KILLING LIFE PARTNERS:
WHY VIATICAL SETTLEMENTS ARE "SECURITIES" IN LIGHT OF *SEC V. MUTUAL BENEFITS CORPORATION* AND OTHER RECENT CASES THAT EXPLICITLY REJECT *SEC V. LIFE PARTNERS*

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I. 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] In other words, it is a way in which dying persons can acquire access to resources by selling off their life insurance benefits at a present discounted rate so that they may enjoy such assets in the last days of their lives.[2] Viatical settlement providers purchase the policies from individual viators and typically sell fractionalized interests in these policies to investors.[3] 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.[4] 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 additional funds from the original investors."[5]

The purpose of these investment articles may seem dignified.[6] Indeed, in the 1980s, largely in response to the increasing number of individuals that became insolvent after incurring huge medical bills for treatment of the AIDS virus, many companies were created that sought to buy out life insurance policies in return for a discounted lump sum payment. However, the practice has been complicated and corrupted by the actions of overzealous entrepreneurs and investment promoters who often take advantage of novice and sophisticated investors alike.[7] The promoters who sell and market viatical settlements

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[1] SEC v. Mutual Benefits Corp*.,* 323 F. Supp. 2d 1337, 1338 (S.D. Fla. 2004) (citing BLACK'S LAW DICTIONARY 1377) (7th ed. 1999), *aff'd*, 408 F.3d 737 (11th Cir. 2005), Petition for Certiorari filed Sept. 13th, 2005 (No. 05-333). The amount that viatical companies claim to pay viators varies in each case. In SEC v. Life Partners*,* 87 F.3d 536, 537 (D.C. Cir. 1996), the company claimed to pay twenty to forty percent of face value of the policy. The viatical company known as the "Life Settlement Guide" promised to pay the policy owner thirty to eighty percent of the full face value of the policy. *Life Settlements Guide, Background Information on Life Insurance Settlements and Viaticals*, *available at* http://www.lifesettlementsguide.com/life_settlements_info (last visited Apr. 7, 2006). *Contra*, Shanah D. Glick, *Are Viatical Settlements Securities Within the Regulatory Control of the Securities Act of 1933?*, 60 U. CHI. L. REV. 957 (1993).

[2] Halechko, *Viatical Settlements and The Elderly: Potential Advantages and Hidden Dangers*, 6 N.Y. CITY L. REV. 135 (2003).

[3] *Mutual Benefits Corp.,* 323 F. Supp. 2d at 1338.

[4] *Life Partners,* 87 F.3d at 537-38.

[5] *Mutual Benefits Corp.* 323 F. Supp. 2d at 1338. Here, as is common in many viatical settlements, when the viator lives longer than expected, the viatical company must keep paying premiums on the policy. In this situation, the investor's profit is either diminished or eliminated, and 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).

[6] 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 basic means of support or additional comforts during the insured's final days." *In re Mcguire*, 284 B.R. 481, 485 (Bankr. 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 a *Ponzi* scheme unsuccessfully sued to except resulting debt from discharge in bankruptcy case).

[7] Halechko, *supra* note 2.

are able to take advantage of investors because of the lack of regulation in the viatical industry.

Indeed, 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. However, in SEC v. Life Partners[8], the court held that viatical settlements were not "securities" and thus could not come under the purview of federal securities laws. In rejecting the position that the SEC could regulate these agreements,[9] the *Life Partners* court left the regulation of viatical settlements[10] to the States, through the use of state Blue Sky laws[11] and actions for common law fraud. While it is true that "the securities laws [are not] a broad federal remedy for all fraud,"[12] this notion should not encourage the Federal Courts to arbitrarily craft bright-line rules resulting in the elimination of SEC jurisdiction over investment articles that should properly be considered "securities".[13]

This note contends that *SEC v. Life Partners* was incorrectly decided. The bright-line distinction announced in *Life Partners* actually encourages fraud, and is contrary to the purpose and spirit of the Securities Laws and the *Howey* test.[14] Regarding the latter, the scheme in which viatical settlements are sold squarely satisfies all three elements of the test.[15] However, 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*.

Moreover, the repeated rejection of *Life Partners* by several state courts serves as persuasive authority for the argument that *Life Partners* does not work in application.[16]

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[8] SEC v. Life Partners, 87 F.3d 536, 537 (D.C. Cir. 1996)

[9] The result of which is a lack of Federal Court jurisdiction.

[10] 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 Corp.,* 323 F. Supp. 2d at 1338.

[11] "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.* 323 F. Supp. 2d at 1341, n. 6 (citing State v. Gopher Tire & Rubber Co., 146 Minn. 52, 177 N.W. 937, 938 (1920)).

[12] *Life Partners,* 87 F.3d at 547. (quoting Marine Bank v. Weaver, 455 U.S. 551, 556 (1982).

[13] *Mutual Benefits Corp.,* 323 F. Supp. 2d at 1343. 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.*

[14] In SEC 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): "[A]n 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 from the efforts of others. *Mutual Benefits Corp.,* 323 F. Supp. 2d at 1341. In *Howey*, 328 U.S. at 294, the promoter offered an individual staying at the "Howey in the Hills" resort a land service contract regarding its citrus acreage in Florida. The court found it to be immaterial that some purchasers chose 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.
Howey, 328 U.S. at 301.

