IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division

LIFE PARTNERS, INC.,

Plaintiff,

v.

CLINTON MILLER;
THEORDORE V. MORRISON, JR.; and
MARK C. CHRISTIE;
in their official capacity as the Commissioners
of the Virginia State Corporation Commission;

and

ALFRED W. GROSS,
in his official capacity as the Virginia
Commissioner of Insurance;

Defendants;

and

JUDITH WILLIAMS JAGDMANN,
in her official capacity as Attorney General
of the Commonwealth of Virginia,

Intervenor.

Civil Action No. 3:05CV368

MEMORANDUM OF LAW OF *AMICUS CURIAE* NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

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INTRODUCTION

The North American Securities Administrators Association, Inc. ("NASAA"), submits this Memorandum of Law in support of the Motion for Summary Judgment filed by the Defendants on November 30, 2005. In this Memorandum, NASAA offers the perspective of state securities regulators, who join with their insurance counterparts in Virginia to oppose the Plaintiff's challenge to the Virginia Viatical Settlement Act ("Virginia Act" or "Act"). That statute, adopted in some form in at least 38 states throughout the country, and its accompanying regulations ("Regulations"), offer important protections to a vulnerable segment of the public: terminally ill patients and elderly citizens who want to sell their life insurance policies at a discount in order to raise funds before they die. Such people, known as "viators," have been the subject of exploitation and abuse since the viatical industry emerged over 15 years ago. The Virginia Act addresses their plight not by prohibiting the sale of insurance policies, but by conditioning those transactions on adherence to a set of insurance standards carefully designed to ensure that viators are treated fairly. Thus, the Act advances an important public policy.

From a legal standpoint, the Virginia Act is a state statute adopted for the purpose of regulating "the business of insurance," and it is therefore immune from challenge under the Commerce Clause by virtue of the McCarran-Ferguson Act. Even in the absence of the McCarran-Ferguson Act, the Virginia Act is constitutional. Congress has expressly approved of the Act and similar state laws governing viatical transactions, by extending favorable tax treatment to those transactions if they are conducted in accordance with state regulation. Finally, even if all of the foregoing immunities were set aside, the statute would still have to be found constitutional. It applies even-handedly to all viatical settlement providers, and the minimal burdens it imposes on industry are reasonable in relation to the important protections it confers

on the public. The Act therefore falls well within the generous boundaries of permissible state regulation under the Commerce Clause. On both legal and policy grounds, this Court should reject the Plaintiff's challenge and enter summary judgment in favor of the Defendants.

IDENTITY AND INTEREST OF THE *AMICUS CURIAE*

NASAA is the nonprofit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has 67 members, including the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Formed in 1919, it is the oldest international organization devoted to protecting investors from fraud and abuse in the offer and sale of securities.

The members of NASAA include the state agencies that are responsible for regulating securities transactions under state law. Their fundamental mission is protecting investors, and their jurisdiction extends to a wide variety of securities, including, in most states, investments in viaticals. Their principal activities include registering certain types of securities; licensing the firms and agents who offer and sell securities; investigating violations of state law; and filing enforcement actions where appropriate. State securities regulators also educate the public about investment fraud and advocate for the adoption of sound laws and regulations governing financial services.

NASAA supports the work of its members in many ways: coordinating multi-state enforcement actions, offering training programs, publishing investor education materials, and offering its views on proposed legislation governing financial services. Another core function of the association is to represent the membership's position, as *amicus curiae,* in significant cases involving financial services regulation. NASAA's interest extends not only to the regulation of securities but also to the regulation of banking and insurance, and to the protection of consumers

in all three branches of the financial services industry. *See, e.g.,* Brief of *Amicus Curiae* North American Securities Administrators Association, Inc., in Support of Appellant Burke and in Support of Reversal, filed in *Wachovia Bank, N.A. v. Burke,* No. 04-3770-CV (2d Cir. Oct. 20, 2005) (supporting the Connecticut Banking Commissioner's position that federal banking law does not preempt state regulation of mortgage lending subsidiaries of national banks for the benefit of consumers).[1]

NASAA and its members have a stake in the outcome of this case for several reasons. First, the Court's disposition of the issues will significantly affect the ability of state insurance regulators to protect the interests of viators, a particularly vulnerable segment of the population. The viaticals industry has been prone to fraud and abuse since it emerged in the late 1980's. Much of that exploitation has been inflicted upon investors – those who are misled into thinking that handsome profits can be reaped from acquiring interests in the life insurance policies of the terminally ill. However, viators also have suffered at the hands of unscrupulous viatical companies. This pattern of abuse gave rise to the NAIC's Model Viatical Settlement Act and its adoption in various forms by Virginia and 37 other states throughout the country. If the Plaintiff succeeds in this case, viators in Virginia will lose the protections of the Virginia Act and will become more susceptible to overreaching and exploitation by viatical settlement providers. The resulting precedent, in this case of first impression, would undoubtedly trigger a nationwide assault on the right of state insurance regulators to enforce similar statutory protections for the benefit of viators.

NASAA has a more general interest in helping to prevent the erosion of state regulatory authority. State regulators in the areas of securities, banking, and insurance all play a vital role

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[1] *Available at* http://www.nasaa.org/content/Files/WachoviaBurkeBrief.pdf.

in protecting the public. Where Congress has given states the leeway to regulate in these areas – whether in the federal securities acts, the national banking laws, or the McCarran-Ferguson Act – the courts should reject attempts to restrict that leeway in derogation of Congressional intent. In the McCarran-Ferguson Act, Congress has made clear that state regulation of insurance is to be free from Commerce Clause restraints. And in the Internal Revenue Code, Congress has made clear that state regulation of the insurance transactions at issue in this case is to be encouraged through tax incentives. The Plaintiff improperly ignores these Congressional determinations in its effort to restrict the scope of state jurisdiction over insurance. Similarly, the Plaintiff invokes the dormant Commerce Clause as a weapon against state regulation, even though the regulatory framework at issue is plainly even-handed in application and reasonable in scope. By siding against these claims, NASAA seeks to uphold respect for the Congressionally recognized authority of state regulators over financial services.

