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CASENOTE: KILLING LIFE PARTNERS: WHY VIATICAL SETTLEMENTS CONSTITUTE SECURITIES – IN LIGHT OF THE SEC v. MUTUAL BENEFITS CORPORATION AND OTHER RECENT CASES EXPLICITLY REJECTING LIFE PARTNERS

A. Introduction

"A viatical settlement is a transaction in which a terminally or chronically ill insured ("viator") sells the benefits of his life insurance policy to a third party in return for a lump-sum cash payment equal to a percentage of the policy's face value."[1] Viatical settlement providers purchase the policies from individual viators and typically sell fractionalized interests in these policies to investors.[2] The investor's profit is the difference between the single payment to the viator and the death benefit collected from the insurer, less transaction costs, premiums paid, and other administrative expenses.[3] The rate of return is dependant upon the term of the investment, which is determined by the life expectancy evaluation made by the viatical company. "If the viator lives beyond his life expectancy, the term of the investment is extended and the premiums must either be paid from new investor funds assigned to other policies or by additionally funds from the original investors."[4]

Largely in response to individuals becoming penniless after incurring huge medical bills while they stepped closer and closer to death's door from affliction with the AIDS virus in the 1980s, many companies were formed that bought out life insurance policies from AIDS victims in return for a discounted present rate. As beneficial[5] as this practice may seem, the fraud and lack of regulation in this newly-formed industry virtually screamed for regulation.

Despite the fact that the investment articles espoused by this new industry should have been regulated by the Securities Act of 1933 and the Securities and Exchange Act of 1934, Judge Ginsburg announced the majority opinion for the D.C. Circuit in S.E.C. v. Life Partners, declaring that viatical settlements were not securities and thus could not come under the purview of federal securities laws.

In this explicit denial of S.E.C. control,[6] the Life Partners court left the regulation of viatical settlements[7] to state Blue Sky laws[8] and common law fraud. The fact that "the securities laws [are not] a broad federal remedy for all fraud"[9] does not vest federal courts with the power to magically craft bright-line rules of law out of thin air in order to place investment articles that are properly deemed securities outside the SEC's jurisdiction.[10]

This note contends that the Life Partners court was legally incorrect and the bright-line distinction announced actually encourages fraud, runs contrary to the purpose and spirit of the Securities Laws and the Howey test.[11] Moreover, the repeated rejection of Life Partners by several state courts operates as persuasive authority that Life Partners does not work in application.[12] Proponents of Life Partners argue that viatical settlements are not securities because profits derive predominantly from external forces, i.e., the death of the viator.[13] However, in the case of viatical settlements, where the investors are dependent on the efforts of the promoters to locate, asses and negotiate a price for the value of life insurance policies, investors realization of a profits turn largely on the promoters efforts.[14] Viewing this reality in light of the purpose and spirit of the securities law,[15] it matters not whether such effort occurs before or after the investor has pledged capital. While the death of the viator may be the event which triggers the investor to realize a profit, it is only one variable.[16]

The most recent[17] federal case to address this issue is S.E.C. v. Mutual Benefits,[18] where Judge Moreno of the Southern District of Florida explicitly refused to apply Life Partners. Despite the fact that Judge Moreno's opinion is written in painstakingly broad terms which could be applied to bring countless investment articles which are not securities under the SEC's jurisdiction, Mutual Benefits cries out for affirmance because the viaticals at question present the quintessential example of what a security is under the Howey test.

Even if Life Partners is read narrowly for the proposition that some post-purchase managerial or entrepreneurial activities must be undertaken by the promoter for an investment article to come within the reach of the SEC's jurisdiction,[19] the viatical settlements in both Life Partners and Mutual Benefits should properly be classified as investment contracts, and thus, securities. Moreover, the D.C. Circuit downplayed the importance of the pre-purchase functions performed by the promoter.[20] The efforts of the promoter in evaluating the "insured's medical condition, review[ing] his insurance policy, negotiate[ing] the purchase price, and prepar[ing] the legal documents" are (as casually noted by the D.C. Circuit) "undeniably essential to the overall success of the investment."[21]

A. What Is A "Security?"

"First and foremost, the federal securities laws were drafted and have consistently been interpreted from the perspective that flexibility in the law's applicability is paramount."[22] The "fundamental purpose undergirding the Securities Acts is 'to eliminate serious abuses in a largely unregulated securities market.'"[23] Recognizing the "virtually limitless scope of human ingenuity, especially in the creation of 'countless and variable schemes devised by those who seek the use of money of others on the promise of profits,'"[24] in order to achieve its goal of protecting investors, Congress "painted with a broad brush"[25] in defining the scope of the market it regulated to "encompass virtually any instrument that might be sold as an investment."[26]

In light of the foregoing considerations of Congress's intent, the Supreme Court crafted a strikingly broad definition of an "investment contract"[27]:

> an investment for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.[28]

In other words, Howey requires three elements: (1) an investment of money; (2) a common enterprise; and (3) leading the investor to expect profits solely from the efforts of a third party.[29] The scope of this note is limited to the third prong of Howey, the expectation of profits based on the efforts of others, which was the prong that was disputed in both Life Partners and Mutual Benefits.[30]

In SEC v. Edwards, the Supreme Court reiterated how the "touchstone" of an investment contract is "'the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.'"[31] The Supreme Court has never departed from Howey's affirmation that the definition of a "security" is a "flexible rather than static principle… [which] is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profited."[32]

II. Viatical Settlements

A. An Introduction: SEC v. Life Partners[33]

The promoter-defendant in Life Partners sold fractional interests in insurance policies to retail investors, who may invest as little as $650 and buy a minimum of 3% of the benefits of a given policy.[34] In order to solicit customers, Life Partners used around 500 commissioned "licensees", who received around 10% of the purchase price after overhead cost was paid out.[35] The promoter claimed to have annual revenues over $150 million in 1994 alone.[36] The D.C. Circuit found that the promoters performed "ultimately no" entrepreneurial or managerial post-purchase functions.[37]

The promoters performed various "pre-purchase" functions: they evaluated the insured's[38] medical condition, review his or her insurance policy, negotiates the purchase price, and prepares any necessary legal documents.[39] After the transaction closed, an independent escrow agent acting for the promoter performed the "post-purchase administrative functions."[40] When the purchase of the fractional interest in the life insurance policy closed, the escrow agent collected its own fee as well as the promoters, and escrowed the funds for the premium payments and delivered the balance to the seller.[41] Subsequently, the escrow agent held the policy and disbursed the funds, followed through with the paperwork and filed the death claim.[42] From the preceding facts, the D.C. Circuit concluded that the promoter had "no continuing economic interest in the transaction after receipt of its fee upon the sale to the investor."[43] Largely considering the fact that the promoters in Life Partners represented that they performed no "significant efforts" after the closing of the transaction, the D.C. Circuit allowed them to avoid the federal securities laws.[44]

Moreover, notwithstanding the fact that the Supreme Court has consistently held that federal securities laws need to be defined by "flexible", rather than "static" principles, the D.C. Circuit, in Life Partners[45] announced a bright-line rule of law that pre-purchase "efforts of other", without more, are never enough to satisfy the third prong of Howey,[46] even if the article possesses all the characteristics of an "investment contract" required by Howey. Life Partners denied that pre-purchase activities could "suffice to make the profits of an investment arise predominantly from the efforts of others"[47] because, once the transaction closes, the "only variable affecting profits is the timing of the insured's death,"[48] which is outside the promoter's control. In other words, the key temporal event in disqualifying an investment article as a security is the closing of the transaction.

