UNITED STATES 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,

VIATICAL BENEFACTORS, LLC, *et al.*,

Relief Defendants.
_____/

RECEIVER'S SUPPLEMENTAL BRIEF
ON PURCHASER ESCROW ACCOUNTS

Roberto Martínez, as court-appointed Receiver (the "Receiver") of Mutual Benefits Corp., Viatical Benefactors, LLC, Viatical Services, Inc., and Anthony Livoti, Jr., P.A. (in its capacity as trustee), hereby files this supplemental brief "on the limited issue of a true escrow account," as directed by the Court's Order Granting, in Part, Motion for Protective Order, dated February 3, 2005 [D.E. 687] (the "Order"). This issue has arisen in connection with the determination whether approximately $103,477,098 (as of October 31, 2004) held in an account at Union Planters Bank, N.A. ("UPBNA") (the "UPBNA Pre-Purchase Account"), which funds have not yet been transferred in connection with the purchase of an insurance policy, should be

paid to the purchasers who originally deposited the funds.[1]

LEGAL BACKGROUND

Under Florida law, the standard for establishing a true escrow account has been described in a variety of similar ways. The Florida Supreme Court has stated that "[t]o constitute a binding escrow, there must be an instrument embodying conditions mutually beneficial to both parties, agreed to by both parties, and it must be communicated to and deposited with a third party." *Smith v. Macbeth*, 161 So. 721, 724 (Fla. 1935). Similarly, the Eleventh Circuit has stated that "[u]nder Florida law, an escrow is established by an instrument embodying conditions mutually beneficial to both parties . . . and it must be communicated to and deposited with a third party." *Gibson v. Resolution Trust Corp.*, 51 F.3d 1016, 1021 (11th Cir. 1996) (citation omitted). And the former Fifth Circuit has stated that "[t]he essential elements of a valid escrow arrangement are a contract between the grantor and the grantee agreeing to the conditions of a deposit, delivery of the deposited item to a third party, and communication of the agreed upon conditions to the third party." *Johansson v. United States*, 336 F.2d 809, 815 (5th Cir. 1964).

The parties have not disputed that Mutual Benefits Corporation ("MBC") and its purchasers entered into a Life and Viatical Settlement Purchase Agreement (the "Purchaser's

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1 There are also bank accounts at Bank of America, RBC Centura Bank and Northern Trust Bank of Florida that have titles suggesting they may contain purchaser funds. As discussed below, the funds in the accounts at these banks should be treated separately, as the nature of those funds and the conditions under which they are held, are different than the funds in the UPBNA Pre-Purchase Account.

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Agreement") in which they agreed to the conditions of the purchasers' deposit, and that the purchasers in fact deposited funds with UPBNA. UPBNA, however, was not a party to any of the Purchaser's Agreements. Thus, without the benefit of discovery, there was no evidence to determine whether the Purchasers' Agreements, or the terms of the deposits, had actually been deposited with, or communicated to, UPBNA, or whether UPBNA had in fact agreed to act as escrow agent with respect to MBC's purchasers. As Magistrate Judge Garber stated in his Report and Recommendation, "[t]he Court does not have sufficient evidence to determine whether the agreements between MBC and the pre-closing purchase escrow plaintiffs were communicated to and deposited with [UPBNA] or any of the other purported escrow agents." Report & Recommendation [D.E. 587] at 9.

Magistrate Judge Garber nonetheless held that "regardless of the fact that the Union Planters account was not the escrow account contemplated in the agreements between MBC and the pre-closing purchase escrow plaintiffs, . . . [t]he receiver has not cited any law or facts which would support a conclusion that MBC or any other defendant had legal title to the funds in the Union Planters account . . . ." Report & Recommendation at 13-14. Magistrate Judge Garber thus recommended "that the Court require the receiver to return the funds at issue to the pre-closing purchase escrow plaintiffs." *Id.* at 14.