Finally, NASAA also has in interest in helping to clarify the jurisdictional distinctions between securities regulation and insurance regulation – a distinction that the Plaintiff tries to blur in this case. Viatical transactions typically involve two essential components: the sale of policies by viators, which are insurance transactions subject to regulation by state insurance regulators, and the offer and sale of interests in those policies to the investing public, which are securities transactions subject to regulation by state and federal securities regulators. Because of the enormous amount of fraud that has occurred with respect to investment offerings in viaticals, state and federal securities regulators have aggressively pursued enforcement actions against viatical settlement companies for years. *See, e.g., SEC v. Mutual Benefits Corp.,* 408 F.3d 737 (11th Cir. 2005)*; In re Beneficial Assistance,* File No. S-01297, 2003 WL 297791, at *3 (Wisc. Comm'r of Sec. Feb. 5, 2003) (Order of Prohibition and Revocation) (citing over 200 opinions,

administrative decisions, and court cases from states across the country finding that viatical settlements are securities); *see generally* Brief of the North American Securities Administrators Association, Inc., as *Amicus Curiae* in Support of the People of the State of California, filed in *People v. Innovative Financial Services, Inc.,* Appeal No. D045555, at 24-30 (Sept. 6, 2005).[2] In some of those cases, defendants have attempted to evade *securities* regulation by arguing that viatical settlements are subject to the exclusive authority of state *insurance* regulators. Now, somewhat ironically, the Plaintiff seeks to exploit confusion about the hybrid nature of viatical transactions by suggesting that its transactions with viators fall entirely *outside* the business of insurance. To reach a correct result in this case, the Court must correctly delineate the proper – and complementary – role that both insurance and securities regulators have in policing the viatical marketplace.

ARGUMENT

I. Viators, As Well As Investors, Are Exposed to a Serious Risk of Fraud and Abuse in the Viatical Process, Warranting Comprehensive Regulation of Both the Securities and the Insurance Aspects of Viatical Transactions

By all accounts, the viatical industry has been rife with fraud and abuse since it emerged in the late 1980's. While not all viatical companies have engaged in these practices, the industry in general has been characterized as "infected with scam artists, 'ponzi' schemes, and other fraudulent activities." Lisa M. Ray, *The Viatical Settlement Industry: Betting on People's Lives Is Certainly No Exacta*, 17 J. CONTEMP. HEALTH L. & POL'Y 321, 322 (2000). Investors have suffered extensively at the hands of viatical settlement promoters. Viators are even more susceptible to fraud and abuse because of their unique physical, mental, and financial vulnerabilities. The state insurance laws and regulations at issue in this case are vitally important

[2] *Available at* http://www.nasaa.org/content/Files/IFSbrief.pdf.

for the protection of viators, just as securities regulation has proven to be vitally important for the protection of those who invest in viaticals. Lessons learned from the struggle to regulate viatical investments as securities reinforce the importance of regulating viator transactions under the insurance laws.

A. Viators Are Susceptible to Abuses That Can Be Most Effectively Addressed Through Regulation Under the Act

When viatical settlements first appeared, the viator market was comprised mainly of terminally ill AIDS patients. However, over the years, viatical settlement providers have found additional markets in the growing population of the chronically ill and the elderly. Anna D. Halechko, *Viatical Settlements: The Need for Regulation to Preserve the Benefits While Protecting the Ill and the Elderly From Fraud,* 42 Duq. L. Rev. 803, 807 (Summer 2004); Lawrence A. Frolik, *Insurance Fraud on the Elderly*, 37 TRIAL 48, 50 (June 2001); Alexander D. Eremia, *Viatical Settlement and Accelerated Death Benefit Law: Helping Terminal, But Not Chronically Ill Patients*, 1 DEPAUL J. HEALTH CARE L. 773, 785 (1997). All classes of viators are vulnerable to exploitation. Facing death, terminally ill patients are often physically weakened and financially stressed. Joy D. Kosiewicz, *Death for Sale: A Call to Regulate the Viatical Settlement Industry*, 48 CASE W. RES. L. REV. 701, 704-05 (Spring 1998). They tend to know very little about viatical transactions, and they lack the time or the resources to research their alternatives thoroughly. Kosiewicz, *supra,* at 704; Halechko, *supra, at* 805-06.

The elderly can be even more inviting targets for fraud and abuse. In addition to having serious physical ailments, they may suffer from hearing loss and cognitive impairments, making them easier to deceive. Frolik, *supra, at* 48-49; Halechko, *supra,* at 808-09. Their living conditions also contribute to their vulnerability: they may be house-bound and alone, with ample time on their hands to receive telephone solicitations or in-person visits. Frolik, *supra,* at 48.

Viators may never suspect that they have been unfairly treated, and even when they do, they often lack the resolve, the resources, or literally the time to seek redress. Frolik, *supra,* at 48.

The result of all these factors is a "major power imbalance between the viator and the viatical settlement provider" and "a strong potential for abuse." Halechko, *supra,* at 805-06. The benefits offered by viatical transactions have been "complicated and often corrupted by the actions of overzealous entrepreneurs who are willing to take advantage of the most vulnerable in society in order to increase profit." Halechko, *supra,* at 804; *see also* Jennifer A. Lann, *Viatical Settlements: An Explanation of the Process, an Analysis of State Regulations, and an Examination of Viatical Settlements as Securities,* 46 DRAKE L. REV. 923, 930 (observing that inequality in bargaining power and financial despair may lead an individual to accept an amount that is objectively unreasonable); Frolik, *supra,* at 50 (the viator often sells the policy for an amount that is not actuarially sound).

