LIFE SETTLEMENT AGREEMENTS AND THE TEXAS SECURITIES ACT: A SUMMARY AND REVIEW OF *LIFE PARTNERS, INC. V. ARNOLD*

By Joseph R. Anderson*

Life Partners, Inc. v. Arnold, 464 S.W.3d 660 (Tex. 2015).

I. Introduction

In *Life Partners, Inc. v. Arnold*,[1] the Texas Supreme Court (the Court) addressed the issue of whether "life settlement agreements" are securities under the Texas Securities Act and thus subject to the Act's registration and disclosure requirements.[2] Holding that the transactions at issue are in fact "investment contracts," and thus "securities," under the Texas Securities Act, the Court solidified important protections for the investing public and rejoined the vast majority of States in interpreting securities regulations broadly so as to maximize the protection provided to investors.[3] After briefly summarizing the law and facts at issue, this article discusses the Court's reasoning and analysis in *Life Partners* and attempts to address some potential impacts of the Court's decision.

II. The Law at Issue

In general, securities regulations "embody the belief that information is the most important form of investor protection."[4] The Texas Securities Act (the Act), in particular, requires that all securities be registered with the State and that all issuers or dealers have a permit to sell such securities.[5] Furthermore, before a permit can be granted, the Act requires that certain disclosures be made in a sworn and verified statement.[6] In addition to other information, the statement must include the following: the names and addresses of the officers of the company; the location of its principal place of business; copies of the securities to be sold; "a copy of any contract it proposes to make concerning such security"; a copy of any "advertisement or other description of security prepared"; and a number of the company's financial statements must be provided.[7]

Moreover, the Act also imposes civil liability on any "person who offers or sells" securities "by means of an untrue statement of a material fact or an omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under

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[1] 464 S.W.3d 660 (Tex. 2015).

[2] *Id.* at 662.

[3] *Id.* at 681.

[4] *Id.* at 676-77 (citing S.E.C. v. Life Partners, Inc., 87 F.3d 536, 550 (D.C. Cir. 1996) (Wald, J., dissenting)). [hereinafter *D.C. Cir. Life Partners*]

[5] Tex. Rev. Civ. Stat. Ann. art. 581-7.A(1) (West 2012) ("No dealer or agent shall sell or offer for sale any securities . . . , except those which shall have been registered . . . and . . . until the issuer of such securities or a dealer registered under the provisions of this Act shall have been granted a permit by the Commissioner . . . .").

[6] *Id.*

[7] *Id.*

which they are made, not misleading."[8] The provisions of this Act, however, only apply to sales and offers to sell "securities," as that term is defined in the Act. While the Act does provide that the "term 'security' or 'securities' shall include any . . . investment contract, or any other instrument commonly known as a security," the Act does not define the term "investment contract."[9] It has therefore been left to courts to determine which types of transactions fit within the meaning of the term "investment contract."[10]

The Texas Supreme Court first adopted the United States Supreme Court's *Howey*/*Forman* Test for determining whether a transaction constitutes an "investment contract" in *Searsy v. Commercial Trading Corp.*[11] There, the Court explained that the term "appear[ed] to have been taken from an almost identical definition of 'security' in the Federal Securities Act of 1933,"[12] and accordingly, the Court "looked to federal cases and other authorities for guidance in construing the term."[13] As the Court noted in *Searsy*, "[t]he *Howey* test embodies four requirements: (1) investment of money; (2) a common enterprise; (3) expectation of profits; (4) solely from the efforts of others."[14]

Before the Texas Supreme Court's holding in *Life Partners*, the Texas courts of appeals were in disagreement regarding the relevance of pre-purchase activities to this test and whether life settlement agreements were investment contracts under the Texas Securities Act.[15] This idea, however, is by no means a new concept. The Eleventh Circuit included life settlement agreements within the meaning of the term "investment contract" in 2005,[16] and in 2010, "the SEC issued a special report on life settlement contracts," which "[a]mong other things, . . . recommended that life settlements be clearly defined as securities."[17] The SEC report also noted that "[a]lmost all states treat life settlements as securities under state laws," and at that time, "[o]nly two states ha[d] not made a determination as to whether life settlements are

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[8] *Id.* art. 581–33.A(2). "In addition, the Act obligates the Attorney General 'to take such measures and to make such investigations as will prevent or detect the violation of any provision thereof.'" *Life Partners*, 464 S.W.3d at 666 n.7 (quoting art. 581-3).