[15] *Id.* at 298-99.

[16] *See* Accelerated Benefits Co. v. Peaslee*,* 818 N.E.2d. 73 (Ind. App. 2004); *accord,* Rumbaugh v. Ohio Dep't of Commerce, 800 N.E.2d 780 (Ohio Ct. App. 2003); Plyser v. Flora*,* 780 N.E.2d 1191 (Ind. Ct.

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.[17] However, in the case of viatical settlements, an investor's return on his/her initial investment is largely dependent on the promoter(s) because the investors are reliant on the efforts of the promoter(s) to locate, assess, and negotiate a price for the value of life insurance policies.[18] Viewing this reality in light of the purpose and spirit of the securities law,[19] it should not matter whether the promoter's effort occurs before or after the investor has pledged capital. While the death of the viator may be the event that triggers the investor to realize a profit, it is merely one variable to consider among many.[20]

The most recent[21] federal case to address this issue is SEC v. Mutual Benefits Corp.,[22] where Judge Moreno of the Southern District of Florida explicitly refused to apply *Life Partners*. *Mutual Benefits* should be affirmed at every level[23] because the viaticals in question presented the quintessential example of a "security" 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,[24] the viatical settlements in both *Life Partners* and *Mutual Benefits* should be considered investment contracts, and

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App. 2003); Michelson v. Voison, 658 N.W.2d 188 (Mich. Ct. App. 2003); Joseph v. Viatical Management, LLC, 55 P.3d 264; Sipornin v. Carrington, 23 P. 3d 92 (Ariz. Ct. App. 2001).

[17] *See generally Life Partners,* 87 F.3d at 536; Jennifer A. Lann, *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).

[18] *Mutual Benefits Corp.,* 323 F. Supp. 2d at 1342. *See e.g.,* Wuliger v. Christie, 310 F. Supp. 2d 897, 904 (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."

[19] "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 Corp.,* 323 F. Supp. 2d at 1339 (internal citations omitted).

[20] *Mutual Benefits Corp.,* 323 F. Supp. 2d at 1342.

[21] At least two other district courts have held that viatical settlements constitute securities: *Wuliger*, 310 F. Supp. 2d 897 is factually similar to *Mutual Benefit;* SEC 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." *Tyler*, 2002 WL 32538418 at *6, (quoting Reves v. Ernst & Young, 494 U.S. 56, 61 (1990)).

[22] *Mutual Benefits Corp.,* 323 F. Supp. 2d at 1337.

[23] The Federal District Court's decision in *Mutual Benefits* has already been affirmed by the Eleventh Circuit. A Petition for Certiorari was filed on September 13th, 2005. At this point in time, the United States Supreme Court has not ruled on the Petition. SEC v. Mutual Benefits Corp., 408 F.3d 737 (11th Cir. 2005), Petititon for Certiorari filed Sept. 13, 2005 (No. 05-333).

[24] 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.

therefore "securities." Moreover, the D.C. Circuit improperly downplayed the importance of the pre-purchase functions performed by the promoter.[25] For instance, the *Life Partners* court noted that the efforts of the promoter in evaluating the "insured's medical condition, review[ing] his insurance policy, negotiat[ing] the purchase price, and prepar[ing] the legal documents [were] undeniably essential to the overall success of the investment."[26] Nevertheless, the court decided that the viatical settlements were not "securities."

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."[27] "The fundamental purpose undergirding the Securities Acts is 'to eliminate serious abuses in a largely unregulated securities market.'"[28] Recognizing the "virtually limitless scope of human ingenuity…in the creation of…[investment schemes],"[29] Congress sought to protect investors. Accordingly, Congress "painted with a broad brush"[30] in defining the scope of the market it regulated to "encompass virtually any instrument that might be sold as an investment."[31]

In light of this Congressional intent, the Supreme Court crafted a strikingly broad definition of an "investment contract:"[32]

> 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.[33]

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[25] *See also Life Partners*, 87 F.3d at 551, n. 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 constituted a managerial post-purchase activity.

[26] *Life Partners,* 87 F.3d at 547. Additionally, "[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." *Id.*

[27] *Mutual Benefits Corp.*, 323 F. Supp. 2d at 1339-40

[28] Reves v. Ernst & Young*,* 494 U.S. 56, 60 (1990) (quoting United Housing Foundation, Inc. v. Forman*,* 421 U.S. 837, 849 (1975)).

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

[30] *Id.* at 60.

[31] *Id.* at 61.

[32] "Section 2(a)(1) of the 1933 Act, 15 U.S.C. § 77b(a)(1), and section 3(a)(10) of the 1934 Act, 15 U.S.C. § 78c(a)(10), …define security to include any note, stock, treasury stock, security future, bond, debenture, investment contract, or any instrument commonly known as a security. Investment contract is not itself defined." SEC v Edwards, 540 U.S. 389, 393 (2004) (internal citations omitted). In determining whether an "investment contract" exists "[f]orm [is] disregarded for substance and emphasis [is] placed upon economic reality. An investment contract [is] 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* 328 U.S. at 298

[33] SEC v. W.J. Howey Co*.,* 328 U.S. 293, 298-299 (1946).