Strong regulation of viatical settlements under state insurance laws has been widely endorsed as an effective way to address these problems. As one commentator has observed:

> Regulation is necessary to curb the potential for abuse stemming from the unbalanced relationship between the viatical company and the viator . . . . On one side of the transaction is a large company with numerous resources, lots of money, and enormous bargaining power. On the other side is a terminally or chronically ill patient or elderly person with little money, big expenses, and few resources. Even if viatical settlements are a positive alternative for the terminally and chronically ill, regulation is necessary to ensure that the transaction is fair, just as transactions in other industries are regulated to prevent coercion and unconscionable conduct . . . .

Kosiewicz, *supra,* at 703.

Adoption of the NAIC Model Act and Regulations, with their pricing requirements, is the favored approach:

> The need is clear for improved scrutiny of the industry for the protection of both viators and investors. All states should adopt legislation which includes the key

> features of the Model Code, particularly the requirement for a predetermined level of payment to the viator, mandated licensure of brokers, and strict limits on misleading advertising.

Halechko, *supra,* at 824; *see also* Frolik, *supra,* at 52 (more effective state laws and regulations, and vigilant enforcement, are necessary to protect the public from insurance scams).[3]

Support for strong regulation of the viatical industry has even come from some sectors of the industry itself. *See Written Statement of David M. Lewis, Representing the Life Settlement Institute, Before the U.S. House of Representatives, Comm. on Financial Services,* at 4 (Feb. 26, 2002) ("[O]n the state level, we urge the passage in every state of legislation patterned after the NAIC Model Act. The NAIC Model Act provides for strong regulation of the viatical settlement industry to be conducted by the Department of Insurance in each state."); *Submission to the Chief Executive Officer and Superintendent of Financial Services, Financial Services Commiss. of Ontario, Regarding Key Elements of a Proposed Regulatory System for Viatical Settlements in Ontario,* Canadian Life and Health Insurance Association Inc., at i, 9 (Aug. 2001) (citing widespread fraud and abuse of viators and advocating for minimum payouts "to prevent unscrupulous operators from persuading terminally ill insureds who are vulnerable by virtue of financial need, emotional distress and/or lack of information to accept extortionate settlements").

State regulation of these viator transactions is essential in part because no other state or federal regulatory scheme offers protection specifically to viators. *See* Halechko, *supra,* at 820

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[3] The price floors contained in the Model Regulations have drawn criticism from some commentators, based principally on the economic theory that price floors will reduce the flow of capital into the viatical marketplace, to the detriment of viators. *See* Denise M. Schultz, *Angels of Mercy or Greedy Capitalists? Buying Life Insurance Policies From the Terminally Ill,* 24 PEPP. L. REV. 99, 112-114 (1996); Jennifer Berner, *Beating the Grim Reaper, or Just Confusing Him? Examining the Harmful Effects of Viatical Settlement Regulation,* 27 J. MARSHALL L. REV. 581 (1994). However, even those with concerns about price floors recognize their benefits. *See* Kosiewicz, *supra,* at 720-721 (noting that minimum payouts are controversial but may be effective in preventing companies from taking advantage of viators).

(the Model Act is unique in its emphasis on protection for the viator); Kosiewicz, *supra,* at 703 (regulation focused on viators is important because the viatical industry engages in activities that go beyond existing laws protecting buyers and sellers, such as contract law, securities law, and the Uniform Commercial Code).

Every indication is that the viatical settlement industry will continue to grow, given the expansion of the viator market as the population ages. The size of the secondary market for insurance policies is said to be "staggering," estimated at $18 billion annually. Stephen L. Ziegler, *Viatical Settlements in Florida,* 79 FLA. BAR J. 36 (May 2005). Along with this growth will come additional exploitation of viators. The Virginia Act and similar state laws must be upheld to curb those abuses.

B. State Regulation of Viator Transactions Should Be Upheld to Avoid the Jurisdictional Uncertainty That Hampered State Regulation of Viatical Investments

NASAA and its members are thoroughly familiar with the abuses that have characterized much of the viatical industry.[4] The offer and sale of investments in viaticals has been marked by a wide range of fraudulent practices aimed at investors: soliciting funds where few if any underlying policies have been acquired from viators; using fraudulent life expectancy evaluations prepared by captive physicians; establishing inadequate premium reserves, which are necessary to keep policies in force; and making unfounded claims of huge and certain profits for investors. *See, e.g.,* Report and Recommendation of Magistrate Barry L. Garber, issued on November 10, 2004 ("Magistrate's Report"), in *SEC v. Mutual Benefits Corp.;*[5] *see generally*

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[4] The companies that sell viatical settlements to investors are often, if not typically, the same companies that buy the underlying policies from viators. *See SEC v. Mutual Benefits Corp.,* 408 F.3d at 738 (viatical settlement providers purchase policies from individual investors and "typically" sell fractionalized interests in those policies to investors).

[5] *Available at* http://www.mbcreceiver.com/images/11-10-2004ReportandRecommendation.pdf.

Brief of the North American Securities Administrators Association, Inc., as *Amicus Curiae* in Support of Appellee Securities and Exchange Commission and in Support of Affirmance, filed in *SEC v. Mutual Benefits Corp.,* No. 04-14850-C (Dec. 8, 2004), and authorities cited therein.[6]

To address these problems, state regulators and the SEC have fought strenuously for years to regulate viatical investments under the securities laws, just as the Virginia Commissioner of Insurance is now fighting for the right to regulate viator transactions under the insurance laws. *See generally* Brief *Amicus Curiae,* filed by NASAA in *People v. Innovative Financial Services, Inc., supra,* at 9-30, and authorities cited therein. Unfortunately, jurisdictional defenses have hampered the regulatory efforts of securities regulators, leaving investors unduly exposed to viatical fraud. *Id.* at 9-12; 25-28. This experience, detailed below, highlights the importance of a ruling in favor of the Defendants in this case, so that the efforts of insurance regulators to protect viators are not similarly frustrated.

