

# VIATICAL SETTLEMENT INDUSTRY: DOES *MUTUAL BENEFITS* RENDER IT TERMINAL?

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## I. INTRODUCTION

Doris Barrilleaux's son died of AIDS.<sup>1</sup> Five years later, when her financial planner suggested that she help another AIDS victim by purchasing the victim's life insurance policy, she agreed.<sup>2</sup> What Ms. Barrilleaux entered into is known as a viatical<sup>3</sup> settlement agreement, which involves an investor acquiring "an interest in the life insurance policy of a terminally ill" individual.<sup>4</sup> The original insured, the viator, sells the policy to an investor at a discount and receives a lump sum with which he can pay mounting medical bills.<sup>5</sup> The investor's rate of return is "the difference between the discounted purchase price paid to the insured and the death

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<sup>1</sup> Tom Stieghorst, *Florida Regulators Call Finances of Fort Lauderdale, Viatical Firm 'Unsound,'* SUN-SENTINEL, May 16, 2004, at 1E.

<sup>2</sup> *Id.*

<sup>3</sup> Miriam R. Albert, *The Future of Death Futures: Why Viatical Settlements Must Be Classified as Securities*, 19 PACE L. REV. 345, 347 n.8 (1999) (citing THE AMERICAN HERITAGE DICTIONARY OF THE AMERICAN LANGUAGE (3d ed. 1996) provides:

The term "viatical" comes from the Latin word "viaticum" which is the...communion given to Christians who are dying or are in danger of death; to the Romans, it meant money or provisions for a journey, but the term came to refer to the last rites—something to sustain the deceased person on his or her "last journey."

<sup>4</sup> SEC v. Life Partners, Inc., 87 F.3d 536, 537 (D.C. Cir. 1996) (hereinafter "Life Partners IV"). For purposes of this article, "*Life Partners*" in the main text refers to Life Partners IV.

<sup>5</sup> Jennifer Berner, Note, *Beating the Grim Reaper, or Just Confusing Him? Examining the Harmful Effects of Viatical Settlement Regulation*, 27 J. MARSHALL L. REV. 581, 584 (1994).

benefit,” minus any transaction fees and premiums paid.<sup>6</sup> If the viatical settlement provider miscalculates life expectancy and the viator lives longer than anticipated, the investor’s rate of return is reduced.<sup>7</sup> Although the industry is often labeled “ghoulish,”<sup>8</sup> it has allowed many AIDS victims to live their final days much more comfortably.<sup>9</sup>

Ms. Barrilleaux saw her chance to help someone with AIDS.<sup>10</sup> After being told that the investment would provide her with a fixed rate of return, she invested \$40,000.<sup>11</sup> In Minnesota, Dick Hausten’s family invested \$92,000 because they were told that viatical settlements were safer than certificates of deposits and to expect a high rate of return and guaranteed profit.<sup>12</sup> Peggy, an eighty-two-year-old woman from Colorado, invested \$12,000 after being told that the viator would die within two years.<sup>13</sup> Upon hearing that certain viators were on their deathbeds, Pauline

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<sup>6</sup> *Life Partners IV*, 87 F.3d at 537. There are two types of viatical settlements, brokered and non-brokered. Timothy P. Davis, *Should Viatical Settlements Be Considered “Securities” Under the 1933 Securities Act?*, 6 KAN. J.L. & PUB. POL’Y 75, 77 (1997) (hereinafter “T. Davis”). With non-brokered viatical settlements, individual purchasers or companies buy the life insurance policy, and the viator names the purchaser as the policy’s beneficiary. *Id.* Brokered viatical settlements involve an intermediary, usually the viatical settlement provider, who, for a commission, matches investors with viators. *Id.* The SEC is attempting to reach only brokered viatical settlements. Joy D. Kosiewicz, Comment, *Death for Sale: A Call to Regulate the Viatical Settlement Industry*, 48 CASE W. RES. L. REV. 701, 712 n.83 (1998). This facet of the industry is referred to as the secondary market. *Id.* at 712. The secondary market developed as viatical settlement providers began to sell fractional interests in the policies to investors. *Id.* This commentary focuses only on the secondary market, i.e., brokered viatical settlements.

<sup>7</sup> See T. Davis, *supra* note 6, at 75.

<sup>8</sup> See, e.g., Michelle Singletary, *Viaticals a Risk for Investors*, COLUMBUS LEDGER-ENQUIRER (Ga.), Mar. 11, 2002, at B1 (hereinafter “Singletary P”).

<sup>9</sup> Kosiewicz, *supra* note 6, at 706.

<sup>10</sup> Stieghorst, *supra* note 1.

<sup>11</sup> *Id.*

<sup>12</sup> Kathy M. Kristof, *Viatical Settlements Not the Secure Investment Some Marketers Claim*, L.A. TIMES, Sept. 20, 1998, at D2 (hereinafter “Kristof P”).

<sup>13</sup> *Id.*

Grissom, a seventy-year-old woman living in Palm Springs, California, invested \$52,000.<sup>14</sup>

Arlene Kaplan from Coconut Creek, Florida, invested \$15,000 after a salesperson assured her she would receive a return of \$19,000 once the viator, whose life expectancy was less than three years, died.<sup>15</sup> In Arizona, Nancy Del Valle and her husband invested a large percentage of their retirement savings in a viatical settlement after being told the viator was seventy-eight years old, had a heart condition, hypertension, depression, and a variety of other ailments.<sup>16</sup>

In Minnesota, the viator has not died and Dick Hausten's family suspects fraud.<sup>17</sup> Contrary to what they were told, investing in a CD at their local bank would have been safer. Unlike CDs, their viatical settlement is not insured and they no longer have access to their funds.<sup>18</sup> In Colorado, Peggy's daughter Victoria is trying to get her mother's money back.<sup>19</sup> Five years after her mother invested in the viatical settlement, the insured is still living.<sup>20</sup> Victoria thinks "the 'viator'—if there really is such a person—will outlive [her mother]...[and] '[i]f [her] mother had invested more, there would not be any money to have a home, pay the bills or eat.'"<sup>21</sup> Pauline Grissom also thinks she lost her \$52,000.<sup>22</sup> In addition, she has to pay a yearly bookkeeping fee of \$116 to the viatical settlement provider.<sup>23</sup> Last year, Arlene

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<sup>14</sup> Nancy Vogel, *Investors Suffer as Drugs Extend Lives*, L.A. TIMES, Sept. 26, 2000, at A1.

<sup>15</sup> Glenn Singer & Tom Stieghorst, *Weak Florida Laws Delayed Action against Firm That Defrauded Investors*, SUN-SENTINEL, May 7, 2004, at 1D.

<sup>16</sup> Singletary I, *supra* note 8.

<sup>17</sup> Kristof I, *supra* note 12. Several "[y]ears later, [the Haustens] suspected misrepresentation for a simple reason: 'People weren't dying.'" *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *See* Vogel, *supra* note 14.

<sup>23</sup> *Id.*

Kaplan filed a complaint with Florida’s Office of Statewide Prosecution because not only has she not received the \$19,000 she was promised, but she has also lost her original \$15,000 investment.<sup>24</sup> Lastly, the Del Valles believe that they have lost their entire investment because the viator has lived more than two years longer than expected.<sup>25</sup>

Although “[t]he plural of anecdote is not [evidence],”<sup>26</sup> the stories highlighted above accurately represent the problem facing many individuals who invest in viatical settlements.

The viatical settlement industry emerged and gained momentum in response to the AIDS epidemic of the late 1980s.<sup>27</sup> The industry grew quickly in part due to the insureds’ inability to sell their life insurance policies.<sup>28</sup> Viatical settlement providers created a market for these policies. Initially, regulation of the industry was focused on protecting the viator.<sup>29</sup> The National Association of Insurance Commissioners (NAIC) developed model statutes under which states could develop their own legislation to regulate the industry.<sup>30</sup> Early legislation focused on the

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<sup>24</sup> Singer & Stieghorst, *supra* note 15.

<sup>25</sup> Singletary I, *supra* note 8.

<sup>26</sup> Roger Brinner is credited as having first made this statement. Paul Lee, *The Nature of Anecdotes*, Skeptic Report, at <http://www.skepticreport.com/health/natureanecdotes.htm> (last visited Oct. 16, 2005).

<sup>27</sup> Michael Cavendish, *Policing Terminal Illness Investing: How Florida Regulates Viatical Settlement Contracts*, 74 FLA. B.J. 10, 10–12 (Feb. 2000) (noting that in its first year, the industry brokered \$90 million in life insurance benefits and that by the year 2000, the industry was on course to generate \$4 billion per year); Abbie Crites-Leoni & Angellee S. Chen, *Money for Life: Regulating the Viatical Settlement Industry*, 18 J. LEGAL MED. 63, 65-66 (1997) (noting that Living Benefits Inc., located in Albuquerque, NM, became the “first viatical settlement company” when it “purchased its first life insurance policy in 1989”).

<sup>28</sup> See Crites-Leoni & Chen, *supra* note 27, at 73 (explaining that a few insurance companies offer accelerated death benefits as an alternative).

<sup>29</sup> See Kosiewicz, *supra* note 6, at 706.

<sup>30</sup> *Id.* In order to protect the viator, the National Association of Insurance Commissioners (NAIC) drafted the Model Act and the Model Regulations. *Id.* The NAIC sought input from the National Association of People with AIDS (NAPWA) and the Viatical Settlement Working Group, which represented the viatical companies. *Id.* at 705-07. The Model Regulations included provisions requiring documentation that the viator understands the ramifications of the agreement and is of sound mind. *Id.* at 708. The viatical settlement company may have to disclose information to the

insured because he or she was in a vulnerable position, facing certain death, and desperate for funds.<sup>31</sup> Initially, the investor's needs were not in the forefront.<sup>32</sup>

In the mid-1990s, because of advances in medicine, AIDS patients began to live much longer.<sup>33</sup> Consequently, industry leaders acknowledged that investors could become nervous and thereby hurt the business.<sup>34</sup> Even after the medical advances, however, investors<sup>35</sup> nationwide were uniformly told they were making a secure investment that would yield high, fixed rates of return.<sup>36</sup> It was in this environment that states began treating viatical settlement agreements as securities.<sup>37</sup>

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viator, register with the state insurance commissioner, meet licensing requirements, and protect the insured's confidentiality. *Id.* The Model Act and Model Regulations also suggest setting a minimum rate upon which viatical companies can base their offers to ensure that viators are receiving a fair amount for their policies. *Id.*

<sup>31</sup> *See id.* at 704.

<sup>32</sup> *See id.* at 717.

<sup>33</sup> David W. Dunlap, *AIDS Drugs Alter An Industry's Math; Recalculating Death-Benefit Deals*, N.Y. TIMES, July 30, 1996, at D1. In 1996, "an AIDS conference in Vancouver, British Columbia, ... drew worldwide attention to the development" of new AIDS medications. *Id.* Once these advancements were made public, the amounts offered to viators with AIDS began to decrease. *Id.* Many viatical companies were forced to reduce their dependence on AIDS victims and expand the market by offering to buy policies from insureds with a variety of life-threatening illnesses. *Id.*

<sup>34</sup> Brian Pardo, President of Life Partners, Inc., explained:

"If the press becomes bullish on these cures, it's going to make the market for viaticals more nervous. Investors will become skittish if they believe there's a cure in the near term, within a three-year window. They'll stop buying viaticals. That will shut off the flow of capital to viatical companies."

*Id.*

<sup>35</sup> The average investor is seventy years old and invests an average of \$40,000. Baird Helgeson, *Lawmakers Approve Protections For Viatical Settlement Investors*, TAMPA TRIB., May 3, 2005, at 4.

<sup>36</sup> *See* Humberto Cruz, *Know Viatical's Rules and Risks*, LONG BCH. PRESS-TEL., Apr. 6, 2003, at BU2 (hereinafter "Cruz I").

<sup>37</sup> The following is a list of several state statutes that now expressly include viatical settlements in the definition of a security: ALASKA STAT. § 45.55.990 (Michie 2004) (defining "viatical settlement interest" in paragraph (37) and "viator" in paragraph (38)); ARIZ. REV. STAT. ANN. § 44-1801 (West 2005) (defining "viatical or life settlement investment contract" in paragraph (29)); CAL. CORP. CODE

For example, on June 16, 2005, Florida became the forty-seventh state to regulate viaticals as securities.<sup>38</sup>

Not only were state legislators taking notice of the investment side of the industry, but the Securities and Exchange Commission (SEC) was also fighting to require viatical settlement providers to register their product.<sup>39</sup> The SEC asserted that its rights under the securities laws allowed it to regulate these investments.<sup>40</sup>

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§ 25019 (West 2005) (including “viatical settlement contract or a fractionalized or pooled interest therein” and “life settlement contract or a fractionalized or pooled interest therein” in the definition of security); GA. CODE ANN. § 10-5-2(a) (2005) (defining “viatical investment” in paragraph (32) and “viatical issuer” in paragraph (33)); IND. CODE ANN. § 23-2-1-1 (West 2005) (including “viatical settlement contract, any fractional or pooled interest in a viatical settlement contract” in subsection (k) and defining “viatical settlement contract” under subsection (t)); IOWA CODE ANN. § 502.102 (West 2005) (including “viatical settlement contract, or any fractional or pooled interest in such contract” in subsection 28f and defining terms regarding viaticals in subsection 31A); MISS. CODE ANN. § 75-71-105 (2005) (including “viatical settlement investment contract or a fractionalized or pooled interest therein” in the definition of security and defining terms regarding viaticals in subsection (p)); NEB. REV. STAT. § 8-1101 (2005) (including “viatical settlement contract or any fractional or pooled interest in such contract” in subsection 15 and defining “viatical settlement contract” in subsection 17); N.C. GEN. STAT. § 78A-2 (2005) (including in subsection (11) “viatical settlement contract or any fractional or pooled interest in a viatical settlement contract” and defining terms relevant to viatical agreements in subsection (13)); N.D. CENT. CODE § 10-04-02 (2003) (including “viatical settlement contract or a fractionalized or pooled interest therein” in subsection 15 and defining terms regarding viaticals in subsection 16); OHIO REV. CODE ANN. § 1707.01 (West 2005) (including “any life settlement interest” in subsection B and explaining in subsection HH that “life settlement contract” includes viatical settlement agreements); W. VA. CODE ANN. § 32-4-401 (Michie 2005) (including “viatical settlement,” along with the term’s definition, in subsection n).

<sup>38</sup> Kathy Bushouse, *Bill to regulate viatical settlements passes Florida legislature*, SUN-SENTINEL, May 3, 2005 (hereinafter “Bushouse I”). The Florida legislature amended Florida’s security statute, FLA. STAT. ch. 517.021 (2005), by adding “viatical settlement investment” to the definition of “security” under subsection 21 and defining the term under subsection 23. S. 107-2412, Reg. Sess., at 2 (Fla. 2005) (effective date: Oct. 1, 2005). Meanwhile, Doug Head, executive director of Viatical and Life Settlement Association of America (VLSAA), a non-profit public relations firm which promotes the needs of viatical settlement providers, argues that fraud has not “existed in a decade” and warns that securities regulation will further impede the viatical market, thereby financially harming both investors and viators. Helgeson, *supra* note 35.

<sup>39</sup> Kosiewicz, *supra* note 6, at 712-13. Many in the viatical industry are opposed to SEC regulation. *Id.* at 707. They claim that regulation would increase the administrative and financial burden on viatical companies and decrease the amounts offered to viators. *Id.* The Viatical Association of America (VAA) has worked to self-regulate the industry. *Id.* at 715. Unfortunately, its efforts have not been as effective as needed, especially with regard to investors. *Id.* at 715-17.

<sup>40</sup> SEC v. Life Partners, Inc., 898 F. Supp. 14, 18 (D.D.C. 1995) (hereinafter “Life Partners I”) (noting that the SEC based its claim on “sections 5(a), 5(c), and 17(a) of the Securities Act of 1933...[codified

Viatical settlement companies refused to register their product because they claimed that the product did not constitute a security.<sup>41</sup> The SEC was forced to continue its fight in the courts and filed an action against Life Partners Incorporated (LPI), the largest viatical settlement provider in the nation at the time.<sup>42</sup> LPI argued that viatical settlements were not securities and therefore should not be monitored by the SEC.<sup>43</sup> The Court of Appeals for the District of Columbia Circuit agreed and found in favor of LPI.<sup>44</sup>

The issue did not reach the federal appellate level again until May of 2005. This time the defendant was viatical settlement provider Mutual Benefits Corporation (MBC).<sup>45</sup> It was with this corporation that Doris Barrilleaux invested.<sup>46</sup> As Ms. Barrilleaux explained, MBC has her “\$40,000 and [she] ha[s] nothing after six years.”<sup>47</sup> She is one of the thousands of investors that face significant losses from

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at] [15 U.S.C. §§ 77e(a), 77e(c), 77q(a)], and sections 10(b), 15(a), and 15(c) of the Securities Exchange Act of 1934...[codified at] [15 U.S.C. §§ 78j(b), 78o(a), 78o(c)]”). Under the Securities Act of 1933, Congress designated the Federal Trade Commission (FTC) as regulator of the securities market. *See* 17 C.F.R. § 200.1 (2005). Under the Securities Exchange Act of 1934, the SEC was created to replace the FTC. *Id.* One of the SEC’s main purposes is to ensure public disclosure of relevant information concerning securities that are sold. *Id.* §200.1(a). For purposes of this article, the Securities Act of 1933 and the Securities Exchange Act of 1934 will be referred to collectively as the “Securities Acts.”

<sup>41</sup> *Life Partners I*, 898 F. Supp. at 18 (stating that defendants deny that their products constitute securities).

<sup>42</sup> *See id.* at 17.

<sup>43</sup> *See id.* at 18.

<sup>44</sup> *Life Partners IV*, 87 F.3d 536, 538 (D.C. Cir. 1996) (holding that “LPI’s contracts are not securities subject to the federal securities laws”).

<sup>45</sup> *SEC v. Mut. Benefits Corp.*, 408 F.3d 737 (11th Cir. 2005) (hereinafter “Mutual Benefits III”). For purposes of this article, “*Mutual Benefits*” in the text refers to Mutual Benefits III.

<sup>46</sup> Stieghorst, *supra* note 1.

<sup>47</sup> *Id.*

her investment after dealing with MBC.<sup>48</sup> On May 20, 2004, Doris Barrilleaux's attorney filed a civil action on her behalf against MBC in a Florida state court.<sup>49</sup>

Meanwhile, the SEC filed an action against MBC in the United States District Court for the Southern District of Florida for various securities law violations.<sup>50</sup> David Nelson, Director of the SEC's Southeast Regional Office (SERO), stated that "[t]he scope of [MBC's] fraud is enormous."<sup>51</sup> Nelson asserted that MBC's scheme "involved more than 29,000 investors."<sup>52</sup> Much like Life Partners, Inc., MBC claimed that viatical settlement agreements do not constitute securities.<sup>53</sup> However, unlike the D.C. Circuit, the Eleventh Circuit found in favor of the SEC.<sup>54</sup>

This article critically examines and analyzes both *Life Partners* and *Mutual Benefits* and, in light of the relevant rule of law, suggests which case's holding is most appropriate.

