MELANIE SENTER LUBIN,	*	IN THE
Plaintiff	*	CIRCUIT COURT
v.	*	FOR
BENEFICIAL ASSURANCE, LTD., *et al.*	*	BALTIMORE CITY
Defendants	*	Case No.: 24-C-02-006515

* * * * * * * * * * * * *

MEMORANDUM OF DECISION

Procedural Background

This matter originally came before the Court on cross Motions for Summary Judgment filed by Plaintiff Melanie Senter Lubin, Securities Commissioner for the State of Maryland ("Commissioner") and Defendant Edwin C. Hirsch ("Hirsch") including all related oppositions and replies thereto. After conducting oral hearing on August 25, 2005 and upon consideration of all motions and associated briefs, on December 19, 2005 this Court issued an order granting Defendant Hirsch's Motion for Summary Judgment and denying the Commission's. In granting Defendant Hirsch's Motion this Court explained that "pursuant to *Baker, Watts & Company v. Miles and Stockbridge, et al.*, 95 Md. App. 145 (1993) Defendant Hirsch can not be held liable as a controlling person with Beneficial Assurance, LTD no longer joined as a defendant, and [that] [ ] Plaintiff has not offered sufficient admissible evidence to refute Defendant's Affidavit that he was not involved in selling policies directly to purchasers, and, accordingly, cannot be held liable as a primary violator."

On December 27, 2005 the Commissioner filed a Motion for Reconsideration

of this Court's December 19, 2005 Order, Hirsch filed an opposition, and the Commission filed a reply. After reviewing these pleadings, this Court asked both parties to file supplemental briefs on the issue of primary liability and scheduled a hearing on this issue for April 7, 2006.

In her Motion for Reconsideration, the Commissioner argues that (1) the holding of *Baker, Watts* does not apply to the instant case, and, thus, Defendant Hirsch can still be held liable as a control person under section 11-703 (c)(1) of the Maryland Securities Act (the "Act"), Md. Code, Corporations and Associations, § 11-703(c)(1), and (2) even though Hirsch may not have sold securities directly to purchasers, he can still be held liable as a primary violator because his actions constituted a "device, scheme or artifice to defraud" and/or an "act, practice, or course of business which operates or would operate as a fraud or deceit on any person" under sections 11-301(1) and (3) of the Act.

For the reasons set forth below, this Court will vacate its December 19, 2005 Order granting Hirsh's Motion for Summary Judgment as to all counts. However, it will still grant Hirsh's Motion for Summary Judgment as to Count I for the Offer and Sale of Unregistered Securities in violation of section 11-501 of the Act and Code of Maryland Regulations ("COMAR") 02.02.03.01 *et seq.* and Count II for the Offer and Sale of Securities by Unregistered Broker-Dealer Agents in violation of section 11-401 of the Act. Finally, this Court will deny both parties' Motions for Summary Judgment for the Violation of the Anti-Fraud Provisions of the Act, section 11-301, as there are genuine issues of material fact relating to this claim.

Factual Background

Beneficial Assurance, Ltd. ("Beneficial"), a subsidiary of Beneficial Financial Services, Inc. ("Beneficial Financial"), is a viatical company incorporated in the State of Maryland on October 10, 1997.1 Barlow Aff. at ¶¶ 3 & 5. Both Beneficial and Beneficial filed for Bankruptcy in November, 2002. *Id.* at ¶ 22. Beneficial has conducted its operations from various offices within Maryland until about March 2002. *Id.* at ¶ 7; Zenian Aff. at ¶ 5. It currently operates out of Bloomington, Illinois. *Id.*

Mr. Hirsch served as Beneficial's Vice President from October 1997 until April 2001 when he became its President. Barlow Aff. at ¶ 8; Hirsch Depo. at 11, 14-15, 23. He also served as the C.E.O. and Chairman of the Board of Directors for Beneficial Financial from April 1997 until November 2002 when it filed for bankruptcy. Barlow Aff. at ¶ 6 & 8; Hirsch Depo. at 8 & 11.

Beneficial offered for sale and sold investments in viatical settlements. A viatical settlement is an investment whereby the owner (or "viator") of a life insurance policy sells the rights to receive the policy's death benefits for a discounted percentage of the life insurance policy's face value. The purchaser or investor receives the face value of the policy when it matures upon the insured's death. The purchaser or investor realizes a profit if the face value of the policy

1 Beneficial was originally formed under the name Imtek Funding Corporation and traded under the name of Beneficial Assistance. Barlow Aff. ¶ 3. It was subsequently renamed Beneficial Assurance, Ltd. in May 2000. *Id.*

exceeds his or her purchase price plus premiums, interest and other transaction costs.

The sales literature Beneficial employed to promote the viatical settlements to potential investors and agents represented that the transactions were safe through the use of "an independent escrow agent... to handle your funds." Barlow Aff. Exh. 1, 2 & 3. It so represented in solicitation material and letters to investors and agents. *Id.* at Exh. 1. It advertised the "independent escrow agent" on its website. *Id.* at Exh. 2. Beneficial also represented that the principal was safe because it dealt only "with life policies from top rated insurance companies that are beyond the applicable contestability period...." *Id.* Exh. 3. Finally, it represented that the returns were safe, high and fixed because it is "fixed and fully collateralized at the time of purchase" and, thus, "clients know[ ] exactly what they will receive upon maturity." *Id.*

When a person invested in a viatical settlement with Beneficial, he or she entered into a Purchase Authorization Agreement ("Agreement"). Zenian Aff. at ¶10, Exh. A., pp. 18-20. This Agreement allowed the investor to select the desired period of investment, such as a twelve (12) or twenty-four (24) month life expectancy. Brown Depo. at 58-59. Along with the Agreement the investor sent in the amount he or she wished to invest to an escrow agent or trustee selected by Beneficial. Zenian Aff, ¶¶ 10, 16, Ex. A., pp. 18-20; Brown Depo. at 22,37, 58-59; Barlow Aff. ¶ 12. Typically, investments from several investors were pooled into an escrow account, so that each investor held a fractional value in the face value of

the policy. Barlow Aff. at ¶ 25 & 27. When the escrow agent had accumulated enough money from investors seeking a policy with the same desired life expectancy, Beneficial personnel evaluated the insured's medical records, sent the insured to a medical consultant, obtained a life expectancy evaluation from the consultant and then negotiated the purchase of the policy. Barlow Aff. at ¶ 27; Brown Depo. at 27-31, 34-36, 59; Jordan Aff. at ¶ 6; Hirsch Depo. at 118, 121.

The accuracy of the life expectancy evaluation was critical not only in determining the purchase price of the policy, but to the success of the investment. An underestimate could result in lower profits or no profit at all if premiums were not paid. Barlow Aff. at ¶ 27. As part of the Purchase Agreement, Beneficial agreed to pay the premiums only up to one year past the insured's life expectancy. *Id.* at ¶ 29; Zenian Aff. at ¶10, Exh. A., pp. 18-20..

At settlement on a policy, the escrow agent paid the insured and the broker who acquired the policy, set aside funds sufficient to pay the premiums for one year past the insured's life expectancy in escrow accounts per the agreement, and forwarded the balance to Beneficial. Barlow Aff. at ¶ 11. After settlement the escrow agents paid premiums and distributed death benefits when the policies matured. *Id.*

Beneficial also performed additional responsibilities after settlement of the policies. It made arrangements for the tracking of the insured's location and health, the payment of premiums, the filing of claims with insurance companies and the distribution of death benefits. Barlow Aff. at ¶ 28; Brown Depo. at 53-55, 184-85.