By the mid-1990's, both state and federal securities regulators were asserting jurisdiction over viatical investments and taking enforcement actions against viatical promoters, principally on the ground that viaticals were investment contracts under the *Howey* test and therefore securities subject to regulation under state and federal securities law.[7] In 1996, however, the SEC suffered a major setback in the United States Court of Appeals for the D.C. Circuit. *SEC v. Life Partners, Inc.*, 87 F.3d 536 (D.C. Cir.), *rehearing denied*, 102 F.3d 587 (D.C. Cir. 1996). In *Life Partners*, the court held that the viaticals at issue were not investment contracts because the promoter's key managerial efforts – the "efforts of others" – happened to occur before money

[6] *Available at* http://www.nasaa.org/content/Files/MBCBriefDec82004.pdf.

[7] Under the Supreme Court's decision in *Howey*, an investment offering is an investment contract – and therefore a security – if it involves: (1) the investment of money, (2) in a common enterprise, (3) with the expectation of profits, (4) derived from the efforts of others. *SEC v. W. J. Howey Co.,* 328 U.S. 293 (1946).

was accepted from investors. *Id.* at 545. The D.C. Circuit also held that *after* investors parted with their money, the viatical promoter's tasks were only "ministerial" in nature, and the profitability of the investment really hinged upon the mortality of the insureds. *Id.* at 548.

Although the decision in *Life Partners* was quickly and widely criticized, it nevertheless had a pronounced and chilling effect on the SEC's enforcement of the federal securities law against those offering viatical investments. *See* JOSEPH C. LONG, 12 BLUE SKY LAW §§ 3:15, 3:16.1 (June 2004) (explaining that the decision was irrational and that it was quickly the subject of judicial and scholarly criticism). Fortunately, many state securities regulators continued to assert jurisdiction over viaticals, but they were often confronted with defenses predicated on the *Life Partners* decision. State courts generally declined to follow the ruling, but not always. *See Griffitts v. Life Partners, Inc.,* No. 10-01-00271-CV, 2004 WL 1178418 (following *Life Partners* and holding that viatical investments were not securities). And even where enforcement actions were successful, state regulators found themselves having to devote significant resources just to establishing their jurisdiction, to the detriment of their overall enforcement programs. *See* Brief *Amicus Curiae,* filed by NASAA in *People v. Innovative Financial Services, Inc., supra,* at 27-29, and authorities cited therein.

In recent years, the *Life Partners* decision has been largely neutralized. At the federal level, this has occurred through a renewed enforcement effort by the SEC, culminating in a favorable decision from the United States Court of Appeals for the Eleventh Circuit. In *SEC v. Mutual Benefits Corp.,* 408 F.3d 737 (11th Cir. 2005), the SEC filed an action against a viatical promoter that had sold over $1 billion in viatical investments to 29,000 investors through a fraudulent sales campaign. *Id.* at 738. The promoter invoked the decision in *Life Partners* to challenge the SEC's jurisdiction. *Id.* at 741. The Eleventh Circuit forthrightly rejected that

challenge, stating "We decline to adopt the test established by the *Life Partners* court." *Id.* at 743. Citing to the lack of a persuasive rationale underlying *Life Partners,* and to Supreme Court precedent requiring a broad application of the securities laws, the court held that the promoter's viatical investments "amount[ed] to a classic investment contract." *Id.* at 744.

At the state level, *Life Partners* has been addressed through a combination of judicial and legislative remedies. Over the last five years, state appellate courts and administrative tribunals have been emphatic in their rejection of the *Life Partners* decision as bad law and bad policy. *See* Brief *Amicus Curiae,* filed by NASAA in *SEC v. Mutual Benefits Corp., supra,* at 12-15, and authorities cited therein. At the same time, many state legislatures have added viaticals to their statutory definitions of a security to remove any doubt that these investments are subject to securities regulation. *See* Brief *Amicus Curiae,* filed by NASAA in *People v. Innovative Financial Services, Inc., supra,* at 28-30.

The resulting clarity in the law is good for investors, but it was hard fought and too long in coming. For nearly a decade, many unethical viatical promoters were able to offer fraudulent viatical investments without complying with the registration, licensing, and anti-fraud protections afforded by the securities laws. With respect to viators, a majority of states have now adopted the Model Code and have given state insurance regulators clear authority to regulate viator transactions. If that authority is undermined in this case, viators will suffer, just as investors suffered from inconsistent application of the securities laws to viatical investments.

II. <u>The Virginia Viatical Settlement Act Is Immune From Commerce Clause Challenge by Virtue of the McCarran-Ferguson Act and the Internal Revenue Code</u>

A. The Virginia Act Was Adopted for the Purpose of Regulating the Business of Insurance Within the Meaning of the McCarran-Ferguson Act and It Is Not Subject to Challenge Under the Commerce Clause

The McCarran-Ferguson Act provides in relevant part as follows:

> (a) State Regulation
>
> The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> (b) Federal Regulation
>
> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, [the Sherman Act, the Clayton Act, and the Federal Trade Commission Act] shall be applicable to the business of insurance to the extent such business is not regulated by State law.

See 15 U.S.C. § 1012(a), (b). The law was enacted in 1945 in response to a Supreme Court decision holding that insurance transactions across state lines involved interstate commerce and were therefore subject to the federal antitrust laws. *United States Dept. of Treasury v. Fabe,* 508 U.S. 491, 499-500 (1993) (discussing *United States v. South-Eastern Underwriters Ass'n,* 322 U.S. 533 (1944)). The ruling was widely perceived as a threat to the traditional power of the states to tax and regulate the insurance industry. *Fabe,* 508 U.S. at 499-500. "To allay those fears, Congress moved quickly to restore the supremacy of the States in the realm of insurance regulation." *Id.* at 500.