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.[34] 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.*[35]

In *SEC v. Edwards*, the Supreme Court reiterated that 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."[36] The Supreme Court has never departed from *Howey's* notion 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 [other people's money based] on the promise of profits."[37]

II. VIATICAL SETTLEMENTS

A. SEC v. Life Partners[38]

The promoter-defendant in *Life Partners* sold fractional interests in insurance policies to retail investors. The investors could invest as little as $650 to buy a minimum of 3% of the benefits of a given policy.[39] In order to solicit customers, Life Partners used around 500 commissioned "licensees," who received around 10% of the purchase price after overhead costs were paid.[40] The promoter claimed to have annual revenues over

[34] Albanese v. Florida Nat'l Bank of Orlando, 823 F.2d 408, 410 (11th Cir. 1987). In *Albanese,* a group of investors sued an ice machine company that agreed to either manage or lease back ice machines from the investors and place them in various institutions. The Eleventh 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.)

[35] The requirement that profits come "solely" from the efforts of others was later relaxed. *See Mutual Benefits Corp.*, 323 F. Supp. 2d 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) (holding 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).

[36] *Edwards*, 540 U.S. at 395. 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 397.

[37] *Howey,* 328 U.S. at 299. *See also Edwards*, 540 U.S. at 394-95.

[38] The overview of viatical settlements is provided in the introduction, *supra* pp. 72-73

[39] *Life Partners,* 87 F.3d at 539.

[40] *Id.*

$150 million in 1994 alone.[41] The D.C. Circuit found that the promoters performed "ultimately no" entrepreneurial or managerial post-purchase functions.[42]

The promoters performed various pre-purchase functions: they evaluated the insured's[43] medical condition, reviewed his or her insurance policy, negotiated the purchase price, and prepared the necessary legal documents.[44] After the transaction closed, an independent escrow agent acting for the promoter performed the "post-purchase administrative functions."[45] When the purchase of the fractional interest in the life insurance policy closed, the escrow agent collected his fee and the promoter's fee, escrowed the funds for the premium payments, and delivered the balance to the seller.[46] Subsequently, the escrow agent followed through with the paperwork, held the policy, filed the death claim, and disbursed the funds.[47] 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."[48] Since the promoters in *Life Partners* represented that they had not performed "significant efforts" after the closing of the transaction, the D.C. Circuit allowed them to avoid the federal securities laws.[49]

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*[50] announced a bright-line rule: Pre-purchase "efforts of others," without more, are never enough to satisfy the third prong of *Howey*,[51] even if the article possesses

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

[42] *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 insisted, 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 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 the profitability of the investment in *Howey* depended entirely on how good the citrus season was? 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,* 328 U.S. at 301.

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

[44] *Life Partners,* 87 F.3d at 539.

[45] *Id* at 540.

[46] *Id.*

[47] *Id.*

[48] *Id.*

[49] After the D.C. Circuit's opinion was issued, the promoters in *Mutual Benefits*, structured their scheme exactly like that of the promoters in *Life Partners.* SEC v. Mutual Benefits Corp., 2004 U.S. Dist. LEXIS 23008 at *42.

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

[51] *Id.* at 540.

all the characteristics of an "investment contract." *Life Partners* rejected the idea that pre-purchase activities could "suffice to make the profits of an investment arise predominantly from the efforts of others"[52] because, once the transaction closes, the "only variable affecting profits is the timing of the insured's death,"[53] which is outside of 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 that if there have been no post-closing entrepreneurial or managerial efforts, then no security has been sold (regardless of the significance of the pre-purchase entrepreneurial or managerial efforts of the promoter). However, this type of bright-line rule does not constitute a "flexible approach" as required under *Howey*. The "pre/post"[54] 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 the requisite elements of a security.[55] Moreover, in *Mutual Benefits Corp.,* the court held that Mutual Benefits Corp. (MBC), a company structured exactly the same way as Life Partners Inc., had conducted sufficient post-purchase activities to classify the viaticals as securities.[56]

B. SEC v. Mutual Benefits Corp.

i. Generally

In *SEC v. Mutual Benefits Cor*p.,[57] investors who were promised a rate of return on their investment funded MBC's business.[58] "Investors were asked to identify a desired maturity date and submit a purchase agreement."[59] The rate of return on an investment was "dependent upon the term of the investment—determined by the life expectancy valuation."[60] Thus, if the viator lived beyond his or her expectancy, the investor would receive less return on the investment than expected.[61] In other words, if

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[52] *Id.* at 548.
[53] *Id.* at 545.
[54] "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").
[55] *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*, 328 U.S. at 298.
[56] *Mutual Benefits Corp.,* 2004 U.S. Dist. LEXIS 23008 at *42. *See also* SEC v. Mutual Benefits Corp., 323 F. Supp. 2d 1337, 1340 (S.D. Fla. 2004), "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)).
[57] *Mutual Benefits Corp.,* 323 F. Supp. 2d 1337 (S.D. Fla. 2004).
[58] *Mutual Benefits Corp.,* 2004 U.S. Dist. LEXIS 23008 at *42.
[59] *Mutual Benefits Corp.,* 323 F. Supp. 2d at 1338.
[60] *Id.*
[61] 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." *Mutual Benefits Corp.,*

the viator lived beyond his life expectancy, the term of the investment would be extended and the premiums paid from either: (1) other investors funds assigned to other policies; or (2) by additional funds from the original investors."[62]