According to a Beneficial employee, Beneficial had always used an independent escrow agent until about December 2001. Jordan Aff. at ¶¶ 12-13. However, the Commissioner has introduced evidence suggesting that the escrow agents employed by Beneficial starting around January 2002 may have ceased to be independent. *See* Barlow Aff. at ¶¶ 16-20, Exhs. 6-10. For instance, the Trust and Services Agreement between Hollywood Premium Escrow Services ("HPES"), Beneficial Financial and Beneficial , signed by Mr. Hirsch on behalf of both Beneficial Financial and Beneficial and effective January 7, 2002, permitted the trustee, HPES, to "act in reliance upon any writing executed by [ ] [Beneficial Financial, which would include Mr. Hirsch], and [ ] assume the validity and accuracy of any statement or assertion contained in such writing…." *Id.* at Exh. 6, p. 4. The agreement also gave Beneficial Financial, of which Mr. Hirsch was a director and officer, the power to approve or remove the trustee. *Id.* at p. 5. It also required that Beneficial prepare the premium checks for the trustee's signature and certify to the trustee the amount of premiums due each month. *Id.* at p. 6. According to the Commissioner and documents she has provided, in 2002 Hirsch gained direct signatory authority over other escrow, trust and brokerage accounts. *See* Barlow Aff. at ¶¶ 18-20, Exhs. 7-10. Mr. Hirsch denies that these various agreements eliminated the independence of the escrow agent.

According to the Commissioner, Mr. Hirsch misused these funds, which were only to be used to pay premiums and death benefits, when he purportedly used his signatory authority over these funds to (a) purchase a life insurance policy for

$760,000.00, (b) transfer $702,000.00 to Beneficial Funding, and (c) pay Amerilease Funding, LLC, a company of which Mr. Hirsch is purportedly a partial owner, more than $313,000.00 and which allegedly performed no services to Beneficial. Barlow Aff. at ¶¶ 34-38; Brown Depo. at 117, 132, 141-42; Grau Aff. at ¶¶ 9-10; Guilford Aff. at ¶ 12; Hirsch Depo. at 251, 288-290. The Commissioner further complains that Beneficial continued to pay premiums on policies beyond one year after the expected life expectancy, in contravention of the purchase agreements, by using premium funds set aside for newer policies "as in a ponzi scheme." Guilford Aff. at ¶¶13-17; Barlow Supp. Aff. at ¶ 8.

Based on these facts, and others this Court may supplement in its analysis below, the Commissioner filed a Complaint against both Beneficial and Mr. Hirsch (collectively the "Defendants") for alleged violations of the Maryland Securities Act. In Count I, she alleges that the Defendants sold and offered for sale unregistered securities in violation of section 11-501 of the Act and Code of Maryland Regulations ("COMAR") 02.02.03.01 *et seq.* In Count II, she alleges that the Defendants sold and offered for sale securities without having registered as broker-dealer agents in violation of section 11-401 of the Act. Lastly, in Count III she alleged that the Defendants violated the Anti-Fraud Provisions of the Act, Section 11-301.

On October 3, 2006 the Commissioner dismissed her claim against Beneficial. The only remaining defendant in this action is Mr. Hirsch.

ANALYSIS

The cross Motions for Summary Judgment raise three principle issues. In Part I this Court will address whether a viatical settlement constitutes an "investment contract", and thus a "security", under section 11-101(r) of the Act. In Part II, it will discuss whether the Commission can proceed against Mr. Hirsch for alleged violations of the Act as a control person with the controlled company, Beneficial, having been dismissed from the case by the Commission. In Part III this Court will address the extent to which Hirsch can be held liable as a primary violator under the Act.

Mr. Hirsch has also moved for summary judgment on two (2) additional grounds. First, he asserts that all of the Commissioner's claims for fines and forfeitures are barred by Md. Code, Courts and Judicial Proceedings, Section 5-107, the applicable statute of limitations. Second, Mr. Hirsch contends that all claims should be barred by the doctrine of latches. The Court will address these issues in Part IV.

Finally, both parties have moved for summary judgment on the Commissioners' claims for disgorgement, restitution and fines. This Court will address this final issue in Part V.

Motion for Summary Judgment Standard

In deciding a motion for summary judgment, the Court must first decide whether there is a genuine dispute as to any material fact, and if not, then decide whether either party is entitled to judgment as a matter of law. Maryland Rule 5-201;

Vogel v. Touhey, 151 Md. App. 682, 704 (2003) (citations omitted); *Okwa v. Harper*, 360 Md. 161 (2000). The Court must determine issues of law, but resolve no disputed issues of fact. *Beatty v. Trailmaster Products*, 330 Md. 726, 737 (1993). Although all inferences must be construed in favor of the non-moving party, those inferences must be reasonable. *King*, 303 Md. at 111; *Brown v. Wheeler*, 109 Md. App. 710, 717 (1996); *Beatty*, 330 Md. at 739 (citing *Clea v. City of Baltimore*, 312 Md. 662, 678 (1998)). In order to defeat a motion for summary judgment, the party opposing the motion must present admissible evidence demonstrating the existence of a dispute of material fact. *Id.; Hines v. French*, 157 Md. App. 536 (2004). A material fact is one the resolution of which will somehow affect the outcome of the case. *Vogel*, 151 Md. App. at 704 (citing *King v. Bankerd*, 303 Md. 98, 111 (1985); *Miller v. Fairchild Indus., Inc.*, 97 Md. App. 324 (1993), *cert denied*, 333 Md. 172 (1993). Mere allegations which do not show facts in detail and with precision are insufficient to prevent summary judgment. *Beatty*, 330 Md. at 738 (citing *Lynx, Inc. v. Ordnance Products*, 273 Md. 1, 7-8 (1974)). Likewise, merely alluding to the "existence of a document and thereby hop[ing] to raise the specter of dispute over a material fact" will not be sufficient to prevent summary judgment. *Id.*

Part I: The Viatical Settlements Sold by Beneficial Constitute an Investment Contract Under Maryland's Securities Act

Whether a viatical settlement constitutes an investment contract under Section 11-101(r) of the Act is a case of first impression in Maryland. As the Court of Special Appeals noted in the unreported opinion of *Goodman v. Lubin* (Ct. Spec.

App., 01-2067, July 18, 2003), the courts of Maryland have yet to determine this issue.

Section 11-101(r) of the Act defines a "security" as

> (i) note; (ii) stock; (iii) treasury stock; (iv) bond; (v) debenture; (vi) evidence of indebtedness; (vii) certificate of interest or participation in any profit-sharing agreement; (viii) collateral-trust certificate; (ix) preorganization certificate or subscription; (x) transferable share; (xi) investment contract; (xii) voting-trust certificate; (xiii) certificate of deposit for a security; (xiv) certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under the title or lease; (xv) in general, any interest or instrument commonly known as a 'security'; or (xvi) Certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrantor right to subscribe to or purchase any of the preceding."

The Commission asserts that viatical settlements should be considered "investment contracts," and, thus, a "security" as defined above. Mr. Hirsch, on the other hand, asserts that viatical settlements are not "investment contracts", relying primarily on the federal case *S.E.C. v. Life Partners, Inc.*, 87 F.3d 536, *rehearing denied*, 102 F.3d 587 (D.C. Cir 1996).

In deciding this issue, this Court is mindful that the term "investment contract" "'embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.'" *Ak's Daks Communications, Inc. v. Maryland Securities Div.*, 138 Md. App. 314, 328 (2001) (quoting *Securities and Exchange Commission v. Howey,* 328 U.S. 293, 66 S.Ct. 1100 (1946). In deciding whether an investment qualifies as an investment contract

under the Act, form is to be disregarded for substance and an emphasis placed on "economic realities." *Ak's Daks Communications, Inc.*, 138 Md. App. 314 at 327.