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REPORT ON DISCOVERY

As directed by the Court's Order, the Receiver's counsel and other permitted counsel obtained documents from UPBNA and conducted depositions of three UPBNA witnesses[2]. The Receiver will attempt to summarize here what the testimony showed "on the limited issue of a true escrow account." Unfortunately, while the discovery process has supplemented, and at times contradicted, information previously provided to the Receiver, the Receiver respectfully suggests that the discovery has not provided a clear or uncontradicted answer to the issue of whether the UPBNA Pre-Purchase Account is a true escrow account under Florida law.

The Receiver will not attempt to summarize all of the testimony provided by the UPBNA witnesses. The Receiver has filed the complete transcripts under seal with the Court (but has not filed the exhibits to the depositions, as they are voluminous).

A. Communication/Depositing of the Purchaser's Agreement: UPBNA's document production shows that UPBNA had at least five unsigned copies of the Purchaser's Agreement, as well as two signed copies of the form of purchase agreement used when American Express Tax & Business Services, Inc. served as escrow agent. (Quinlan dep., Ex. Cook 5.) The copies were "kept in the file just to see what the purchaser contract was." (*Id.* at 90.) UPBNA did not produce any signed copies of the Purchaser's Agreement for the period of time UPBNA served as escrow agent. UPBNA maintained "case files" for each insurance policy that was purchased. UPBNA did not have signed (or unsigned) copies of the Purchaser's Agreement in any of the case files. (*Id.* at 22-23, 33.)

2 Although the Order authorized the parties to take depositions of four UPBNA witnesses, one of those witnesses (Joanne Daniels) was no longer employed by UPBNA, and was reported to be living in Ohio, so the parties agreed to

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By contrast, the procedures followed by UPBNA with respect to the viator's sale of the insurance policy clearly seemed designed to meet the standard of a valid escrow under Florida law. The Escrow Agreement between MBC, UPBNA and the viator (the "Seller's Escrow Agreement") were communicated to, and deposited with, UPBNA, and UPBNA maintained signed copies in its "case files." (Quinlan dep. at 20-21, 33.) UPBNA had expressly agreed in writing to serve as an escrow agent for the purchase of insurance contracts from the insureds, and the signed Seller's Escrow Agreement that UPBNA executed in connection with the purchase of each insurance contract expressly outlines UPBNA's undertaking as escrow agent for that transaction. UPBNA maintained the originals of the Seller's Escrow Agreements in a vault. (Traxler dep. at 29-30.) UPBNA thus appears to have believed its obligation as escrow agent to the insureds required the Sellers' Escrow Agreements to be deposited with, and maintained by, UPBNA. UPBNA did not do so with the Purchaser's Agreements.

B. <u>Acceptance of Role as Escrow Agent to Purchasers</u>: Regardless of whether the Purchaser's Agreements were deposited with, and communicated to, UPBNA, the Receiver's counsel also asked the UPBNA witnesses directly whether, from their perspective, the bank had agreed to act as escrow agent for the purchasers, and whether UPBNA had assumed a fiduciary responsibility toward the purchasers. On this point, UPBNA's witnesses directly contradicted each other, as follows:

Felipe Larcada (Senior Vice President)	**Patricia Quinlan (former Vice President)**
Q: Did you have an understanding of whether	Q: To your understanding, did Union Planters

forego her deposition.

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the purchasers had appointed Union Planters to act as their **escrow agent**? A: My understanding was that no. Q: Did Union Planters at any time agree to assume that responsibility of acting as escrow agent for the purchasers? A: No, sir. (Larcada dep. at 25-26)	act as **escrow agent** for the purchasers? A: Yes. Q: Explain how they acted as escrow agent for the purchasers of the policies. A: Well, because we had set up a sub-account for each purchasers, and we monitored those accounts with separating their cash with their investment. . . . I believe we acted as escrow agent for the purchasers as well. (Quinlan dep. at 23-24)
Q: Was it your understanding that Union Planters did or did not have a **fiduciary duty** to the purchasers? A: That we did not. * * * Q: What was your understanding of what duties Union Planters did owe to the purchasers? A: Directly to the purchasers? None. (Larcada dep. at 31-32)	Q: Did Union Planters have any **fiduciary duty** to the purchasers? A: I believe so, yes. * * * Q: And did you have an understanding of what the source of that duty was or what gave rise to that duty? A: In any escrow account that you would be escrow agent for, you have a duty . . . to both parties, to the party that's – you know – the person that gave you the money and the person that will be receiving the money. So you have a duty to both as an escrow agent. (Quinlan dep. at 24-25)

