The Howey Test Turns 64: Are the Courts Grading this Test on a Curve?

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THE *HOWEY* TEST TURNS 64: ARE THE COURTS GRADING THIS TEST ON A CURVE?

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ABSTRACT

Sixty-four years ago, the Supreme Court decided SEC v. W.J. Howey, crafting a definition for one form of security, known as an investment contract. The Supreme Court's definition of investment contract in Howey is flexible, consistent with the Congressional approach to defining the broader concept of what constitutes a security. This choice of adopting a flexible definition for investment contract is not without cost, and raises the specter of inconsistent interpretation and/or application by the lower courts that threatens to undermine the utility of the Howey test itself as a trigger for investor protection. The intentional breadth and adaptability of the definition of investment contract necessarily leads to complex and fact-intensive judicial inquiries in the application thereof, and allows for inconsistent results between and among the various courts engaging in such inquiries, creating the possibility of similarly-situated litigants winding up with dissimilar outcomes.

Examples of these disparate outcomes are present in a number of industries, including the viatical settlement industry. Viatical settlements are a form of "asset-backed securities" under which purchasers buy the right to receive death benefits under life insurance policies from policyholders. These days, the very words "asset-backed security" may cause the public to recoil in horror, thinking of the sub-prime mortgage

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debacle and Bernard Madoff being led off in handcuffs while his devastated victims sobbed on the evening news. But not all asset-backed securities are problematic, and when undertaken legally and ethically, these interests can be solid investment vehicles, providing needed liquidity to the capital markets.

As the financial markets continue to grow and innovate, new forms of asset-backed securities will likely be created, and the potential for inconsistent treatment of similarly-situated investors in these asset-backed securities arguably increases, prompting the question explored herein of whether the definition of investment contract in the Howey test is too flexible to further the underlying legislative intent of the federal securities laws to protect investors through mandatory disclosure and anti-fraud liability. At present, investors and issuers have no certainty as to the absolute parameters of the test or how any given court will articulate or interpret the definition of investment contract. The test has been burdened by judicially-imposed nuances, as judges try to give meaning to the Supreme Court's words, and as a consequence, has triggered uneven applications.

This Article challenges the Howey test in light of today's increasingly complicated and volatile securities markets, focusing on whether the underlying legislative goals of the federal securities laws are still met by the Howey test, as currently construed by the courts. The Article provides an overview of the legislative history and current status of the U.S. law on the definition of investment contracts, with a brief examination of the component parts of the Howey test, followed by a discussion of the current regulation of the purchase of insurance policies from insurance policy holders in viatical settlement transactions, as background for the analysis highlighting the shortcomings of the Howey test discussed therein. The Article examines the resale of interests in life insurance policies purchased in viatical settlements, focusing on the inconsistent characterization of viatical settlements by the federal courts, specifically in the D.C. Circuit's decision in SEC v. Life Partners, Inc. and the Eleventh Circuit's decision in SEC v. Mutual Benefits Corp. and offers recommendations to further the underlying goals of the securities laws with respect to investor protection through disclosure and anti-fraud requirements in an effort to honor these goals without sacrificing consistency for the very investors these laws were enacted to protect. The Article ultimately concludes that the benefits of the flexibility of the Howey test outweigh the costs in terms of dissimilar results for similar investments and that the uneven applications of the Howey test by courts should be considered necessary collateral damage, acceptable in light of the significant protections still triggered by the Howey test.

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INTRODUCTION

Sixty-four years ago, the Supreme Court decided *SEC v. W.J. Howey Co.*,[1] crafting a definition for one form of security, known as an investment contract. Discussion by judges and academics of the Supreme Court's definition of investment contract, which has come to be known as the *Howey* test, has primarily focused on the individual components of the test,[2] virtually ignoring the more fundamental underlying question explored in this Article, whether the *Howey* test itself furthers investor protection through mandatory disclosure and anti-fraud liability, the intended purpose of the federal securities laws.[3] The *Howey* test seeks to identify transactions in which investors are relying on others to manage the enterprise that will produce financial returns on their investments.[4] The theory is that these investors need the disclosure that would come from registration under the federal securities laws more than investors who are themselves participating in the management of the enterprise.[5]

Under the *Howey* test, any interest that "involves an investment of money in a common enterprise with profits to come solely from the efforts of others" is an investment contract,[6] thereby included within the definition of "security" and subject to the rules and regulations of the

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[1] 328 U.S. 293 (1946).

[2] *See* Theresa A. Gabaldon, *A Sense of Security: An Empirical Study*, 25 J. CORP. L. 307 (2000):

> [T]here have been no fewer than 792 cases decided and over 300 law review articles written in which either the '33 or '34 Act definition of a security has played a prominent role. There has been an ebb and flow in the rate of production of these cases and articles with a sharp, although perhaps temporary, decline in the period since 1993.
>
> Much, if not most, of the law review commentary dealing with the definition of a security takes inspiration from, and focuses on, relatively few decisions. For instance, a number of authors have chosen to critique one or more of the eleven Supreme Court cases that address the definitional question. Another popular, and sometimes coterminous, approach has assessed some single aspect of the meaning of security in the context of the most significant cases.

Id. at 308-09.

[3] According to the Supreme Court, the statutory purpose of the securities laws is "compelling full and fair disclosure relative to the issuance of 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.'" *Howey*, 328 U.S. at 299 (quoting H.R. REP. NO. 73-85, at 11 (1933)).

[4] *Id.* at 299.

[5] *Id.*

[6] *Id.* at 301.

federal securities laws.[7] The term "security" is defined broadly[8] in both the Securities Act of 1933 (1933 Act)[9] and the Securities Exchange Act of 1934 (1934 Act).[10] Both statutes provide a laundry list of examples and categories of securities, including "any interest or instrument commonly known as a 'security,'"[11] in an effort to include in the definition all of the many types of instruments Congress predicted would or should fall within the ordinary concept of what constitutes a security.[12] Although there are

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[7] 15 U.S.C. § 77b(a)(1) (2006). The threshold issue triggering the application of the federal securities laws to any instrument is whether such instrument satisfies the statutory definition of "security." *See* 15 U.S.C. §§ 77b(a)(1), 78c(10) (2006). The determination that an instrument constitutes a security has far-reaching implications for both issuer and holder. Issuers of securities have disclosure, anti-fraud and registration obligations (absent any available exemption from registration). 15 U.S.C. §§ 77d-g (2006). It is unlawful to engage in the offer or sale of a security without registration or an exemption listed in section 4 of the Securities Act of 1933. *See* 15 U.S.C. §§ 77d-e (2006). Holders of securities have related rights and remedies for any violations by the issuer, including the issuer's defective registration or failure to register such securities. *See* 15 U.S.C. §§ 77k-p.

[8] According to the Supreme Court, Congress painted with a broad brush in defining the scope of the market that it wished to regulate. *Howey*, 328 U.S. at 299. It recognized the virtually limitless scope of human ingenuity, especially in the creation of "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Id*. So the Court concluded that Congress determined that the best way to achieve its goal of protecting investors was to define the term "security" in "sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security." United Hous. Found. v. Forman, 421 U.S. 837, 847-48 (1975) (quoting H.R. REP. NO. 73-85, at 11 (1933)). "Congress therefore did not attempt precisely to cabin the scope of the Securities Acts. Rather, it enacted a definition of 'security' sufficiently broad to encompass virtually any instrument that might be sold as an investment." Reves v. Ernst & Young, 494 U.S. 56, 61 (1990).

[9] 15 U.S.C. § 77b(a)(1).

[10] 15 U.S.C. § 78c(10).

[11] 15 U.S.C. §§ 77b(a)(1), 78c(10).

[12] According to one commentator:

> The term was included in the definitional section of the Federal Securities Act of 1933, § 15 U.S.C. 77b, as well as many state securities laws for a particular reason: the drafters of these statutes realized that, at one point in time, they could not predict all the various investment products the ingenuity of participants in the securities business could concoct. In effect then, the term investment contract can be analogized to an expansion joint as it provides flexibility and adds a universal quality to the definition of investment security. This is especially true in the federal domain, and in particular, the Securities Act of 1933, § 15 U.S.C. 77a, et seq. It was because the courts imposed an expansive construction of federal securities law that a definition evolved for the term investment contract. For, standing alone, the term would be meaningless.

minor differences between the two statutes' definitions, these differences are not germane here for two reasons. First, the Supreme Court has made clear that the two statutory definitions are to be treated as the same.[13] Second, and more relevant here, while both statutes include within their respective definitions the term "investment contract,"[14] neither statute defines that term.[15]

Thus, when it comes to fleshing out what constitutes an investment contract, the Supreme Court's admonishment that "[t]he starting point in every case involving construction of a statute is the language itself" is not very helpful.[16] In the absence of any statutory definition, the concept of what constitutes an investment contract has been developed through extensive case law, which provides a starting point for statutory construction, and ultimately, statutory critique.[17] These judicial decisions take into account, to varying degrees, the underlying legislative purposes of the federal securities laws[18] to provide investor protection through mandatory disclosure of the information investors need to make informed

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Willis H. Riccio, *The Ubiquitous Investment Contract*, 56 R.I. BAR J. 15, 15 (2007).

[13] The Supreme Court has consistently held that "[t]he definition of a security in § 3(a)(10) of the 1934 Act ... is virtually identical [to the definition in the Securities Act of 1933] and, for present purposes, the coverage of the two Acts may be considered the same." *Forman*, 421 U.S. at 847 n.12.

[14] 15 U.S.C. §§ 77b(a)(1), 78c(10).

[15] *Id.*

[16] Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975) (Powell, J., concurring).

[17] *See* SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946). Arguably, the groundwork for the *Howey* decision was laid in *SEC v. C.M. Joiner Leasing Corp.* when the Court noted that varying canons of construction would lead to overly narrow results and that such canons should be subordinated to:

> [T]he doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy.

SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 350-51 (1943).

[18] According to the Supreme Court:

> The primary purpose of the Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is 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. Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto.

Forman, 421 U.S. at 849.

investment decisions[19] and, through anti-fraud liability, to put some teeth into the mandatory disclosure requirements by imposing significant penalties for violations thereof.[20] As a result of the disclosure requirements and anti-fraud liability, investors and securities markets arguably will have the information needed to move capital to its optimal uses.

These judicial decisions also reflect the desire for flexibility that is manifest in the legislative history of both the 1933 and 1934 Acts.[21] Congress intentionally avoided a rigid statutory definition of security in an effort to give the courts flexibility in interpreting this important and far-reaching concept.[22] The definition of security thus encompasses stocks, options, debt instruments, and other financial interests typically considered to be securities.[23] The definition has also been broadly interpreted to include instruments that might not at first appear to be securities, such as fractionalized interests in pools of home mortgage or auto loans, interests in earthworm farms and chinchilla ranches, and various forms of pyramid schemes, all of which have been classified as investment contracts under the *Howey* test and thus have been deemed securities.[24] The Securities and

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[19] *See* SEC v. Capital Gains Research Bureau, 375 U.S. 180, 186 (1963) (holding that the primary purpose of the federal securities laws is to "substitute a philosophy of full disclosure for the philosophy of *caveat emptor*"). Moreover, "[o]ne of [the 1934 Act's] central purposes is to protect investors through the requirement of full disclosure by issuers of securities …." Tcherepnin v. Knight, 389 U.S. 332, 336 (1967). Thus, the design of the statute was to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions." SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953) (citing A.C. Frost & Co. v. Coeur D'Alene Mines Corp., 312 U.S. 38, 40 (1941)). "[T]he Court repeatedly has described the 'fundamental purpose' of the Act as implementing a 'philosophy of full disclosure ….'" Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477-78 (1977) (quoting Capital Gains, 375 U.S. at 186).

[20] 15 U.S.C. §§ 77k-p (2006) (prescribe the forms of liability, actions, and remedies against violators); *see also Ralston*, 346 U.S. at 124 n.10 (noting that the 1933 Act's second primary objective is to prevent fraud in the sale of securities).

[21] *See, e.g.*, SEC v. Mut. Benefits Corp., 323 F. Supp. 2d 1337, 1339 (S.D. Fla. 2004), *aff'd*, 408 F.3d 737 (11th Cir. 2005) (stating that "[f]irst and foremost, the federal securities laws were drafted and have consistently been interpreted from the perspective that flexibility in the law's applicability is paramount").

[22] Reves v. Ernst & Young, 494 U.S. 56, 61 (1990) ("Congress' purpose in enacting the securities laws was to regulate *investments*, in whatever form they are made and by whatever name they are called."). To that end, the Court found that Congress enacted a broad definition of "security," sufficient "to encompass virtually any instrument that might be sold as an investment." *Id.*

[23] 15 U.S.C. §§ 77b(a)(1), 78c(10).

[24] Timothy P. Davis, *Should Viatical Settlements Be Considered "Securities" Under the 1933 Act?*, 6 KAN. J.L. & PUB. POL'Y 75, 78 (1997) (noting that these interests have all been characterized as "investment contracts," and thus securities) (citing Smith v. Gross, 604 F.2d 639 (9th Cir. 1979) (earthworm farms); Miller v. Cent. Chinchilla

Exchange Commission (SEC), in an effort to further investor protection, has maintained with varying degrees of success that the concept of investment contract should and/or does include many financial schemes not specifically mentioned by the federal securities laws, thereby honoring the Supreme Court's instruction that, "in searching for the meaning and scope of the word 'security'… form should be disregarded for substance and the emphasis should be on economic reality."[25]

The Supreme Court's definition of investment contract in *Howey* is flexible, consistent with the congressional approach to defining the broader concept of what constitutes a security.[26] The choice of adopting a flexible definition for investment contract is not without cost, however. The intentional breadth and adaptability of the definition of investment contract necessarily leads to complex and fact-intensive judicial inquiries in the application thereof, and allows for the possibility of inconsistent results between and among the various courts engaging in such inquiries, creating the possibility of similarly-situated litigants winding up with dissimilar outcomes.[27] Indeed, the specter of inconsistent interpretation and/or application by the lower courts arguably threatens to undermine the utility of the *Howey* test itself as a trigger for investor protection.

