UNITED STATE DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
CASE NO. 04-60573
CIV – MORENO/GARBER

SECURITIES AND EXCHANGE COMMISSION

Plaintiff,

v.

MUTUAL BENEFITS CORP., et al.,

Defendants,

AMERICAN UNITED LIFE INSURANCE COMPANY, et al.,

Intervenors.
_____/

INTERVENING INSURERS' OBJECTION TO MOTION TO APPROVE STALKING HORSE PURCHASE AGREEMENT AND BIDDING PROCEDURES

The Receiver's Motion to Approve Stalking Horse Purchase Agreement and Bidding Procedures (the "Motion to Approve") violates the Receiver's legal obligations. The Intervening Insurers[1] proposed an alternative method to distribute receivership assets that is consistent with the Receiver's obligations to all creditors of the receivership, and also ensures the viability of policies in this receivership for any purchaser or investor who might assume obligations under these policies in the future. If, nevertheless, the Court decides to grant the Motion to Approve, the February 9, 2007 Order should be clarified to

[1] Intervening Insurers include the following insurers: American United Life Insurance Company, Continental Assurance Company, Jefferson-Pilot Life Insurance Company, Jefferson Pilot LifeAmerica Insurance Company, Jefferson Pilot Financial Insurance Company, Midland Life Insurance Company, Pioneer Mutual Insurance Company, Reassure America Life Insurance Company, Southwestern Life Insurance Company, The Columbus Life Insurance Company, The State Life Insurance Company, The Western and Southern Life Insurance Company, and Valley Forge Life Insurance Company.

confirm that the Intervening Insurers' rights and obligations under the policies and at law are unaffected by any policy sale. So that the record will be complete, this objection begins with an account of the effort that the Intervening Insurers have made, so far unsuccessfully, to secure their right to be heard.

I. PROCEDURAL CONTEXT AND BACKGROUND FACTS

A. The SEC Commences Enforcement Action Against Mutual Benefits.

The Securities and Exchange Commission (the "SEC") commenced this proceeding against Mutual Benefits and its affiliates (collectively "MBC") (the "Securities Action") [D.E. 1], via an *ex parte* application for an injunction against MBC, and for the appointment of a receiver [D.E. 1]. The SEC alleged that: (a) in raising money for its viatical enterprise, MBC falsely represented to investors that its life expectancy evaluations had been prepared by independent physicians; (b) 65% of MBC's outstanding life insurance policies were sold to investors using fraudulent life expectancy figures; and (c) approximately 90% of MBC's policies had already passed the assigned life expectancy. Id.; see also SEC v. Mutual Benefits Corp., 408 F.3d 737, 740-41 (11th Cir. 2005). According to the SEC, because certain of MBC's older policies failed to mature at the projected time, shortfalls in escrowed premiums required MBC to employ a "Ponzi" premium payment scheme. Id.

B. The Court Appoints a Receiver, and the Enforcement Action Against Mutual Benefits Gets Underway.

The Court acted immediately. On May 4, 2004, it entered an injunction against MBC and appointed Roberto Martinez as Receiver [D.E. 26]. The Court directed the Receiver, among other things, to "investigate the manner in which the affairs of [MBC]

were conducted and institute such actions . . . for the benefit and on behalf of [the Received Entities], *and their investors and other creditors*." Id. (emphasis added).

The SEC began the job of litigating its securities fraud case against MBC. To streamline the Securities Action, the Court's May 4, 2004 Order appointing the Receiver required that lawsuits against MBC or its affiliates be commenced – if at all – in the Southern District of Florida in a proceeding ancillary to the Securities Action. Id.

C. The Receiver Moves to Distribute the Policies.

Within days after the Court established the Receivership, the Intervening Insurers concluded that the fraudulent business practices of MBC went beyond alleged investor fraud. Regulatory investigations and partial file data available revealed that MBC had also engaged in insurance fraud, actively seeking out, acquiring, and then dealing in known fraudulent policies. So the Intervening Insurers requested that the Receiver identify the fraudulent policies under his control, provide this information to the Intervening Insurers, and agree to suspend dealings in these fraudulent policies. The Receiver refused.

Instead, the Receiver filed, on April 22, 2005, his motion for approval of a plan to distribute the MBC insurance policy portfolio (the "Motion to Distribute") [D.E. 902]. The Intervening Insurers consequently sought intervention in the Securities Action. The Intervening Insurers contended they had unique interests in prohibiting a Distribution Plan that violated Florida law and the due process clause of the Fifth Amendment [D.E. 1054]. The Court granted intervention for the purpose of opposing the Motion to Distribute [D.E. 1146]. Rather than simply attacking the Receiver's Motion to Distribute

as the unlawful thing it was, the Intervening Insurers offered an alternative distribution plan that was consistent with controlling law (the "Alternative Plan") [D.E. 1150].

