. was also the investment adviser to MDL Large Cap Growth Equity Fund (the "Equity Fund"), a registered mutual fund that was closed and liquidated in March 2002 in order to permit the Investment Adviser and its affiliates to concentrate exclusively on fixed-income products. The investment objectives of the Affiliate Fund are similar or identical to those of the Fund. See "CONFLICTS OF INTEREST."

Mr. Mark D. Lay, Mr. Steven L. Sanders and Mr. Edward Adatepe, principals of the Investment Adviser, will have direct and primary responsibility for all investment decisions of the Fund.

Mark D. Lay, age 39, Chairman of the Board and Chief Executive Officer of the Investment Adviser, received his Bachelor of Arts in Economics from Columbia University in 1985. From 1984 to 1989, Mr. Lay was with Citicorp Investment Bank and among other positions served as a vice president in foreign exchange trading responsible for hedging portfolios using government bonds, futures and commodities. From September 1989 to July 1992, he was with Dean Witter Reynolds, Inc. as an investment account executive. In 1993, Mr. Lay founded the predecessor to MDL Capital Management, Inc. and has been its principal shareholder and Chairman of the Board since that time.

Steven L. Sanders, age 43, President of the Investment Adviser, has been a principal since inception of the firm. He has co-managed MDL's Equity Fund since its inception. Prior to joining the Investment Adviser, he served as president and CEO of his investment advisory firm, Sanders Financial. Mr. Sanders received his Bachelor of Arts in Business Administration degree from Howard University in 1982.

Edward Adatepe, age 43, has served as Chief Investment Officer of the Investment Adviser and its predecessors since 1994. He has co-managed MDL's mutual funds (and their predecessor funds) since their inception. Prior to joining the Investment Adviser, Mr. Adatepe served as a managing director of RRZ Investment Management and previously served as a fixed income portfolio manager with C.S. McKee Investment Advisors. Mr. Adatepe has a Bachelor of Science degree from Allegheny College and a Masters in Business Administration from Carnegie-Mellon University.

#### The Administrator

The Fund has appointed Olympia Capital International, Inc. as Administrator of the Fund under an Agency, Administration and Indemnification Agreement (the "Administration Agreement"). The Administrator will perform various administrative services for the Fund, including the supervision of share issuance and redemption services, and will calculate the Fund's Net Asset Value and the Net Asset Value per Share on a monthly basis. Cash from subscriptions and for redemptions will be held in one or more accounts at an affiliate of the Administrator.

The Administration Agreement provides that the Administrator and its employees and affiliates shall not be liable to the Fund or its Shareholders for any error of judgment or mistake of law or for any loss suffered by the Fund or its Shareholders in connection with its services in the absence of bad faith, gross negligence, willful or reckless misconduct, bad faith or gross negligence in the performance of their duties under the Agreement. The Administration Agreement contains provisions for the indemnification of the Administrator, its employees and affiliates by the Fund against liabilities to third parties arising in connection with the performance of its services, except in the case of willful or reckless misconduct, bad faith or gross negligence in the performance of their duties under the Agreement. The Administration Agreement also contains provisions for the indemnification of the Administrator and its employees and

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CONFIDENTIAL TREATMENT

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affiliates by the Investment Adviser in certain circumstances. The Administration Agreement may be terminated by either party upon 60 days' prior written notice to the other party.

See "FEES AND EXPENSES" herein for a description of the fees payable to the Administrator pursuant to the Administrative Services Agreement.

**The Registrar and Transfer Agent**

The Fund has appointed Winchester Fiduciary Services Limited, located in Hamilton, Bermuda as Registrar and Transfer Agent under a Registrar and Transfer Agent Agreement. The Registrar and Transfer Agent is wholly owned by Winchester Global Trust Company Limited, an affiliate of the Administrator.

The Registrar and Transfer Agent is responsible for, among other things: (i) maintaining the register of Shareholders of the Fund and generally performing all actions related to the issuance and transfer of Shares, (ii) performing all acts related to the redemption and/or purchase of the Shares; (iii) maintaining a record of dividends declared, if any, and dividends paid; (iv) on behalf of the Fund, dealing with and replying to all correspondence and other communications addressed to the Fund in relation to the transfer of Shares; and (v) performing all other incidental services necessary to its duties under the Registrar and Transfer Agent Agreement.

The Registration and Transfer Agent Agreement contains exculpation and indemnification provisions identical to those set forth in the Administration Agreement.

See "FEES AND EXPENSES" herein for a description of the fees payable to the Registrar and Transfer Agent.

**Custodian and Prime Broker**

The Fund has engaged Credit Suisse First Boston Corporation, a Massachusetts corporation, located in New York, New York, to serve as Custodian of the Fund's assets and as the Fund's prime broker under a customer agreement (the "Custody Agreement"). The Custodian will assist the Administrator, Registrar and Transfer Agent and the Fund by providing banking and wire transfer services. Fund investments not held in brokerage accounts and cash from subscriptions and for redemptions will be held in one or more accounts at the Custodian. The Fund will also use the Custodian's clearing and settling facilities for trades of the Fund's securities.

**The Purpose Trust**

On January 6, 2003, Messrs. Lay, Sanders and Adatepe conveyed all of the issued and outstanding Management Shares to the MDL Active Duration Purpose Trust (the "Purpose Trust"). The Purpose Trust, an entity unrelated either to the Investment Adviser or the Administrator, was formed on December 13, 2002, to hold the Management Shares, which constitute all of the voting stock of the Fund. Harrington Trust Limited, a Bermuda company, is the sole trustee of the Purpose Trust. The general purposes of the Trust are to hold the Management Shares and exercise its rights as shareholder of the Fund and to support the business activities of the Fund. All income and capital of the Trust are to be applied in furtherance of the Trust purposes for the benefit of the Fund. Upon termination of the Trust, any remaining assets of the Trust not applied for Fund purposes will be distributed for charitable purposes by the Trustee. Winston Lowe, Esq. has been appointed "Enforcer" of the Trust. Mr. Lowe is a shareholder of the law firm of Buchanan Ingersoll, 1835 Market Street, 14th Floor, Philadelphia, PA

19103. The Enforcer has the power to appoint and remove trustees, to change the law applicable to or the situs of the Trust and to apply for amendments to the Trust.

#### DESCRIPTION OF THE ADVISORY AGREEMENT

The Fund has entered into an Advisory Agreement with the Investment Adviser. The Advisory Agreement provides that the Investment Adviser shall have broad discretion to direct and manage the Fund's investments. Subject to the approval of the Directors, the Investment Adviser 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 Adviser 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 willful violation of any material law, and provided that such indemnification obligation shall not apply to any liabilities, costs or expenses imposed on the Investment Adviser 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 Adviser represents and acknowledges, among other things, that (a) the Investment Adviser is a registered investment adviser, (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.

#### CONFLICTS OF INTEREST

The Fund's Directors and the Investment Adviser and its principals are currently and may in the future be subject to certain actual and potential conflicts of interest, including the following:

The Investment Adviser and its affiliates render advice to investment clients and funds other than the Fund and may have financial and other incentives to favor certain of such clients and funds over the Fund.

An affiliate of the Investment Adviser is an active investment adviser that manages the Affiliate Fund, a mutual fund with investment objectives similar or identical to those of the Fund. In addition, the Investment Adviser and its affiliates may in the future organize one or more other entities with investment objectives similar or identical to those of the Fund. Under the Investment Advisory Agreement, the Investment Adviser will be required to devote only such time and attention to the activities of the Fund as may be required for the efficient conduct thereof.

The compensation payable to the Investment Adviser by the Fund has not been negotiated at arm's length.

The Investment Adviser and its affiliates may engage in a broad range of investment, investment advisory and other activities. The Investment Adviser and its affiliates will provide advisory services for the Affiliate Fund and other managed accounts. As a result, the Fund, the Affiliate Fund and such other managed accounts and clients may frequently purchase or sell the same securities, and there may be conflicts of interest among the Fund, the Affiliate Fund and such other managed accounts with respect to, for example, the allocation of investment opportunities and purchases and sales of securities in connection with particular investment situations. With respect to all client accounts over which they maintain control, the Investment Adviser and its affiliates will resolve all conflicts of interest in good faith and on a fair and equitable basis. Investment opportunities and the purchases or sales of securities generally will be allocated to the Fund, the Affiliate Fund and the other managed accounts in proportion to the capital which the Fund, the Affiliate Fund and the other managed accounts respectively make available for each investment situation, taking into consideration the differing investment objectives, cash availability, and other portfolio restrictions of the Fund, the Affiliate Fund and the other managed accounts.

The Investment Adviser, its affiliates and their respective principals may invest and trade for their own account in securities and derivatives similar to those acquired by the Fund and the Master Fund for their own accounts. The records of such trading will not be made available to Shareholders.

The Investment Adviser will not have any obligation to engage in any transaction or investment for the Fund or to recommend any transaction to the Fund that the Investment Adviser may engage in for its own account or the account of any clients except as required by applicable law.