Examples of these disparate outcomes are present in a number of industries, including the viatical settlement industry. Viatical settlements are a form of asset-backed security under which purchasers buy the right to receive death benefits under life insurance policies from policyholders.[28] These days, the very words "asset-backed security" may cause the public to recoil in horror, thinking of the sub-prime mortgage debacle and Bernard Madoff being led off in handcuffs while his

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Group, Inc., 494 F.2d 414, 417 (8th Cir. 1974) (chinchilla ranch); SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 480 (9th Cir. 1973) (pyramid schemes)).

[25] Tcherepnin v. Knight, 389 U.S. 332, 336 (1967).

[26] United Hous. Found., Inc. v. Forman*,* 421 U.S. 837, 847-48 (1975).

[27] In one of the first Supreme Court cases to interpret the *Howey* test, the Court noted that, in defining the term "security," Congress was not attempting to:

> [A]rticulate the relevant economic criteria for distinguishing "securities" from "non-securities"…. The task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of these statutes.

Id. at 847-48.

[28] Davis, *supra* note 24, at 75. Viatical settlements occur when insureds sell the right to receive their life insurance policies to investors who typically pool multiple policies and sell fractionalized interests in the pool. *Id.* The circuits are split on whether such an interest constitutes a security. *See infra* Part III (discussing the two federal appellate decisions considering this issue).

devastated victims sobbed on the evening news. But not all asset-backed securities are problematic, and, when undertaken legally and ethically, these interests can be solid investment vehicles, providing needed liquidity to the capital markets. Asset-backed securities include a wide array of financial instruments that give investors a claim on the interest and principal payments generated by a pool of assets, like mortgage loans, car loans, or, in the case of viatical settlements, life insurance policies.[29] As the financial markets continue to grow and innovate, new forms of asset-backed securities will likely be created, and the potential for inconsistent treatment of similarly-situated investors in these asset-backed securities arguably increases, prompting the question explored herein of whether the definition of investment contract in *Howey* is *too* flexible to further the underlying legislative intent of the federal securities laws to protect investors through mandatory disclosure and anti-fraud liability.[30] At present, investors and issuers have no certainty as to the absolute parameters of the test or how any given court will articulate or interpret the definition of investment contract.[31] The test has been burdened by judicially imposed nuances as judges try to give meaning to the Supreme Court's words, triggering uneven applications. The issue at hand is whether these uneven applications are necessary collateral damage balanced by the protections offered by the *Howey* test or a signal that the test should be revised, reframed, or even retired as it approaches age sixty-five.

The *Howey* test is analogous to that house in your neighborhood onto which the owners build a myriad of new additions. The additions are in roughly the same style as the original house, but are clearly additions, and sometimes awkward additions at that. Some additions seem to have nothing to do with the original house, and may even look unstable. The consensus of neighbors with taste is that the house should be torn down

[29] *See* O. Emre Ergungor, *Securitization*, ECON. COMMENT. (2003).

[30] The federal securities laws were enacted "to restore the confidence of the prospective investor in his ability to select sound securities." S. REP. NO. 73-47, at 1 (1933); *see also* H.R. REP. NO. 73-85, at 1-2 (1933).

[31] *See* Kyle M. Globerman, Casenote, *The Elusive and Changing Definition of a Security: One Test Fits All*, 51 FLA. L. REV. 271 (1999).

> Nevertheless, the lack of uniformity that results from this ad hoc method of review is problematic because investors cannot, with predictability, determine if the transactions they engage in are within the scope of the Security and Exchange Acts. In view of the varying tests available to the judiciary, the legislature can achieve the intended purpose of the Acts by rewriting the definition of a security to be any transaction that satisfies the elements of a slightly modified *Howey* test.

Id. at 274-75.

and rebuilt from scratch. In the case of the *Howey* test, our congressional homeowner and, more importantly, the equally recalcitrant courts, refuse to do so, piling on more additions, potentially threatening not just the symmetry, but ultimately the integrity of the underlying structure.

Despite the volume of scholarly and judicial writings on *Howey*, much of it critical,[32] the *Howey* test is still good law and arguably has taken on a quasi-statutory aura.[33] This Article challenges the *Howey* test in light of today's increasingly complicated and volatile securities markets, focusing on whether the underlying legislative goals of the federal securities laws are still met by the *Howey* test, as currently construed by the courts. This necessitates an overview of the legislative history and current status of U.S. law on the definition of investment contracts, with a brief examination of the component parts of the *Howey* test. Part I of this Article will explore the statutory, case law, and academic discussion centered on the definition of investment contract under U.S. law, including a brief discussion of the relevant Supreme Court jurisprudence. Part II discusses the current regulation of the purchase of insurance policies from insurance policy holders in viatical settlement transactions as background for the analysis in Part III highlighting the shortcomings of the *Howey* test discussed therein.

Part III provides a critique of the current approach to defining investment contracts and, using viatical settlements as a focal point, demonstrates a weakness in our securities laws that can and has resulted in otherwise identical investments triggering very different outcomes for injured investors. This analysis will support the conclusion that the courts, and by extension some state and federal lawmakers, have expressed a reluctance, both implicit and explicit, to pin down a specific definition of investment contract, leaving this task to any willing state court or legislature. The Article will further demonstrate that a cost of this reluctance is that similarly situated litigants are denied reliably consistent remedies—certainly with respect to the ultimate boundaries of such a definition. Part III also examines the resale of interests in life insurance policies purchased in viatical settlements, focusing on the inconsistent characterization of viatical settlements by the federal courts, specifically in the D.C. Circuit's decision in *SEC v. Life Partners, Inc.*[34] and the Eleventh Circuit's decision in *SEC v. Mutual Benefits Corp.*[35]

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[32] *See* Gabaldon, *supra* note 2, at 308-09.

[33] Riccio, *supra* note 12, at 15; *see, e.g.*, SEC v. Charles E. Edwards, 540 U.S. 389 (2004) (where the Court reverses a lower court ruling that conflicts with the *Howey* test).

[34] 87 F.3d 536 (D.C. Cir. 1996).

[35] 408 F.3d 737 (11th Cir. 2005).

Part IV questions the characterization of viatical settlements under state statutory and case law, offering recommendations to further the underlying goals of the securities laws with respect to investor protection through disclosure and anti-fraud requirements in an effort to honor these goals without sacrificing consistency for the very investors these laws were enacted to protect. This Article ultimately concludes that the benefits of the flexibility of the *Howey* test outweigh the costs in terms of dissimilar results for similar investments and that the uneven applications of the *Howey* test by courts should be considered necessary collateral damage acceptable in light of the significant protections still triggered by the *Howey* test.

I. DEFINING "INVESTMENT CONTRACT"

Before the Supreme Court decided *Howey,* and before Congress enacted the 1933 Act, courts struggled to concretize a meaning for the term investment contract.[36] The term had no standard meaning in any commercial context, yet appeared in many states' blue sky laws predating the 1933 Act, always without a statutory definition.[37] Conceptually, the lack of a statutory definition provides an opportunity for progress on both the disclosure and anti-fraud fronts. Courts have the flexibility to bring within the reach of the securities laws those interests that would not otherwise constitute securities, but nonetheless are the kind of investments that trigger a need for investor protection through mandatory, accurate disclosure. This flexibility also creates the opportunity for inconsistent or unsound interpretations of the definition, potentially triggering instability for the investing public.

State and lower federal courts attempted to flesh out the definition of investment contract, seeking a definition, the interpretation of which would ideally cover any investment scheme that triggered an investor's need for the protection of the securities laws.[38] The Supreme Court, in

[36] *See* Larry Soderquist, *Reach of the Securities Act Regulation*, 1490 PLI/CORP. 113, 116 (2005).

[37] *Id.*

[38] According to the Supreme Court:

> Form was disregarded for substance and emphasis was placed upon economic reality. An investment contract thus came to mean a contract or scheme for "the placing of capital or laying out of money in a way intended to secure income or profit from its employment." This definition was uniformly applied by state courts to a variety of situations where individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of some one other than

crafting the original *Howey* test, tipped its hat to the judicial and legislative history surrounding the definition of investment contract.[39] The Court noted that the term investment contract had been "broadly construed by state courts so as to afford the investing public a full measure of protection."[40]

The state court definition of investment contract evolved over time, and served as the basic framework for the test the Supreme Court ultimately crafted in *Howey*.[41] The Court noted that this definition had been uniformly applied by the state courts "to a variety of situations where individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of some one [sic] other than themselves."[42] The Court found the prior judicial interpretation of the term to be reasonable, both because Congress had used the same interpretation, and because the Court found the interpretation to be consistent with the statutory aims of "compelling full and fair disclosure relative to the issuance of 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.'"[43] The Court went on to state the oft-quoted language that

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> themselves.

SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946) (quoting State v. Gopher Tire & Rubber Co., 177 N.W. 937, 938 (1920)).

[39] *Id*.

[40] *Id.*

[41] *Id.*

[42] *Id.* According to one commentator, the federal courts looked to the state courts for guidance on defining investment contract:

> Initially, federal courts followed suit and looked to how states were defining and interpreting the term "investment contract" as per their Blue Sky laws. By 1941 the lower federal courts began expanding on the principles established by states and developing their own method for defining and analyzing the investment contract issue. While the form of the transaction was given careful consideration, courts were willing to "look through the form to discover the real nature of the transaction." In doing so, it was determined that "an 'investment contract' ... is one which contemplates the entrusting of money or other capital to another, with the expectation of deriving a profit or income therefrom, to be created through the efforts of others."

Christopher L. Borsani, *A "Common" Problem: Examining the Need for Common Ground in the "Common Enterprise" Element of the* Howey *Test*, 10 DUQ. BUS. L.J. 1, 4 (2008).

[43] *Howey*, 328 U.S. at 299.

> By including an investment contract within the scope of § 2(1) of the Securities Act, Congress was using a term the meaning of which had been crystallized by this prior judicial interpretation. It 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.

this interpretation of the term investment contract "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."[44]

Before *Howey*, the SEC brought various actions in support of its view that the concept of investment contract should be construed broadly to include a variety of financial schemes not specifically mentioned by the federal securities laws.[45] In bringing the *Howey* facts to a trial court, the SEC contended that the activities of the W.J. Howey Company and its sister service corporation, Howey-in-the-Hills Service, Inc. (Howey Service) constituted the sale of unregistered securities in violation of section 5(a) of the 1933 Act;[46] it sought an injunction to prevent the companies from using the mails and the instrumentalities of interstate commerce in the offer and sale of these interests.[47] Each prospective investor was offered both a land sales contract from W.J. Howey Company and a service contract from Howey Service, and all were told that it was not feasible to invest in the grove without a service contract,[48] presumably because the investors would have no ability to tend to the trees themselves and needed to outsource this critical function. The investors took this to heart, and of the fifty-one parcels sold during the time period relevant to the litigation, forty-two purchasers entered into service agreements with Howey Service.[49] The SEC claimed that, because the

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Id. at 298; *see* H.R. REP. NO. 73-85, at 11 (1933).

[44] *Howey*, 328 U.S. at 299.

[45] *See, e.g.*, SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943) (sales of oil-producing land leases).

[46] SEC v. W.J. Howey Co., 151 F.2d 714, 715 (5th Cir. 1945), *rev'd*, 328 U.S. 293 (1946). The Fifth Circuit found:

> [T]he two companies under the same common control, with the same officers, facilities, and personnel, and substantially the same stockholders, were engaged in carrying on an investment business, to-wit, the growth and cultivation of citrus trees and the marketing and sale of fruit therefrom; that by the device of deeds from the Howey Company to the groves, and cultivation and management contracts from the Service Company, they were in substance and effect selling investment contracts to customers in that, though the purchasers of groves paid their money in form as purchasers of specific tracts of land, they were in fact investors with the Howey Companies in a citrus growing and marketing enterprise, the profits from their purchases to be derived not from their own skill and efforts but from the skill and efforts of others.

Id.

[47] *Howey*, 328 U.S. at 294.

[48] *Id*. at 295.

[49] SEC v. W.J. Howey Co., 60 F. Supp. 440, 441 (S.D. Fla. 1945), *aff'd*, 151 F.2d

investment interests had to be accompanied by a service contract, the investors were purchasing securities.[50] The trial court disagreed with the SEC and denied the relief requested.[51]

The trial court's reasoning provides insight into the then-current judicial thinking about the definition of security. The trial court focused on the established nature of the citrus industry in Florida,[52] primarily to contrast earlier precedent, where the same trial court found the sale of land contracts in the "new untried and undeveloped industry"[53] of tung oil to be the sale of investment contracts, and thus securities, because of the remedial nature of the 1933 Act.[54] This idea, that offerings from established firms were not investment contracts but that somehow, otherwise substantially similar offerings from new or undeveloped industries were investment contracts, is not supportable under the legislative history of the 1933 Act, nor is it consistent with the judicial thinking underlying prior state cases.[55] The SEC thus eventually brought the case to the Supreme Court, seeking judicial clarification of the definition of investment contract.[56]

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714 (5th Cir. 1945), *rev'd*, 328 U.S. 293 (1946).

[50] *Id.*

[51] *Id.* at 442.

[52] *Id*. (noting that the long established citrus industry "antedates the building of railroads in the State and its progress has been such that it is the largest single farming activity in the State today").