D. After Granting Intervention, the Court Precluded the Intervening Insurers From Making Any Record to Support Their Position.

The Intervening Insurers filed their opposition to the Motion to Distribute [D.E. 1054], and then sought narrowly tailored discovery to demonstrate two fatal flaws in the Receiver's arguments. First, although the Receiver contended that his distribution would include *no policies subject to a claim of fraud* [D.E. 1105], the Receiver never affirmatively represented that he had determined which policies in the MBC portfolio were procured through fraud. See Mot. to Distribute [D.E. 1152]. To make the record on this important matter, the Intervening Insurers noticed the Receiver's deposition. But the Court precluded the deposition before the Intervening Insurers could even respond to the Receiver's motion for a protective order [D.E. 1177]. Second, although the Receiver stated that he had *consulted with the Florida Office of Insurance Regulation ("OIR") to ensure that his Motion to Distribute comported with Florida law* [D.E. 1105], the Receiver had actually never obtained any such opinion from the Florida OIR [D.E. 1169]. The Intervening Insurers noticed the deposition of the OIR to demonstrate this fact, but the Court again precluded that deposition [D.E. 1191].

When the Court set an evidentiary hearing on the Receiver's Motion to Distribute on two days' notice, the Intervening Insurers attempted through trial subpoenas to elicit testimony from the Receiver and the OIR to demonstrate the flaws in the Motion to Distribute. Again, the Court denied the Intervening Insurers this right, electing instead to hear only direct testimony from the Receiver and limited cross examination on a narrow set of issues that the Court had identified in advance [D.E. 1312].

E. The Intervening Insurers' Notice of Appeal and Stipulation to Dismiss on the Basis of the Receiver's Agreement to Seek this Court's Approval of any Policy Sale after the Provision of Notice to the Intervening Insurers.

The Court entered an Order granting the Motion to Distribute on September 14, 2005 (the "Disposition Order") [D.E. 1339]. The Intervening Insurers then filed a Motion for Clarification, Reconsideration and Modification of the Disposition Order (the "Motion for Clarification") [D.E. 1368]. In the Motion for Clarification, the Intervening Insurers asked the Court to exclude the policies issued by the Intervening Insurers from the scope of the Disposition Order. Id. On November 10, 2005, the Court, without a hearing on the Motion for Clarification, entered an Order excluding only five of the Intervening Insurers' policies from the scope of the distribution (the "Clarification Order") [D.E. 1454]. In the Clarification Order, the Court specifically rejected the Intervening Insurers' request to exclude the 400 policies issued by the Intervening Insurers. Id.

The Intervening Insurers timely filed a Notice of Appeal to the United States Court of Appeals for the Eleventh Circuit on December 21, 2005. After submitting briefs on the Eleventh Circuit's jurisdiction over the appeal, the Intervening Insurers and the Receiver dismissed the appeal without prejudice, agreeing that the Receiver would seek this Court's approval of any policy sale and provide notice of same to the Intervening Insurers.

The Receiver's Motion to Approve is now before this Court, seeking approval of the terms of an asset purchase agreement (the "Asset Purchase Agreement") for the sale of 1,405 insurance policies (the "Auction Portfolio") and approval of bidding procedures

that will govern the sale of the Auction Portfolio.[2] The Asset Purchase Agreement purports, among other things, to transfer the Auction Portfolio "free and clear of all Encumbrances . . .." See Asset Purchase Agreement at § 2.1. During conference calls between undersigned counsel and counsel for the Receiver, the Receiver expressed his view that the Intervening Insurers' rights and defenses under the insurance contracts and at law would be unaffected by the Asset Purchase Agreement. However, the Receiver's Motion to Approve does not seek an express finding on this point. Consistent with the notice provision in the Motion to Approve, the Intervening Insurers hereby submit this timely objection.

II. ARGUMENT

In his Motion to Approve, the Receiver seeks the Court's approval of an Asset Purchase Agreement which, among other things, purports to sell the Auction Portfolio "free and clear of all Encumbrances," see Asset Purchase Agreement at §2.1. The Intervening Insurers oppose this Motion to Approve, inasmuch as the Asset Purchase Agreement is both (1) inconsistent with the Receiver's obligations under controlling law; and (2) requires clarification to confirm that the proposed sale of the Auction Portfolio does not, because it cannot consistent with due process, abridge the Intervening Insurers' rights and defenses under the insurance contracts or at law.