Because the question of whether sales of viaticals are investment contracts actually lies within the purview of the Securities Act of 1933 and the Securities and Exchange Act of 1934, Part II of this article examines the historical setting surrounding these Acts and the policy rationale behind their enactments. Part III provides an overview of the cases in which these Acts have been tested, and Part IV examines comparatively the decisions and rationale of the D.C. Circuit case, *Life Partners*, and the Eleventh Circuit case, *Mutual Benefits*.

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<sup>48</sup> Peter Zalewski, *Recovery Effort: Suit in Fort Lauderdale Says Mutual Benefits Corp. Defrauded Investors of \$1.5 Billion Before Receivership*, MIAMI DAILY BUS. REV., May 21, 2004, at 11.

<sup>49</sup> "Barrilleaux's suit alleges [that] the defendants committed breach of fiduciary duty, breach of contract and negligence.... The suit requests compensatory damages of at least \$1.5 billion plus interest, punitive damages, [and] legal costs." *Id.*

<sup>50</sup> SEC v. Mut. Benefits Corp., 323 F. Supp. 2d 1337 (S.D. Fla. 2004) (hereinafter "Mutual Benefits I").

<sup>51</sup> Patrick Danner, *Death Benefit Firm Closed in Scam*, MIAMI HERALD, May 6, 2004, at 1A (hereinafter "Danner I").

<sup>52</sup> *Id.*

<sup>53</sup> Mutual Benefits III, 408 F.3d 737, 741 (11<sup>th</sup> Cir. 2005).

<sup>54</sup> *Id.* at 745 (holding that viatical settlement agreements constitute "investment contracts" and are subject to the securities laws).

Part V—as a corollary of Part IV, considers the reaction of both state and federal courts to the *Life Partners* decision and looks at the consequential application of the *Life Partners* precedent. Part VI explores the public policy in favor of the Eleventh Circuit’s opinion. Part VII demonstrates the reasons why courts should follow *Mutual Benefits* instead of *Life Partners*. The article concludes by providing reasons why viatical settlement agreements should be considered securities and therefore be subject to SEC regulation.

## II. LEGISLATIVE HISTORY OF THE 1933 AND 1934 SECURITIES ACTS

In order to determine whether an instrument is a security, courts usually begin their analysis by looking to the Securities Act of 1933<sup>55</sup> and the Securities Exchange Act of 1934.<sup>56</sup> “On September 1, 1929, ‘the aggregate value of all stocks

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<sup>55</sup> For purposes of this discussion, the relevant section of the 1933 Act is the section that defines “security.” Section 1 of the Securities Act of 1933, as amended, 15 U.S.C. § 77b(a), provides:

[T]he term “security” means any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security[;”] or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

<sup>56</sup> Section 3(a) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78c(a)(10) provides:

The term “security” means any note, stock, treasury stock, security future, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly

listed on the New York Stock [E]xchange...was \$89 billion[,]’ [but b]y the end of October [their aggregate value] had fallen by \$18 billion.”<sup>57</sup> Two years later, the market had suffered a \$74 billion loss.<sup>58</sup> On March 29, 1933, as one of his first acts in office, President Franklin Roosevelt sent a message to Congress in which he advocated the passing of legislation to supervise the securities market.<sup>59</sup> His letter stressed the importance of full disclosure by adding to “the ancient rule of caveat emptor,<sup>60</sup> the...doctrine ‘let the seller also beware.’”<sup>61</sup> In addition to facilitating the free flow of information, the goal of the Securities Acts was to “correct unethical and unsafe practices on the part of...corporations.”<sup>62</sup>

In the 1920s, American investors spent \$50 billion on new securities, half of which turned out to be worthless.<sup>63</sup> Congress responded by passing the Securities Acts.<sup>64</sup> As illustrated by President Roosevelt’s letter and the House and Senate

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known as a “security[;]” or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker’s acceptance, which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

<sup>57</sup> William L. Doerler, Comment, *SEC v. Life Partners, Inc.: An Extended Interpretation of the Howey Test Finds That Viatical Settlements are Investment Contracts*, 22 DEL. J. CORP. L. 253, 254 (1997).

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*; H.R. REP. NO. 73-85, at 1–2 (1933); S. REP. NO. 73-47, at 6–7 (1933).

<sup>60</sup> Latin for “let the buyer beware.” BLACK’S LAW DICTIONARY 236 (8th ed. 2004).

<sup>61</sup> H.R. REP. NO. 73-85, at 2; S. REP. NO. 73-47, at 6. Roosevelt’s words are in stark contrast to those uttered by Doug Head, the head of the VLSAA, when he dismissed investor complaints by explaining, “‘Hey, it’s *caveat emptor*.... Take your chances, dude, *don’t come crying to me*.” Arthur Allen, *As They Lay Dying*, WASH. POST, Nov. 17, 1996, at W13 (emphasis added).

<sup>62</sup> H.R. REP. NO. 73-85, at 2; S. REP. NO. 73-47, at 7.

<sup>63</sup> H.R. REP. NO. 73-85, at 2.

<sup>64</sup> *See id.* The 1933 Act deals with the initial issuance of securities and requires securities traded via interstate commerce to be registered. 1 LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 225 (3d ed. 1999). The 1934 Act focuses on the distribution of securities and has four objectives: “to afford a measure of disclosure to people who buy and sell securities; to prevent and afford remedies for fraud in securities trading and manipulation of the markets; to regulate the securities markets; and

reports, the aim of the Acts was two-fold.<sup>65</sup> First, Congress hoped to protect investors by forcing sellers of securities to provide investors with “material information” about their products.<sup>66</sup> Second, the Acts were an attempt to curb fraud and deceit in securities sales, which, according to House and Senate reports, was commonplace.<sup>67</sup>

Roosevelt elaborated on the first objective, stating that “every issue of new securities to be sold...shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.”<sup>68</sup> The theory behind full disclosure was that the free flow of information would enable investors to educate themselves before investing their life savings.<sup>69</sup> Congress did not pass the Securities Acts to create a paternalistic SEC.<sup>70</sup> As long as securities dealers<sup>71</sup> fully disclose all relevant information, “the SEC has no

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to control the amount of the Nation’s credit that goes into those markets.” *Id.* at 226. Louis Loss “is considered the intellectual father of securities law in the United States...[and] is the author of an 11-volume treatise on securities law, which has been cited by courts hundreds of times,” including fifty times by the Supreme Court. *Louis Loss, Emeritus Law Professor, Securities Law Specialist, Dies at 83*, HARV. U. GAZETTE, Jan. 15, 1998, available at <http://www.hno.harvard.edu/gazette/1998/01.15/LouisLossEmerit.html>.

<sup>65</sup> H.R. REP. NO. 73-85, at 1–2; S. REP. NO. 73-47, at 6–7; T. Davis, *supra* note 6, at 76.

<sup>66</sup> T. Davis, *supra* note 6, at 76.

<sup>67</sup> *See* H.R. REP. NO. 73-85, at 2; S. REP. NO. 73-47, at 1.

<sup>68</sup> H.R. REP. NO. 73-85, at 2; S. REP. NO. 73-47, at 6.

<sup>69</sup> *See* *Life Partners IV*, 87 F.3d 536, 550 (D.C. Cir. 1996) (Wald, J., dissenting).

<sup>70</sup> H.R. REP. NO. 73-85, at 2; S. REP. NO. 73-47, at 6 (President Roosevelt explained that “the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn profit”); *see also* 1 LOSS & SELIGMAN, *supra* note 64 at 225 (stating that “[t]he Commission has no authority to approve any security or to pass on its merits.”).

<sup>71</sup> 15 U.S.C.A. § 77b(12) (2005) provides, “The term ‘dealer’ means any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.” Courts often refer to dealers as “promoters.”

power to prevent a security from being marketed because it believes the security to be too risky.”<sup>72</sup> In other words, the final decision rests with the investor.

When profits depend on the promoter’s activities, the purpose behind requiring disclosure is clear because, in this scenario, investors do not have access to all relevant information.<sup>73</sup> This is especially true when the type of information necessary for an investor to make an informed decision is specific to the promoter.<sup>74</sup> An investor needs to know “not generally how [a given] 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.”<sup>75</sup> Investors, however, do not need such information when their profits depend primarily on market forces.<sup>76</sup> In that situation, “the realization of investor profits is fundamentally outside of the promoter’s control.”<sup>77</sup> In addition, when investor profits are dependent on the market, “there will be public information available to an investor by which the investor [can] assess the likelihood of the investment’s success.”<sup>78</sup> For example, when investing in artwork, a potential buyer can research the art market. If considering an investment in silver bars, the investor can assess trends in the silver market.<sup>79</sup> Moreover, when investor profits depend on the market, “registration...could provide no data about the seller which would be relevant to...market risks.”<sup>80</sup>

The second objective of the Securities Acts was “to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities

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<sup>72</sup> *Life Partners IV*, 87 F.3d at 550 (Wald, J. dissenting).

<sup>73</sup> *Id.* at 552.

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Id.* (quoting *SEC v. G. Weeks Sec., Inc.*, 678 F.2d 649, 652 (6th Cir. 1982)).

through misrepresentation.”<sup>81</sup> Congress thought that, by encouraging honest dealings, it could rekindle public confidence in the securities market.<sup>82</sup> Prior to the passage of the Securities Acts, the Senate Committee on Banking and Currency engaged in a long, publicized investigation into both “the stock market[’s business] practices and the reasons [behind] the stock market crash of October 1929.”<sup>83</sup> Congress acknowledged that fraudulent practices harm the stock market in general, and the Securities Acts were meant to “protect honest enterprise...against the competition afforded by dishonest securities offered to the public through crooked promotion.”<sup>84</sup> Congress did not want fraudulent promoters poisoning free market competition and thus making it more difficult for honest businesses to make a profit.<sup>85</sup>

Because the Securities Acts were remedial in nature,<sup>86</sup> courts have construed the laws “flexibly to effectuate [their] purposes,” rather than “technically and restrictively.”<sup>87</sup> Because Congress was aware that there was an infinite number of possible enterprises in which to invest, it included the all-encompassing term “investment contract” in the definition of security.<sup>88</sup> Congress looked to state blue

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<sup>81</sup> S. REP. NO. 73-47, at 1 (1933).

<sup>82</sup> *Id.* The Supreme Court explained that the Securities Acts were an attempt “to eliminate serious abuses in a largely unregulated securities market.” *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 849 (1975). In making that attempt, Congress focused “on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors.” *Id.*

<sup>83</sup> *Tcherepnin v. Knight*, 389 U.S. 332, 336 n.10 (1967) (citing Philip A. Loomis, Jr., *The Securities Exchange Act of 1934 and the Investment Advisers Act of 1940*, 28 GEO. WASH. L. REV. 214, 216-17 (1960)).

<sup>84</sup> S. REP. NO. 73-47, at 1.

<sup>85</sup> *See id.*

<sup>86</sup> *Id.* at 7; H.R. REP. NO. 73-85, at 2 (1933) (President Roosevelt directed Congress to enact “legislation *to correct*” the problems caused by the stock market crash) (emphasis added).

<sup>87</sup> *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963).

<sup>88</sup> *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946) (stating that “Congress was using a term the meaning of which had been crystallized by...prior judicial interpretation[, and]...[i]t is therefore reasonable to attach that meaning to the term as used by Congress, especially since such a definition is consistent with the statutory aims”).

sky laws”<sup>89</sup> definitions of “security” and state courts’ consistently broad interpretations of the term “investment contract” within those definitions.<sup>90</sup> Congress included this term in its definition of “security” specifically to regulate novel and unorthodox investments.<sup>91</sup> Congress intentionally failed to define the term “investment contract” and instead transferred that responsibility to the courts.<sup>92</sup>

### III. JURISPRUDENCE BEGINNING WITH *U.S. v. HOWEY*

In the landmark decision *United States v. W.J. Howey*,<sup>93</sup> the United States Supreme Court defined “investment contract.”<sup>94</sup> The seller of the securities, W.J.

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<sup>89</sup> 69A AM. JUR. 2D *Securities Regulation—State* § 1 (2004). Kansas was the first state to regulate its securities market. *Id.* By the time Congress passed the federal securities acts, forty-seven other states had followed Kansas’ lead. *Id.* The purpose of the state blue sky laws was “to stop the sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines, and... ‘speculative schemes which have no more basis than so many feet of blue sky.’” *Id.* (quoting *Hall v. Geiger-Jones Co.*, 242 U.S. 539 (1917)).

<sup>90</sup>*Howey*, 328 U.S. at 298, provides:

The term “investment contract”...was common in many state “blue sky” laws in existence prior to the adoption of the federal statute and, although the term was also undefined by the state laws, it had been broadly construed by state courts so as to afford the investing public a full measure of protection.

<sup>91</sup> *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943) (holding that “the reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached”). Courts have found a wide variety of unique investment schemes to constitute securities. *See, e.g.*, *SEC v. Edwards*, 540 U.S. 389 (2004) (pay phones); *Bailey v. J.W.K. Props., Inc.*, 904 F.2d 918, 919 (4th Cir. 1990) (cattle breeding); *Miller v. Cent. Chinchilla Group, Inc.*, 494 F.2d 414, 415 (8th Cir. 1974) (chinchillas); *Cont’l Mktg. Corp. v. SEC*, 387 F.2d 466 (10th Cir. 1967) (beavers); *Roe v. United States*, 287 F.2d 435 (5th Cir. 1961) (mineral leases); *Penfield Co. v. SEC*, 143 F.2d 746, 747 (9th Cir. 1944) (whiskey bottling contracts); *SEC v. Crude Oil Corp.*, 93 F.2d 844 (7th Cir. 1937) (crude oil sales contracts).

<sup>92</sup> *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 848 (1975) (explaining that “[t]he task has fallen...to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of [the Securities Acts]”).

<sup>93</sup>328 U.S. 293 (1946).

<sup>94</sup> *Id.* at 301. The Court first interpreted the Securities Acts ten years after their being passed. *Joiner Leasing*, 320 U.S. at 344. In *Joiner*, the Court held that the proper test to determine the existence of a security “is what character the instrument is given in commerce by the terms of the offer, the plan of

Howey Company (Howey), operated a citrus farm in Florida.<sup>95</sup> Howey solicited investors nationwide to finance the enterprise.<sup>96</sup> Each investor entered into a land sale contract under which Howey promised to convey a tract of land and a service contract by which Howey promised to cultivate, harvest, and market the crops grown on the tract of land.<sup>97</sup> Investors had neither discretion nor authority over the process and could not even enter upon the land without the promoter's consent.<sup>98</sup> After the harvest, the investor received the net profits from his tract of land, less the costs of labor and materials.<sup>99</sup>

In determining whether the buyers had invested in a security, the Court acknowledged that the Securities Acts failed to define "investment contract."<sup>100</sup> Because Congress had considered state blue sky laws when passing the Securities Acts, the Court considered how state courts had interpreted the term "investment contract."<sup>101</sup> The state courts' flexibility complied with the legislature's goal of protecting the investing public from a limitless variety of schemes.<sup>102</sup> The Court refused to restrict its analysis to the form of the agreement, in this case a simple

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distribution, and the economic inducements held out to the prospect." *Id.* at 352–53. However, in *Howey*, the Court clarified the definition of "security." *Howey*, 328 U.S. at 298–99.

<sup>95</sup> *Howey*, 328 U.S. at 295. *Howey* was brought under the Securities Act of 1933. However, the United States Supreme Court has explained that it has "repeatedly ruled that the definitions of 'security'...in the 1934 Act and...the 1933 Act are virtually identical and will be treated as such in [its] decisions." *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 686 n.1 (1985).

<sup>96</sup> *See Howey*, 328 U.S. at 296.

<sup>97</sup> *Id.* at 295.

<sup>98</sup> *Id.* at 296.

<sup>99</sup> *Id.*

<sup>100</sup> *Id.* at 298.

<sup>101</sup> *Id.* (explaining that in the state courts, "[a]n investment contract...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'" (quoting *State v. Gopher Tire & Rubber Co.*, 177 N.W. 937, 938 (Minn. 1920))).

<sup>102</sup> *Id.* at 299.

conveyance of property, and instead looked to the economic reality of the arrangement.<sup>103</sup>

Based on the economic reality analysis, the Court created a four-pronged conjunctive test.<sup>104</sup> Under this test, an investment contract is any “transaction or scheme whereby a person [1] invests his money [2] in a common enterprise and [3] is led to expect profits [4] solely from the efforts of the promoter or a third party.”<sup>105</sup> The Court concluded that this test “embodie[d] a flexible rather than a static principle...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 profits.”<sup>106</sup> Because investors did not purchase the land for their own use but instead in order to get a percentage of the overall profit generated by the promoters, the Court held that an investment contract existed.<sup>107</sup> Following *Howey*, federal courts have also applied the test flexibly.

#### **A. Investment of Money**

This prong of the test is almost always satisfied and often overlooked. When analyzing this prong, courts look to whether risk is an ingredient in the investment.<sup>108</sup> This prong requires that the investor “commit his assets to the enterprise in such a manner as to subject himself to financial loss.”<sup>109</sup>

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<sup>103</sup> *See id.* at 297-98.

<sup>104</sup> *Id.* at 299. Courts often apply the *Howey* test using three prongs and explaining that “an investment contract is a security...if investors purchase with (1) an expectation of profits arising from (2) a common enterprise that (3) depends upon the efforts of others.” *Life Partners IV*, 87 F.3d 536, 542 (D.C. Cir. 1996).

<sup>105</sup> *Howey*, 328 U.S. at 298–99.

<sup>106</sup> *Id.* at 299.

<sup>107</sup> *Id.* at 299-300.

<sup>108</sup> *Hector v. Wiens*, 533 F.2d 429, 432 (9th Cir. 1976).

<sup>109</sup> *Id.*

### **B. Common Enterprise**

There are two types of commonality, vertical and horizontal.<sup>110</sup> With regard to horizontal commonality, the court determines the nature of the relationship among the investors.<sup>111</sup> This type of commonality is generally considered more difficult to establish.<sup>112</sup> The three essential elements of horizontal commonality are “(1) a pooling of investors’ resources; (2) profit sharing among the investors; and (3) loss sharing among the investors.”<sup>113</sup> For example, in *SEC v. C.M. Joiner Leasing Corp.*,<sup>114</sup> the promoter solicited funds from investors nationwide in order to finance his oil drilling business. The investors received a percentage of the profits generated by the promoter’s oil wells, and these profits rose and fell together.<sup>115</sup>

On the other hand, when determining whether vertical commonality exists, courts look at the relationship between the promoter and the investor.<sup>116</sup> Vertical commonality “requires that the investor and the promoter be involved in some common venture without mandating that other investors also be involved.”<sup>117</sup> For example, in *SEC v. R.G. Reynolds Enterprises*,<sup>118</sup> Mr. Reynolds informed investors that

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<sup>110</sup> Doerler, *supra* note 57, at 261.