[53] *Id*.

[54] SEC v. Bailey, 41 F. Supp. 647, 650 (S.D. Fla. 1941). Discussing the application of the Securities Act, the trial court found:

> The Securities Act is remedial in nature, to be liberally construed. It affects, not ordinary land sale contracts, but 'investment contracts' which evidence primarily a right to participate in the proceeds of an income-producing venture, membership in which is secured through entrusting an investor's capital to the management of others. In appraising contracts for the purpose of determining the applicability of the statute, courts readily look through the form to discover the real nature of the transaction. Labels affixed by the parties are of little moment.

Id.; *see also* SEC v. W.J. Howey Co., 60 F. Supp. 440, 442 (S.D. Fla. 1945), *aff'd*, 151 F.2d 714 (5th Cir. 1945), *rev'd*, 328 U.S. 293 (1946). The *Howey* trial court relied on the fact that, during the time period relevant to the suit, all the purchasers had actually inspected the property. *Id.* This lays the groundwork nicely for the last prong of the Supreme Court's *Howey* test, requiring that the profits of the investment contract "come solely from the efforts of others." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946). Since the purchasers had all physically inspected the land before buying the land, they were involved enough in the process to arguably not need the protections of registration under the 1933 Act.

[55] *Howey*, 328 U.S. at 298-99.

[56] *Id.* at 294.

The Supreme Court then articulated the original *Howey* test that, although refined over time by subsequent case law, is still the current test for classifying interests as investment contracts, and embodies what the Supreme Court considers the "essential attributes that run through all the Court's decisions defining a security."[57] The Supreme Court articulated the *Howey* test as follows: "The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."[58] The *Howey* test isolates transactions in which ownership is separated from control,[59] which suggests the importance of mandatory disclosure and higher liability standards to ensure that investors allocate capital to its highest-valued uses.[60] The test is entirely consistent with the investor protection goal of the federal securities laws.

Returning to the house analogy discussed earlier, the four prongs of the test constitute the original house. Judicial interpretations, especially judicially-imposed additions and bright-line tests, constitute the remodels and extensions to the initial structure that some neighbors may think are appropriate while others worry about the structural integrity of the entire house. As a matter of common sense, there is a limit to how much additional weight any one structure can hold in total, with similar, smaller calculations necessary to determine how much weight any one particular part of the structure can withstand. So too with the *Howey* test: judicial additions to some of the components may be supportable on their own, but the cumulative effect may call into question the structural integrity of the entire test.

Numerous litigants have explored the parameters of the *Howey* test, but litigation involving *Howey* does not tend to focus on the validity or correctness of the test itself; rather the cases focus on the specific meaning of one or more of the component parts.[61] Courts typically break the test into four parts: a transaction constitutes an investment contract, and thus a security, triggering the application of the federal securities laws if (1) the purchaser invests money; (2) in a common enterprise; (3) with the expectation of profits; (4) solely from the efforts of others.[62] Other commentators have already dissected the components of the *Howey* test at length,[63] and thus only a brief overview of the test is provided, in order to

[57] United Hous. Found., Inc. v. Forman*,* 421 U.S. 837, 852 (1975).
[58] *Howey,* 328 U.S. at 301.
[59] *Id.* (the *Howey* test focuses on profits resulting "from the efforts of others").
[60] *See supra* note 19-20 and accompanying text.
[61] Gary M. Brown, *Reach of Securities Act Regulation*, 1756 PLI/CORP. 177, 183 (2009).
[62] *Id.*
[63] *See generally* Borsani, *supra* note 42; Brown, *supra* note 61.

offer context for the later challenge of the inconsistent outcomes for similarly-situated investors that flow from differing judicial interpretations and additions to the test.

First prong: investment of money. The first prong of the *Howey* test requires that the purchaser of the investment contract invest money into the enterprise.[64] This prong is rarely litigated, as proponents typically can establish an investment of something of value.[65] The Supreme Court relied on *State v. Gopher Tire & Rubber Co.*[66] for the framework underlying this component of the test, building on the Minnesota Supreme Court's definition in *Gopher Tire* that "[t]he placing of capital or laying out of money in a way intended to secure income or profit from its employment is an 'investment' as that word is commonly used and understood."[67] The investment of money criterion is satisfied if one puts out consideration with the hope of some future return.[68]

Second prong: commonality. The second prong of the *Howey* test requires that the investment of money be in a "common enterprise."[69] The Supreme Court did not explicitly define the term "common enterprise" in *Howey*, but the Court did implicitly define the term by holding that the investors in *Howey* had satisfied this prong.[70] In the absence of guidance from the Supreme Court, the lower courts have taken up the issue and fleshed out the definition of a common enterprise.[71] These lower court definitions focus on the extent to which the success of the investor's interest rises and falls with others involved in the enterprise, including the other investors or the promoter, with three different judicial standards emerging to satisfy the requirement of a common enterprise.[72]

Three circuits require a form of common enterprise known as horizontal commonality, which focuses on the connection between the individual investor and other investors in the enterprise.[73] This form of

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[64] *Howey*, 328 U.S. at 301. Although the investment of money prong has not been at issue in any of the viatical settlements litigations at either the federal or state level and so is not central to the analysis herein, this brief mention is included for the sake of completeness.

[65] *But see* Shannon L. Thompson, *Securities Regulation in a Virtual World*, 16 UCLA ENT. L. REV. 89, 103 (2009) (discussing potentially problematic "virtual world currencies" and whether their value in "virtual world investments" can satisfy the first prong of the *Howey* test).

[66] 177 N.W. 937 (Minn. 1920); Brown, *supra* note 61, at 184.

[67] *Gopher Tire*, 177 N.W. at 938.

[68] Soderquist, *supra* note 36, at 119.

[69] *Howey,* 328 U.S. at 301.

[70] *Id.* at 300.

[71] Borsani, *supra* note 42, at 7.

[72] *Id*. at 7, n.40.

[73] Horizontal commonality has been adopted by the Third, Sixth and Seventh

commonality requires that investors share the risk of the enterprise, usually through a pooling of funds. When horizontal commonality is present, multiple investors have interrelated interests in a common scheme and their fortunes are interwoven; they pool resources, share profits and share losses on a pro rata basis.[74]

Other circuits look for vertical commonality between the investor and the promoter of the scheme, which requires that the promoter and at least one investor share the risk.[75] When vertical commonality is present, one single investor has a common interest with the manager of his investment so that the investor's fortunes are inextricably interwoven with and dependent on the fortunes of the promoter/manager of the enterprise.[76]

Vertical commonality has been further broken down into two subparts: strict vertical commonality and broad vertical commonality.[77] Strict vertical commonality has its roots in a footnote from *SEC v. Glenn W. Turner Enterprises, Inc.*,[78] in which the Ninth Circuit noted that "a common enterprise is one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties."[79] Strict vertical commonality thus requires "the fortunes of the investor to be commingled with, and dependent upon the success of the promoter."[80] The Ninth Circuit, currently the only proponent of this form of common enterprise, looks for the fortunes of the investor to be commingled with and dependent on the success or failure of the promoter, requiring that the promoter have a financial stake in the investment at issue.[81]

Broad vertical commonality has its roots in *SEC v. Koscot Interplanetary, Inc*.[82] Like strict vertical commonality, this approach looks

Circuits. *See* Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 622 F.2d 216, 222 (6th Cir. 1980), *aff'd*, 456 U.S. 353 (1982); Hirk v. Agri-Research Council, Inc., 561 F.2d 96, 101 (7th Cir. 1977); Wasnowic v. Chi. Bd. of Trade, 352 F. Supp. 1066, 1070 (M.D. Pa. 1972), *aff'd*, 491 F.2d 752 (3d Cir. 1973).

[74] Borsani, *supra* note 42, at 8.

[75] Brown, *supra* note 61, at 185.

[76] SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 482 n.7 (9th Cir. 1973).

[77] The Fifth, Eleventh and Ninth Circuits have adopted vertical commonality, with the Fifth and Eleventh Circuits adopting a broad vertical commonality approach and leaving the Ninth Circuit standing alone as a proponent of strict vertical commonality. *See* Eberhardt v. Waters, 901 F.2d 1578, 1580 (11th Cir. 1990); Brodt v. Bache & Co., 595 F.2d 459, 461 (9th Cir. 1978); SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 479 (5th Cir. 1974).

[78] 474 F.2d 476 (9th Cir. 1973).

[79] *Id.* at 482 n.7.

[80] Borsani, *supra* note 42, at 10.

[81] *Id.*

[82] 497 F.2d 473 (5th Cir. 1974).

to the connection between the fortunes of the investor and the fortunes of the promoter.[83] Broad vertical commonality focuses on the efforts of the promoter, requiring that the investor be dependent on the promoter.[84] The promoter need not benefit from the investment under this form of commonality.[85]

These three approaches to finding a common enterprise illustrate the courts' response to the flexibility of the *Howey* test, and provide an example of the judicial remodeling of the original structure of the test. While some investments satisfy both horizontal and vertical commonality, some may satisfy only one. Thus, which circuit ultimately reviews a particular investment and rules on whether it constitutes a security is critical, leading to the very real possibility of inconsistent results for similarly situated, injured investors. The Supreme Court denied *certiorari* in *Mordaunt v. Incomco*,[86] a case examining the classification of discretionary commodities futures contracts, with Justice White dissenting:

> The importance of this conflict is not limited to the classification of discretionary commodities futures contracts. In related areas the lower courts are similarly divided as to whether *Howey* requires vertical or horizontal commonality …. In light of the clear and significant split in the Circuits, I would grant certiorari.[87]

Despite Justice White's observations in *Mordaunt*, the Supreme Court has, to date, declined to take up the issue of what constitutes a common enterprise, to the disappointment of many.[88]

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[83] *See id.* at 478.
[84] *See id.* at 478-79.
[85] Borsani, *supra* note 42, at 10-11.
[86] 469 U.S. 1115 (1985) (*cert. denied*).
[87] *Id.* at 1116-17 (White, J., dissenting).
[88] *See* Borsani, *supra* note 42. One commentator highlights the current state of the law:

> With essentially three competing theories on the proper method for analyzing the "common enterprise" it begs the question: what is the proper method to utilize? But more importantly, it implores the Supreme Court to take a stance on the issue so that there may be some uniformity amongst the lower courts.

Id. at 14. He goes on to say:

> In a hazy, and often complex area full of many uncertainties within the various circuits, what is clear is that the Supreme Court needs to take the initiative and, at the very least, address the confusion. It has been over sixty years since the Supreme Court first laid out the test for an investment contract in *SEC v. Howey,* and since then every court has struggled with interpreting the "common enterprise" element. It is time

Third prong: expectation of profits. The third prong of the *Howey* test requires that the investment of money into this common enterprise be undertaken with the expectation of profits.[89] The expected return on the investment must come from earnings of the enterprise, not merely additional contributions, and this return must be the principle motivation for the investment.[90]

Fourth prong: solely from the efforts of others. The fourth prong of the original *Howey* test requires that the investment of money into this common enterprise be undertaken with the expectation of profits solely from the efforts of others.[91] Lower courts have considered whether "solely" means "only" in their articulation of the *Howey* test, and some courts have eased the rigidity of the need to have the profits derived solely from the efforts of others by including profits that come "primarily," "substantially," or "predominantly" from the efforts of others.[92] In the absence of this movement away from the strict construction of the word "solely," investors would be excluded from the protection of the securities laws with respect to any arrangement that involved even the most minimal efforts from the investors themselves.[93]

The Supreme Court itself softened its stance and seemingly endorsed a more relaxed standard for the derivation of the expectation of profits by omitting the word "solely" from its explication of the *Howey* test in *United Housing Foundation v. Forman,*[94] noting that the "touchstone 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."[95] There is a split in the circuits about whether to follow

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> for the current Justices to assume the role that Justice White wanted the Court to take back in 1985 and the role that was circumvented by the Court in *SEC v. Edwards.* There needs to be commonality among the courts for what will constitute an investment of money in a common enterprise. Otherwise, courts will be faced with the coming attractions of even more complex analysis with the same answer: we don't know.

Id. at 17.

[89] SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

[90] Many courts combine the third and fourth components, and thus refer to the test as a three part test. *See*, *e.g.*, Warfield v. Alaniz, 569 F.3d 1015, 1020 (9th Cir. 2009) (citing SEC v. Rubera, 350 F.3d 1084 (9th Cir. 2003)) ("We distilled *Howey*'s definition into a three-part test …."). This combination makes sense, as the full idea is that the investor has an expectation of profit and that expectation must come, to a large measure, from the efforts of someone other than the investor.

[91] *Howey*, 328 U.S. at 301.

[92] *See, e.g.*, SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 480-81 (5th Cir. 1974).

[93] Robinson v. Glynn, 349 F.3d 166, 170 (4th Cir. 2003).

[94] United Hous. Found., Inc. v. Forman, 421 U.S. 837 (1975).

[95] *Id.* at 852.

this more flexible interpretation implicitly adopted by the Supreme Court.[96]

Regardless of whether a court chooses to adopt the more flexible interpretation, that court, and later, commentators, examine how much effort the promoter put into the project and how much effort the investor put in to see if the expectation of profits prong is met. Once a court has determined how much effort the promoter has put into the project, the next step is to evaluate such efforts to see "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."[97]

Courts availing themselves of the flexibility in *Howey*'s "expectation of profits solely from the efforts of another" prong, either by adding in additional facets to the four prongs, or bright-line tests, have created inconsistent outcomes; this is also the case with resale of pools of fractionalized interests in life insurance policies purchased by viatical settlement companies.[98]

II. THE VIATICAL SETTLEMENT INDUSTRY

Congress intended the securities laws to have a broad reach,[99] and the courts have complied, honoring Congress' broad definition of what constitutes a security. The Supreme Court made clear that:

> [T]he reach of the [1933] Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts.'[100]

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[96] According to the Supreme Court:

> This test speaks in terms of "profits to come solely from the efforts of others." Although the issue is not presented in this case, we note that the Court of Appeals for the Ninth Circuit has held that "the word 'solely' should not be read as a strict or literal limitation on the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities." We express no view, however, as to the holding of this case.

