UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO.: 04-60573 CIV-MORENO/SIMONTON

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MUTUAL BENEFITS CORP., et al.,

Defendants,

VIATICAL BENEFACTORS, LLC, et al.,

Relief Defendants.
_____/

RECEIVER'S MOTION TO APPROVE PROCEDURE FOR DISPOSITION OF POLICIES, DISTRIBUTION OF PROCEEDS OF POLICIES, AND TREATMENT OF PREMIUM FUNDS
Memorandum of Law included

The Receiver, Roberto Martínez, moves this Court for entry of an Order Approving the Receiver's proposed Procedure for Disposition of Policies, Distribution of Proceeds of Policies, and Treatment of Premium Funds. In support of the relief sought in this Motion the Receiver submits the following for the Court's consideration.

SUMMARY OF RELIEF REQUESTED

As discussed herein, the Receiver has faithfully and diligently preserved the assets of the Receivership estate. This motion addresses the proposed liquidation of that estate, which must be accomplished expeditiously, because cash reserves are dwindling.

The Receiver presently controls over 7000 insurance policies (as categorized below), $5,885,295 in proceeds of policies that have "matured" during his tenure, and $70,649,668 in funds held in escrow for payment of premiums.

The policies in the Receiver's control fall into the following ownership categories:

Category A: Policies where record beneficial ownership is in the name of the investor.

Category A1: 160 Policies having a face value of $12,746,408, where both legal title and record beneficial ownership is in the name of the investor.

Category A2: 67 Policies having a face value of $5,345,166 titled in the name of the insured where the record beneficial owners are the investors.

Category A3: 4,770 Policies having a face value of $528,483,849 in the name of nominee owners (e.g, Livoti) where the record beneficial owners are the investors.

Category B: Policies where the policies are titled in the names of Insiders1, and the recorded beneficial interest is held by nominees.

Category B1: 13 policies having a face value $1,596,937 where MBC is nominee beneficiary.

Category B2: 32 policies having a face value of $57,803,767 where Livoti is nominee beneficiary.

Category B3: 469 policies having a face value of $761,417,171where there are institutional nominee beneficiaries (Union Planters or American Express)

Category C: Policies where MBC or an Insider is the record owner and record beneficiary, and the actual, not nominee, beneficiary or owner[2], or where no interest was assigned to a beneficiary.

Proposed Disposition of Assets: For the reasons set forth herein, the Receiver requests an order confirming (i) that policies (and proceeds of matured policies, subject to possible

surcharge) in Categories A1 and A2, and those in Category A3 holding irrevocable beneficial interests belong to the record beneficiaries and owners, but that, subject to their consent, the Receiver can sell those interests; and (ii) that all other policies (and their proceeds, where they have matured) can and should be liquidated by the Receiver with the net proceeds distributed *pro rata* for the benefit of all persons holding allowed claims against the Receivership Entities. The Receiver further requests an order confirming that all premium escrow funds in the Receiver's control be similarly available to the Receiver for the benefit of all persons holding allowed claims against the Receivership Entities.

Finally, the Receiver requests Court approval of the specific Disposition Procedures described in detail herein. This includes a process for sale of the policy interests of owner/investors in Category A, or to the extent the owner/investors object to such sale, a process for distribution of those interests. Since a distribution will require the continued servicing of policies, including payment of premiums, the Receiver is also proposing a process for the investors in those categories to continue to have policies serviced if those investors object to their interests being sold by the Receiver.

PROCEDURAL HISTORY AND CURRENT STATUS

On May 4, 2004 this Court entered a Temporary Restraining Order and Other Emergency Relief (the "TRO") [D.E. 25], together with its Order Appointing Receiver ("OAR")[D.E. 26], appointing Roberto Martínez as Receiver of Mutual Benefits Corp. ("MBC"), Viatical Services, Inc. ("VSI") and Viatical Benefactors, LLC ("VBLLC"). The OAR placed under the Receiver's administration "all MBC, VBLLC and VSI property, assets and estate, and all other property of

1 Insiders include MBC, VSI, VBLLC, Livoti as well as all the relief defendants, and their affiliates.

MBC, VBLLC and VSI of every kind whatsoever and wheresoever located belonging to or in the possession of MBC, VBLLC and VSI, . . ." and directed the Receiver "to administer such assets as is required in order to comply with the directions contained in this Order, and to hold all other assets pending further order of this Court...". The assets placed under the control of the Receiver included bank accounts at several banks, and approximately 7500 viaticated insurance policies. On February 2, 2005, this Court entered its Order Expanding Receivership to Include Livoti Entities (D.E. 694), recognizing that the purpose of the Order Appointing Receiver was to give the Receiver full control and authority over all insurance policies purchased though MBC, including those for which Anthony M. Livoti, Jr. or Anthony M. Livoti, Jr., P.A. (hereinafter "Livoti") serves as trustee or owner of record for the policies.

On February 14, 2005 this Court entered its Order Granting Motion for Preliminary Injunction [D.E. 712] (the "Preliminary Injunction Order"), sustaining the Report and Recommendation of Magistrate Judge Barry Garber dated November 10, 2004 [D.E. 522], as supplemented on November 16, 2004 [D.E. 529].

Between the time when the TRO was entered, and entry of the Preliminary Injunction Order, the Receiver has, to the extent possible, maintained the status quo. Consistent with the directive of the OAR (as clarified and amended by subsequent orders), the Receiver has maintained all insurance policies and serviced and tracked all policies. This has included the payment of all premiums, when required, to prevent policies from lapsing, and the collection of all death benefits for policies that have matured since entry of the TRO.

As the Receiver has previously advised the Court, it is no longer possible to maintain the

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2 This group of policies are actually a subset of categories A and B.

status quo. The funds the Receiver are holding will be exhausted in the near future, as detailed in the Fourth Report of Receiver. Furthermore, the Receiver has now been able to develop a database analysis of the legal and beneficial titles to the policies, a copy of which is attached as **Exhibit A** to this Motion, and the Receiver is now in a position to make a recommendation regarding the disposition of the policies, the proceeds of those policies, and the treatment of funds held in "premium escrow accounts;" the financial circumstances require that the disposition process begin as soon as practicable.