[9] Art. 581-4.A.

[10] *See* Searsy v. Commercial Trading Corp., 560 S.W.2d 637, 639–41 (Tex. 1977).

[11] *Id.* at 641; *see also*, *Life Partners*, 464 S.W.3d at 670 ("When we addressed the meaning of 'investment contract' in *Searsy*, we adopted the Supreme Court's *Howey* test, as restated in *Forman*, as the basis for determining whether a transaction is an 'investment contract,' and thus a 'security,' under the Texas Securities Act.").

[12] *Searsy*, 560 S.W.2d at 639 (citing 15 U.S.C. § 77b(1)).

[13] *Id.* at 639–41. "American courts have thus developed a significant body of law on the topic, and while these courts have not always agreed, their decisions have served as a guide to the meaning and application of the term 'investment contract' in the securities-law context throughout the country." *Life Partners*, 464 S.W.3d at 667.

[14] *Searsy*, 560 S.W.2d at 640.

[15] In the cases before the Court in *Life Partners*, both the Dallas and Austin Courts of Appeals rejected the Waco court's conclusion, in Griffitts v. Life Partners, Inc., No. 10–01–00271–CV, 2004 WL 1178418, at *2 (Tex. App.—Waco May 26, 2004, no pet.) (mem. op.), that Life Partners' life settlement agreements were not investment contracts. Arnold v. Life Partners, Inc., 416 S.W.3d 577, 592 (Tex. App.—Dallas 2013), *aff'd*, 464 S.W.3d 660 (Tex. 2015); State v. Life Partners Holdings, Inc., 459 S.W.3d 619, 619 (Tex. App.—Austin 2014) (mem. op.), *aff'd sub nom.*, Life Partners, Inc. v. Arnold, 464 S.W.3d 660 (Tex. 2015).

[16] S.E.C. v. Mut. Benefits Corp., 408 F.3d 737, 744 (11th Cir. 2005).

[17] 1 Thomas Lee Hazen, The Law of Securities Regulation §1.6[2][D] (7th ed. 2012)

securities under state law."[18]

III. The Factual Background & Procedural History of *Life Partners, Inc. v. Arnold*

For more than 20 years, Life Partners, Inc. ("Life Partners") "has been engaged in the business of buying existing life insurance policies from those whose lives the policies insure, and then selling interests in those policies to others."[19] The Court in *Life Partners* refers to these types of transactions, in general, as "life settlement agreements."[20] Life Partners purchases insurance policies[21] from the insureds "for a 'cash settlement' that is less than the amount the policy will pay at the time of the insured's death."[22] It funds these transactions by selling "interests in the policies' future benefits to 'investors' or 'purchasers.'"[23] In particular, Life Partners uses the investors' funds to "(1) pay the insured for the policy, (2) create an escrow account from which to pay the policy's future premiums as they come due, (3) pay fees to escrow agents and to any brokers . . . , and (4) pay Life Partners an administration or brokerage fee."[24] Life Partners then becomes legal owner of the policy and "appoints a trustee to serve as the beneficiary."[25] Thus, the investors do not actually own or have control over the policies, and once the insured dies, Life Partners is responsible for obtaining the death certificate, submitting a claim to the life insurance company, and facilitating payment of the benefits, which are first paid to the trustee and then distributed "to the purchasers according to their fractional interests."[26]

The subject of these lawsuits is the transaction between Life Partners and the purchasers of these fractionalized interests, which the court refers to as "life settlement agreements."[27] The issue in these two consolidated cases then is "whether a 'life settlement agreement' . . . is an 'investment contract' and thus a 'security' under the Texas Securities Act."[28] In the first case, *Arnold v. Life Partners, Inc.*,[29] Michael and Janet Arnold, and other purchasers of these life settlement agreements, "filed a class action lawsuit in Dallas County, seeking rescission and damages based on claims that Life Partners . . . violated the Texas Securities Act by selling unregistered securities and materially misrepresenting to purchasers that they were not, in fact, securities."[30] In the second case, "*State v. Life Partners, Inc.*,[31] the State of Texas filed a

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[18] Life Settlements Task Force, S.E.C., Staff Report to the United States Securities and Exchange Commission 36 (July 22, 2010) [hereinafter SEC Report], http://www.sec.gov/news/studies/2010/lifesettlements-report.pdf.