Nothing precludes transactions between the Fund and any affiliate of the Investment Adviser acting in and for its own account, provided that the Investment Adviser determines, at the time of requesting such services, that such services are in the best interests of the Fund, and further provided that the rate of compensation to be paid for any such service shall be reasonable as compared to the amount paid for such similar services in arm's length transactions between unrelated parties. In any event, the Investment Adviser will not cause the Fund to retain affiliates of the Investment Adviser to provide services to the Fund under circumstances that would violate ERISA.

The Purpose Trust, the holder of the Management Shares (which carry the voting rights of the Fund), is the principal shareholder of, and acquired the Management Shares from Messrs. Lay, Sanders and Adatepe on January 6, 2003. The Directors were initially selected by Messrs. Lay, Sanders and Adatepe when they were the owners of the Management Shares and, accordingly, may have an incentive to take actions which benefit the Investment Adviser. The independent trustee of the Purpose Trust is required to act in certain matters relating to the voting of the Management Shares in accordance with directions from the Enforcer pursuant to the Trust Agreement. The Enforcer of the Trust is Winston Lowe, Esq. of the law firm of Buchanan Ingersoll, which represents the Investment Adviser and its affiliates on various legal matters.

The Directors, the Investment Adviser and the Administrator may from time to time act as directors, trading advisors or administrators in relation to or otherwise be involved with other companies established by parties other than the Fund which have similar objectives. In such event should a conflict of interest arise, the Directors will endeavor to ensure that it is resolved fairly.

#### RISK FACTORS

There is high risk associated with an investment in the Fund and an investment in the Fund should only be made after consultation with independent qualified sources of investment and tax advice.

the possibility exists that the Fund would bear the burden of an increased share of the Master Fund's expenses. ~~Moreover, investors with larger investments than others may outvote the smaller investors to their detriment. (See "SPECIAL INFORMATION ON THE MASTER FUND/FEEDER FUND INVESTMENT STRUCTURE.")~~

*Counterparty Risk.* The Fund is subject to the risk of the failure or default of any counterparty to the Fund's transactions. If there is a failure or default by the counterparty to such a transaction, the Fund will have contractual remedies pursuant to the agreements related to the transaction. The Fund seeks to minimize the Fund's counterparty risk through the selection of financial institutions and types of transactions employed. However, the Fund's currency hedging transactions and other operational mechanisms designed to match the Fund's maturity requirements to cash flow may involve counterparty and other risk elements that may create unforeseen exposures.

*Nature of Certain Investments.* There is no limitation on the size or operating experience of the companies in which the Fund may invest, provided that such securities have a Standard & Poor's rating of B or better. Some small companies in which the Fund may invest may lack management depth or the ability to generate internally or obtain externally the funds necessary for growth. Companies with new products or services could sustain significant losses if projected markets do not materialize. Further, such companies may have, or may develop, only a regional market for products or services and may be adversely affected by purely local events. Such companies may be small factors in their industries and may face intense competition from larger companies and entail a greater risk than investment in larger companies.

*Risks of Special Techniques Used by the Investment Adviser.* The Fund may invest using special investment techniques that may subject the Fund's investments to certain risks. Certain, but not all, of these techniques and the risks that they entail are summarized below. The Fund, in any event, is not designed to correlate to the broad bond market, and should not be viewed as a substitute for conventional fixed income investments.

*Investments in Fixed-Income Securities Generally.* The prices of the Fund's fixed-income securities respond to economic developments, particularly interest rate changes, as well as to perceptions about the creditworthiness of individual issuers, including governments. Generally, the Fund's fixed-income securities will decrease in value if interest rates rise and vice versa, and the volatility of lower-rated securities is even greater than that of higher-rated securities. Also, longer-term securities are generally more volatile, so the average maturity or duration of these securities affects risk.

Although the Fund's U.S. government securities are considered to be among the safest investments, they are not guaranteed against price movements due to changing interest rates. Obligations issued by some U.S. government agencies are backed by the U.S. Treasury, while others are backed solely by the ability of the agency to borrow from the U.S. Treasury or by the agency's own resources.

The Fund is also subject to the risk that its investment approach, which focuses on a broad range of fixed income instruments, may perform differently than other funds which target specific segments of the fixed-income market or invest in other asset classes.

*Risks of Leverage.* Borrowing money to purchase securities may provide the Investment Adviser with the opportunity for greater capital appreciation and to extend or shorten the average duration of the Fund's portfolio but, at the same time, will increase the Fund's exposure to

capital risk and higher current expenses. The use of leverage also increases the volatility of the Fund's portfolio by magnifying both increases and declines in the value of the Fund's assets.

Up to 150% of the Fund's assets, at the time of investment, may be leveraged (*i.e.*, the combined value of borrowings and short positions). If the Fund's assets decline in value or there are significant redemptions from the Fund, the Fund may be required to post additional collateral with the lender or liquidate assets to pay off its borrowings. Moreover, if the assets under management are not sufficient to pay the principal of and interest on the debt when due, the Fund could sustain a total loss of its investment.

Investments in Mortgage-Backed Securities. Mortgages underlying mortgage-backed securities may be paid off early, particularly in periods when interest rates are low, which makes it difficult to determine the actual maturity of such securities and therefore to calculate how they will respond to changes in interest rates. The Fund may have to reinvest prepaid amounts of lower interest rates. The risk of prepayment is an additional risk of mortgage-backed securities.

Short Selling. The Fund may sell securities of an issuer short. If the price of the issuer's securities declines, the Investment Adviser may then cover the short position with securities purchased in the market. The profit realized on a short sale will be the difference between the price received in the sale and the cost of the securities purchased to cover the sale.

The possible losses from selling short a security differ from losses that could be incurred from a cash investment in the security; the former may be unlimited, whereas the latter can only equal the total amount of the cash investment. Short selling activities are also subject to restrictions imposed by the various national and regional securities exchanges, which restrictions could limit the investment activities of the Investment Adviser.

Risks of Options Trading. In seeking to enhance performance or hedge assets, the Investment Adviser may purchase and sell call and put options on both securities and securities indexes. A securities index measures the movement of a certain group of securities by assigning relative values to the securities included in the index.

Both the purchasing and the selling of call and put options contain risks. Although an option buyer's risk is limited to the amount of the purchase price of the option, an investment in an option may be subject to greater fluctuation than an investment in the underlying securities. In theory, the exposure to loss is potentially unlimited in the case of an uncovered call writer (*i.e.*, a call writer who does not have and maintain during the term of the call an equivalent long position in the stock or other security underlying the call), but in practice the loss is limited by the term of existence of the call. The risk for a writer of an uncovered put option (*i.e.*, a put option written by a writer that does not have and maintain an offsetting short position in the underlying stock or other security) is that the price of the underlying security may fall below the exercise price.

The effectiveness of purchasing or selling securities index options as a hedging technique will depend upon the extent to which price movements in assets that are hedged correlate with price movements of the index selected. Because the value of an index option depends upon movement in the level of the index rather than the price of a particular security, whether a gain or loss will be realized from the purchase or writing of options on an index depends upon movements in the level of prices in the securities market generally, rather than movements in the price of a particular security. Successful use of options on indexes will depend upon the ability of the Investment Adviser to predict correctly movements in the direction of the

market generally. This ability requires skills and techniques different from those used in predicting changes in the price of individual securities.

Risks of Futures Trading. Upon licensing of the Investment Adviser by the CFTC as a CPO and satisfaction of certain other conditions, the Fund may acquire commodities futures contracts and options on futures contracts.

Futures contracts and options thereon are highly volatile. Price movements of financial and interest rate futures and options thereon are influenced by a wide variety of factors, including, among other things, government, trade, fiscal, monetary and exchange programs and policies, national and international political and economic events and changes in interest rates.

When futures contracts are traded on United States exchanges, both buyer and seller are required to post margins with the broker handling their trades as security for the performance of their purchase and sale undertakings and to offset losses in their trades due to daily fluctuations in the markets. The low margin deposits typically required in futures trading (typically between 2% and 15% of the value of the futures contracts) permit an extremely high degree of leverage. Accordingly, a relatively small change in interest rates or the price of a commodity can produce a disproportionately large profit or loss, which can exceed substantially more than the initial margin on a trade. The Investment Adviser intends to limit the Fund's initial margin and option deposits in connection with such futures contracts to not more than 10% of the Fund's assets.

Successful use of futures by the Investment Adviser is also subject to the Investment Adviser's ability to predict correctly movements in the direction of interest rates and other relevant financial markets, and to the extent a transaction is entered into for hedging purposes, to ascertain the appropriate correlation between the transaction being hedged and the price movements of the futures contract.

Swap Agreements. The Fund may enter into interest rate, index or currency rate swap agreements in an attempt to hedge against changes in interest or currency rates or index values exceeding minimum or maximum values. Most swap agreements entered into by the Fund would calculate the obligation of the parties on a "net" basis. Consequently, the Fund's obligations or rights on a swap agreement, and the risk of loss, would be limited only to the net amount to be paid or received based on the relative values of the positions held by each party.

