NO. 04-14850-C

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

MUTUAL BENEFITS CORP., *et al.*,

Defendants-Appellants

On appeal from the
United States District Court for the Southern District of Florida,
Case Number 04-60573-Civ-Moreno

BRIEF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., AS *AMICUS CURIAE* IN SUPPORT OF APPELLEE SECURITIES AND EXCHANGE COMMISSION AND IN SUPPORT OF AFFIRMANCE

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Securities and Exchange Commission v. Mutual Benefits Corp.
No. 04-14850-C

CERTIFICATE OF INTERESTED PERSONS AND CORPORATE DISCLOSURE STATEMENT

Certificate of Interested Persons

Pursuant to Fed. R. App. P. 26.1 and 29(c), and 11th Cir. R. 26.1-1, NASAA represents that the following persons or entities have an interest in the outcome of this appeal, in addition to those persons and entities already listed by the parties:

1. Alabama Securities Commission
2. Alaska Department of Community & Economic Development, Division of Banking, Securities & Corporations
3. Alberta Securities Commission
4. Arizona Corporation Commission, Securities Division
5. Arkansas Securities Department
6. British Columbia Securities Commission
7. California Department of Corporations
8. Colorado Division of Securities
9. Connecticut Department of Banking
10. Davis, Mark J.
11. Delaware Department of Justice
12. District of Columbia

13. Florida Office of Comptroller, Department of Banking
14. Georgia Office of the Secretary of State, Division of Securities & Business Regulation
15. Hall, Stephen W.
16. Hawaii Department of Commerce & Consumer Affairs
17. Idaho Department of Finance
18. Illinois Office of the Secretary of State, Securities Department
19. Indiana Office of the Secretary of State, Securities Division
20. Iowa Insurance Division, Securities Bureau
21. Kansas Office of the Securities Commissioner
22. Kentucky Department of Financial Institutions
23. Louisiana Securities Commission
24. Maine Office of Securities
25. Manitoba Securities Commission
26. Maryland Office of the Attorney General
27. Massachusetts Securities Division
28. Mexico Comision Nacional Bancaria y de Valores
29. Michigan Office of Financial & Insurance Services
30. Minnesota Department of Commerce

31. Mississippi Office of the Secretary of State, Business Regulation & Enforcement Division
32. Missouri Office of the Secretary of State
33. Montana Office of the State Auditor, Securities Department
34. Nebraska Department of Banking & Finance, Bureau of Securities
35. Nevada Secretary of State, Securities Division
36. New Brunswick Department of Justice, Securities Administration Branch
37. Newfoundland Securities Commission
38. New Hampshire Bureau of Securities Regulation, Department of State
39. New Jersey Department of Law & Public Safety, Bureau of Securities
40. New Mexico Regulation & Licensing Department, Securities Division
41. New York Office of the Attorney General, Investment Protection Bureau
42. North Carolina Department of the Secretary of State, Securities Division
43. North Dakota Securities Commission
44. Northwest Territories Securities Registry, Department of Justice
45. Nova Scotia Securities Commission
46. Nunavut Department of Justice, Legal Registries Division
47. Ohio Division of Securities
48. Oklahoma Department of Securities
49. Ontario Securities Commission

50. Oregon Department of Consumer & Business Services, Division of Finance & Corporate Securities
51. Pennsylvania Securities Commission
52. Prince Edward Island Office of the Attorney General
53. Puerto Rico Commissioner of Financial Institutions
54. Quebec Commission des Valeurs Mobilieres du Quebec
55. Rhode Island Department of Business Regulation
56. Saskatchewan Securities Commission
57. South Carolina Office of the Attorney General, Securities Division
58. South Dakota Division of Securities
59. Staples, Rex A.
60. Tennessee Department of Commerce & Insurance, Securities Division
61. Texas State Securities Board
62. Utah Department of Commerce, Division of Securities
63. Vermont Department of Banking, Insurance, Securities & Health Care Administration
64. Virginia State Corporation Commission, Division of Securities & Retail Franchising
65. Washington Department of Financial Institutions, Securities Division
66. West Virginia, Office of the State Auditor, Securities Division

67. Wisconsin Department of Financial Institutions, Division of Securities

68. Wyoming Secretary of State, Securities Division

69. Yukon Department of Justice

Corporate Disclosure Statement

Pursuant to Fed. R. App. P. 26.1 and 29(c), NASAA hereby represents that it has no parent corporation and that there is no publicly held corporation that owns 10% or more of NASAA's stock.

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IDENTITY, INTEREST, AND AUTHORITY OF THE *AMICUS CURIAE*

The North American Securities Administrators Association, Inc. ("NASAA"), is the nonprofit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has 66 members, including the securities regulators in all 50 states, the District of Columbia, and Puerto Rico. Formed in 1919, it is the oldest international organization devoted to protecting investors from fraud and abuse in the offer and sale of securities. [1]

The members of NASAA include the state agencies that are responsible for regulating securities transactions under state law. Their fundamental mission is protecting investors, and their jurisdiction extends to a wide variety of securities, including "investment contracts." Their principal activities include registering certain types of securities, such as viaticals; licensing the firms and agents who offer and sell securities; investigating violations of state law; and filing enforcement actions where appropriate. State securities regulators also educate the public about investment fraud and advocate for the adoption of strong, fair, and uniform securities laws and regulations at both the state and federal level.