Thus, the D.C. Circuit concluded, regardless of how significant the pre-purchase entrepreneurial or managerial efforts of the promoters is, if there is no post-closing entrepreneurial or managerial efforts, no security has been sold. This bright-line rule of law is the type that runs entirely contrary to the flexible approach required by Howey. The pre/post[49] investment distinction places an improper impediment on defining what a security is because it exalts "form over substance" and ignores the economic reality that the investment articles in question, viaticals, meet all the requisite elements of what a security is.[50] Moreover, Mutual Benefits, (hereinafter "MBC") a company structured exactly the same as Life Partners, carried out enough post-purchase activities to classify the viaticals as securities.[51]

B. Mutual Benefits

i. Generally

In SEC v. Mutual Benefits,[52] MBC's business was funded by investors whose capital was used and were promised a rate of return on such investment.[53] "Investors were asked to identify a desired maturity date and submit a purchase agreement."[54] MBC promised a range of rates of return, which was "dependent upon the term of the investment, which was determined by the life expectancy valuation."[55] Thus, if the viator lived beyond her or his expectancy, as evaluated by the viatical company[56] in assessing the value of policies, the investor would receive a lesser amount of return on her of his investment than expected. Or, in the alternative, "[i]f the viator lives beyond his life expectancy, the term of the investment is extended and the premiums must either be paid from new investors funds assigned to other policies or by additional funds from the original investors."[57]

Quite notably, MBC was structured virtually the same as Life Partners.[58] In fact, after Life Partners was handed down, MBC was advised by its' lawyers that viatical settlements were not securities and thus it was not required to follow federal securities law.[59] Based on this advice, MBC structured the business plan of MBC so that it accorded with applicable law."[60]

> Indeed, the bright-line rule enunciated in Life Partners created a loophole, which became the Defendants' corporate structure model. Anthony Livoti, trustee for MBC, testified in his deposition that the "attorneys of Mutual Benefits were cognizant of the SEC v. Life Partners case." Indeed counsel for MBC, Michael McNerney, testified at the evidentiary hearing that MBC attempted to restructure certain portions of their operations to conform to the D.C. Circuit's ruling in Life Partners.[61]

Thus, MBC, a company providing securities, was able to avoid the disclosure and antifraud provisions of the federal securities laws based on the bright-line rule of law announced by Life Partners. Does Life Partners then stand for the proposition that promoters of securities are free to evade the federal securities laws if they structure their businesses based on the nuances described in federal appellate court decisions? The obvious answer to this query stands as direct evidence of why the securities laws must be flexible and why courts must avoid establishing bright-line rules of law.[62]

ii. Significant Post-Purchase Managerial Activities.

Notwithstanding the fact that the “pre/post” investment distinction places an improper burden in bringing certain investment schemes under the purview of the federal securities laws, the promoters in Mutual Benefits performed significant post-purchase managerial and entrepreneurial activities to satisfy the distinction espoused in Life Partners.[63] Assuming, arguendo, that the “pre/post” investment distinction is the proper one, the promoters in Mutual Benefits failed to contain their efforts to solely pre-investment, largely as a result of their own fraud.

Starting in 1997, MBC was experiencing persistent problems with life expectancies to viators of a majority of the policies it sold.[64] When a MBC sales agent who represented hundreds of MBC investors complained to one of the majority owners (named Leslie Steinger) of MBC that the policies were not maturing within their life expectancies,[65] he misrepresented that MBC was not experiencing and company-wide problems and it was a “‘fluke’ or ‘bad luck of the draw.’”[66] Subsequently, the sales agents responded to investors with the same response.[67] More specifically, at the time the SEC commenced the action against MBC, “at least 93.5% and possibly as many as 94.2% of MBC’s AIDS policies have matured or will mature beyond their viator’s life expectancies, as calculated by MBC."[68] As for the non-AIDS policies, "an astounding 66.2% were beyond their life expectancies as of June 11, 2004."[69]

As a result of MBC's doctors underestimating the life expectancies by 2.5 to 3.5 years, there were millions of dollars that were needed to pay the premiums on the policies that had not yet matured.[70] Although MBC advised potential investors that it would "escrow funds sufficient to pay future premiums due under a given life insurance policy for a minimum of the projected life expectancy relied upon by MBC of the respective insured, or longer at MBC's discretion"[71], from 1995 until 1997 MBC did not fund any premium escrow accounts to pay future premiums.[72] As a result of MBC failing to "create escrow accounts for those policies, MBC paid premiums on those policies from its own operating accounts. The funds for MBC's operating accounts came almost exclusively from the amounts paid to MBC from each closing on the purchase of an interest in a viatical settlement by a new investor."[73]

It is here that MBC performed sufficient post-closing efforts to satisfy even Life Partners post-closing requirement.

> In other words, MBC's revenue from a new viatical settlement contract funded the premium payments for the older insurance policies. As of the date the SEC commenced this action, 1,227 of those more than 1,500 policies had not yet matured, and those 1,227 policies required annual premium payments of approximately $952,359. Because

> MBC's only source of income is new investors funds, MBC's inability to continue to make premium payments does, or eventually will, depend on MBC's ability to bring in new investors.[74]

Consequently, if MBC fails to bring in more investors in order to pay the premiums of the underestimated policies, then the policies will lapse and the investors will lose all their money. In light of this, it becomes abundantly clear that the profit of the investors depends predominately on the efforts of the promoters, thus satisfying the third prong of Howey.[75] Clearly, the profits of the investors do depend "predominately on the efforts of the promoters."[76] These managerial and entrepreneurial efforts may even be deemed significant enough to satisfy the more stringent "efforts of others" requirement announced in Life Partners.[77]

On the other hand, these efforts may not satisfy Life Partners, considering that Life Partners stated that "[t]he promoter's 'efforts' not to engage in criminal or tortuous behavior, or not to breach its contract are not the sort of entrepreneurial exertions that the Howey court had in mind when it referred to profits arising from 'the efforts of others.'"[78] Apparently the Life Partners court did not consider the consequences of certain propositions it asserted. For example, what if such criminal or tortious behavior constitutes sufficient "efforts" to satisfy Howey's third prong? In Howey, the Supreme Court stated that the "Securities Act prohibits the offer as well as the sale of unregistered, non-exempt securities. Hence, it is enough that the respondents merely offer the essential ingredients of an investment contract."[79]

iii. Promoters Cannot Evade Federal Securities Laws By Representing Their Actions to Fail the Howey Test

Consequently, the question becomes whether a promoter of a security can evade the federal securities laws by representing that his actions are not enough to satisfy the Howey test? Obviously not. "The test if whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. **If that test be satisfied, <u>it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value</u>**."[80]

This question presented in the preceding paragraph was indirectly addressed in an analogous situation in Albanese, where a group of investors sued an ice machine company which agreed to either manage or to lease back ice machines from the investors and place them in various institutions.[81] Consequently, the 11th Circuit reversed the district court's finding that the contracts did not satisfy the third prong of