<sup>111</sup> *Id.* at 262.

<sup>112</sup> Mutual Benefits I, 323 F. Supp. 2d 1337, 1341 (S.D. Fla. 2004) (explaining that the “horizontal commonality” test is more stringent than the “vertical commonality” test). The horizontal test not only requires that a relationship exist among the investors; it further requires that the relationship exhibit specific characteristics. The vertical test requires only the presence of a relationship between the investor and the promoter. *Id.*

<sup>113</sup> Dave Luxenberg, Comment, *Why Viatical Settlements Constitute Investment Contracts Within the Meaning of the 1933 & 1934 Securities Acts*, 34 WILLAMETTE L. REV. 357, 365 (1998) (citing Life Partners IV, 87 F.3d 536, 544 (D.C. Cir. 1996)).

<sup>114</sup> 320 U.S. 344, 346 (1943).

<sup>115</sup> *Id.* at 348-49.

<sup>116</sup> Doerler, *supra* note 57, at 262 (noting that there are two types of vertical commonality, “broad vertical,” which requires that the investors’ fortunes be tied to the promoter’s efforts, and “strict vertical,” which requires that the investors’ fortunes be tied to the promoter’s fortunes).

<sup>117</sup> Brodt v. Bache & Co., Inc., 595 F.2d 459, 461 (9th Cir. 1978).

<sup>118</sup> 952 F.2d 1125 (9th Cir. 1991).

he would take a certain percentage of their profits as his management fee.<sup>119</sup> Because the promoter’s commission was contingent upon the investors’ profits, the court deemed the vertical commonality requirement satisfied.<sup>120</sup>

There is a split among the federal circuits regarding the “common enterprise” prong.<sup>121</sup> Currently, the Third, Sixth, and Seventh Circuits apply the more stringent horizontal commonality test.<sup>122</sup> The Fifth, Ninth, and Eleventh Circuits require only vertical commonality.<sup>123</sup> The Supreme Court has not resolved the split thus far.<sup>124</sup>

### **C. Expectation of Profits**

When determining whether the “profits” prong is satisfied, most courts follow the Supreme Court’s decision in *United Housing Foundation, Inc. v. Forman*.<sup>125</sup> In *Forman*, United Housing Foundation (UHF) organized the development of Co-op City, a low-income housing facility.<sup>126</sup> UHF established Riverbay Corporation (Riverbay) “to own and operate the land and buildings constituting Co-op City.”<sup>127</sup> For each room that a tenant desired, he or she had to purchase eighteen shares of Riverbay stock.<sup>128</sup> Because the Securities Acts define security as “any note [or]

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<sup>119</sup> *Id.* at 1130–31.

<sup>120</sup> *Id.* at 1131.

<sup>121</sup> Doerler, *supra* note 57, at 257.

<sup>122</sup> *Id.*

<sup>123</sup> *Id.*

<sup>124</sup> See *Mordaunt v. Incomco*, 469 U.S. 1115, 1117 (1985) (White, J., dissenting) (urging the Court to grant certiorari in light of the split among federal appellate courts regarding commonality).

<sup>125</sup> 421 U.S. 837 (1975); see also Stephanie Ann Miranda, *Can Pre-Purchase Entrepreneurial Efforts Satisfy the Fourth Prong of the Howey Test? A Critique of SEC v. Life Partners, Inc.*, 38 SANTA CLARA L. REV. 269, 283 (1997) (noting that under *Forman*, “courts generally agree that both monetary and non-monetary forms of returns or earnings on one’s investment will meet the ‘expectation of profits’ sub-element”).

<sup>126</sup> *Forman*, 421 U.S. at 841.

<sup>127</sup> *Id.*

<sup>128</sup> *Id.* at 842.

stock,”<sup>129</sup> the Court had to determine whether the buying of stock from Riverbay should be monitored by the SEC.<sup>130</sup>

The Court ultimately held that the stocks in the case at bar did not constitute securities.<sup>131</sup> Conscious of its reasoning in *Howey*, the *Forman* Court focused on the economic reality of the arrangement rather than the term used.<sup>132</sup> The Court provided two forms of “profits” that satisfy this element: “capital appreciation resulting from the development of the initial investment”<sup>133</sup> and “participation in earnings resulting from the use of investors’ funds.”<sup>134</sup>

In *Forman*, the tenants were not expecting to receive a financial return on their investment.<sup>135</sup> Furthermore, the tenants’ money was not pooled solely to fund the construction of Co-op City.<sup>136</sup> Instead, the tenants bought stock from Riverbay in order to obtain a place to live.<sup>137</sup> The *Forman* Court’s decision crystallized the term “profit” by differentiating the tenant’s expected return with the purely financial return in *Howey*.<sup>138</sup> Courts now focus on whether the investor reasonably expects a monetary return or whether he or she invests for consumption purposes.<sup>139</sup> The latter does not amount to a security.

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<sup>129</sup> *Id.* at 847 (quoting the Securities Act of 1933, 15 U.S.C. § 77b(1)).

<sup>130</sup> *Id.* at 848.

<sup>131</sup> *Id.* at 851.

<sup>132</sup> *Id.* at 848.

<sup>133</sup> *Id.* at 852 (citing *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943)).

<sup>134</sup> *Id.* (citing *Tcherepnin v. Knight*, 389 U.S. 332 (1967)).

<sup>135</sup> *Id.* at 853.

<sup>136</sup> *Id.* at 843.

<sup>137</sup> *Id.* at 853.

<sup>138</sup> Michael R. Davis, Note, *Unregulated Investment in Certain Death: SEC v. Life Partners, Inc.*, 42 VILL. L. REV. 925, 935–36 (1997) (hereinafter “M. Davis”) (citing *Forman*, 421 U.S. at 853).

<sup>139</sup> *Forman*, 421 U.S. at 858.

#### **D. Based on the Efforts of Others**

Finally, in order for an instrument to be deemed an investment contract, the profits must be generated “solely from the efforts of the promoter or a third party.”<sup>140</sup> Following the *Howey* Court’s insistence on flexibility, in *SEC v. Glenn W. Turner Enterprises, Inc.*,<sup>141</sup> the Ninth Circuit declined to literally apply the fourth prong, namely the term “solely.”<sup>142</sup> The *Turner* court adopted a more realistic approach, considering “whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.”<sup>143</sup> The court reasoned that adhering to a strict interpretation of the word “solely” “could result in a mechanical, unduly restrictive view...of an investment contract...[that]...would be easy to evade by adding a requirement that the buyer contribute a modicum of effort.”<sup>144</sup> In other words, the *Turner* court did not want to create a loophole by which promoters could easily avoid SEC regulation by manipulating their schemes to fall outside the definition of “investment contract.”

One year later, the Fifth Circuit, in *SEC v. Koscot Interplanetary, Inc.*,<sup>145</sup> added support to the *Turner* holding. The court explained that the state court cases on which the *Howey* Court based its definition of “investment contract” did not strictly apply the “solely from the efforts of others” prong.<sup>146</sup> In these state court decisions, despite the investors’ participation, courts held that an investment contract existed.<sup>147</sup> In addition, the court noted that, in *Howey*, the Supreme Court cited several circuit

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<sup>140</sup> SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946).

<sup>141</sup> 474 F.2d 476 (9th Cir. 1973).

<sup>142</sup> *Id.* at 483.

<sup>143</sup> *Id.* at 482.

<sup>144</sup> *Id.*

<sup>145</sup> 497 F.2d 473 (5th Cir. 1974).

<sup>146</sup> *Id.* at 480.

<sup>147</sup> *Id.* (citing *State v. Gopher Tire & Rubber Co.*, 177 N.W. 937 (Minn. 1920) (involving an agreement that required investors to act as booster agents for the sale of tires); *Stevens v. Liberty Packing Corp.*, 161 A. 193 (N.J. Ch. 1932) (involving an arrangement under which investors would raise rabbits bought from the promoter who, in turn, would purchase the offspring for a fixed price)).

court cases that either failed to mention the word “solely” or did not impliedly support a strict construction of the rule.<sup>148</sup> The *Koscot* court also included a long list of cases in which other courts had held that an investment contract was present despite actions taken by investors.<sup>149</sup> Recently in *SEC v. Edwards*,<sup>150</sup> the Supreme Court implicitly supported the holdings of both *Koscot* and *Turner*.<sup>151</sup> The Court clarified the *Howey* test in holding that 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.”<sup>152</sup> Because the Supreme Court is undoubtedly aware of the case law construing the term “investment contract,” it more than likely purposefully omitted the word “solely” from its definition of “investment contract.”

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<sup>148</sup> *Id.* at 481 n.11 (citing *SEC v. Universal Serv. Ass’n*, 106 F.2d 232, 237 (7th Cir. 1939) (the court omitted the word “solely” from its definition of “investment contract,” stating that an “investment contract” is an “investment of money with the expectation of profit through the efforts of [others]”); *SEC v. Crude Oil Corp.*, 93 F.2d 844 (7th Cir. 1937) (the court did not mention the word “solely” at all)).

<sup>149</sup> *Id.* at 482.

*Miller v. Central Chinchilla Group, Inc.*, 494 F.2d 414 (8th Cir. 1974) (investors purchased and raised Chinchillas which were then repurchased by promoters and sold by [the] latter to new prospects);...*Blackwell v. Bentsen*, [203 F.2d 690 (5th Cir. 1953)] (deeds for citrus acreage and management contracts, with provision that purchasers are permitted to give directions as to the marketing of crops on their tract); *1050 Tenants v. Jakobson*, 365 F. Supp. 1171 (S.D.N.Y. 1973) (offering of shares of stock, entitling purchasers to proprietary leases in apartment at 1050 Park Avenue, which after closing date, was to be managed by tenants); *Mitzner v. Cardet International, Inc. et al.*, 358 F. Supp. 1262 (N.D. Ill. 1973) (scheme wherein area managers recruited area distributors who in turn found people to deliver Cardet brochures and pick up orders and deliver Cardet products to purchasers); *SEC v. Addison*, 194 F. Supp. 709 (N.D. Tex. 1961) (in lieu of investing capital in potential profits of a mining company, workers were entitled to invest by participating in mining and other operations on a non-salaried basis).

*Id.*

<sup>150</sup> 540 U.S. 389 (2004).

<sup>151</sup> *Id.* at 395.

<sup>152</sup> *Id.* (quoting *United Hous. Found. v. Forman*, 421 U.S. 837, 852 (1975)).

In *Williamson v. Tucker*,<sup>153</sup> the court also focused on the fourth prong.<sup>154</sup> The *Williamson* court created a list of factors to consider when applying this element of the test, including whether:

(1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.<sup>155</sup>

The *Williamson* test suggests that courts should focus on the investor's degree of dependence on the promoter. Therefore, the less the investor's involvement, the more likely the "efforts of others" element is satisfied.<sup>156</sup> For example, in *Howey*, the investors lived all over the country, had no input in the daily activities of the citrus enterprise, and were not even permitted to enter their land without the promoter's permission.<sup>157</sup> Due in part to the investors' complete lack of control, the Court deemed the fourth prong satisfied.<sup>158</sup>

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<sup>153</sup> 645 F.2d 404 (5th Cir. 1981).

<sup>154</sup> *Id.* at 424. In *Williamson*, the court applied the Securities Acts to a series of transactions in which undivided interests in a parcel of undeveloped real estate were transferred to several joint ventures created for the purpose of holding the interests for a small number of purchasers, in exchange for promissory notes from the purchasers to the original owners of the property. *Id.* at 406.

<sup>155</sup> *Id.* at 424.

<sup>156</sup> *Id.*

<sup>157</sup> SEC v. W.J. Howey Co., 328 U.S. 293, 296 (1946).

<sup>158</sup> *Id.* at 300.

### **E. *Howey* Today**

In 2004, the United States Supreme Court again applied the *Howey* test in *SEC v. Edwards*.<sup>159</sup> In *Edwards*, business owners purchased payphones from ETS Payphones, Inc. (ETS).<sup>160</sup> In addition, the buyer entered a lease, management agreement, and buyback agreement with ETS.<sup>161</sup> ETS selected the site, installed the phone, arranged for phone service, collected the coins, handled repairs, and generally maintained the payphone.<sup>162</sup> The buyer received a guaranteed eighty-two dollars per month, plus “a [fourteen percent] annual return” on his or her investment.<sup>163</sup> The buyback agreement, into which a majority of buyers entered, provided that the buyer could return the phone within 180 days and ETS would refund the purchase price.<sup>164</sup> ETS’s solicitation materials trumpeted “an exciting business opportunity...[with] the potential for ongoing revenue generation that is available in today’s pay telephone industry.”<sup>165</sup>

In a unanimous decision, the Court held that the scheme constituted an investment contract.<sup>166</sup> The case focuses on investor protection and “in tone and analysis reads very much like *Howey*.”<sup>167</sup> The Court began its analysis with an explanation of the legislative intent surrounding the Securities Acts, namely “to regulate *investments*, in whatever form they are made and by whatever name they are called.”<sup>168</sup> The Court also highlighted Congress’ reasons for including the term

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<sup>159</sup> 540 U.S. 389 (2004).

<sup>160</sup> *Id.* at 391 (explaining that Charles Edwards was the CEO of ETS).

<sup>161</sup> *Id.*

<sup>162</sup> *Id.* at 391-92.

<sup>163</sup> *Id.* at 391.

<sup>164</sup> *Id.* at 392.

<sup>165</sup> *Id.*

<sup>166</sup> *Id.* at 397; *see also* 2 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 512–16, 514 (Supp. 2005) (noting that Justice O’Connor, “perhaps in an unconscious bow to post-Enron jurisprudence,” wrote the decision with a populist tone).

<sup>167</sup> 2 LOSS & SELIGMAN, *supra* note 166, at 516.

<sup>168</sup> *Edwards*, 540 U.S. at 393 (quoting *Reves v. Ernst & Young*, 494 U.S. 56, 61 (1990)).

“investment contract” in the definition of “security,” noting that Congress chose this term in light of state courts’ broad interpretation of the same term in their blue sky laws.<sup>169</sup>

The issue facing the Court was whether an investment scheme that “offered a contractual entitlement to a fixed, rather than a variable, return” constituted a security.<sup>170</sup> In reaching its conclusion, the Court refused to “read into the securities laws a limitation[,] not compelled by the language[,] that would...undermine the laws’ purposes.”<sup>171</sup> The Court explained that it did not find any distinction between fixed and variable returns in state blue sky laws.<sup>172</sup> In addition, post-*Howey* precedent stressed that the Securities Acts were meant to reach “countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.”<sup>173</sup> Furthermore, in *Edwards*, the Supreme Court unanimously re-affirmed the need to be flexible when applying the securities laws.<sup>174</sup> Even before *Edwards*, both the Eleventh<sup>175</sup> and D.C. Circuits were able to look to well-developed case law interpreting the Securities Acts in general and the term “investment K” in particular, to determine whether viaticals constitute securities.

#### IV. COMPARISON OF *MUTUAL BENEFITS* AND *LIFE PARTNERS*

The SEC asserts that viatical settlements are securities and that therefore the Securities Acts give it the power to regulate this industry.<sup>176</sup> In 1996, the SEC

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<sup>169</sup> *Id.* at 393-94 (explaining that blue sky laws were “precursors to federal securities regulation and were so named...because they were ‘aimed at promoters who ‘would sell building lots in the blue sky in fee simple’”) (citing 1 LOSS & SELIGMAN, *supra* note 64, at 31-43, 36).

<sup>170</sup> *Id.* at 391.

<sup>171</sup> *Id.* at 395.

<sup>172</sup> *Id.*

<sup>173</sup> *Id.* at 393 (quoting SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946)).

<sup>174</sup> *Id.*

<sup>175</sup> Because *Mutual Benefits* was decided shortly after *Edwards*, the Eleventh Circuit was able to gauge the current Court’s interpretation of the term “investment contract.”

<sup>176</sup> See *Mutual Benefits III*, 408 F.3d 737, 740 (11th Cir. 2005); *Mutual Benefits I*, 323 F. Supp. 2d 1337, 1338 (S.D. Fla. 2004).

unsuccessfully attempted to make Life Partners, Inc. (LPI) comply with the Securities Acts.<sup>177</sup> Even after this initial setback, the SEC continued its fight.<sup>178</sup> In May 2004, it filed a complaint against a Florida-based viatical settlement company, Mutual Benefits Corporation (MBC), alleging that it too had violated federal securities laws.<sup>179</sup> This time the SEC was victorious.<sup>180</sup> Contrary to the D.C. Circuit's opinion, the Eleventh Circuit held that viatical settlement agreements *do* constitute securities.<sup>181</sup> A comparison of these two decisions is imperative.

### **A. Life Partners Facts and Procedure**

In *Life Partners*, the SEC filed an action in which it claimed that LPI was selling unregistered securities.<sup>182</sup> At the time, LPI was the largest viatical settlement company in the United States and “accounted for more than half of the [viatical settlement] industry’s estimated annual revenues” in 1994.<sup>183</sup> Much like MBC, LPI’s basic plan entailed buying insurance policies from viators and then selling fractional interests in those policies to retail investors.<sup>184</sup> Prior to closing on a policy, LPI arranged for its doctors to perform a medical evaluation of the insured.<sup>185</sup> LPI also reviewed the insurance policies, opting to buy only those policies that met a certain standard.<sup>186</sup> During the litigation process, LPI changed its business scheme three

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<sup>177</sup> *Life Partners IV*, 87 F.3d 536, 538 (D.C. Cir. 1996).

<sup>178</sup> *See, e.g., Mutual Benefits I*, 323 F. Supp. 2d at 1337.

<sup>179</sup> *Id.* at 1337-38.

<sup>180</sup> *Mutual Benefits III*, 408 F.3d at 745.

<sup>181</sup> *Id.*

<sup>182</sup> *Life Partners IV*, 87 F.3d at 538.

<sup>183</sup> *Id.* at 539. Brian Pardo owned ninety-five percent interest in the company and acted as its president. *Id.*

<sup>184</sup> *Id.* LPI hired 500 independent financial planners and paid them ten percent of the insurance policy’s purchase price to recruit investors. *Id.*

<sup>185</sup> *Id.* at 539.