[19] *Life Partners*, 464 S.W.3d at 663 ("These types of transactions are generally referred to as 'life settlements' when the insured is elderly or 'viatical settlements' when the insured is terminally ill.").

[20] *Id.*

[21] "When selecting policies to purchase, Life Partners identifies insureds who are interested in selling their policies, evaluates their medical condition, predicts their life expectancy, and evaluates the policies' terms and conditions to ensure they are assignable." *Id.* at 664.

[22] *Id.* at 663.

[23] *Id.*

[24] *Id.* at 664.

[25] *Id.*

[26] *Id.* at 665.

[27] *Id.* at 663. The transaction between Life Partners and the insureds is not at issue in these cases. *Id.*

[28] *Id.* at 662.

[29] Arnold v. Life Partners, Inc., 416 S.W.3d 577 (Tex. App.—Dallas 2013), *aff'd*, 464 S.W.3d 660 (Tex. 2015)

[30] *Life Partners*, 464 S.W.3d at 662 (footnote omitted) (discussing the facts of *Arnold*).

separate suit in Travis County, seeking an injunction and other relief based on allegations that Life Partners and others had committed fraud in connection with the sale of securities."[32] In both cases, the district courts granted summary judgments "in favor of Life Partners, holding that Life Partners had not promoted or marketed any 'securities' and thus could not be liable under the Texas Securities Act."[33]

IV. The Texas Supreme Court's Reasoning

The Court's decision in *Life Partners* is primarily based on a fundamental analysis and clarification of the term "investment contract," as used in the Texas Securities Act.[34] Relying heavily on the reasoning and guidance of the United States Supreme Court and other federal and state courts, as it did in *Searsy*, the Court concluded that, "[b]ased on these authorities and our reading of the statute's language, . . . three key principles must guide our construction and application of the term 'investment contract.'"[35] In accordance with these guiding principles, the Court re-clarified the term as it applies to the Texas Securities Act and held that "the entrepreneurial or managerial efforts that are relevant to this inquiry . . . include those that are made prior to the transaction as well as those that are made after."[36] Accordingly then, applying its restated definition to Life Partners' life settlement agreements, the Court held that, "based on the undisputed material facts," the agreements in question "are investment contracts, and thus securities, under the Texas Securities Act."[37]

A. Guiding Principles & the *Howey/Forman* Test

The Court begins its analysis by discussing the origins of the term "investment contract" and how it has been interpreted by the United States Supreme Court.[38] Relying on a number of state court constructions of the term, the Supreme Court, in *S.E.C. v. W.J. Howey Co.*,[39] "noted that state courts 'broadly construed' the term" and "disregarded 'form' over 'substance,'" emphasizing "the 'economic reality' of the transactions."[40] The Supreme Court thus concluded that "an investment contract for purposes of the [Federal] Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party."[41]

Clarifying the definition from *Howey*, the Supreme Court again, in *United Housing*

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[31] State v. Life Partners Holdings, Inc., 459 S.W.3d 619, 619 (Tex. App.—Austin 2014) (mem. op.), *aff'd sub nom.*, Life Partners, Inc. v. Arnold, 464 S.W.3d 660 (Tex. 2015)

[32] *Life Partners*, 464 S.W.3d at 663 (footnote omitted) (discussing the facts of *Life Partners Holdings*).

[33] *Id.*

[34] *See id.* at 666–67.

[35] *Id.* at 667.

[36] *Id.* at 681.

[37] *Id.* at 682.

[38] *Id.* at 666–70.

[39] 328 U.S. 293 (1946).

[40] *Life Partners*, 464 S.W.3d at 668 (quoting *Howey*, 328 U.S. at 298).

[41] *Howey*, 328 U.S. at 298–99.