The effect of the McCarran-Ferguson Act is two-fold. It shields state regulation of insurance from preemption under federal law, except to the extent federal law "specifically relates to the business of insurance." *See* 15 U.S.C. § 1012(b). In addition, it removes *all* Commerce Clause limitations on the authority of states to regulate and tax the business of insurance, even where such statutes are plainly discriminatory or burdensome. *Western & Southern Life Ins. Co. v. State Board of Equalization of California,* 451 U.S. 648, 653 (1981) (California retaliatory insurance tax levied on out-of-state insurers held to be invulnerable to

Commerce Clause challenge); *see also Prudential Ins. Co. v. Benjamin,* 328 U.S. 408 (1946) (tax on premiums collected by out-of-state insurer sustained against attack under the Commerce Clause).

To be covered by the McCarran-Ferguson Act, a state law must be one that was enacted "for the purpose of regulating the business of insurance." 15 U.S.C. § 1012(a), (b). The Supreme Court has defined this language broadly to encompass any law aimed at protecting or regulating, directly or indirectly, the relationship between the insurance company and the policyholder. *Fabe,* 508 U.S. at 501 (provisions in Ohio priority statute governing policyholder claims against insolvent insurance company satisfied McCarran-Ferguson definition, and were therefore not preempted by claims of United States as obligee of insurance company bonds) (citing *SEC v. National Securities , Inc.,* 393 U.S. 453 (1969)); s*ee also American Chiropractic Ass'n, Inc. v. Trigon Healthcare, Inc.,* 367 F.3d 212, 231 (4th Cir.), *cert. denied,* 125 S. Ct. 479 (2004) (RICO claim against insurer would not impair insurance regulation, so it was not prohibited under McCarran-Ferguson).[8]

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[8] A more limited definition of the "business of insurance" has evolved under the second clause of Section 1012(b). That clause was intended to provide the business of insurance with a relatively narrow exemption from the federal *antitrust* laws. *Fabe,* 508 U.S. at 505. Accordingly, the more limited definition of the "business of insurance" does not apply in cases such as this, where no antitrust claim is involved. *See Ambrose v. Blue Cross & Blue Shield of Virginia, Inc.,* 891 F. Supp. 1153, 1158 (E.D. Va. 1995). Even if that definition were deemed to govern this case, the Virginia Act would still fall under the protections of McCarran-Ferguson. At the heart of the more stringent definition is the "transferring or spreading [of] a policyholder's risk." *See Union Labor Life Ins. Co. v. Pireno,* 458 U.S. 119, 129 (1982). The Virginia Act regulates these aspects of the business of insurance as well. Viatical settlement providers create a secondary market in life insurance policies. That market enables policyholders to use their life insurance policies to transfer not only the risk of death, but the risk of catastrophic illness as well. If policyholders become seriously ill, they can use viatical settlements to extract value from their life insurance policies while they are still alive. This accomplishes risk transfer. *See* Neil A. Doherty, *The Secondary Market for Life Insurance Policies: Uncovering Life Insurance's "Hidden" Value,* 6 MARQ. ELDER'S ADVISOR 95, 111 (Fall 2004) (although life insurance is primarily a hedge against mortality risk, assignable policies provide consumers with

The Virginia Act and similar laws regulating viatical settlements easily meet this definition. They are aimed at regulating the circumstances under which an insured may terminate his or her relationship with an insurer and extract value from the policy while the insured is still living. In literal terms, such laws satisfy the *Fabe* definition because they are focused on the relationship between the insurance company and its policyholders, including the termination of that relationship. In spirit as well, the Virginia Act satisfies the *Fabe* definition. A viatical settlement can be viewed as the functional equivalent of an accelerated death benefit under the terms of a life insurance policy. *See* Lisa M. Ray, Comment, *The Viatical Settlement Industry: Betting on People's Lives Is Certainly No Exacta*, 17 J. CONTEMP. HEALTH L. & POL'Y 321, 345 (2000) (despite a variety of technical distinctions, accelerated death benefits are fundamentally similar to viatical settlements). Accelerated death benefits also enable viators to terminate their relationships with insurers and extract value from their policies. *Cf. Fabe*, 508 U.S. at 503 (the actual performance of an insurance contract clearly falls within the "business of insurance"). This mechanism for terminating the insured/insurer relationship is undoubtedly an insurance transaction. Viatical settlements, which function in much the same way, should be regarded similarly. Laws regulating all of these arrangements are laws enacted for the purpose of regulating the business of insurance, within the meaning of McCarran-Ferguson, and they are immune from challenge under the Commerce Clause.

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the added value of a hedge against serious health impairments). The secondary market also has the effect of making policies more liquid and more valuable. This in turn attracts more policyholders and increases the size of the pool over which a life insurance carrier will spread its risks. This accomplishes risk spreading. *See id. at* 99 (the viatical market has increased the value and liquidity of insurance policies as well as the number of policies sold). For these reasons, Virginia's regulation of viatical settlement providers in their dealings with viators can be viewed as regulation of the "business of insurance" even under the more stringent standard applicable in antitrust cases.

This conclusion finds direct support in *Legal Asset Funding, LLC v. Travelers Casualty & Surety Co.,* 155 F. Supp. 2d 90 (D.N.J. 2001). In *Legal Asset Funding,* an assignee of a structured settlement agreement invoked the Commerce Clause to challenge a Connecticut law requiring court approval of the assignment. The district court's principal concern was whether the structured settlement could fairly be considered an insurance product, given that it was funded in part by an annuity. After resolving that issue in the affirmative, the court had no hesitation in finding that the state law regulating the *assignment* of those insurance products was enacted for the purpose of regulating the business of insurance and therefore immune from Commerce Clause challenge. *Id.* at 98. Under this rationale, this Court should have no hesitation in finding that the Virginia Act, which regulates the assignment of mainstream insurance products, was enacted for the purpose of regulating the business of insurance.[9]