<sup>186</sup> *Life Partners I*, 898 F. Supp. 14, 17, 22 (D.D.C. 1995).

times, creating what the court referred to as Version I, Version II, and Version III.<sup>187</sup> The post-purchase activities differ in each version.<sup>188</sup>

In Version I, LPI, and not the investor, was the record owner of the policy and was designated as the policy's beneficiary.<sup>189</sup> In Version II, LPI was no longer the owner but could still hold the policy, monitor the insured's health, pay premiums, convert a group policy into an individual policy, file the death claim, collect and distribute death benefits, and assist investors who wanted to resell their interests.<sup>190</sup> In Version III, LPI no longer provided any post-purchase services, shifting all responsibility to the investors.<sup>191</sup> The investors, however, could purchase these services from Sterling Trust Company, an independent escrow agent hired by LPI.<sup>192</sup>

In 1995, the SEC filed a motion for a preliminary injunction claiming that LPI had violated securities laws.<sup>193</sup> The court held that LPI's scheme constituted an investment contract and ordered LPI "to bring [its operations] into compliance with securities laws."<sup>194</sup> LPI responded by transforming its scheme from Version I to Version II.<sup>195</sup> Because the SEC was not satisfied with LPI's efforts, it filed a motion to hold LPI in contempt for continuing to engage in the practice of selling unregistered securities.<sup>196</sup> The district court again held that an investment contract existed and ordered LPI to comply with the securities laws.<sup>197</sup> LPI was "preliminarily

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<sup>187</sup> *Life Partners IV*, 87 F.3d at 539-40.

<sup>188</sup> *Id.*

<sup>189</sup> *Id.* at 539.

<sup>190</sup> *Id.* at 540.

<sup>191</sup> *Id.*

<sup>192</sup> *Id.*

<sup>193</sup> *Life Partners I*, 898 F. Supp. 14, 17 (D.D.C. 1995).

<sup>194</sup> *Id.* at 24.

<sup>195</sup> *See SEC v. Life Partners, Inc.*, 912 F. Supp. 4, 6-7 (D.D.C. 1996) (hereinafter "Life Partners II").

<sup>196</sup> *Id.* at 7.

<sup>197</sup> *Id.* at 12.

enjoined from...offering or selling unregistered securities in the form of investment contracts representing fractional interests in the death benefits.”<sup>198</sup> Accordingly, LPI again altered its scheme in order to avoid securities laws by creating Version III.<sup>199</sup> The SEC was not satisfied and filed an emergency motion for supplemental provisional relief.<sup>200</sup> The court preliminarily enjoined LPI from selling interests in death benefits pending the decision of the D.C. Circuit.<sup>201</sup>

### **B. Mutual Benefits Facts and Procedure**

In 2004, the SEC again sought to make the largest viatical settlement provider in the United States—this time Mutual Benefits Corporation—comply with securities regulation.<sup>202</sup> The SEC filed an action in federal court alleging violations of various securities laws.<sup>203</sup> MBC was run by brothers, Joel and Leslie Steinger, and

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<sup>198</sup> *Id.* at 12–13.

<sup>199</sup> *See* SEC v. Life Partners, Inc., No. 94-1861, 1996 U.S. Dist. LEXIS 3451, at \*3 (D.D.C. Mar. 19, 1996) (hereinafter “Life Partners III”).

<sup>200</sup> *Id.* at \*1.

<sup>201</sup> *Id.* at \*3–4.

<sup>202</sup> Mutual Benefits I, 323 F. Supp. 2d 1337 (S.D. Fla. 2004); Danner I, *supra* note 51. MBC’s size and financial power enabled it to influence Florida state legislators. Danner I, *supra* note 51. Prior to its being hauled into court by the SEC in Florida, MBC successfully lobbied to decrease the state’s ability to regulate viatical settlement providers. *Id.* At the behest of MBC lobbyists, state legislators added an amendment at the last minute that “strip[ped] authority from two of the three Florida regulators who oversee the controversial viaticals business.” *Bush Signs Viatical Bill*, ST. PETE. TIMES (Fla.), July 2, 2004, at 1D. One week after the bill became law, MBC’s offices were raided and its assets frozen. Tom Stieghorst & Glenn Singer, *Insurance Regulators Shut Down Fort Lauderdale, Fla., Viaticals Firm*, SUN-SENTINEL, May 6, 2004, at 1A. One year later, perhaps in light of the Mutual Benefits situation, the Florida legislature *unanimously* passed legislation empowering the Department of Financial Services to regulate viaticals as securities. Helgeson, *supra* note 35.

<sup>203</sup> Mutual Benefits III, 408 F.3d 737, 740 (11th Cir. 2005). The SEC filed an action against MBC seeking “injunctive and other relief” for violations of securities laws. *Id.* MBC filed a motion to dismiss for lack of subject matter jurisdiction, arguing that a federal court did not have the power to adjudicate the dispute because its product did not fall within the purview of the securities laws. *Id.* at 738. However, the district court held that viatical settlements constituted “investment contracts.” *Id.* at 741. The court entered a temporary restraining order and appointed a receiver for MBC. *Id.* The district court ordered a magistrate judge to conduct evidentiary hearings. *See* SEC v. Mut. Benefits Corp., No. 04-60573-CIV-MORENO/GARBER, 2004 U.S. Dist. LEXIS 23008, at \*3 (S.D. Fla. Nov. 10, 2004) (hereinafter “Mutual Benefits II”). After hearing evidence from both sides, over the course of a month, the magistrate judge recommended that the court grant the SEC’s motion. *Id.* at \*79.

Peter Lombardi.<sup>204</sup> From 1994 to 2004, over 30,000 people invested, in the aggregate, more than \$1 billion in MBC's viatical settlement scheme.<sup>205</sup> MBC would find terminally ill individuals, negotiate a purchase price, bid on the policy, and recruit doctors to perform life expectancy evaluations.<sup>206</sup> On the investor front, MBC solicited funds from potential investors, placed those funds in an escrow account, and then purchased insurance policies with the funds.<sup>207</sup> Once it closed on a policy, MBC would pay the policy premiums and monitor the health of the insured.<sup>208</sup> MBC would also collect and distribute the death benefits.<sup>209</sup> MBC profited by negotiating one price with the viator and then selling fractional interests to investors at a "marked-up" price.<sup>210</sup>

MBC promoted its product nationwide through a network of independent sales agents, in-house sales agents, newspapers, direct mailings, and seminars.<sup>211</sup> The

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<sup>204</sup> *Mutual Benefits I*, 323 F. Supp. 2d at 1338. In 1998, the SEC brought an action against Joel and Leslie Steinger, claiming that, from October 1994 through April 1996, the Steinger brothers had misled investors in selling them \$100 million worth of viatical settlements. Danner I, *supra* note 51. "The Stingers were ordered to give up \$850,000 and [each] pay a \$50,000 civil penalty." *Id.*; see also Singer & Stieghorst, *supra* note 15. Shortly after filing charges against Mutual Benefits in 2004, David Nelson, head of SERO, told the Miami Herald, "That's what makes this scheme particularly galling.... At or about the time they settled with us [in 1996], they were continuing" to sell unregistered securities. Danner I, *supra* note 51. In 1996, pursuant to the settlement, the brothers were no longer allowed to run MBC and could only act as consultants. Singer & Stieghorst, *supra* note 15. According to the SEC, however, the brothers "remained principals of the company, setting policy and controlling funds." *Id.*

<sup>205</sup> *Mutual Benefits II*, 2004 U.S. Dist. LEXIS 23008, at \*7.

<sup>206</sup> *Mutual Benefits III*, 408 F.3d at 738.

<sup>207</sup> *Id.* at 738-39.

<sup>208</sup> *Id.*

<sup>209</sup> *Id.* at 739.

<sup>210</sup> *Id.*

<sup>211</sup> *Mutual Benefits II*, 2004 U.S. Dist. LEXIS 23008, at \*19. MBC promoted its products to investors nationwide. See Singer & Stieghorst, *supra* note 15. Because of these questionable sales practices, MBC has faced scrutiny "in nearly a dozen states over the past six years." *Id.* In 1999, a complaint was filed against MBC in Indiana requiring the company to register with the state securities department. *Id.* The following year Alaska and Alabama took action, "followed in 2001 by Kansas, Virginia and Vermont, in 2002 by Ohio, in 2003 by Pennsylvania, Arizona and Iowa," and finally in 2004 by Colorado. *Id.*

investor would enter a purchase agreement with MBC, which gave the investor seven return rate choices.<sup>212</sup> MBC's sales agents guaranteed these rates because, according to information provided to them by MBC, "70-80% of the viatical settlements...matured—*i.e.*, the viators died—on or before the viators' projected life expectancies."<sup>213</sup>

MBC made other questionable representations to potential investors. It claimed that each policy was reviewed by a state-licensed doctor who verified the viator's terminal illness and made a life expectancy determination *before* MBC bought the policy.<sup>214</sup> It explained that the high, fixed rates of return were not subject to the volatility of the stock market and that viaticals were a safe investment.<sup>215</sup> MBC also focused on the humanitarian aspects of the investment while steering away from the investment's risks.<sup>216</sup>

The medical advances in the mid-1990s dramatically affected MBC's business.<sup>217</sup> MBC's practice was to bid on AIDS policies immediately, without the benefit of an independent medical evaluation.<sup>218</sup> Although MBC claimed to have

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<sup>212</sup> *Mutual Benefits II*, 2004 U.S. Dist. LEXIS 23008, at \*19. For example, an investor could chose "a 12% fixed, total return on purchase price" within twelve months, "a 28% fixed, total return on purchase price" within twenty-four months, or "a 72% fixed, total return on purchase price" within seventy-two months. *Id.* at \*19-20; *Mutual Benefits III*, 408 F.3d at 739. The investor simply chose the most appealing percentage. *Mutual Benefits II*, 2004 U.S. Dist. LEXIS 23008, at \*19–20.

<sup>213</sup> *Mutual Benefits II*, 2004 U.S. Dist. LEXIS 23008, at \*20–21.

<sup>214</sup> *Id.* at \*21.

<sup>215</sup> *Id.* at \*21-22.

<sup>216</sup> *Id.* at \*21. In reality, the statistics regarding rates of return were nowhere near what MBC claimed. *Id.* at \*36–39. In November 2003, 90% of active AIDS policies were beyond the life expectancies predicted by MBC. *Id.* at \*29. From 1994 to 2004, MBC bought approximately 1,000 policies from patients with terminal illnesses other than AIDS. *Id.* at \*36. As of June 2004, 66% of the non-AIDS policies had already passed their predicted maturation date. *Id.* at \*38. By the time all of these policies have matured, 85% of the insureds could be beyond their life expectancies. *Id.* In dollars, "by the time all of the non-AIDS policies have matured, up to 94.7% (approximately \$1.0435 billion) of the values of those policies could be beyond their life expectancies." *Id.* at \*39.

<sup>217</sup> *Id.* at \*33.

<sup>218</sup> *Id.* at \*29.

stopped selling AIDS policies after 2000, there was evidence that it sold 700 AIDS policies between 2000 and 2003.<sup>219</sup>

Even with the knowledge of the medical advancements, MBC did not adjust its life expectancy predictions accordingly.<sup>220</sup> It did not inform potential investors of the new treatments' effects on the viatical industry.<sup>221</sup> It comforted current investors by saying that the treatments were not universally effective.<sup>222</sup> Paradoxically, in response to former investors' complaints regarding the late maturation of their investments, MBC explained that the new AIDS treatments caused the policies' late maturation.<sup>223</sup>

MBC's practices regarding life expectancy evaluations were also problematic. MBC bid on AIDS policies based on the insured's T-cell count.<sup>224</sup> After the viator accepted the offer, MBC would complete the transaction with the insured.<sup>225</sup> Next, MBC "match[ed] the policy to investors."<sup>226</sup> Lastly, MBC's in-house doctors reviewed the viator's medical records and prepared a written summary.<sup>227</sup> After

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<sup>219</sup> *Id.* at \*33.

<sup>220</sup> *Id.* at \*34. In fact, MBC sent potential investors articles in which these new medical treatments were discredited. *Id.* at \*35. Understandably, many current investors began complaining that they were not realizing their promised rates of return. *Id.* at \*36.

<sup>221</sup> *Id.* at \*34-35.

<sup>222</sup> *Id.* at \*35

<sup>223</sup> *Id.*

<sup>224</sup> *Id.* at \*29. T-cells play an integral part in the human immune system and are attacked by the HIV virus. This causes the number of T-cells to decrease in patients with HIV and AIDS, making it more difficult for these individuals to combat illness. AIDS.org, Fact Sheets, at <http://www.aids.org/factSheets/124-T-Cell-Tests.html> (last visited Oct. 17, 2005).

<sup>225</sup> *Mutual Benefits II*, 2004 U.S. Dist. LEXIS 23008, at \*29.

<sup>226</sup> *Id.*

<sup>227</sup> *Id.* at \*29-30. Dr. Mitchell, who was hired by MBC in 1996, would send investors a letter or notarized affidavit that he had signed. *Id.* at \*30. The affidavit included the life expectancy of the viator. *Id.* Dr. Mitchell was arrested in May 2004 and charged with Medicaid fraud, unrelated to his part in the MBC scheme. Patrick Danner, *Testimony Begins in Case Against Mutual Benefits*, MIAMI HERALD, July 1, 2004, at 3C (hereinafter "Danner II"). If convicted he could receive a sentence of up to 150 years in prison. *Id.* Dr. Mitchell admitted that even though he did not speak with the viator's

MBC's closing coordinator received the medical evaluation, he or she "would prepare the life expectancy letter or affidavit" for the doctor to sign.<sup>228</sup> MBC required that the life expectancy letter date back to the time MBC purchased the policy so that it looked as though MBC did not bid on a policy until its doctor had evaluated the viator and made a life expectancy prediction.<sup>229</sup>

Because many policies were not maturing on time, MBC faced the problem of having to pay premiums for a longer period of time than expected.<sup>230</sup> The company assured investors that a reserve account existed to pay premiums after a given life expectancy date had passed.<sup>231</sup> In reality, MBC used the money it received from new investors to pay premiums for older policies.<sup>232</sup> In other words, "MBC's ability to continue to make premium payments...depend[ed] on MBC's ability to bring in new investors."<sup>233</sup> The Eleventh Circuit described MBC's operation as a Ponzi Scheme.<sup>234</sup>

### **C. Eleventh and D.C. Circuit Application of *Howey***

The Eleventh and D.C. Circuits applied *Howey* to a similar set of facts.<sup>235</sup> Nevertheless, the two courts came to opposite conclusions.<sup>236</sup> *Mutual Benefits* begins

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doctor, in his letter to investors he claimed to have done so. *Mutual Benefits II*, 2004 U.S. Dist. LEXIS 23008, at \*30. Mitchell testified that he was not comfortable with this arrangement and made his feelings known to Joel Steinger. *Id.* Mitchell claims that Mr. Steinger "told him to continue to execute the letters and affidavits as they were written." *Id.*

<sup>228</sup> *Mutual Benefits II*, 2004 U.S. Dist. LEXIS 23008, at \*31.

<sup>229</sup> *Id.*

<sup>230</sup> *Id.* at \*43.

<sup>231</sup> *Id.* at \*42.

<sup>232</sup> *Id.* at \*43.

<sup>233</sup> *Id.*

<sup>234</sup> *Mutual Benefits III*, 408 F.3d 737, 741 (11th Cir. 2005). This scheme is named after Charles Ponzi, "the organizer of such a scheme in the U.S. [in] 1919-20." RANDOM HOUSE WEBSTER'S COLLEGE DICTIONARY 1049 (4th ed. 1996). The term "Ponzi" is defined as "a swindle in which a quick return on an initial investment paid out of funds from new investors lures the victim into bigger risks." *Id.*

<sup>235</sup> *Mutual Benefits III*, 408 F.3d 737; *Life Partners IV*, 87 F.3d 536 (D.C. Cir. 1996).

with a discussion of the history of the Securities Acts and their primary purpose: “to regulate *investments*, in whatever form they are made and by whatever name they are called.”<sup>237</sup> Because most courts applying *Howey* begin their analyses with the historical background of the Securities Acts,<sup>238</sup> the D.C. Circuit’s failure to preface its discussion with this information stands out.<sup>239</sup> Obviously, courts are not required to follow a certain structure when interpreting securities laws, but the majority of courts has done just that.<sup>240</sup> Because the D.C. Circuit chose to stray from this accepted structure, the *Life Partners* decision is an anomaly. Both *Mutual Benefits* and *Life*

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<sup>236</sup> *Mutual Benefits III*, 408 F.3d at 745; *Life Partners IV*, 87 F.3d at 549.

<sup>237</sup> *Mutual Benefits III*, 408 F.3d at 742 (quoting *SEC v. Edwards*, 540 U.S. 389, 393 (2004) (emphasis in original)).

<sup>238</sup> See, e.g., *Reves v. Ernst & Young*, 494 U.S. 56, 63 (1990) (providing that courts should interpret securities law “against the backdrop of what Congress was attempting to accomplish in enacting the Securities Acts”).

<sup>239</sup> The district court in *Mutual Benefits I* found for the SEC specifically “in accordance with the underpinning principles[, namely flexibility,] of the federal securities laws...interpreted time and again by...the Supreme Court.” *Mutual Benefits I*, 323 F. Supp. 2d 1337, 1344 (S.D. Fla. 2004). Courts that have had to interpret “investment contract” often begin their analyses with the historical context of the Securities Acts of 1933 and 1934, followed by an explanation of the underlying legislative intent, then followed by a discussion of precedent in which courts invoke flexibility. See *SEC v. Edwards*, 540 U.S. 389, 393–94 (2004) (including a comprehensive explanation of the Securities Acts, underlying legislative intent, and precedent in which courts have stressed flexibility); *United Hous. Found. v. Forman*, 421 U.S. 837, 849 (1975) (beginning the analysis with the purposes underlying the Securities Acts of 1933 and 1934 and including the doctrine that form should be ignored in favor of economic reality); *Tcherepnin v. Knight*, 389 U.S. 332, 335–38 (1967) (discussing the Securities Acts, the legislative intent that securities laws not be narrowly interpreted, and the *Howey* Court’s directive that its test is meant to be flexible); *SEC v. Howey*, 328 U.S. 293, 298–99 (1946) (including in its analysis the Securities Acts, legislative intent, and the flexibility used by state courts when interpreting the term “investment contract”); *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 479–80 (5th Cir. 1974) (beginning with an explanation of Congress’ intent regarding the securities laws, followed by a detailed discussion of the Supreme Court’s analysis in *Howey*); *SEC v. Glenn W. Turner Enters., Inc.*, 474 F.2d 476, 480 n.4, 481 (9th Cir. 1973) (beginning the discussion with the definition of “security,” followed by legislative intent in favor of a broad application, and citing precedent in which courts have stressed flexibility). Other cases in which the analysis follows a similar structure include *Rodriguez v. Banco Cent. Corp.*, 990 F.2d 7, 10 (1st Cir. 1993); *SEC v. R.G. Reynolds Enters., Inc.*, 952 F.2d 1125, 1130 (9th Cir. 1991); *Gary Plastic Packaging Corp. v. Merrill Lynch*, 756 F.2d 230, 237–38 (2d Cir. 1985); *Glen-Arden Commodities, Inc. v. Costantino*, 493 F.2d 1027, 1034 (2d Cir. 1974).