Foundation, Inc. v. Forman,[42] "explained that Congress 'sought to define the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that . . . fall within the ordinary concept of a security.'"[43] The Court reemphasized that "Congress intended the application of these statutes to turn on the economic realities underlying a transaction and not on the name" the parties had given it.[44] Slightly restating the *Howey* test, the Court clarified that "[t]he touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the *entrepreneurial or managerial efforts of others*."[45]

While the Texas Supreme Court's analysis and review of these Supreme Court decisions[46] is relevant for the purposes of reiterating the appropriate test under the Texas Securities Act, the Court further explained that "they also describe the proper *approach* to the term's construction."[47] Accordingly, the Court derived "from these cases three key principles to guide [its] application of the *Howey/Forman* test to any particular transaction":[48]

> First, we must "broadly construe[]" the term "investment contract" to maximize the protection the Act is intended to provide to the investing public. Second, we must focus on the "economic realities" of the transaction to determine whether it meets the test's requirements. And third, if the "economic realities" satisfy the requirements, we must conclude that the transaction is an "investment contract" regardless of the labels or terminology the parties used to describe it.[49]

"Following the lead of numerous other courts," the Court concluded that it "accept[s] and appl[ies] these guidelines when using the *Howey/Forman* test to determine whether a transaction constitutes an 'investment contract.'"[50]

B. "Profits from the Efforts of Others"

The Court then moved on to consider the element at issue in the case—that the investor is "led to expect profits 'solely from the efforts of the promoter or third party.'"[51] Looking to its guiding principles and again to the reasoning and decisions of other courts, the Court reviewed the test's proper application and transformation after *Howey*, "particularly with regard to (1) whether the profits must come 'solely' from the efforts of others, and (2) the kinds of 'efforts' of promoters and others on which the purchasers must rely."[52] In light of this review, the

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[42] 421 U.S. 837 (1975).

[43] *Life Partners*, 464 S.W.3d at 669 (quoting *Forman*, 421 U.S. at 847–48).

[44] *Forman*, 421 U.S. at 849.

[45] *Id.* at 852 (emphasis added).

[46] In addition to *Howey* and *Forman*, the Court also discussed the reasoning and principles applied in S.E.C v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943), Reeves v. Ernst & Young, 494 U.S. 56 (1990), and S.E.C. v. Edwards, 540 U.S. 389 (2004).

[47] *Life Partners*, 464 S.W.3d at 670.

[48] *Id.*

[49] *Id.* (alteration in original) (citations omitted).

[50] *Id.* at 670–71.

[51] *Id.* at 671.

[52] *Id.*

Court then further clarified and restated the "'efforts' aspect of the *Howey/Forman* test."[53]

First, regarding the amount or distribution of efforts involved in the enterprise (i.e., between the investor and the promoter or other third parties), the Court reiterated the approach it adopted in *Searsy*.[54] There, the Court concluded that the proper test "inquires whether the investor made any *significant* efforts," not whether they made *any* efforts at all.[55] Accordingly, "even if the purchaser's profits depend in part on the purchaser's own efforts," the *Life Partners* Court concluded as it did in *Searsy* that "a transaction will satisfy the 'efforts' element of the *Howey/Forman* test if the efforts of others 'are undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.'"[56]

Likewise, regarding the "kinds" of efforts that are "significant" in applying the *Howey*/*Forman* test, the Court again re-urged the approach it adopted in *Searsy*.[57] There, the Court adopted the Ninth Circuit's language from *Turner Enterprises*, where the Ninth Circuit held that "the 'efforts' that count 'are the undeniably significant ones, those *essential managerial efforts* which affect the failure or success of the enterprise.'"[58] In other words, the Court noted that the key consideration is whether "the holder is relying on the managerial skills of others to generate his profit."[59] Thus, "[b]y implication, if the holder is relying on his own entrepreneurial talents to generate his profit, his interest is not treated as a security."[60] The Court then discussed again the decisions and reasoning of several other courts and concluded,

> The cases thus indicate that, to constitute an investment contract under the "efforts" aspect of the *Howey/Forman* test, the transaction must be such that, in reality, the seller, or another party other than the purchaser, exercises the predominate managerial or entrepreneurial control on which the purchaser's anticipation of profits is based. Conversely, courts have recognized that control over merely "ministerial" or "clerical" functions does not constitute the kind of "significant efforts" that satisfy the *Howey/Forman* test.[61]

Furthermore, "[b]ecause the *Howey/Forman* test does not strictly require that the purchaser rely 'solely' on the efforts of others," the Court reiterated that "the distinction between 'managerial or entrepreneurial control' and 'perfunctory or ministerial duties'" must be applied "to the activities of both the purchasers and the sellers in any given transaction."[62]

C. Pre-purchase versus Post-purchase Efforts

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53 *Id.* at 674.

54 *Id.* at 672–73.

55 *Searsy*, 560 S.W.2d at 641 (emphasis added).