While the Act does not specifically define an "investment contract," the Court of Special Appeals in *Ak's Daks Communications* adopted the federal three part definition as set out in the seminole case of *Securities and Exchange Commission v. Howey*, 328 U.S. 293 (1946), and as refined by later judicial decisions: "[1] an investment of money [2] in a common enterprise [3] with an expectation of profits derived solely from the efforts of others." *Ak's Daks Communications, Inc.*, 138 Md. App. at 328.

The term "solely" in the third prong of the test is to be interpreted flexibly to prevent circumvention of the security laws and to effectuate their purpose: the protection of investors. As the Court of Special Appeals has noted, even the United States Supreme Court has dropped the term "solely" from its definition of an "investment contract." *See Ak's Daks Communications, Inc.*, 138 Md. App. at 329 fn. 6 *citing Reves v. Ernst and Young,* 494 U.S. 56, 64 (1990). Instead, the emphasis is on who performs the "significant managerial and entrepreneurial efforts." *Ak's Daks Communications, Inc.*, 138 Md. App. at 329. "[M]inimal efforts by the investor will not preclude an interest from being classified as an investment contract." *Id.*

Mr. Hirsch in his Opposition to Plaintiff's Motion for Summary Judgment does not contest that the viatical settlements at issue involve an investment of money in a common enterprise. Rather, he asserts that the viatical settlements were not investments with an expectation of profits to be derived solely from the efforts of

others. First, he argues that under the holding *of S.E.C. v. Life Partners, Inc.*, 87 F.3d 536 (D.C. Cir. 1996), no viatical settlements are "investment contracts" under the federal securities laws and that this is, or should be, the law in Maryland. Alternatively, under the same holding he argues that the viatical settlements sold by Beneficial are not derived solely by the efforts of others because Beneficial allegedly performed only ministerial, as opposed to managerial, tasks after their purchase.

The D.C. Circuit was the first federal appellate court to address whether a viatical settlement constituted a security under federal securities law. It created a bright-line test: if the promoters' entrepreneurial and managerial efforts occur pre-purchase, then the investment does not qualify as a security. *Id.* at 547-48. If, on the other hand, the promoters' significant efforts occur after the purchase, then the investment qualifies as a security. *Id.*

In *Life Partners* the D.C. Circuit held that because all the managerial functions conducted by the promoters occurred pre-purchase, the viatical settlements at issue in that case were not securities under federal securities law. *Id.* Prior to sale of the viatical investments, Life Partners performed functions "undeniably essential to the overall success of the investment." *Id.* at 547. "[E]ven before assembling the investors, [Life Partners] evaluates the insured's medical condition, reviews his insurance policy, negotiates the purchase price, and prepares the legal documents." *Id.* at 539. However, the D.C. Circuit reasoned that these significant efforts were already incorporated into Life Partners' fees or into the ultimate

purchase price of the viatical settlement. *Id.* at 547. Thus, Life Partners' remaining functions, such as "monitoring the insured's health, paying premiums, converting a group policy into an individual policy where required, filing the death claim, collecting and distributing the death benefit...." were only ministerial and insufficient to render the viatical settlements securities. *Id.* at 546-48. Ultimately, the Court concluded that the only relevant post-purchase event effecting the investment's profitability was the insured's death. *Id.*

The reasoning of *Life Partners* has been subsequently rejected by numerous federal and state courts as inconsistent with the U.S. Supreme Court's decision in *Howey*. *See, e.g., Securities and Exchange Comm'n v. Mutual Benefits Corp.*, 408 F.3d 737, 743 (11th Cir. 2005) ("We decline to adopt the test established by the *Life Partners* court.... Significant pre-purchase managerial activities undertaken to insure the success of the investment may also satisfy Howey."); *Siporin v. Carrington*, 23 P.3d 92, 103-04 (Ct. App. Ariz. 2001) ("*Life Partners* disregards the premise underlying the Howey test - that is, that the statutory definition of 'security' embodies a flexible rather than a static principle...."); *Poyser v. Flora*, 780 N.E.2d 1191 (Ct. App. Ind. 2003) (Court rejected *Life Partners* even though it believed the viatical settlements at issue would have survived the *Life Partners* test because the managerial and entrepreneurial efforts occurred pre-investment,); *see also Rumbaugh v. Ohio Dept. of Commerce*, 800 N.E.2d 780, 786 (Ohio App. 2003); *Joseph v. Viatica* Management, LLC, 55 P.3d 264, 266 (Colo. App. 2002); *Wuliger v. Christie*, 310 F.Supp.2d 897, 903 (N.D. Ohio 2004); *c.f. Employers Reinsurance Corp. v. Threlkeld &*

Co. Ins. Agency, 152 S.W.3d 595, 596 (Tex. App. 2003).

This Court need not decide, however, whether or not Maryland endorses the *Life Partners* test because the viatical settlements at issue in the instant case even pass the *Life Partners* test. Unlike in *Life Partners* where the significant managerial and entrepreneurial efforts occurred "before assembling the investors", Beneficial's efforts occurred after the investors entered into a Purchase Authorization Agreement ("Agreement"). Zenian Aff. &10, Ex A., pp. 18-20. This Agreement allowed the investor to select the desired period of investment, such as a twelve (12) or twenty-four (24) month life expectancy. Brown Depo. at 58-59. Along with the Agreement the investor sent in the amount he or she wished to invest to an escrow agent or trustee selected by Beneficial. Zenian Aff, ¶¶ 10, 16, Ex. A., pp. 18-20; Brown Depo. at 22,37, 58-59; Barlow Depo. ¶ 12.

Most importantly, only *after* the investor entered into the agreement and the escrow agent had accumulated enough funds from other investors to purchase a policy for the requested period of investment, did Beneficial perform any of what even the *Life Partners*' Court considered the significant managerial and entrepreneurial functions. After securing the necessary funds from investors, Beneficial personnel evaluated the insured's medical records, sent the insured to a medical consultant, obtained a life expectancy evaluation from the consultant and then negotiated the purchase of the policy. Barlow Aff. ¶ 27; Brown Depo. at 27-31, 34-36, 59; Jordan Depo. at 6; Hirsch Depo. at 118, 121. These are the same efforts that the *Life Partners'* Court defined as essential to the profitability of the investment.

However, in the instant case, unlike in *Life Partners* where these significant efforts occurred pre-purchase, Beneficial performed all these functions *after* the investors entered into a binding agreement to purchase the viatical settlements. Thus, this Court finds that the Commission has produced sufficient evidence to support a finding that the viatical settlements sold by Beneficial were investment contracts under section 11-101(r) of the Act.

The only evidence Mr. Hirsch has produced to the contrary is an affidavit in which he stated, "After the sale of policies, the trustee did only ministerial work in monitoring the policies and distributing payment." Hirsch Supp. Aff. at ¶ 12. This is a conclusory statement devoid of any underlying facts to support it. Moreover, it only addresses the actions of the trustee, not the post-purchase actions of Beneficial. Once the movant on a motion for summary judgment has produced sufficient evidence to support the motion, the non-moving party must produce sufficient facts to generate a genuine issue of material fact to defeat the motion. *Lightolier, A Div. of Genlyte Thomas Group, LLC v. Hoon*, 387 Md 539, 552 (2005). "[U]nsupported statements or conclusions of law are insufficient." *Hoffman Chevrolet, Inc. v. Washington County Nat'l Sav. Bank*, 297 Md. 691, 712 (1983).