Regarding this contradictory testimony, there are several points worth noting.[3] On the

3 The Receiver's counsel had previously met with both Mr. Larcada and Ms. Quinlan, and UPBNA's counsel, after the Receivership Order was entered. In those meetings, Mr. Larcada had made statements similar to those quoted here. Ms. Quinlan's views quoted here, which directly contradict her then-supervisor's views, had not previously been expressed to Receiver's

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one hand, Mr. Larcada, a Senior Vice President and current officer of UPBNA, holds a more senior position at the bank than did Ms. Quinlan, and was Ms. Quinlan's direct supervisor.[4] (Larcada dep. at 4; Traxler dep. at 42.) Ms. Quinlan is no longer an employee of UPBNA. (Quinlan dep. at 5.) On the other hand, Mr. Larcada had no direct responsibilities for the MBC account (Larcada dep. at 5), "was not involved in the day to day of this account" (*id.* at 20), and repeatedly testified that Ms. Quinlan was the one knowledgeable about the day-to-day operation of the MBC account (*see, e.g., id.* at 12). Ms. Quinlan, by contrast, was the manager of the MBC account and oversaw the daily processes involving the account. (Quinlan dep. at 5.) The trust administrator on the account, Sandra Traxler, also testified that Ms. Quinlan was more knowledgeable about both the day-to-day workings of the account and the structure of UPBNA's relationship with MBC. (Traxler dep. at 44.)

C. **Name of the account:** Although the UPBNA Escrow Agreement says the account would be named the "Union Planters Bank, N.A. -- MBC Purchase Escrow Account" (Quinlan dep., Ex. R1 at 2), the account was in fact opened under the name, and referred to by UPBNA, as the "Union Planters Bank, N.A. -- MBC Purchaser Escrow Account." (Quinlan dep. at 61-62.)

D. **Customer:** According to Ms. Quinlan, UPBNA's customer for the account was MBC. (Quinlan dep. at 13.) Mr. Larcada, on the other hand, testified that UPBNA's customer was

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counsel.

4 In response to a Notice of Deposition previously served on UPBNA by Life Settlement Holding, UPBNA designated Mr. Larcada as its Rule 30(b)(6) witness. In the deposition taken pursuant to the Court's Order, no such formal designation was made.

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"the trustee" of MBC. (Larcada dep. at 37.)

E. Beneficiar(ies) of the Account: According to the UPBNA Escrow Agreement, the UPBNA Pre-Purchase Account was established "for the benefit of MBC or MBC's designee." (Larcada dep., Ex. R1 at § II.A.1.) MBC never designated anyone to be its designee. (Quinlan dep. at 11.) However, Ms. Quinlan understood the account to have been opened for the benefit of the purchasers (though nobody from MBC ever informed her that was the case). (*Id.* at 11-12). From Ms. Quinlan's perspective, the bank knew that the funds were the purchasers' money until closing, and not MBC's. (*Id.* at 84-85.) Similarly, Mr. Larcada stated that funds in the account were not intended to benefit MBC, but "were there for the purchase of policies for the purchasers." (Larcada dep. at 71.)

F. Access to the Account: MBC was given access to the account and was provided with monthly statements; the purchasers were not. (Quinlan dep. at 15; Traxler dep. at 13-14.) However, approximately 10 to 15 purchasers did ask Ms. Quinlan for statements on their sub-accounts and were provided with them. (Quinlan dep. at 15-17). Although Ms. Quinlan asked MBC for permission before providing the statements to the purchasers, she did not believe she needed permission. (*Id.* at 17-18.)