Quite notably, MBC was structured virtually the same way as Life Partners Inc.[63] In fact, following the *Life Partners* decision, MBC was advised that viatical settlements were not securities and, therefore, not subject to federal securities law.[64] As a result, MBC structured its business plan accordingly."[65]

> 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*.[66]

Thus, MBC was able to avoid the disclosure and anti-fraud provisions of the federal securities laws based on the bright-line rule articulated in *Life Partners*. If *Life Partners* stands for the proposition that securities promoters can evade federal securities laws by simply structuring their business around the nuance of a federal appellate court decision, then *Life Partners* provides a great example why courts should be flexible, and avoid drawing bright-line rules in such situations.[67]

ii. Significant Post-Purchase Managerial Activities

Despite 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 and arguably satisfied the distinction espoused in *Life Partners*.[68] Assuming, arguendo, that the "pre/post" investment distinction is appropriate, the promoters in *Mutual Benefits* (as a result of their fraud) failed to limit their efforts to the pre-investment timeline.

2004 U.S. LEXIS 23008 at *30. 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 (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. "It 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 ever placed a longer life expectancy than three years." *Mutual Benefits,* 2004 U.S. Dist. LEXIS 23008 at *34.

[62] *Mutual Benefits Corp.,* 323 F. Supp. 2d at 1338. *See supra* note 4.

[63] *Id.* at 1343.

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

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

[66] *Mutual Benefits Corp.,* 323 F. Supp. 2d at 1343.

[67] *See Mutual Benefits Corp.,* 323 F. Supp. 2d at 1337; *Wuliger,* 310 F. Supp. 2d at 904.

[68] *See Mutual Benefits Corp.,* 2004 U.S. Dist. LEXIS 23008.

Starting in 1997, MBC experienced persistent problems with life expectancies in the majority of the policies it sold.[69] When an MBC sales agent complained to one of the majority owners (Leslie Steinger) that the policies were not maturing within their announced life expectancies,[70] Steinger dismissively responded, saying MBC was not experiencing company-wide problems and that whatever maturity issues there were resulted merely from a "fluke" or a 'bad luck of the draw.'[71] MBC's sales agents then passed this information on to its investors.[72] Notably however, by the time the SEC commenced its action against MBC, "at least 93.5% and possibly as many as 94.2% of MBC's AIDS policies [had] matured or [would] mature beyond their viator's life expectancies, as calculated by MBC."[73] As for the non-AIDS policies, "an astounding 66.2% were beyond their life expectancies as of June 11, 2004."[74]

MBC's doctors had underestimated the life expectancies by 2.5 to 3.5 years, and as a result, MBC needed millions of dollars to pay the premiums on the policies that had not yet matured.[75] MBC advised potential investors in their purchase agreements 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…."[76] Yet, between 1995 and 1997 MBC failed to provide any funding for the premium escrow accounts allocated for future policy premiums.[77] As a result of MBC's failure to fund the escrow accounts the company was forced to pay premiums on these 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."[78]

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

> 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 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 ability to continue to make premium

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69 *Id.* at 35-36.
70 To reiterate, the longer a viator lived, the less profit the investor received.
71 *Id.*
72 *Id.* at 36.
73 *Id.* at 32-33. 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.
74 *Id.* at 38.
75 *Id.* at 40-41. The court identified that there had been an underestimation of life expectancies for non-AIDS polices by 2.5 to 3.5 years. *Id.* at 41.
76 *Id.* at 40-42.
77 *Id.* at 42.
78 *Id.* at 42.

> payments does, or eventually will, depend on MBC's ability to bring in new investors.[79]

Consequently, if MBC failed to bring in more investors in order to pay the premiums of the underestimated policies, then the policies would have lapsed and the investors would have lost their entire investment. In light of this, it becomes abundantly clear that the investors' profits depended almost entirely on the promoters' efforts, thus satisfying the third prong articulate in Howey.[80] Arguably, these managerial and entrepreneurial efforts could even be found substantial enough to satisfy the more stringent "efforts of others" standard announced in *Life Partners*.[81]

On the other hand however, these efforts may be insufficient under *Life Partners*, considering that *Life Partners* explained a "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.'"[82] Apparently, the *Life Partners* court did not consider the consequences of certain propositions it asserted. For example, what if such criminal or tortious behavior does constitute a sufficient "effort" under *Howey*? The Supreme Court in *Howey,* stated that the "Securities Act prohibits the offer, as well as the sale of unregistered, non-exempt securities [and that] it is enough that the respondents merely offer the essential ingredients of an investment contract."[83]

iii. Promoters Cannot Evade Federal Securities Laws by Claiming that Their Actions Fail the Howey *Test*

Can a securities promoter evade federal securities law by representing that his actions are insufficient to satisfy the *Howey* test? Recall that:

> The test is 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, it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value.*[84]