Howey because the plaintiffs retained the potential for ultimate control over their investments, and held that, because the level of control that the investor maintained was insubstantial and illusory and allowed for no reasonable alternatives than relying on the promoter-ice machine company, the third prong of Howey was not disqualified, as a matter of law, and thus summary judgment was inappropriate.[82] The court reasoned that, "[e]ven if the agreements' words did grant the investors sufficient potential control over their ice machines to prevent the agreements from being securities, the record demonstrates that, in fact, any such control was illusory because plaintiffs had no realistic alternative to allowing PCI [the promoters] to manage their investments."[83]

Applying this reasoning to Mutual Benefits, it can be argued that even if the agreements did not place the success of the investment predominately in the promoters, their subsequent actions did, and thus the third prong of Howey can be satisfied. Moreover, the fundamental nature of this "Ponzi scheme"[84] can constitute a security in and of itself. Hence, the viatical settlements in Mutual Benefits were investment contracts and thus constitute securities under any reasonable analysis.[85]

III. Why Life Partners is Incorrect and Must Not Be Followed

The black-letter rule of law espoused in Life Partners was created out of thin air and finds no support in any Supreme Court precedent, statutory text or legislative history.[86] In its endeavor to offer some precedent for the "pre/post purchase" distinction, the D.C. Circuit attempted to distinguish McCown v. Heidler,[87] where the (D.C. Circuit claims) the Tenth Circuit applied the same "pre/post investment" principle to reach a different result with respect to an investment in undeveloped land.[88]

In McCown, the investors claimed that, because the promoters had promised to make future improvements on the lots, the parcels marketed were securities.[89] The Court found that "'without the substantial improvements pledged by [the promoters] the lots would not have a value consistent with the price which purchasers paid.... The utilization of purchase money accumulated from lot sales to build the promised improvements could bring the scheme within the purview of the securities laws." From this proposition, the court blindly concludes that

> In both Noa and McCown, the court of appeals regarded the promoter's pre-purchase efforts as insignificant to the question whether the investments – in silver bars and parcels of land, respectively – were securities. The different outcomes trace wholly to the promoters' commitment to perform meaningful post-purchase functions in McCown but not in Noa.[90]

The ultimate problem which this fallacy is that its first premise and conclusion are exactly the same: "pre-purchase efforts are never enough to satisfy the third prong of Howey". It runs contrary to any form of accepted logic to make this argument while recognizing that LPI's[91] pre-purchase efforts were "undeniably essential the overall success of the investment…. [and] [t]he investors rely heavily, if not exclusively, upon LPI to locate insureds and to evaluate them and their policies, as well as to negotiate an attractive purchase price."[92]

The Life Partners court failed to discover any persuasive precedent to support the "pre/post" investment distinction in McCown, so it was forced to "rely" on Noa v. Key Futures[93],

> which involved investments in silver bars, the court observed that the promoter made pre-purchase efforts to identify the investment and to locate prospective investors; offered to store the silver bars at no charge for a year after purchase and to repurchase them at the published spot price at any time without charging a brokerage fee. The court concluded, however, that these services were only minimally related to the profitability of the investment: "Once the purchase … was made, the profits to the investor depended upon the fluctuations of the silver market, not the managerial efforts of [the promoter]."[94]

However, the method of purchasing and selling silver bars, as illustrated in Noa, is entirely distinguishable from the purchase and sale of fractional interests in life insurance policies.

Noa stands for the proposition that some post-purchase managerial or entrepreneurial efforts must be performed by the promoter for a transaction to be classified as a security. HOWEVER, this proposition is properly limited to situations where the value of the investment is left entirely to external forces outside the control of the promoter. In the case of viatical settlements, the expertise of the promoter in assessing the policy pre-investment largely dictates the profitability of the investor. Whereas investing in silver or other similar "products", the established commodities market dictates the value, of which the promoter has no control. The reason why this distinction is proper is because "when profits depend on the intervention of market forces, there will be public information available to an investor by which the investor could assess the likelihood of the investment's success.[95] For example,

> a purchaser of silver bars has access to information on the trends in silver prices, an investor in paintings can get a sense, at least generally, of how the market for artwork is faring, and a purchaser of an undeveloped lot has access to information on growth trends in the area. Obviously, the degree to which this information is actually available to an investor depends on the sophistication and education of an investor, but that is true about investments generally. Moreover, where profits depend on the

> operation of market forces "registration … could provide no data about the seller which would be relevant those market risks."

In light of the preceding, Judge Wald correctly opined as to the proper distinction,

> that the third prong of the Howey test can be met by pre-purchase managerial activities of the promoter when it is the success of the success of these activities, either entirely or predominately, that determines whether profits are eventually realized.[96]

Moreover, the D.C. Circuit failed to distinguish Noa on the grounds that the promoters performed neither pre nor post purchase entrepreneurial efforts[97], and had no control over the investment whatsoever. Rather, the investors ultimately decided when to sell their interest, with a mere option to sell to the promoters. The only similarity between the scheme in Noa and Life Partners is that the time of sale dictated the profitability of the investment. However, the investors in viatical settlements rely on the expertise of the promoters in procuring and evaluating the policies, including the physician's review of the insured's life expectancy and the promoters' representations regarding the accuracy of such expectancies.[98] "The profitability of investments in these viatical settlements is wholly determined by the efforts of the promoters in evaluating life expectancies."[99] All the investor can do is pay his money and "trust" that the promoters' effort was sufficient to guarantee him or her a decent return.[100]

"Once the purchase of silver bars was made, the profits of the investor depended upon the fluctuations of the silver market, not the managerial efforts of Key Futures."[101] On the other hand, the investor's profit deriving from viatical settlements is wholly dependant on the promoters' evaluation of the viator's life expectancy, not the time of the viator's death,

> [p]rofits from investments in viatical settlements are determined by whether MBC's life expectancy evaluation is correct. Here, MBC located policies, evaluated viators' life expectancies, bid on policies, negotiated the purchase price of policies. The profitability of investments in these viatical settlements is wholly determined by the efforts of the promoters in evaluating life expectancies. In investments in viatical settlements, the investor only chooses the desired term of investment, MBC matches the investors' funds with viators' policy whose life expectancies match the investors' desired term of investment. The longer the viator lives beyond his life expectancy, as evaluated by MBC, the lower the investors' profits. The investors plainly rely on MBC's life expectancy evaluations.[102]

In light of the preceding, the fact that Noa focuses on the post-purchase efforts of the promoter in determining whether a scheme is an investment contract does not prove dispositive in the case of viatical settlements.[103] Rather, the "pre-post" investment distinction is only triggered when an investors' realization of profits is wholly dependant on external market forces of which the promoter is unable to exert control over. Even if "the timing of the viator's death is of great consequence in the realization of investors' profits"[104] the profits from investments in viatical settlements are determined by whether the promoters' life expectancy valuation is correct.[105] "[T]he crucial inquiry [for the third prong] is the amount of control that the investors retain under their written agreements."[106] In light of this proposition, the "efforts of others" prong of Howey is satisfied because it is the "promoters' efforts, not that of the investors, that form the 'essential managerial efforts which affect the failure or success of the enterprise.'"[107]

It is crucial to recognize that the "efforts of others" prong of Howey largely considers the "expertise" that the promoter provides.[108] In fact, the Noa court explicitly stated that the fact pattern it addressed was not analogous to Glen-Arden Commodities, Inc. v. Costantino[109], where promoters "provided their expertise."[110] In the alternative, the promoters in Noa neither offered their expertise nor "controlled" the investors' realization of a profit; all they did was offer storage and assured that they would buy back the silver. Moreover, there is no case[111] that holds "that pre-purchase activities alone cannot satisfy Howey's third prong."[112] Accordingly, it can rationally be said that Noa is nothing like Life Partners.