RECEIVERSHIP ASSETS VS. NON-RECEIVERSHIP ASSETS

The general rule is that, upon appointment, a receiver acquires no greater rights in property than was held by the debtor. *Javitch v. First Union Securities, Inc.*, 315 F.3d 619 (6th Cir. 2003). The receiver holds receivership property by the same right and title as the corporation for which property the receiver was appointed to administer, subject to the same liens and equities. *Powell v. Maryland Trust Co.*, 125 F.2d 260 (4th Cir. 1942); *Witherspoon v. Choctaw Culvert & Machinery Co.*, 56 F.2d 984 (8th Cir. 1932). Accordingly, the receiver stands in no better position than the debtor with regard to the assets in the receivership. *Glenn Justice Mortgage Co., Inc. v. First National Bank of Fort Collins*, 592 F.2d 567 (10th Cir. 1979); *Eschew v. Harrison Securities Co.*, 79 F.2d 777 (9th Cir. 1935). Where a person or entity has a lien or beneficial interest in property under the receiver's control, the receiver holds the property for the benefit of the person or entity lawfully entitled thereto. *Powell,* 125 F.2d at 271.

In instances where legal ownership under applicable law is based on equitable, rather than actual legal, principles, equity allows, and at times dictates, that those assets become available to the receiver to liquidate for the benefit of all victims.

The case *SEC v. Elliott*, 953 F. 2d 1560 (11th Cir. 1992), arose out of a fraud perpetrated by Mr. Elliott. In one of his schemes, Elliott tricked investors into signing over ownership of securities and other assets to him, while the investors believed they were merely giving him a power of attorney to invest the securities. In return, Mr. Elliott delivered "notes" on which he would pay interest to reflect the investors' return on investments. But Elliott was actually just selling the securities rather than using them for investment purposes. When the SEC stepped in, there were some securities that Elliott had not yet transferred to third parties. Several investors sought the return of those securities on the basis of rescission and fraud in the inducement or, alternatively, on the ground that the investors actually had retained legal title to their securities. The district court found that the investors had transferred legal title to the securities to Elliott whether or not they had intended to, and that they were therefore unsecured creditors of the receivership. The Eleventh Circuit agreed. The Eleventh Circuit also rejected the rescission argument and held that it was not an abuse of the district court's discretion to disallow tracing of specific investor funds to specific securities.

Citing the original Ponzi case, *Cunningham v. Brown*, 265 U.S.1, 44 S.Ct. 424, 68 L.Ed. 873 (1924) the Circuit Court noted

> A district court has broad powers and wide discretion to determine the appropriate relief in an equity receivership...
>
> The Supreme Court has recognized that, in equity, certain tracing rules should be suspended.... [T]he Supreme Court recognized that since [the creditors invoking rescission or tracing] occupied the same legal position as other creditors, equity would not permit them a preference; for "equality is equity".

953 F.2d at 1569-570.

In the case *SEC v. Forex Asset Mgt. LLC*, 242 F.3d 325 (5th Cir. 2001) the Whitbecks were duped into investing funds with Forex Asset Management, LLC ("Forex"). After an initial investment appeared successful, the Whitbecks gave Forex $800,000 more. The $800,000 was the only deposit made into a particular account. Subsequently $750,000 of the $800,000 was moved to another account, in which the $750,000 was the sole deposit. In the ensuing SEC receivership, the receiver recommended that all assets, including the Whitbecks' $800,000, should be distributed *pro rata* to all investors. The Fifth Circuit held that the district court's approval of the receiver's proposed *pro rata* distribution was not an abuse of discretion.

Citing a prior case it had decided, *United States v. Durham*, 86 F. 3d 70 (5th Cir. 1996) the Fifth Circuit noted that "the district court, acting as a court of equity, was afforded the discretion to determine the most equitable remedy." 242 F. 3d 332, which for the Whitbecks meant that the Court would not recognize either tracing or an equitable lien on the funds that had clearly come only from them.

The case *Liberte Capital Group v. Capwill*, 229 F. Supp.2d 799 (N.D. Ohio 2002) involved a viatical related Ponzi. In this case the Court held that equity requires a *pro rata* distribution of the rights in viaticated insurance policies rather than a distribution based on tracing. In *Capwill*, the company in receivership was apparently the nominee owner and beneficiary on various viaticated life insurance policies. Apparently, investors knew the policies to which their investments were "assigned" and were told that they were the named beneficiaries on the policies.

During the course of the receivership, the receiver needed to use receivership funds to pay premiums on various policies, and, in fact, received the court's permission to pay premiums for unmatured policies from the proceeds of policies that matured during the receivership. The receiver

ultimately proposed a *pro rata* distribution of the proceeds of the policies. Several investors objected, arguing that a constructive trust should be imposed on the proceeds of those policies that could be traced to their investments. In certain instances, the investors apparently also argued they were the record beneficial owners.

The district court rejected the argument that tracing should apply. Citing *Elliott, Forex,* and *Cunningham,* the court held that, "in instances where tracing places one party in a superior position over another victim, equity dictates tracing rules be suspended." *Capwill, supra,* 229 F.Supp. at 803. The court also found that tracing was not feasible, due to the cross-funding of premiums.

The *Capwill* court also held that the investors were not the actual owners of the beneficial interests in the policies, but even if they were, equity allows the suspension of applicable state law remedies. The court cited *Elliott* and *U.S. v. Vanguard Inv. Co.*, 6 F.3d 222 (4th Cir. 1993) in support of this latter proposition.[3]

Based on the holdings of *Cunningham* and its progeny, the Receiver submits that equity dictates all policies other than those for which actual legal and beneficial title is held in the name of irrevocable beneficiaries and non-Insiders, should be liquidated for the benefit of all investors, and that all funds remaining in the premium fund account similarly be used for the benefit of all investors. To do otherwise would be to prefer one set of victims over another.

THE ASSET ANALYSIS

THE POLICIES

The database reflects that the policies fall into the following ownership categories:

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3 In each of those cases the "suspended" state law remedy was rescission based on fraud – another equitable remedy. Neither *Vanguard* nor *Elliott* holds that equity could suspend an actual legal property right; in each instance the Court reviewed competing equitable remedies.