This issue was indirectly addressed in *Albanese*, where a group of investors sued an ice machine company that agreed to either manage or lease-back ice machines from the investors and place them in various institutions.[85] There, the district court held that the contracts did not satisfy the third prong of the *Howey* test. Specifically, the district court

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[79] *Id.* at 42-43.
[80] *Howey*, 328 U.S. at 298-99.
[81] *Life Partners,* 87 F.3d at 545.
[82] *Id.*
[83] *Howey,* 328 U.S. at 301. "The registration requirements of § 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.*, n. 6
[84] *Howey,* 328 U.S. at 301 (emphasis added).
[85] Albanese v. Florida Nat'l Bank of Orlando, 823 F.2d 408, 410 (11th Cir. 1987).

found that: (1) the level of control the investors maintained was insubstantial and illusory; and (2) since the investors had no reasonable alternatives, they were left to rely on the promoter-ice machine company. The 11th Circuit reversed, finding instead that because the plaintiffs ultimately retained the potential for control of their investments[86] the contracts did in fact satisfy the *Howey* test The 11th circuit or the district 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 demonstrated that, in fact, any such control was illusory because plaintiffs had no realistic alternative to allowing PCI [the promoters] to manage their investments."[87]

Applying this rationale to *Mutual Benefits*, one could argue that even if the agreements themselves did not put the success of the investments predominantly in the hands of the promoters, the promoters' subsequent actions clearly did, and therefore the third prong of *Howey* can be satisfied. Moreover, the fundamental nature of this "Ponzi scheme"[88] 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.

III. WHY *LIFE PARTNERS* IS INCORRECT AND SHOULD NOT BE FOLLOWED

The bright-line rule espoused in *Life Partners* is not supported by any Supreme Court precedent, statutory text or legislative history.[89] In its attempt to offer some precedent for the distinction between "pre/post" investment efforts, the D.C. Circuit attempted to distinguish *McCown v. Heidler*.[90] In *McCown,* the court applied the same "pre/post investment" principle to reach a different result with respect to an investment in undeveloped land.[91]

In *McCown*, the investors claimed that the parcels marketed were securities because the promoters had promised to make future improvements on the lots.[92] The Court found that "[w]ithout the substantial improvements pledged by [the promoters] the lots would not have a value consistent with the price which purchasers paid...[t]he utilization of

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[86] *Id.*
[87] *Id.*
[88] 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.

Martino v. Edison Worldwide Capital, 189 B.R. 425, 437(Bankr. 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.
[89] *Mutual Benefits Corp.*, 323 F. Supp. 2d at 1343.
[90] McCown v. Heidler, 527 F.2d 204 (10th Cir. 1975)
[91] *Life Partners,* 87 F.3d at 547.
[92] *McCown,* 527 F.2d 204.

purchase money accumulated from lot sales to build the promised improvements could bring the scheme within the purview of the securities laws."[93] From this proposition, the court blindly concluded 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*.[94]

The fundamental problem with 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*.[95] This argument is illogical because the Court recognized that LPI's[96] 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."[97]

The *Life Partners* court, ostensibly, failed to discover persuasive precedent to support the "pre/post" investment distinction in *McCown*, and had to "rely" on *Noa v. Key Futures*[98], a case involving investments in silver bars. In *Noa,*

> 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]."[99]

However, *Noa* is readily distinguishable because the method of purchasing and selling the silver bars is far different from the purchase and sale of fractional interests in life insurance policies.

Noa stands for the proposition that the promoter must perform some post-purchase managerial or entrepreneurial efforts in order to classify a transaction as a security. It is important to note, however, that 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, it is the expertise of the promoter in assessing the policy, pre-investment, which largely dictates the profitability of the investor. On the other hand, with silver or other similar "products", the established

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[93] *Life Partners,* 87 F.3d at 547 (quoting *McCown*, 527 F.2d at 211).
[94] *Life Partners,* 87 F.3d at 547.
[95] *Life Partners,* 87 F.3d at 557 (Wald, J., dissenting).
[96] LPI was the promoter-defendant in *Life Partners.*
[97] *Id.* at 547.
[98] Noa v. Key Futures, 638 F.2d 77 (9th Cir. 1980).
[99] *Life Partners,* 87 F.3d at 546 (quoting *Noa,* 638 F.2d at 79-80).

commodities market dictates the value—the promoter has no control. This distinction is important because "[w]hen 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."[100] 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."[101]

Judge Wald correctly pointed out 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 these activities, either entirely or predominantly, that determines whether profits are eventually realized.[102] Additionally, the D.C. Circuit failed to distinguish *Noa* on the grounds that the promoters performed neither pre nor post purchase entrepreneurial efforts,[103] and had no control over the investment whatsoever. In *Noa,* the investors ultimately decided when to sell their interest. 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 promoters' expertise to procure and evaluate the policies, which includes the physician's review of the insured's life expectancy and the promoters' representations of such expectancies.[104] "The profitability of investments in these viatical settlements is wholly determined by the efforts of the promoters in evaluating life expectancies."[105] All the investor can do is pay his money and "trust" that the promoters' efforts were sufficient to guarantee a decent return.[106]

"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."[107] Conversely, the investor's profit 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, and negotiated the purchase price of policies. The profitability of investments

[100] *Life Partners* 87 F.3d at 552. (Wald, J., dissenting).
[101] *Id.* (quoting SEC v. G. Weeks Securities, Inc., 678 F.2d 649, 652 (6th Cir. 1982)).
[102] *Id.* at 551.
[103] The D.C. Circuit simply failed to make this crucial distinction.
[104] *Mutual Benefits Corp.,* 323 F. Supp. 2d at 1342.
[105] *Id.*
[106] *Noa* is also distinguishable because the scheme it addressed failed the second prong of *Howey* since there was no common enterprise.
[107] *Noa*, 638 F.2d at 79.