Portfolio Turnover. Because the Investment Adviser will make changes whenever necessary, in its opinion, to take advantage of anticipated movements in the U.S. Treasury yield curve and/or inter-sector spread relationships, it is anticipated that the Fund's portfolio will have a high turnover rate. Turnover of the Fund's portfolio may involve the payment by the Fund of dealer spreads or underwriting commissions, and other transaction costs, on the sale of securities, as well as on the reinvestment of the proceeds in other securities. The greater the portfolio turnover, the greater the transaction costs to the Fund which will reduce the Fund's total return.

Lack of Diversification. The Fund's portfolio may not be diversified among sectors, industries, geographic areas, duration or types of securities. In addition, the Fund's portfolio may not be diversified among a wide range of issuers. Accordingly, the Fund's portfolio may be subject to a more rapid change in value than would otherwise be the case if the Fund were required to maintain a wide diversification of its investments.

Acquisition of Illiquid Securities. Fund investments may include significant amounts of debt securities and other financial instruments for which no market or only a limited market

exists (and which may even be restricted as to transferability under federal or state securities laws), and the disposition of such investments in the event of an unsuccessful outcome may be possible only at substantial discounts from their purchase price or intrinsic business value. The Fund's holding of illiquid securities may adversely affect the ability of Shareholders to receive redemption proceeds.

*Incentive Fee Arrangements.* The Investment Adviser could receive substantial compensation if it generates increases in Net Asset Value above the Hurdle for the Shareholders. Such compensation may provide an incentive for the Investment Adviser to effect larger and more risky transactions than would be the case in the absence of such arrangements. The Investment Adviser does not expect to modify or adjust its investment methodology in any way as a result of such incentive. The Investment Adviser may receive compensation with respect to unrealized appreciation of Fund assets as well as with respect to realized gains.

*Advisers Act Prohibition.* Section 205(a)(1) of the Advisers Act prohibits investment advisers, unless exempted from registering as an investment adviser under the Advisers Act, from providing investment advice for compensation "on the basis of a share of capital gains upon or capital appreciation of the funds or any portion of the funds of [a] client." The Investment Adviser will provide investment advice to the Fund and will be compensated, in part, upon a share of the capital gains of the Fund.

In order to prevent a possible violation of Section 205(a)(1) of the Advisers Act, the Fund will seek to comply with Rule 205-3 (the "Rule") under the Advisers Act, which permits an investment adviser to collect fees on a capital gains basis if such advice is provided solely to "qualified clients" as defined under the Rule. Since all Investors must be "Qualified Purchasers" in order to invest in the Fund and a Qualified Purchaser also satisfies the criteria for a Qualified Client, the Fund will be in compliance with the Rule.

The intended purpose behind the Advisers Act prohibition of such fee arrangements with clients (unless the client is a "qualified client") is the belief that this type of performance fee arrangement may create an incentive for the Investment Adviser to make investments that are riskier or more speculative than would be the case in the absence of a performance fee.

*Non-Public Information.* From time to time, the Investment Adviser may come into possession of material non-public information regarding a potential investment that limits the Investment Adviser's flexibility in buying and selling Fund investments. The Fund's investment flexibility may be constrained as a consequence of the Investment Adviser's inability to use such information for investment purposes.

*Broker-Dealers.* All orders for the purchase or sale of Fund investments will be placed on behalf of the Fund by the Investment Adviser. The Investment Adviser may negotiate the purchase of investments directly with the sellers or may utilize broker-dealers to execute transactions. In selecting broker-dealers, subject to applicable limitations of the federal securities laws, the Investment Adviser will consider such factors as size and type of the transaction, the nature and character of the markets for the security, the quality of the execution and settlement services, the financial condition of the broker-dealer firm and the reasonableness of any commissions.

The Fund may execute portfolio transactions with broker-dealers who provide research and/or execution services to the Fund and/or other accounts over which the Investment Adviser or its affiliates exercise investment discretion. The selection of such broker-dealers generally is made by the Investment Adviser based upon the quality of such research and/or execution services. In any case where the Fund is to pay higher commissions in recognition of such research and/or execution services, the Investment Adviser must determine in good faith that such commissions are reasonable in relation to the value of the

brokerage and/or research service viewed in terms of a particular transaction for the Investment Adviser's overall responsibilities to the Fund or its other clients.

*Custodial Risks of Broker/Dealers.* Various broker/dealers will trade with the relevant exchange as a principal on behalf of the Fund, in a "debtor-creditor" relationship, unlike other clearing broker relationships where the broker is merely a facilitator of the transaction. Such broker could, therefore, have title to certain assets of the Fund (for example, the transactions which the broker has entered into on behalf of the Fund as principal as well as the margin payments which the Fund provides). In the event of such broker's insolvency, the transactions which the broker has entered into as principal could therefore default and such assets of the Fund could become part of the insolvent broker's estate, to the detriment of the Fund.

*Early Termination.* In the event of the early termination of the Fund, the Fund would have to distribute to the Shareholders their pro rata interest in the assets of the Fund. Such an early termination would have the effect of accelerating the unamortized portion of any organizational fees, thereby decreasing amounts otherwise available for distribution. Certain assets held by the Fund may be illiquid and might have little or no marketable value. It is possible that at the time of such sale or distribution, certain securities held by the Fund would be worth less than the initial cost of such securities, resulting in a loss to Shareholders.

*Effect of Substantial Withdrawals.* Substantial withdrawals by Shareholders within a short period of time could require the Investment Adviser to liquidate positions more rapidly than would otherwise be desirable, which could adversely affect the value of the Fund's assets. The resulting reduction in the Fund's assets could make it more difficult to generate a positive rate of return or to recoup losses due to a reduced equity base.

*Regulation.* The Fund is not registered as an investment company under the Investment Company Act (or any similar state laws). Registered investment companies are subject to extensive regulation. Investors, therefore, will not be accorded the protective measures provided by such legislation. The Fund is governed by Bermuda law. Under Bermuda law, the Directors' principal duty is to act in the best interests of the Company. Shareholders may therefore not have the same statutory protection or remedies available under the laws of other jurisdictions.

*Changes in Regulatory Requirements.* The Fund's investments will be subject to various Federal, state and local regulatory requirements. Failure to comply with these requirements could result in the imposition of fines by governmental authorities or awards of damages to private litigants. Further, the Securities and Exchange Commission ("SEC") recently announced that it has commenced a review of "hedge funds" (i.e., unregistered and unregulated investment entities like the Fund) to determine if it is necessary to enhance regulation of such entities for investor protection purposes. In the event that new regulations are adopted that require registration and/or impose other regulatory requirements under the securities laws for hedge funds, there can be no assurance that the Fund's operations would not be materially affected, in the form of increased costs and other regulatory requirements that could affect the potential return to investors in the Fund. There can be no assurance that these requirements will not require significant unanticipated expenditures by the Fund.

*Conflicts of Interest.* The Fund is subject to conflicts of interest. See "Conflicts of Interest."

*Reserve for Contingent Liabilities* Under certain circumstances, the Board of Directors may find it necessary to establish a reserve for contingent liabilities or withhold a portion of the Shareholder's settlement proceeds at the time of redemption, in which case, the reserved portion would remain at the risk of the Fund's activities.

*Risk of Litigation.* The Fund may accumulate substantial positions in the securities of a specific company. Sometimes the Investment Adviser may engage in a proxy fight, become involved in litigation or attempt to gain control of a company. Under such circumstances, the Fund may be named as a defendant in a lawsuit or regulatory action and be subject to the costs involved.

*Lack of Independent Experts Representing Investors.* The Fund and the Investment Adviser have each consulted with counsel, accountants and other experts regarding the formation and terms of the Fund and the Advisory Agreement. The investors, however, have not been represented by such independent experts. Each prospective investor should consult his own legal, tax and financial advisers regarding the desirability of purchasing Shares and the suitability of an investment in the Fund. Foley & Lardner and Appleby, Spurling & Kempe are U.S. and Bermuda counsel to the Fund, respectively, and do not represent the prospective investors or Shareholders of the Fund.

*Lack of Voting Rights.* The Shares being offered participate in the profits and losses of the Fund but do not carry voting rights except under very limited circumstances. See "Statutory and General Information."

*Limited Ability to Liquidate Investment in Shares.* There is no public market for the transfer of Shares. A Shareholder may require the Fund to redeem all or any whole number of its Shares as of the close of business on any Valuation Date at their Net Asset Value. However, the right to obtain payment on redemption is contingent upon the receipt by the Fund of 15 Business Days' written notice, and the Redemption Price may differ significantly from the value of such Shares when redemption was requested. Requests for redemptions may not be withdrawn. The Fund may suspend any or all of the calculation of Net Asset Value, the calculation of Net Asset Value per Share and redemptions in the circumstances set out under "Redemptions and Transfers - Temporary Suspensions." The Fund may also temporarily suspend redemptions in order to effect an orderly liquidation of the Fund's assets necessary to effect redemptions.