Because Hirsch has not countered with sufficient facts, this Court holds that the viatical settlements sold by Beneficial in this case constitute an "investment contract", and thus a "security", under Section 11-101(r) of the Maryland Securities Act.

Part II: Mr. Hirsch Cannot Be Held Liable Under a

Theory of Control Liability

Section 11-703(a)(1)(ii) of the Act provides that "Every person who, directly or indirectly, controls any person liable under any provision of this chapter... shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable...." Thus, the Commissioner argues that Mr. Hirsch can be held liable to the same extent as Beneficial for violations of the Act attributable to Beneficial because Mr. Hirsch was a control person under section 11-703(a)(1)(ii) of the Act. Mr. Hirsch may very well have qualified as a control person under section 11-703(a)(1)(ii), but under the holding of *Baker, Watts & Company v. Miles and Stockbridge*, 95 Md. App. 145 (1993) the Commission cannot proceed against Mr. Hirsch on this theory without also proceeding against the controlled party.

In *Baker, Watts* the plaintiff, Baker, Watts & Company, a dealer-manager in a private offering and sale of limited partnership interests, had been previously adjudicated liable for its own violations of the securities laws. *Id.* at 158-59. After it was so adjudicated, it then sought contribution from the defendant law firm whom it had retained to perform legal services in connection with the offering claiming that the defendant law firm was a controlling person over the controlled entity that offered and sold the securities. *Id.* at 159.

The Court of Special Appeals held that the dealer-manager could not seek contribution based on joint and several liability against the defendant control person without a judgment against the principle violator, i.e. the controlled party.

Id. at 173-75. In reaching this decision the Court addressed two lines of cases: (1) the first line of cases stood for the "proposition that the person who was the primary violator must be proceeded against in order for a plaintiff to attempt to impose joint and several liability"; and (2) the other stood for the proposition that the controlling party may still be held liable even without the controlled party having been adjudicated liable because controlling parties may avoid liability by dissolving the controlled entity. *Id.* at 174-75. In electing to adopt the former, rather than the latter, the Court opined that this concern was not present in Maryland because "when a Maryland corporation is voluntarily dissolved the directors become trustees of the corporation's assets; therefore a party would still be able to proceed against the trustees of the corporation." *Id.* at 175.

The Commission urges this Court to interpret *Baker, Watts* as somehow limited to a case for contribution. This Court has considered this argument but does believe that the holding is so limited. In fact, this Court can see no principled difference between the holding of *Baker, Watts* and the instant case. Whether the action is based on contribution for damages or on some other basis of liability, the Court of Appeals specifically explained that there can be no control liability without the primary violator having been adjudicated liable. That the premise of liability in *Baker, Watts* happened to be contribution did not appear relevant to the Court of Appeals' opinion. The Commission argues that the primary violator in *Baker, Watts* (the entity that sold and offered for sale the securities) had never been adjudicated liable and therefore, Baker, Watts "could not obtain contribution from an alleged

control person of an entity that had not been found jointly liable." The exact same can be said of the instant case by only substituting party names and replacing contribution with "damages": the primary violator (Beneficial) has never been adjudicated liable, and therefore, (a third party, the Commission) can not obtain damages from an alleged control person (Hirsch) of an entity that has never been found jointly liable. There is simply no basis for the distinction the Commission seeks. For liability to be imposed upon a control party the primary violator must first be found liable. This was the holding of *Baker, Watts* and this Court is bound by that decision.

Part III: Whether Hirsch Can Be Held Liable Under a Theory of Primary Liability

A. Hirsch Is Not Liable for Violations of Sections 11-501 and 11-401 of the Act for the Offer and Sale of Unregistered Securities and for the Offer and Sale of Securities by Unregistered Broker-Dealer Agents

Mr. Hirsch argues that he cannot be held primarily liable under sections 11-501 and 11-401 of the Act. Section 11-501 provides that "[a] person may not offer or sell any security in this State unless: (1) The security is registered under this title; (2) The security or transaction is exempted under Subtitle 6 of this title; or (3) The security is a federal covered security." MD Code, Corporations and Associations, § 11-501. Section 11-401(a) provides that "[a] person may not transact business in this State as a broker-dealer or agent unless the person is registered under this subtitle." MD Code, Corporations and Associations, § 11-401 (a). As discussed *supra*, the viatical settlements sold or offered for sale by Beneficial constitute a security under the Act.

In both of his affidavits, Mr. Hirsch represented that he "never sold a viatical product directly to any purchaser. I never made a sales call, in person or on the phone, to any purchaser." Hirsch Aff. at ¶ 4; Hirsch Supp. Aff. at ¶ 4. Thus, Mr. Hirsch, himself, never directly sold or offered for sale a viatical settlement. The Commissioner has not produced any evidence to the contrary. In addition, as Mr. Hirsch never sold or offered for sales a security, he did not function as a broker-dealer or agent. Accordingly, this Court will grant Mr. Hirsch's Motion for Summary Judgment as to Counts I and II for violations of sections 11-501 and 11-401 of the Act.

B. Mr. Hirsch Can Be Held Liable for Violations of the Anti-Fraud Provisions of the Act, Section 11-301

In Count III of the Amended Complaint the Commissioner alleges that Hirsch made misrepresentations and omissions of material fact under section 11-301 (2) of the Act, employed a device, scheme or artifice to defraud under section 11-301 (1), and engaged in a course of business that defrauded or deceived investors under section 11-301 (3). Complaint at ¶¶ 65-68.

Section 11-301 makes it "unlawful for any person, in connection with the offer, sale, sale or purchase of any security, directly or indirectly to: (1) Employ any device, scheme, or artifice to defraud; (2) Make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or (3) Engage in any act, practice or course of business which operates

or would operate as a fraud or deceit on any person." Md. Code, Corporations and Associations, §11-301.

The Commissioner urges that Mr. Hirsch violated this statute in one of two ways. First, she argues that Mr. Hirsch made material misrepresentations under section 11-301 (2) to investors, either through conversations he had with the investors or through sales literature of which he was allegedly in charge of generating. Second, she argues that Mr. Hirsch violated Sections 11-301 (1) and (2) because he engaged in a fraudulent scheme/course of business.[2] According to the Commissioner, he did so by eliminating the independent escrow agent and then misappropriating funds set aside in the escrow accounts, thereby rendering untrue Beneficial's representations that the escrow account was independent along with other assurances such as safety of principal and returns. She also contends that he engaged in a fraudulent scheme/course of business when he continued to pay, through Beneficial, policy premiums beyond the contractual one-year obligation. She argues that this scheme of using funds set aside to pay newer policy premiums to pay older policy premiums beyond the contractual obligation operated as a ponzi scheme, and that eventually the bottom would fall out and Beneficial would not have sufficient funds to pay premiums on the new policies per the terms of the contracts.

Maryland Courts have not addressed the exact scope of section 11-301 of the Act ("Antifraud Provisions") in terms of its application to secondary actors and

2 Throughout the following discussion this court will refer to Mr. Hirsch's violations of sections 11-301 (1) and (2) as a "fraudulent scheme/course of business." Neither the Commissioner nor the

primary liability. Therefore, in accordance with Section 11-804 of the Act[3], this Court will turn to interpretations of Section 11-301's federal counterpart, Rule 10b-5, 17 C.F.R. § 240.10b-5, implemented pursuant to section 10(b) of the 1934 Securities Exchange Act ("Exchange Act"), 15 U.S.C. § 78j(b). For present purposes there is no substantive difference between the language of Rule 10b-5 and section 11-301.[4]

This Court will first address whether Mr. Hirsch can be held liable for a violation of section 11-301 (b) for purportedly making any material misrepresentations to investors. It will then address the allegations that Mr. Hirsch engaged in a fraudulent scheme/course of business under sections 11-301 (a) and (c).