In consideration of the preceding, the pre/post investment distinction, of which viatical settlements promoters wholly rely on to avoid the SEC's scrupulous disclosure and antifraud provisions, is derived from a case which is not analogous to the sale of fractional interests in life insurance policies. In other words, the D.C. Circuit capriciously allows promoters of a certain type of investment contract to side-step government regulation that is aimed at protecting investors simply because they represent to investors that all their efforts occur before the investor pledges his or her money.

It is necessary to question whether Judge Ginsburg pondered the countless instances that this hapless distinction could be used to evade federal securities laws. Perhaps he did not, considering that Judge Ginsburg declared that the time of sale is not an artificial dividing line.[113]

> It is a legal construct but a significant one. If the investor's profits depend thereafter predominantly upon the promoter's efforts, then the investor may benefit from the disclosure and other requirements of the federal securities laws. But if the value of the promoter's efforts has already been impounded into the promoter's fees or into the purchase price of the investment, and if neither the promoter nor anyone else is expected to make further efforts that will affect the outcome of the investment,

> then the need for federal securities regulation is greatly diminished.[114]

The preceding proposition fails to assert why the need for regulation is greatly diminished when the investor's profits depend on pre-investment efforts. Consequently, Judge Ginsburg's statement can be read to stand for the proposition that where the promoter's efforts only occur pre-purchase, even if those efforts are undeniably "essential managerial efforts which affect the failure or success of the enterprise"[115], the philosophy is one of caveat emptor.[116] Such a proposition permits promoters to decide, sua sponte,[117] whether their investment scheme will be regulated by the SEC. Obviously Judge Ginsburg did not intend to establish such treacherous precedent.[118]

In light of the foregoing consideration, a further analysis reveals that the "pre/post" distinction in measuring "efforts of others" is wholly backwards and thus incorrect. Rather, the need for disclosure to investors is actually heightened when all the promoters efforts occurs pre-purchase, because the investor is ultimately helpless in the control of his pledge of money.[119] If the promoter's efforts are finished at the time the investment closes, then the return on the investment is entirely dependant on the promoter's valuation of irrepressible outside forces, such as the insured's death. Thus, the need for disclosure is heightened because once the investor pledges their money and it is placed on a policy, he or she is helpless because the investment is now set in stone and cannot be saved by any subsequent measure.[120] However, if fractional interests in life insurance policies were properly deemed investment contracts, then the investor would get the more protective remedies under federal securities laws, such as recession of the purchase and other extraordinary remedies that are usually unavailable at common law.[121] Considering this fact, it cannot rationally be said that the need for disclosure is reduced if the efforts occur pre-purchase.

Even if the need for disclosure is not amplified when the promoters' effort occurs post-investment (as argued above), the time of sale is, contrary to Judge Ginsburg's assertion[122], an artificial dividing line. As stated in the preceding, the focus should be on the "degree of dependence between the investor's profits and the promoter's activities."[123] Stated differently, in determining whether the "efforts of others" prong of Howey is satisfied, the ultimate question is whether the investor's profit would theoretically increase as a result of the promoter's efforts, not on the time of which the promoter's efforts occur.[124]

Moreover, the antifraud and disclosure provisions of the federal securities laws were enacted to prevent investors from being defrauded by the "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits"[125] and to "restore the confidence of the prospective investor in his ability to select sound securities."[126] The emphasis has never been on when the fraud occurred. Rather, whenever an investor's profits depend on the success of the promoter's activities, "there is less access to protective information and the type of information that is needed is more specific to the promoter."[127] The need for disclosure is not magically diminished because the promoter's efforts occurred before the investor pledged his or her money. Even more,

> [g]iven the pivotal role of the promoter's activities, what the investor needs to know is not generally how this type of activity has fared but what the specific risk factors attached to the investment are and whether there is any reason why the investor should be leery of the promoter's promises. This need for information holds true in regard to investors prior to purchase as much as to investors who have committed their funds – indeed, more so, if they are to avoid over-risk investments.[128]

Thus, the temporal distinction is, contrary to Judge Ginsburg's assertion, an artificial dividing line.

A. Potential Counter-Arguments

OR, on the other hand, it can be argued that the focus on post-purchase activities, as espoused in Life Partners (as discussed throughout this note), is the appropriate distinction in furthering the purpose of securities laws. The argument starts with the proposition that "'the securities laws [are not] a broad federal remedy for all fraud."[129] From this, it is contended that an investor has a superior ability to evaluate and assess the efforts undertaken by a promoter before he invests his money, as opposed to a promoter's promises about what will happen in the future to generate profits.[130] Thus, the need for SEC regulation and disclosure is lessened. This argument seems perfectly rational; however, it falls short of explaining why the time of the promoter's efforts matters. Ultimately, as evidenced above, it is revealed to be based on a faulty logic.

In fact, if the securities laws are meant to protect against the risk involved in trusting someone else to make a profit with your money, in other words, an investor who "seeks the use of they money of others on the promise of profits"[131], then the need to SEC regulation should apply with equal force whether the effort occurs before or after an investor pledges her money.[132] Moreover, contrary to some legal scholar's arguments, viatical settlements do meet the requirements of what a security is, both in substance and form, to fall under the SEC's jurisdiction.[133]

Moreover, promoters of viatical settlements are not exactly "innocent" middle men whose efforts are significant in generating profits. Purchasers in viatical settlements are "attracted by representations of investment income"[134] and the promoter's purpose is to raise money "to finance substantial investments."[135] They are not, contrary to Glick's argument, merely matching investors in viatical settlements with viators.[136] As evidenced above, the promoter's efforts dictate the profits of the investor.

IV. Cases Rejecting Life Partners

In light of the preceding, it should come of no surprise that Life Partners has been repeatedly rejected since it was handed down.

A. Federal Cases

In Wuliger v. Christie[137], the court agreed with Judge Wald's dissent in Life Partners that "insisting that some activity must occur after purchase but allowing any activity, no matter how trivial, to satisfy this requirement violates the principle that form should not be elevated over substance and economic reality."[138] The court ultimately refused to apply Life Partners, finding it unpersuasive."[139]

Two years before Wuliger, a viatical investment program was found to be a security in S.E.C. v. Tyler.[140] In addressing whether the scheme in question was a security, the court in Tyler "focused on the promoters representations to the investors in conjunction with the Supreme court's directive in giving a broad definition to a security coupled with 'Congress' purpose in enacting the securities laws to regulate investment, in whatever form they are made and by whatever name they are called."[141]

B. State Cases

There have been several state court cases that have rejected the Life Partners "pre/post" purchase distinction in analyzing whether viaticals are securities under state blue sky laws.[142] Recently, an Indiana appellate court in Accelerated Benefits Co. v. Peaslee[143] rejected Life Partners because it found that the "profits the investors expect to realize depends almost entirely upon the purchaser's expertise in choosing which life insurance policies to purchase. More specifically, the investors rely upon the purchaser's ability to estimate the life expectancy of each prospective viator by obtaining expert medical evaluations … [and] to determine the actual death benefits, ensure the policy is not contestable on any grounds, and ensure that the policy is assignable."[144]

In concluding that a viatical settlements constitute investment contracts, the Indiana court found support in Poyser v. Flora[145], Security Trust Corp. v. Estate of Fisher[146], and Siporin v. Carrington[147]. The repeated rejection of Life Partners lends more than strong support for the proposition that Life Partners was wrongly decided.[148]

For further rejection of Life Partners, look no further than: Rumbaugh v. Ohio Department of Commerce[149], Michelson v. Voison[150], and Joseph v. Viatical Management, LLC.[151] In sum, viatical settlements are investment contracts and thus securities and must be regulated under the Securities Act of 1933 and the Securities and Exchange Act of 1934.