The foregoing list of risk factors does not purport to be a complete explanation of the risks involved in an investment in the Fund. Potential investors should read this entire Memorandum before determining whether to invest in the Fund and consult with their own financial and tax advisers. Potential investors should also be aware that, if they decide to purchase Shares, they will have no role in the management of the Fund, will not have any voting rights (except under very limited circumstances), and will be required to rely on the expertise of the Fund's Directors and the Investment Adviser in dealing with the foregoing (and other) risks on a day-to-day basis.

THE SHARES ARE SPECULATIVE AND INVOLVE A HIGH DEGREE OF RISK. THEY ARE SUITABLE ONLY FOR PERSONS WHO CAN AFFORD TO LOSE THEIR ENTIRE INVESTMENT. SHAREHOLDERS SHOULD READ THE MEMORANDUM AND ARTICLES OF ASSOCIATION AS WELL AS THE FUND'S CONTRACTS WITH SERVICE PROVIDERS WHICH ARE REFERENCED IN "STATUTORY AND GENERAL INFORMATION."

DETERMINATION OF NET ASSET VALUE

The Net Asset Value of the Fund shall be its assets less its liabilities, determined in accordance with United States generally accepted accounting principles ("US GAAP"), except that the Fund may elect to modify the treatment of organizational costs and expenses to accommodate its practical needs,



including without limitation, by amortizing such costs and expenses over a period of up to 60 months. The Directors may, in their absolute discretion and where considered to be in the best interests of the Fund, decide not to follow US GAAP. The Net Asset Value is calculated by the Administrator, on a quarterly basis, subject to the overall supervision of the Directors acting in good faith. The Net Asset Value of the Fund shall be the value of its gross assets less its gross liabilities (excluding accrued Incentive Fees) on any Valuation Date. The Net Asset Value Per Share as of any Valuation Day shall be the net asset value of those assets and liabilities of the Fund which are properly attributable to the Series of Shares of which that Share forms a part, divided by the number of Shares of the Series outstanding on that day.



- (i) Securities (other than options), listed or admitted to trading on a national securities exchange shall be valued at the last closing price on the Valuation Date or the mean between the bid and ask prices on the principal securities market on which such a security is traded on the nearest date preceding the Valuation Date on which a sale occurred if no such sale occurred on the date of determination. In the case of securities traded on more than one national securities exchange, such price shall be as reported on the exchange where such securities are listed or traded, as the Administrator may determine.
- (ii) Securities (other than options), traded in the over-the-counter market shall be valued at the "closing price" as reported by the quotation system of such market as of the Valuation Date or, if no such "closing price" is reported for the date of determination, at the mean between the current "bid" and "asked" prices at the close of business on the Valuation Date as reported by such quotation system or, if neither such "closing price" nor such "bid" and "asked" prices are reported by such quotation system for the Valuation Date, subject to the Bye-laws, at such price as an independent valuation service to be engaged by the Directors (the "Valuation Service") determines to be the fair market value.
- (iii) The fair market value of securities held short by the Fund shall be calculated in the manner provided in paragraph (i) for securities listed or admitted to trading on a national securities exchange and in the manner provided in paragraph (ii) for securities traded in the over-the-counter market. The fair market value of securities held short by the Fund shall be treated as a liability of the Fund.
- (iv) Options listed on a national securities exchange shall be valued at the mean between the current "bid" and "asked" prices at the close of business on the Subscription Date as reported on the exchange where such options are principally traded, or, if not available, as reported on any other exchange on which such options are listed, as selected by the Valuation Service.
- (v) Short term debt securities with remaining maturities of 60 days or less at the time of purchase are valued at amortized cost; other short-term securities are valued on a mark-to-market basis until such time as they reach a remaining maturity of 60 days, whereupon they are valued using the amortized cost method, taking as cost their market value on the 61st day.
- (vi) Futures contracts or options traded on a United States exchange shall be based upon the settlement price on the exchange on which the particular futures contract or

201810/54 15

-25-

CONFIDENTIAL TREATMENT

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option is customarily traded by the Fund. If a futures contract or option cannot be liquidated on a Valuation Date, such futures contract or option shall be assigned a value by the Valuation Service as it shall deem to represent fair value. Generally, daily price limits or the operation of other rules of the futures exchange on which the contract is normally traded, shall be the settlement price on the first subsequent day on which the contract can be liquidated. The liquidating value of a futures, spot, forward or option contract not traded on a United States futures exchange shall be determined by reference to policies established by the Fund's Directors from time to time.

- (vii) The value or amount of any other assets or liabilities of the Fund shall be as determined by the Valuation Service.

Notwithstanding the foregoing, if the Administrator should determine, after consulting with the Investment Adviser, that special circumstances exist whereby the value of any asset or liability of the Fund should be determined in a manner other than as set forth above, the value of such asset or liability shall be determined by the Valuation Service. In all events, the value of such asset or liability determined by the Valuation Service shall be conclusive and binding on all of the Shareholders and all parties claiming through or under them.

In no event and under no circumstances shall the Administrator, the directors or officers of the Fund, the Investment Adviser, the Valuation Service or their respective agents and employees, incur any individual liability or responsibility for any determination made or other action taken or omitted to be taken by them so long as they act in good faith or as otherwise required by applicable law.

Prospective investors should be aware that situations involving uncertainties as to the valuation of portfolio positions could have an adverse effect on the Net Asset Value if judgments regarding appropriate valuations should prove incorrect. Absent bad faith or manifest error, Net Asset Value determinations are conclusive and binding on all Shareholders.

All accrued debts and liabilities will be deducted from the value of the Fund's assets in determining the Fund's Net Asset Value. These debts and liabilities include (a) fees of the Investment Adviser that are earned but not yet paid, (b) monthly amortization of organization costs, if any, (c) any allowance for the Fund's estimated annual audit and legal fees and (d) any contingencies for which reserves are determined to be required. Net Asset Valuations are expressed in U.S. Dollars and any items denominated in other currencies are translated at prevailing exchange rates as determined by the Administrator in its sole discretion, with consideration to any premium or discount it considers relevant and to costs of exchange.

#### CHARGES TO THE FUND

The charges to the Fund are set forth below. In addition, any extraordinary expense incurred by the Fund will be paid by the Fund. The Fund, through its portfolio investments and any investment in the Master Fund, will earn interest on substantially all of its assets, most of which will be in the form of fixed income securities. Such interest income will offset some or all of the Fund's expenses.

<u>Entity</u>	<u>Form of Compensation</u>	<u>Amount of Compensation</u>
Investment Adviser	Advisory fee.	See "Calculation of Investment Adviser Compensation" below.
Investment Adviser	Incentive fee.	See "Calculation of Investment Adviser Compensation" below.
Custodian and Prime Broker	Brokerage and clearance fees and margin interest	Portfolio fees per transaction based upon type of transaction. Minimum fee of \$5,000 per month. Margin financing rates based on 55 basis points over federal fund rates for U.S. Dollar balances.
Administrator	Administrative fees.	A percentage of month-end Net Asset Value at an annual rate as follows (U.S. \$3,000 per month minimum):  NAV < \$75 million     .20% NAV > \$75 million     .175% NAV > \$150 million   .15%
Registrar and Transfer Agent	Fees.	\$2,500 per annum.
Directors	Director fees to Directors not affiliated with the Investment Adviser.	\$2,000 per Director per annum.
Trustee of Purpose Trust	Trustee fees.	\$1,500 initial acceptance fee. \$1,500 annual fee.
Others	Legal, audit, organization and offering expenses and stock exchange listing expenses.	As incurred, provided organization and offering expenses may be amortized by the Fund.

#### Calculation of Investment Adviser Compensation

The Fund will pay a management fee to the Investment Adviser equal to 1% per annum of the Fund's Net Asset Value at the end of each calendar quarter. The management fee is accrued monthly in arrears and paid as of the end of each calendar quarter.

The Fund also will pay a quarterly Incentive Fee to the Investment Adviser equal to 20% of "Net Profit" with respect to each series of Shares. See "SERIES OF SHARES" below. "Net Profit" is defined as the excess of the Net Asset Value of a Series as of the end of the quarter (after deduction of the Management Fee accrued for the quarter but excluding any deduction for Incentive Fees accrued on each Series) less the sum of (i) the Net Asset Value of the Series as of the first day of the quarter plus (ii) the amount of interest which would have been earned during the quarter if the Fund's net assets had been

invested at a rate equal to the yield on the Lehman Government Credit Index for the quarter (the "Hurdle"), adjusted to reflect subscriptions and redemptions with respect to such period.

Incentive Fees are based only on the portion of the appreciation in the Net Asset Value of a Series of Shares during a quarter that constitutes an increase in its Net Asset Value in excess of the sum of the cumulative Hurdle and its highest Net Asset Value as of the end of any prior quarter or, for the quarter the Series was issued, as of its issue date, net of any Incentive Fee calculated and payable at such time. If Shares are redeemed at any time other than the end of a quarter, the date of redemption will be treated as the end of a quarter for the purposes of determining the amount of Incentive Fee payable with respect to such Shares. The amount of any Incentive Fee accrued with respect to the redeemed Shares will be payable to the Investment Adviser, notwithstanding that following the redemption, the Net Asset Value of the relevant Series of Shares decreases.