Forman, 421 U.S. at 851 n.16 (citing SEC v. Glenn W. Turner Enters., 474 F.2d 476, 482 (9th Cir. 1973), *cert. denied*, 414 U.S. 821 (1973)).

[97] *Glenn Turner*, 474 F.2d at 482.

[98] *See infra* Part II.

[99] *See* H.R. REP. NO. 73-85, at 11 (1933) (referencing "the many types of instruments that in our commercial world fall within the ordinary concept of a security").

[100] SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943).

Viatical settlements, arguably one such novel, uncommon, or irregular device, are a form of asset-backed security under which purchasers, known as viatical settlement companies, buy the right to receive death benefits under life insurance policies from policyholders, known as viators, at some discounted rate that takes into account, among other factors, the expected life span of the viator.[101] Viatical settlements are admittedly less novel, uncommon, and irregular today than they were in the late 1980s when they first came into the public eye.[102]

The typical viatical settlement has two phases: a purchase phase, where some person or entity purchases the life insurance policy from the terminally-ill policyholder, and a resale phase, where this new owner either (1) holds the policy until it matures, (2) sells the policy to someone else, or (3) pools the policy with other policies and sells fractionalized interests therein.[103]

The pooling of income-generating assets and the subsequent sale of fractionalized interests therein is virtually mainstream these days, and in most cases, such resales should satisfy the *Howey* test. Further, the typical

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[101] For a discussion of the history of the viatical settlement industry, see Miriam R. Albert, *Selling Death Short: The Regulatory and Policy Implications of Viatical Settlements*, 61 ALB. L. REV. 1013 (1998).

> The amount paid to the viator for a policy is an estimation of its present value. This present value is calculated in light of factors such as the projected life expectancy of the policyholder, the prevailing economic climate (particularly current interest rates), the face value of the policy, and the cost of at least two years of future premiums, which, under the viatical settlement agreement, become the responsibility of the purchaser, absent a disability waiver of premiums. Also relevant to the purchase price are such factors as the financial strength of the issuing life insurance company, the viatical settlement company's cost of funding the policy acquisition, and any miscellaneous expenses.

Id. at 1020.

[102] SEC v. Life Partners, Inc., 898 F. Supp. 14, 17 n.1 (D.D.C. 1995), *vacated*, 87 F.3d 536 (D.C. Cir. 1996) ("The viatical settlement industry emerged during the late 1980s as a result of the AIDS crisis and has grown rapidly.").

[103] *See* Fiona M. Jones, Comment, *The Viatical Settlement Industry: The Regulatory Scheme and Its Implications for the Future of the Industry*, 6 CONN. INS. L.J. 477, 478-81 (1999). The first option does not trigger securities law issues, and thus will not be explored here. The SEC implicitly acknowledged this, as noted by the trial court in *Life Partners*, 898 F. Supp. at 19. "The Commission readily agrees that a straight viatical settlement is not a security." *Id.* Presumably a "straight viatical settlement" means one in which the purchaser of the policy holds the policy till maturity and does not resell it. The D.C. Circuit court further supports this idea when it said "presumably a firm might also buy insurance policies for its own account or act as an agent, matching a single investor with a terminally ill insured, without running afoul of the securities laws." *Life Partners*, 87 F.3d at 539.

arrangement for the resale of insurance policies pooled by the viatical settlement company are arguably offered in such a way as to support their characterization as investment contracts.[104] To be clear, the focus of this analysis is not the issue of *whether* viatical settlements should be characterized as securities; commentators have weighed in on that a myriad of times in the past fifteen years.[105] Nor is the focus herein on how to harmonize the differing characterizations of investments for similarly-situated viators. Rather, the issue herein is whether the *Howey* test, with its inherent and intentional flexibility, continues to further the investor protection goals of the federal securities laws in light of the disparate outcomes for such viators, and if not, what approaches can be taken with respect to the *Howey* test to further the goal of investor protection.

The viatical industry was largely unregulated in the 1980s and 1990s. Various interested parties have changed this, at least on the purchase side.[106] The initial purchase of life insurance policies by viatical settlement firms from AIDS patients and other terminally ill viators was the first area of regulation in this industry, undertaken in an effort to protect this vulnerable population from being exploited by unscrupulous and unlicensed purchasers.[107] The purchase side of the viatical settlement industry is now subject to fairly extensive regulation at the state level, typically by state insurance departments, in forty-five states. [108] On the

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[104] The *Life Partners* district court put it succinctly when it said "[a]t issue is an unusual investment that rests within the grey area of securities laws." 898 F. Supp. at 17. Commentators, including this author, have argued that viatical settlements should be characterized as securities to provide protections for the vulnerable viators who, in the absence of the federal securities laws' required disclosure and remedies, are left to their own information-gathering and with just common law fraud and any state law remedies. Miriam R. Albert, *The Future of Death Futures: Why Viatical Settlements Must Be Classified as Securities*, 19 PACE L. REV. 345, 349 (1999).

[105] Shanah Glick, *Are Viatical Settlements Securities Within the Regulatory Control of the Securities Act of 1933?*, 60 U. CHI. L.R. 957, 975 (1993). Glick was the first to comment in a law journal on the regulation of viatical settlements, concluding that viatical settlements were categorically not securities. *Id.* Since then, over 100 commentators have weighed in on the issue.

[106] These interested parties include viatical settlement companies and industry groups who strongly opposed regulating the purchase of policies, like the Viatical Association of America, the National Association of People with AIDS and AIDS lobbyists who pushed hard for regulation to protect the vulnerable viators, along with state insurance departments who banded together to draft model legislation. *See infra* note 109 and accompanying text.

[107] *See infra* note 109 and accompanying text.

[108] In 1993, the National Association of Insurance Commissioners drafted the "Viatical Settlements Model Act," which was adopted by eleven jurisdictions. These laws typically cover the licensing of viatical settlement companies, disclosure obligations, confidentiality concerns, and best practices for viatical settlement firms. *See infra* app. A

resale side, the SEC has continued its efforts to have these interests characterized as securities under the federal securities laws, with some success.[109]

III. VIATICAL SETTLEMENTS AS A VEHICLE TO EVALUATE *HOWEY*

The purchase and pooling of any assets, like car loans, mortgages, or life insurance policies, and the resale of fractionalized interests therein, triggers the critical securities law issue of whether the sale constitutes a sale of investment contracts, and thus securities, under the *Howey* test.[110] The characterization of any interest as a security has important and far-reaching ramifications for both the investor and seller thereof. Ideally, this characterization should be consistent and supportable under the relevant law. This has not been the case in the viatical settlement industry, raising concerns about the continued viability of the *Howey* test with respect to viatical settlements, which in turn raises concerns on a broader level with respect to the status of asset-backed securities in general.

(a list of the jurisdictions that have statutes and/or regulations covering the purchase of insurance policies from viators).

[109] The two federal appellate courts to rule on this issue are the D.C. Circuit and the Eleventh Circuit. *See* discussion *infra* Part III. The D.C. Circuit court offered its thoughts on why the viatical settlement industry had not been subject to more regulation at the time of the case:

> At the same time that it was issuing these three preliminary injunctions against *LPI*, the district court acknowledged that the company provides "valuable funds [to] AIDS patients in their final illness" and that after "an apparently exhaustive two-year investigation" the SEC could produce no evidence or even allegations "that any investor, terminally ill patient, or insurance company has been defrauded, misled, or is in any way dissatisfied with an *LPI* viatical settlement." The Commission, however, points out that the securities laws, and in particular the disclosure requirements of the 1933 and 1934 Acts, are intended to prevent abuses before they arise. Still, that neither policyholders nor investors have complained of any abuse may help to explain why the viatical settlements industry is not more regulated. A number of states have enacted laws protecting the insureds but, according to the SEC, no state has undertaken specifically to protect investors in viatical settlements. (In all states investors are still protected by the common law of fraud, of course.)

Life Partners, 87 F.3d at 538-39.

[110] If the viatical settlement firm sells the policy as a whole, in what is known as a "brokered" viatical settlement, no securities law issue arises as there is no commonality of either sort. There is no horizontal commonality because there are no other investors with interest in the policy and no vertical commonality because there is no reliance on the promoter's efforts to generate a profit.

The characterization of viatical settlements as securities has been considered by two federal courts of appeal: the Court of Appeals for the District of Columbia in *Life Partners* (*LPI*)[111] and by the Eleventh Circuit in *Mutual Benefits* (*MBC*).[112] Although both the *LPI* and *MBC* courts anchor their decisions onto their particular understanding and interpretation of the *Howey* test, both explicitly availing themselves of the flexibility that Congress created by leaving the term investment contract undefined,[113] the two courts reached opposite conclusions.[114] Because the cases are factually consistent, however, it is not possible to harmonize the two holdings. Investors are thus left with no clarity or certainty regarding the treatment of their interests under the federal securities laws, and viatical settlement companies can have no confidence that they can conduct their businesses as currently conducted, without potentially running afoul of the securities laws.[115]

In *LPI* and *MBC*, the SEC charged a large viatical settlement firm[116] with violations of the federal securities laws, including the offering and sale of unregistered securities in violation of section 5 of the 1933 Act.[117] In each case, the respective district court agreed with the SEC, and issued opinions, leading to the imposition of an injunction against the viatical settlement firms, prohibiting the sale of these securities.[118] However, the D.C. Circuit Court of Appeals reversed the district court in *LPI*, finding the viatical settlements at issue not to be securities,[119] while the Eleventh

[111] 87 F.3d 536 (D.C. Cir. 1996).

[112] SEC v. Mut. Benefits Corp., 408 F.3d 737 (11th Cir. 2005).

[113] *Life Partners*, 87 F.3d at 549; *Mut. Benefits Corp.*, 408 F.3d at 742.

[114] *Compare Life Partners*, 87 F.3d at 549 (finding viatical settlements are not securities under *Howey*), *with Mutual Benefits Corp*., 408 F.3d at 743 (finding viatical settlements to be securities consistent with *Howey*).

[115] The Eleventh Circuit acknowledged the similarity in facts when it referred to "*Life Partners*, a case involving facts similar to those presented here." *Mut. Benefits Corp.*, 408 F.3d at 743 (italics added).

[116] At the time of *LPI*, Life Partners was the largest viatical settlement firm in the nation. SEC v. Life Partners*,* 898 F. Supp. 14, 17 (D.D.C. 1995), *vacated*, 87 F.3d 536 (D.C. Cir. 1996). Similarly, between 1994 and 2004 more than 29,000 investors nationwide invested more than $1 billion in viatical settlements offered by the Mutual Benefits Corp. *Mut. Benefits Corp*., 408 F.3d at 738.

[117] The SEC charged Mutual Benefits Corp. with: sale of unregistered securities in violation of sections 5(a) and 5(c) of the Securities Act, fraud in violation of section 17(a)(l) of the Securities Act, fraud in violation of section 10(b) of the Exchange Act and Rule 10b-5, thereunder. *See* Complaint at 18-19, SEC v. Mut. Benefits Corp., 323 F. Supp. 2d 1337 (S.D. Fla. 2003) (No. 04-60573), 2004 WL 2876016.

[118] *See Life Partners,* 898 F. Supp. 14, 17 (D.D.C. 1995), *vacated*, 87 F.3d 536 (D.C. Cir. 1996); *see also* Mut. Benefits Corp., 323 F. Supp. 2d 1337 (S.D. Fla. 2004), *aff'd*, 408 F.3d 737 (11th Cir. 2005).

[119] *Life Partners*, 87 F.3d at 549.

Circuit affirmed the district court in *MBC*, finding that the viatical settlements were securities;[120] both cases relied on the same law and applied that law to essentially the same facts.

A side-by-side examination of each court's analysis of the *Howey* test demonstrates the inconsistencies in the courts' respective articulations, and, more importantly, the inconsistencies in their respective applications of the language of the *Howey* test. Although this examination supports the conclusion that the decision in *MBC* is sound as a matter of law and policy while the decision in *LPI* is not, or vise versa, the analysis of these cases is a means to an end. These conflicting decisions prompt an evaluation of the continued viability of the *Howey* test as the touchstone for determining the characterization of an interest as an investment contract, ultimately questioning whether the *Howey* test is furthering the goals of the federal securities laws.

Both the *LPI* and *MBC* courts acknowledged *Howey*'s precedent as binding, but each court articulated the test slightly differently. The Eleventh Circuit articulated the *Howey* test as follows: (1) an investment of money; (2) in a common enterprise; and (3) the expectation of profits derived solely from the efforts of others.[121] The D.C. Circuit articulated the *Howey* test as follows: "an investment contract is a security subject to the [1933] Act if investors purchase [the interest] with (1) an expectation of profits arising from (2) a common enterprise that (3) depends upon the efforts of others."[122] These differing expressions of the *Howey* test are noteworthy only to support the conclusion that the courts take latitude in articulating the precedents under which they are bound; however, the differences in articulation themselves have no substantive effect in these viatical settlement cases. What has a substantive effect in these cases, however, is the differing interpretation of the same precedent by the two courts, which is problematic and results in two entirely opposite characterizations of the same interests under the same test. This raises concerns not only in the context of the viatical settlement industry, as the two decisions are binding precedents in their respective jurisdictions, but also for the issuers and purchasers of other forms of asset-backed securities who may face a judge inspired to apply the *LPI* holding to other forms of asset-backed investments.