> 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.[108]

While *Noa* may focus on the post-purchase efforts of the promoter in determining whether a scheme is an investment contract, this issue does not prove dispositive in cases involving viatical settlements.[109] Rather, the "pre-post" investment distinction is only triggered when an investors' profit margin is wholly dependent on uncontrollable, external market forces. Even if "the timing of the viator's death is of great consequence in the realization of investors' profits"[110] the profits from investments in viatical settlements are determined by whether the promoters' life expectancy valuation is correct.[111] "[T]he crucial inquiry [for the third prong] is the amount of control that the investors retain under their written agreements."[112] In light of this notion, *Howey's* third prong 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.'"[113]

It is important to note that there is no case[114] holding "that pre-purchase activities alone cannot satisfy *Howey's* third prong." The third prong of *Howey* primarily considers the promoter's expertise.[115] In fact, the *Noa* court explicitly stated that the fact pattern it was addressing was not analogous to the facts of *Glen-Arden Commodities, Inc. v. Costantino,*[116] where promoters did provide expertise.[117] In contrast, the promoters in *Noa* neither offered their expertise nor "controlled" the investors' profit margin. The *Noa* promoters merely offered storage space, and provided the investors with assurances that they would buy back the silver. [118] Overall, it is clear that the facts of *Noa* and *Life Partners* are quite different.

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108 *Mutual Benefits Corp.,* 323 F. Supp. 2d at 1342.

109 *Contra, Mutual Benefits Corp.,* 323 F. Supp. 2d at 1343, where Judge Moreno stated that a "fair reading of *Noa* reveals no such distinction between pre and post-purchase activities."

110 *Mutual Benefits Corp.,* 323 F. Supp. 2d. at 1342.

111 *Id.*

112 SEC v. Unique Financial Concepts*,* 196 F.3d 1195, 1201 (11th Cir. 1999) (citing Albanese v. Florida Nat'l Bank, 823 F.2d 408, 410 (11th Cir. 1987)).

113 *Mutual Benefits Corp.*, 323 F. Supp. 2d at 1342 (citing *Unique Financial Concepts,* 196 F.3d 1195, 1201, where the Eleventh 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). *See also Albanese*, 823 F.2d at 410.

114 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.*

115 *See Noa,* 638 F.2d at 80 (discussing Glen-Arden Commodities, Inc. v. Costantino, 493 F.2d 1027 (2d Cir. 1974)).

116 Glen-Arden Commodities, Inc. v. Costantino*,* 493 F.2d 1027 (2d Cir. 1974).

117 *Noa,* 638 F.2d at 80.

118 *Life Partners,* 87 F.3d at 553. (Wald, J., dissenting)

The "pre/post" investment distinction that viatical settlement promoters rely on to avoid SEC regulation is derived from a case that is not analogous to the sale of fractional interests in life insurance policies. In short, the D.C. Circuit capriciously allows promoters of certain investments to side-step government regulation aimed at protecting investors simply because the promoters represent to the investors that all their efforts occur before the investor pledges money.

Did Judge Ginsburg consider the countless instances that this type of distinction could be used to evade federal securities laws? Perhaps not, considering that Judge Ginsburg declared that the time of sale is not an artificial dividing line:[119]

> 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.[120]

Yet, this proposition fails to assert why the need for regulation is greatly diminished when the investor's profits depend on pre-investment efforts. Judge Ginsburg's statement seems 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"[121], the philosophy is one of caveat emptor.[122] Such a proposition permits promoters to decide, sua sponte, whether the SEC will regulate their investment scheme. Obviously, Judge Ginsburg could not have intended to establish this sort of unsound precedent.[123]

In light of the foregoing consideration, the "pre/post" distinction in measuring "efforts of others" is completely erroneous. The need for disclosure to investors is actually heightened when all the promoters' efforts occur pre-purchase, because the investor may have absolutely no control over his investment after making the initial pledge.[124] Thus, if fractional interests in life insurance policies were considered investment contracts, as they should be, then the investor would not be completely helpless. He would be protected under the federal securities laws, and would therefore have certain remedies available to him. These remedies could include rescission of the

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[119] *Id.* at 547.
[120] *Id.*
[121] *Id.* at 545 (quoting SEC v. Glenn W. Turner Enters., Inc. 474 F.2d 476, 482 (9th Cir. 1973)).
[122] "[a] fundamental purpose, common to [the securities laws], was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor." Life Partners* 87 F.3d 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).
[123] *See generally, Mutual Benefits Corp.,* 323 F. Supp. 2d at 1343 (explaining that "the Court is uncomfortable with the bright-line rule enunciated by the D.C. Circuit and must decline Defendants' invitation to adopt a rule that is inconsistent with the policies underlying the federal securities laws and misconceives the nature of investments in viatical settlements." *Id*).
[124] This is especially true in the case of viatical settlements because of the lack of an established secondary market that an investor can access.

purchase, or other extraordinary measures of relief that are not typically available through the common law.[125] Overall, it seems clear that the need for disclosure is reduced if the efforts occur pre-purchase.