[9] *SEC v. Life Partners, Inc.* does not support the Plaintiff's case. 87 F.3d 536 (D.C. Cir. 1996). The issue before the D.C. Circuit in *Life Partners* was whether the *investment side* of a viatical transaction satisfied the "business of insurance" test under McCarron-Ferguson, not whether the assignment or sale of policies by viators satisfied the definition. The court framed the issue as whether "*the marketing of fractional interests* is part of the business of insurance within the meaning of the McCarran-Ferguson Act." 87 F.3d at 541 (emphasis added). The court's holding plainly states that "the business of selling fractional interests in insurance policies is no part of the 'business of insurance.'" *Id.* at 542. The court furthermore expressly embraced the argument advanced by the SEC, which is the same one that NASAA advances here: "The Commission states that 'the business of insurance' referred to in the McCarron-Ferguson Act encompasses the relationship between an insurance company and an insured; the relationship that the SEC wants to regulate is that between a promoter and its investors, and regulation of that relationship 'is not insurance regulation, but securities regulation'. . . . The SEC's argument on this score is much more persuasive than LPI's." *Id.* at 541 (citing *SEC v. National Securities, Inc.,* 393 U.S. at 460). It follows that the Plaintiff's reliance on *Life Partners, Inc. v. Life Insurance Co. of North America,* No. W-98-CA-096, 1998 U.S. Dist. LEXIS 23544, at *8, cited in the Complaint, is misplaced, because that Texas decision relied squarely on *SEC v. Life Partners.*

B. <u>In the Internal Revenue Code, Congress Has Authorized the Regulatory Scheme Embodied in the Virginia Act, So the Commerce Clause Does Not Apply</u>

Although framed as a grant of regulatory power to Congress, the Commerce Clause has long been interpreted as a curb on the power of the states to discriminate against or burden interstate commerce in an unjustifiable manner. *See Environmental Technology Council v. Sierra Club,* 98 F.3d 774, 782 (4th Cir. 1996), *cert. denied,* 531 U.S. 1103 (1997) (citing *Oregon Waste Systems, Inc. v. Department of Env'l Quality,* 511 U.S. 93 (1994)). However, where Congress has specifically authorized state laws, the Commerce Clause is inapplicable, regardless of any impact such laws may have on interstate commerce. *Id.* In the words of the Supreme Court, it is "clear that Congress may 'redefine the distribution of power over interstate commerce' by 'permit[ting] the states to regulate the commerce in a manner which would otherwise not be permissible." *South-Central Timber Development, Inc. v. Wunnicke,* 467 U.S. 82, 87-88 (1984) (quoting *Southern Pacific Co. v. Arizona,* 325 U.S. 761 (1945)). This rule applies wherever the Congressional intent to authorize the state law in question is either "expressly stated" or "unmistakably clear." *Environmental Technology Council,* 98 F.3d at 782 (quoting *South-Central Timber Development, Inc.,* 467 U.S. at 91-92).

Under this test, the Virginia Act deserves to be upheld, regardless of any claimed burdens it may impose on interstate commerce. In the Internal Revenue Code, Congress has specifically endorsed and encouraged – not merely authorized – state regulation of viatical settlement providers, in the manner embodied in the Virginia Act. *See* 26 U.S.C. § 101(g)(2)(B)(i), (ii). That provision of the tax code, enacted in 1996, excludes certain viatical settlement proceeds from gross income. As evidence of Congress's explicit and unmistakable approval of the Virginia Act and similar state regulations, the tax exemption only applies if the provider is

licensed in the *viator's* state or if it complies with various provisions of the Model Act and the "reasonable payment" provisions contained in the Model Regulations. *Id.* Those reasonable payment provisions, endorsed by Congress, are essentially identical to the Virginia provisions that the Plaintiff challenges in this case. As noted by one commentator, "[t]hrough the tax code, Congress and the IRS not only have recognized the viatical settlement industry, they have also recognized a need to ensure regulation of the industry and have looked to both the Model Act and state law for such regulation." Joy D. Kosiewicz, *Death for Sale: A Call to Regulate the Viatical Settlement Industry*, 48 CASE W. RES. L. REV. 701, 712 (Spring 1998).

The tax code reflects an explicit and unmistakably clear Congressional authorization for the states to regulate viator transactions in accordance with the approach taken by Virginia. Under the rule set forth in *Environmental Technology Council* and *South-Central Timber Development, Inc.,* the Virginia Act and the Regulations are exempt from challenge under the Commerce Clause.

III. The Virginia Viatical Settlement Act Does Not Violate the Commerce Clause

The Virginia Viatical Settlement Act does not violate the Commerce Clause under well-established principles of constitutional law. Accordingly, the Plaintiff's challenge to the Virginia Act must fail, and the Act should be upheld as a legitimate exercise of state power.

The Commerce Clause gives Congress the power "to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. CONST. art. I, § 8, cl. 3. Over the years, the Commerce Clause has been understood to contain a "'negative command' known as the 'dormant Commerce Clause,'" prohibiting the states from "legislating in ways that impede the flow of interstate commerce." *Star Scientific v. Beales*, 278 F.3d 339, 355 (4th Cir. 2002) (citing *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179 (1995)), *cert.*

denied, 537 U.S. 818 (2002). However, these limitations on State power are "by no means absolute." *Id*. (citing *Lewis v. BT Investment Mgrs, Inc.*, 447 U.S. 27, 36 (1980)). States "retain authority under their general police powers to regulate matters of 'legitimate local concern,' even though interstate commerce may be affected." *Id.*

Where a state statute is challenged under the Commerce Clause, courts apply a two-tiered analysis to determine the constitutionality of the statute. Under the first tier, the inquiry is whether "a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests." *Healy v. Beer Institute*, 491 U.S. 324, 337 (1989) (citing *Brown-Forman Distillers v. New York State Liquor Authority*, 476 U.S. 573, 579 (1986)); s*ee also Baltimore Gas and Elec. Co. v. Heintz*, 760 F.2d 1408, 1420 (4th Cir. 1985), *cert. denied* 474 U.S. 847 (1985). Where a state law has this effect on interstate commerce, it may be found *per se* invalid. *Id.*

However, "[w]here the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." This is the second-tier test first enunciated in *Pike v. Bruce Church, Inc.* 397 U.S. 137, 142 (1970).