56 *Life Partners*, 464 S.W.3d at 673 (quoting *Searsy*, 560 S.W.2d at 641).

57 *Id.*

58 *Id.* (emphasis added) (quoting *Turner Enterprises*, 474 F.2d at 482).

59 *Id.* at 674 (quoting Siebel v. Scott, 725 F.2d 995, 999 (5th Cir. 1984)).

60 *Id.* (quoting *Siebel*, 725 F.2d at 999).

61 *Id.* at 674–75 (footnote omitted).

62 *Id.* at 675.

After re-analyzing the basic concepts of the *Howey*/*Forman* test and its application by other courts, the Court next turned to the central issue in the case—whether pre-purchase efforts are relevant in determining if a transaction constitutes an investment contract.[63] In general, the Court first noted that "[e]arly cases applying the *Howey/Forman* test generally focused on the efforts and control that the parties exercised *after* the transaction occurred."[64] However, the Court then discussed some cases that have addressed the issue more directly.

In particular, the Court focused on the D.C. Circuit's opinion in *S.E.C. v. Life Partners, Inc.*,[65] which addressed facts nearly identical to those in the present case and specifically dealt with "whether the efforts [Life Partners] exerted *before* the transaction were relevant to the *Howey/Forman* analysis."[66] In that case, a majority of the D.C. Circuit held that "prepurchase services cannot by themselves suffice to make the profits of an investment arise predominantly from the efforts of others."[67] However, the Court in *Life Partners* also focused heavily on the dissent from D.C. Circuit's decision.[68] Justice Wald's dissenting opinion rejected "the majority's conclusion that pre-purchase efforts 'should be categorically excluded,'" and instead, concluded that "'the *Howey* test can be met by pre-purchase managerial activities of a promoter when it is the success of these activities, either entirely or predominantly, that determines whether profits are eventually realized.'"[69]

Following the D.C. Circuit's decision, the Waco Court of Appeals also addressed the same issue, in *Griffitts v. Life Partners, Inc.*, and reached the same result as the D.C. Circuit's majority.[70] "The following year, however," the Court noted, "[T]he Eleventh Circuit Court of Appeals reached the opposite conclusion in *S.E.C. v. Mutual Benefits Corp.*"[71] There, the Eleventh Circuit expressly "deline[d] to adopt the test established by the [D.C. Circuit] *Life Partners* court," and it rejected the notion that *Howey* "require[s] such a clean distinction between a promoter's activities prior to his having use of an investor's money and his activities thereafter."[72] Accordingly, "[b]ecause the 'investors relied on both the pre- and post-purchase managerial activities of [the promoter] . . . ,' the court concluded that the promoter 'thus offered what amounts to a classic investment contract.'"[73] The Court next moved on to restate and confirm the Texas test.

D. The Texas Test, Clarified and Confirmed

Mentioning again that "many courts throughout the country have addressed the meaning

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[63] *Id.* at 676.

[64] *Id.*

[65] 87 F.3d 536 (D.C. Cir. 1996) [hereinafter *D.C. Cir. Life Partners*].

[66] *Life Partners*, 464 S.W.3d at 676 (citing *D.C. Cir. Life Partners*, 87 F.3d 536).

[67] *D.C. Cir. Life Partners*, 87 F.3d at 547.

[68] *Life Partners*, 464 S.W.3d at 676–78 (discussing *D.C. Cir. Life Partners*, 87 F.3d at 549–56 (Wald, J., dissenting)).

[69] *Id.* at 677–78 (quoting *D.C. Cir. Life Partners*, 87 F.3d at 551 (Wald, J., dissenting)).

[70] No. 10-01-00271-CV, 2004 WL 1178418 (Tex. App.—Waco May 26, 2004, no pet.) (mem. op.).

[71] *Life Partners*, 464 S.W.3d at 679 (citing S.E.C. v. Mut. Benefits Corp., 408 F.3d 737 (11th Cir. 2005)).

[72] *Id.* (quoting *Mut. Benefits Corp.*, 408 F.3d at 743).