G. Sub-Accounts: The funds deposited by purchasers would initially be deposited into a UPBNA "Bank-side" account. (Traxler dep. at 8-9.) After receiving identifying information from MBC, UPBNA would then transfer the purchasers' deposits into individual sub-accounts of a master account in UPBNA's Trust Department. (*Id.*) Although the funds in the "Bank-side" account were commingled when they arrived, they were transferred into the "sub-accounts" within the Trust

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Department by the next day, based on information provided by MBC. (*Id.* at 33.) From UPBNA's perspective, each purchaser had a "sub-account within the master." (*Id.* at 10.) Thus, the funds in the account were accounted for separately and, from UPBNA's perspective, were not commingled. (Larcada dep. at 39, 72; Quinlan dep. at 83.) UPBNA is able to identify each purchaser's funds. (Traxler dep. at 37.)

H. **Contacts with Purchasers**: Ms. Quinlan signed a letter from UPBNA to MBC, in which it was stated that "Union Planters is the Escrow Agent for MBC viatical or life settlement purchasers." (Quinlan dep., Ex. R3). MBC authored the letter. (*Id.* at 49) Ms. Quinlan understood that the letter was being provided to purchasers. (*Id.* at 48-49.) The letter was not intended to modify the UPBNA Escrow Agreement. (*Id.* at 49.) Ms. Quinlan also met in person with a representative of Life Settlement Holding, A.G. ("LSH"), and "probably" said to him that LSH's funds were being held separately and in escrow by UPBNA. (*Id.* at 57.)

I. **Closing Procedures:** Before funds in the UPBNA Pre-Closing Account would be disbursed to the viator, certain conditions precedent had to be satisfied. UPBNA would receive the change of beneficiary forms, signed by the insured, from MBC. (Traxler dep. at 86.) UPBNA would sign the Escrow Agreement and return the change of beneficiary forms to MBC, who, presumably, sent the forms on to the insurance company. According to the Purchaser's Agreement, when UPBNA had "[reviewed] the written acknowledgment from the issuing insurance company evidencing the acceptance on its books and records of the transfer or assignment of the ownership of the life insurance policy and the change of beneficiary (ies)" (Larcada dep., Ex. R1 at III.A.1(c)), then the funds would be released. UPBNA did not release

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purchaser's funds to anyone before these conditions were met. (Traxler dep. at 86.) UPBNA received the change of beneficiary forms, as well as the insurance company acknowledgement, from MBC or its attorneys and relied entirely on what it received from them; UPBNA did not have any direct contact with the insurance company or independently verify the change of beneficiary with the insurer. (*Id.* at 23-24.)

J. **Refunds:** In the case of refunds, UPBNA would receiver a letter from MBC directing UPBNA that a particular purchaser was to receive a refund. UPBNA would then prepare a check made out to the purchaser and send the check to MBC. UPBNA did not act, and would not have acted, on requests from a purchaser for a refund. (Quinlan dep. at 74-75; Traxler dep. at 14-15.)

K. **Funds Remaining in the Account More than 90 Days:** The UPBNA Escrow Agreement states that "[p]urchasers' funds on deposit in the Purchase Escrow Agreement shall be transferred into Policies, pursuant to this Agreement, within ninety (90) days of receipt of those funds." (Larcada dep., Ex. R1 at § III.B.3.) UPBNA, however, did not keep track of this 90-day period (Quinlan dep. at 70), did not advise purchasers if their funds had been in the account for 90 days or more (*id.* at 73), and would not have returned the funds to the purchasers if they had been in the account more than 90 days (*id.*).

ACCOUNTS AT BANKS OTHER THAN UPBNA

Counsel for the Receiver and counsel in the Cook Action have worked together to determine whether the funds in accounts at RBC Centura Bank, Northern Trust Bank of Florida and Bank of America are purchaser funds in an escrow account comparable to the funds in the

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UPBNA Pre-Purchase. The Receiver requests that the Court defer on ordering any disposition of the funds in these accounts at this time.