Whether a secondary actor, such as an officer or director like Mr. Hirsch, can be held primarily liable for violations of the antifraud provisions is a complex question because holding a secondary actor primarily liable may blur the line between primary liability and aiding and abetting liability.[5] Typically, the secondary actors involved in these cases are accountants, lawyers, banks and/or underwriters.

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caselaw significantly differentiate between the two sections.

3 Section 11-804 provides that the Act "shall be construed to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this title with the related federal regulation." MD Code, Corporations and Associations, § 11-804.

4 Rule 10b-5 states, "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

5 The Commissioner concedes that the Act does not give it authority over aiding and abetting liability, unlike the Private Securities Litigation Reform Act of 1995, 15 U.S.C. 78t(e), which gave such authority to the U.S. Securities and Exchange Commission.

See, e.g., *Wright v. Ernst & Young LLP*, 152 F.3d 169(2d Cir. 1998), cert. denied, 525 U.S. 1104 (1999); *Shapiro v. Cantor*, 123 F.3d 717 (2d Cir. 1997); *In re Enron Corp. Sec., Derivative & ERISA Litig.,* 235 F. Supp. 2d 549, 583 (S.D.Tex. 2002); *In re Software Toolworks*, 50 F.3d 615 (9th Cir. 1994); *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194 (11th Cir. 2001); *Anixter v. Home-Stake Production Co.*, 77 F.3d 1215 (10th Cir. 1996). However, corporate officers are also secondary actors that can be help primarily liability. See, e.g., *In re Enron Corp. Sec., Derivative & ERISA Litig.,* 235 F. Supp. at 583 (S.D.Tex. 2002); *S.E.C. v. Lucent Technologies*, Inc., 363 F. Supp. 2d 708, 720 (D.N.J. 2005); *Copland v. Grumet,* 88 F. Supp. 2d 326, 330 (D.N.J.1999).

There is no implied private right of action for aiding and abetting under section 10(b) of the Exchange Act, the statute upon which Rule 10b-5 was promulgated. *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994)*. However, the U.S. Supreme Court made it clear that secondary actors can still be held liable for primary violations of Rule 10b-5. "Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met." *Id.*

1. Misrepresentations Under Section 11-301 (b)

At least with regard to misrepresentations or omissions under 10b-5 (b), the lower federal courts have developed three tests to determine whether a secondary

actor can be held primarily liable. The Second Circuit engineered what has become known as the "bright line" test. While under this test the purported violator need not directly communicate the misrepresentation to the investor, the actor must actually have made the statement and it must be directly and publicly attributable to him or her. *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998), cert. denied, 525 U.S. 1104 (1999); *see also Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997) ("If Central Bank is to have any real meaning, a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b). Anything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be it is not enough to trigger liability under Section 10(b)." (internal quotation marks and citations omitted)). Other courts have also applied the "bright line" test or some derivative thereof. *See, e.g., Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194 (11th Cir. 2001); *S.E.C. v. Lucent Technologies*, Inc., 363 F. Supp. 2d 708, 720 (D.N.J. 2005) (applying test to corporate officers); *Copland v. Grumet,* 88 F. Supp. 2d 326, 330 (D.N.J.1999) (applying test to corporate officers); *Anixter v. Home-Stake Production Co.*, 77 F.3d 1215 (10th Cir. 1996); *In re Kendall Square Research Corp. Sec. Litig.*, 868 F. Supp. 26 (D. Mass. 1994); *Vosgerichian v. Commodore Int'l*, 862 F. Supp. 1371 (E.D.Pa. 1994).

The Ninth Circuit adopted the "substantial participation" test. It provides for primary liability when the secondary actor participates substantially or is intricately involved in the preparation of fraudulent statements "even though that participation might not lead to the actor's making of the statements." Howard v.

Everex Systems, Inc., 228 F.3d 1057, 1051 n. 5 (9th Cir. 2000); *see also In re Software Toolworks*, 50 F.3d 615, 628 n. 3 (9th Cir. 1994), *cert. denied sub nom Montgomery Sec. V. Dannenberg*, 516 U.S. 907 (1995). A few other courts have adopted similar tests providing for liability when the secondary actor was "centrally involved" or played a "significant role." See *Cashman v. Coopers & Lybrand*, 877 F. Supp. 425, 432-34 (N.D. Ill. 1995); McNamara v. Bre-X Minerals Ltd., 57 F. Supp. 2d 396, 426 (E.D. Texas 1999).

The "substantial participation" test, however, has been criticized for blurring the line between primary and aiding and abetting liability. See, e.g., *Anixter*, 77 F.3d at 1226 n.10 ("To the extent that these cases allow liability to attach without requiring a representation be made by defendant and reformulate the 'substantial assistance' element of aiding and abetting liability into primary liability, they do not comport with *Central Bank of Denver*.").

The court *In re Enron Corp. Sec., Derivative & ERISA Litig.,* 235 F.Supp.2d 549, 583 (S.D. Tex. 2002) adopted a different test, one proposed by the SEC itself. Under the "*Enron*" test "when a person, acting alone or with others, creates a misrepresentation,... the person can be liable as a primary violator... if... he acts with the requisite scienter" even though he or she was not publicly associated with the misstatement. *Id.* at 588, 590-91. In adopting this test, the *Enron* Court found that the substantial participation test was over-inclusive as it may fail to differentiate between primary and aiding and abetting liability. *Id.* at 585. It also found that the

"bright line" test could be under-inclusive for "[c]reators of misrepresentations could escape liability as long as they concealed their identities." *Id.* at 587.

Indeed, this concern over the "bright line" test is exasperated with regard to a corporate employee, officer or director such as Mr. Hirsch. The "bright line" test's requirement that the statement be attributable to the actor at the time it is publicly disseminated "ignore[s] the reality that actionable misstatements are typically issued in the company's name rather than the name of the officer or director behind such statements." *S.E.C. v. Lucent Technologies, Inc.*, 363 F. Supp. 2d 708, 723 (D.N.J. 2005) *citing* Robert A. Prentice, *Locating That "Indistinct" and "Virtually Nonexistent" Line Between Primary and Secondary Liability Under Section 10(b),* 75 N.C. L.Rev. 691, 780 n. 212 (March 1997). The Court in *Lucent Technologies* ultimately endorsed the "bright line" test in an action brought by the SEC because, the SEC has authority to pursue a action under aiding and abetting liability. Thus, an under-inclusive test would be more appropriate as the SEC can always file actions against those who do not meet the more restrictive "bright line" test.

Unlike the SEC, the Commissioner, even by her own admission, does not have authority to pursue aiding and abetting liability. Therefore, a more inclusive test is warranted with regard to corporate officers who rarely issue actionable statements in their own names. The "substantial participation" test, however, fails to delineate between primary and secondary liability: this Court cannot see where "substantial participation" ends and "substantial assistance" begins. Thus, this Court believes

that the *Enron* test is the most appropriate test to apply to corporate employee secondary actors such as Mr. Hirsch.