Category A: Policies where record beneficial ownership is in the name of the investor

Category A1: Policies where both legal title and record beneficial ownership is in the name of the investor

Category A2: Policies titled in the name of the insured where the record beneficial owners are the investors

Category A3: Policies in the name of nominee owners (e.g, Livoti) where the record beneficial owners are the investors

Category B: Policies where the policies are titled in, and the recorded beneficial interest is held by, nominees.

Category C: Policies where MBC or an Insider is the record owner and record beneficiary, or the actual, not nominee beneficiary, or where no beneficial interest was "assigned" to an investor.

Category A: Policies in Which Investors Hold Record Beneficial Ownership

The vast majority of policies (6,617 out of 7131) are beneficially owned on the records of the insurance companies by the investors (or by their designated IRAs). The face value of these policies is $ 716,915,977.00; 6310 of these polices are AIDS policies and 770 are non-AIDS policies. Over 90% of investors hold policy interests that fall in Category A. The legal (record) ownership of these policies resides in either (i) the investor, (ii) MBC, or (iii) MBC affiliates and Insiders. Approximately 90% of the beneficial interests in the AIDS policies are irrevocable. It is the Receiver's position that, in each instance where the beneficial interest is irrevocable, or the record owner of the policy is the investor, the interest in these policies belong to the investors. In those instances where an Insider is the record owner and the beneficial interests are revocable, the interests in those policies must be liquidated for the benefit of all investors.

1. Category A1: Investor Holds Legal and Beneficial Title

There are many policies where the investor is both the legal owner and the record beneficial owner. Under applicable law, these policies are not assets of the receivership entities, or assets that the Receiver can liquidate for the benefit of all investors, but rather assets of the record beneficial and legal owners as their rights appear under applicable law.

2. Category A2: Insured Holds Legal Title; Investor Holds Beneficial Title

There are some instances, in the case of group policies, where the owner of record continues to be the insured. The record beneficial ownership of each of these sixty-seven (67) policies is held in the name of the insured, and these beneficial interests are irrevocable. These policies are administered in the same way as other policies. Under applicable law, these policies are assets of the record beneficial and legal owners as their rights appear under applicable law.

3. Category A3: Insider Holds Legal Title; Investor Holds Beneficial Title

This group consists of policies owned of record by Livoti, MBC, VBLLC, or Les Steinger. It is the Receiver's understanding that for every Livoti-owned policy, there is a trust agreement (described in more detail below) between Livoti and the investors. The Receiver has not been able to locate any such agreement between investors and other Insider owners. However, the Receiver believes that the existence of the Trust Agreement doesn't change the analysis, because Livoti is an Insider.

In those instances where the beneficial ownership in a particular policy is irrevocable, under applicable law the beneficial ownership resides in the investor. Conversely, in those instances where the beneficial interest is revocable, and an Insider is the owner, control of that beneficial interest resides with the Receiver, and, under applicable law, those interests can and should be made

available for the benefit of all investors.

Category A3 includes eight (8) policies owned by either Life Settlement Alliance or Dignity Partners. These policies have been administered through the Receivership Entities and VSI has been monitoring the premium payment obligations. The premiums of the LSA policies have been paid out of MBC operating funds. Based upon recent deposition testimony, the Receiver believes LSA is controlled by an Insider. Thus, policies in which LSA holds record ownership should be treated the same as other Insider-owned policies. If LSA disputes its Insider status then LSA must reimburse MBC for all premiums paid in connection with LSA policies and begin to pay VSI a servicing fee.

Apparently MBC purchased the Dignity Partners/ viatical portfolio of policies many years ago. The Receiver has not been able to determine why the policies are still titled in the name of Dignity Partners or its trustees/agents Bankers Trust Company or Deutsche Bank Trust Company Americas. Since MBC did purchase these policies MBC should be considered the record owner.

Category B: Nominee Beneficiaries Hold Record Beneficial Ownership

Category B comprises policies in which the actual beneficiary is a nominee, whether it is Livoti, another Insider, Union Planters Bank, NA ("Union Planters") or American Express Tax and Business Services ("American Express"). There are 514 such policies, with a total face value of $821,817,875.

MBC is the beneficiary of 13 of these policies, with a combined face value of $1,596,937. Livoti is the named beneficiary of 32 of these policies, having a total face value of $57,803,767. Either Union Planters or American Express is the beneficiary on the remaining policies. In each instance where Union Planters or American Express is the beneficiary, the owner of the policy is

Livoti. All of the beneficial interests of Union Planters and American Express are revocable interests.

Because the beneficial interests of Union Planters and American Express are revocable, the owner, Livoti as trustee, has the ability to change the beneficial ownership of these policies. Thus, the authority to change the beneficial ownership on these policies, as well as those in which MBC and Livoti are nominee beneficiaries, now rests with the Receiver, which authority, equity dictates, should be used to liquidate the policies for the benefit of all investors.

A review of the applicable documents is helpful to understand the manner in which these interests were created and held.

Each investor signed a Purchase Agreement with MBC that contemplates the designation of nominee beneficiaries in certain instances. A copy of the latest version of the Florida Purchase Agreement is attached as **Exhibit B**. The Purchase Agreement provides that "the only benefit the Purchaser will receive pursuant to this Agreement will be payment of the agreed portion of the death benefit upon the maturity of the life insurance policy(ies)." MBC's stated role is to "assist Purchaser in the purchase of the death benefit. . ." The purchaser authorizes MBC to "enter into any agreements or contracts which may be necessary for the purchase of death benefits on behalf of the Purchaser. . ."

Paragraph 27 of the Purchase Agreement provides for the designation of nominee beneficiaries, and states:

> Some life insurance companies limit the total number of beneficiaries that may be recorded on a single life insurance policy. In this event, the Purchaser agrees that Mutual Benefits Corp. may designate and record as the beneficiary of record in the place of the Purchaser either the owner of the policy, a trustee, a bank or an escrow agent to receive payment of the

death benefit from the insurance company on behalf of the Purchaser and/or to disburse to the Purchaser his/her share of the life insurance policy(ies) death benefit.