The Investment Adviser may, in its sole discretion, waive all or part of its Incentive Fee otherwise due with respect to any Shareholder's investment by rebate of the waived fees to such Shareholder. The Investment Adviser may also, in its sole discretion, elect prior to the commencement of the Fund's trading activities and prior to the commencement of each calendar year thereafter, to defer for a period of up to ten years all or any portion of the Management Fee or Incentive Fee to be earned with respect to such period. In the event of such deferral, the deferred amount will appreciate or depreciate, at the election of the Investment Adviser, based on either (1) the Fund's performance (before Management or Incentive Fees) or (2) the performance of any other investment chosen by the Investment Adviser prior to the commencement of the deferral period. The deferred fees will be reflected on the books of the Company as a liability and will reduce the Fund's Net Asset Value.

**SHARES OF SHARES**

In order to ensure a more equitable allocation of Incentive Fees among investors investing in the Fund at different times during the calendar year, Shares issued as of separate Subscription Dates will be designated as Shares of separate series (each with its own Net Asset Value per Share) as follows: Shares issued on the first Subscription Date of a calendar year will be designated as Series 1 Shares. Shares issued on Subscription Dates that do not fall on the first Subscription Date of a calendar year will be designated as Shares of a consecutive series of Shares. These additional series of Shares will generally be converted into Series 1 Shares at the beginning of each calendar year.

At the beginning of each calendar year, each series of Shares, other than any series of Shares the Net Asset Value of which has not, for the last quarter of such year, exceeded the sum of the Hurdle and the previous highest quarter end Net Asset Value of that Series in relation to which an Incentive Fee was payable (and which therefore has a loss carryforward for the next quarter), will be converted into Series 1 Shares at the current Net Asset Value per Share of Series 1 Shares (unless Series 1 Shares are subject to a similar loss carryforward, in which case these conversions will be suspended until Series 1 Shares have recouped that loss). There will be no change in the aggregate net asset value of a Shareholder's investments due to the conversion of any series of Shares held by it into Series 1 Shares, although a different number of Shares may be held by it after the conversion. If a series of Shares has a net loss allocable to it at the end of any quarter and at the end of a subsequent quarter there is Net Profit allocable to that series of Shares, there will be no Incentive Fee payable with respect to those Shares until the amount of the net loss previously allocated to those Shares has been fully recouped (excluding the Incentive Fee from the calculation of net loss). This ensures that the Investment Adviser will receive an Incentive Fee only when the net asset value of a series of Shares increases above the "high water mark" net asset value for that series of Shares.

*High Water Mark.* The Incentive Fee with respect to a Series of Shares is calculated on a cumulative basis and is payable only where the Net Asset Value per Share of that Series has risen above (i) the higher of the sum of the cumulative Hurdle amount and issue price of the Shares in the relevant Series or, thereafter, (ii) the sum of the Hurdle and the Net Asset Value per Share of the relevant Series immediately following the last calculation of an Incentive Fee with respect to such Series, net of the Incentive Fees calculated and payable at such time. In effect, the Incentive Fee payable with respect to a Series is not payable until all prior net losses with respect to such Series (including the cumulative Hurdle amount and excluding the Incentive Fee from the calculation of net losses) are recouped. Appropriate adjustments may be made to account for subscriptions and redemptions.

*Hurdle.* The Hurdle with respect to a Series for a calendar quarter means an amount equal to the opening Net Asset Value of the relevant Series multiplied by a percentage based on the yield of the Lehman Government Credit Index for the calendar quarter. The Hurdle will be prorated from any calculation period of less than a calendar quarter. The Hurdle is cumulative with respect to each Series.

## REDEMPTIONS AND DIVIDENDS

### Redemption of Shares

Shares may be redeemed at a Shareholder's option at the Net Asset Value per Share as of any Valuation Date, upon at least 15 Business Days prior written notice to the Administrator, subject to such longer or shorter notice period as the Directors may determine from time to time. In the discretion of the Directors, the Fund may, for any reason or no reason or where, in the absolute discretion of the Directors, the holding of such Shares may result in regulatory, pecuniary, legal, taxation or material administrative disadvantage to the Fund or its Shareholders, compulsorily redeem the Shares of any Shareholder at the applicable Net Asset Value per Share on at least ten days' prior written notice to such Shareholder. There is no redemption charge or penalty.

An amount equal to 95% of the net redemption proceeds normally will be settled within 30 business days of the effective date of the redemption, without interest. The balance of the net redemption proceeds will be paid promptly at such time as the Fund shall determine that the retention of the remaining redemption proceeds is unnecessary, with interest thereon. Reasonable reserves may also be imposed depending upon the particular circumstances. Notwithstanding any contrary restriction expressed herein, the Fund may leverage its assets to fund redemptions.

The Fund reserves the right to decrease, limit, delay or deny any redemption request, or any payment on a redemption request, if reasonably necessary in order to comply with the Fund's credit and other agreements, as well as for other reasons.

Redemptions of Shares generally will be made in U.S. Dollars. Cash settlements will be remitted by wire transfer to an account designated by the Shareholder at the Shareholder's bank as specified by the Shareholder in its written redemption notice. The cost of remitting the redemption proceeds will be charged to the account of the Shareholder.

The Directors may in their sole discretion waive all or any of the restrictions or provisions relating to the redemption of Shares set forth in the Bye-Laws either generally or in any particular case and on such conditions as they may determine in their sole discretion.

### Temporary Suspensions

The Directors may temporarily suspend any or all of the determination of the Net Asset Value of the Fund, the determination of Net Asset Value per Share, and/or the issue and the redemption of Shares for the whole or part of any period:

- (i) during which, in the opinion of the Directors, disposal by the Fund of its direct or indirect securities which constitute a substantial portion of the assets of the Fund is not practically feasible or as a result of which any such disposal would be materially prejudicial to Shareholders;
- (ii) when, in the opinion of the Directors, for any reason it is not possible to transfer monies involved in the acquisition or disposition or realization of securities which constitute a substantial portion of the assets of the Fund at normal rates of exchange;
- (iii) (other than customary holiday or weekend closings) when any recognized exchange or market on which the Fund's direct or indirect securities are normally dealt in or traded is closed, or during which trading thereon is restricted or suspended; or
- (iv) when proceeds of any sale or redemption of the Shares cannot be transmitted to or from the Fund's account or transmissions cannot be effected at normal rates of exchange;
- (v) when, as a result of political, economic, military or monetary events or any other circumstances outside the control, responsibility and power of the Directors, any disposal or valuation of investments of the Fund is not, in the opinion of the Directors, reasonably practicable without this being seriously detrimental to the interests of owners of Shares or if, in the opinion of the Directors, the Net Asset Value of the Fund or the Net Asset Value per Share cannot fairly be calculated or such disposal would be materially prejudicial to the owners of Shares;
- (vi) when, in the opinion of the Directors, any breakdown occurs in the means of communication normally employed in determining the value of any of the investments of the Fund or when for any other reason the value of any securities which constitute a substantial portion of the assets of the Fund cannot reasonably or fairly be ascertained; or
- (vii) when, in the judgment of the Directors upon advice of the Investment Adviser, the suspension is necessary or advisable in order to allow for the disposition of Fund or Master Fund investments in a manner which is in the best interest of the Fund, in light of market conditions at the time.

In the event of any suspension as set out above, the Directors will, where possible, take all reasonable steps to bring any period of suspension to an end as soon as possible. With respect to any redemption request which is impacted by a suspension of redemption of the Shares, such redemption will be effected as of the next Redemption Date following the date on which the period of suspension terminates.

### Dividends

It is not expected that the Fund will declare any regular dividends. All Fund earnings normally will be returned for re-investment (subject to the redemption privilege). The Fund reserves the right to change such policy.

## REGISTRATION AND TRANSFERS

Shares will be issued only in registered form; the Fund may not issue bearer shares under Bermuda law. The Registrar and Transfer Agent maintains a current register of the names and addresses of the Fund's Shareholders, and the Administrator's entry in the share register will be conclusive evidence of ownership of such Shares. Certificates representing Shares will not be issued.

In accordance with Bermuda law and the Bye-Laws of the Fund, Shares are only issued or registered in the names of companies, partnerships or individuals (including fiduciaries of trusts investing in the Fund). Shares purchased for those under 21 years of age must be registered in the name of a parent or guardian, but may be designated with the minor's initials for the purposes of identification. The Fund will take no cognizance of any trust applicable to the Shares so registered.

Transfers of Shares by instruments in writing in the usual common form are permitted only with the prior consent of the Directors, which consent may be withheld in the absolute discretion of the Directors.

The Shares may not be sold, transferred or otherwise disposed of by a Shareholder in the United States or to any person, corporation or entity which is not a "Qualified Holder" without prior written consent of the Directors and compliance with all applicable laws. Transfers of Shares are restricted where the holding of such Shares may result in regulatory, pecuniary, legal, taxation or material administrative disadvantage for the Fund or its Shareholders as a whole or to maintain a minimum holding per Shareholder, should the Fund be subject to such a minimum. Transfers of Shares are permitted only with the prior consent of the Fund, which may be withheld for any reason in the sole discretion of the Directors. Any transferee is required to furnish the same information, including as necessary or required, verification of identity and source of funds in connection with anti-money laundering regulations, which would be required in connection with a direct subscription in order for a transfer application to be considered by the Directors.