Under the *Enron* Test, the Commissioner has produced no evidence that Mr. Hirsch created the misrepresentation. The only evidence that she produced is deposition testimony from another officer of Beneficial, Robert Brown, stating that Mr. Hirsch, as chief executive officer of Beneficial, was ultimately in charge of the disclosure material which presumably contained investor assurances such as an independent escrow agent.[6] Brown Depo. at pp. 109-110. However, Mr. Brown did not testify that Mr. Hirsch actually had a hand in creating the disclosure material. Moreover, Mr. Brown did not even testify as to what, if any role, Mr. Hirsch played with respect to the disclosure material other than as the chief executive officer he was ultimately responsible for it. Being ultimately responsible for a document as C.E.O. and actually creating that document, or even participating in its production, are two very different propositions. Ultimate responsibility for a document sounds more like control person liability, rather than primary liability. Therefore, this Court finds that the Commissioner has failed to provide any evidence linking Mr. Hirsch to the creation of the disclosure/sales material.

On the other hand, Mr. Hirsch has not presented any evidence that he did not create the sales literature. In the two affidavits he filed in conjunction with these

6 The deposition transcript references "Exhibit 2." No exhibits were attached to the deposition transcript filed in connection with the motions for summary judgment. However, deposition testimony later describes "Exhibit 2" as letters from Staci Mandros. This Court believes that "Exhibit 2" references a letter sent by Staci Mandros to Vartan Zenian, a copy of which is attached to Zenian's Affidavit at page 3. This letter listed as a feature of Beneficial's viaticals that Beneficial used an independent escrow agent.

cross motions for summary judgment, Mr. Hirsch has represented that he "never sold a viatical product directly to any purchaser. I never made a sales call, in person or on the phone, to any purchaser." Hirsch Aff. at ¶ 4; Hirsch Supp. Aff. at ¶ 4. This does not address what, if any, role Mr. Hirsch played in the creation of Beneficial's sales literature.

Thus, a material issue of fact remains as to (a) whether Mr. Hirsch actually created the sales literature, and (b) as discussed *infra*, whether Mr. Hirsch eliminated the independence of the escrow agent. Lastly, this Court will note that for the sales literature representation that the escrow agents were independent to constitute a misrepresentation, the sales literature dissemination would have had to occur after the elimination of the independent escrow agent. For the foregoing reasons, this Court will deny both parties' Motions for Summary Judgment as to Count III based on a violation of section 11-301 (b) of the Act.

2. Fraudulent Scheme/Course of Business Under Sections 11-301 (a) and (c)

The Commissioner has also alleged that Mr. Hirsch engaged in a fraudulent scheme/course of business under sections 11-301 (1) and (3) of the Act (a) when he eliminated the independent escrow agent, misappropriated funds, thereby rendering false certain assurances contained in sales literature, and (b) when he allegedly used funds to pay premiums on older policies beyond their one-year contractual obligation with funds reserved to pay premiums on newer policies as in a ponzi scheme.

A cause of action under the federal counterparts of 11-301 (1) and (3) is separate and distinct from under 11-301 (2). "While subsection (b) of Rule 10b-5 provides a cause of action based on the making of an untrue statement of a material fact and the omission to state a material fact, subsections (a) and (c) are not so restricted and allow suit against defendants who, with scienter, participated in a course of business or a device, scheme or artifice that operated as a fraud on sellers or purchasers of stock even if these defendants did not make a materially false or misleading statement or omission." *In re Enron Corp. Securities*, 235 F. Supp. 2d at 577, *quoting Affiliated Ute Citizens v. United States,* 406 U.S. 128, 152-53 (1972) (internal quotation marks omitted).

Most cases addressing the scope of primary liability for secondary actors under Rule 10b-5 concern fraudulent misrepresentations rather than fraudulent schemes/courses of business. The three tests, just described *supra*, developed within the context of fraudulent misrepresentations and do not apply readily to fraudulent schemes/courses of business.

Rather, in determining whether a secondary actor can be held liable for engaging in a fraudulent scheme/course of business the salient question is whether that actor personally committed a fraudulent act in connection with the sale and/or offer of sale of a security. *See S.E.C. v. U.S. Environmental, Inc.*, 155 F.3d 107, 112 (2d Cir. 1998) (Secondary-actor stock broker primarily liable because he himself "committed a manipulative act by effecting the very buy and sell orders that manipulated [the] stock upward."); *In re Parmalat Securities Litigation*, 376 F. Supp.

2d 472, 501, 504 (S.D.N.Y. 2005) (Secondary-actor banks potentially liable because they personally securitized worthless securities which constituted an "act[ ], practice[ ], or courses of business that would operate as a fraud or deceit upon others."); *see also In re Lernout & Hauspie Sec. Litig.,* 236 F. Supp. 2d 161, (D. Mass. 2003) (holding business partner of issuer primarily liable for creating shell companies to increase issuer's bottom line because the partner "substantially participated" in the fraudulent scheme of which he was aware).[7]

Section 10b of the Exchange Act, like section 11-301 of the Act, "should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes." *S.E.C. v. Zandford*, 535 U.S. 813, 819 (2002) quoting *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972) (internal quotation marks and other citations omitted). "[I]t [is not] sound to dismiss a complaint merely because the alleged scheme does not involve the type of fraud that is usually associated with the sale or purchase of securities. We believe that § 10(b) and Rule 10b-5 prohibit all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception." *Superintendent of Ins. v. Bankers Life & Cas. Co.* 404 U.S. 6, 11 n.7 (1971)(internal quotation marks and citations omitted). "Novel or atypical methods should not provide immunity from the securities laws." *In re Enron Corp. Securities, Derivative & ERISA Litig.*, 235 F. Supp. 2d at 577 (S.D.Tex.,2002).

7 This version of the substantial participation test is more inclusive than that employed by this Court as defined above for it would subject secondary actors to primary liability even if they, themselves, did not commit a fraudulent act.

a. Elimination of Independent Escrow Agent & Misappropriation of Funds

The actions purportedly taken by Mr. Hirsch, as alleged by the Commissioner, i.e. that he eliminated the independent escrow agent and misappropriated the funds from the escrow accounts, closely resemble those taken by the Defendant in *Zandford*. In *Zandford*, the investors opened a joint investment account with the defendant securities broker that gave the broker discretion to manage their account. *Zandford*, 535 U.S. at 815. It was later discovered that the broker at various times transferred money from the investors' account to his own. *Id.* Several of these transfers required the broker to sell and/or liquidate some of the investors' securities. *Id.* The underlying issue in *Zandford*, as this Court will discuss in detail below, was whether this scheme to defraud was in connection with the sale or purchase of a security. However, the Fourth Circuit Court of Appeals in affirming Zandford's criminal case for the same actions stated that "Zandford's contention that there is insufficient evidence supporting that he had engaged in a scheme to defraud the [investors] is meritless." *Id.* at 818 n. 2.

Likewise, if Mr. Hirsch's purported conduct occurred in connection with the sale or offer for sale of a security, it, too, would qualify as a fraudulent scheme/course of business under sections 11-301 (1) and (3) of the Act. According to the Commissioner, Mr. Hirsch eliminated the independent escrow agent, gained signatory authority over several of the trust accounts and then misappropriated funds from these accounts for his own benefit. In support of her argument that Mr.

Hirsch eliminated the independent escrow agent, the Commissioner cites to several agreements and signatory cards, that if properly tied together, could infer that Mr. Hirsch did gain signatory access over the trust accounts. *See* Barlow Aff. Exh.'s 4 – 10. The Commissioner has also presented various documents that would support a finding that Mr. Hirsch transferred funds from the trust accounts to Beneficial's account. See Barlow Aff. Exh.'s 7, 10 &16.