V. Conclusion

In light of all the foregoing factors, the viatical settlements offered and sold in Mutual Benefits[152] must be found to be investment contracts and thus securities, as defined by the Supreme Court in SEC v. WJ Howey[153]. Moreover, even if the Eleventh Circuit[154] declines to issue an opinion contrary to Life Partners, it should still conclude that the promoters of the viatical settlements performed sufficient post-closing managerial and entrepreneurial efforts to satisfy the third prong of Howey, even under the more stringent test announced in Life Partners. Upon the possibility that Life Partners was legally correct at the time it was decided, experience has proved the contrary, because the promoters of the sale of fractional interests in life insurance policies routinely engage in sufficient efforts to conclude that the investors profits depended predominately on the efforts of the promoter.[155] Moreover, it runs contrary to the federal securities laws as well as logic to follow a legal doctrine that stands for the proposition that, where the promoter's efforts only occur pre-purchase, even if those efforts are undeniably "essential managerial efforts which affect the failure or success of the enterprise"[156], the philosophy is one of caveat emptor.[157]

[1] *S.E.C. v. Mutual Benefits Corp.,* 323 F. Supp 2d 1337, 1338 (S.D. Fla. 2004) (*citing Black's Law Dictionary* 1377 (7th Ed. 1999) . The amount that viatical companies claim to pay viators varies in each case. In *S.E.C. v. Life Partners,* 87 F. 3d 536,537 (D.C. Cir. 1996), the company claimed to pay 20%-40% of face value of the policy. The viatical company called the "Life Settlement Guide" promised to pay the policy owner 30%-80% of the full face value of the policy.
(*available at* www.lifesettlementsguide.com/life settlements info) Last visited 10/21/2004 at 16:22. *Contra*, see fn. 132: Glick, ARE VIATICAL SETTLEMENTS SECURITIES WITHIN THE REGULATORY CONTROL OF THE SECURITIES ACT OF 1933? 60 U. Chi. L. Rev. 957 (1993).

[2] *Id. at* 1338.

[3] *Life Partners,* 87 F. 3d 536, 537.

[4] *Mutual Benefits* at 1338. Here, as is common in many viatical settlements, when the viator lives longer than expected, then the viatical company must keep paying premiums on the policy and the investor's profit is either diminished or eliminated. Then, the viatical company will either (i) not pay the investor or (ii) use another investor's funds to pay the original investor. *See generally,* VIATICAL SETTLEMENTS: AN EXPLANATION OF THE PROCESS, AN ANALYSIS OF STATE REGULATIONS, AND AN EXAMINATION OF VIATICAL SETTLEMENTS AS SECURITIES, 46 Drake L. Rev. 923. (1998).

[5] Depending on the reader's view, perhaps as "'ghoulish' as this investment vehicle sounds, it actually allows a terminally ill person in the later stages of a disease, to obtain additional funds with which to secure either the basis means of support or additional comforts during the insured's final days." *In re Mcguire*, 284 B.R. 481, 485 (Bkrtcy. D. Colo. 2002) (where a creditor who invested in viatical settlements offered by a bankruptcy debtor without knowing that the company whose viaticals it *allegedly* purchased was engaged in *Ponzi* scheme unsuccessfully sued to except resulting debt from discharge in bankruptcy case).

[6] This denial also dictated a denial of federal court jurisdiction.

[7] This note uses the term "viatical" settlement and "life" settlement interchangeably. "The only distinction between life settlements and viatical settlements is that in life settlements, the insured is not terminally or chronically ill." *Mutual Benefits Co.* at 1338.

[8] "The term appears to have originated from the speculative schemes that these early laws intended to prevent that 'had no more basis that so many feet of blue sky'". *Mutual Benefits Corp.* at 1341, fn 6. (*citing State v. Gopher Tire & Rubber Co.,* 146 Minn. 52, 177 N.W. 937, 938 (1920).)

[9] *Life Partners* at 547. (quoting *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982).

[10] *Mutual Benefits* at 1342. Judge Moreno noted that "[b]right-line rules are discouraged in the context of federal securities laws for the reason that

they tend to created loopholes that can be used by the clever and dishonest." *Id.*

[11] In *S.E.C. v. W.J. Howey Co.,* 328 U.S. 293, 298-299 (1946), the Supreme Court crafted an expansive definition of "investment contract," (and all investment contracts are securities, unless explicitly exempt), "…an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely form the efforts of the promoter of a third party…". The Courts have interpreted the *Howey* test to comprise the following three elements: (1) an investment of money; (2) a common enterprise; and (3) the expectation of profits derived solely form the efforts of others. *Mutual Benefits Co.* at 1341. In *Howey*, 328 U.S. 294, the promoter offered individual staying at the "Howey in the Hills" resort a land a service contract regarding its citrus acreage in Florida. The court found it to be immaterial

that some purchasers choose not to accept the full offer of an investment contract by declining to enter into a service contract with the respondents. The Securities Act prohibits the offer as well as the sale of unregistered, non-exempt securities. Hence, it is enough that the respondents merely offer the essential ingredients of an investment contract.

Id. at 301.

[12] *See e.g., infra, p.__* *See Accelerated Benefits Co. v. Peaslee,* 818 N.E. 2d. 73 (Ind. App. 2004); *Rumbaugh v. Ohio Department of Commerce,* 800 N.E. 2d 780 (Ohio Ct. App. 2003); *Plyser v. Flora,* 780 N.E. 2d 1191 (Ind. Ct. App. 2003); *Michelson v. Voison,* 658 N.W. 2d 188 (Mich. Ct. App. 2003); *Joseph v. Viatical management, LLC,* 55 P. 3d 264; and *Sipornin v. Carrington*, 23 P. 3d 92 (Ariz. Ct. App. 2001).

[13] *See generally,* Life Partners at 536*;* Glick, 46 Drake L. Rev. 923.

[14] *Mutual Benefits* at 1342. *See e.g., Wuliger v. Christie*, 310 F. Supp. 2d 897 (N.D. Ohio 2004), noting that "[w]hile the decision in *Life Partners* [sic] is characterized as having been largely unchallenged, it is perhaps a more accurate assessment to state that it has not altogether been embraced by other circuits and continues to generate much discussion in the academic realm." *Id.* at 904.

[15] "Enacted in the early 1930's, the federal securities laws came in direct response to the stock market crash of late 1929 and the resulting depression that forged a political consensus in Congress to regulate securities. As noted by the Supreme Court, '[i]t requires little appreciation … of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail' in every facet of the securities industry." *Mutual Benefits* at 1339. (internal citations omitted).

[16] *Id.* at 1342.