[73] *Id.* at 680 (quoting *Mut. Benefits Corp.*, 408 F.3d at 744).

of 'investment contract,'" the Court went on to briefly discuss the development of the *Howey*/*Forman* test in Texas.[74] The Court concluded,

> Having reviewed both the statute's language and the extensive authorities from Texas and throughout the country, we now confirm and clarify, *first*, that the Texas Securities Act's definition of "securities" must be construed broadly to maximize the protection it provides to investors, while focusing on the economic realities of the transaction regardless of any labels or terminology the parties may have used.[75]

"*Second*, in light of these guiding principles and consistent with the uniform constructions of the precedents [it] discussed,"[76] the Court restated its definition of "investment contract":

> [W]e confirm and clarify that an "investment contract" for purposes of the Texas Securities Act means a contract, transaction, or scheme through which a person pays money to participate in a common venture or enterprise with the expectation of receiving profits, under circumstances in which the failure or success of the enterprise, and thus, the person's realization of the expected profits, is at least predominately due to the entrepreneurial or managerial, rather than merely ministerial or clerical, efforts of others.[77]

In other words, for a transaction to qualify as an investment contract it must involve (1) "the payment of money," (2) "a common enterprise," (3) "the expectation of profits," and (4) "dependence *predominately* on the entrepreneurial or managerial efforts of others to achieve the anticipated profits."[78]

Third, the Court held that "the entrepreneurial or managerial efforts that are relevant to this inquiry, whether those of the purchasers or of others, include those that are made prior to the transaction as well as those that are made after."[79] Relying heavily on Judge Wald's dissent, in particular, the Court made clear that Texas's version of the *Howey*/*Forman* test "can be met by pre-purchase managerial activities."[80] The Court explained, "[T]he key question is not when the efforts of others take place, but whether they are entrepreneurial or managerial efforts that affect the failure or success of the enterprise."[81]

E. The Law Applied to Life Partners' Life Settlement Agreements

Applying its restated definition to Life Partners' life settlement agreements, the Court held that, "based on the undisputed material facts[,] . . . they are investment contacts, and thus

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74 *Id.*

75 *Id.* at 681.

76 *Id.*

77 *Id.*

78 *Id.* at 682.

79 *Id.* at 681.

80 *Id.* at 682 (quoting *D.C. Cir. Life Partners*, 87 F.3d at 551 (Wald, J., dissenting)).

81 *Id.*

securities, under the Texas Securities Act."[82] The Court explained that "Life Partners' pre-purchase efforts are 'undeniably essential to the overall success of the investment.'"[83] In particular, Life Partners' pre-purchase efforts require it "to accurately evaluate the insured's life expectancy and to set the correct purchase price (discount) to yield a profit based on the insured's life expectancy, future premiums, and end-value of the policy's benefits."[84] In other words, the investors' expectations of profits are almost entirely reliant on Life Partner's pre-purchase predictions and decisions, and as such, they clearly meet the required standard. Regarding post-purchase efforts, the Court considered the fact that Life Partners "holds legal title to the policy, monitors the insured and the policy premium payments, and collects and distributes the necessary funds."[85] Thus, the Court concluded that, because "Life Partners exercises complete control and discretion over the investment and the investment's success," their "post-purchase efforts are managerial, not ministerial."[86]

Accordingly, the Court held that the life settlement agreements at issue "are investment contracts, and thus securities, under the Texas Securities Act."[87] Moreover, because the Court concluded its "decision merely interprets and applies a very old law, consistent with the manner in which other courts have interpreted and applied it for decades," the Court declined to limit its holding to only prospective application, as Life Partners had requested.[88] Finally, the Court agreed with the Austin Court of Appeals and remanded the issues regarding the "relief defendants" for further proceedings in the trial court.[89]

V. Potential Impact[90]

The Texas Supreme Court's unanimous decision in *Life Partners* solidifies and reinforces some of the most important protections for investing consumers in Texas.[91] Confirming that the Texas Securities Act "must be construed broadly to maximize the protection it provides to investors," the decision re-emphasized the United States Supreme Court's "flexible approach" and realigned Texas with the overwhelming majority of States in their interpretations of the term "investment contract."[92] Consequently, life settlement agreements like those offered by

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[82] *Id.*

[83] *Id.* (quoting *D.C. Cir. Life Partners*, 87 F.3d at 547).

[84] *Id.*

[85] *Id.* at 683.

[86] *Id.*

[87] *Id.* at 684.

[88] *Id.* at 685.

[89] *Id.* at 686 ("The State sued these Petitioners as 'relief defendants,' seeking equitable relief 'on the belief that they might hold property or assets belonging to Life Partners.'").