Mr. Hirsch has not countered with any evidence that would sustain a finding that the escrow agents remained independent, and, thus, summary judgment in his favor is inappropriate. Summary judgment in favor of the Commissioner would also be inappropriate. "Even if it appears that the relevant facts are undisputed, if those facts are susceptible to inferences supporting the position of the party opposing summary judgment, then a grant of summary judgment is improper." *Sadler v. Dimensions Healthcare Corp.*, 378 Md. 509, 533 (2003). Because the evidence proffered by the Commissioner is inconclusive and susceptible to inferences in favor of Mr. Hirsch, this Court will deny both parties' motions for summary judgment.

This, however, does not end the Court's analysis for Mr. Hirsch's fraudulent scheme/course of business must have occurred "in connection with the offer, sale or purchase of [a] security" to constitute a violation of sections 11-301 (1) and (3) of the Act. While 11-301 of the Act "must not be construed so broadly as to convert every common-law fraud that happens to involve securities into a violation of [11-301]," it is sufficient that the "fraud coincided with the sales themselves." *Zandford*, 535 U.S. at 820. A seller's fraudulent intent to deprive the purchaser of the benefit of

a securities sale provides this requisite nexus between the sale or offer for sale of a security and the fraudulent scheme/course of business. *Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc.*, 532 U.S. 588, 596-97 (2001); *see also Zandford*, 535 U.S. at 823-24.

In *Wharf*, the seller sold a security to an investor "while secretly intending from the very beginning not to honor the [security]." *Wharf*, 532 U.S. at 597. The Court found that this fraudulent intent at the time of the sale of the security provided the requisite nexus to constitute a violation of Section 10(b) of the Securities Exchange Act.

In *Zandford*, discussed *supra*, the broker sold the investors' securities entrusted to him in a discretionary account "while secretly intending from the beginning to keep the proceeds." *Zandford*, 535 U.S. at 823-24. After the sale of the investors' securities, the broker then misappropriated the proceeds. The broker argued that at worst his actions constituted a simple theft of cash from an investment. The Court disagreed, holding that it was the broker's intent to deprive the purchaser of the benefits from the beginning when he sold them the securities that provided the requisite nexus between the fraud and the sale of a security so as to come within the purview of Section 10b. *Id.*

In the instant case Mr. Hirsch's allegedly fraudulent actions did not occur until early 2002 when he purportedly entered into agreements eliminating the independence of the escrow agents. *See* Barlow Aff., Exh.'s 4-6. The Commissioner has never challenged the independence of the escrow agents prior to this

timeframe. The Commissioner has also offered evidence that sales occurred after early 2002, but the evidence fails to reveal whether those sales were to Maryland residents or sold by Beneficial from offices in Maryland, and, thus, it is inconclusive. Barlow Aff., Exh. 12. It has, however, provided evidence that there was at least one offer to a Maryland resident after early 2002. Zenian Aff. at ¶¶ 3 & 4, Exh. A.

In his affidavits Mr. Hirsch asserts that "[a]s of March 2002, all of Beneficial's sales and marketing activities were from its Bloomington, Illinois, office." Hirsch Supp. Aff. at ¶ 5. However, according to the Commissioner, Hirsh entered into the first agreement eliminating the independence of the escrow agent on January 7, 2002. Thus, sales could have occurred from Maryland between January 7, 2002 and March 2002. Barlow Aff., Exh. 4. Moreover, even though Hirsch asserts that "Beneficial did not *sell* to any Maryland purchaser after October 2001," the Commissioner has offered evidence that there was at least one *offer* for sale to a Maryland resident in October 2002. Hirsch Supp Aff. at ¶ 6 (emphasis added); Zenian Aff. at ¶¶ 3 & 4, Exh. A.

As C.E.O of Beneficial Mr. Hirsch knew or should have known that Beneficial continued to send out sales literature stating that the escrow agent was independent. Yet, his actions had purportedly eliminated the independence of the escrow agents. His fraudulent actions would have, therefore, furthered a fraud upon investors as part of a scheme or course of business to potentially deprive purchasers of the benefit of their purchases. That he knew the sales literature represented an independent escrow agent after he allegedly took steps to

eliminate their independence and to eventually misappropriate the funds provides strong evidence that at the time of the securities' sales and/or offers for sale he intended to defraud investors. This convergence of an intent to defraud and sale and/or offer for sale provides the requisite nexus to constitute a violation of section 11-301 of the Act.

Finally, if the Commissioner seeks to impose penalties against Mr. Hirsch for his purported fraudulent conduct based on sales before he began to eliminate the independence of the escrow agents, it will have to provide evidence that Mr. Hirsch had at the time of the sale or offer for sale of the security the intent to defraud the purchaser of the benefits of his or her purchase.

Because there are material issues of fact regarding Beneficial's sales and offers for sale from the beginning of 2002, when Mr. Hirsch allegedly started to eliminate the independent escrow agent, this Court will deny both parties' Motions for Summary Judgment as to Count III for violations of sections 11-301 (a) and (c).

b. Operation of Ponzi Scheme

This Court will also deny both parties' Motions for Summary Judgment as to Count III for violations of sections 11-301 (a) and (c) based on Mr. Hirsch's involvement in an alleged ponzi scheme operated by Beneficial for the reason that there are genuine issues of material fact. The same analysis just discussed applies: an officer of a corporation can be held primarily liable if he or she (a) committed a fraudulent act in furtherance of the fraudulent act, and (b) at the time of the sale or

offer for sale of the security the officer had an intent to defraud the investor of the benefit of the investment.

The Commissioner has not provided any evidence of Mr. Hirsch's involvement in the ponzi scheme except that Hirsch directed the escrow agent to continue to pay premiums on policies that had no premium reserves beyond the one-year obligation. Guilford Aff., ¶¶ 13-17. If Mr. Hirsch diverted funds from newer policies, which Beneficial was still under an obligation to pay, to pay premiums on older policies which Beneficial was under no obligation to pay, this would constitute a fraud upon the purchasers of the newer policies. Again, Mr. Hirsch is charged with the knowledge contained in the disclosure/sales literature representing the safety of return and principle.

Of course, the Commissioner must also show that Mr. Hirsch had the intent to defraud the purchasers or potential purchasers at the time of the sale of the securities. That he knew of the representations contained in the literature, yet took steps to render them untrue by diverting funds, would provide some evidence that at the time of the sales/offers for sale of the securities that he had an intent to defraud investors. Unlike the accusation that sales and offers for sale occurred after the elimination of the independent escrow agent, the diversion of funds from newer policies would not necessarily render untrue the assurances contained in the literature as to all future sales and offers. However, an inference could be made that once he used premium reserves from newer policies once, he would have to

continue to do so against all future policies to make premium payments on the policies from which he had already diverted reserves.

The Commissioner has offered no evidence detailing Mr. Hirsch's precise role in this purported scheme or his intent at the time of the sales/offers for sale. Nor has Mr. Hirsch. Therefore summary judgment is inappropriate, and this Court will deny both parties' Motions for Summary Judgment for violations of Sections 11-301 (a) and (c) based on Mr. Hirsch's participation in the ponzi scheme.

PART IV: DOCTRINE OF LACHES AND STATUTE OF LIMITATIONS

A. Statute of Limitations

Mr. Hirsch asserts that Md. Code, Courts and Judicial Proceedings, Section 5-107, the applicable statute of limitations, functions as a complete bar to the Commissioner's claims against Mr. Hirsch. With certain exceptions not applicable here, Section 5-107 provides that "a prosecution or suit for a fine, penalty, or forfeiture shall be instituted within one year after the offense was committed." Md. Code, Courts and Judicial Proceedings, § 5-107.