## TAX CONSIDERATIONS

### General

The Bermuda tax consequences to the Fund, which are described below, are derived from existing legislation in Bermuda. The United States income tax consequences applicable to the Fund and the Shareholders, also described below, are based upon factual representations made by the Fund and the Investment Adviser concerning the proposed conduct of the activities to be carried out by the Fund and the Investment Adviser and the proposed composition of the Shareholders. The Fund has not asked for, and has not received, an opinion of counsel with respect to any of the tax consequences discussed below. The conclusions summarized herein with respect to United States tax consequences could be affected adversely if any of the material factual representations on which they are based should prove to be inaccurate. Moreover, while this summary is considered to be a correct interpretation of existing laws in force on the date of this Memorandum, no assurance can be given that no changes in such tax laws will occur or that courts or fiscal authorities responsible for the administration of such tax laws will agree with the interpretations or that changes in such laws will not occur.

As a result of changing laws or practice, or unfulfilled expectations as to how the Fund or its investors will be regarded by revenue authorities in different jurisdictions for taxation purposes, taxation consequences may be otherwise than as stated below. Investors are therefore advised to consult their own professional advisors on the tax consequences of subscribing for, purchasing, holding, selling or

redeeming Shares in the Fund under the laws of their countries of citizenship, residence, ordinary residence or domicile.

#### Bermuda

Under existing legislation in Bermuda, there are no income, capital gains or withholding taxes payable by the Fund, nor are there any Bermuda estate, succession, or inheritance taxes payable by the Shareholders with respect to their Shares, other than persons ordinarily resident in Bermuda.

There is, at present, no direct taxation in Bermuda and interest, dividends and gains payable to the Fund will be received free of all Bermuda taxes. The Fund is an exempted company under Bermuda law and the Fund has made application to the Minister of Finance of Bermuda for, and expects to receive, an undertaking as to tax concessions pursuant to the Exempted Undertakings Tax Protection Act of 1966 which will provide that until March 23, 2016, no law hereafter enacted in Bermuda imposing any taxes or duty to be levied on income or capital assets, gains or appreciation will apply to any income or property of the Fund, or to the Shares or other obligations of the Fund except to the extent that any such tax or duty applies to persons ordinarily resident in Bermuda and holding Shares or other obligations of the Fund or any land in Bermuda leased to the Fund.

#### United States

The Fund will be treated as a corporation for U.S. federal income tax purposes. The Fund intends to conduct its affairs so that none of its income will be effectively connected with the conduct of a U.S. trade or business or otherwise subject to regular U.S. federal income taxation on a net basis. Under current U.S. federal income tax law and regulations, payment of principal and interest (including original issue discount) on debt obligations issued by a U.S. person or the U.S. Government after July 18, 1984 are not subject to U.S. federal withholding tax, provided that, with respect to interest (including original issue discount), certain certification and other requirements are met. Payments of principal, premiums and interest on debt obligations issued by a non-U.S. issuer generally will not be subject to U.S. withholding tax.

As indicated above, the Fund does not expect to conduct a trade or business in the U.S. or invest in securities the income of which is treated for U.S. tax purposes as arising from a U.S. trade or business. Thus, none of the income of the Fund (other than income subject to U.S. federal withholding tax, as described above) is expected to be subject to U.S. federal income taxation. If, contrary to its intended method of operation, the Fund is considered to be engaged in a U.S. trade or business, any income that is effectively connected with such U.S. trade or business will be subject to regular U.S. federal income taxation, plus a 30% U.S. "branch profits" tax.

Payments of dividends to the Fund on stock of a U.S. corporation generally will be subject to a 30% U.S. withholding tax. Gains (other than original issue discount) realized upon the sale, exchange or redemption of debt obligations will, in general, not be subject to U.S. federal withholding taxes (including "back-up" withholding taxes), provided that, in the case of securities held by a custodian or nominee in the United States, the Fund certifies to its non-U.S. status or otherwise establishes an exemption from "back-up" withholding.

In general, the Fund believes that a non-U.S. person (foreign trust, non-resident alien individual, foreign partnership or foreign corporation) will not be subject to U.S. income taxes on the interest income or capital gain of the Fund.

Capital gain realized by a non-U.S. person upon the sale or exchange or redemption of Shares held as a capital asset generally should not be subject to the U.S. federal income tax, provided that the gain is not effectively connected with the conduct by such non-U.S. person of a trade or business in the United States. However, in the case of a non-resident alien individual, such gain will be subject to a U.S. income tax rate of 30% (or a lower tax treaty rate) if such individual is present in the U.S. for 183 days or more during the taxable year.

Generally, the source of any capital gain upon the sale, exchange or redemption of Shares is determined by the place of residence of the Shareholder. For purposes of determining the source of any capital gain, residency is defined in a manner that may result in an individual who otherwise is a non-resident alien individual of the U.S. being treated as a U.S. resident only for purposes of determining the source of income. Each prospective individual Shareholder who anticipates being present in the United States for 183 days or more (in any taxable year) or otherwise has a substantial connection to the United States should consult his or her tax adviser with respect to the possible imposition of U.S. federal income taxes on the sale, exchange or redemption of Shares and to the possible impact of such presence on such individual's status in general as a nonresident for U.S. income tax purposes.

Capital gains realized by a Shareholder engaged in the conduct of a U.S. trade or business will be subject to U.S. federal income tax upon the sale, exchange or redemption of Shares if such gain is effectively connected with its U.S. trade or business.

Any U.S. Person transferring cash or other property to a foreign corporation such as the Fund or owning 10% or more of the value or voting power of the shares of a foreign corporation such as the Fund will, with certain limited exceptions, likely be required to file an information return with the U.S. Internal Revenue Service containing certain disclosure concerning the filing shareholder, other shareholders and the corporation. The Fund has not committed itself to provide the information about the Fund or its Shareholders needed to complete the return.

The Fund has been classified as non-resident of Bermuda for exchange control purposes by the Bermuda Monetary Authority, whose permission for the issue of Shares has been obtained. The issue, redemption and transfer of Shares to, by and between persons regarding as non-resident in Bermuda for exchange control purposes may be effected without specific consent under the Exchange Control Act 1972 of Bermuda and regulations thereunder. Issues and transfers involving any person regarded as resident in Bermuda for exchange control purposes require specific prior authorization under that Act. The Fund is thus permitted by Bermuda law to acquire, hold and sell any foreign currency and securities without restriction.

#### EMPLOYEE BENEFIT PLAN CONSIDERATIONS

The Fund expects to admit Shareholders that are "benefit plan investors" as defined in ERISA (the U.S. Employee Retirement Income Security Act of 1974, as amended), which are "employee benefit plans" as defined in ERISA and "plans" as defined in Section 4975 of the U.S. Internal Revenue Code (collectively, "Plans"). Plans include corporate pension and profit-sharing plans, SEP ("simplified employee pension") plans, Keogh plans for self-employed individuals, governmental plans, and IRAs (individual retirement accounts described in Code Section 408). If Plans hold 25% or more of the Shares (excluding Shares that are held other than through Plan investments by the Advisor or any affiliate thereof), the Fund's underlying assets would be "plan assets" under ERISA with respect to those investors that are Plans subject to ERISA or the Code. (The 25% level is measured each time Shares are bought or sold.)

Since it is expected that Plan investments in the Fund will exceed the 25% level, a person considering investing in the Fund on behalf of a Plan subject to ERISA or the Code should evaluate the plan asset consequences of the investment, including the risk that unintended prohibited transaction or fiduciary duty delegation consequences may arise under ERISA or the Code. The Investment Adviser qualifies as a "qualified professional asset manager" under applicable regulations under ERISA and will take all appropriate steps to ensure that the Company does not engage in any prohibited transactions under ERISA. In particular, the Investment Adviser will not make loans to the Fund or permit the Fund to retain affiliates of the Investment Adviser under circumstances that would violate ERISA. The Investment Adviser has acknowledged in the Investment Advisory Agreement that it will be a fiduciary of Plans investing in the Company for purposes of ERISA and will be subject to all of the prohibited transactions and fiduciary responsibility and liability provisions of ERISA.

Certain prospective ERISA Plan investors may currently maintain relationships with the Investment Adviser or other entities which are affiliated with the Investment Adviser (collectively the "Affiliated Entities"). Each of the Affiliated Entities may be deemed a party in interest with respect to and/or fiduciary of such plans if any of the Affiliated entities provides investment management, investment advisory or other services to them. Consequently, in the case of an ERISA Plan with respect to which an Affiliated Entity is a party in interest or disqualified person, the prohibited transaction provisions of ERISA may preclude such plan from engaging in certain transactions with the Fund, including the acquisition of Shares. In this circumstance, Benefit Plan Investors should consult with counsel to determine if participation in the Fund is a transaction which is prohibited by ERISA and/or the Code.