[90] The author would like to thank Michael J. Durrschmidt of Hirsch and Westheimer P.C. for his valuable input and suggestions regarding this section of the article.

[91] Jess Davis, *Texas Supreme Court Says Life Partners Sold Securities*, Law360 (May 8, 2015, 2:54 PM), http://www.law360.com/articles/653461/texas-supreme-court-says-life-partners-sold-securities (quoting Keith Langston of Langston Law Firm, the attorney for the investors) ("It's a good victory for Texas consumers as a whole. It provides them with the requisite security that anybody who wants to do this in the future now is required to register these products with the Texas State Securities Board, and future investors will now have access to all the information necessary to make an informed decision before they invest.").

[92] *Life Partners*, 464 S.W.3d at 681; *see also* SEC Report, *supra* note 18, at 36 ("A majority of states include

Life Partners are now subject to the registration and disclosure requirements of the Texas Securities Act.[93] Again, securities regulations "embody the belief that information is the most important from of investor protection."[94] The Court's unanimous decision now extends that protection to investors considering the purchase of these life settlement agreements, which have allegedly involved a significant amount of fraud over the years.[95]

Life Partners, on the other hand, argued that "the consideration of pre-purchase efforts will transform every traditional land acquisition or purchase for use or consumption into an 'investment contract,'" but this is unlikely.[96] As the Court pointed out, every disputed transaction still must meet the Court's definition.[97] Also, as mentioned earlier, interpreting the term "investment contract" to include life settlement agreements is by no means a new idea, and there is no indication that this minor extension of the term (in line with the statutes purpose and a majority of other jurisdictions) has had such an effect elsewhere. Shifting focus from the time of the efforts to the kinds of efforts at issue does not, by any means, equate to removing the efforts analysis all together. The bottom line is that the law regarding life settlement agreements has been moving in this direction for some time, and at least in the Court's opinion, the official shift in Texas will have little impact on other similar transactions because they still must meet the Court's now further clarified definition.

Additionally, one commentator mentioned that one of the biggest impacts of the Court's decision is the fact that the Court declined to give its ruling only prospective application.[98] Due to the relevant statutes of limitations,[99] Life Partners and other similar companies are now

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life settlements in their statutory definition of 'security,' either directly in that definition, or as part of the definition of 'investment contract.'"); George Lee Flint, Jr., *Securities Regulation*, SMU L. Rev. 102 (forthcoming), http://smulawreview.law.smu.edu/getattachment/Journals/TX-Survey/2015-Texas-Survey/Securities-Regulation.pdf ("Texas courts have joined the rest of the nation in concluding that interests in life settlements constitute 'investment contracts' and therefore securities under the TSA.").

[93] *See* Tex. Rev. Civ. Stat. Ann. art. 581-7.A(1), 581–33 (West 2012).

[94] S.E.C. v. Life Partners, Inc., 87 F.3d 536, 550 (D.C. Cir. 1996) (Wald, J., dissenting).

[95] Brief of Amicus Curiae: North American Securities Administrators, Inc. at 14, Life Partners, Inc. v. Arnold, 464 S.W.3d 660 (Tex. 2015) (No. 14-0122), 2014 WL 7208665 ("Life settlements are rife with fraud and the potential for investor abuse. Over the last fifteen years, there have been widespread problems in the sale of Life Settlement Contracts, and as a result, thousands of investors have lost significant amounts of money. The patterns of investor abuse in the sale of these products are well documented.").

[96] *Life Partners*, 464 S.W.3d at 681–82.

[97] *Id.* at 682 ("[W]e believe the various aspects of the definition we have provided are sufficient to ensure that the transaction in question is the type of 'investment contract' the Act aims to address. The transaction must involve the payment of money, a common enterprise, the expectation of profits and dependence *predominantly* on the entrepreneurial or managerial efforts of others to achieve the anticipated profits . . . .").

[98] *Life Partners, et al. v. Arnold et al.; Texas Supreme Court confirms fractionalized life settlement interests sold to Texas investors are Investment Contracts*, Locke Lord (May 27, 2015) [hereinafter Locke Lord], http://www.lockelord.com/newsandevents/publications/2015/05/life-partners-et-al-v-arnold-et-al-texas-supreme-court-confirms-fractionalized-life-settlement-interests-sold-to-texas-investors-are-investment-contracts ("Perhaps the most intriguing (and somewhat unexpected) aspect of the Texas Supreme Court ruling was that it should be afforded retroactive application.").