Investment of money. Both the *LPI* and *MBC* courts acknowledged, either tacitly or expressly, that the investors in the viatical settlements at issue met the investment of money requirement of *Howey*.[123]

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[120] *Mut. Benefits Corp.*, 408 F.3d at 745.
[121] *Id.* at 742-43.
[122] *Life Partners*, 87 F.3d at 542.
[123] The *MBC* trial court tacitly acknowledged that the investment of money criteria is

Commonality. Both the *LPI* and *MBC* courts concluded that investors in the viatical settlements at issue met the appropriate version of commonality.[124] The D.C. Circuit has adopted horizontal commonality as the standard for a common enterprise under *Howey*, noting that "it is the inter-dependency of the investors that transforms the transaction substantively into a pooled investment."[125] The court found the pooling of investment funds, shared profits, and shared losses present in the viatical settlements at issue, and as a result, found horizontal commonality.[126]

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satisfied when it noted that the defendants were seeking to dismiss the action for lack of subject matter jurisdiction because "viatical settlements fail to meet the second and third elements of the test set forth in *Howey*." *Mut. Benefits Corp.*, 323 F. Supp. 2d at 1341. The Eleventh Circuit expressly acknowledged that the investment of money criteria is met when it says that there "is no genuine dispute here that there was (1) an investment of money." *Mut. Benefits Corp.*, 408 F.3d at 742. The *LPI* trial court did not discuss the investment of money criteria, which is consistent with its articulation of the *Howey* test: "An investment contract is 'a contract, transaction or scheme whereby a person invests his money [1] in a common enterprise and [2] is led to expect profits [3] solely from the efforts of the promoter or a third party.'" *Life Partners*, 898 F. Supp. at 19 (quoting SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946)). The court began its analysis with its first prong, focusing on whether a common enterprise is present, thereby tacitly acknowledging that the requisite investment of money has occurred. *Id.* at 19.

[124] Both trial courts concluded that their respective viatical settlements satisfy commonality. The *LPI* trial court found both forms of commonality:

> Horizontal commonality exists through LPI's sale of fractional interests in the death benefit due under a single policy. The fortunes of each investor are tied to that of the other investors in that policy, with proceeds to be divided on a *pro rata* basis …. Both types of vertical commonality are also present in this case. The investors' fortunes are tied to those of the promoter since LPI takes title to the policies. From the perspective of both the insurance company and the insured, LPI is the new owner and beneficiary of the life insurance policies. Investors are dependent upon LPI to protect their interests, and their interests would be greatly affected by LPI's dissolution or insolvency. Such risks are sufficient to meet the test for vertical commonality.

Life Partners, 898 F. Supp. at 20. The *MBC* trial court only found vertical commonality. *Mut. Benefits Corp.*, 323 F. Supp. 2d at 1341.

[125] *Life Partners*, 87 F.3d at 544.

[126] According to the court:

> It seems to us that the pooling issue reduces to the question whether there is a threshold percentage of a policy that must be sold before an investor can be assured that his purchase of a smaller percentage interest will be consummated. If not, then each investor's acquisition is independent of all the other investors' acquisitions and LPI is correct in asserting that there is no pooling. On the other hand, if LPI must have investors ready to buy some minimum percentage of the policy before the transaction will occur, then the investment is contingent upon a pooling of capital.

Id.

These characteristics were present because the viatical settlements involved multiple investors who aggregated their invested funds into the purchase of interests in one or more policies, so no one investor could purchase a single policy alone. Further, as a result of the structure, no investor in any policy could realize a gain or loss without the identical, albeit proportional, effect on the remaining investors in that same policy.[127]

The Eleventh Circuit has adopted vertical commonality as its standard for a common enterprise under *Howey*, which requires only "the success of the investors to be dependent on the success of the investment promoters' efforts to secure a return."[128] Here, the investors' return was "highly dependent" on the promoters' efforts, which included efforts by *MBC* to locate policies, negotiate the purchase price, and bid on policies. *MBC* recruited doctors to evaluate the health of potential viators and produce a life expectancy valuation on the viators, and created the legal documents necessary to conclude the transactions.[129] *MBC* marketed its expertise in these areas to potential investors.[130] As a result, the district court found that the viatical settlements in *MBC* satisfied the commonality requirement of *Howey*, and the Eleventh Circuit affirmed this conclusion.[131]

Expectation of profit. Both the *LPI* and *MBC* courts concluded that the investors had the requisite expectation of profits from their investments. The *LPI* district court held that the investors' returns under the viatical settlements "qualifie[d] as profit under *Howey*."[132] The D.C. Circuit court was not so quick to make that determination, looking into whether

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[127] *Id.* at 543.

[128] *Mut. Benefits Corp.*, 323 F. Supp. 2d at 1341.

[129] *Id.* at 1338.

[130] *Mut. Benefits Corp.*, 408 F.3d 737 at 739. The court found:

> MBC touted to potential investors its expertise in evaluating life expectancy, and thus its ability to make the venture successful. *Id.* Robert Roberts, a former in-house sales director at MBC, testified that investors were told about MBC's expertise in selecting policies and the track record it claimed in predicting life expectancy…. Roberts was instructed to inform inquiring investors that MBC correctly estimated life expectancy 80% of the time.

Id.

[131] *Mut. Benefits Corp.*, 408 F.3d at 743 n.4. The Eleventh Circuit notes that Mutual Benefits Corp. made what it characterized as a "passing objection" to the district court's conclusion that the investments in viatical settlements satisfied the common enterprise prong of *Howey*, but the court found that argument meritless, finding that these interests satisfy both horizontal and vertical commonality. *Id.*

[132] SEC v. Life Partners, Inc., 898 F. Supp. 14, 21 (D.D.C. 1995), *vacated*, 87 F.3d 536 (D.C. Cir. 1996).

investors in the *LPI* viatical settlements had the requisite expectation of profit.[133] The D.C. Circuit court ultimately found that investors received an asset in the form of a claim on future death benefits of the viator, which was not able to be "currently consumed" but instead was purchased for the prospect of return on the investment.[134] Thus, the D.C. Circuit determined that the sale of fractionalized interests in these viatical settlements satisfied the "expectation of profit" requirement from *Howey*. The Eleventh Circuit acknowledged that the investors in the *MBC* viatical settlements had an expectation of profit, noting there was "no genuine dispute" as to the satisfaction of this portion of the *Howey* test.[135]

Solely from the efforts of others. As noted above, both the *LPI* and *MBC* courts concluded that the investors in the viatical settlements at issue invested money in a common enterprise with an expectation of profits.[136] The two courts differed, however, in their interpretation of what the "expectation of profits" prong requires, and their application of their own differing interpretation to essentially the same investments.

A necessary first step for both the *LPI* and *MBC* courts was to catalogue the efforts of the promoters, in order to then evaluate whether such efforts were "undeniably significant," "essential," and "managerial."[137] Both viatical settlement companies located the policies, negotiated the purchase price with the viators, drafted the relevant legal documentation necessary to complete the purchase of each policy, and retained doctors to evaluate the life expectancy of the viators.[138] Both firms undertook to pay the post-closing premiums necessary to keep the policies in good standing, either from operating funds or from the investors' funds, if the purchase agreement so provided.[139]

After cataloging the efforts of the promoters, both courts measured them against the requirements of the *Howey* test. Both the D.C. Circuit and the Eleventh Circuit have adopted the more relaxed reading of "solely from the efforts of others," looking for those efforts that are "undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."[140] How the two courts interpret this relaxed standard, however, is quite different.

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[133] *Life Partners, Inc.*, 87 F.3d at 542-43.

[134] *Id.* at 543.

[135] *Mut. Benefits Corp.*, 408 F.3d at 742-43.

[136] *See supra* notes 123-134 and accompanying text.

[137] SEC v. Mut. Benefits Corp., 323 F. Supp. 2d 1337, 1342 (S.D. Fla. 2004), *aff'd*, 408 F.3d 737 (11th Cir. 2005) (quoting SEC v. Unique Fin. Concepts, Inc., 196 F.3d 1195, 1201 (11th Cir. 1999)).

[138] *Id.* at 1338; *Life Partners*, 87 F.3d at 539.

[139] *Mut. Benefits Corp.*, 408 F.3d at 740; *Life Partners*, 87 F.3d at 540.

[140] *Mut. Benefits Corp.*, 323 F. Supp. 2d at 1342, *aff'd*, 408 F.3d 737 (11th Cir. 2005)

Both viatical settlement companies asked that the courts draw a distinction between the promoter's activity before the resale of fractionalized interests to the investor and that same activity after such sale, for purposes of this prong of *Howey*. Their argument was that the promoter's efforts before the resale of the policy to the investor somehow falls outside the scope of the *Howey* test, as if the *Howey* test required that the investor's expectation of profits derived solely from efforts of the promoter *after* the investor had invested money in to the common enterprise.[141] This concept is not present in the verbiage or interpretation of the original *Howey* test, and in fact is not present in any other judicial decision interpreting *Howey* other than the *LPI* opinion.

The *LPI* court had an opportunity to further the goals of the federal securities laws, but instead chose to judicially validate the non-existent nuances in the *Howey* test proposed by Life Partners as a basis to find that the viatical settlements in question were not investment contracts, thereby denying the protection of the federal securities laws to the investors therein.[142] Perhaps in an effort to rein in the flexibility of the *Howey* test, the D.C. Circuit created a bright-line test tied to the time of sale, so that the same undeniably significant and essential managerial efforts that occur before the investor buys the policy do not satisfy *Howey*. Yet if these same efforts occurred post-closing, they would somehow then satisfy *Howey.*[143] This artificial test is neither required by nor supportable under *Howey*. It is inconsistent with the goals of the federal securities laws, and is based on a misconception or misunderstanding about the nature of this form of asset-backed security.[144] As the Eleventh Circuit stated, "[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."[145] Indeed, the bright-line rule enunciated in *LPI* created a

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(quoting SEC v. Unique Fin. Concepts, Inc., 196 F.3d 1195, 1201 (11th Cir. 1999)). The court's standard in *LPI* is also relaxed from "soley" looking instead for "profits derived prominently from the efforts of others." *Life Partners*, 87 F.3d at 545.

[141] *Life Partners*, 87 F.3d at 545.

[142] *Id.* at 548.

[143] *See id.* at 551.

[144] It is worth noting that the SEC commented:

> [E]ven if the Court were to adopt the bright-line rule of *Life Partners*, MBC's significant entrepreneurial and managerial post-purchase activities would still satisfy the third prong of *Howey*. Defendants dispute the contention. Because the Court declines to follow *Life Partners*, the Court need not reach the issue of timing.

Mut. Benefits Corp., 323 F. Supp. 2d 1337, 1343 n.8 (S.D. Fla. 2004), *aff'd*, 408 F.3d 737 (11th Cir. 2005). Other courts have declined to follow *LPI*. *See*, *e.g.*, Wuliger v. Christie, 310 F. Supp. 2d 897 (N.D. Ohio 2004).

[145] *Mut. Benefits Corp.*, 323 F. Supp. 2d at 1343.

loophole, which became the defendants' corporate structure model in *MBC*. Anthony Livoti, trustee for Mutual Benefits, testified in his deposition that the "attorneys of Mutual Benefits were cognizant of the *SEC vs. Life Partners* case."[146] Indeed, counsel for Mutual Benefits testified at the evidentiary hearing that Mutual Benefits attempted to restructure certain portions of their operations to conform to the D.C. Circuit's ruling in *LPI*.[147]

The Eleventh Circuit declined to make the distinctions that the D.C. Circuit did, and refused to differentiate pre and post-sale efforts for purposes of characterizing the underlying instruments.[148] The "key question" according to the court was "whether profits are derived from the activities of the promoter or rather, the operation of external market forces beyond the control of the promoter."[149] This distinction makes sense in light of the underlying goals of the securities law: disclosure will only offer protection in investments that depend on the promoters, and will have no effect on investments that depend on the operation of market forces external to those promoters.[150] With that standard in place, the court was not persuaded by Mutual Benefits's contention that the profits of the viatical settlements are determined by the purely external force of the actual date of death of the viator.[151] While the date of death is certainly an important factor in the profitability of a viatical settlement, the underlying pricing is more critical; the viatical settlement company's efforts, pre-purchase, in locating and negotiating the terms of purchase (and inherent therein in calculating a probable life expectancy for the viator), will have a significant, if not dispositive effect on the profitability of the viatical settlement.[152] The investors' initial dependence on the viatical settlement company's expertise also continues after the investment. The *MBC* court noted that neither offerees nor purchasers of the fractionalized interests had access to the insureds' medical files, and so could not hire experts to engage in life expectancy evaluations.[153] The investors had to rely on the

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[146] *Id.* (italics added).

[147] *Id.*

[148] *Id.* at 1343 n.8. The SEC disputed the validity of the new bright-line test, but in an effort to cover all bases, advanced the position that even if the court were to somehow adopt the *Life Partners* test, MBC's "significant entrepreneurial and managerial post-purchase activities would still satisfy the third prong of *Howey*." *Id.* Because the *MBC* court declined to follow *Life Partners*, it refused to evaluate the SEC's argument. *Id.*

[149] *Id.* at 1342.

[150] *Id.*

[151] *Id.*

[152] *Id.*

[153] SEC v. Mut. Benefits Corp., 408 F.3d 737, 739 (11th Cir. 2005).

viatical settlement company for this critical pre-purchase function[154] to monitor and protect their investment. In the absence of required disclosures under the federal securities laws, this reliance may be to their detriment.