[1] Pursuant to Fed. R. App. P. 29(a), NASAA states that all parties to this appeal have consented to the filing of this brief.

NASAA supports the work of its members by coordinating multi-state enforcement actions, offering training programs, publishing investor education materials, and presenting the views of its members in testimony before Congress on matters of securities regulation. Another core function of the association is to represent the membership's position, as *amicus curiae*, in significant cases involving the interpretation of the securities laws and the rights of investors.

NASAA and its members have a stake in the outcome of this appeal because it will have a significant impact on the ability of the SEC, and state regulators as well, to protect investors from fraud and abuse. The district court correctly held that the viatical settlements offered and sold by Mutual Benefits Corp. ("MBC") are investment contracts and therefore securities subject to federal regulation. If this Court were to reverse that decision and terminate the SEC's jurisdiction in this case, MBC will be free to resume selling viaticals to the investing public without the regulatory and remedial protections provided under the federal securities laws. That result would pose an especially grave threat to the investing public because the Magistrate's report in this case, discussed below, indicates that MBC not only flaunted the registration requirements of the securities laws, but also committed fraud in the offer and sale of its viatical investments. The injunctive and ancillary relief sought by the SEC is essential to prevent further harm to the investing public from MBC's misconduct.

Affirming the SEC's jurisdiction over viaticals will also help ensure that other viatical companies either comply with the securities laws or cease operations. Regulation of the viaticals industry under the securities laws is necessary because viaticals have proven to be fertile ground for investor abuse. Although state regulation of these investments will continue, depriving the SEC of jurisdiction over such offerings will increase the burden on state regulators and undoubtedly expose more investors to the risks inherent in these investments. NASAA thus has an interest in seeking affirmance of the district court's decision and the restoration of federal regulation of these products.

Affirming the district court decision is also important to help ensure that the federal securities laws are broadly interpreted in accordance with their underlying remedial purposes. When the D.C. Circuit issued its decision in *Life Partners* in 1996, it substantially narrowed the federal definition of "investment contract" under *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). In a surprising departure from the precedents and policies of the securities laws, the court held that investment contracts do not include offerings where the promoter's key managerial efforts happen to occur before money is accepted from investors. *SEC v. Life Partners, Inc.*, 87 F.3d 536 (D.C. Cir.), *rehearing denied*, 102 F.3d 587 (D.C. Cir. 1996). This novel interpretation of *Howey* opened a loophole that unscrupulous promoters can exploit as they devise new investment schemes for defrauding the public. The district court's forthright rejection of the rule in *Life Partners* was an important step in the process of closing this loophole and restoring the investment contract definition to full strength as a regulatory and enforcement tool. Even more important would be affirmance of the district court's decision by this Court. NASAA thus has an interest in helping to limit the adverse impact of the *Life Partners* decision on securities regulation generally.

STATEMENT OF THE ISSUES

Whether a promoter's entrepreneurial efforts should be excluded from consideration as the "efforts of others" under *Howey* merely because the promoter chooses to conduct those activities before accepting investors' funds.

Whether the post-investment activities of ensuring that premiums are paid, monitoring viators' health, collecting benefits upon death, and distributing proceeds to investors constitute the "efforts of others" under *Howey,* where those activities are essential to the profitability of the investment.

SUMMARY OF THE ARGUMENT

The district court's ruling should be affirmed because MBC's viatical settlements are investment contracts under *Howey.* Any profits from those investments were derived from the "efforts of others." Among those efforts were MBC's evaluations of viator life expectancies. The mere fact that those evaluations may have occurred prior to the receipt of investor funds does not alter their status as the "efforts of others" within the meaning of *Howey.* The decision in *Life Partners*, which discounts a promoter's pre-investment activities, was incorrectly decided. That ruling has no support in the securities acts, the case law, or the policy of full disclosure underlying securities regulation.

As a separate basis for affirmance, MBC's post-investment activities also constituted "efforts of others" under *Howey.* Those activities included ensuring that premiums were paid, monitoring viators' health, collecting benefits upon death, and distributing proceeds to investors. Regardless of how labeled, these activities were also critical to the success of MBC's enterprise and any profits to investors were derived from those activities as well as from the life expectancy evaluations.

Affirming the district court's decision will serve the cause of investor protection by preserving the SEC's jurisdiction in this case, enabling the SEC to regulate the activities of other viatical companies, and helping to close the loophole in the definition of an investment contract that the D.C. Circuit created in *Life Partners.*

ARGUMENT

I. The Viatical Investments Offered By MBC Are Investment Contracts Subject To Regulation Under Federal Securities Law

The district court correctly held that MBC's viatical settlements are investment contracts subject to regulation as securities by the SEC. Under the

Supreme Court's decision in *Howey*, an investment offering is an investment contract if it involves: (1) the investment of money, (2) in a common enterprise, (3) with the expectation of profits, (4) derived from the efforts of others. *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946). Profits are deemed to flow from the "efforts of others" where "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." *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973).