Based on the discovery to date, the funds in RBC Centura Bank (account # 7060005702) and in Northern Trust Bank of Florida (account # 1410019424) do not presently contain funds deposited by pre-closing purchasers.[5] In addition, counsel for the Receiver and counsel in the Cook Action have also worked together to determine the nature of the funds currently held by Bank of America (account # 003449021786 (money market), #005487540405 (checking), and #005487540337 (interest)). Initial investigation suggests that some of the funds in these related accounts are "unidentified funds" – that is, funds wired into the accounts by individuals or entities with which MBC does not have a Purchaser's Agreement (and which should therefore not be considered pre-closing purchasers' funds). The Receiver subpoenaed Bank of America for its records regarding these accounts on December 16, 2004. Despite a number of assurances from Bank of America's counsel that the documents were forthcoming, Bank of America has produced no documents as of this filing. The Receiver will be filing an appropriate motion to compel the production. Accordingly, the Receiver requests that the Court defer entering any order on the funds in the Bank of America accounts until this discovery has been obtained and the actual nature of the funds in the accounts can be determined.

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5 The bank accounts are both titled "Brinkley McNerney et al. Escrow Account F/B/O Mutual Benefits Corp. Purchasers." Accordingly, the Receiver's accountants have previously included the accounts in a listing of accounts believed to contain pre-closing purchaser funds. However, as a result of subpoenas issued to the banks and a joint interview of Michael McNerney, Esq., it appears that the accounts do not presently contain funds deposited by pre-closing MBC purchasers. The parties are waiting for documentary confirmation of this from Mr. McNerney.

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DISTRIBUTION ISSUES

If the Court determines that the funds in the UPBNA Pre-Purchase Account should be returned to the purchasers, there are a number of administrative issues that will need to be addressed by the Court. The return of the funds is not simply a matter of directing UPBNA to cut checks and mail them to the address in UPBNA's records: the disbursement of the funds will give rise to a number of administrative issues. Some of the administrative issues are as follows:

- **Verification.** A process will need to be put in place to verify the identity of the purchaser before a disbursement is made by check, wire transfer or otherwise, and to confirm that the disbursement has in fact been received by the purchaser. (For example, the Receiver has received, and kept track of, numerous changes of address, changes in "beneficiaries", and other changes in information for MBC's purchasers.)

- **Pooled Investments**. Some of the funds in the UPBNA account were deposited by institutional investors or other entities that have pooled the funds of a number of individual purchasers. The Court will need to determine whether funds should be returned directly to the actual purchasers. If funds are not returned to the actual purchasers, then a procedure should be in place to assure both the Receiver and UPBNA that the actual purchasers will not later bring claims against the Receiver or UPBNA if the institutional investors do not return the funds in their entirety to the individual investors.

- **Finality/Releases.** Once a disbursement is made to a purchaser, both the Receiver and UPBNA should be assured that the purchaser will not make any future claim against either or both of them for their funds in the UPBNA Pre-Purchase Account (although certain purchasers may still have claims for funds placed on closed policies).

- **Set-offs**. Certain of the purchasers (for example, Mutual Benefits Japan Co.) that currently have funds in the UPBNA account were also paid commissions by MBC. These commissions were received for the sale of what this Court has determined to be securities. Commissions for the sale of unregistered securities are subject to disgorgement. *See, e.g., In re Alpha Telcom, Inc.*, 2004 WL 3142555, at *4 (D. Or. 2004). The treatment of rights of set-off relating to that disgorgement will need to be addressed.

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- **"Roll-over" Funds.** The Court will need to determine whether and how to differentiate the approximately $442,778 in "rolled-over" funds that are currently in the UPBNA Pre-Purchase Account. Because these "rolled-over" funds came from death benefits that may have been paid out on insurance policies for which the premiums were paid using *other* investors' funds, such funds stand in a different position than the "new money" in the UPBNA Pre-Purchase Account. The investors as a whole, whose investments were commingled and used to pay premiums on policies, have a much stronger equitable claim to share in such "recycled" money.

- **Assurances Against Disbursements to Defendants.** There should be assurances before disbursements are made that the funds are not being returned to any of the defendants or relief defendants in the SEC Action via a nominee, affiliate or offshore entity.

- **Administrator.** The Court will need to determine who will actually administer the disbursement of the funds.