In an odd wrinkle that came out during the *MBC* trial, it turns out that Mutual Benefits, among its other acts of fraud, typically had the life expectancy evaluations done after the closing.[155] This highlights the reliance that investors have on Mutual Benefits's efforts, as they have no access to the necessary medical information to undertake a life expectancy calculation on their own. Ironically, because of this fraud, more of Mutual Benefits's efforts were actually made post-purchase, although one doubts if that is what the D.C. Circuit had in mind when crafting their bright-line test.[156]

IV. LEGISLATING AROUND THE *HOWEY* TEST

In the absence of guidance from the Supreme Court on issues like horizontal versus vertical commonality, or on pre-purchase versus post-purchase promoter efforts for satisfying *Howey*, investors are denied certainty about the characterization of new and innovative investments as securities, including viatical settlements. Arguably as a result of the Supreme Court's silence on the lower courts' interpretations of the *Howey* test, other avenues of investor protection have been opening up in the form of model laws, amended statutes, and judicial opinions.

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[154] *Id.*

[155] *Id.* at 740

[156] According to the court:

> There is evidence in the record that MBC, in fact, routinely did not receive life-expectancy evaluations until after closing. Melanie Goldberg was the person at MBC responsible for preparing the post-closing information to be sent to investors. She explained that she worked from a spreadsheet listing recently "closed" policies. This "closed" list provided the insureds' names, their life expectancies, and the closing dates. Goldberg routinely received medical records after a closing and sent them to one of the doctors used by MBC. Later, she got the medical reports back from the doctors and sent them to investors. When drafting reports for doctors to sign, Goldberg testified that she (in accordance with MBC policy) entered the date MBC acquired a particular policy as the date of the medical report. Doctors' reports were always pre-dated, she explained, because "it had to look like it was being reviewed at the time the viator was selling the policy ... that it had to show that it was reviewed at the time the file was sold, not afterwards."

Id. at 739 (internal citations omitted).

First, the National Conference of Commissioners on Uniform State Laws updated the Uniform Securities Act, included the following as part of its definition of security in section 102(28)(D) of the revised act:

> [A]n investment in a common enterprise with the expectation of profits to be derived primarily from the efforts of a person other than the investor and a "common enterprise" means an enterprise in which the fortunes of the investor are interwoven with those of either the person offering the investment, a third party, or other investors.[157]

This first part of the definition is derived from the *Howey* test*,* and essentially codifies the most liberal version of the test; this definition adopts the looser approach to "solely from the efforts of others" and specifically authorizes both horizontal and vertical commonality, offering an inclusive reading of the test that will cover interests that would satisfy the definition of investment contract across all circuits. The definition excludes any mention of pre- or post-purchase efforts bright-line, and so arguably includes viatical settlements like those at issue in *LPI* within the definition of security.

The Uniform Act language offers clarity on the characterization of all interests as investment contracts, allowing states that adopt this language to offer much more certainty to investors in their jurisdiction on the characterization of a particular investment interest, including viatical settlements. That said, the treatment of viatical settlements by the *LPI* court was a factor for the drafters of the Uniform Act in constructing this definition. As the prefatory notes to the 2002 version of the Uniform Act provide, the definition of security was modernized, among other goals, to "amplify the definition of investment contract so that it can expressly reach interests in … viatical settlement agreements, among other contracts, when they satisfy the definition of investment contract."[158] Thus the drafters included in their definition of security in section 102(28)(E) that the term investment contract includes an interest in "a viatical settlement or similar agreement."[159]

States have begun to legislate around the uncertainty stemming from the flexibility of *Howey* by essentially codifying a clear explication of the components of the *Howey* test, with some states using the language in the Uniform Securities Act. To date, seventeen states have included in their statutory definition of security, language that codifies some or all of the concepts of the *Howey* test, in essence, crafting state law tests for

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[157] UNIF. SEC. ACT § 102(28)(D) (amended 2002), 7C U.L.A. 29 (2006).
[158] UNIF. SEC. ACT General Notes (amended 2002).
[159] UNIF. SEC. ACT § 102(28)(E) (amended 2002), 7C U.L.A. 29 (2006).

identifying an investment contract.[160] This approach may eliminate some of the uncertainty presently surrounding the application of the *Howey* test to innovative and unusual investment vehicles, dependent, of course, on how the states articulate and apply these tests.

Some states have gone further in the context of viatical settlements through judicial decisions and legislation. These states can distance themselves from the bright-line test in *LPI* for purposes of evaluating the characterization of a particular interest under their own state law, and at the same time, further the underlying purposes of their securities laws, which are typically analogous to those underlying the federal securities laws. To date, ten state courts have ruled that viatical settlements are securities.[161] These courts focused on the remedial goals of their state securities laws,[162] and the persuasive, non-binding nature of federal court

[160] Arizona, Arkansas, California, Florida, Kentucky, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Jersey, North Carolina, Ohio, Tennessee, Utah, West Virginia, and Wisconsin include viatical settlements within their definition of security. *See infra* app. B.

[161] *See* Siporin v. Carrington, 23 P.3d 92, 98 (Ariz. Ct. App. 2001); In People *ex rel.* Wood v. Innovative Fin. Services, No. D045555, 2006 WL 392030, at *6 (Cal. Ct. App. Feb. 17, 2006), the California courts were

> not persuaded by the analysis of the court in *Life Partners*, which in finding the viatical settlement contracts were not investment contracts, made a distinction between an investment promoter's activities prior to his having use of an investor's money and his activities after he has use of the money. Like other federal courts, "we are not convinced that [*Howey*] require[s] such a clean distinction."

Id. at *6 (quoting *Mut. Benefits Corp.*, 408 F.3d 737 (citation omitted)); *see also* Joseph v. Viatica Mgmt., LLC, 55 P.3d 264 (Colo. App. 2002); Kligfeld v. Office of Fin. Regulation, 876 So. 2d 36 (Fla. Dist. Ct. 2004); Allen v. Jones, 604 S.E.2d 644 (Ga. Ct. App. 2004); Accelerated Benefits Corp. v. Peaslee, 818 N.E.2d 73 (Ind. Ct. App. 2004); Sec. Trust Corp. v. Estate of Fisher, 797 N.E.2d 789 (Ind. Ct. App. 2003); Poyser v. Flora, 780 N.E.2d 1191 (Ind. Ct. App. 2003); Hill v. Dedicated Res., Inc., No. 99-C-1714, 2000 WL 34001915 (Kan. Ct. App. July 12, 2000); Lubin v. Benefit Assurance, Ltd., No. 24-C-02-006515, 2006 WL 5781983 (Md. Nov. 19, 2002); Michelson v. Voison, 658 N.W.2d 188 (Mich. Ct. App. 2003); Schwalm v. Penn. Sec. Comm'n, 965 A.2d 326 (Pa. Commw. Ct. 2009); Stellar v. Penn. Sec. Comm'n, 877 A.2d 518 (Pa. Commw. Ct. 2005). The only court, other than the D.C. Circuit, to hold viatical settlements do not constitute securities is *Griffitts v. Life Partners, Inc.*, No. 10-01-00271-CV, 2004 WL 1178418 (Tex. App. May 26, 2004).

[162] For example, the Colorado court noted:

> Moreover, we conclude defendants [sic] position is inconsistent with the policies embraced by Colorado's own General Assembly. *See* § 11-51-101(3), C.R.S. 2001 (provisions and rules under the Act shall be coordinated with federal acts and statutes to the extent consistent with the purposes of the Act) …. One purpose of the Act is to protect investors. The Act is remedial in nature and is to be broadly construed

decisions on state courts interpreting state laws, in holding that the viatical settlements at issue were, in fact, securities.[163]

The Court of Appeals of Arizona, for example, considered the characterization of viatical settlements in *Siporin v. Carrington*,[164] holding that the viatical settlement agreements at issue were securities for purposes of the Arizona Securities Act.[165] In so holding, the court focused on remedial goals of the Arizona Securities Act.[166] The court noted that the Arizona definition of security was virtually identical to that of the 1933 and 1934 Acts, and further noted that in interpreting the otherwise undefined term investment contract, it would look to the federal courts for guidance.[167] At the time of the decision, the only federal court to opine on the issue was the D.C. Circuit's *LPI* decision. The Arizona court declined to follow the bright-line test therein, to avoid "taking a position inconsistent with the policies embraced by our own legislature," one that would "not advance the Arizona policy of protecting the public from unscrupulous investment promoters" like the *LPI* decision.[168] The court had harsh words for the bright-line test, finding no more than "tangential support"[169] for it in *Howey* or any other federal decisions; the court found

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> to effectuate its purposes. *See* § 11-51-101(2), C.R.S. 2001; Sauer v. Hays, 36 Colo. App. 190, 539 P.2d 1343 (1975). In light of the prophylactic and remedial purposes of the Act, and our duty to interpret it broadly, we conclude that *Life Partners* is clearly distinguishable, and we are not persuaded by either the rationale or conclusions reached in that case.

Viatica Mgmt., 55 P.3d at 267.

[163] According to the Fourth Appellate District of the Court of Appeal of California, "[A]lthough the California Corporate Securities Law was patterned after the federal Securities Act of 1933, the federal cases interpreting the federal law offer *persuasive* rather than controlling authority in construing state law." *People ex rel. Wood*, 2006 WL 392030, at *6 (citation omitted).

[164] 23 P.3d 92.

[165] *Id.* at 98.

[166] *Id.* at 95 (quoting 1951 Ariz. Sess. Laws ch. 18, § 20). The court stated:

> The intent and purpose of this Act is for the protection of the public, the preservation of fair and equitable business practices, the suppression of fraudulent or deceptive practices in the sale or purchase of securities, and the prosecution of persons engaged in fraudulent or deceptive practices in the sale or purchase of securities. This Act shall not be given a narrow or restricted interpretation or construction, but shall be liberally construed as a remedial measure in order not to defeat the purpose thereof.

Id. at 95.

[167] *Id.* at 96.

[168] *Id.* at 98.

[169] *Id.*

the bright-line test to be a "convenient but inflexible and formalistic approach to the application of the 1933 and 1934 federal Securities Acts"[170] that does not serve "the prophylactic and remedial purposes of the Arizona Securities Act."[171] The Arizona legislature apparently agreed and amended the securities laws in 2000 to specifically include viatical settlements within the definition of security.[172]

Like Arizona, thirty-three other states have amended their securities laws to include viatical settlements in their definition of security, offering the investors therein added protection under the state securities laws.[173] These statutes describe viatical settlements in different ways, consistent with the Uniform Act's inclusion on its list of securities "viatical settlement or similar agreement."[174] The official comments to the Uniform Act state that

> [t]his Act also refers to an investment in a viatical settlement or a similar agreement to make unequivocally clear that viatical settlement [sic] and similar agreements, which otherwise satisfy the definition of an investment contract, are securities. This is intended to reject the holding of one court that a viatical contract could not be a security.

These comments are followed by a citation to the D.C. Circuit Court opinion in *LPI.*[175]

The amended statutes did not put an immediate end to the litigation about the status of viatical settlements as securities. In the states that have specifically included viatical settlements in the laundry list definition of "securities," litigation has arisen over interests that were purchased or sold prior to the inclusion of viatical settlements in the statute.[176] The

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[170] *Id.* at 99.

[171] *Id.*

[172] *Id.*

[173] *See infra* app. B (for a list of the states that include viatical or life settlements in their definition of security).

[174] *See* UNIF. SEC. ACT § 102(28)(E) (amended 2002); 7C U.L.A. 28 (2006).

[175] UNIF. SEC. ACT § 102 cmts. (amended 2005); 7C U.L.A. 28 (2006) (quoting Joel Seligman, *The New Uniform Securities Act*, 81 WASH. UNIV. L.Q. 243, 250 (2003)).

[176] To date, fifteen states have amended their statutory definition of security to include viatical settlements. *See infra* App. B. Defendants in these states made creative arguments that the legislature's amendment of the statute to specifically include viatical settlements within the definition of security somehow shows that viatical settlements did not previously come within the definition of the statute. The courts have not been persuaded by that argument, arguably because viatical settlements satisfy the *Howey* test and should be considered securities even in the absence of statutory authority. In Georgia, the court held that "before July 1, 2002, a viatical contract could qualify as a security under Georgia law. Accordingly, we reject the trial court's ruling that Jones was entitled to summary judgment because the Allens and Adams could not prove the predicate RICO

defendants in these cases argue that because the definition at the time of the transaction did not include viatical settlements, they had not violated the state securities laws by selling unregistered securities, as the viatical settlements were not then considered securities. All but one of the courts to consider these cases have held that, although the statutory definition was not in place at the time of the transaction, an application of the *Howey* test demonstrated that the interests in question were nonetheless securities under *Howey*, even before the change in statutory language.[177]

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act of selling unregistered securities by an unregistered agent." Allen v. Jones, 604 S.E.2d 644, 647 (Ga. Ct. App. 2004). *See also* Accelerated Benefits Corp. v. Peaslee, 818 N.E.2d 73 (Ind. Ct. App. 2004); Poyser v. Flora, 780 N.E.2d 1191, 1197 (Ind. Ct. App. 2003); Security Trust Corp. v. Estate of Fisher *ex rel.* Roy, 797 N.E.2d 789, 797 (Ind. Ct. App. 2003), *trans. denied*, 812 N.E.2d 796 (Ind. Ct. App. 2004).