In this case, the Appellants do not dispute that their viatical settlements meet the first three requirements of the *Howey* test. The Appellants furthermore concede that their efforts in determining viator life expectancy were critical to the profitability of their investment offerings. However, they rest their appeal on the formalistic notion that because they chose to perform those life expectancy evaluations before investors parted with their money, rather than afterwards, those evaluations cannot constitute the "efforts of others" within the meaning of Howey.[2]

[2] The record developed so far in this case indicates that MBC actually conducted many life expectancy evaluations *after* investors had closed on their viatical settlements, and that MBC falsified records in some instances to make it appear that those evaluations predated the closings. *See* Magistrate's Report, cited *supra* in text, at 17-19. To the extent this is true, the Appellants' reliance upon the *Life Partners* decision is groundless, as is their challenge to the SEC's jurisdiction.

For this distinction, they rely upon the decision of the D.C. Circuit in *SEC v. Life Partners, Inc.*, 87 F.3d 536 (D.C. Cir.), *rehearing denied*, 102 F.3d 587 (D.C. Cir. 1996). They also contend, in accordance with *Life Partners*, that all of their "post-purchase" efforts in furtherance of the investment were strictly ministerial in nature, and therefore incapable of satisfying Howey's "efforts of others" test.

The Appellants' argument is wrong on both counts. First, as the district court held, the arbitrary dividing line between pre- and post-investment efforts set forth in *Life Partners* is untenable. That distinction, based upon the chronology of events under a promoter's control, finds no support in the federal securities laws or in the extensive line of cases that have applied the *Howey* test over the past 60 years. Moreover, the *Life Partners* decision violates the Supreme Court's time-honored rule that the securities laws are to be interpreted flexibly to achieve their remedial purposes and to enhance the disclosure of information to investors.

Second, putting aside life expectancy evaluations, the activities that Life Partners performed *after* receiving investor funds were essential prerequisites to any investors realizing a return on their investments. Accordingly, those efforts should be deemed to satisfy the efforts of others test under *Howey*, regardless of whether they are considered "ministerial" in nature. While the district court did not reach this issue, it nevertheless consititutes an additional basis upon which to affirm the district court's ruling.

A. The Distinction Set Forth In *Life Partners* Between The Pre- and Post-Investment Efforts Of A Promoter Has No Legal Support Or Policy Rationale And Should Be Rejected

In *SEC v. Life Partners, Inc.*, 87 F.3d 536 (D.C. Cir.), *rehearing denied*, 102 F.3d 587 (D.C. Cir. 1996), the D.C. Court of Appeals held that work performed by a promoter before receiving investor funds cannot be a significant factor in determining whether any profits from the investment are derived from the "efforts of others" under *Howey*. 87 F.3d at 545. The court also held that the actions taken by Life Partners *after* investors parted with their money were only "ministerial" and therefore insufficient to constitute the "efforts of others" for purposes of *Howey*. *Id.* at 548.

The *Life Partners* decision has been widely criticized by courts and scholars alike for narrowing the *Howey* test in a way that has no legal support or rationale. *See* JOSEPH C. LONG, 12 BLUE SKY LAW §§ 3:15, 3:16.1 (June 2004) (explaining that the decision was irrational and that it was quickly the subject of judicial and scholarly criticism); Anna D. Halechko, *Viatical Settlements: The Need for Regulation to Preserve the Benefits While Protecting the Ill and the Elderly From Fraud*, 42 DUQ. L. REV. 803, 815, 817 (Summer 2004) (the timing of promoter effort is immaterial). The distinction between pre- and post-investment efforts certainly cannot be drawn from the wording or the structure of the securities laws. The definition of a "security" found in the federal securities acts includes a wide variety of instruments and offerings in addition to "investment contracts," ranging from stocks and bonds to notes and profit-sharing agreements. *See* 15 U.S.C. § 78c(a)(10). The items encompassed by the definition do not suggest a legislative intention to define securities strictly in terms of post-investment efforts. Indeed, many of the investments listed in the definition of a security "derive their potential profitability from managerial and entrepreneurial efforts employed prior to investor involvement." *See Siporin v. Carrington*, 23 P.3d 92, 99 (Ariz. Ct. App. 2001).

The ruling in *Life Partners* also lacks support in the case law. In *Howey*, the Supreme Court simply held that for an investment contract to exist, an investor's profits must be derived from "the efforts of the promoter or a third party." *See* 328 U.S. at 299. The Court did not impose any limitations on when those efforts must be expended in relation to the investment of funds. The facts in *Howey* actually suggest that the timing of the promoter's effort was immaterial to the Supreme Court. In *Howey*, investors were offered the opportunity to purchase citrus groves, coupled with service contracts for the cultivation and harvesting of the crops. *Id.* at 295-96. Arguably, the most critical elements in the success of the venture were the selection of an optimal growing climate, the choice of suitable land, and the selection of the trees. The promoters had made all of these important arrangements prior to accepting investors' funds. *Id.* Nevertheless, the Supreme Court had no hesitation in finding that the offerings at issue were investment contracts. *Id.* at 299.