Because the Virginia Viatical Settlement Act withstands first-tier analysis as well as second-tier balancing as outlined in *Pike*, the Virginia Act must be upheld as a constitutional exercise of state power in an area of legitimate local public interest.

A. The Virginia Viatical Settlement Act Survives First-Tier Analysis and Therefore is an Even-Handed Regulation Under *Pike*

The Virginia Act passes the first-tier analysis because it does not directly regulate or discriminate against interstate commerce, nor does it favor in-state interests over out-of-state

interests. For purposes of this test, a law does not "directly regulate" interstate commerce if it only applies to transactions conducted within the state. *See Star Scientific,* 278 F.3d at 356. In *Star,* the Fourth Circuit held that a Virginia statute regulating the sale of cigarettes did not directly regulate interstate commerce because it had "no effect on transactions undertaken by out-of-state distributors in other States," only on cigarettes actually sold in Virginia. *See Id.*

As in *Star,* the Virginia Viatical Settlement Act does not directly aim to regulate, or have the effect of regulating, interstate commerce because the Virginia statute only applies to a viatical transaction made within the Commonwealth of Virginia. The Act has no impact on out-of-state viatical providers conducting business in states other than Virginia. Only when out-of-state viatical providers avail themselves of the Virginia marketplace and bring their viatical business into the Commonwealth of Virginia must they comply with the Virginia Act.

For purposes of first-tier analysis, "'discrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste Sys. v. Department of Envtl. Quality*, 511 U.S. 93, 99 (1994). The Virginia Act in no way discriminates between in-state and out-of-state economic interests because under the statute, all viatical settlement providers – local and foreign – are on an equal footing.

The Virginia Act states "[n]o person shall act as a viatical settlement provider with a resident of this Commonwealth without first obtaining a license from the Commission." V.C.A. § 38.2-6002. This licensing requirement applies uniformly to both in-state and out-of-state persons wishing to transact business as a viatical settlement provider in the Commonwealth of Virginia. The Act mandates that *any* person in the viatical settlement industry wishing to deal with a viator residing in the Commonwealth of Virginia, without regard to the applicant's own residency status, first obtain a license from the State Corporation Commission ("SCC").

Not only is the licensing requirement imposed in a non-discriminatory way, the rest of the Act regulates in a non-discriminatory and even-handed fashion as well. All of the provisions of the Act, ranging from Commission approval of contracts and disclosure statements to the advertising standards, apply equally to all viatical settlement providers, resident and non-resident alike, who wish to conduct viatical business in the Commonwealth of Virginia. V.C.A. § 38.2-6002-6010.

The Act plainly does not have the intent of inhibiting non-residents from entering into viatical settlements with Virginia residents in favor of resident viatical providers, and application of the statute does not have the effect of favoring a local viatical provider over an out-of-state one.

The Virginia Act has neither the purpose nor the effect of favoring local commerce over out-of-state commerce and it "imposes no burden on interstate commerce that it does not impose on intrastate commerce." *Baltimore Gas*, 760 F.2d at 1423. Therefore, the Act passes the first-tier test, and is an "even-handed statute" within the meaning of *Pike,* regulating residents and non-residents in equal fashion.[10]

B. The Virginia Viatical Settlement Act Effectuates a Legitimate, Indeed Vital, Local Public Interest

Not only does the Virginia Act regulate in an even-handed fashion, the Virginia Act furthers a legitimate local public interest. As discussed in Section I above, the Virginia Act

[10] It is noteworthy that the Virginia Act is similar to viatical laws that have been widely adopted in states across the country. In 1993, the National Association of Insurance Commissioners adopted the Viatical Settlements Model Act ("Model Act"). Since the Model Act was originally written, thirty-eight states have adopted some version of it, including Virginia. The Virginia Act is based on the Model Act and contains only minor variations from it. The Model Act, as adopted by the states, has never previously been challenged as discriminatory under the Commerce Clause.

protects a vulnerable segment of the Virginia population from being exploited in the process of selling their life insurance policies.

"In determining whether a state has a 'legitimate local public purpose' and 'putative local benefits,'" a court must proceed with deference to the state legislature." *Yamaha Motor Corp. v. Jim's Motorcycle*, 401 F.3d 560, 569 (4th Cir. 2005), *cert. denied*, 129 S.Ct. 422 (2005). This deference is hardly necessary in this case, because Virginia clearly has an interest in protecting its citizens from unscrupulous viatical providers, especially where those citizens are in a compromised state, emotionally and physically, at the time of their dealings. The viatical industry itself has even expressed support for viator protections in the form of a regulatory scheme similar to that found in the Virginia Act. The legislative history of the Viatical Settlements Model Act contains a statement from a spokesperson for a viatical settlement association who "spoke favorably of the model act and its development." The spokesperson affirmed that protecting viators was an important effort because not everyone respected the fragile nature of those who are stricken with a life-threatening disease." NAIC 697-97, 1993 Proc. 3rd Quarter 438-439. It is with these interests in mind that the Virginia legislature enacted its Viatical Settlement Act. Under *Yamaha*, "[c]ourts 'are not inclined to second-guess the empirical judgments of lawmakers concerning the utility of legislation." *Id*. (citing to *CTS Corp v. Dynamics Corp. of Amer*., 481 U.S. 69, 92 (1987)).

Thus, because Virginia has an interest in protecting its citizens from the abuses that have marked the viatical settlement industry, the second prong under *Pike* is satisfied.