The database reflects that the Category B policies fall into three sub-categories, based on the identity of the nominee:

Category B1: MBC is nominee

Category B2: Livoti is nominee

Category B3: Institutional nominee (Union Planters or American Express)

1. Category B1: Policies Where MBC is Nominee Beneficiary

The case law cited above clearly supports the Receiver's position that the policies in which MBC is the nominee owner are assets available for *pro rata* distribution because there is no agreement between MBC and the purchasers that MBC will act as the nominee beneficiary, thus MBC is the beneficiary under the policies.

2. Category B2: Policies Where Livoti is Nominee Beneficiary

Livoti serves as nominal beneficiary on 32 policies with a face value of approximately $58 million. As mentioned *supra*, the Receiver understands that Livoti has a trust agreement with the investor on each policy. However, the Livoti Trust Agreement does not alter the fact that Livoti held, and now the Receiver is the holder of, the beneficial interest in these policies.

The agreement between Livoti and MBC is a simple letter agreement dated June 25, 1996 (the "Livoti Letter Agreement"). The Livoti Letter Agreement merely provides that Livoti will agree to "act according to the Trust Agreement which will be executed by the beneficiaries, Mutual Benefits Corp. and myself." The Trust Agreement (the "Livoti Trust Agreement") is attached to the Livoti Letter Agreement. MBC is not a party to the Livoti Trust Agreement. A copy of the Livoti

Letter Agreement, with a copy of the Livoti Trust Agreement are attached as **Composite Exhibit C**.

The Livoti Trust Agreement echoes paragraph 27 of the Purchase Agreement and provides that the Purchaser acknowledges that:

> ... the Trustee, a bank or an escrow agent may be designated and recorded as the beneficiary of record in the place of the Purchaser and as such may receive payment of the death benefit from the insurance carrier on the Purchaser's behalf and will disburse to the Purchaser his/her share of the life insurance policy(ies) death benefit.

The Livoti Trust Agreement further provides:

> When the Trustee is notified of the death of an insured, the Trustee shall assist the Purchaser in being paid the Purchaser's pro rata share of the death benefit payable under the life insurance policy(ies) in which the Purchaser has acquired an interest.

The Court has previously ruled that Livoti, as trustee, is a receivership entity. Livoti, as trustee, served at the pleasure of MBC pursuant to a written letter agreement. Livoti was compensated for his services by MBC. Thus, the Receiver now controls Livoti's position as trustee.[4]

3. Category B3: Policies With Institutional Nominee Beneficiary

The agreements MBC has with Union Planters and American Express are virtually identical regarding the respective institutions' obligations as nominee beneficiaries, and provide that:

> [T]he Escrow Agent [*i.e.*, American Express or Union Planters] may be designated and recorded as the beneficiary of record on behalf of purchasers for the life insurance policy death benefits purchased by MBC and agrees to execute all insurance company forms or documents necessary to transfer and record Escrow Agent as the beneficiary of life insurance policies purchased by MBC as designated.

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4 In its Response in Opposition to Receiver's Motion to Clarify Order Appointing Receiver, Traded Life Policies ("TLP") dismisses as irrelevant to the analysis the fact that this Court has previously ruled, with no objection, that Livoti, as Trustee is a receivership entity. TLP's position is wrong. However, even were Livoti, as Trustee not a Receivership Entity, as otherwise noted herein, Livoti served at the pleasure of MBC and its principals and was paid by them, and accordingly, the result would be the same even if Livoti, as Trustee were not a receivership entity.

The agreements further provide:

> When Trustee, MBC or Law Firm has advised Escrow Agent that an Insured has died, Escrow Agent shall execute a claim as beneficiary on behalf of purchasers and mail the claim for death benefits to the appropriate insurance company using the documentation prepared by MBC or Trustee and delivered to the Escrow Agent for this purpose, and when the Escrow Agent receives payment of such claim, Escrow Agent shall deposit such payment in the Beneficiary Escrow Account and promptly pay (and no later than thirty (30) days of receipt by Escrow Agent of cleared funds), upon clearance of the funds, the individuals set forth on the case file disbursement instructions provided by Trustee at the addresses and amounts shown thereon.

¶Paragraph 15 of the Purchase Agreement, which describes the escrow agent's duties, states:

> Purchaser appoints [UPNBA] as Escrow Agent for the purpose of holding funds for the purchase of the death benefit of a life insurance policy(ies). The sole responsibilities of the Escrow Agent are: . . . (e) When so designated, act as beneficiary of record for the Purchaser(s) and receive and disburse payment of the life insurance policy death benefit(s).

Copies of the American Express and Union Planters Agreements are attached as **Exhibit D** and **Exhibit E** respectively.

Neither Union Planters nor American Express has any formal "agreement" with the investors. However, each institution issued beneficiary certificates to investors, each of which is signed (either specimen signature or personally) by an agent of the institution, which is identified as "escrow agent". Those certificates state:

> [U]pon notification of maturity of this policy, [American Express/Union Planters] will receive the death benefit and disburse it to you in accordance with the following designation [which has the investor's details, including percentage of allocated interest in the policy].

Specimen copies of these certificates are attached as **Composite Exhibit F**.

However, the beneficial rights of American Express and Union Planters Bank exist at the pleasure of Livoti, who, at any time, could have changed the beneficial interests of American Express and Union Planters Bank so that, upon maturity of the policies, neither would have received benefits which could then be distributed to investors.

Thus, these policies should be liquidated for the benefit of all investors in accordance with the proposed Disposition Procedures outlined below.

Category C: Policies Owned by MBC and Insiders

The third category of policies, although really a subset of categories A and B, are those policies that are assets of MBC and Insiders. There are many instances where either at the initial time of investment, or on those rare occasions when MBC would provide an investor with a refund, or when additional interests were generated by a policy as a dividend, MBC retained or received a partial or complete beneficial interest in a policy. These interests are clearly receivership assets, which the Receiver has the authority to sell.

In addition, there are some policies, most of which were closing around the time the Receiver was appointed, interests in which were never assigned by MBC internally, or, if assigned by MBC internally, were never funded by Union Planters.[5] These interests are also receivership assets, which the Receiver has the authority to sell.