[17] At least two other district courts have held that viatical settlements constitute "securities." *Wuliger*, 310 F. Supp. 2d 897 is factually similar to *Mutual Benefits, S.E.C. v. Tyler*, 2002 WL 32538418 (N.D. Tex 2002) is factually different, but quite relevant. In *Tyler*,

the promoters enticed elderly investors by touting the investment's liquidity, a fixed interest rate, specific maturity date and maturity value at the outset of the investment. The promoter then took the investors' money and purchased fractional shares of viatical investments which had none of the attributes represented to the investor. In considering whether these investments constituted securities, the district court focused on the promoters representations to the investors in conjunction with the Supreme Court's directive in giving a broad definition to a security coupled with "Congress' purpose in enacting the securities laws to regulate investments, in whatever form they are made and by whatever name they are called."

Wuliger v. Christie, 310 F. Supp. 2d 897, 904. (quoting *Reves v. Ernst & Young*, 494 U.S. 56, 61, 110 S. Ct. 945 (1990).

[18] *Mutual Benefits* at 1337.

[19] The fact that *Life Partners* was often inaccurate in evaluating a viator's life expectancy required them to execute significant *managerial* and *entrepreneurial* efforts, post-investment. *See infra, p. 18*

[20] *See also, Life Partners* at 551, fn. 1 (Wald, J., dissenting), arguing that the promoter's promise to assist in the "resale of policies combined with its emphasis on the availability of resale activities to constitute a managerial post-purchase activity.

[21] *Life Partners* at 547, also noting how "[t]he investors rely heavily, if not exclusively, upon LPI to locate insureds and to evaluate them and their policies, as well as to negotiate an attractive purchase price.

[22] *Mutual Benefits* at 1339.

[23]*Reves v. Ernst & Young,* 494 U.S. 56, 60 (quoting *United Housing Foundation, Inc. v. Forman,* 421 U.S. 837, 849 (1975).

[24] *Id.* at 60-61 (quoting *Howey,* 328 U.S. 293, 299).

[25] *Id.* at 60.

[26] *Id.* at 61.

[27] "Section 2(a)(1) of the 1933 Act, 15 U.S.C. § 77(a)(1), and § 3(a)(10) of the 1934 Act, 15 U.S.C. § 78c(a)(10), in slightly different formulations which we have treated as essentially identical in meaning…define 'security' to include 'any note, stock, treasury bond, debenture…investment contract…[or any] instrument commonly known as a 'security'….'[i]nvestment contract' is not itself defined." *SEC v. Edwards*, 124 S. Ct. 892, 896 (2004) (quoting *Reves* at 61, n. 1, 110 S. Ct. 945). In interpreting what fell under the category of "investment contract",

[f]orm was disregarded for substance and emphasis was placed upon economic reality. An investment contract thus came to mean a contract or scheme for "the placing of capital or laying out of money in a way intended to secure income or profit from its employment."

Howey at 298.

[28] *Howey* at 298-299.

[29] *Albanese v. Florida Nat'l Bank of Orlando*, 823 F. 2d 408, 410 (11th Cir. 1987). In *Albanese,* where a group of investors sued a ice machine company which agreed to either manage or to lease back ice machines from the investors and place them in various institutions, the 11th Circuit reversed the district court's finding that the contracts did not satisfy the third prong of *Howey* because the plaintiffs retained the potential for ultimate control over their investments, and held that, because the level of control that the investor maintained was insubstantial and illusory and allowed for no reasonable alternatives than relying on the promoter-ice machine company, the third prong of *Howey* was not disqualified, as a matter of law, and thus summary judgment was inappropriate. *Id.* ("Even if the agreements' words did grant the investors sufficient potential control over their ice machines to prevent the agreements from being securities, the record demonstrates that, in fact, any such control was illusory because plaintiffs had no realistic alternative to allowing PCI [the promoters] to manage their investments." *Id.* at 412)

[30] The requirement that profits come "solely" from the efforts of others was later relaxed. *See Mutual Benefits* at 1342; *SEC v. Int'l Loan Network, Inc.*, 968 F. 2d 1304, 1308 (D.C. Cir. 1992) (commenting that investors expect profits to result "if not solely, at least predominantly" from the efforts of the promoter); *SEC v. Glenn W. Turner Enters., Inc.* 474 F. 2d 476, 482 (9th Cir. 1973), where the court held that the question is whether "the efforts made by those other than the investor are undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *SEC v. Koscot Interplanetary, Inc.,* 497 F. 2d 473, 483 (5th Cir. 1974).

[31] *Edwards*, 124 S. Ct. at 897-898. In *Edwards,* the Supreme Court duly noted that "[t]he fact that investors have bargained for a return on their investment does not mean that the return is not also expected to come *solely from the efforts of others.* Any other conclusion would conflict with our holding that an investment contract was offered in *Howey* itself." *Id.* at 898.

[32] *Howey* at 299. *See also Edwards* at 897-898.

[33] The overview of viatical settlements is provided in the introduction, *supra.*

[34] *Life Partners* at 539.

[35] *Id.*

[36] *Id.* "[I]n 1994 the company accounted for more than half of the industry's estimated annual revenues of $300 million."

[37] *Id.* at 539-540. The promoter could appear,

and continued to appear after the investors had purchased their interests, in an insurance company's records as the owners of a policy; LPI insists, however that this practice was adopted not because LPI had any continuing entrepreneurial role to play but only at the urging of the insurance companies for their *administrative convenience*; the investor was at all times the legal owner … once an investor acquired an interest in a policy he could avail himself of LPI's on-going administrative services, which included monitoring the insured's health, assuring that the policy did not lapse, converting a group policy into an individual policy where required, and arranging where required, and *arranging for resale of the investor's interest when so required and feasible.*

Id. If it can be said that the investor would not make a profit if these activities were not performed, then how does the profitability of the investment depend *solely* on the death of the viator? Is this factual situation not similar to *Howey?* Can it not be reasonably argued that *if the profitability of the investment depends entirely on the death of the viator here,* then why wouldn't the profitability of the investment in *Howey* depend entirely on how good of a citrus season occurred? Moreover, *Howey* explicitly rejected the argument that the "fact that some purchasers choose not to accept the full offer of an investment contract by declining to enter into a service contract … it is enough that the respondents merely offer the essential ingredients of an investment contract." *Howey* at 1102.

[38] In other words, the person who was selling the benefits of their life insurance policy, called a "viator".

[39] *Id.* at 539

[40] *Id* at 540.

[41] *Id.*

[42] *Id.*

[43] *Id.*

[44] After the D.C. Circuit's opinion was issued, the promoters in *Mutual Benefits*, *discussed infra*, structured their scheme exactly like the promoters in *Life Partners.*

[45] *SEC. v. Life Partners,* 87 F. 3d 536, 537

[46] *Id.* at 540.

[47] *Id.* at 547.

[48] *Id.* at 545.

[49] "MBC located the policies to purchase, negotiated purchase prices, bid on policies, obtained life expectancy evaluations of individual viators, and created the legal documents need to conclude the transaction. In order to sell the viatical settlements, MBC solicited investors both directly and through sales agents." *See SEC v. Mutual Benefits,* 2004 U.S. Dist. LEXIS 23008 at 4 (S. D. Fla. Nov. 10, 2004) Dkt. No. 529 (Judge Garber's "Report and Recommendation"

[50] *Howey* stated in painstakingly unambiguous terms that in determining what an "investment contract" is, form should be disregarded for substance and emphasis should be placed upon the economic reality. *Howey* at 1102.