<sup>240</sup> See cases cited *supra* note 239.

*Partners*, however, separate the prongs of the *Howey* test and apply each to the facts at hand.<sup>241</sup>

### 1. “In a common enterprise”

Both circuits deemed the commonality prong satisfied.<sup>242</sup> In *Life Partners*, the D.C. Circuit applied the horizontal commonality test.<sup>243</sup> The investors’ money was pooled when LPI brought together a group of investors, each of whom purchased a fractional interest in a life insurance policy.<sup>244</sup> If an insured died prior to the expected date, all of the investors received a higher return.<sup>245</sup> The investors also shared the risk that the insured might live longer than predicted.<sup>246</sup> Because all three elements of horizontal commonality were satisfied, the court determined that the commonality requirement was met.<sup>247</sup> The D.C. Circuit saw no need to determine whether vertical commonality existed.<sup>248</sup>

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<sup>241</sup> *Mutual Benefits III*, 408 F.3d at 742–43; *Life Partners IV*, 87 F.3d at 542. The Eleventh Circuit quickly addressed the first three prongs explaining that “[t]here is no genuine dispute here that there was (1) an investment of money, (2) in a common enterprise, (3) involving an expectation of profits.” *Mutual Benefits III*, 408 F.3d at 742-43. Because the Eleventh Circuit was satisfied with the district court’s holding with respect to these elements, the court turned to the issue at hand, namely “whether the investor’s expectation of profits is based ‘solely on the efforts of the promoter or a third party.’” *Id.* at 743. The D.C. Circuit focused on only three elements: “(1) an expectation of profits arising from (2) a common enterprise that (3) depends upon the efforts of others.” *Life Partners IV*, 87 F.3d at 542.

<sup>242</sup> *Mutual Benefits III*, 408 F.3d at 742-43; *Life Partners IV*, 87 F.3d at 544. The three elements of horizontal commonality are “(1) pooling of investors’ resources; (2) profit sharing among the investors; and (3) loss sharing among the investors.” Luxenberg, *supra* note 113, at 365.

<sup>243</sup> *Life Partners IV*, 87 F.3d at 544.

<sup>244</sup> *Id.* at 543-44.

<sup>245</sup> *Id.* at 543.

<sup>246</sup> *Id.*

<sup>247</sup> *Id.* at 544.

<sup>248</sup> *Id.*

In the *Mutual Benefits* district court decision, Judge Moreno explained that the Eleventh Circuit requires only vertical commonality.<sup>249</sup> With vertical commonality, it is only necessary that the success of the investor(s) and promoter be intertwined.<sup>250</sup> It is not a prerequisite that the investors' profits be connected.<sup>251</sup> In *Mutual Benefits*, the “investors' return [was] highly dependent on MBC's efforts because the investors rel[ie]d on MBC's skill in locating, negotiating, bidding, and evaluating policies.”<sup>252</sup> Based on these facts, the court deemed the commonality requirement satisfied.<sup>253</sup>

## 2. “Based on a reasonable expectation of profits”

As with commonality, both circuits held that individuals invested their money in the hopes of receiving a monetary return.<sup>254</sup> In *Life Partners*, the court, following *Forman*, correctly determined that the investor expected to receive a financial return.<sup>255</sup> The D.C. Circuit accurately noted that “[t]he buyer [was] obviously purchasing not for consumption—unmatured claims cannot be currently consumed—but rather for the prospect of a return on his investment.”<sup>256</sup>

## 3. Derived from the entrepreneurial and managerial efforts of others

The Eleventh and D.C. Circuits took different paths regarding the “efforts of others” prong.<sup>257</sup> In *Life Partners*, the court followed the broad interpretation of the word “solely,” requiring only that profit-generating activities come “‘predominantly’

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<sup>249</sup> *Mutual Benefits I*, 323 F. Supp. 2d 1337, 1341 (S.D. Fla. 2004).

<sup>250</sup> *Id.*

<sup>251</sup> *See id.*

<sup>252</sup> *Id.*

<sup>253</sup> *Id.*

<sup>254</sup> *Mutual Benefits III*, 408 F.3d 737, 742-43 (11th Cir. 2005); *Life Partners IV*, 87 F.3d 536, 543 (D.C. Cir. 1996).

<sup>255</sup> *Life Partners IV*, 87 F.3d at 543.

<sup>256</sup> *Id.*

<sup>257</sup> *Mutual Benefits III*, 408 F.3d at 743-45; *Life Partners IV*, 87 F.3d at 545-48.

from the efforts of others.”<sup>258</sup> The court went on to separate entrepreneurial and managerial efforts from ministerial efforts, declaring the latter irrelevant.<sup>259</sup> Finally, the court concluded that “post-purchase entrepreneurial activities are the ‘efforts of others’ most *obviously* relevant to the question whether a promoter is selling a ‘security.’”<sup>260</sup> After making this statement, however, the court failed to cite any precedent to support its assertion.<sup>261</sup> According to its reasoning, pre-purchase entrepreneurial and managerial efforts alone are never enough to satisfy this prong.<sup>262</sup> In order for a given scheme to constitute an investment contract, there must be some *significant* post-purchase services.<sup>263</sup> The court then applied this new bright-line test to the facts before it.<sup>264</sup>

First, the court determined whether LPI’s post-purchase activities were managerial or entrepreneurial in nature.<sup>265</sup> In Version I, because LPI was named as the policy owner and beneficiary, investors relied “on LPI’s continuing to deal honestly with them.”<sup>266</sup> The court found that LPI would have had to engage in criminal conduct or fail “to perform its post-purchase ministerial functions” in order to impede investor profits.<sup>267</sup> This type of conduct did not satisfy the “efforts of others” prong because it was “not the sort of entrepreneurial exertions that the *Howey* Court” envisioned.<sup>268</sup>

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<sup>258</sup> *Life Partners IV*, 87 F.3d at 545.

<sup>259</sup> *Id.* at 545-46.

<sup>260</sup> *Id.* at 545 (emphasis added).

<sup>261</sup> *See id.*

<sup>262</sup> *Id.* at 548.

<sup>263</sup> *Id.* at 545-46.

<sup>264</sup> *Id.*

<sup>265</sup> *Id.*

<sup>266</sup> *Id.* at 545

<sup>267</sup> *Id.*

<sup>268</sup> *Id.*

In Version II, the court found that the post-purchase services offered by LPI were purely ministerial.<sup>269</sup> It held that LPI's "assistance" did not add to or take away from an investor's potential profits.<sup>270</sup> Version III contained no post-purchase activities to which the court could look for entrepreneurial efforts.<sup>271</sup> In conclusion, the court determined that LPI did not engage in any significant non-ministerial activities after the sale of the policy.<sup>272</sup> Therefore, the three versions at issue did not constitute securities.<sup>273</sup> According to the holding, combining the managerial and entrepreneurial pre-purchase efforts with the ministerial post-purchase efforts did not satisfy the "efforts of others" prong.<sup>274</sup> The basis for the court's conclusion was that investor profits depended "entirely upon the mortality of the insured."<sup>275</sup>

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<sup>269</sup> *Id.* at 545-46.

<sup>270</sup> *Id.* at 546. The court had to overcome case precedent such as *Gary Plastic Packaging Corp. v. Merrill Lynch*, 756 F.2d 230 (2d Cir. 1985), in which the Second Circuit reasoned that a promoter's offering to buy back the investor's interest satisfied the "efforts of others" prong. *Id.* at 240. The D.C. Circuit held that the facts in *Life Partners II* were distinguishable because there was no evidence that investors sought to liquidate their policies and because LPI warned clients that resale opportunities were not guaranteed. *Life Partners IV*, 87 F.3d at 546.

<sup>271</sup> *Life Partners IV*, 87 F.3d at 546.

<sup>272</sup> *Id.* To support its decision that pre-purchase efforts, regardless of their nature, were irrelevant, the court cited *Noa v. Key Futures, Inc.*, 638 F.2d 77 (9th Cir. 1980) and *McCown v. Heidler*, 527 F.2d 204 (10th Cir. 1975)). *Id.* In *Noa*, the promoter's pre-purchase services included purchasing silver from a specific seller and then refining the silver to achieve the proper purity. *Noa*, 638 F.2d at 79. The D.C. Circuit likened the *Noa* promoter's pre-purchase selection process to that of LPI. *Life Partners IV*, 87 F.3d at 547. In *Noa*, the court held that investor profits depended on "fluctuations [in] the silver market, not the managerial efforts of" the promoter. *Noa*, 638 F.2d at 79. In *McCown*, the Tenth Circuit found that the purchase of land was potentially transformed into a security due to the post-purchase services promised by the promoter. *McCown*, 527 F.2d at 211. The D.C. Circuit apparently found that, because both the *Noa* and *McCown* courts regarded pre-purchase efforts as insignificant, it could not base a finding of an investment contract solely on pre-purchase entrepreneurial and managerial efforts. *Life Partners IV*, 87 F.3d at 547. The dissent did not find these cases to support the majority's bright-line test. *Id.* at 553-54 (Wald, J., dissenting). The dissent argued that the profits in *Noa* and *McCown* were dependent upon market forces and not pre- or post-purchase efforts of the promoter. *Id.* at 553. With viatical settlements, however, investor profits depend not upon the market but upon the promoter's efforts, which happen to occur primarily prior to closing. *Id.* at 555.

<sup>273</sup> *Life Partners IV*, 87 F.3d at 548.

<sup>274</sup> *Id.* at 549.

<sup>275</sup> *Id.* at 548.

The SEC filed a petition for rehearing, and the D.C. Circuit responded by reiterating that LPI's pre- and post-purchase services combined did not satisfy the "efforts of others" requirement.<sup>276</sup> The court asserted that its prior holding neither established an "'artificial bright-line' rule"<sup>277</sup> nor deemed all pre-purchase efforts irrelevant.<sup>278</sup> The court went on to explain that its holding required only "'that [1] pre-purchase services cannot by themselves suffice to make the profits of an investment arise predominantly from the efforts of others, and that [2] ministerial functions should receive a good deal less weight than entrepreneurial activities."<sup>279</sup> The SEC did not appeal the decision to the Supreme Court.

In *Mutual Benefits*, both the Eleventh Circuit and the district court declined the defendant's invitation to follow the D.C. Circuit's holding.<sup>280</sup> The courts explained that the bright-line rule adopted in *Life Partners* did not comport with the underlying purpose of the securities laws, namely, looking past form to the economic reality of the arrangement.<sup>281</sup> The Eleventh Circuit held that although the fourth "prong of the *Howey* test is more easily satisfied by post-purchase activities, there is no basis for excluding pre-purchase managerial activities from the analysis."<sup>282</sup>

In *Mutual Benefits I*, the district court's Judge Moreno changed the issue's focus from whether the investor's profit is dependent upon the promoter's efforts to "whether profits are derived from the activities of the promoter or rather, the operation of external market forces beyond the control of the promoter."<sup>283</sup> The reason for making this "distinction is because the securities laws disclosure requirements will only protect investments that depend on the efforts of promoters,

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<sup>276</sup> SEC v. Life Partners, Inc., 102 F.3d 587, 588 (D.C. Cir. 1996).

<sup>277</sup> *Id.*

<sup>278</sup> *Id.*

<sup>279</sup> *Id.* (quoting *Life Partners IV*, 87 F.3d at 548).

<sup>280</sup> *Mutual Benefits III*, 408 F.3d 737, 743 (11th Cir. 2005); *Mutual Benefits I*, 323 F. Supp. 2d 1337, 1343 n.8 (S.D. Fla. 2004).

<sup>281</sup> *Mutual Benefits III*, 408 F.3d at 743 (citing *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1969)).

<sup>282</sup> *Id.* at 743 (citing *Life Partners IV*, 87 F.3d at 551 (Wald, J., dissenting)).

<sup>283</sup> *Mutual Benefits I*, 323 F. Supp. 2d at 1342.

not those that depend on the operation of external market forces.<sup>284</sup> In the case at bar, market forces had no bearing on profits.<sup>285</sup> In fact, MBC regularly included in its promotional materials the fact that the investment was free from the uncertainty associated with the stock market.<sup>286</sup> The court held that the promoter's expertise in choosing policies—not outside market forces—determined investor profits.<sup>287</sup>

The Eleventh Circuit advocated a review of all activities, both pre- and post-purchase, when deciding whether the fourth prong is satisfied.<sup>288</sup> In holding that MBC's efforts satisfied the fourth prong, the court highlighted a long list of activities performed by the promoter, including selecting and bidding on insurance policies, negotiating with viators, and evaluating life expectancy.<sup>289</sup> The court also noted that the investor had little or no ability to assess the accuracy of MBC's analysis.<sup>290</sup>

Even though the facts in *Mutual Benefits* could be distinguished from those in *Life Partners*, the appellate court stressed that viatical settlement agreements constituted investment contracts regardless of the timing of the promoter's activities.<sup>291</sup> The court held that MBC's scheme constituted an investment contract “[w]hether the investors were offered a longer or shorter window in which to withdraw funds from escrow, whether the life-expectancy evaluation was actually

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<sup>284</sup> *Id.* (citing SEC v. G. Weeks Sec., Inc., 678 F.2d 649, 652 (6th Cir. 1982)).

<sup>285</sup> *Id.*

<sup>286</sup> *Mutual Benefits II*, No. 04-60573-CIV-MORENO/GARBER, 2004 U.S. Dist. LEXIS 23008, at \*22-23 (S.D. Fla. Nov. 10, 2004).

<sup>287</sup> *Mutual Benefits I*, 323 F. Supp. 2d at 1342.

<sup>288</sup> *Mutual Benefits III*, 408 F.3d 737, 743-44 (11<sup>th</sup> Cir. 2005).

<sup>289</sup> *Id.* at 744.

<sup>290</sup> *Id.* As explained in *Williamson v. Tucker*, when the “agreement among the parties leaves...little power in the hands of the [investor who]...is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising [any] powers,” the fourth prong is most likely satisfied. 645 F.2d 404, 424 (5th Cir. 1981).

<sup>291</sup> *Mutual Benefits III*, 408 F.3d at 744-45. The SEC argued, in the alternative, that if the court adopted the D.C. Circuit's bright-line rule, MBC's post-purchase entrepreneurial and managerial efforts would still satisfy the “efforts of others” prong. *Mutual Benefits I*, 323 F. Supp. 2d at 1343 n.8. The district court chose not to distinguish the case at bar and instead held that “[b]ecause the Court declines to follow *Life Partners*, the Court need not reach the issue of timing.” *Id.*

performed before or after closing, and despite certain differences in how premiums were paid.”<sup>292</sup> The court also noted that investors “relied on the pre- and post-purchase [entrepreneurial and] managerial efforts of MBC.”<sup>293</sup> The Eleventh Circuit refused to distinguish these facts from those in *Life Partners* even though they could easily have done so.<sup>294</sup> The court instead went one step further and rejected the D.C. Circuit’s formulistic bright-line test.<sup>295</sup>

## V. OTHER COURTS RESPOND TO *LIFE PARTNERS*

Although the D.C. Circuit was the only federal appellate court to decide this issue for ten years, many lower courts, both state and federal, were called on to determine whether viatical settlements constitute investment contracts. Although none of these courts was bound by *Life Partners*, many addressed the decision and either distinguished its facts or refused to follow its holding.<sup>296</sup>

In the 2001 case of *Siporin v. Carrington*,<sup>297</sup> the Arizona Court of Appeals declined to apply the bright-line rule established by the *Life Partners* court.<sup>298</sup> In *Siporin*, the plaintiff brought a claim under state securities law.<sup>299</sup> The court explained

<sup>292</sup> *Mutual Benefits III*, 408 F.3d at 744-45.

<sup>293</sup> *Id.* at 745.

<sup>294</sup> *See id.*

<sup>295</sup> *Id.* at 743.

<sup>296</sup> Thus far there have been no decisions at the district court level in the D.C. Circuit regarding whether a viatical settlement agreement constitutes an investment contract.

<sup>297</sup> 23 P.3d 92 (Ariz. Ct. App. 2001).

<sup>298</sup> *Id.* at 99.

<sup>299</sup> *Id.* at 93. For purposes of this article, the relevant portion of the state statute is the section that includes the definition of “security.” In *Siporin*, because the viatical settlements were sold in 1999, the court had to determine “whether the viatical settlements sold by Carrington qualified as a security under the general category of ‘investment contracts’ within the meaning of section 44-1801(23)” of the Arizona Securities Act. *Id.* at 96 (citing ARIZ. REV. STAT. ANN. § 44-1801(23) (West 1999) (amended 2000)). At the time of the decision, the Arizona securities laws had been amended to expressly include “viatical or life settlement investment contract” within the definition of a “security.” ARIZ. REV. STAT. ANN. § 44-1801(26) (West 2003).

that the definition of “security” under section 44-1801 of the Arizona Securities Act “is virtually the same as that contained in the federal Securities Act of 1933 and the Securities and Exchange Act of 1934.”<sup>300</sup> Therefore, the court “look[ed] to the federal courts for guidance.”<sup>301</sup>

The *Siporin* court explained that the investors’ profits were predominantly dependent upon the viatical company’s expertise in selecting policies and predicting insureds’ life expectancies.<sup>302</sup> The court separated the promoter’s responsibilities into three categories: estimating life expectancy, analyzing the policy, and closing the deal.<sup>303</sup> First, the promoter reviewed the viator’s medical records, gauged whether the viator was truthful regarding his or her condition, hired medical experts to evaluate the viator’s condition, and reviewed all potential medical treatments that could affect life expectancy.<sup>304</sup> Second, the promoter analyzed the insurance policy to determine whether the death benefits would be paid.<sup>305</sup> In doing this, the promoter determined whether the policy would be contested by other beneficiaries, whether the policy was assignable, whether the policy was a group policy, and whether the insurance company was economically viable.<sup>306</sup> Finally, in closing the deal, the promoter negotiated with the viator, marketed fractional interests to retail investors, ensured premiums were paid to prevent the policy from lapsing, and timely claimed death benefits for investors.<sup>307</sup> The court concluded that, “[a]lthough it is the viator’s death that ultimately yields a return, the profitability of the return depends almost exclusively on the viatical seller’s entrepreneurial pre-closing investigations, analyses, and negotiations in selecting the viator and the policy.”<sup>308</sup>

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<sup>300</sup> *Siporin*, 23 P.3d at 96.

<sup>301</sup> *Id.*

<sup>302</sup> *Id.* at 97.