[177] *But see* Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985) (illustrating that interests specifically set out in the definition do not have to, and in most cases, will not, satisfy *Howey*). In *People ex rel. Wood v. Innovative Fin. Services*, No. D045555, 2006 WL 392030, at *6 (Cal. Ct. App. Feb. 17, 2006), the court noted that California had regarded viatical settlements as securities even prior to the amendment of the statute, and concluded that the amendment was intended only to clarify *existing* law. In Glick v. Sokol, 777 N.E.2d 315, the court declined to include viatical settlement investments purchased prior to the amendment of the statute to include viatical settlements as securities under Ohio law:

> Under current Ohio law, viatical settlements are securities subject to registration. By Am.Sub.H.B. No. 551, enacted after the transaction at issue in this case, the Ohio legislature amended the Ohio Revised Code "to make life settlement interests subject to the Ohio Securities Law." Am.Sub.H.B. No. 551, Preamble. Accordingly, as of October 5, 2001, the statutory definition of "security" expressly includes "any life settlement interest." R.C. 1707.01(B).

Id. at 317. The court applies the Ohio case law test for the existence of a security from *State v. George*, 50 Ohio App. 2d 297 (Ohio Ct. App. 1975), and finds that the viatical settlements did not satisfy the test. *Glick*, 777 N.E.2d at 319 ("We conclude that a viatical settlement promoter's efforts to perform the services it promised does not constitute the risks of the enterprise under *George*."). This is especially surprising in light of the Ohio Division of Securities' pronouncement prior to the opinion. According to the *Glick* court, "the division issued a pronouncement in which it concluded that in virtually all instances viatical settlements are securities subject to the regulatory framework of the Ohio Securities Act." *Id.* at 319. The court declined to follow the Ohio Division of Securities' interpretation of what constituted a security:

> Although we afford due deference to interpretations by administrative agencies with substantive expertise, we decline to follow the Division's determination that Glick's viatical settlements were securities under the Ohio Securities Act prior to the effective date of Am.Sub.H.B. No. 551. We disagree with the Division's conclusion that viatical settlements are securities under the *George* test .... Our conclusion that the viatical settlements at issue were not securities is further bolstered by the legislature's clear intent for prospective application of Am.Sub.H.B. No. 551. Am.Sub.H.B. No. 551 specifically provides that the *addition*

CONCLUSION

The Supreme Court provided a rationale to support the statutory and jurisprudential policy of flexibility in the context of determining the coverage of the federal securities laws, finding that "[s]uch an approach has the corresponding advantage, though, of permitting the SEC and the courts sufficient flexibility to ensure that those who market investments are not able to escape the coverage of the Securities Acts by creating new instruments that would not be covered by a more determinate definition."[178] Flexibility in law is a valuable goal and powerful tool; but when taken to extremes, it can give the courts too much room to maneuver, and has the potential to undermine the purpose of the law at issue. In the case of the definition of investment contract, the cost of the flexibility built into the *Howey* test is the protection of at least one group of investors who seek judicial relief in a court bound to follow the D.C. Circuit's bright-line test in *LPI*.

With the current flexible definition of investment contract, a court can flesh out the definition to fit its view of a particular instrument, and courts in other jurisdictions not bound by this determination can flesh out the definition of the same interest in a different way. The cost of maintaining this flexible definition of investment contract is the potential for a very real difference in the kinds of protections offered to investors depending on where they buy the interests in question. Query whether this level of flexibility is what the Supreme Court had in mind when rendering the *Howey* opinion. That house in the neighborhood with all the additions built on is in danger of falling down around itself if these additions increase in weight.

> of "life settlement interests" to the list of express securities under R.C. 1707.01(B) "shall take effect six months after the effective date of this act." Am.Sub.H.B. No. 551, Section 3. The legislature further provided that "[a]ny person that, on the effective date of this act, transacts business in this state as a viatical settlement provider, viatical settlement representative, or viatical settlement broker may continue to do so pending approval of the person's application for a license, if the person applies for the license during the six-month period immediately following the effective date of this act." Am.Sub.H.B. No. 551, Section 4. The Division's determination that Glick's investments were securities under the *George* test flies in the face of the legislative intent for prospective addition of viatical settlements to the list of securities under R.C. 1707.01.

Id. at 319-20. But a year later, the same court found the viatical settlements in question to be securities. Rumbaugh v. Ohio Dep't of Commerce, 800 N.E.2d 780 (Ohio Ct. App. 2003).

[178] Reves v. Ernst & Young, 494 U.S. 56, 63 n.2 (1990).

That said, the benefits of the flexibility of the *Howey* test arguably outweigh the costs in terms of inconsistent results for similar investments, as states have begun offering additional protections to investors within their borders through legislation and judicial rulings on the status of viatical settlements. And the Supreme Court does not seem interested in revisiting *Howey*, despite the "clear and significant" split in the courts on the issue of commonality[179] and the *LPI* bright-line test.

Certainly one rogue court crafting a bright-line test in *LPI* does not constitute a clear and significant split, but *LPI* is still good law in the D.C. Circuit, and is binding precedent for the characterization of viatical settlements in that jurisdiction.[180] Potentially more problematic, *LPI* and its bright-line test are available for all the courts in that circuit to apply to any other interests that the courts believe are factually similar to the *LPI* facts. With the increasing numbers and types of innovative investment vehicles, including new forms of asset-backed and receivable financing, this is a real concern that should continue to be handled at the state level through appropriate legislation and judicial guidance.

When and if the Supreme Court revisits *Howey,* it should comment on the component parts of the test, specifically adopting horizontal or vertical commonality, or, like the Uniform Act, both. At a minimum, the Court should also overrule the pre versus post purchase bright-line test from the D.C. Circuit. This would provide clarity for all the participants, both sellers and investors, in the "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."[181] This would have the added benefit of bringing increased investor protection in the viatical settlement industry to supplement protections offered at the state level. This could be accomplished without the Court even classifying fractional interests in viatical settlements as securities for purposes of the securities laws. Just these modifications to *Howey* would bring the resale of the fractionalized interests under the protection of the securities laws, complete with antifraud and disclosure obligations, and civil remedies. This would lend consistency to the viatical settlement markets, but more importantly, to the world of innovative and creative investment interests as a whole.

In the absence of such clarity from the Supreme Court, states will continue to try to bridge the uncertainty, and through legislation and court decisions, get clarity for their investors. We can only hope that they craft their decisions with more precision and consistency than the D.C. Circuit did in *LPI*.

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[179] Mordaunt v. Incomco*,* 469 U.S. 1115, 1117 (1985), *cert. denied*, 469 U.S. 1115 (1985) .

[180] *See* SEC v. Life Partners, Inc., 87 F.3d 536 (D.C. Cir. 1996).

[181] SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946).

APPENDIX A: VIATICAL REGULATIONS

The following jurisdictions have statutes and/or regulations covering the purchase of insurance policies from viators:

Alaska:

- Statutes: ALASKA STAT. § 21.96.10 (2010) (viatical settlement transactions); ALASKA STAT. § 45.55.155 (2010) (viatical settlement interests).
- Regulations: ALASKA ADMIN. CODE tit. 3, §§ 31.300-449 (2010).

Arizona:

- Statutes: ARIZ. REV. STAT. § 44-1850 (LexisNexis 2010) (viatical or life settlement investment contracts).
- No regulations.

Arkansas:

- Statutes: ARK. CODE ANN. §§ 23-81-801 to -818 (2010) (Life Settlements Act).
- Regulations: 54-00 ARK. CODE R. § 69 (Lexis Nexis 2010) (viatical settlements).

California:

- Statutes: CAL. INS. CODE §§ 10113.1-10113.2 (West 2005) (life and disability insurance, viatical settlement); CAL. INS. CODE § 10209.3 (West 2005) (group life policies, assignment of incidents of ownership, viatical settlements); CAL. CORP. CODE § 25508.5 (West 2006) (rescission or cancellation of viatical or life settlement contracts).
- Regulations: CAL. CODE REGS. tit. 10, §§ 2548.1-2548.31 (2010) (viatical settlements).

Colorado:

- Statutes: COLO. REV. STAT. §§ 10-7-601 to -620 (2010) (viatical settlements).
- Regulations: 3 COLO. CODE REGS. § 702-2 (2009) (viatical settlements).

Connecticut:

- Statutes: CONN. GEN. STAT. §§ 38a-465 to -465q (2010) (life settlements).
- Regulations: CONN. AGENCIES REGS. §§ 38a-465-1 to -10 (2000) (viatical settlements).

Delaware:

- Statutes: DEL. CODE ANN. tit. 18, §§ 7501-7510 (2010) (viatical settlements).
- No regulations.

Florida:

- Statutes: FLA. STAT. §§ 626.991 to 626.99295 (LexisNexis 2010) (viatical settlements).
- Regulations: FLA. ADMIN. CODE ANN. r. 69O-204.010 to .201 (2009) (viatical settlements).

Georgia:

- Statutes: GA. CODE ANN. §§ 33-59-1 to -18 (2010) (life settlements).
- Regulations: GA. COMP. R. & REGS. 120-2-93-.01 to -.10 (2010) (life settlements).

Hawaii:

- Statutes: HAW. REV. STAT. ANN. §§ 431E-1 to -53 (repealed 2010) (life settlements).
- No regulations.

Idaho:

- Statutes: IDAHO CODE ANN. §§ 41-1950 to -1965 (2010) (life settlements).
- No regulations.

Illinois:

- Statutes: 215 ILL. COMP. STAT. ANN. 159/1 to 159/999 (West 2010) (viatical settlements).
- Regulations: ILL. ADMIN. CODE tit. 50, § 5701.10 to .100 (2010) (viatical settlements).

Indiana:

- Statutes: IND. CODE §§ 27-8-19.8-1 to -26 (LexisNexis 2010) (living benefits arrangement).
- Regulations: 760 IND. ADMIN. CODE 1-61-1 to -12 (2010) (viatical settlements).

Iowa:

- Statutes: IOWA CODE §§ 508E.1 to .20 (West 2009) (viatical settlement contracts).
- Regulations: IOWA ADMIN. CODE r. 191-48.1 to .14 (2009) (viatical and life settlements).

Kansas:

- Statutes: KAN. STAT. ANN. §§ 40-5001 to -5016 (2009) (viatical settlements).
- No regulations

Kentucky:

- Statutes: KY. REV. STAT. ANN. §§ 304.15-700 to -725 (Lexis Nexis 2010) (viatical settlements).
- Regulations: 806 KY. ADMIN. REGS. 9:310 to :320 (2010) (Viatical Settlement Broker License and Notification; Viatical Settlement Provider License); 806 KY. ADMIN. REGS. 15:050 (2010) (reporting and general requirements for Viatical Settlement Providers and Brokers).

Louisiana:

- Statutes: LA. REV. STAT. ANN. §§ 22:1791 to :1805 (2010) (viatical settlements).
- Regulations: LA. ADMIN. CODE tit. 37, §§ 3901-19 (2010) (viatical settlements).

Maine:

- Statutes: ME. REV. STAT. ANN. tit. 24-A, §§ 6801-6819 (2010) (viatical and life settlements); ME. REV. STAT. ANN. tit. 32, § 16511 (2010) (right to rescission applicable to sales of viatical or life settlement contracts).
- Regulations: 02-031-931 ME. CODE R. § 1-12 (Weil 2010) (viatical and life settlements); 02-032-539 ME. CODE R. § 1-6 (Weil 2010) (offers and sales of viatical or life settlement contracts).

Maryland:

- Statutes: MD. CODE ANN., INS. §§ 8-601 to -611 (LexisNexis 2010), (Viatical Settlement Providers and Viatical Settlement Brokers); MD. CODE ANN., INS. § 27-403 (LexisNexis 2010) (fraudulent insurance acts, failure to return premiums, false or misleading claims); MD. CODE ANN., INS. § 27-802 (LexisNexis 2010) (reporting suspected insurance fraud); MD. CODE ANN., INS. § 27-804 (LexisNexis 2010) (antifraud plans for viatical settlement providers).
- Regulations: MD. CODE REGS. 31.09.11.00 to .02 (2010) (viatical settlements).

Massachusetts:

- Statutes: MASS. ANN. LAWS ch. 175, §§ 212-23 (LexisNexis 2010) (viatical settlements).
- Regulations: 940 MASS. CODE REGS. 18.01 to .08 (2010) (viatical settlements and viatical loans).

Michigan:

- Statutes: MICH. COMP. LAWS ANN. §§ 550.521-.528 (West 2010) (viatical settlement contracts).

- No regulations.

Minnesota:

- Statutes: MINN. STAT. ANN. §§ 60A.961-.974 (West 2010) (viatical settlements).
- No regulations.

Mississippi:

- Statutes: MISS. CODE ANN. §§ 83-7-201 to -223 (West 2010) (viatical settlements).
- Regulations: 28-000-074 MISS. CODE R. § 2000-1 (Weil 2010) (viatical settlements regulation).

Montana:

- Statutes: MONT. CODE ANN. §§ 33-20-1301 to -1317 (2010) (Viatical Settlement Act).
- Regulations: MONT. ADMIN. R. 6.6.8501 to -8512 (2010) (Viatical Settlement Agreement).

Nebraska:

- Statutes: NEB. REV. STAT. ANN. §§ 44-1101 to -1117 (LexisNexis 2010) (viatical settlements).
- Regulations: 210 NEB. ADMIN. CODE § 76-001 (2010) (viatical settlements).

Nevada:

- Statutes: NEV. REV. STAT. ANN. §§ 688C.010 to -.510 (West 2010) (viatical settlements).
- Regulations: NEV. ADMIN. CODE §§ 688C.010 to -.240 (2010) (viatical settlements).

New Jersey:

- Statutes: N.J. STAT. ANN. § 17B:30B-1 to -17 (West 2010) (viatical settlements).
- Regulations: N.J. ADMIN. CODE § 11:4-35.1 to -.18 (2010) (viatical settlements).