PROCEEDS OF MATURED POLICIES AND SURCHARGE RIGHTS

The analysis of the rights to proceeds of matured policies is the same as the analysis of the

5 The Receiver has agreed that unfunded purchase money should be returned to the investors in accordance with this Court's Order Requiring Union Planters Bank to Disburse Funds [D.E. 727]. Accordingly, as the Defendants pointed out in one of their pleadings, these investors should not receive the windfall of the return of their escrowed funds plus a claim arising from an "interest" in a policy.

policies themselves. Accordingly, proceeds of matured policies that are currently being held by either the Receiver or the Court, together with any allocable interest earned on those proceeds, should be turned over to the investor holding the interest in the policy, if, in fact, the policy was one in which the investor held an irrevocable beneficial interest, but only after the Receiver has determined his surcharge against those particular proceeds. As illustrated in the *Capwill* case discussed above, it is appropriate for the Receiver to seek to recoup from the proceeds of a matured policy that portion that relates to the amount of funds used to pay the premiums that were not funds otherwise allocated to that policy at the time the policy was purchased. Should the Court approve the Receiver's ability to seek such a surcharge, then, by separate motion, and notice to all affected investors, the Receiver shall identify the amount of the appropriate surcharge and the manner in which such surcharge was calculated. The Receiver's right to surcharge should extend to all proceeds of matured policies until the policies are sold or transferred, including proceeds currently being withheld by insurance companies. Proceeds of all other matured policies should be held by the Receiver for *pro rata* distribution to all investors.

THE PREMIUM FUNDS

The final asset subject to the Receivership administration addressed in this Motion are the funds currently held in so-called "premium escrow account". The Receiver submits that these funds are assets that should be held for the benefit of all investors and available for administration of the Receivership, the collection of other assets, including litigation, and ultimately *pro rata* distribution to all investors. Equity dictates that these remaining premium funds should not be subject to "tracing" by investors who own policies that may not be "out of escrow" yet, because to do otherwise would "prefer one set of victims over another". The Receiver's position is undisputedly supported

by the law and the facts and circumstances surrounding the deposit and use of these funds, and the contracts pursuant to which these accounts were created.

According to all the documentation and evidence, MBC used its funds to pay premiums, whether through the artifice of "premium escrow accounts" or directly from its operating account. The "escrowed" funds were all commingled together with any funds that might have otherwise gone into the non-existent premium reserve account.

The Ponzi scheme was based on fraudulently understated life expectancies, and the "premium escrow reserve" was at the heart of the scheme. The ability to continue to pay premiums depended upon generation of additional investor funds, and when the flow of investor funds ran dry, the commingled funds began to dry up as well.

While the investors had a contractual expectation the premiums would be paid (at least up to a point), the investors did not, and do not, have an ownership interest in the premium funds. Indeed there is no equitable way that these funds could be allocated. There is no possible way, since the funds were commingled, to determine what funds from what policies that had, in theory, premium funds still available, were used to fund premiums for policies whose premium funds either never existed or had been exhausted. This, together with the factors summarized below, overwhelmingly illustrate that, under applicable law, equity not only allows, but dictates, that these funds should be held for the benefit of all investors, to support administration of the Receivership, the Disposition Procedures, collection of additional assets for all investors, and ultimate distribution to all investors.

--- The funds were provided by MBC;

--- The use of the funds was directed by a Receivership Entity (Livoti);

--- The funds were commingled;

--- The applicable documents expressly stated that the investors had no right whatsoever to these funds; and

--- This account has a direct relationship to the Ponzi scheme

Relevant Contractual Provisions

1. MBC Purchase Agreement

The waterfall provision of the 2/05/02 Purchase Agreement[6], attached as Exhibit B, provides that "Mutual Benefit Corp. will escrow with a trustee funds for future premium payments for a minimum of the projected life expectancy of the insured, or longer at the company's discretion . . .", that MBC "has agreed that the interest on [the escrowed funds] and any unused premiums may be retained as a reserve for payment of premiums on those policies . . .", and that VSI "has agreed to establish a premium reserve account to pay unpaid premiums for those policies that exceed their projected life expectancy" if the premium reserve fund runs out. Finally, if the VSI funds are exhausted "the Purchaser may be responsible for payment of his/her *pro rata* share of any unpaid premium."

As discussed in prior Receiver Reports, other than an account held by VSI[7], there are no premium reserve accounts, and all premium escrow funds were commingled, although there was an attempt to relate groups of policies with the MM1, MM2 and Union Planters' accounts.[8]

2. Livoti Trust Agreement

As described *supra*, Livoti has a trust agreement with a great majority of the investors who invested in viaticals and life settlement policies through MBC. The Livoti Trust Agreement states

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6 The form of Purchase Agreement is not identical for each purchaser, but the funds remaining in the Union Planters premium escrow account, the Receiver submits, were all deposited by investors who executed purchase agreements with the same language included.

7 There was approximately $721,000 in this account when the case was filed.

"the Trustee has agreed to hold in escrow future premiums received at the time of the closing for the projected life expectancy of any policy in an interest-bearing account(s)." The Livoti trust agreement echoes the waterfall arrangement described in the Purchase Agreement but also includes a description of how *pro rata* payment of the premiums will be administered:

> If, for any reason, the Trustee cannot confirm that future premiums on any policy will be satisfied from [escrow, reserves, VSI or waivers], then the Trustee will notify the Purchaser ninety (90) days before the next premium is due. Upon receipt of such notice, Purchaser will provide the Trustee with his/her pro rata share of the premium payment. If any Purchaser fails to pay his/her pro rata share of the premium payment, then the other Purchaser(s) on the policy shall have the right to pay the remaining balance due and shall thereafter have the right to recover the amount paid from the delinquent Purchasers. The Trustee shall also have the right, but not the obligation, to pay the pro rata share of any Purchaser(s) failing to pay his/her pro rata share of the premium payment from his own funds.

However, although the agreements set forth the contractual obligations of others to pay the premiums as described in the agreements, the agreements also make clear that the investors have no interest in the premium funds:

> The accrued interest on the Trustee's account, unused premiums and other funds or property held by the trustee are not the property of the Purchaser, and the Purchaser has no right to any funds or property held by the Trustee.