<sup>303</sup> *Id.*

<sup>304</sup> *Id.*

<sup>305</sup> *Id.*

<sup>306</sup> *Id.*

<sup>307</sup> *Id.*

<sup>308</sup> *Id.*

The court declined the defendant's invitation to follow *Life Partners* for several reasons.<sup>309</sup> First, the *Life Partners* court disregarded the *Howey* test's underlying rationale, that legislative intent dictates that the statutory definition of "security" embodies a flexible, not static, principle.<sup>310</sup> The court also pointed out a contradiction in the *Life Partners* decision. The D.C. Circuit first accepted the flexible and realistic rule which replaced "solely" with "predominantly" but then proceeded to establish "an even more inflexible" rule, namely the bright-line test.<sup>311</sup> Finally, the court noted 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*."<sup>312</sup> In the years following the *Siporin* decision, many other state and federal courts declined to follow *Life Partners*. Most of these decisions included the Arizona court's reasoning in their analyses.

Three decisions from the Indiana Court of Appeals followed the *Siporin* court's holding and reasoning. In *Poyser v. Flora*,<sup>313</sup> the defendant was sued for failing to comply with Indiana securities laws.<sup>314</sup> In rejecting the *Life Partners* decision, the *Poyser* court reiterated the *Siporin* court's insistence upon applying *Howey* flexibly.<sup>315</sup> The same year, in *Security Trust Corp. v. Estate of Fisher*,<sup>316</sup> another Indiana appellate court followed the *Poyser* court's decision.<sup>317</sup> In declining to follow *Life Partners*, the

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<sup>309</sup> *Id.* at 99.

<sup>310</sup> *Id.*

<sup>311</sup> *Id.*

<sup>312</sup> *Id.*

<sup>313</sup> 780 N.E.2d 1191 (Ind. Ct. App. 2003).

<sup>314</sup> *Id.* at 1192. The dispute was based on a viatical settlement sale that occurred in 1997; therefore the suit was brought under the prior version of section 23-2-1-1 of the Indiana Code. *Id.* at 1192, 1194 (citing IND. CODE § 23-2-1-1(k) (West 1999)). Section 23-2-1-1(k) defines "security" as "a note, stock, treasury stock...[or an] investment contract." The court cited a Seventh Circuit opinion that applied Indiana law and noted "the identical terms under the Securities Act[s]...and the Indiana 'Blue Sky' Act." *Poyser*, 780 N.E.2d at 1194-95 (citing *Am. Fletcher Mortgage Co. v. U.S. Steel Credit Corp.*, 635 F.2d 1247, 1253 (7th Cir. 1980)). The Indiana statute was amended in 2000 to include viatical settlements. IND. CODE ANN. § 23-2-1-1(k) (West Supp. 2004).

<sup>315</sup> *Poyser*, 780 N.E.2d at 1197 (citing *Siporin*, 23 P.3d at 98).

<sup>316</sup> 797 N.E.2d 789 (Ind. Ct. App. 2003).

<sup>317</sup> *Id.* at 795 (citing *Poyser*, 780 N.E.2d 1191).

*Fisher* court summarized the *Siporin* court's reasoning.<sup>318</sup> Finally, in *Accelerated Benefits Corp. v. Peaslee*,<sup>319</sup> the Indiana Court of Appeals held that "the success of [the investor's] viatical settlement investment was dependent upon the [promoter's] expertise in choosing which life insurance policies to purchase."<sup>320</sup> The *Peaslee* court did not mention *Life Partners*, but it did explain that it was following the holdings of *Poyser* and *Fisher*.<sup>321</sup> Because both of those decisions rejected *Life Partners*, the *Peaslee* court also declined to accept the D.C. Circuit's reasoning.<sup>322</sup>

In *Joseph v. Viatica Management*,<sup>323</sup> the Colorado Court of Appeals also followed the *Siporin* court's reasoning when it rejected *Life Partners*.<sup>324</sup> In *Joseph*, the insurance policies were purchased after the investment was made.<sup>325</sup> Although the court noted that it could distinguish the facts in *Joseph* from those in *Life Partners*, it went further by noting that it was "not persuaded by either the rationale or conclusions reached" in *Life Partners*.<sup>326</sup>

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<sup>318</sup> *Id.* at 795–97 (citing *Poyser*, 780 N.E.2d at 1195–97). *Fisher* arose from a 1998 viatical agreement. *Id.* at 791. Like in *Poyser*, the *Fisher* court had to determine "[w]hether viatical settlements were subject to the Indiana Securities Act at the time of sale" and, more specifically, "whether the viatical settlement at issue [was] an 'investment contract.'" *Id.*

<sup>319</sup> 818 N.E.2d 73 (Ind. Ct. App. 2004).

<sup>320</sup> *Id.* at 76. In *Peaslee*, the plaintiff entered into viatical settlement agreements in 1997 and 1998. *Id.* at 74. Therefore, the court relied on the appropriate version of the Indiana securities laws. *Id.* at 75–76 (citing IND. CODE ANN. § 23-2-1-1(k)).

<sup>321</sup> *Id.* at 76–77 (citing *Fisher*, 797 N.E.2d at 797; *Poyser*, 780 N.E. 2d at 1196).

<sup>322</sup> *Id.* at 77.

<sup>323</sup> 55 P.3d 264 (Colo. Ct. App. 2002).

<sup>324</sup> *Id.* at 267. (citing *Siporin v. Carrington*, 23 P.3d 92 (Ariz. Ct. App. 2001)). The plaintiff brought the suit under Colorado's securities laws. *Id.* at 266 (citing COLO. REV. STAT. § 11-51-201(17) (2001) (amended 2005)). The court explained that the "provisions and rules under the [Colorado Securities] Act shall be coordinated with federal acts and statutes to the extent consistent with the purposes of the Act[,]...[which] is remedial in nature and is to be broadly construed to effectuate its purposes." *Id.* at 267 (citing § 11-51-101).

<sup>325</sup> *Joseph*, 55 P.3d at 265.

<sup>326</sup> *Id.* at 267

In holding that viatical settlements are securities, a Michigan Court of Appeals adopted the *Siporin* holding “that ‘the *Life Partners* rationale does not serve the prophylactic and remedial purposes of the [securities] laws.’”<sup>327</sup> The court further supported its argument with evidence that several state legislatures had recently added the term “viatical settlement agreement” to their definitions of “security.”<sup>328</sup> In addition, the court gave deference to the view of the Michigan Department of Commerce’s Corporation and Securities Bureau that viatical settlements constituted securities.<sup>329</sup>

Conversely, the Ohio Court of Appeals held that viatical settlements were not securities in *Glick v. Sokol*.<sup>330</sup> The plaintiff in *Glick* was an investor who claimed that his financial advisor had violated state securities laws.<sup>331</sup> The plaintiff did not

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<sup>327</sup> *Michelson v. Voison*, 658 N.W.2d 188, 190 (Mich. Ct. App. 2003) (citing *Siporin*, 23 P.3d at 99. The defendants were sued under the Michigan Uniform Securities Act (the “Michigan Act”), *Id.* at 189 (citing MICH. COMP. LAWS § 451.501 *et seq.* (2003)), which provides that it “shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this act with the related federal regulation.” *Id.* at 190 (citing MICH. COMP. LAWS § 451.815 (2003)). Accordingly, the *Michelson* court stated that it was “appropriate to consider other state and federal decisions.” *Id.* Section 451.801(z) of the Michigan Act defines “security.” MICH. COMP. LAWS ANN. § 451.801(z) (West 2005).

<sup>328</sup> *Michelson*, 658 N.W.2d at 190-91 & nn.6-8.

<sup>329</sup> *Id.* at 191.

<sup>330</sup> 777 N.E.2d 315, 319 (Ohio Ct. App. 2002). The court explained that an investment constitutes a security if it meets the following conditions:

“(1) An offeree furnishes initial value to an offeror, and (2) a portion of this initial value is subjected to the risks of the enterprise, and (3) the furnishing of the initial value is induced by the offeror’s promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and (4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.”

*Id.* at 318 (quoting *State v. George*, 362 N.E.2d 1223, 1227–28 (Ohio Ct. App. 1975)).

<sup>331</sup> *Id.* at 316-17. Because the plaintiff entered into the viatical settlement agreement in 1998, the defendant was sued under the prior version of the Ohio securities laws. *Id.* at 317–18 (citing OHIO REV. CODE ANN. § 1707.01(B) (West 1998) (amended 2000)). The previous section 1707.01(B) included the term “investment contract” in the definition of “security.” § 1707(B). The statute was amended in 2000 to include “life settlement” in the definition of “security.” OHIO REV. CODE ANN. § 1707.01(B) (West 2005).

bring the action against the viatical settlement provider, Liberte Capital Group, even though the viatical settlement agreement was between the plaintiff and Liberte Capital.<sup>332</sup> In addition, a manager at Liberte Capital signed all correspondence regarding the investment.<sup>333</sup> In reaching its conclusion, the court refused to accept the Ohio Division of Securities' view that viatical settlements constitute investment contracts subject to its regulation.<sup>334</sup> Similar to *Life Partners*, the court held that "the only variable that can impact the profitability of the viatical settlements at issue is the timing of the death of the insured."<sup>335</sup> The court noted that if "the viatical companies constitute an enterprise, the...analysis appears to apply to Liberte Capital and not to" the defendants.<sup>336</sup> The *Glick* court's flawed reasoning was highlighted in *Wuliger v. Christie*.<sup>337</sup> The *Christie* court asserted that "[i]f the viatical investment was deemed to be a security based upon Liberte's conduct/actions, its status would not change in a suit against Liberte's agent."<sup>338</sup>

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<sup>332</sup> *Glick*, 777 N.E.2d at 316, 319.

<sup>333</sup> *Id.* at 319.

<sup>334</sup> *Id.*

<sup>335</sup> *Id.* The court did not mention *Life Partners* but came to the same conclusion. *Id.*; see *Life Partners IV*, 87 F.3d 536, 545 (D.C. Cir. 1996) (holding that "the only variable affecting profits is the timing of the insured's death"). A Texas state court also agreed with the D.C. Circuit's holding in *Life Partners* in *Griffitts v. Life Partners, Inc.*, No. 10-01-00271-CV, 2004 Tex. App. LEXIS 4844, at \*6 (May 26, 2004) (citing *Life Partners IV*, 87 F.3d at 545-45). The plaintiff in *Griffitts* sued under state securities laws. *Id.* at \*13 (citing TEX. REV. CIV. STAT. ANN. art. 581-4(A) (Vernon Supp. 2005)). The court stated that the "definition of 'security' includes, in relevant part, 'any . . . note . . . or other evidence of indebtedness, . . . [or] investment contract.'" *Id.* at \*3. (citing art. 581-4(A)). The court dismissed the defendant's pre-purchase efforts and found that only ministerial efforts were made after closing. *Id.* at \*5-6. The court cited *Life Partners* in concluding that "profitability...[was] not determined by any managerial efforts...but [was] determined by the mortality of the insureds." *Id.* (citing *Life Partners IV*, 87 F.3d at 545-46). The court applied the bright-line rule and quickly dismissed the plaintiff's argument. *Id.* This is exactly what the dissent in *Life Partners* warned against. *Life Partners IV*, 87 F.3d at 551 (Wald, J., dissenting). The *Life Partners* dissent asserted that the majority's new rule will make it simple for courts to determine whether an investment contract existed, but only at the expense of flexibility. *Id.* One member of the *Griffitts* court dissented, stating that "viatical settlement contracts...are securities under the...*Howey* four-pronged test." *Griffitts*, 2004 Tex. App. LEXIS 4844, at \*11 (Vance, J. dissenting).

<sup>336</sup> *Glick*, 777 N.E.2d at 319.

<sup>337</sup> 310 F. Supp. 2d 897, 906 (N.D. Ohio 2004).

<sup>338</sup> *Id.*

The following year, in *Rumbaugh v. Ohio Department of Commerce*,<sup>339</sup> the Ohio Court of Appeals affirmed the state securities department's view<sup>340</sup> and simultaneously rejected the *Glick* court's holding.<sup>341</sup> *Rumbaugh* is similar to *Life Partners* in that the securities department—this time on the state level—brought an action against a promoter for selling unregistered securities.<sup>342</sup> The *Rumbaugh* court also cited *Siporin*, *Poyser*, and *Michelson* as support for its declining to follow *Life Partners*.<sup>343</sup>

In *Wuliger v. Christie*,<sup>344</sup> a federal district court in the Sixth Circuit did not find the *Life Partners* reasoning persuasive.<sup>345</sup> The court noted 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.”<sup>346</sup> The court held that economic reality dictated against a strict construction of *Howey*

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<sup>339</sup> 800 N.E.2d 780 (Ohio Ct. App. 2003).

<sup>340</sup> *Id.* at 784 (holding “that courts must defer to an agency's administrative interpretation[,] particularly when that agency is empowered to enforce the statute at issue”) (citing *Leon v. Ohio Bd. of Psychology*, 590 N.E.2d 1223, 1226 (Ohio 1992)).

<sup>341</sup> *Id.* at 784 (citing *Glick*, 777 N.E.2d at 319).

<sup>342</sup> *Id.* at 783. As in *Glick*, the plaintiff in *Rumbaugh* sued under state securities laws. *Id.* at 783–84 (citing OHIO REV. CODE ANN. § 1707.01(B) (West Supp. 2002)). The court explained that “viatical settlement contracts are *now* regulated by the division[,]...[but in 1998] at the time of the allegations against Rumbaugh, the definition [of “security”] did not expressly include ‘life settlement interests.’” *Id.* (citing § 1707.01(B) (West 1998) (amended 2000)).

<sup>343</sup> *Id.* at 785–86 (citing *Siporin v. Carrington*, 23 P.3d 92 (Ariz. Ct. App. 2001); *Poyser v. Flora*, 780 N.E.2d 1191 (Ind. Ct. App. 2003); *Michelson v. Voison*, 658 N.W.2d 188 (Mich. Ct. App. 2003)).

<sup>344</sup> 310 F. Supp. 2d 897 (N.D. Ohio 2004). Wuliger was appointed Receiver of Alpha Capital Group, LLC, in 2001 and of Liberte Capital in 2002. *Id.* at 900. Both companies are viatical settlement providers. *Id.* As Receiver, Wuliger was “empowered to represent and pursue the interests of the investors directly.” *Id.* Christie acted as a sales agent for Alpha and solicited individuals to invest in viatical settlements. *Id.* Because this dispute came before a federal court, the federal securities laws applied. *Id.* at 902 (citing the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10)). *Christie* is the first decision related to *Liberte Capital Group v. Capwill*, 229 F. Supp. 2d 799 (N.D. Ohio 2002), in which a court held that viatical settlements constitute securities. *Id.* at 908.

<sup>345</sup> *Id.* at 907.

<sup>346</sup> *Id.* at 904.

and that a more flexible construction was necessary to keep promoters from manipulating their schemes to avoid securities laws.<sup>347</sup> In conclusion, the court found that “it is not the date of the viator’s death which establishes the success of the investment but the selection by the promoter of the policy...based upon its expertise in assessing the viator’s life expectancy.”<sup>348</sup> *Christie* is an outgrowth of *Liberte Capital Group v. Capwill*,<sup>349</sup> which has spawned litigation in both state and federal courts.<sup>350</sup> In *Wuliger v. Mann*,<sup>351</sup> the most recent related decision, the court cited the Eleventh Circuit’s holding in *Mutual Benefits* as support for its holding that viatical settlements constituted securities.<sup>352</sup>

In *SEC v. Tyler*,<sup>353</sup> the federal court in the northern district of Texas distinguished the facts at hand from those in the *Life Partners*.<sup>354</sup> One factor that the *Life Partners* court found significant in refusing to deem the “efforts of others” prong satisfied was the fact that there was no established market for the resale of policies.<sup>355</sup> In *Tyler*, the promoter “created a liquid market of viatical shares to sell his investors.”<sup>356</sup> If investors wanted to resell their fractional interests, Tyler would

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<sup>347</sup> *Id.* at 907.

<sup>348</sup> *Id.*

<sup>349</sup> 229 F. Supp. 2d 799 (N.D. Ohio 2002).

<sup>350</sup> See *Wuliger v. Liberty Bank*, No. 3:02 CV 1378, 2004 U.S. Dist. LEXIS 27353, at \*1 (N.D. Ohio Mar. 4, 2004). In *Liberty Bank*, the court noted that, “[a]s of the last count, there are over one hundred and fifty related civil actions pending in the Northern District of Ohio as well as a number of state related cases.” *Id.* at \*2 n.2. The decisions citing *Christie* as support in holding that viatical settlements are securities include *Wuliger v. Anstaett*, 363 F. Supp. 2d 917, 921 (N.D. Ohio 2005) and *Wuliger v. Mann*, No. 3:03 CV 1531, 2005 U.S. Dist. LEXIS 13021, at \*10 (N.D. Ohio July 1, 2005).

<sup>351</sup> 2005 U.S. Dist. LEXIS 13021.

<sup>352</sup> *Id.* at \*13 (citing *Mutual Benefits III*, 323 F. Supp. 2d 1337, 1344 (S.D. Fla. 2004)).

<sup>353</sup> No. 3:02-CV-0282-P, 2002 U.S. Dist. LEXIS 2952 (N.D. Tex. Feb. 21, 2002).

<sup>354</sup> *Id.* at \*15–16. The *Tyler* court applied the Securities Acts of 1933 and 1934. *Id.* at \*7 (citing 15 U.S.C. § 77i(b) and 15 U.S.C. § 78u(d)).

<sup>355</sup> *Life Partners IV*, 87 F.3d 436, 546.

<sup>356</sup> *Tyler*, 2002 U.S. Dist. LEXIS 2952, at \*6.

either buy them back or sell them to another investor.<sup>357</sup> The court followed the rule established in *Gary Plastic Packaging Corp. v. Merrill Lynch*,<sup>358</sup> which held that “Merrill Lynch’s post-purchase services and creation of a secondary market satisfied the [“efforts of others”] prong of the *Howey* test.”<sup>359</sup>

Several cases did not mention *Life Partners* but came to a conclusion opposite that of the *Life Partners* court regarding the “efforts of others” prong.<sup>360</sup> In *Hill v. Dedicated Resources, Inc.*,<sup>361</sup> the court held that the promoter’s policy selection process predominantly determined the investor’s rate of return.<sup>362</sup> Interestingly, in finding the “efforts of others” prong satisfied, the Kansas court cited the lower court’s decision in *Life Partners* even though that decision had already been overruled by the D.C. Circuit.<sup>363</sup> Florida’s Fourth District Court of Appeal also found the *Howey* test satisfied in *Kligfeld v. State*.<sup>364</sup> The Florida Office of Financial Regulation alleged that the defendants were selling unregistered securities.<sup>365</sup> The *Kligfeld* court held that the defendants’ program satisfied the investment contract requirements set forth in *Howey*.<sup>366</sup> Finally, in *Allen v. Jones*,<sup>367</sup> the Georgia Court of Appeals held that viatical

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<sup>357</sup> *Id.*

<sup>358</sup> 756 F.2d 230 (2d Cir. 1985).