[51] *Mutual Benefits,* 2004 U.S. Dist. LEXIS 23008 at 42. *See also, Mutual Benefits* at 1340, "the Supreme Court has consistently repeated the interpretive principle that courts should determine the contours of the term 'security' from the posture that substance should be elevated over form, with a special sensitivity to the economic reality of the transaction, not its formal characteristics." *(*citing *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967)).

[52] *Supra,* note 1.

[53] *Mutual Benefits,* 2004 U.S. Dist. LEXIS 23008

[54] *Mutual Benefits* at 1338.

[55] *Id.*

[56] The viatical company in *Mutual Benefits* hired doctors to write letters which represented that they had "spoken to or consulted with the viator's treating physicians, which was not true." *Id.* at 18. Regardless of whether the promoters (Mutual Benefits) were actually carrying out *pre-purchase activities to determine the success of the investment*, they represented that they were, and thus carried out extensive pre-purchase activities. Moreover, Mutual Benefits (*hereinafter* "MBC") routinely lied to investors regarding the possibility that the viators would live beyond their life expectancy, which would diminish the return on their investment. "'[i]t was kind of a standing banter in the [MBC] office, that these people were going to live a lot longer than three years and yet no HIV, AIDS file was ever placed a longer life expectancy than three years." *Mutual Benefits,* 2004 U.S. Dist. LEXIS 23008 at 20.

[57] *Mutual Benefits* at 1338. *See supra* note 4.

[58] *Id.* at 1343.

[59] *Mutual Benefits,* 2004 U.S. Dist. LEXIS 23008 at 42.

[60] *Id.* In other words, based on the *Life Partners'* court "pre/post " purchase distinction, MBC structured their company identical to Life Partners business structure.

[61] *Id.* at 1343

[62] *See generally, Mutual Benefits* at 1337.*; Wuliger* at 904.

[63] *See generally, Mutual Benefits,* 2004 U.S. Dist. LEXIS 23008

[64] *Id.* at 35-36.

[65] To reiterate, the longer a viator lived, the less profit the investor received.

[66] *Id.*

[67] *Id.*

[68] *Id.* at 33-35. In fact, MBC completely stopped selling the AIDS policies in 1993. Additionally, "MBC did not advise new investors about the effects which new medical treatments were having on the viatical settlement industry and, particularly, on the policies MBC sold. To the contrary, in the late 1990's, MBC addressed investors' concerns about new AIDS treatments by informing them that the treatments did not work for all individuals." *Id.* at 34-35.

[69] *Id.* at 38.

[70] *Id.* at 41. The court identified that there had been an underestimation of life expectancies for non-AIDS polices by 2.5 to 3.5 years.

[71] *Id.* at 41.

[72] *Id.* at 42

[73] *Id.* at 42.

[74] *Id.* at 42-43.

[75] *Howey* at 298-299.

[76] *Infra,* fn 26.

[77] *Life Partners* at 545.

[78] *Id.*

[79] *Howey* at 301. "The registration requirements of s 5 refer to sales of securities. Section 2(3) defines "sale" to include every 'attempt or offer to dispose of, or solicitation of an offer to buy,' a security for value." *Id., FN6.*

[80] *Howey* at 301. (emphasis added).

[81] *Albanese v. Florida Nat'l Bank of Orlando*, 823 F. 2d 408, 410.

[82] *Id.*

[83] *Id.*

[84] This process of using additionally investors to pay out original investors without any realized profits is a form of "Ponzi scheme" and usually falls under common law fraud. Although the term "Ponzi scheme" is "generally used to describe an investment scheme which is not really supported by any underlying business venture," the viatical companies way of attracting investors with high rate of returns is quite analogous:

The investors are paid profits from the principal sums paid in by newly attracted investors. Usually those who invest in the scheme are promised large returns on their principal investments. The initial investors are indeed paid the sizable promised returns. This attracts additional investors. More and more investors need to be attracted into the scheme so that the growing number of investors on top can get paid. The person who runs this scheme typically uses some of the money invested for personal use. Usually this pyramid collapses and most investors not only do not get paid their profits, but also lose their principal investments.

In Re Randy, 189 B.R. 425, 437 (Bkrtcy. N.D. Ill., 1995); *see also In re Mcguire*, 284 B.R. 481, 485

However, a more in-depth analysis of a "Ponzi scheme" is beyond the scope of this note.

[85] In other words, the 11th Circuit could affirm the lower courts finding without conflicting (or over-ruling if the Supreme Court grants certiorari)with *Life Partners.*

[86] *Mutual Benefits* at 1343.

[87] 527 F. 2d 204 (10th Cir. 1975)

[88] *Life Partners* at 547.

[89] 527 F. 2d 204.

[90] *Life Partners* at 547.

[91] LPI was the promoter-defendant in *Life Partners.*

[92] *Id.* at 547.

[93] 638 F. 2d 77 (9th Cir. 1980).

[94] *Life Partners* at 546.

[95] *Life Partners* at 552. (Wald, J., dissenting).

[96] *Id.* at 551.

[97] The D.C. Circuit failed to make this crucial distinction.

[98] *Mutual Benefits* at 1342.

[99] *Id.*

[100] *Noa* is also distinguishable because the scheme it addressed failed the second prong of *Howey* because there was no common enterprise.

[101] *Noa* at 79.

[102] *Mutual Benefits* at 1342.

[103] *Contra, Id.* at 1343, where Judge Moreno stated that a "fair reading of *Noa* reveals no such distinction between pre and post-purchase activities."

[104] *Id.* at 1342.

[105] *Id.*

[106] *S.E.C. v. Unique Financial Concepts,* 196 F. 3d 1195, 1201 (11th Cir. 1999),

citing *Albanese* at 410; fn 29.

[107] *Mutual Benefits* at 1342. (citing *Unique Financial Concepts,* 196 F. 3d 1195, where the 11th Circuit found the purported offer of the sale of foreign currency options to be securities because (1) the investors retained no control over their investments, since their were no actual investments to control, and (2) the customer agreement gave the promoters the *sole discretion* to use the total funds deposited by the investors. *Unique Financial Concepts* 196 F. 3d 1195, 1201. (internal quotation marks omitted)). *See also, Albanese* at 410, *infra*

[108] *See Noa* at 80. (discussing *Glen-Arden Commodities, Inc. v. Costantino*, 493 F. 2d 1027 (2d Cir. 1974).

[109] 493 F. 2d 1027.

[110] *Noa* at 80.

[111] At a minimum, when *Life Partners* was decided, there was no case that held that pre-purchase activities alone failed the third prong of *Howey.*

[112] *Life Partners* at 553. (Wald, J., dissenting)

[113] *Id.* at 547.

[114] *Life Partners* at 547.

[115] *Life Partners* at 547, and 550 (Wald, J., dissenting) *See also: SEC v. Glenn W. Turner Enters., Inc.* 474 F. 2d 476, 482 (9th Cir. 1973).

[116] "[a] fundamental purpose, common to [the securities laws], was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor." Life Partner* at 550 (Wald, J., dissenting) (quoting LOUIS LOSS & JOEL SELIGMAN, 1 SECURITIES REGULATION 171-94, 391-94 (3d ed. 1989)(describing the disclosure philosophy of the securities laws).