Purchase Agreement, ¶21; Livoti Agreement, ¶5.

In fact, the Purchase Agreement clearly states that MBC is funding the premium escrows (albeit with money raised from investors), and MBC's consent directs interest and unused premium funds to the so-called premium reserve:

¶36: "Mutual Benefits Corp. pays the following costs associated with the closing of

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8 See Second Report of Receiver dated June 29, 2004, [D.E. 209]

> a policy: . . . Premium payments for a minimum of the projected life expectancy of the insured. . . ."
>
> ¶35 : "Mutual Benefits Corp. will escrow with a trustee funds for future premium payments . . ."
>
> ¶21 : "Mutual Benefits Corp. has agreed that the accrued interest and any unused premiums [in the premium escrow account] may be retained as a reserve for payment of premiums on those policies where the insured outlives his/her projected life expectancy. . ."

Thus, the documents are clear that MBC funded the premiums; in some instances it would do so through the establishment of escrow accounts, and the consensual use of interest and the unused premiums to which MBC would otherwise be entitled to fund the so-called reserve.

3. Union Planters Agreement

The Union Planters Agreement provides

> Upon the execution of this Agreement, Escrow Agent shall also establish and maintain one or more additional escrow accounts, as requested by MBC, for the benefit of Trustee [identified as Livoti, or anyone else designated by MBC]. The first such account shall be named "Union Planters Bank, N.A. – Premium Escrow Account". . .. From time to time, funds shall be deposited with the Escrow Agent for premiums for Policies purchased by MBC on behalf of purchasers.

Interest earned on the Premium Escrow Account "shall be designated for the Premium Reserve Sub-Account [a sub-account that was never established]" (para. II.C); "All interest earned on the cash balances held on the Premium Escrow Account shall remain on deposit therein as part of the premium reserve available to pay premiums", (para. II.F.). The Union Planters agreement also states that Union Planters will pay premiums at the direction of the Trustee, and interest earned on the Escrow Account will be attributed to the Trustee's TIN. The Trustee is defined as Anthony Livoti or anyone else that MBC designates in his place. The Trustee served at the pleasure and direction of

MBC.

Thus it is clear that applicable law not only authorizes, but expects, these funds to be made available for the benefit of all MBC investors.

RECEIVER'S AUTHORITY TO LIQUIDATE ASSETS

Peter Lombardi, nominal owner of MBC, has repeatedly asserted that an equity receiver should not liquidate assets of a company in receivership and indeed, that case law dictates that any liquidation should occur in a bankruptcy context. The Receiver submits that Mr. Lombardi is wrong; it is entirely appropriate for the Receiver to liquidate the assets of MBC, VBLLC and VSI in this proceeding, that resort to the bankruptcy courts is unnecessary, and indeed, under these circumstances, would potentially render it impossible to fashion a remedy for the victims of this fraud.

Despite Mr. Lombardi's assertions to the contrary, there is no general rule prohibiting the liquidation of assets by an equity receiver. In fact, equity receivers have many of the same powers as those possessed by bankruptcy trustees, such as the ability to reject executory contracts and unexpired leases. *See Bayshore Executive Plaza Partnership v. FDIC*, 750 F.Supp. 507 (S.D. Fla. 1990) (under federal and state common law, a receiver is not liable for rent accruing after rejection of lease); *FTC v. Metropolitan Communications Corp.*, 1995 WL 571461 (S.D.N.Y. Sept. 27, 1995) (equity receivers appointed under federal law may reject executory contracts); 75 C.J.S. Receivers § 168 (2004) (receiver has option to adopt and assume lease, or not to do so); 44 Fla. Jur. 2d Receivers § 66 (2004) (receiver is entitled to reasonable time within which to affirm or disavow lease).

Receivers can also sell property of the receivership free and clear of liens. *See SEC v. Whitworth Energy Resources Ltd.*, 2002 WL 500543 (9th Cir. Jan. 2, 2002); *SEC v. Tyler*, 2004 WL

859203 (N.D. Tex. April 7, 2004).

Particularly in the context of a Ponzi scheme or other fraud, it is not uncommon for a receiver to liquidate receivership assets. *See SEC v. Capital Consultants, LLC*, 397 F.3d 733 (9th Cir. 2005) (receiver appointed to liquidate entity involved in "junk debt" and ponzi scheme); *SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80 (2d Cir. 2002) (court approved receiver's liquidating plan); *SEC v. Forex Asset Management LLC*, 242 F.3d 325 (order approving receiver's distribution plan affirmed); *Commodity Futures Trading Commission v. Topworth Intl., Ltd.*, 205 F.3d 1107 (9th Cir. 2000) (court affirmed approval of receiver's distribution plan); *U.S. v. Real Property Located at 13328 and 13324 State Highway 75 North, Blaine County, Idaho*, 89 F.3d 551 (9th Cir. 1996) (receiver's plan proposed *pro rata* distribution to victims of fraud); *SEC v. Elliott*, 953 F. 2d 1560 (Receiver's plan to liquidate assets and distribute proceeds approved); *SEC v. Sunco Resource & Energy, Ltd.*, 1990 WL 128232 (S.D. Fla. 1990) (district court approved receiver's plan of distribution of receivership assets).

Receivers liquidate corporations in other contexts as well. *See U.S. v. Royal Business Funds Corp.*, 724 F.2d 12 (2d Cir. 1983) (corporation liquidated in receivership, created under Small Business Investment Act, governed by principles applicable to federal equitable receivers); *State of Florida v. U.S.*, 1989 WL 91135 (S.D. Fla. 1989) (corporation liquidated by receiver appointed upon finding of violations of the Florida Security and Investment Protection Act); *U.S. v. Vanguard Investment Co., Inc.*, 694 F.Supp. 1219 (M.D.N.C. 1988) (small business investment company liquidated by receivership, rather than bankruptcy court, where business was to be dissolved).

Whether or not it is appropriate for a federal court to allow the liquidation of a corporation by a receiver depends upon the circumstances of each case. *SEC v. Bartlett*, 422 F.2d 475, 478 (8th Cir.