New Mexico:

- Statutes: N.M. STAT. ANN. §§ 58A-20A-1 to -20A-11 (West 2010) (viatical settlements).
- Regulations: N.M. CODE R. §13.9.15.1 to -.15.17 (Weil 2010) (viatical settlements).

New York:

- Statutes: N.Y. INS. LAW §§ 7801-7810 (McKinney 2010) (life settlements).
- Regulations: N.Y. COMP. CODES R. & REGS. tit. 11, §§ 380.1-.10 (2010) (viatical settlements).

North Carolina:

- Statutes: N.C. GEN. STAT. ANN. § 58-200 to -310 (West 2010) (viatical settlements).
- Regulations: 11 N.C. ADMIN. CODE 12.1710 to -.1720 (2010) (viatical settlements).

North Dakota:

- Statutes: N.D. CENT. CODE §§ 26.1-33.4-01 to -33.4-16 (2010) (life settlements).
- Regulations: N.D. ADMIN. CODE 45-04-13-01 to -13-03 (2010) (viatical settlement advertising).

Ohio:

- Statutes: OHIO REV. CODE ANN. §§ 3916.01 to -.99 (West 2010) (viatical settlements regulation).
- Regulations: OHIO ADMIN. CODE 3901-1-63 (2010) (viatical settlements).

Oklahoma:

- Statutes: OKLA. STAT. tit. 36, §§ 4055.1 to -.17 (West 2010) (Viatical Settlements Act of 2008).
- Regulations: OKLA. ADMIN. CODE §§ 365:25-11-1 to -11-6 (2010) (viatical settlements).

Oregon:

- Statutes: OR. REV. STAT. ANN. §§ 744.319 to -.358 (West 2008) (life settlement contracts).
- Regulations: OR. ADMIN. R. 836-014-0200 to -014-0400 (2010) (life settlements).

Pennsylvania:

- Statutes: 40 PA. CONS. STAT. ANN. §§ 626.1 to -.17 (West 2010) (viatical settlements).
- Regulations: 31 PA. CODE §§ 90f.1-g.16 (2010) (individual imminent death/lifetime health care facility confinement benefits provided as accelerated death benefit or settlement of death benefit; provided by riders or built into policies–statement of policy).

South Dakota:

- No statutes.
- Regulations: S.D. ADMIN. R. 20:08:07:31 (2010) (viatical settlements).

Tennessee:

- Statutes: TENN. CODE ANN. §§ 56-50-101 (2010) (Viatical Settlements Act of 2009).

- Regulations: TENN. COMP. R. & REGS. 0780-1-71-.01 to -.11 (2010) (life settlements).

Texas:

- Statutes: TEX. INS. CODE ANN. §§ 1101.001 to .006 (Vernon 2010) (life and viatical settlements).
- Regulations: 28 TEX. ADMIN. CODE §§ 3.1701 to .1717 (2010) (viatical and life settlements); 28 TEX. ADMIN. CODE §§ 21.101 to .122 (2010) (insurance advertising, certain trade practices, and solicitation).

Utah:

- Statutes: UTAH CODE ANN. § 31A-23a-117 (West 2010) (special requirements for life settlement providers and producers); UTAH CODE ANN. § 31A-36-101 to -119 (West 2010) (Life Settlements Act).
- Regulations: UTAH ADMIN. CODE r. 590-222-1 to -222-17 (2010) (viatical settlements); UTAH ADMIN. CODE r. 590-226-1 to -226-18 (2010) (submission of life insurance filings).

Vermont:

- No statutes.
- Regulations: 21-020-047 VT. CODE R. § 1 (2010) (viatical settlements).

Virginia:

- Statutes: VA. CODE ANN. §§ 38.2-1865.1 to .5 (2010) (licensing of viatical settlement brokers); VA. CODE ANN. §§ 38.2-6000 to -6016 (2007) (viatical settlements).
- Regulations: 14 VA. ADMIN. CODE § 5-71-10 to -100 (2010) (viatical settlement providers and viatical settlement brokers).

Washington:

- No statutes.
- Regulations: WASH. ADMIN. CODE § 284-97-010 to -050 (2010) (viatical settlements); WASH. ADMIN. CODE § 460-10A-215 (2010) (viatical and life settlement agreements).

West Virginia:

- Statutes: W. VA. CODE ANN. § 33-13C-1 to -18 (LexisNexis 2010) (viatical settlements).
- Regulations: W. VA. CODE R. § 114-80-1 to -12 (2010) (viatical settlements).

Wisconsin:

- Statutes: WIS. STAT. ANN. § 632.68 (West 2010) (viatical settlements).

- No regulations.

APPENDIX B: STATES DEFINING VIATICAL SETTLEMENTS AS SECURITIES

The following states include viatical or life settlements in their definition of security:

Alaska: ALASKA STAT. § 45.55.990(32), (37) (2010) ("viatical settlement interest," which is further defined as "the entire interest or any fractional interest in a life insurance policy or in the death benefit under a life insurance policy that is the subject of a viatical settlement contract …").

Arizona: ARIZ. REV. STAT. § 44-1801(26), (29) (2010) ("viatical or life settlement investment contract" which is further defined as "an agreement for consideration for the purchase, assignment, transfer, sale, devise or bequest of any portion of the death benefit under or ownership of either an insurance policy or certificate of insurance").

Arkansas: ARK. CODE. ANN. § 23-42-102 (2010) ("viatical settlement contract or fractionalized or pooled interest therein").

California: CAL. CORP. CODE § 25019 (West 2009) ("viatical settlement contract or a fractionalized or pooled interest therein; life settlement contract or a fractionalized or pooled interest therein").

Colorado: Colo. Rev. Stat. § 11-51-201(17), (20) (2010) ("viatical settlement investment" which is further defined as "the contractual right to receive any portion of the death benefit or ownership of a life insurance policy or certificate, in exchange for consideration that is less than the expected death benefit of the life insurance policy or certificate").

Florida: FLA. STAT. ANN. § 517.021(21), (23) (LexisNexis 2010) ("viatical settlement investment," which is further defined as "an agreement for the purchase, sale, assignment, transfer, devise, or bequest of all or any portion of a legal or equitable interest in a viaticated policy as defined in chapter 626").

Georgia: GA. CODE ANN. § 10-5-2 (2010) ("The term ... [i]ncludes as an investment contract, among other contracts, an interest in a limited partnership or a limited liability company and an investment in a viatical settlement or similar agreement.").

Hawaii: HAW. REV. STAT. § 485A-102 (2010) ("The term … [i]ncludes as an 'investment contract', among other contracts, an interest in a limited partnership and a limited liability company and an investment in a viatical settlement or similar agreement.").

Idaho: IDAHO CODE ANN. § 30-14-102 (2010) ("'Security' … [i]ncludes as an 'investment contract,' among other contracts, an interest in a limited partnership and a limited liability company and an investment in a viatical settlement, life settlement or senior settlement or similar agreement.").

Indiana: IND. CODE ANN. § 23-19-1-2 (LexisNexis 2010) ("The term … includes as an 'investment contract', among other contracts, an interest in a limited partnership and a limited liability company and an investment in a viatical settlement or similar agreement.").

Iowa: IOWA CODE § 502.102(28)(f) (2010) ("viatical settlement investment contract," which is further defined in § 502.102 (31A) as "a contract entered into by a viatical settlement purchaser, to which the viator is not a party, to purchase a life insurance policy or an interest in the death benefits of a life insurance policy, which contract is entered into for the purpose of deriving economic benefit").

Kansas: KAN. STAT. ANN. § 17-12a102(28)(E) (2009) ("'investment contract' may include an interest in a limited partnership and a limited liability company and shall include a viatical investment as defined by rule adopted or order issued under this act").

Kentucky: KY. REV. STAT. ANN. § 292.310 (18), (20) (LexisNexis 2010) ("life settlement investment," which is further defined as "the contractual right to receive any portion of the death benefit or ownership of a life insurance policy or certificate, for consideration that is less than the expected death benefit of the life insurance policy or certificate").

Maine: ME. REV. STAT. ANN. tit. 32, § 16102 (28), (32) (2009) ("investment in a viatical or life settlement contract," which is further defined as a "written agreement establishing the terms under which compensation or anything of value will be paid, which compensation or value is less than the expected death benefit of the insurance policy or certificate, in return for the assignment, transfer, sale, devise or bequest of the death benefit or ownership of any portion of an insurance policy or certificate of insurance").

Michigan: MICH. COMP. LAWS SERV. § 451.2102 (LexisNexis 2010) ("'Security' means … an investment in a viatical or life settlement agreement ….").

Minnesota: MINN. STAT. § 80A.41 (2009) ("The term … includes as an 'investment contract,' among other contracts, an interest in a limited partnership and a limited liability company and an investment in a viatical settlement or similar agreement").

Mississippi: MISS. CODE ANN. § 75-71-105(n), (p) (repealed 2010) ("viatical settlement investment contract or a fractionalized or pooled interest therein," which is further defined as "any agreement, regardless of title or caption, for the purchase, sale, assignment, transfer, devise or bequest of any portion of the death benefit or ownership of a life insurance policy or certificate for consideration that is less than the expected death benefit of the life insurance policy or certificate").

Missouri: MO. REV. STAT. § 409.1-102(28)(E) (2009) ("May include as an 'investment contract', [sic] among other contracts, an interest in a limited partnership and a limited liability company and an investment in a viatical settlement or similar agreement").

Montana: MONT. CODE ANN. § 30-10-103(22)(a) (2009) ("viatical settlement purchase agreement").

Nebraska: NEB. REV. STAT. § 8-1101(15), (17) (2007) ("viatical settlement contract or any fractional or pooled interest in such contract," which is further defined as "an agreement for the purchase, sale, assignment, transfer, devise, or bequest of all or any portion of the death benefit or ownership of a life insurance policy or contract for consideration [sic] which is less than the expected death benefit of the life insurance policy or contract").

Nevada: NEV. REV. STAT. § 90.295 (2009) ("viatical settlement investment").

New Jersey: N.J. STAT. ANN. § 49:3-49(m), (w) (2010) ("a viatical investment," which is further defined as "the contractual right to receive any portion of the death benefit or ownership of a life insurance policy or certificate, for consideration that is less than the expected death benefit of the life insurance policy or certificate").

New Mexico: N.M. STAT. § 58-13C-102(DD)(7) (2010) ("includes as an investment contract an investment in a viatical settlement or similar agreement").

North Carolina: N.C. GEN. STAT. § 78A-2(11), (13) (2009) ("viatical settlement contract or any fractional or pooled interest in a viatical settlement contract," and viatical settlement contract is further defined as "an agreement for the purchase, sale, assignment, transfer, devise, or bequest of all or any portion of the death benefit or ownership of a life insurance policy or contract for consideration which [sic] is less than the expected death benefit of the life insurance policy or contract").

North Dakota: N.D. CENT. CODE § 10-04-02(19), (21) (2009) ("viatical or life settlement contract or a fractionalized or pooled interest therein," which is further defined as "an agreement for the purchase, sale, assignment, transfer, devise, or bequest of any portion of the death benefit or ownership of a life insurance policy or certificate, for consideration that is less than the expected death benefit of the life insurance policy or certificate").

Ohio: OHIO REV. CODE ANN. § 1707.01(B) (West 2009) ("any life settlement interest," which is further defined in § 1707.01(HH): "'Life settlement interest' means the entire interest or any fractional interest in an insurance policy or certificate of insurance, or in an insurance benefit under such a policy or certificate, that is the subject of a life settlement contract. For purposes of this division, 'life settlement contract' means an agreement for the purchase, sale, assignment, transfer, devise, or bequest of any portion of the death benefit or ownership of any life insurance policy or contract, in return for consideration or any other thing of value that is less than the expected death benefit of the life insurance policy or contract. 'Life settlement contract' includes a viatical settlement contract ….").

Oklahoma: OKLA. STAT. tit. 71, § 1-102(32)(e) (2010) ("includes as an 'investment contract,' among other contracts, an interest in a limited partnership and a third party managed limited liability company and an investment in a viatical or life settlement or similar contract or agreement").

South Carolina: S.C. CODE ANN. § 35-1-102(29)(E) (2009) ("'Investment contract' may include, among other contracts, an interest in a limited partnership and a limited liability company and shall include an investment in a viatical settlement or similar agreement").

South Dakota: S.D. CODIFIED LAWS § 47-31B-102(28)(E) (2010) ("includes as an investment contract, among other contracts, an interest in a limited partnership and a limited liability company and an investment in a viatical settlement or similar agreement").

Tennessee: TENN. CODE ANN. § 48-2-102(16) (West 2010) ("a life settlement contract, as defined in former § 56-50-102, or any fractional or pooled interest in a life insurance policy or life settlement contract").

Utah: UTAH CODE ANN. § 61-1-13(ee)(i)(R) (2010) ("life settlement interest," which is defined in § 61-1-13(v)(i) as "the entire interest or a fractional interest in any of the following that is the subject of a life settlement: (A) a policy; or (B) the death benefit under a policy").

Vermont: VT. STAT. ANN. tit. 9, § 5102(28)(E) (2009) ("includes as an 'investment contract' among other contracts an interest in a limited partnership, a limited liability company, an investment in a viatical settlement, or similar agreement").

West Virginia: W. VA. CODE § 32-4-401(n) (2009) ("viatical settlement contract").

Wisconsin: WIS. STAT. § 551.102(28) (2010) ("viatical settlement investment or similar agreement," which is further defined by § 551.102(32) as "the entire interest or any fractional or pool interest in a life insurance policy or certificate of insurance or in the death benefit thereunder that is the subject of a viatical settlement").