[99] See Tex. Rev. Civ. Stat. Ann. art. 581-33.H(1), (2) (West 2012); Flint, *supra* note 92, at 107 (A claim based on the sale of unregistered securities or other related violations "carries a three year statute of limitations, which begins running at the time of the sale. A 'sale by misstatement' claim carries limitations of five years from the sale, and three years from the time the buyer should have discovered the misstatement.").

potentially subject to a significant amount of liability for transactions completed up to three to five years ago.[100] Undoubtedly, this potential liability and a number of other similar concerns played a large part in Life Partners' decision to file for bankruptcy in January.[101]

The proceedings in the bankruptcy court have raised some other very interesting issues, such as what interest the investors in these life settlement agreements actually own.[102] Technically, the investors "do not have legal title to the insurance policy."[103] Instead, "[w]hen Life Partners purchases a policy, it becomes the legal owner [and] appoints a trustee to serve as the beneficiary."[104] In fact, the insurance policy is typically not even purchased until after the investors have paid for the life settlement agreements.[105] Thus, the transfer of the investors' interest in the life settlement normally precedes the transfer of Life Partners' interest in the insurance policy. Furthermore, even assuming the investors do have something more than a mere contract right, they still only own a fractionalized interest in any one life insurance policy.[106]

Consequently, the investors' position in the bankruptcy is tenuous to say the least, and the Trustee's final determination could have far reaching implications on similar transactions in the future, possibly even ones in other states.[107] Most likely, this will again require investors to be more conscious of the types of transactions they are entering into. At least now these investors have access to the necessary information, and this is the core principle of the securities regulations.

VI. Conclusion

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[100] Locke Lord, *supra* note 98 ("[The retroactive application] issue is very significant because, among other things, there is a three year automatic strict liability rescission right for purchasers of a security that should have been, but were not, registered under the Texas Securities Act.").

[101] *See* Davis, *supra* note 91 ("Life Partners Holdings Inc. filed for Chapter 11 protection in January, in a bid to buy time while it appeals a $47 million judgment won by the U.S. Securities and Exchange Commission against the holding company and Life Partners executives Brian Pardo and Scott Peden, who resigned in February. The bankruptcy judge in March appointed a trustee, and in April authorized the trustee to file bankruptcy petitions on behalf of LPHI subsidiaries, including Life Partners Inc. and LPI Financial Services Inc.").

[102] Locke Lord, *supra* note 98 ("The Trustee in the bankruptcy proceeding has seized upon the Texas Supreme Court case to take some very significant positions with respect to the life settlement investors which, using his terminology, hold "Contract Positions" with respect to the death benefits payable to the escrow agents in connection with approximately 3,600 life insurance policies with an aggregate face value in excess of $2.4 billion owned of record by Life Partners.").

[103] *Life Partners*, 464 S.W.3d at 666.

[104] *Id.* at 664.

[105] *Id.* ("Life Partners uses the purchasers' funds to (1) pay the insured for the policy, (2) create an escrow account from which to pay the policy's future premiums as they come due, (3) pay fees to escrow agents and to any brokers who helped sell the interests to the purchasers, and (4) pay Life Partners an administration or brokerage fee.").

[106] Locke Lord, *supra* note 98 ("This case impacts the sale of fractionalized interests only . . . .").

[107] *Id.* ("Until the Trustee can sort through the complexities of the bankruptcy proceeding and potential claims of creditors/contract position holders, particularly in light of the Texas Supreme Court decision, he has suspended all payments of death benefit proceeds to contract position holders, advised them that they remain obligated to fund premium calls and servicing expenses for the life insurance policies with respect to which they hold contract positions and has frozen the sale and transfer of any of the contract positions on the grounds that such transfers might be in violation of applicable state security laws (presumably not limited to Texas.").

Accordingly, the Texas Supreme Court's decision in Life Partners effectively finalizes a decisive shift in Texas securities law in favor of the investing public. While there may be other related effects of the Court's opinion, this is biggest and most important—life settlement agreements like the ones offered by Life Partners must be offered and sold in accordance with Texas securities regulations. While the issue is still largely undecided at the federal level, the fact that life settlement agreements are investment contracts, and thus securities, under the Texas Securities Act is now decided, and the relevance of pre-purchase efforts is definitively established.