Rather than simply to file a brief in opposition [D.E. 1054] to the Receiver's attempts to distribute assets from this receivership estate, the Intervening Insurers have

[2] Prior to the time for objections under the local rules, the Court granted the Motion to Approve by Order dated February 8, 2007. The Intervening Insurers filed a motion for reconsideration on February 26, 2007 [D.E. 1844], which is incorporated herein by reference. This notwithstanding, the Motion to Approve called for objections on or before March 15, 2007.

proposed their own Alternative Plan for distribution [D.E. 1150]. The Intervening Insurers contend that an investigation of the viability of the insurance portfolio by this Receiver is not only consistent with the Receiver's obligations to all creditors of the receivership estate under controlling law, but also would provide valuable certainty to anyone that might purchase or acquire obligations under these insurance policies in the future.

In the normal course, the Intervening Insurers' objection to the relief sought in this Motion to Approve would begin with the argument that the motion should be denied outright, and then argue, alternatively, that – if granted – the Court should impose provisions in its order to clarify the requested relief. However, as demonstrated by the procedural history cited above, this has not been a normal case for the Intervening Insurers. And so, although not classically ordered, the Intervening Insurers will begin with their alternative argument and move then to the bases upon which the Motion to Approve should be denied outright.

A. The Receiver's Proposed Sale of Policies Does not Affect the Intervening Insurers' Rights or Defenses, and the Order Approving the Asset Purchase Agreement Should be Clarified Accordingly.

The Intervening Insurers possess constitutionally-protected rights and defenses related to the policies in the Auction Portfolio, which arise under the subject insurance contracts and at law and which necessarily survive any sale of the Auction Portfolio. See Mem. in Opp'n to Mot. to Distribute at Argument B [D.E. 1054]. The Receiver agrees that the Asset Purchase Agreement would not affect the Intervening Insurers' rights and defenses. However, the Motion to Approve did not seek an express finding to this effect. Therefore, assuming arguendo that this Court permits the sale of the Auction Portfolio,

the Court should modify its Order of February 9, 2007, to include the express finding that any claims, rights, causes of actions, remedies, or interests possessed by the Intervening Insurers under the policies, at law, or in equity are expressly reserved. Failing this, an argument might be made – albeit inconsistent with controlling law and the views of the Receiver and the Intervening Insurers – that the Auction Portfolio would pass to any purchaser free and clear of the Intervening Insurers' rights and defenses.

B. The Receiver is Obligated to Identify and Report Fraudulent Policies, and the Court Should Insist that this Obligation is Fulfilled Before Approving the Asset Purchase Agreement.

Federal receivers must manage and operate the property in their possession according to the requirements of the laws of the State in which the property is situated, in the same manner that the owner or possessor thereof would be bound if in possession. See U.S.C. § 959. In Florida, the Viatical Settlement Act (the "FVSA") requires viatical settlement providers to, among other things, adopt and implement anti-fraud plans. See § 626.99278. The Receiver, who now acts on behalf of MBC, is bound by this requirement, among others. An anti-fraud plan must include descriptions of procedures for: (1) detecting and investigating possible fraudulent acts; (2) resolving material inconsistencies between medical records and insurance applications; (3) mandatory reporting of possible fraudulent insurance acts and prohibited practices; and (4) performing initial and continuing review of the accuracy of life expectancies used in connection with a viatical settlement contract or viatical settlement investment. See § 626.99278.

Florida's Unfair Trade Practices Statute also imposes requirements upon this Receiver. See § 626.989(6). In 2001, Florida's First District Court of Appeals affirmed

an Administrative Law Judge's decision to revoke the viatical license of Accelerated Benefits Corporation. See Accelerated Benefits Corp. v. Dep't of Ins., 813 So. 2d 117 (Fla. Dist. Ct. App. 2001). The Accelerated Benefits holding provides guidance here. In Accelerated Benefits, the Administrative Law Judge decided that – in failing to report instances where records collected during viatical underwriting demonstrated that a viator's application for insurance had omitted reference to an existing medical diagnosis – Accelerated Benefits Corporation violated Florida's Unfair Trade Practices Statute, which requires persons with knowledge of insurance fraud to report the fraud. See § 626.989(6).

Despite the fact that the Receiver has his office by virtue of MBC's widespread fraud, and despite the fact that the Intervening Insurers have provided detailed information related to at least five fraudulent policies, the Intervening Insurers do not believe that the Receiver has developed a procedure to identify and resolve inconsistencies between viatical underwriting materials and corresponding insurance applications. In addition to those policies identified by the Intervening Insurers, the OIR filed an Emergency Cease and Desist Order against MBC on May 3, 2004, suspending the license of MBC and identifying additional fraudulent policies. A copy of the Cease and Desist Order is attached as Exhibit A.