1970), and numerous courts have rejected arguments similar to those raised by Mr. Lombardi that a liquidation should be conducted only in bankruptcy. For instance, in *SEC v. Lincoln Thrift Assoc.*, 577 F.2d 600 (9th Cir. 1978), the court distinguished the facts from those in *Los Angeles Trust Deed Mortgage Exchange v. SEC*, 285 F.2d 162 (9th Cir. 1960) and *Esbitt v. Dutch Am. Mercantile Corp.*, 335 F.2d 141 (2d Cir. 1964), cited by Mr. Lombardi, and upheld the district court's refusal to transfer the liquidation to a bankruptcy court. Other cases cited by Mr. Lombardi also recognize that receivers can and do conduct liquidations. *See SEC v. Bartlett*, 422 F.2d at 479 (court refused to vacate receivership where receiver made substantial progress toward liquidating corporation); *SEC v. TLC Investments and Trade Co.*, 147 F. Supp. 2d 1031 (C.D. Cal. 2001) (liquidation by receiver, without resort to bankruptcy, was appropriate); *SEC v. Elliott*, 1987 WL 46231 (S.D. Fla. 1987) (motion to convert receivership to bankruptcy proceeding denied).

Moreover, the structure of bankruptcy would make it impossible to effectuate a relief for the investors. The definition of who may be a debtor is dictated by 11 U.S.C. §109. "Anthony Livoti individually, and Anthony Livoti, P.A., solely in their capacity as trustee" could not qualify as a debtor under the Bankruptcy Code9. Consequently, any bankruptcy trustee would need to demonstrate to the bankruptcy court the ability to take control of the Livoti, as Trustee, interests, in order to administer the policy interests, whether as proposed herein or otherwise. That outcome is not guaranteed. Conversely, in this case, the Court has ruled, with no objection, that Livoti, as Trustee is a receivership entity, giving the Receiver the responsibility and control over those assets that are assets of Livoti, as Trustee.

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9 Title 11 of the United States Code.

Mr. Lombardi also suggested that the "ad hoc procedures" of an SEC enforcement action receivership "is not an appropriate method for the complex reorganization of business corporations that control more than $1.5 billion in assets and which have more than 29,000 potential creditors. . .."[10]

A similar issue was addressed by the 11th Circuit in the *Elliott* case. In that case several investors protested that the manner in which the Court reviewed the Receiver's proposed liquidation and distribution of assets under his control violated their due process rights. The Court held that the summary proceedings employed by the Court were acceptable because all investors were given notice of the proposed distribution and an opportunity to be heard.

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:

> 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.

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10 Defendant Peter Lombardi's Motion for Leave to File Petition for Bankruptcy Protection. [D.E. 705].

The *Elliott* court cited another case, *SEC v. Universal Financial,* 760 F.2d 1034 (9th Cir. 1985), where the district court and receiver used two test cases for the assets the receiver asserted were not owned by investors. In each instance the court noted that summary proceedings, where investors received notice, were permitted to take discovery, and be heard, satisfied due process. Thus, the "ad hoc" procedures of an SEC enforcement action satisfy the requirements of a complex case so long as all parties in the interest have an opportunity to be heard.

In this case, the Receiver submits the Disposition Procedures outlined below will duly satisfy the due process rights of all investors.

PROPOSED DISPOSITION PROCEDURES

Upon entry of the Court's order granting the relief herein requested, the Receiver will implement the Disposition Procedures.

Disposition of Policies owned by investors and insureds or held by irrevocable beneficiaries

As illustrated on the attached database, there are 227 policies that are owned by investors and insureds. All but 15 of these policies are AIDS policies. Only five of these 227 policies have more than ten beneficiaries. There are 67 other policies where the investors hold irrevocable beneficial interests. Based on conversations that the Receiver and his professionals have had with many people in this field, there is virtually no market for AIDS policies; any one interested in purchasing these types of policies buys them at a very low rate (usually between 4% and 8% of face value).

There are three options available to owners of this category of policies – the owners

can allow the Receiver to try to sell these policies for them; they can assume, subject to arrangement with the beneficiaries, responsibility to pay the premiums, if any,11 and a servicing fee associated with that ownership; or the policies will be allowed to lapse. These options will be described in a notice substantially in the form attached hereto as **Exhibit G,** and served on all affected investors.

1. Sale of the Policies

Because most of the policies that fall in this category are worth very little, the Receiver believes it is in the best interest of this group of investors to allow the Receiver to try to sell the policies for them. However, should an investor object to the Receiver selling his, her or its interest, the investor, in accordance with the notice attached as **Exhibit G,** may file an objection to the proposed disposition by the Receiver. If such a notice were received from a beneficiary or owner of a policy with other investors holding some interest in the same policy, the Receiver would provide notice to all other investors associated with that policy of the objection. All parties would then have the opportunity to appear and discuss the treatment of their equity interest.

2. Continued Ownership of Policies

Should an investor seek to continue ownership or assume ownership of the policy, the policy cannot be transferred outright to the investor or investors. Ownership of the policies carries with it the responsibility to pay any premiums due. That obligation is one that at least some of the investors assumed to pay when the premium funds ran out. In fact, as the attached database illustrates, virtually all of these policies either never had funds placed in

11 As the attached database illustrates, there are some policies on permanent or current premium waiver.

"escrow" accounts to pay premiums, or those funds have been exhausted.

Control of these viaticated policies cannot just be surrendered to the owners; thus the Receiver will advise the investor/owners, when making their choice to assume control of the policies, that they will either need to identify a servicer approved by the Department of Insurance Regulation, or, as outlined below, VSI will continue servicing the policies, at least until the receivership is concluded.

3. Lapse of the policies

The Receiver proposes to continue to pay premiums on all policies until the Disposition Procedures are completed so that investors have the opportunity to make a decision regarding their policies. However, it is not equitable to ask the other investors to carry the cost of these policies forward, nor will it be practicable, certainly once the Receivership is concluded. Accordingly, if the investors do not choose to keep and service, or sell, their interests in these policies, the policies will be allowed to lapse.