<sup>359</sup> *Tyler*, 2002 U.S. Dist. LEXIS 2952, at \*17 (citing *Gary Plastic*, 756 F.2d at 240–41).

<sup>360</sup> See *Kligfeld v. State*, 876 So. 2d 36, 38 (Fla. Dist. Ct. App. 2004); *Allen v. Jones*, 604 S.E.2d 644, 647 (Ga. Ct. App. 2004); *Hill v. Dedicated Res., Inc.*, No. 99-C-1714, 2000 WL 34001915, at \* 1 (Kan. Dist. Ct. July 12, 2000).

<sup>361</sup> 2000 WL 34001915.

<sup>362</sup> *Id.* at \*3. The plaintiffs brought their suit under state securities laws. *Id.* at \*1-2 (citing KAN. STAT. ANN. § 17-1252(j) (Supp. 2004) (amended 2004)). “The Kansas Securities Act defines a ‘security’ as, ‘any note; stock; treasury stock; bond;...[or] investment contract.’” *Id.* at \*2. The state legislature amended the statute in 2004 by adding “viatical investment” to the definition of “investment contract.” H.R. 80-2347, Reg. Sess., at 5 (Kan. 2004) (effective July 1, 2005).

<sup>363</sup> *Hill*, 2000 WL 34001915, at \*3 (citing *Life Partners I*, 898 F. Supp. 14 (D.D.C. 1995)).

<sup>364</sup> 876 So. 2d at 38. The court explained that the term “investment contracts” is included in the definition of “security” under Florida securities law. *Id.* (citing FLA. STAT. ch. 517.021(20)(q) (2003) (amended 2005)). Florida’s legislature added viatical settlements to the definition of security in 2005. S. 107-2412, Reg. Sess., at 2 (Fla. 2005).

<sup>365</sup> *Kligfeld*, 876 So. 2d at 37.

settlements are investment contracts under *Howey*.<sup>368</sup> The court did not mention *Life Partners*, but it did cite *Fisher*, which refused to embrace the *Life Partners* decision.<sup>369</sup>

## VI. PUBLIC POLICY

While the reaction of other courts provides support for the *Mutual Benefits* holding, public policy, namely investor protection, also highlights the need for securities regulation in this industry.<sup>370</sup> Much of the media coverage regarding this industry over the past ten years has been negative. Many articles warn investors of the many pitfalls associated with the industry.<sup>371</sup> One article warned that viaticals are “peddled to older people as a ‘safe’ investment with a ‘guaranteed’ return[.]...[but]...[t]here has been a lot of fraud in viatical deals[.]...[therefore] buyer beware.”<sup>372</sup> Another article cautioned that, despite the sales pitch promising high returns, “viaticals are a dangerous business,...[c]heating is rife,...potential returns are often stated deceptively[, and] [s]everal states have indicted viatical salespeople for

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<sup>366</sup> *Id.* at 38.

<sup>367</sup> 604 S.E.2d 644.

<sup>368</sup> *Id.* at 647. The plaintiffs sued under the Georgia Racketeer Influenced Corrupt Organization (RICO) Act, and thus Georgia securities laws applied. *Id.* at 645-46 & n.5 (citing GA. CODE ANN. § 10-5-2(a)(26) (Supp. 2004)). Because the plaintiffs’ purchases of viatical settlement contracts occurred in 1998, the court applied the appropriate version of the statute. *Id.* at 645-46 & n.5 (defining “security” without including “viatical investment” under GA. CODE ANN. § 10-5-2(a)(26) (2000) (amended 2002)).

<sup>369</sup> *Allen*, 604 S.E.2d at 646 (citing *Sec. Trust Corp. v. Estate of Fisher*, 797 N.E.2d 789 (Ind. Ct. App. 2003)).

<sup>370</sup> The Supreme Court has held that “it is proper for a court to consider...policy considerations in construing terms in” the Securities Acts. *Pinter v. Dahl*, 486 U.S. 622, 653 (1988) (quoting *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 695 n.7 (1985)).

<sup>371</sup> See Jane Bryant Quinn, *Assess This Investment’s Health Warily*, ALBANY TIMES UNION (N.Y.), May 13, 2001, at C1 (hereinafter “Quinn I”); Jane Bryant Quinn, *Steer Clear of ‘Viaticals’? You Bet Your Life*, SEATTLE POST-INTELLIGENCER, Sept. 19, 2000, at D1 (hereinafter “Quinn II”).

<sup>372</sup> Quinn I, *supra* note 371.

fraud.”<sup>373</sup> The *Los Angeles Times* simply advised its readers to “[a]void [v]iaticals [l]ike the [p]lague.”<sup>374</sup>

The North American Securities Administrators Association (NASAA) has also reached out to potential investors.<sup>375</sup> It publishes a list of investment scams each year.<sup>376</sup> Viaticals were in the top ten as recently as 2005.<sup>377</sup> Christine Bruenn, NASAA president in 2003, explained that the problem of scammers preying on seniors began due to a volatile stock market, record low interest rates, and a three-year bear market.<sup>378</sup> If you “[m]ix all that in with rising medical costs and the fact that people are living longer[,]...people who are retired...are becoming desperate[,]...mak[ing] them vulnerable to investment fraud and abuse.”<sup>379</sup> Richard Walker of the SEC spoke at a NASAA training session for broker-dealers in Ft. Lauderdale and told the audience “that he wanted to ‘draw attention to...areas where sales practice abuses have clustered of late[,]’...[including t]he sale of...viatical settlements.”<sup>380</sup>

During the 2003 “Fight Financial Fraud in Florida Week,” the state unveiled a list of dangerous investments that included viatical settlements.<sup>381</sup> In 2002, the U.S.

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<sup>373</sup> Quinn II, *supra* note 371.

<sup>374</sup> Liz Pulliam Weston, *Bankruptcy Filing Makes It Tough to Get a Home Loan*, L.A. TIMES, Feb. 17, 2002, at 3.

<sup>375</sup> Helen Huntley, *Stocks are risky - but you could do worse*, ST. PETERSBURG TIMES, May 15, 2005, at 1D.

<sup>376</sup> *Id.*

<sup>377</sup> *Id.*

<sup>378</sup> Michelle Singletary, *Scams Target Vulnerable Seniors*, ST. PAUL PIONEER PRESS, Sept. 10, 2003, at C2 (hereinafter Singletary II).

<sup>379</sup> *Id.* In *Edwards*, the Supreme Court highlighted this particular problem, stating that “investments pitched as low risk (such as those offering a ‘guaranteed’ fixed return) are particularly attractive to individuals more vulnerable to investment fraud, including older and less sophisticated investors” like the investors preyed upon by viatical settlement providers. *SEC v. Edwards*, 540 U.S. at 389, 394 (2004).

<sup>380</sup> Humberto Cruz, *SEC Official Sounds Fraud Alarm; Brokers Warned About Abusive Selling Tactics*, SUN-SENTINEL (Fla.), June 22, 2000, at 1D (hereinafter “Cruz II”).

<sup>381</sup> Purva Patel, *Financial Con Artists Reap \$35M In State; Regulators List Top 10 Scams*, SUN-SENTINEL (Fla.), June 10, 2003, at 1D.

Department of Banking released “a list of the top five investment scams” that also included viaticals.<sup>382</sup> In addition to these specific examples, “phony viaticals still place regularly on state regulators’ annual top [ten] lists of investment scams.”<sup>383</sup>

In 2002, the United States House of Representatives Financial Services Committee held hearings as a result of investors’ losing “more than \$400 million to viatical frauds” since 1999.<sup>384</sup> Stephen B. Mercer, an attorney representing AIDS patients, testified that despite patients’ needs for funds and his desire for viatical settlements to provide those funds, “no one should be putting a dime into [the viatical industry].”<sup>385</sup> Mercer went on to explain that, because of its current structure, the industry is “prone to fraud...[and] encourages middlemen to charge large commissions.”<sup>386</sup>

There is much evidence of fraud in the viatical industry, especially after the medical advancements of the mid-1990s.<sup>387</sup> Florida, with its large population of elderly individuals, has been a breeding ground for dishonest viatical companies.<sup>388</sup> Scott Stephan, former owner of Justus Viatical Group LLC, was sent to state prison for defrauding investors by selling them phony insurance policies.<sup>389</sup> Viatical Capital, Inc., was accused of swindling older investors out of \$61 million.<sup>390</sup> Top officials of Future First Financial Group (FFFG) were charged with racketeering and securities fraud for scamming elderly investors out of \$57 million.<sup>391</sup> Frederick C. Brandau, a

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<sup>382</sup> Victoria Lim, *Keep Skepticism Handy When Retooling Investments*, TAMPA TRIB., Jan. 27, 2002, at 1.

<sup>383</sup> Cruz I, *supra* note 36.

<sup>384</sup> Kathy M. Kristof, *Lawmakers Probe Viatical Fraud*, L.A. TIMES, Feb. 27, 2002, at 6 (hereinafter “Kristof II”).

<sup>385</sup> *Id.*

<sup>386</sup> *Id.*

<sup>387</sup> Helgeson, *supra* note 35.

<sup>388</sup> *Id.* “The state estimates that fraud has cost investors \$2 billion since 1996.” *Id.*

<sup>389</sup> Kathy Bushouse, *Cost of Fraud: \$820 Million; State CFO Unveils Year’s Top 10 Scams*, SUN-SENTINEL (Fla.), June 15, 2004, at 3D (hereinafter “Bushouse II”).

<sup>390</sup> *Sarasota Company’s Assets Frozen*, ST. PETERSBURG TIMES, SEPT. 12, 2003, at 1E.

<sup>391</sup> Dale K. DuPont, *Future First Execs Jailed*, MIAMI HERALD, May 3, 2003, at 3C.

top executive with Financial Federated Title & Trust, was sentenced to fifty-five years in prison.<sup>392</sup> Brandau's sentence is one of the longest ever handed down for fraud.<sup>393</sup> Brandau told investors he would use their funds to purchase viaticals, but instead he spent nearly \$117 million of this money on mansions, cars, boats and helicopters.<sup>394</sup> Based purely on public policy, it is in the best interest of the viator, the investor, and the *honest* viatical settlement provider for the SEC to regulate viatical settlements.

## VII. ANALYSIS

There are three main reasons why the Eleventh Circuit was correct in holding that the Securities Acts grant the SEC the power necessary to regulate viatical settlements. First, the Eleventh Circuit correctly followed precedent in anchoring its finding of an investment contract on both pre- and post-purchase entrepreneurial and managerial activities. Second, the *Mutual Benefits* holding embraced the underlying principles of the Securities Acts, namely facilitating full disclosure and preventing fraud. Finally, by rejecting the D.C. Circuit's stringent bright-line rule, the Eleventh Circuit adhered to the doctrine that remedial legislation must be applied flexibly. Both courts and legal scholars repeatedly emphasize these three fundamentals when analyzing *Howey* and the securities laws.<sup>395</sup>

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<sup>392</sup> Johnny Diaz, *Davie Man Sentenced to 55 Years for Fraud*, MIAMI HERALD, Dec. 12, 2000, at 5B.

<sup>393</sup> *Id.*

<sup>394</sup> *Id.*

<sup>395</sup> The *Life Partners* decision has been critiqued by legal scholars on several grounds. First, the court erred by creating a loophole that other promoters could use in order to avoid securities regulations. Albert, *supra* note 3, at 423–24; Miranda, *supra* note 125, at 303–06. Second, the court erred by failing to apply the *Howey* test broadly and flexibly. Luxenberg, *supra* note 113 at 375–79; Miranda, *supra* note 125, at 306. Third, the D.C. Circuit ignored economic reality and instead created a formulistic bright-line rule. M. Davis, *supra* note 138, at 963–67; Elizabeth L. Deeley, Note, *Viatical Settlements Are Not Securities: Is It Law or Sympathy?*, 66 GEO. WASH. L. REV. 382, 406–07 (1998); Katherine DePeri, Recent Decision, *Brokered Viatical Settlement Contracts are not Securities*—Securities Exchange Commission v. Life Partners, Inc., 87 F.3d 536 (D.C. Cir. 1996), 70 TEMP. L. REV. 857, 871 (1997); Miranda, *supra* note 125, at 300, 309–310. Fourth, the court ignored the remedial purposes of the Securities Acts, namely to protect investors and prevent fraud. Deeley, *supra*, at 407; DePeri, *supra*, at 869, 874–75. Finally, some commentators have highlighted a list of cases in which courts relied on pre-purchase efforts to satisfy the “efforts of others” prong. Luxenberg, *supra* note 113, at 376–79; Miranda, *supra* note 125, at 288–90.

### **A. Eleventh Circuit Supported by Precedent**

While most courts look first to post-purchase efforts, courts have never deemed the timing of the promoter's activities dispositive.<sup>396</sup> In fact, there are several decisions in which the court based its holding primarily on pre-purchase efforts.<sup>397</sup>

In *Glen-Arden Commodities, Inc. v. Costantino*,<sup>398</sup> the court found that the fourth prong of the *Howey* test was satisfied because “[a]n investor was dependent upon [the promoters] for the utilization of their ‘expertise in selecting the type and quality of Scotch whisky and casks to be purchased...[and] the very investment made was in goods to be specifically selected by’ the promoters.”<sup>399</sup> The selection process on which the court based its decision occurred prior to closing.<sup>400</sup>

In *SEC v. International Loan Network, Inc.*,<sup>401</sup> the D.C. Circuit also found pre-purchase efforts significant.<sup>402</sup> International Loan's business involved a pyramid scheme in which people joined the network and paid a membership fee.<sup>403</sup> Current investors (i.e., members) would bring potential investors to promotional meetings.<sup>404</sup> If the promoters were “successful in persuading the potential recruit to join, the person who extended the invitation [to the potential recruit], otherwise known as the ‘sponsor,’ w[ould] be credited as having made the recruitment and w[ould] earn

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<sup>396</sup> *Life Partners IV*, 87 F.3d 536, 553 (D.C. Cir. 1996) (Wald, J., dissenting) (stating that there is “no case which holds, as the majority here does, that pre-purchase activities alone cannot satisfy *Howey*'s [fourth] prong”).

<sup>397</sup> See *SEC v. Int'l Loan Network, Inc.*, 968 F.2d 1304 (D.C. Cir. 1992); *Bailey v. J.W.K. Props., Inc.*, 904 F.2d 918 (4th Cir. 1990); *Glen-Arden Commodities, Inc. v. Costantino*, 493 F.2d 1027 (2d Cir. 1974); *SEC v. Brigadoon Scotch Distribs.*, 388 F. Supp. 1288 (S.D.N.Y. 1975).

<sup>398</sup> 493 F.2d 1027.

<sup>399</sup> *Id.* at 1035.

<sup>400</sup> *Miranda*, *supra* note 125, at 288-89.

<sup>401</sup> 968 F.2d 1304.

<sup>402</sup> *Int'l Loan*, 968 F.2d at 1308 & n.9.

<sup>403</sup> *Id.* at 1306.

<sup>404</sup> *Id.* at 1306-08 & n.9.

income from it.”<sup>405</sup> The court ultimately held that the promoters’ pre-closing efforts to “bait” new members were directly linked to investor profits.<sup>406</sup> Therefore, the “efforts of others” prong was satisfied.<sup>407</sup>

In *Bailey v. J.W.K. Properties, Inc.*,<sup>408</sup> investors purchased interests in the defendants’ cattle breeding program.<sup>409</sup> Prior to receiving investor funds, the promoters selected embryos and prepared them for crossbreeding.<sup>410</sup> The investors knew nothing about this process and depended on the promoters’ expertise.<sup>411</sup> Eventually the defendants abandoned the scheme, and investors sued, alleging violations of federal securities laws.<sup>412</sup> The court held that the realization of profits was dependent upon the pre-purchase embryo selection process.<sup>413</sup> Accordingly, it held that the scheme constituted a security.<sup>414</sup>

In *SEC v. Brigadoon Scotch Distributors*,<sup>415</sup> yet another court focused primarily on the promoters’ pre-purchase activities in holding that the *Howey* test was satisfied.<sup>416</sup> The promoters in *Brigadoon* selected rare coins and prepared coin portfolios for sale.<sup>417</sup> The people who bought the portfolios did so not as coin

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<sup>405</sup> *Id.* at 1308 n.9.

<sup>406</sup> *Id.* at 1308.

<sup>407</sup> *Id.*

<sup>408</sup> 904 F.2d 918 (4th Cir. 1990).

<sup>409</sup> *Id.* at 919.

<sup>410</sup> *Id.* at 923.

<sup>411</sup> *Id.* at 924.

<sup>412</sup> *Id.* at 919.

<sup>413</sup> *Id.* at 923–25.

<sup>414</sup> *Id.* at 925.

<sup>415</sup> 388 F. Supp. 1288 (S.D.N.Y. 1975).

<sup>416</sup> *Id.* at 1293.

<sup>417</sup> *Id.* at 1290, 1293.

collectors but as investors.<sup>418</sup> The defendants argued that they did not require customers to use their coin selecting experts.<sup>419</sup> Testimony revealed, however, that a majority of the portfolios were comprised of coins specifically chosen by the defendants' coin specialists.<sup>420</sup> Because of the promoters' pre-purchase coin selection, the court found the "efforts of others" prong satisfied.<sup>421</sup>

All of these cases link investor profits to the promoters' specialized skills. The facts in these cases are similar to the facts in both *Mutual Benefits* and *Life Partners*.<sup>422</sup> Viatical companies use many experts to generate investor profits.<sup>423</sup> Viatical settlement providers must analyze the viator's medical condition to obtain, at a minimum, information regarding T-cell count, platelet count, and pulmonary studies.<sup>424</sup> These companies must also be knowledgeable about insurance policies and know how to negotiate for a policy, whether the policy is assignable, and whether it is a group or individual policy.<sup>425</sup> They must also have knowledge of the specific state insurance laws and track all relevant legislation affecting viaticals.<sup>426</sup> Finally, viatical settlement providers need legal experts to draft contracts, ensure that other beneficiaries will not attempt to claim death benefits, be cognizant of tax regulations, and draft other necessary legal documents.<sup>427</sup>

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<sup>418</sup> *Id.* at 1291.

<sup>419</sup> *Id.* at 1293.

<sup>420</sup> *Id.*

<sup>421</sup> *Id.*

<sup>422</sup> *Mutual Benefits III*, 408 F.3d 737 (11th Cir. 2005); *Life Partners IV*, 87 F.3d 536 (D.C. Cir. 1996).

<sup>423</sup> *Mutual Benefits III*, 408 F.3d at 738–39.

<sup>424</sup> *Life Partners IV*, 87 F.3d at 555 (Wald, J., dissenting).

<sup>425</sup> *Id.*

<sup>426</sup> *Id.* at 555–56.

<sup>427</sup> *Id.* at 555.