In its Cease and Desist Order, the OIR noted that MBC posed an "immediate danger to the public health, safety and welfare . . .." See Ex. A at ¶1. The OIR also described, among other things, its review of one hundred seventy three sample policy files within the MBC portfolio. See Ex. A at ¶ 1. Specifically, the OIR had concluded that sixteen of MBC's files

> contained medical records or other data, which showed that MBC knew or should have known the policies were obtained, from the insurance company, by means of a false, deceptive, or misleading application for the life insurance policy. MBC bought and sold these policies and failed to report to the Division of Insurance Fraud, information concerning any fact material to the policy, where the viator or the viator's agent intended to defraud the policy's insurer.

See Exhibit A at ¶35. For this, the OIR concluded that MBC had been "dealing in fraudulently obtained policies in violation of Sections 626.989(6) and 626.99275(1)(a), Florida Statutes." See Ex. A at ¶ 34, and generally at ¶¶ 12, 36, and 41; as well as affidavit of Janice S. Davis in Support of Cease and Desist Order at ¶ 8.

Similar to Accelerated Benefits Corporation, MBC's violations involved instances where a viator's initial life insurance application omitted medical diagnoses that became known to MBC during viatical underwriting. The OIR deemed MBC's failure to report this insurance fraud as violative of Florida's Unfair Trade Practice Statute, as well as the FVSA. Id. Within the last month, two of MBC's managers entered guilty pleas before the Honorable Paul C. Huck, District Judge. One manager, Bari Wiggins, who managed MBC's policy service department, admitted, among other things, that she had helped MBC to fraudulently obtain certain group insurance policies. See Feb. 27, 2007 Press Release from United States Attorney's Office for the Southern District of Florida, which is attached as Exhibit B.

At this point, the Receiver must develop and execute an anti-fraud plan consistent with Florida law. The Intervening Insurers request this Court to ensure that the Receiver satisfies his obligation to identify and report fraudulent policies, prior to transferring policies outside of this receivership proceeding. Such a holding would not simply protect the Intervening Insurers' interests, but also would provide certainty to potential purchasers of the Auction Portfolio. The Receiver's fraud reporting obligations under

Florida law are clear,[3] and the Court should ensure that these obligations are met prior to the sale of the Auction Portfolio.

C. An Alternative Method Exists to Distribute the Assets of the Received Entities in a Manner Consistent With the Receivership Order and Controlling Law.

As this Court is aware, the Intervening Insurers have not simply identified deficiencies in this Receiver's attempts to distribute receivership assets. To the contrary, in opposing the Receiver's Motion to Distribute, the Intervening Insurers filed with this Court an Alternative Plan, outlining a mechanism for the Receiver to distribute receivership assets in a manner that was not only expedient and consistent with the rights of the Intervening Insurers, but which also would provide certainty regarding the viability of any policy that might be acquired in the future by purchasers or MBC investors. See Alternative Plan [D.E. 1150]. The Intervening Insurers' Alternative Plan would: (i) allow the Intervening Insurers a short period of time to investigate and quantify their setoff claims by determining the exact amount of proceeds that have been paid or may become payable under matured policies procured by fraud; (ii) allow the Intervening Insurers a short period of time to investigate and quantify their contractual, equitable and statutory defenses concerning active policies; (iii) direct the Receiver to allow the Intervening Insurers access to documents containing the above information, as such documents are in

[3] In their brief on appeal from dismissal of the Ancillary Action, the Intervening Insurers also argued that the FVSA precluded any transfer of known, fraudulent policies by virtue of its prohibition against "dealing in" viatical settlement contracts the subject of which are policies procured by fraud. Under this statutory construction, the Receiver could be liable to the Intervening Insurers for the transfer of knowingly fraudulent policies. The Intervening Insurers recognize, however, that the Court does not construe the FVSA in this manner, and that the Eleventh Circuit has not squarely addressed this issue of statutory construction.

the Receiver's sole possession and appear to have been provided to potential bidders on the Auction Portfolio; and (iv) defer decision on distribution until the Intervening Insurers have completed their investigation and reported their findings to the Court.

The Alternative Plan continues to offer an efficient, as well as lawful, method of distribution. If adopted, the Court would ensure that the Receiver has satisfied his obligations to the insurer-creditors of the receivership estate, while - at the same time – introducing certainty regarding the viability of insurance policies to be transferred to MBC investors or sold to third-party purchasers.

III. CONCLUSION

For all of the foregoing reasons, the Intervening Insurers respectfully submit that the Receiver's Motion to Approve should be denied, and that the Court's February 9, 2007 Order should be vacated, or in the alternative, clarified.

Respectfully submitted,

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Dated: March 15, 2007

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CERTIFICATE OF SERVICE

I certify that on March 15, 2007, I electronically filed the foregoing with the Clerk of the Court by using the CM/ECF system which will send a notice of electronic filing to the following:

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