Trustees and other fiduciaries of Plans should also consider that their actions may be governed by the fiduciary responsibility provisions of ERISA. Generally, fiduciaries of a Plan subject to ERISA are required to discharge their duties, among other things, (i) for the exclusive purpose of providing benefits to participants and their beneficiaries, (ii) with the same standard of care that would be exercised by a prudent man acting under similar circumstances, and (iii) by diversifying the investment of the Plan, unless it is clearly prudent not to do so. In analyzing the prudence of an investment in the Fund, special attention should be given to the Department of Labor's regulations on investment duties which require, among other things, (i) a determination that each investment is reasonably designed, as part of a Plan's portfolio, to further the purposes of such Plan, (ii) an examination of risk and return factors, and (iii) consideration of the portfolio's composition with regard to diversification, the liquidity and current return on the total portfolio relative to anticipated cash flow needs of the Plan and the projected return of the total portfolio relative to the Plan's funding objectives.

The fiduciaries of each ERISA Plan, IRA or Keogh Plan investing in the Fund will be required to represent, and by making an investment in the Fund thereby will represent, that, among other matters, they have been informed of and understand the Fund's investment objectives, policies and strategies, that the decision to invest plan assets in the Fund is consistent with the provisions of ERISA and/or the Code that require diversification of plan assets and impose other fiduciary responsibilities and that in making the decision to invest they have not relied on any advice or recommendation of the Investment Adviser or any selling agent or any of their respective affiliates or employees.

Whether or not the Fund's underlying assets are plan assets under ERISA, such persons should consult with their counsel as to the ERISA or Code consequences of an investment in the Fund by a Plan.

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### Unrelated Business Taxable Income

The term "Permitted U.S. Person" means a U.S. Person that is subject to ERISA or is otherwise exempt from payment of U.S. Federal income tax. Generally, a Permitted U.S. Person is exempt from Federal income tax on certain categories of income, such as dividends, interest, capital gains and similar income realized from securities investment or trading activity. This type of income is exempt even if it is realized from securities trading activity which constitutes a trade or business. This general exemption from tax does not apply to the "unrelated business taxable income" ("UBTI") of a Permitted U.S. Person. Generally, except as noted above with respect to certain categories of exempt trading activity, UBTI includes income or gain derived from a trade or business, the conduct of which is substantially unrelated to the exercise or performance of the Permitted U.S. Person's exempt purpose or function. UBTI also includes (i) income derived by a Permitted U.S. Person from debt-financed property and (ii) gains derived by a Permitted U.S. Person from the disposition of debt-financed property.

A Permitted U.S. Person investing in a foreign corporation such as the Fund should not realize UBTI with respect to an unleveraged investment in Shares. Permitted U.S. Persons are urged to consult their own tax advisors concerning the U.S. tax consequences of an investment in the Fund.

### PLAN OF DISTRIBUTION

The Fund is authorized to issue 100 voting Management Shares, par value U.S. \$0.01 per Share ("Management Shares"), all of which are currently held by the Purpose Trust and 10,000,000 non-voting redeemable Participating Shares, par value U.S. \$0.001 per Participating Share (the "Shares"). The voting Management Shares do not participate in the Fund's profits and losses and are not redeemable. The non-voting Shares have no voting power, but are participating and redeemable. The Shares are entitled to receive, to the exclusion of the Management Shares, any dividends which may be declared by the Directors. Upon the winding up of the Fund, the assets available for distribution to Shareholders (other than an amount equal to the par value of the Management Shares, which would be distributed to the holder of the Management Shares) would be distributed among the holders of the Shares. Shares in the Fund participate ratably in the Net Asset Value of the Fund on liquidation and in other distributions, if any, based on the relative Net Asset Value of the Shares of the respective Series outstanding at the time of such liquidation or distribution.

Each Share will be issued at a price of U.S. \$1,000.00 during the Initial Offering Period, which will commence upon the filing of this Memorandum with the Bermuda Registrar of Companies on January 15, 2003 and will end on the earlier to occur of the acceptance of \$3,000,000 of subscriptions or the close of business on May 15, 2003. The Fund will commence investing promptly following its receipt and acceptance of subscriptions for at least the minimum amount of \$3,000,000. This shall be the minimum amount required to be raised from the Initial Offering in order to provide for the matters set out in Section 28 of the Bermuda Companies Act. If the Fund does not receive at least the minimum amount by the end of the Initial Offering Period (or any extension thereof), the offering of Shares in the Fund will be terminated and each subscriber's subscription payment will be refunded, along with any interest earned thereon. Following commencement of trading by the Fund, Shares of the Fund will be available for subscription as of the last day of each Fiscal Period at the Net Asset Value per Share.

The minimum initial subscription per investor is U.S. \$1,000,000. All subscriptions must be paid in U.S. Dollars to the Custodian. Subsequent subscription payments shall be made in the minimum amount of U.S. \$500,000 and shall be made to the Fund by wire transfer to the Custodian. The subscription documents provide details regarding payment procedures.

Any subscription payments shall be held for the benefit of the subscriber pending either the acceptance of the subscription and the investment in the Shares, or the refund or rejection of the subscription and return of the subscription payment. Share applications may be rejected by the Fund in whole or in part. If any application is not accepted, the subscription amount paid with the application will be returned, with interest earned on the subscription proceeds, if any. If any application is accepted only in part, the balance of the amount paid with the application will be returned.

#### ELIGIBLE SUBSCRIBERS

The Shares are offered only to Qualified Holders. Qualified Holders are "non-United States Persons" and U.S. tax-exempt investors who are "qualified eligible participants" under CFTC Regulation 4.7 and "qualified purchasers" under Section 3(c)(7) of the Investment Company Act.

For this purpose, "qualified eligible participant" means (1) a plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of \$5 million; (2) an employee benefit plan within the meaning of ERISA, provided that the investment decision is made by a plan fiduciary, as defined in Section 3(21) of ERISA, which is a bank, savings and loan association, insurance company, or registered investment adviser, or that the employee benefit plan has total assets in excess of \$5 million or, if the plan is self-directed, that investment decisions for, or the decisions as to the types of investment alternatives under, the plan are made solely by persons that are qualified eligible participants; (3) an organization described in Section 501(c)(3) of the Code which has total assets in excess of \$5 million; (4) a trust, insurance company separate account or bank collective trust which has total assets in excess of \$5 million, is not formed to invest in the Fund and whose purchase is directed by a qualified eligible participant; (5) a governmental entity (including the United States, a state or a foreign government) or political subdivision thereof, or a multinational or supranational entity or an instrumentality, agency or department of any of the foregoing; and (6) a tax-exempt entity in which all of the unit owners or participants are qualified eligible participants; provided in each of (1)-(5) above that the entity must also (i) own securities (including participations in the Fund and other pools) of issuers not affiliated with such entity and other investments (i.e., real estate held for investment purposes) with an aggregate market value of at least \$2,000,000, (ii) have on deposit with a commodity broker at least \$200,000 in exchange-specified initial margin and option premiums for commodity interest transactions, or (iii) own a portfolio comprised of a combination of (i) and (ii) (i.e., \$1,000,000 in securities and \$100,000 in margin and premiums). For this purpose, "qualified purchaser" means (i) natural persons who own at least \$5 million in investments, (ii) an entity that owns at least \$5 million in investments and the entity is owned by or for two or more related natural persons, (iii) a trust where the trustee and each person contributing assets to the trust is a qualified purchaser, (iv) any person acting on behalf of its own account or the account of another qualified purchaser that owns and invests in an aggregate basis in excess of \$25 million in investments, and (v) qualified institutional buyers, as defined in Rule 144A under the Securities Act of 1933 (except qualified institutional buyers which are dealers which own or invest less than \$25 million in investments and defined contribution plans whose participants are able to direct their plan investments, unless such participants themselves are qualified purchasers).

The following persons are excluded from being subscribers: (i) a United States Person (other than a Permitted U.S. Person); (ii) any person, corporation or entity which cannot acquire or hold the Shares without violating laws or regulations applicable to it; or (iii) a custodian, nominee, or trustee for any person, corporation or entity described in (i) or (ii) above.

## STATUTORY AND GENERAL INFORMATION

1. Bermuda Law.

The Fund is an exempted, open-ended mutual fund company incorporated with limited liability under Bermuda law.

Permission under the Exchange Control Act of 1972 of Bermuda (and the regulations thereunder) has been obtained from the Bermuda Monetary Authority (the "Authority") for the issue of the 100 Management Shares (as defined herein) and up to 10,000,000 Shares in the Fund. In addition, a copy of this Memorandum will be delivered to the Registrar of Companies (the "Registrar") in Bermuda for filing pursuant to the Companies Act 1981 of Bermuda, as amended (the "Bermuda Act"). It must be distinctly understood that in granting such permission and in accepting this Memorandum for filing, the Authority and the Registrar accept no responsibility for the financial soundness of any proposal or for the correctness of any of the statements made or opinions expressed with regard to them.