C. Any Burden on Interstate Commerce Is Incidental and Reasonable in Relation to the Important Local Public Interests

The final prong under *Pike* is whether "the burden on interstate commerce is clearly excessive in relation to the putative local benefits." *Pike,* 397 U.S. at 137. As recognized by the

Fourth Circuit, "States retain authority under their general police powers to regulate matters of 'legitimate local concern,' even though interstate commerce may be affected." *Star Scientific v. Beales*, 278 F.3d at 355. The Fourth Circuit has also observed that "nondiscriminatory measures are generally upheld, in spite of [some burden] on interstate commerce…" *Yamaha*, 401 F.3d at 569 (citing *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994)). In fact, "incidental burdens on interstate commerce may be unavoidable when a State legislates to safeguard the health and safety of its people." *Baltimore Gas,* 760 F.2d at 1422 (citing *Philadelphia v. New Jersey*, 437 U.S. 617, 623-624 (1978)).

The Virginia Viatical Settlement Act imposes burdens that are incidental, not excessive. Cases upholding other, similar regulatory schemes support this conclusion. For example, Virginia's securities act has been upheld as a legitimate exercise of state power and that rationale should extend to the regulatory requirements found in the Viatical Settlement Act. In *Underhill Associates, Inc. v. Bradshaw*, the Virginia Securities Act was challenged by three nonresident discount securities brokers. *Underhill Associates, Inc. v. Bradshaw*, 674 F.2d 293 (4th Cir. 1982). The plaintiffs alleged, in part, that the Virginia Securities Act was a violation of the Commerce Clause. The statute imposed certain requirements on all applicants for registration, including a demonstration that:

> "he…is a person of good moral character and reputation, that he intends to maintain his records pertaining to the securities business in accordance with the rules of the Commission, that his knowledge or conduct of the securities business and his financial responsibility are such that he is a suitable person to engage in the business, that he has supplied all information required by the Commission, and that he had paid the necessary fee."

Id. (citing V.C.A § 13.1-505(a)).

The court in *Underhill* first held that the Virginia Securities Act regulated evenhandedly, by applying to both in-state and out-of-state broker-dealers equally. *See Underhill* 624 F.2d at

297. The court further recognized that "Virginia's interest in protecting its citizens from possibly dishonest or incompetent dealers is obvious," and that any burdens imposed under the act were incidental and reasonable. *Id*. at 295. Based on these two considerations, the court upheld the act as constitutional under the Commerce Clause. This analysis also applies to the Virginia Viatical Settlement Act: the Act regulates both in-state and out-of-state providers equally, and Virginia is trying to protect viators from possibly dishonest or overreaching viatical settlement providers. In accordance with *Underhill,* Virginia's viatical statute should also be upheld.

Other state securities laws have consistently been upheld by the courts. In *Shappley v. State of Texas*, an Arizona salesman offered a security to a Texas purchaser, without being licensed in Texas. *Shappley v. State of Texas*, 520 S.W.2d 766 (Tex. Crim. App. 1974). The Arizona salesman made the offer through a telephone conversation with the Texas buyer. This alone was enough for the Texas court to conclude the seller was unlawfully dealing in securities in the state of Texas without being licensed, and the court found that the Texas Securities Act was not an unreasonable restraint on interstate commerce. *See Shappley*, 520 S.W. 2d at 772. In reaching this outcome, the court held that "any incidental burden on interstate commerce created by the act was insubstantial and not unreasonable." *Id*. The court followed the reasoning in *Hall v. Geiger-Jones*, where the Supreme Court upheld a similar blue-sky statute on the ground that the statute was not "unduly burdensome" and did not regulate at all in the absence of "any attempt to dispose of securities within [the] state." *See Shappley*, 520 S.W. 2d at 772, (citing *Hall v. Geiger-Jones*, 242 US 539, 558 (1917).[11]

[11] Life Partners tries to characterize their contacts with Virginia, and more specifically with the Virginia resident, as merely "ministerial" in nature and insufficient to justify application of the Virginia Act. The ruling in *Shappley* disposes of this contention. There, one phone call was

California's securities statute also has been upheld against Commerce Clause challenges. *People v. Sears*, 138 Cal.App.2d 773 (Cal. Dist. Ct. App. 1956). The California court responded to the appellant's Commerce Clause argument by holding that "until the Congress acts, the states are free to impose such an incidental or indirect burden on interstate commerce as may result from the provisions of the Corporate Securities Law which forbids the sale or disposition of corporate securities without a permit." *Id.* at 792.

In *Johnson-Bowles Comp. v. Utah*, 829 P.2d 101 (Utah Ct. App.), *cert denied*, 843 P.2d 516 (Utah 1992), the ability of the Utah Division of Securities to suspend a broker-dealer's license was upheld against a Commerce Clause challenge. The plaintiff, an out-of-state representative, challenged an order issued by the Utah Division of Securities claiming that because he was not a Utah resident, the order violated the Commerce Clause. *Id.* at 111. The court held that "Utah may apply its securities laws to operations that are conducted within [Utah], even if those laws affect, or are aimed at, non-residents." *Id.* at 110. The court further declared that "any interference with interstate commerce by the Division's March 1, 1989 order is merely incidental to the local benefit of preventing the trading of fraudulent stocks, or the trading of otherwise legal stocks in a fraudulent manner." *Id.*

The Viatical Settlement Act was enacted to prevent fraud against viators in Virginia. Under the foregoing authorities, any incidental burden the Act places on interstate commerce is

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sufficient for the court to conclude that the out-of-state seller was availing itself of the right to do business in the state, requiring it to comply with the state's reasonable regulations. In this case, of course, Life Partners' contacts with Jane Doe, the Virginia resident, went much further, encompassing multiple phone contacts, the exchange of express mail packages, a fax transmission, and the signing of key documents in Virginia.

outweighed by the important consumer protections that the Act provides for its citizens, and no violation of the Commerce Clause arises.

CONCLUSION

For the reasons set forth above, the Court should grant the Defendants' Motion for Summary Judgment and should dismiss the Plaintiff's claims.

Respectfully submitted,

[Signed]

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CERTIFICATE OF SERVICE

I hereby certify that on December 14, 2005, a true and correct copy of the foregoing MEMORANDUM OF LAW OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY JUDGMENT, was served by hand on:

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