After *Howey* was decided, some federal courts held that the pre-investment efforts of a promoter are sufficient to satisfy the "efforts of others" test. In these cases, promoters applied their expertise to select items within a particular class that had greater value than other items within that class or that would appreciate at a higher rate than other items within the class. *See, e.g., Bailey v. J.W.K. Properties, Inc.*, 904 F.2d 918 (4th Cir. 1990) (embryos for cattle breeding); *Glen-Arden Commodities, Inc. v. Costantino,* 493 F. 2d 1027 (2nd Cir. 1974) (scotch whiskey); *SEC v. Brigadoon Stock Distributors, Ltd.*, 388 F. Supp. 1288 (S.D.N.Y. 1975) (rare coins). For example, in *SEC v. Brigadoon*, the investors relied upon the company's expertise in selecting rare coins, and they had no obligation to subscribe to any post-purchase services. 388 F. Supp. at 1291-92. The court held that under these circumstances, the company's sale of the coins to investors constituted the sale of investment contracts. 388 F. Supp. at 1293. Whether any of the company's post-purchase services affected the value or price of the coins was deemed irrelevant since the initial "selection is the most crucial factor in determining how much profit an investor in coins will make." *Id.* This reasoning applies to the selection of viators and their life insurance policies just as it does to the selection of scotch whiskeys, coins, and embryos.

The federal courts have not had many occasions to address the *Life Partners* decision, due to the chilling effect it has had on the SEC's enforcement actions against viatical settlement companies. However, at least two federal district courts have shown an inclination to reject the holding in *Life Partners*. In *Wuliger v. Christie,* 310 F. Supp. 2d 897 (N.D. Ohio 2004), the district court held that viaticals were investment contracts and that the efforts of others test was met because it was the promoter's selection of viator policies that determined the success of the venture. *Id.* at 907. Those selections were made after purchase, so the court observed that the viaticals at issue would meet the *Howey* test even under *Life Partners*. *Id.* Nevertheless, the court stated that narrowly considering only the pre-investment conduct of the promoter would '"violate the principle that form should not be elevated over substance and economic reality."' *Id.* (quoting Judge Wald in *SEC v. Life Partners,* 87 F.3d at 551).

The United States District Court for the Western District of Texas also addressed the status of viaticals in *Melton v. Keisling*, MO:99-CA-145 (W.D. Texas, May 16, 2000). In denying a viatical promoter's motion to dismiss, the court cast doubt on the validity of the *Life Partners* decision. Although not prepared to reject the *Life Partners* analysis in its entirety, the court acknowledged the importance of the defendants' pre-purchase activities:

> [T]he Plaintiffs argue convincingly that the Defendants' Motion to Dismiss should not be granted because the return on viatical

> settlements is so dependant upon the accuracy of the promoter's prediction of the viator's life expectancy. The Court agrees that the return on a viatical settlement does not depend solely on the death of the viator but rather on the accuracy of the promoter's assessment of the viator's life span, *a prediction that is made pre-purchase*.

Melton v. Keisling, *supra*, at 8 (emphasis added). The court deferred decision on the ultimate issue of whether the "efforts of others" test was satisfied based on the record before it, but implicit in the court's analysis is an acknowledgement that pre-purchase activities of a promoter may satisfy the *Howey* test. *But cf. SEC v. Tyler*, 2002 WL 32538418, at *5, 6 (N.D. Tex. Feb. 21, 2002) (holding that the promoter's creation of a secondary market distinguished the case from *Life Partners*, but expressing an inclination to follow the result in *Life Partners* if not for the distinction).

While the federal courts have seldom addressed the holding in *Life Partners*, many state courts have done so and the vast majority of them have declined to adopt the D.C. Circuit's analysis.[3] *See Michelson v. Voison*, 658 N.W. 2d 188 (Mich. Ct. App. 2003); *Poyser v. Flora*, 780 N.E. 2d 1191 (Ind. Ct. App. 2003); *Joseph v. Viatica Management, LLC*, 55 P. 3d 264 (Colo. Ct. App. 2002); *Siporin v. Carrington*, 23 P.3d 92 (Az. Ct. App. 2001); *Alabama v. Kash*, Case Nos. CC-

[3] State court decisions are relevant in this case because the term "investment contract" originated in state securities laws enacted during the early 1900's, and it was interpreted extensively by state courts before Congress enacted the federal securities laws. *See Howey*, 328 U.S. at 298. For this reason, the Court in *Howey*

00-25, 26, & 27 (Ala., St. Clair Co. Cir. Ct., July 14, 2001); *Landau v. Sheaffer*, Case No CI-00-04672 (Pa. Ct. of Common Pleas, Lancaster County, June 22, 2001); *Oklahoma Dept. of Securities v. Accelerated Benefits Corp.*, No. CJ-99-2500-66 (Okla. Co. Dist. Ct., Mar. 13, 2001)[4]; *Hill v. Dedicated Resources*, 2000 WL 34001915, Case No. 99-C-1714 (Kan. D. Ct., July 12, 2000).

These courts have faulted the decision in *Life Partners* because it lacks precedent, strains logic, and conflicts with the investor protection rationale of the securities laws. For example, in one of the leading state court decisions addressing *Life Partners*, the Arizona Court of Appeals declared that it would not follow the D.C. Circuit's decision on these policy grounds:

> We disagree with the court of appeals' analysis in *Life Partners*. Although Arizona courts have consistently been guided by the federal courts' interpretation of the 1933 and 1934 federal Acts when applying the Arizona Securities Act, we will not defer to federal case law when, by doing so, we would be taking a position inconsistent with the policies of our own legislature. We will depart from those federal decisions that do not advance the Arizona policy of protecting the public from unscrupulous investment promoters. *Life Partners* falls squarely within this category.