[117] *See* discussion of *Mutual Benefits* at p.___

[118] *See generally, Id.* at 1343.

[119] This is especially true in the case of viatical settlements because of the lack of an established secondary market that an investor can access.

[120] *See Plaintiff's Amicus Brief for Scheck Investments.*

[121] *See generally, Rowe v. Maremont Corp.*, 850 F. 2d 1226 (7th Cir. 1988), for example, see _____

[t]he Supreme Court had broadly stated that in Rule 10b-5 cases involving defrauded sellers, "the correct measure of damages … is the difference between the fair value of all the … seller received and the fair value of what he would have received had there been no fraudulent conduct, except for the situation where the defendant received more than the seller's actual loss. In the latter case damages are the amount of the defendant's profit."

Id. quoting *Affiliated Ute Citizens of Utah v. U.S.*, 406 U.S. 128 (1972).

[122] *See Life Partners* at 547, where Judge Ginsburg declared that the time of sale is not an artificial dividing line.

[123] *Id. at* 552. (Wald, J., dissenting).

[124] *Wuliger* at 906.

[125] *Howey* at 299. *See also, Life Partners* at 551, (Wald, J., dissenting). Judge Wald was troubled by the majority's approach because it "undercuts the flexibility and ability to adapt to 'the countless and variable schemes' that are the hallmarks of the *Howey* test.

[126] *See* H.R. Rep. No. 73-85, at 1-2 (1933).

[127] *Life Partners* at 552, (Wald, J., dissenting).

[128] *Id.*

[129] *Id.* at 547. (quoting *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982).

[130] *See generally, Life Partners* at 547.

[131] *Howey* at 299.

[132] *Life Partners* at 552, (Wald, J., dissenting).

[133] *Glick* at 984. Glick takes the position that in the case of viatical settlements, Howey's goal of "divining substance through form succeeds" because "substance must prevail over form, and viatical settlements are similar in form, but not substance, to securities. " *Id.* Glick further argues that viatical settlements cannot be securities because they play no role in capital markets or formation.

[134] *Edwards*, 124 S. Ct. 892, 897

[135] *Reves* at 56.

[136] *Glick* at 974. She argues that, in brokered viatical transactions, "the broker's efforts fail Howey's third prong because the broker's efforts are not post-sale managerial or entrepreneurial….the broker facilitates the transfer of ownership rights from the policyholder to independent investors. The broker itself never acquires or retains ownership rights. Instead, it simply matches a willing investor with a seller. However, Glick posits her argument on the same faulty logic as *Life Partners (*even though her note was written before the D.C. Circuit's opinion was issued), that is, that pre-purchase efforts alone can never satisfy the third prong of *Howey.*

However, Glick's own argument crumbles through her own explanation of the process of buying and selling viatical settlements, "[t]he potential investor is presented with a fixed purchase price predetermined by the broker. Whereas the price may or may not be negotiable, the bulk of the calculations have been performed by the broker, thereby relieving the buyer of the responsibility of acquiring and mastering the specialized medical, actuarial, and financial information needed to assess a particular policy's market value." *Id.* This author's question for Mz. Glick is, what happens when the promoter does not perform those services? Are those servies not analogous to a mutual fund manager's decision of what stock to include in a given fund?

[137] *Supra,* note __

[138] *Wuliger* at 903.

[139] *Id.* at 904.

[140] *Tyler*, 2002 WL 32538418.

[141] Wuliger at 904. (*quoting Reves*, at 56, 61.) "'What truly determines viatical settlement profitability is the realization, over time, of an outcome predicted by the seller through its analysis of the viator's life expectancy, the soundness of the insurer, the actions need to keep the policy in effect for the original face amount, and the insurer's unconditional liability under the policy's terns.'" *Id.* at 904

[142] *Contra, Griffitts v. Life Partners,* 2004 WL 1178418 (Tex. App. 2004) In *Griffitts,* a Texas appellate court followed the *Life Partners* reasoning and denied that viatical settlements were securities under the reasoning in *Life Partners.* Quite notably, the defendants in this case were the same promoters as in the SEC action seven years before in the D.C. Circuit. The Texas court explained,

Likewise, in the instant ca[]se [sic], the profitability of Griffitts's interests in life insurance policies is not determined by any managerial efforts on the part of Life Partners. Griffitts points to Life Partners efforts prior to her purchase, such as locating, researching, and evaluating the policies; and to the post-purchase efforts of the trust company that held and managed the policies, such as paying the policy premiums commission; however, Griffitts and Life Partners shared no common interest in the profitability of the policies. [sic] And any ministerial post-purchase efforts on the part of Life Partners or the trust company could have no effect on the profitability of the policies, which was overwhelmingly determined by how long the insured lived.

Id. at 2.

[143] 818 N.E. 2d. 73

[144] *Id.* at 77.

[145] 780 N. E. 2d 1191, 1197 (Ind. App. 2003) *Poyer* found that the pre-purchase efforts of the promoters were sufficient to satisfy *Howey*'s third prong.

[146] 797 N.E. 2d 789, 797 (Ind. App. 2003)

[147] 23 P. 3d 92,98. (Ariz. Ct. App. 2001). *Siporin* directly disagreed with *Life Partners* because of its "inflexible and formalistic approach" to application of the securities laws", and concluding that "[n]either *Howey* nor any federal securities decision lends anything more than tangential support for the bright-line rule set forth in *Life Partners.* The Howey test as evolved under *Forman* is more consistent with the view that pre-investment entrepreneurial or managerial activities may satisfy the third prong of the Howey test under appropriate circumstances." *Id.* at 98.

[148] Recently, many states have added the term "viatical settlements" to their definitions of a security in their Blue Sky laws. *See,* Alas Stat. 45.55.990; *Cal. Corp. Code 25019; Ga. Code Ann. 10-5-2* (added 2001)*;* Ind. Code 23-2-1-1*;* Iowa Code 502.102*;* Me Rev. Stat. Ann., Title 32, 10501*;* Miss. Code Ann., 75-71-105*;* Neb. Rev. Stat. 8-1102*;* NC Gen. Stat. 78A-2 (added 2002)*;* ND Cent. Code 10-04-02*;* SD Codified Laws Ann. 47-31A-401*;* W. Va Code 32-4-401 (added 2001). In light of *Life Partners*, hopefully more states will add the term to the list of what falls under the subheading "investment contract"

[149] 800 N.E. 2d 780.

[150] 658 N.W. 2d 188.

[151] 55 P. 3d 264.

[152] 1337.

[153] 298-299.

[154] Or the United States Supreme Court, if it is appealed that far (and if it grants certiorari).

[155] *Mutual Benefits* at 1342; *Mutual Benefits,* 2004 U.S. Dist. LEXIS 23008 at 42. *Supra,* fn. 58.

[156] *Life Partners* at 547, and 550 (Wald, J., dissenting) *See also: SEC v. Glenn W. Turner Enters., Inc.* 474 F. 2d 476, 482 (9th Cir. 1973).

[157] "[a] fundamental purpose, common to [the securities laws], was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor." Life Partner* at 550 (Wald, J., dissenting) (quoting LOUIS LOSS & JOEL SELIGMAN, 1 SECURITIES REGULATION 171-94, 391-94 (3d ed. 1989)(describing the disclosure philosophy of the securities laws).