Even assuming, arguendo, that the need for disclosure is not heightened when the promoters' efforts occur pre-investment, the time of sale is (contrary to Judge Ginsburg's assertion[126]) an artificial dividing line. As noted above, the focus should be on the "degree of dependence between the investor's profits and the promoter's activities…."[127] Stated differently, in determining whether the "efforts of others" prong of *Howey* is satisfied, the ultimate question should not be: At what point in time did the promoters' efforts occur? Rather, the question should be: Can the investor's profit theoretically increase as a result of the promoter's efforts?[128]

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"[129] and to "restore the confidence of the prospective investor in his ability to select sound securities."[130] The emphasis has never been on when the fraud occurred. 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."[131] The need for disclosure is not diminished in any way simply because the promoter's efforts occurred before the investment was made. Judge Wald, dissenting in *Life Partners* explained:

> [g]iven the pivotal role of the promoter's activities, what the investor needs to know is not generally how this type of [investment] 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.[132]

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[125] *See generally,* Rowe v. Maremont Corp., 850 F.2d 1226 (7th Cir. 1988). For example:

> [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 at 1240 (quoting Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972)).

[126] *See Life Partners*, 87 F.3d at 547, where Judge Ginsburg declared that the time of sale is not an artificial dividing line.

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

[128] *See,* Wuliger v. Christie, 310 F. Supp. 2d 897, 906 (N.D. Ohio 2004).

[129] SEC v. W.J. Howey Co*.,* 328 U.S. 293, 299 (1946), *See also Life Partners,* 87 F.3d 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.").

[130] Lincoln Nat'l Bank v. Herber, 604 F.2d 1038, 1041 (1979) (citing*:* S.Rep.No.47, 73d Cong., 1st Sess., to accompany S. 875, April 27, 1933). *See also* H.R. Rep.No.85, 73d Cong., 1st Sess., to accompany H.R. 5480, May 4, 1933; and 77 Cong.Rec. 2983 (1933) (statement of Sen. Fletcher, who introduced the bill.).

[131] *Life Partners,* 87 F.3d at 552 (Wald, J., dissenting).

[132] *Id.*

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

IV. POTENTIAL COUNTER-ARGUMENTS

On the other hand, one can argue that the *Life Partners* court's focus on post-purchase activities is appropriate, and advances the purpose of the securities laws. This argument starts with the proposition that "the securities laws [are not] a broad federal remedy for all fraud."[133] From this, it is argued 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.[134] Thus, the need for SEC regulation and disclosure is decreased. At first glance, this argument seems perfectly rational; however, upon closer review the argument falls apart. Most importantly, it fails to explain why the timing of the promoter's efforts is significant.

If the securities laws are meant to protect against the risks involved in trusting someone else to make a profit with your money,[135] then the need for SEC regulation should apply with equal force whether the effort occurs before or after an investor pledges his money.[136] Moreover, an investor in viatical settlements deserves protection under the federal securities laws because viatical settlements do, in fact, fit the characteristics of a "security" both in substance and form.[137]

Promoters of viatical settlements are not simply "innocent" middlemen whose efforts are insignificant in generating profits. Purchasers in viatical settlements are "attracted by representations of investment income,"[138] and the promoter's purpose is to raise money "to finance substantial investments."[139] They are not, contrary to Glick's argument, merely matching investors in viatical settlements with viators.[140] As indicated above, the promoter's efforts completely dictate how much the investor will profit.

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[133] *Id.* at 547 (quoting Marine Bank v. Weaver, 455 U.S. 551, 556 (1982)).
[134] *See Life Partners,* 87 F.3d at 547.
[135] *Howey,* 328 U.S. at 299.
[136] *Life Partners,* 87 F.3d at 551-52 (Wald, J., dissenting).
[137] Glick, *supra* note 1, at 984. Glick takes the position that in the case of viatical settlements, *Howey's* goal of "divining substance through form succeeds…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." *Id.*
[138] SEC v. Edwards, 540 U.S. 389, 394 (2004).
[139] Reves v. Ernst & Young, 494 U.S. 56, 66 (1990).
[140] Glick, *supra* note 1, at 974. Glick argues that, in brokered viatical transactions:

> [t]he broker's efforts fail Howey's third prong because, like the seller's efforts, the broker's efforts are not post-sale managerial or entrepreneurial….[t]he 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.

Id. 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 falls apart when she explains the process of buying and selling viatical settlements:

V. CASES REJECTING *LIFE PARTNERS*

It should be no surprise that *Life Partners* has been repeatedly rejected ever since it was decided. The following section highlights just a few cases that have rejected the *Life Partners* rationale.