Siporin v. Carrington, 23 P. 3d at 98. The court went on to describe the essential legal flaw in the *Life Partners* decision:

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expressly adopted state judicial interpretations of the term "investment contract" as a guide to its meaning under federal law. *Id.*

[4] *Available at* http://www.securities.state.ok.us/Enforcement/Orders/ABC_Order.pdf

> The extent to which each package would be profitable for the investor depended on the accuracy of Carrington's conclusions concerning the life expectancy of the viator, the terms of the insurance policy, and the financial soundness and reliability of the issuing insurance company. The fact that Carrington's efforts preceded the sale of interests in viatical settlements to its investors does not change the nature of the investment. . . . Under the *Howey* test, as here, the pre-sale activities were sufficient to classify the transaction as an investment contract.

Id.

Other state courts have been equally emphatic in their criticism of the decision. In the words of the court in *Alabama v. Kash:*

> [T]his Court expressly rejects the decision of the Circuit Court of the District of Columbia in *SEC v. Life Partners* . . . . The *Life Partners* decision is based upon flawed logic and is without case precedence. It establishes a "bright line rule" that "whatever the surrounding circumstances, an investment is not a security unless significant managerial activities by the promoter occur post-purchase." [citation omitted]. No Court before *Life Partners,* nor since, has ever read into the fourth prong of the *Howey* test a requirement that the efforts of others generating profits of others must be expended after the purchase of the investment. To ignore the significant pre-purchase efforts made by the viatical company is simply illogical. [*citing Siporin v. Carrington*]

Alabama v. Kash, supra, at 3.

The court in *Oklahoma Dept. of Securities v. Accelerated Benefits Corp.* similarly repudiated the *Life Partners,* rejecting the court's emphasis on managerial efforts at the point of investment and holding that the outcome of the investment "is totally dependent on the expertise and managerial efforts of ABC in seeking out and choosing the right viatical settlement." *Oklahoma Dept. of Securities v. Accelerated Benefits Corp., supra,* at 8-9.[5]

At the heart of these cases is the recognition that the *Life Partners* decision conflicts with the policy of full disclosure underlying the federal securities laws and with the Supreme Court's admonition that the securities laws must be interpreted flexibly to serve that policy. In *Howey*, the Court described the purpose of the securities laws as one of "compelling full and fair disclosure relative to the issuance of" securities. *Id.* at 299. The Court established a broad and flexible definition of an investment contract to ensure that the law would be "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." *Id.* In accordance with

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[5] NASAA's research reveals only one case in which a state court clearly followed the D.C. Circuit's ruling in *Life Partners. See Decker v. Mutual Benefits Corp.*, Case No. 00-0541-CA-17 (19th Judicial Circuit, River County, Fla. May 17, 2001) (Order on Motion to Dismiss). In *Decker*, the court felt compelled to adopt the federal rule, citing language from the Florida Supreme Court to the effect that the state legislature "intended Florida securities law to be *hand-in-glove* with federal securities law." *Id.* at 2 *(quoting Oppenheimer v. Young*, 456 So. 2d 1175, 1178 (Fla. 1978)) (emphasis added). Two other state courts have held that viaticals are not securities, but they did not rely on the temporal divide established in *Life Partners. See Griffitts v. Life Partners, Inc.*, 2004 WL 1178418, at *2 (Tex. Ct. App. May 26, 2004) (finding that the profitability of the investment was determined by the "mortality of the insured," not by "any managerial efforts"); *Glick v. Sokol*, 777 N.E. 2d 315, 319 (Ohio Ct. App. 2002) (not applying the *Howey* test and not mentioning *Life Partners*, but nevertheless holding that viaticals are not securities on the view that the only variable affecting the profitability of the investment is the timing of death).

this approach, the Court in *Howey* rejected a series of technical distinctions advanced by the defendants to evade application of the securities laws under an investment contract analysis – distinctions relating to how the investment was documented, *id.* at 299; whether the investment was speculative in nature, *id.* at 301; and whether investors received an interest in tangible assets having intrinsic value independent from the success of the enterprise, *id.* The Court brushed aside all of these distinctions by observing that "The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae." *Id.*

The Supreme Court reaffirmed this principle last year in *SEC v. Edwards*, 540 U.S. 389, 124 S. Ct. 892 (2003). There the Court held that a pay phone sale and leaseback program was an "investment contract" under federal securities law, notwithstanding the respondent's contention that the program offered investors a fixed, as opposed to a variable, rate of return. The Court unanimously rejected the respondent's technical distinction based on rates of investment return, stating that "We will not read into the securities laws a limitation not compelled by the language that would so undermine the laws' purposes." *SEC v. Edwards,* 124 S. Ct. at 897.

As in *Howey* and *Edwards*, the Appellants here are advancing a technical distinction that will enable them to evade the requirements of the securities laws.

The Appellants' justification for this departure from Supreme Court precedent does not withstand scrutiny. They claim *Howey* embodies a "forward-looking inquiry" that focuses on what a promoter will do in the future with an investor's money. Appellants' Opening Br. at 13. This is an unduly narrow view of federal securities regulation: Equally important is requiring disclosure about what a promoter has done in the past that will affect the future success of the enterprise.