- **Costs of Disbursement.** The Court will need to determine how the costs of administering the disbursement of funds will be paid. The Eleventh Circuit has held that, in the context of an equitable receivership, the costs and fees may be awarded from the property if the actions are taken to benefit that property. *See SEC v. Elliott*, 953 F.2d 1560, 1576 (11th Cir. 1992).

Accordingly, some mechanism for establishing a procedure, either consensually among the parties, or by judicial direction, will be necessary.

DUE PROCESS ISSUES

If the Court holds that the UPBNA Pre-Purchase Account is a true escrow account, then these funds are not receivership assets and the issue presented to the Court will be the manner and method used to distribute these funds to their owners as outlined above. However, should the Court hold that no true escrow was created, but that nonetheless the funds should be distributed to the original parties depositing those funds, then the Court will also need to rule on the method of notice to all investors in MBC.

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If the Court rules that the funds currently in the UPBNA Pre-Purchase Account are not held in a true escrow, and that legal title to the funds rests with MBC, the funds are receivership assets. *See* Receiver's Response to Order to Show Cause; Receiver's Objections to Report & Recommendation. Due process dictates that anyone having a possible interest in those funds must receive notice, and have an opportunity to be heard, on the proposed interim distribution of receivership assets. This does not, however, require a plenary proceeding on the issue.

In *Securities and Exchange Commission v. Elliott*, 953 F. 2d 1560, the Eleventh Circuit considered the objection of several investors to a receiver's Final Plan for Distribution of Assets and the Order approving that Plan. In that case the receiver proposed taking assets, including those directly traceable to investors, and use all the assets to distribute to investors. The first issue the Court had to consider was the argument of several investors that their property had been taken without due process of law.

In the procedure used by the *Elliott* receiver in proposing the plan of distribution when all claims had been filed and reviewed, the receiver notified all claimants of the proposed plan, together with

> fill in the blank pleading forms for filing objections within thirty days of the notice. After the objections were filed, the Receiver responded by briefing the district court on the factual and legal issues raised in the objections. In some cases, the claimants replied to the receiver's response to their objections. Then the district court entered its Order Establishing final Plan for Distribution of Assets.

953 F. 2d at 1566.

In finding that the summary procedures employed by the District Court satisfied the investors' due process rights, the Eleventh Circuit stated:

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> Thus, a district court does not generally abuse its discretion if its summary procedures permit parties to present evidence when the facts are in dispute and to make arguments regarding those facts.

Id. at 1567.

Accordingly, if this Court orders a partial, interim distribution of receivership assets, the Court should also direct the procedure by which all creditors receive notice of the proposed distribution and an opportunity to be heard.

CONCLUSION

The Receiver respectfully submits that the discovery process has not resolved the issue of whether the UPNA Pre-Purchase Account is a true escrow. Accordingly, if the Court determines that legal title to the funds rests with MBC, any distribution of those funds will be based on equitable considerations, made in a vacuum, as the balance of the claims and the assets of the Receivership Entities have not been fully assessed due to the delays caused by the litigation. Such a decision carries with it associated administrative and due process issues that must be addressed.

Wherefore, the Receiver respectfully requests this Court enter an order rejecting Judge Garber's Report and Recommendation dated December 17, 2004, or, if the Court accepts the Report and Recommendation, then the Receiver respectfully requests that any order regarding the disbursement of funds either (a) allow 10 days for the parties to submit memoranda to the

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Court regarding disbursement procedures, or (b) set a status conference on these and any other disbursement issues the parties may raise.

DATED this 16th of February 2005.

Respectfully submitted,

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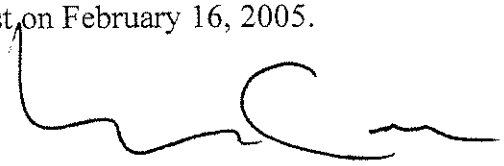
CERTIFICATE OF SERVICE

WE HEREBY CERTIFY that a true and correct copy of the foregoing was served in accordance with the attached Receiver's Service List on February 16, 2005.



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