Cases in which pre-purchase efforts alone satisfy the fourth prong are rare.<sup>428</sup> However, in such cases, “the most common pre-purchase managerial activity is the use of some special expertise to select items for purchase [so as] to identify items ‘within a particular class of items which will appreciate at a faster rate than will the particular class in general.’”<sup>429</sup> The infrequency of this type of case should not render pre-purchase efforts irrelevant.<sup>430</sup> At the time of the D.C. Circuit’s decision, no court had previously focused on the timing of entrepreneurial and managerial efforts.<sup>431</sup>

In analyzing viatical settlement agreements, courts should focus on the nature of the promoter’s efforts rather than on the timing of those efforts.<sup>432</sup> This focus will force courts to evaluate the underlying economic reality of the investment rather than the form of the investment.<sup>433</sup> If investors rely on the promoter’s special expertise to generate profits, it is more likely that the “efforts of others” requirement will be met.<sup>434</sup>

### **B. Eleventh Circuit Embraced Purpose of Securities Acts**

By passing the Securities Acts, the legislature intended to force promoters to disclose pertinent information to investors.<sup>435</sup> In *Mutual Benefits I*, Judge Moreno accurately explained that securities laws require promoters to disclose information that is not available to the public.<sup>436</sup> If the public is investing in the stock market, individuals already have access to relevant information rendering securities laws

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<sup>428</sup> *See id.* at 553.

<sup>429</sup> *Id.* at 554 (quoting *Bailey v. J.W.K. Props. Inc.*, 904 F.2d 918, 924 (4th Cir. 1990)).

<sup>430</sup> *See id.* at 553–55 (Wald J., dissenting).

<sup>431</sup> *See id.* at 553.

<sup>432</sup> *Id.* at 551 (stating that in determining whether the “efforts of others” prong is satisfied, courts should focus on “the kind and degree of dependence between the investors’ profits and the promoter’s activities”).

<sup>433</sup> *See id.* at 550.

<sup>434</sup> *See id.* at 554.

<sup>435</sup> H.R. REP. NO. 73-85, at 2 (1933); S. REP. NO. 73-47, at 6 (1933).

<sup>436</sup> *Mutual Benefits I*, 323 F. Supp. 2d 1337, 1340 (S.D. Fla. 2004).

redundant.<sup>437</sup> In the viatical industry, potential investors need to be able to find out how others have fared with a particular promoter.<sup>438</sup> This type of information is not available to the public at large.<sup>439</sup> This is exactly the type of information the securities laws hope to unearth.

Despite the foregoing, in *Life Partners*, the majority did not think that investors need information when profitability of the investment depends on pre-purchase efforts.<sup>440</sup> “Presumably this is because investors already have a potent weapon—they can refuse to invest.”<sup>441</sup> In her dissent, Judge Wald debunked this argument because investors also need to be protected *prior to* investing.<sup>442</sup> The dissent explained that the majority’s view “has been rejected by Congress, which made the goal of ensuring that investors have adequate information before they commit their money...the central concern of the Securities Acts.”<sup>443</sup>

The second purpose of the Securities Acts was to prevent further fraud in the securities industry.<sup>444</sup> Preventing fraud is important from a public policy standpoint.<sup>445</sup> The SEC, however, has the power to regulate *all* securities.<sup>446</sup> It is irrelevant that a particular scheme is promoted by using false information. If all of the *Howey* elements are met, the seller of securities must adhere to the law.<sup>447</sup>

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<sup>437</sup> *Id.* at 1342.

<sup>438</sup> *Life Partners IV*, 87 F.3d 536, 552 (D.C. Cir. 1996) (Wald, J. dissenting).

<sup>439</sup> *Id.*

<sup>440</sup> *Id.*

<sup>441</sup> *Id.*

<sup>442</sup> *Id.*

<sup>443</sup> *Id.*

<sup>444</sup> H.R. REP. NO. 73-85, at 2 (1933); S. REP. NO. 73-47, at 6 (1933).

<sup>445</sup> See discussion *supra* Part VI.

<sup>446</sup> See 17 C.F.R. § 200.1 (2005).

<sup>447</sup> See *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298–99 (1946).

In *Life Partners*, the lack of any evidence of fraud seemed to sway the court.<sup>448</sup> Prior to the case's reaching the D.C. Circuit, the SEC performed a two-year investigation into LPI's business practices.<sup>449</sup> Despite this exhaustive examination, the SEC failed to find any "evidence or...allegations 'that any investor, terminally ill patient, or insurance company had been defrauded, misled, or [was] in any way dissatisfied with an LPI viatical settlement.'"<sup>450</sup> In this environment, the D.C. Circuit could more comfortably conclude that viatical settlements were not investment contracts. Additionally, *Life Partners* was decided prior to the medical advancements that plagued MBC's investors in particular and the viatical settlement industry at large.<sup>451</sup>

Perhaps in light of MBC's fraudulent business practices, the Eleventh Circuit could more easily conclude that viatical settlements should be monitored. Nevertheless, the existence of fraud is not a prerequisite for holding that a particular scheme is a security. Although there was no evidence of fraud, the D.C. Circuit erred by dismissing the SEC's argument that "the securities laws, and in particular the disclosure requirements,...are intended to prevent abuses before they arise."<sup>452</sup> Perhaps if the *Life Partners* court had found evidence of fraud it "would have determined that more disclosure was required, and, thus, ruled the interests were securities."<sup>453</sup> Unfortunately, if the D.C. Circuit had reached the opposite conclusion, the Mutual Benefits fiasco might have been avoided.

### **C. Eleventh Circuit Flexibly Applied *Howey***

Because the Securities Acts are remedial in nature, courts must apply them flexibly.<sup>454</sup> Congress included the term "investment contract" in its definition of a

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<sup>448</sup> *Life Partners IV*, 87 F.3d 536, 538-39 (D.C. Cir. 1996).

<sup>449</sup> *Id.*

<sup>450</sup> *Id.*

<sup>451</sup> *Mutual Benefits II*, No. 04-60573-CIV-MORENO/GARBER, 2004 U.S. Dist. LEXIS 23008, at \*34-36 (S.D. Fla. Nov. 10, 2004) (explaining the effects of medical advancements on the viatical industry).

<sup>452</sup> *Life Partners IV*, 87 F.3d at 539.

<sup>453</sup> DePeri, *supra* note 395 at 873-74.

<sup>454</sup> *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967) (emphasizing that "remedial legislation should be construed broadly to effectuate its purposes"); *see also* H.R. REP. NO. 73-85, at 2 (1933); S. REP. NO.

“security” because it was “sufficiently broad to reach ‘devious’ schemes.”<sup>455</sup> It was Congress’ intention that courts broadly apply this term.<sup>456</sup>

In *Mutual Benefits*, both the district court and the Eleventh Circuit explained the importance of flexibility.<sup>457</sup> According to the district court, Congress chose the term “investment contract” because state courts had not narrowly defined the term.<sup>458</sup> In rejecting the D.C. Circuit’s bright-line test, the district court explained that “[b]right-line rules are discouraged in the context of federal securities laws for the reason that they tend to create loopholes that can be used by the clever and dishonest.”<sup>459</sup> The Eleventh Circuit also stressed the Supreme Court’s statement in *Howey* that its test “embodies a flexible rather than a static principle.”<sup>460</sup> The court also pointed out that only a year earlier, in *Edwards*, the Supreme Court reiterated the need for flexibility when applying securities laws.<sup>461</sup> In fact, the *Edwards* Court expressly stated that it refused to read a limitation into the securities laws that would undermine their purposes.<sup>462</sup> By creating a bright-line test in *Life Partners*, the D.C. Circuit read a limitation into the Securities Acts that is demonstrably at odds with legislative intent.

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73-47, at 7 (1933) (President Roosevelt’s message directing Congress to enact “legislation to correct” the problems caused by the stock market crash) (emphasis added).

<sup>455</sup> *Miranda*, *supra* note 125, at 279.

<sup>456</sup> *Id.*

<sup>457</sup> *Mutual Benefits III*, 408 F.3d 737, 742 (11th Cir. 2005) (stating that “the Supreme Court provided a flexible test for determining whether a particular transaction qualified as an ‘investment contract’”) (citing *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298–9 (1946)); *Mutual Benefits I*, 323 F. Supp. 2d 1337, 1339 (S.D. Fla. 2004) (stating that “[a]fter a survey of the relevant case law, the Court has identified the principle of flexibility in the law’s application”).

<sup>458</sup> *Mutual Benefits I*, 323 F. Supp. 2d at 1340.

<sup>459</sup> *Id.* at 1343.

<sup>460</sup> *Mutual Benefits III*, 408 F.3d at 742 (citing *Howey*, 328 U.S. at 299).

<sup>461</sup> *Id.* (citing *SEC v. Edwards*, 540 U.S. 389, 393 (2004)).

<sup>462</sup> *Edwards*, 540 U.S. at 395.

*Life Partners* conspicuously lacks a discussion of flexibility.<sup>463</sup> Similar to most other cases that have interpreted securities laws, *Mutual Benefits* highlighted precedent in which the courts stressed flexibility.<sup>464</sup> A discussion of precedent emphasizing the adaptable nature of the *Howey* test is missing in *Life Partners*.<sup>465</sup> In fact, the word “flexible,” “flexibly,” or “flexibility” is not found anywhere in the majority’s opinion.<sup>466</sup> This separates the D.C. Circuit from most courts which have ruled on this issue.<sup>467</sup>

At best, the D.C. Circuit was inconsistent regarding flexibility. On one hand, the court accepted the flexible rule adopted in *Turner* regarding the word “solely.”<sup>468</sup> The court then proceeded to create *an even* more inflexible rule by holding that pre-purchase managerial and entrepreneurial efforts alone could not satisfy the “efforts of others” prong.<sup>469</sup> With this decision, the court rejected the legislative intent that the securities laws be flexibly applied.<sup>470</sup> The D.C. Circuit’s bright-line rule creates a loophole that allows promoters to easily evade the SEC.<sup>471</sup> Even if a promoter’s pre-purchase activities are unmistakably profit-generating, the promoter can simply eliminate all post-purchase efforts and successfully avoid securities regulation.<sup>472</sup>

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<sup>463</sup> *Life Partners IV*, 87 F.3d 536, 536–49 (D.C. Cir. 1996). Conversely, the dissent’s second paragraph reads in part, “Several background principles should guide our analysis of whether or not...*Howey’s* [fourth] prong [is satisfied]...[and o]ne such principle is that we should avoid imposing overly formal restrictions on what qualifies as a security and instead apply securities laws flexibly so as to achieve their remedial purposes.” *Id.* at 549 (Wald, J., dissenting).

<sup>464</sup> *Mutual Benefits III*, 408 F.3d at 743–44.

<sup>465</sup> *Life Partners IV*, 87 F.3d at 536–49.

<sup>466</sup> *Id.*

<sup>467</sup> See cases cited *supra* note 239.

<sup>468</sup> *Life Partners IV*, 87 F.3d at 545 (citing *SEC v. Glenn W. Turner Enters., Inc.*, 474 F.2d 476, 482 (9th Cir. 1973)).

<sup>469</sup> *Id.* at 548; see also *Siporin v. Carrington*, 23 P.3d 92, at 98 (Ariz. Ct. App. 2001).

<sup>470</sup> *Miranda*, *supra* note 125, at 304.

<sup>471</sup> *Mutual Benefits I*, 323 F. Supp. 2d 1337, 1343 (S.D. Fla. 2004).

This is analogous to the loophole the *Turner* court sought to eliminate: one that permitted promoters to completely avoid the SEC by simply giving investors a small, irrelevant task.<sup>473</sup> Although the *Turner* court effectively closed one loophole, the decision in *Life Partners* created a new, and perhaps more dangerous, one.<sup>474</sup>

In *Life Partners*, the defendants took advantage of the loophole by manipulating their corporate structure to avoid the Securities Acts.<sup>475</sup> In the first district court decision, the court concluded that the “efforts of others” prong had been satisfied in part because LPI, and not the investor, was named as the owner and beneficiary of the policy post-purchase.<sup>476</sup> Although the court’s order required the defendants to comply with securities laws,<sup>477</sup> LPI instead shifted ownership to the investor and continued selling interests in viaticals.<sup>478</sup>

In the district court’s second decision, the court again ordered LPI to comply with securities regulations; however, LPI again altered its scheme to avoid the court’s directions.<sup>479</sup> In a footnote, the court noted that it did “not...find that LPI’s pre-closing activities alone [were] sufficient to sustain [its] finding. Instead, the court relie[d] on the pre-closing activities in addition to the post-closing activities that LPI

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<sup>472</sup> *Id.* Judge Wald also criticized the loophole created by the majority’s opinion, stating that “[i]nsisting 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.” *Life Partners IV*, 87 F.3d at 551 (Wald, J., dissenting).

<sup>473</sup> SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 482 (9th Cir. 1973).

<sup>474</sup> *Id.*; see *Mutual Benefits I*, 323 F. Supp. 2d at 1343.

<sup>475</sup> *Life Partners III*, No. 94-1861 (RCL), 1996 U.S. Dist. LEXIS 3451, at \* 2-3 (D.D.C. 1996).

<sup>476</sup> *Life Partners I*, 898 F. Supp. 14, 22 (D.D.C. 1995).

<sup>477</sup> *Id.* at 24.

<sup>478</sup> *Life Partners II*, 912 F. Supp. 4, 6-7 (D.D.C. 1996).

<sup>479</sup> *Id.* at 12-13; *Life Partners IV*, 87 F.3d 536, 540 (D.C. Cir. 1996).

continue[d] to perform.”<sup>480</sup> LPI latched on to this statement, did away with all of its post-purchase activities, and continued selling interests in viatical settlements.<sup>481</sup>

In response, the SEC brought LPI before the district court a third time.<sup>482</sup> The SEC explained it “w[ould] not provide advice to LPI on how to structure their transactions so as to fall outside the purview of the securities laws [because] they are not in the business of helping companies subvert the protections provided to investors by the securities laws.”<sup>483</sup> Relying on precedent, the court reasoned that LPI’s changes were only in form and not based on the economic reality of the situation.<sup>484</sup> Neither the district court nor the SEC was satisfied with LPI’s efforts to manipulate its operations in an attempt to avoid securities regulations.<sup>485</sup>

The D.C. Circuit’s holding that the third version of LPI’s scheme fell outside the purview of the Securities Acts allowed it to ignore LPI’s manipulations.<sup>486</sup> In so holding, the *Life Partners* court again ignored the underlying purposes of the Securities Acts.<sup>487</sup> The *Howey* test is flexible for the specific reason of preventing promoters from structuring their programs outside the SEC’s grasp.<sup>488</sup>

The *Life Partners* decision served as a blueprint for viatical companies that sought to avoid securities regulations.<sup>489</sup> In fact, Mutual Benefits Corporation was

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<sup>480</sup> *Life Partners II*, 912 F. Supp. at 9 n.7.

<sup>481</sup> *Life Partners III*, No. 94-1861 (RCL), 1996 U.S. Dist. LEXIS 3451, at \*2 (D.D.C. 1996).

<sup>482</sup> *Id.* at \*1.

<sup>483</sup> *Life Partners II*, 912 F. Supp. at 7 n.2.

<sup>484</sup> *Life Partners III*, 1996 U.S. Dist. LEXIS 3451, at \*2-4 (holding that “it is neither realistic nor feasible for multiple investors, who are strangers to each other, to perform post-purchase tasks without relying on the knowledge and expertise of a third party”).

<sup>485</sup> *Id.* at \*3-4.

<sup>486</sup> *Life Partners IV*, 87 F.3d 536, 546 (D.C. Cir. 1996).

<sup>487</sup> *Miranda*, *supra* note 125, at 304.

<sup>488</sup> *Id.* at 279.

<sup>489</sup> *Mutual Benefits I*, 323 F. Supp. 2d 1337, 1343 (S.D. Fla. 2004).

aware of the *Life Partners* decision and made a conscious effort to replicate LPI's business practices.<sup>490</sup> In *Mutual Benefits*, the district court stated that *Life Partners* had created a loophole "which became the [defendants'] corporate structure model."<sup>491</sup> In fact, a "trustee for MBC[ ] testified...that the 'attorneys of Mutual Benefits were cognizant of the *SEC v. Life Partners* case,'" and MBC's counsel testified that MBC "attempted to restructure certain portions of its operations to conform to the D.C. Circuit's ruling."<sup>492</sup> This example highlights the problem with the *Life Partners* decision. Because *Life Partners* left open this loophole, MBC was able to avoid SEC regulation for more than a decade.

### VIII. CONCLUSION

The consensus is that viatical settlement agreements are securities and should be monitored by the SEC. There are several reasons why this outcome is correct. First, precedent exists in which courts refused to distinguish between pre- and post-purchase efforts when holding that a given scheme must be monitored by the SEC. Second, *Mutual Benefits* adheres to the underlying objectives of the Securities Acts of 1933 and 1934. Third, *Mutual Benefits* flexibly applies the *Howey* test. Fourth, nearly every state legislature agrees that viatical settlements are securities and has added some form of the term to the definition of "security" in its state statute. Fifth, public policy dictates that investors need protection from viatical settlement providers. The securities laws give investors this protection. Finally, in light of the unanimous decision in *Edwards*, the Supreme Court would most likely hold that viatical settlement agreements should be treated as investment contracts.<sup>493</sup>

In light of the tepid response to *Life Partners*, the decision seems to be an aberration. Contrary to what many in the legal community predicted, the D.C. Circuit's holding and rationale did not metastasize.<sup>494</sup> In fact, the opposite occurred.

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<sup>490</sup> *Id.*

<sup>491</sup> *Id.*

<sup>492</sup> *Id.*

<sup>493</sup> M. Davis, *supra* note 138, at 967 (stating that "[i]f the *Life Partners* decision leads to a clash between the D.C. Circuit and the Supreme Court, it appears likely the D.C. Circuit's alteration of the ["efforts of others"] prong...will be erased and a new test formulated").

<sup>494</sup> See, e.g., Jennifer A. Lann, Note, *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, 943 (1998). In conclusion, the author explained that "[t]he view that viatical settlements are securities under the

After surveying virtually every available case that has addressed this exact issue, nearly all of them, for some or all of the reasons listed above, refused to follow both the reasoning and holding in *Life Partners*. Now that the *Mutual Benefits* decision exists, courts no longer have to justify their refusals to follow *Life Partners*. Instead, as the district court in *Wuliger v. Mann* has done, courts can cite the *Mutual Benefits* decision as precedent for a holding that viatical settlement agreements must be regulated by the SEC.<sup>495</sup>

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Security Act of 1933 is the minority view [and] *SEC v. Life Partners, Inc.* may be an indication of the direction of future litigation.” *Id.*

<sup>495</sup> *Wuliger v. Mann*, No. 3:03 CV 1531, 2005 U.S. Dist. LEXIS 13021, at \*13 (N.D. Ohio July 1, 2005) (citing *Mutual Benefits III*, 323 F. Supp. 2d 1337, 1344 (S.D. Fla. 2004)).