Crucial to the Appellants' argument is the notion that investors can assess for themselves the actions of the promoter before investing. *Id.* at 15. This premise is flawed on three levels. Often, as in this case, investors simply do not have access to the information they need to make such assessments. Second, as a practical matter, investors cannot fairly be presumed to have the time, resources, or expertise to conduct a thorough analysis of the promoter's actions prior to investment. Finally, it is not sound policy to impose that burden upon investors as a substitute for mandatory disclosure under the securities laws. Expecting investors to recalculate the life expectancy evaluations of a viatical promoter prior to investing is woefully impractical and inefficient. Moreover, it conflicts with a core principle of investment contract theory: the investor is passive while the promoter expends the effort necessary to make the enterprise a success. Congress has already made the judgment, embodied in the securities laws, that investors are entitled to receive material information from promoters and to rely on that information when assessing an investment opportunity. The dissent in *Life Partners* expressed the point this way:

> The majority argues that we need not be concerned about protecting investors where the profitability of an investment hinges on pre-purchase activities. Maj. op. at 548. Presumably this is because investors already have a potent weapon – they can refuse to invest in the policy. But the claim that investors need not be protected prior to committing funds has been rejected by Congress, which made the goal of ensuring that investors have adequate information before they commit their money or enter contracts the central concern of the securities acts. [Citations omitted]

SEC v. Life Partners, 87 F. 3d at 552. Thus, an investor in viaticals is entitled to the protections of the securities laws regardless of when a promoter expends his efforts on behalf of the enterprise.

B. MBC's Post-Investment Efforts, Apart From Life Expectancy Evaluations, Were Essential To The Success Of The Enterprise And Therefore Qualify As The "Efforts Of Others" Under *Howey*

The court in *Life Partners* gave insufficient weight to the post-purchase efforts of the promoter that were necessary to maintain the viaticated insurance policies and to realize the investors' return: holding the policy for the duration of the insured's life, matching each investor to an insurance policy, making premium payments, monitoring the insured's health, filing the death claim, and collecting and distributing the death benefit. *See* 87 F.3d at 540. The D.C. Circuit unduly trivialized these responsibilities, regarding them as "ministerial" rather than managerial. *Id.* In reality, those efforts were critical to the success of the investments at issue in *Life Partners*, and in this case as well, and they should have been deemed sufficient by themselves to satisfy the *Howey* test.

Although federal courts other than the D.C. Circuit have not addressed the issue, a number of state courts have held that post-purchase efforts of the type described above, and present in this case, are significant "efforts of others" within the meaning of *Howey*. In *Siporin v. Carrington*, the Arizona Court of Appeals identified the actions needed to keep policies in force as among those factors that determine the profitability of a viatical investment:

> What truly determines viatical settlement profitability is the realization, over time, of an outcome predicted by the seller through its analyses of the viator's life expectancy, the soundness of the insurer, *the actions needed to keep the policy in effect for the original face amount*, and the insurer's unconditional liability under the policy terms.

Siporin v. Carrington, 23 P.3d at 98-99 (emphasis added); *see also Alabama v. Kash*, *supra*, at 4-5 ("[T]he *Life Partners* decision wrongfully trivialized the post-purchase efforts of the viatical company. As previously noted, the post-purchase efforts are vital to the success of the viatical settlement investment."); s*ee also* LONG, *supra*, § 3:16, at 1 ("The *Life Partners* courts were incorrect in holding that the post-purchase efforts were not entrepreneurial. Clearly, they were.")

In this case, of course, MBC or its agents performed a number of post-investment services much like those described in *Life Partners*. Those services included paying the premiums to ensure that policies did not lapse; monitoring the health of the viators; collecting benefits upon death; and distributing proceeds to investors. *See SEC v. Mutual Benefits Corp.*, 323 F. Supp. 2d 1337, 1338 (S.D. Fla. 2004). However labeled, those ongoing efforts by MBC were indispensable to the realization of any profits by investors. *See* LONG, § 3:16, at 2 (regardless of whether the efforts were "ministerial," they were essential for the success of the venture and therefore "entrepreneurial" under *SEC v. Glenn W. Turner).* Those efforts took place after investors paid their money, so even under the rule in *Life Partners*, they satisfy the efforts of others test.[6]

II. Affirming The District Court's Decision Will Serve Important Investor Protection Interests

Affirming the district court's decision will serve the cause of investor protection in two important ways. First, it will help restore much needed federal regulation of viaticals, an investment vehicle marked by a history of fraud and abuse. Second, it will close the loophole in the definition of an investment contract that was opened in *Life Partners.*

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[6] Managing premium reserves to ensure that policies are kept in force is another promoter activity that is critical to the success of a viatical investment. Where a promoter has failed to establish adequate reserves, as in this case, then the promoter's ability to sustain business revenues becomes an especially critical factor in determining the profitability of the investments. *See* Magistrate's Report, cited *supra* in text, at 38-39 (citing investors' dependence upon MBC's ability to make premium payments, due to insufficient reserves). These undeniably post-purchase activities clearly satisfy the efforts of others test under *Howey* and *Life Partners.*

A. Viaticals Must Be Regulated As Securities For The Protection of Investors

Affirming the district court's decision is important first and foremost to ensure that the SEC may continue to pursue the injunctive and remedial relief it seeks against MBC. The record developed thus far in this case demonstrates that MBC not only failed to comply with the registration requirements under the federal securities laws, but also engaged in a pattern of fraud in the offer and sale of its viatical investments. The Report and Recommendation of Magistrate Barry L. Garber, issued on November 10, 2004 ("Magistrate's Report"), summarizes the evidence adduced at the preliminary injunction hearing in this case and sets forth Findings of Fact and Conclusions of Law. The Magistrate's Report details MBC's fraudulent operations and sales practices, including these:

(1) MBC assured investors that each viator's medical records would be reviewed by independent, state-licensed physicians who would estimate the viator's life expectancy, when in fact, this was often not done. *See* Magistrate's Report at 37.