A. FEDERAL CASES

In *Wuliger v. Christie*[141], the court agreed with Judge Wald (dissenting 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."[142] The court went on to reject the logic of *Life Partners*.[143] Likewise, two years before *Wuliger*, a viatical investment program was considered a security in *SEC v. Tyler*.[144] In addressing whether the scheme in question was a security, the court in *Tyler* "focused on the promoters representations to the investors [combined] with the Supreme court's directive [to broadly define] a security [and] 'Congress' purpose in enacting the securities laws [which was to] regulate investment, in whatever form they are made and by whatever name they are called."[145]

B. STATE CASES

There have also 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.[146] Recently, in *Accelerated Benefits Co. v. Peaslee*[147] an Indiana appellate court rejected *Life Partners* because it found that the

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> [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 Ms. Glick is: What happens when the promoter does not perform those services? Are those services not analogous to a mutual fund manager's decision of what stock to include in a given fund?

141 Wuliger v. Christie, 310 F. Supp. 2d 897 (N.D. Ohio 2004).

142 *Wuliger,* 310 F. Supp. 2d at 903.

143 *Id*.

144 SEC v. Tyler, 2002 WL 32538418 (N.D. Tex. 2002).

145 *Wuliger,* 310 F. Supp. 2d at 904. The *Wuliger* Court explained that

> [w]hat 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.

146 *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:

> [p]rofits the investors expect[ed] to realize depend[ed almost entirely upon the purchaser's expertise in choosing which life insurance policies to purchase. More specifically, the investors rel[ied] 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 [was] not contestable on any grounds, and ensure that the policy [was] assignable.[148]

In concluding that viatical settlements constitute investment contracts, the Indiana court found support in Poyser v. Flora,[149] Security Trust Corp. v. Estate of Fisher,[150] and Siporin v. Carrington.[151] A number of other cases have similarly rejected *Life Partners*. including *Rumbaugh*,[152] *Michelson*,[153] and *Joseph*.[154] Obviously, the repeated rejection of *Life Partners* tends to support the proposition that it was wrongly decided.[155]

> Likewise, in the instant cavse [sic], the profitability of Griffitts's interests in life insurance policies is not determined by any managerial efforts on the part of Life Partners, but is determined by the mortality of the insureds. Griffitts points to Life Partner's 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 and filing evidence of death with the insurance company. After Griffitts paid Life Partners its commission, however, Griffitts and Life Partners shared no common interest in the profitability of the policies. 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.

[147] Accelerated Benefits Co. v. Peaslee, 818 N.E.2d. 73 (Ind. Ct. App. 2004).

[148] *Id.* at 77.

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

[150] Security Trust Corp. v. Estate of Fisher, 797 N.E.2d 789, 797 (Ind. Ct. App. 2003).

[151] Siporin v. Carrington, 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 concluded 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.

[152] Rumbaugh v. Ohio Dep't of Commerce, 800 N.E.2d 780 (Ohio Ct. App. 2003).

[153] Michelson v. Voison, 658 N.W.2d 188 (Mich. Ct. App. 2003).

[154] Joseph v. Viatical Mgmt., LLC, 55 P. 3d 264.

[155] Recently, many states have added the term "viatical settlements" to their definitions of a security in their Blue Sky laws. *See* Alaska 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. tit. 32, § 10501; Miss. Code Ann. § 75-71-105; Neb. Rev. Stat. § 8-1102; N.C. Gen. Stat. § 78A-2 (added 2002); N.D. 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."

VI. CONCLUSION

In summation, viatical settlements constitute investment contracts and, therefore, "securities" subject to regulation under the Securities Act of 1933 and the Securities and Exchange Act of 1934. *Life Partners* was incorrectly decided because the investors' profits *did* depend, primarily, on the efforts of the promoter. This fact should control, regardless of *when* these efforts took place (pre or post purchase). Not only is it contrary to federal securities laws, it is simply irrational to follow a legal doctrine of *caveat emptor* that essential, managerial *pre-purchase* efforts that significantly affect the failure or success of the enterprise[156] are insufficient to satisfy the third prong of *Howey*.

The bright-line distinction announced in *Life Partners* actually encourages fraud, and is contrary to the purpose and spirit of the Securities Laws and the *Howey* test. Moreover, the repeated rejection of *Life Partners* by various courts serves as persuasive authority for the argument that *Life Partners* does not work in application. Most notably, the viatical settlements in *Mutual Benefits* were analogous to those in *Life Partners*, and the *Mutual Benefits* court correctly held that the settlements at issue were, in fact, investment contracts and thus securities under *Howey*.[157] Assuming certiorari is granted to resolve the resulting direct conflict between the eleventh and D.C. circuits, the foregoing discussion clearly illustrates why the more consistent and cogent reasoning of *Mutual Benefits* should prevail.

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[156] *Life Partners*, 87 F.3d at 547, 550 (Wald, J., dissenting). *See also: SEC v. Glenn W. Turner Enters., Inc.* 474 F.2d 476, 482 (9th Cir. 1973).

[157] SEC v. Mutual Benefits Corp., 323 F. Supp. 2d 1337, 1338 (S.D. Fla. 2004), *aff'd*, 408 F.3d 737 (11th Cir. 2005), Petititon for Certiorari filed Sept. 13, 2005 (No. 05-333).