Disposition of all other policies

As outlined above, the Receiver submits that he has the authority to sell all the interests in all policies that are not owned by investors or the insureds, and which are not held by beneficiaries irrevocably. The Receiver proposes to sell the policies through the use of a stalking horse bidder and an auction process, which will be set up to proceed in stages.

In the first stage the Receiver will complete his interview of various potential stalking horse bidders. The Receiver will give each potential bidder the opportunity to present their best proposal for disposing of the portfolio. Each potential bidder will be required to sign an appropriate confidentiality agreement.

Once the potential stalking horse bidders have submitted their proposals, the Receiver will determine which proposal the Receiver believes would create the maximum benefit for the investors.

The Receiver will then file a motion with this Court seeking approval of the stalking horse bidder and approving an auction process for the sale of the policies. This motion will include the approval of any expense reimbursement or other consideration to the stalking horse bidder, as well as the requirements that must be satisfied by any other party seeking to bid.

Once the Court enters the order approving the stalking horse bidder and the auction procedures, the Receiver will then publicize the portfolio for sale. A final hearing on approval of the sale to the stalking horse bidder or any other successful bidder at the auction will be scheduled to immediately follow the auction.

The Receiver anticipates the entire process, through closing, should be completed within nine months of entry of the Order granting the relief sought herein. In order to satisfy due process, every investor will receive notice of the motion to approve the stalking horse bidder and the auction process as well as notice of the auction and final hearing to approve the sale. This will give investors the opportunity to raise objections to the proposed disposition of the assets as well as the process.

ADMINISTRATION AND DISPOSITION OF THE POLICIES

Viaticated policies cannot just be turned over to the investor; the administration of the policy, even with one owner/beneficiary, must continue through a third party servicer. VSI can continue to service the policies through the conclusion of the Disposition Procedures, and, subject to the amount

of policies to be serviced, and approval by the Department of Insurance Regulation, VSI could possibly continue to service policies after the conclusion of the Receivership.

Continuing Obligations of a Dissolving Viatical Settlement Provider

Pursuant to §626.9924, Fla. Stat., the ultimate responsibility to track a viaticated policy lies with the viatical settlement provider; MBC was a viatical settlement provider. These obligations include "keeping track of the insured's whereabouts and health status, submission of death claims or assisting the beneficiary in the submission of death claims, and the status of the payment of premiums until the death of the insured." This responsibility may be contracted out to a third party (MBC's "third party" was VSI); however, the ultimate responsibility remains with the initial provider. The responsibility to track the policy continues with the initial provider, "notwithstanding any transfers of the viaticated policy in the secondary market."

The Florida Statutes and Florida Administrative Code do not addresses the windup of a viatical settlement provider other than to state that the viatical settlement provider can be prevented from doing further business by virtue of a cease and desist order. The Cease and Desist Order entered by the Florida Office of Insurance Regulation in this case so provides. However, notwithstanding the entry of a Cease and Desist Order, the viatical settlement provider is expected to conclude its affairs, but continue servicing policies until they have matured, been canceled or expired.

VSI has serviced these policies since they were purchased and can continue to do so during the receivership. VSI had adequate funds to operate for approximately two years. If enough investors choose to continue to service policies through VSI, then it is possible that VSI could continue to operate. In fact, if VSI can continue as an operating entity, and subject to appropriate regulatory approval, it is possible that ultimately the Receiver could dispose of VSI and generate additional

funds to pay investors. The Receiver is exploring this possibility with the Office of Insurance Regulation.

CONCLUSION

There is no question that in each instance that an investor turned money over to MBC, the investor had a contractual expectation that he, she or it would receive an indefeasible beneficial interest in a life insurance policy, whether that indefeasible interest was held directly by the investor or through a third party nominee, as well as an expectation that there would be adequate funds set aside to maintain those policies. But as *Cunningham, Elliott, Forex* and *Capwill* illustrate, contractual expectations do not overcome equity. Thus, in each instance were an indefeasible property right in the policies has not been established under state law, applicable law directs the Receiver and this Court to review what equity should dictate. In this case, depending on the timing of the investment, and the fortuity of life in general, some investors were assigned interests in AIDS policies, some in group policies, some in life settlement policies, some in policies that matured early, others that matured "on time", and others that won't mature until long after the stated life expectancy, either due to the fraud perpetrated by the defendants or due to change in health options. Some of these interests have little or no value. Similarly, funds set aside to service these policies have or have not been exhausted, and have or have not been used to service other policies. In each instance, if tracing is applied to the interests, then, by happenstance, some of the victims of this scheme will achieve a meaningful recovery, and others will receive nothing. Thus, equity compels a solution that evens out the impact of the fraud, that is, a liquidation of all the assets that can be liquidated, for the benefit of all investors. As the Supreme Court wrote in *Cunningham* - "**Equality is Equity**."

Wherefore, the Receiver, Roberto Martínez, respectfully requests this Court enter an order

a. Holding that the funds in the premium account are assets available for the benefit of all investors, including costs of administration of the receivership, which in turn includes the cost of the Disposition Procedures as well as the cost of pursuing litigation, and ultimate *pro rata* distribution to all investors;

b. holding that the policies in which an investor is not an owner or holder of an irrevocable beneficial interest may be sold by the Receiver and the proceeds made available for the benefit of all investors;

c. approving the Receiver's ability to sell the interests of other investors in the absence of an objection and to mail to each Class A1 and Class A2 and certain Class A3 investors the form of notice substantially in the form attached as Exhibit G;

d. approving the proposed Distribution Procedures so that the Receiver may solicit stalking horse bidders as described in the Disposition Procedures;

e. approving the format of the Disposition Procedures, subject to submission of a detailed procedures motion for approval when a stalking horse bidder has been selected;

f. authorizing the Receiver to prepare a claims procedure based on all of the foregoing; and

g. for such other and for the future relief as the Court deems appropriate.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Receiver's Motion To Approve Procedure For Disposition Of Policies, Distribution Of Proceeds Of Policies, And Treatment Of Premium Funds was served in accordance with the attached Receiver's Service List on April 22, 2005.

_____
Curtis B. Miner, Esq.

252248.1

SERVICE LIST OF RECEIVER

Case No.: 04-60573 CIV-Moreno

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