(2) MBC disseminated the claim that 70-80% of the viatical settlements it sold matured within predicted life expectancies, when in fact MBC's policies matured at nowhere near that rate. *Id.* at 38.

(3) MBC represented that at closing it would set aside sufficient funds to pay premiums on investors' policies through at least the viators' expected maturity dates, when in fact, for at least 1,500 policies, MBC failed to set aside any funds for future premium payments. *Id.* at 38-39.

(4) MBC failed to disclose to investors (a) that over 90% of MBC's viators had lived past their life expectancies; (b) that there was a premium escrow deficiency of more than $19 million; (c) that MBC had been the subject of cease and desist orders from five state regulatory agencies; (d) that the principals of MBC had criminal and civil disciplinary histories; and (e) that the principals had paid themselves millions of dollars pursuant to undisclosed consulting agreements. *Id.* at 39.

In light of these conclusions, it is evident that the public must be protected from any further predations by MBC, and that the SEC's enforcement action for injunctive and ancillary relief should proceed unabated. Affirming the district court's decision will answer this most immediate need.

Unfortunately, the abuses revealed in this case are not isolated instances in the viatical industry. Over the last decade, there have been widespread problems in the sale of viatical investments, and as a consequence, thousands of investors have lost money. While some viatical companies have not been embroiled in scandal, the industry in general has been characterized as "infected with scam artists, ‘ponzi’ schemes, and other fraudulent activities.” Lisa M. Ray, Comment, *The Viatical Settlement Industry: Betting on People’s Lives Is Certainly No Exacta*, 17 J. CONTEMP. HEALTH L. & POL’Y 321, 322 (2000). The potential for easy money has created a strong incentive for firms to defraud investors, as they seek market share in an industry estimated to have grown from $1 billion in sales in 1999 to as much as $4 billion in 2000. Joy D. Kosiewicz, *Death for Sale: A Call to Regulate the Viatical Settlement Industry*, 48 CASE W. RES. L. REV. 701, 702 (Spring 1998); Ffiona M. Jones, *The Viatical Settlement Industry: The Regulatory Scheme and Its Implications for the Future of the Industry*, 6 CONN. INS. L. J. 477, 483, 498 (1999-2000).

The patterns of investor abuse in the marketing of viaticals are well documented. Many investors have sustained losses due to outright fraud, as when viatical settlement companies sell non-existent policies or pocket investment proceeds. *See, e.g.,* Lawrence A. Frolik, *Insurance Fraud on the Elderly*, 37 TRIAL 48, 51-52 (June 2001). Other opportunities for fraud abound. Viatical companies may misrepresent the medical condition of the viators, particularly if the certifying physicians are not truly independent. In many instances, policies have been sold with assurances that the viator is very ill and likely to die soon. When viators live on, investors find that premiums must be paid for indefinite periods to avoid lapse of policies and forfeiture of investments. *See* Frolik, *supra*, 37 TRIAL at 51.

Viatical companies also may fail to set aside adequate reserves to make premium payments. And of course, sales agents may assert bold but unfounded claims about the rates of return on viatical investments.

Fraud may also be committed through the failure to disclose material information. There are many risks associated with viatical investments and these risks may not be adequately disclosed to prospective investors. For example, rates of return are difficult to predict – and yields vary greatly – because of uncertainties in calculating viator life expectancy. The health of viators must be monitored so death certificates can be obtained at the proper time. There is no return whatsoever until viators die and claims for death benefits are properly filed and paid. There is little recourse for an investor needing access to his or her funds since a secondary market for viatical investments contracts is virtually non-existent. *See* Michael Cavendish, *Policing Terminal Illness: How Florida Regulates Viatical Settlement Contracts*, 74 FLA. B.J. 10, 14 (Feb. 2000).

There are other risk factors and fees associated with viaticals that may not be disclosed to investors. Policies that have been transferred may not be honored by the insurance companies that issued them. Policies may still be in their contestable periods. Term or group policies may be subject to subsequent contract changes. Viators may not have taken all the necessary steps to perfect the transfer of interests in their policies, and surviving family members may contest such. *See*

Eterna Benefits L.L.C. v. Hartford Life & Accident Insurance Co., 1998 WL 874296 *1 (N.D. Tex. Nov. 25, 1998). The bankruptcy of a viatical company can result in a total loss for investors. Alexander D. Eremia, *Viatical Settlement and Accelerated Death Benefit Law: Helping Terminal, But Not Chronically Ill Patients*, 1 DEPAUL J. HEALTH CARE L. 773, 777 (1997). The administrative fees charged in connection with these investments can be substantial – as much as thousands of dollars per policy – and these fees may not be disclosed. Eremia, *supra*, at 784. Finally, little if any information may be available about the viatical companies and their principals, such as the length of time they have been in business, whether and where they are registered to do business, and any civil and criminal disciplinary histories they may have.