The Fund has been classified as a Bermuda Institutional Scheme under the Bermuda Monetary Authority (Collective Investment Scheme Classification) Regulations 1998 (the "Regulations"). As such, the Fund is exempted from the requirement to appoint a Bermuda custodian and may not be supervised to the same degree as other schemes which are regulated and supervised by the Authority. Therefore, the Fund should be viewed as an investment suitable only for investors who can fully evaluate and bear the risks involved. Approvals from the Bermuda Monetary Authority who do not constitute a guarantee by the Authority as to the performance of the Scheme or its creditworthiness. Furthermore, in giving such approvals the Authority shall not be liable for the performance or default of the scheme or for the corrections of any opinions or statements expressed.

## 2. Incorporation, Registered Office and Share Capital.

(a) The Fund was incorporated in Bermuda on May 20, 2002, as an exempted, open-ended mutual fund company with limited liability under the name MDL Active Duration Fund Ltd. The Directors of the Fund confirm that since the date of the Fund's incorporation, the Fund has not commenced business, no accounts have been made up and no dividends have been declared.

(b) The registered office of the Fund is presently at Williams House, 20 Reid Street, Hamilton HM 11, Bermuda.

(c) The authorized share capital of the Fund is U.S. \$100,000 divided into 100 Management Shares of U.S. \$0.01 par value each and 10,000,000 Participating Shares of U.S. \$0.001 par value each. The Purpose Trust has acquired all of the Management Shares. No further Management Shares will be issued.

(d) None of the Participating Shares has been issued and no capital of the Fund is under option or agreed conditionally or unconditionally to be put under option.

(e) Neither the Management Shares nor the Shares carry pre-emptive rights.

(f) All shares will be issued in registered form only.

3. Management and Participating Shares.

The Management Shares shall:

- (a) only be issued at par value fully paid;
- (b) confer upon the holder thereof rights in a winding-up or repayment of capital in accordance with the Memorandum of Association and to all dividends, if any, declared by the Directors; and
- (c) carry the right to receive notice of, attend and vote at General Meetings of the Fund.

The Participating Shares shall:

- (a) not be issued at less than par value fully paid;
- (b) confer upon the holder thereof rights in a winding-up or repayment of capital in accordance with the Memorandum of Association and to all dividends, if any, declared by the Directors; and
- (c) carry the right to receive notice of General Meetings of the Fund but do not carry the right to attend or vote at General Meetings of the Fund.

4. Memorandum of Association.

The Memorandum of Association of the Fund provides that the Fund's objects, as set forth in "Investment Objective and Strategy of the Fund," are unrestricted and include the collective investment of its funds and giving members of the Fund the benefit of the results of the management of its funds. The object and powers of the Fund are set out in the Memorandum of Association. The Memorandum of Association also sets forth provisions relating to share capital, issuance and redemption of shares, dividends and distributions upon dissolution or winding up of the Fund. The Memorandum of Association is available for inspection at the office of the Administrator upon request to the Fund.

5. Anti-Money Laundering Regulations.

To ensure compliance with statutory and other generally accepted principles relating to anti-money laundering regulations and policies, including the Fund's obligations under the U.S. Patriot Act, the Fund will require verification of identity and source of funds from any prospective investor in the Fund. Depending on the circumstances of each application, a detailed verification might not be required where:

- (a) the applicant makes the payment from an account held in the applicant's name at a recognized financial institution; or
- (b) the applicant is made through a recognized intermediary.

These exceptions will only apply if the financial institution or intermediary referred to above is within a country recognized by both Bermuda and the U.S. as having sufficient anti-money laundering regulations.

Pending the provision of evidence satisfactory to the Fund as appropriate, admission of an investor as a shareholder may be delayed in the sole discretion of the Directors. If within a reasonable

## 10. Inspection of Documents.

Copies of the following documents for the Fund will be available for inspection at any time during normal business hours on any Business Day free of charge from the Administrator of the Fund and for 14 days from the date of this Memorandum.

- (a) the Memorandum and Bye-Laws of the Fund;
- (b) the Administration Agreement;
- (c) the Broker and Custody Agreement;
- (d) the Registrar and Transfer Agent Agreement;
- (e) the Advisory Agreement; and
- (f) the Companies Act 1981 (as amended) of Bermuda.

## DEFINITIONS

"Administrator", Olympia Capital International, Inc.

"Administration Agreement", the Agency, Administration and Indemnification Agreement dated January 9, 2003 between the Administrator and the Fund

"Advisory Agreement", the Investment Advisory Agreement dated as of January 9, 2003 between the Investment Adviser and the Fund.

"Affiliate Fund", the MDL Broad Market Fixed Income Fund, a mutual fund registered under the Investment Company Act and managed by MDL Advisers, Inc., an affiliate of the Investment Adviser.

"Auditors", Deloitte & Touche.

"Business Day", a day on which banks are open in Bermuda and the United States (other than Saturday and Sunday).

"Bye-Laws", the Bye-Laws of the Company as amended from time to time.

"Custodian", Credit Suisse First Boston Corporation.

"Directors", the Directors of the Fund or any duly authorized committee thereof.

"Fund", the MDL Active Duration Fund, Ltd., an exempted open-ended mutual fund company incorporated under the Bermuda Companies Act 1981 (as amended) with limited liability.

"Hurdle", the increase in value that would be obtained on the Net Asset Value of the Fund for a quarter if the portfolio achieved a return equal to the yield of the Lehman Brothers Government Credit Bond Index for such quarter.

"Incentive Fee", a quarterly profit fee paid to the Investment Adviser equal to 20% of the increase in the Net Asset Value over the Hurdle.

"Initial Offer", the offer of Shares to be made during the Initial Offer Period.

"Initial Offering Period", the period commencing on the date this Memorandum is filed with the Bermuda Registrar of Companies and ending on the earlier to occur of the acceptance of \$3,000,000 of subscriptions or May 15, 2003.

"Investment Adviser", MDL Capital Management, Inc.

"Management Fee", a quarterly management fee to the Investment Adviser equal to 1% per annum of Net Asset Value.

"Management Shares", 100 voting shares of par value U.S. \$0.01 per Share, all of which have been issued to the MDL Active Duration Purpose Trust.

"Net Asset Value", the net asset value of the Fund determined in accordance with the Bye-Laws. "Net Asset Value per Share" means the net value of those assets and liabilities of the Fund which are properly attributable to the Series of Shares of which a Share forms a part, divided by the number of Shares of the Series which are issued and outstanding.

"Permitted U.S. Person", a U.S. Person that is subject to ERISA or is otherwise exempt from payment of U.S. Federal Income Tax

"Qualified Holder", any person, corporation or entity which satisfies the investor qualifications set forth in "Eligible Subscribers" and who is not (i) a United States Person other than a Permitted U.S. Person; (ii) any person, corporation or entity which cannot acquire or hold Shares without violating laws or regulations applicable to it; or (iii) a custodian, nominee, or trustee for any person, corporation or entity described in (i) or (ii) above.

"Redemption Date", shall be the Valuation Date following a request to redeem.

"Redemption Price", the price at which Shares can be redeemed as calculated in the manner set out herein.

"Share", a share of U.S. \$0.001 par value in the Fund designated as a Participating Share by the Bye-Laws.

"Shareholder", the holder of a Share.

"Subscription Date", the Business Day immediately following a Valuation Date.

"Subscription Price", the price at which Shares can be subscribed.

"United States" or "U.S.", the United States of America or any of its territories, possessions or other areas subject to its jurisdiction including the Commonwealth of Puerto Rico.

**"United States Person" or "U.S. Person"**

- (a) any natural person who is resident in or a citizen of the United States;
- (b) any corporation, partnership or other entity organized in or under the laws of the United States (or any state or other political subdivision thereof), and any trust, estate or other

entity organized under the laws of any jurisdiction in the United State or that is subject to U.S. federal income taxation on its worldwide net income regardless of its source;

- (c) any estate of which any executor or administrator is a U.S. Person;
- (d) any trust of which any trustee is a U.S. Person ;
- (e) any agency or branch of any non-U.S. entity located in the United States;
- (f) any non-discretionary account or similar account (other than an estate or trust) held by a securities dealer or other fiduciary for the benefit or account of a U.S. Person;
- (g) any discretionary account or similar account (other than an estate or trust) held by a securities dealer or other fiduciary organized, incorporated or (if an individual) resident in the United States;
- (h) any partnership or corporation organized or incorporated under the laws of any non-U.S. jurisdiction and formed directly or indirectly by one or more U.S. Persons; and
- (i) an entity organized principally for passive investment whose units of participation held by U.S. Persons represent in the aggregate 10% or more of the beneficial interest in the entity or the entity was formed principally for the purpose of facilitating investment by U.S. Persons in a pool with respect to which the operator is exempt from certain requirements of Part 4 of the CFTC's regulations by virtue of its participants being non-U.S. Persons.

"U.S. Dollar" or "U.S. \$", the lawful currency of the United States.

"Valuation Date", the last day of a calendar quarter and any other date established as a Valuation Date by the Directors.