In short, while viaticals have helped some terminally ill people by providing them with funds they can use for medical expenses and other purposes before they die, these benefits have come at a high price for investors. And the risks to investors are likely to increase because the viatical industry continues to expand. *See* Halechko, *supra*, at 806-07 (viatical providers have found new classes of viators in the chronically ill and the elderly).

Regulation of viatical investments as securities is regarded as an effective way to help "alleviate many of the problems inherent in the viatical settlement industry." Dave Luxenberg, *Why Viatical Settlements Constitute Investment*

Contracts Within the Meaning of the 1933 & 1934 Securities Acts, 34 WILLAMETTE L. REV. 357, 386 (Spring 1998); *see also* Halechko, *supra*, at 824 (viaticals should be treated as securities to reduce abuses). The securities themselves must be registered so that material information about the offering is made available to prospective investors before they part with their money. *See* 15 U.S.C. §§ 77f, 77g, 77j; Unif. Sec. Act of 1956 § 301 (registration of securities).[7] Those who sell securities must be tested and licensed to help ensure they have the knowledge and fitness to accept investor funds and render investment advice. *See* 15 U.S.C. § 78o; Unif. Sec. Act of 1956 § 201 (licensing of industry participants). The securities laws impose stiff civil and criminal penalties as a deterrent against violations of the licensing, registration, and anti-fraud provisions. *See* 15 U.S.C. §§ 77q, 77t, 77x, 78f, 78j, 78u; Unif. Sec. Act of 1956 §§ 101, 408-410 (civil and criminal penalties). Finally, the securities laws give regulators the authority to seek important remedial measures, including injunctions, disgorgement, and restitution. *See id.* (injunctive relief and civil liabilities); s*ee generally* Timothy P. Davis, *Should Viatical Settlements Be Considered "Securities" Under the 1933 Securities Act?*, 6 KAN. J. L. & PUB. POL'Y 75 (Winter 1997). All of these

[7] The Uniform Securities Act of 1956 is the predominant model for state securities laws, having been adopted by 34 states, with some variations. *See* Chart showing states adopting Unif. Sec. Act of 1956, *available at* www.law.cornell.edu/uniform/vol7.html#secur.

provisions can play an important role in limiting the harm that viatical investments inflict upon the investing public.

Although nearly every state regulates viatical settlements as securities, based upon an investment contract analysis or an express statutory provision, *see* Long, *supra*, at § 3:16.9, federal jurisdiction over these investments is important. This case against MBC illustrates the need. Over the past several years, a number of states, including Arizona, Colorado, and Vermont, have taken enforcement actions against MBC. *See, e.g., In the Matter of Mutual Benefits Corp.*, Docket No. S-03464A-03-0000 (Ariz. Corp. Comm'n, Apr. 25, 2003).[8] However, the company continued its operations in many parts of the country. This action filed by the SEC in May was necessary to halt MBC's operations on a nationwide basis, thus affording a measure of relief to investors in all states.

B. The Decision In *Life Partners* Opened A Significant Loophole In The Definition Of An Investment Contract That Should be Closed

Affirming the district court decision is also important to help ensure that the federal securities laws are broadly interpreted in accordance with their underlying remedial purposes. Congress intended to define the term "security" broadly in order to eliminate serious abuses in the securities markets. *See, e.g., Reves v. Ernst & Young*, 494 U.S. 56, 60 (1990); *United Housing Foundation, Inc. v. Forman*,

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[8] *available at* http://www.ccsd.cc.state.az.us/enforcement/Actions/2003/Apr25-03.pdf

421 U.S. 837, 847-48 (1975). The term "investment contract" was added as a catchall provision to ensure that the statute would cover not just the items specifically listed, such as stocks and bonds, but "virtually any instrument that might be sold as an investment." *See Reves v. Ernst & Young*, 494 U.S. at 61; *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943).

When the D.C. Circuit issued its decision in *Life Partners* in 1996, it narrowed the federal definition of "investment contract" under *Howey*. By holding that investment contracts do not include offerings where the promoter's managerial efforts happen to occur before money is accepted from investors, the court created a loophole in the law, not just with respect to viaticals but as to other investments as well. *See SEC v. Life Partners*, 87 F.3d 536, 556 (D.C. Cir. 1996) (Wald, J., dissenting) (cautioning that the majority's restrictive, bright-line rule will apply "to all investments, not just viatical settlements"). Unscrupulous promoters can be expected to structure their investment offerings to take advantage of this loophole by delaying acceptance of investor funds, instituting complex escrow arrangements, or even falsifying records to alter the apparent sequence of their activities in relation to the receipt of funds. Affirming the district court's decision will help close this loophole and discourage further abuses in the offer and sale of investment contracts.

CONCLUSION

For the reasons discussed above, the decision of the court below finding that viatical investments are securities subject to federal regulation should be affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 8th day of December, 2004, a copy the foregoing BRIEF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., AS *AMICUS CURIAE* IN SUPPORT OF APPELLEE SECURITIES AND EXCHANGE COMMISSION AND IN SUPPORT OF AFFIRMANCE, in No. 04-14850-C, was served by next day delivery service, on each of the following persons, at the following addresses:

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