Mr. Hirsch argues that the Commissioner's claims against Mr. Hirsch accrued in 2001 at the latest because Mr. Hirsch assumed management responsibility of Beneficial in 2000. Accordingly, so the argument goes, because the Commissioner did not bring suit until 2002, after the date of accrual, all claims are barred. Mr. Hirsch's interpretation of Section 5-107 is incorrect.

Section 5-107 limits the Commissioner's claims to those that occurred within one (1) year of the filing of the Complaint. "[T]he period of limitations under § 5-107 begins to run when the offense, for which the fine is sought, is complete, regardless of whether the Attorney General had knowledge of the commission of the offense at that time. The offense is complete when each element has occurred." *Attorney General of Md. v. Dickson*, 717 F. Supp. 1090, 1104 (D.Md. 1989).

The Commissioner filed its Complaint against Mr. Hirsch on November 19, 2002. Therefore, under Section 5-107 the Commissioner may seek fines for all offenses that were completed on or after November 19, 2001. Accordingly, this Court will deny Mr. Hirsch's Motion for Summary Judgment based on this ground.

B. Doctrine of Laches

Mr. Hirsch asserts that the Commissioner's claims against him should also be barred by the doctrine of laches. To establish the equitable defense of laches, the defendant must show (1) unexcusable delay, and (2) prejudice as a result of that delay. *Salisbury Beauty Schools v. State Bd. of Cosmetologists*, 268 Md. 32, 63 (1973). However, the doctrine of laches is an application of estoppel and cannot be asserted the government, or an agency thereof, "in enforcement of its police powers." *Id.* "The statute of limitations nor laches applies to the State when it sues in its sovereign capacity in its own courts." *Cent. Collection v. Gettes,* 321 Md. 671, 675, (1991). The logic of this limitation is simple: "[T]he principles of equitable estoppel cannot be applied to deprive the public of the protection of a statute

because of mistaken action or lack of action on the part of public officials." *Salisbury Beauty Schools*, 268 Md. at 64-65.

There can be no doubt that the Maryland Division of Securities is an agency of the state as it's office is within that of the Attorney General. *See* Md. Code, Corps. & Ass'ns, § 11-201 (a). The Commissioner is the principal executive officer of the Division and Melanie Lubin, the Commissioner, has brought suit against Mr. Hirsh, not in her personal capacity, but in her official capacity. Id.; *See* Complaint. She has brought suit against Mr. Hirsch to enforce alleged violations of the Act pursuant to Section 11-702. The purpose of the Act and the Division of Securities, like their federal counterparts, is to protect the investing public. Thus, the Commissioner, on behalf of the Division of Securities, has brought an action enforcing the laws of the State of Maryland to protect the investing public in a Maryland court. Accordingly, Mr. Hirsch cannot assert the doctrine of laches against the Commissioner in this action.

Even if Mr. Hirsch could assert the doctrine of laches against the Commissioner in this action, he cannot establish that he has been prejudiced by any delay. In fact, it appears that if the allegations against Mr. Hirsch are true, he has probably benefited from the delay. As this Court discussed *supra*, the Commissioner can only seek fines for violations that were completed within one (1) year before the Commissioner filed her Complaint on November 19, 2002. Therefore, the Commissioner cannot seek fines for violations that occurred prior to November 19, 2001. Mr. Hirsch in his own affidavit stated that "Beneficial sold no

viatical product to any purchaser in Maryland from the fall of 2001 forward. Beneficial did not sell to any Maryland purchaser after October 2001." Hirsch Supp. Aff. at ¶ 6. If this is true, the Commissioner will not be able to prove any claims for fines against Mr. Hirsch except those related to offers for sale of securities. Had the Commissioner not delayed, Mr. Hirsch could have faced even greater liability. Presumably prior to the fall of 2001 Beneficial was actively selling viatical settlements to Maryland residents and out of its Maryland office. But for the delay, the Commissioner could have sought fines for violations that occurred while Beneficial was actively selling in Maryland.

Therefore, this Court will deny Mr. Hirsch's Motion for Summary based on the doctrine of laches.

Part V: Damages

Both parties have sought summary judgment with respect to the remedies of restitution and disgorgement.[8] Section 11-702 (b)(8) of the Act specifically empowers the Commissioner to bring claims for restitution. Restitution is measured not by the loss to the plaintiff, or in this case the loss to policy holders, but rather by the gain to the defendant. See *Slick v. Reinecker*, 154 Md. App. 312, 334 (2003). "*The restitution claim… is not aimed at compensating the plaintiff, but at forcing the defendant to disgorge benefits that it would be unjust for him to keep.*" *Id.* (emphasis in original) *quoting Mass Transit Admin. v. Granite Const. Co.*, 57 Md.

8 The parties have also referred to the restitution claims as disgorgement because the Commissioner seeks to disgorge any profits Mr. Hirsch may have obtained through his alleged misconduct. For present purposes there is no need to address the technical distinctions between the two terms and the situations under which each would be applicable.

App. 766, 775 *citing* Dobbs, *Handbook on the Law of Remedies* (1973), § 4.1. The purpose of disgorgement is "to deprive the wrongdoer of his ill-gotten gain." *SEC v. AMX International, Inc.*, 7 F.3d 71, 75 (5th Cir. 1993).

The Commissioner seeks "disgorgement of all funds received directly or indirectly from viatical programs offered or sponsored by Beneficial [and] restitution to investors." Mem. in Support of the Securities Commissioner's Mot. For S.J. as to Hirsch, at p. 28. She further asserts that "[r]estitution may be measured by the amount of premium money that Hirsch misused." *Id.*

First, as a practical matter, both a claim for restitution or disgorgement under the Act would be measured by the amount that the defendant, here Mr. Hirsch, was unjustly enriched. Thus, the Commissioner, to the extent she seeks restitution and/or disgorgement from Mr. Hirsch, is limited to the amount that Mr. Hirsch benefited, i.e. profits that he, personally, received as a result of any alleged violations of the Act. She cannot seek from Mr. Hirsch benefits that other entities received as a result of Mr. Hirsch's purported misconduct.

Therefore, the amount of restitution and/or disgorgement the Commissioner seeks from Mr. Hirsch cannot be measured by the loss to investors or even "the amount of premium money that Hirsch misused." Mr. Hirsch may not have gained any personal benefit from his purported misuse of funds, or, indeed, the benefits he received may have exceeded any loss to investors or the allegedly misused premium money. The Commissioner has offered no conclusive evidence that Mr. Hirsch personally benefited from his alleged violations of the Act. To support her

claim for restitution, the Commissioner argues that Mr. Hirsch used his signatory authority over some of the escrow accounts to transfer over $1.4m from these accounts (a) to purchase a life insurance policy of which Beneficial Financial became an owner, and (b) directly to Beneficial Funding Corporation, Beneficial's successor in interest. The Commissioner also maintains that Beneficial and Beneficial Funding paid more than $300K to Amerilease, a company of which Mr. Hirsch is a partial owner, even though, according to the Commissioner, Amerilease did no business with Beneficial or Beneficial Funding. Of course, Mr. Hirsch vehemently denies these allegations citing to Beneficial's bankruptcy proceedings, which are not in the record.

There remains an issue of material fact. The Commissioner has not provided this Court with evidence that Mr. Hirsch personally benefited from these transactions, and, if he did, the extent to which he benefited. Mr. Hirsch has also failed to provide this Court with evidence that would support a conclusion that he did not personally benefit. Accordingly, this Court will deny both parties Motions for Summary Judgment as to the Commissioner's restitution/disgorgement claims.

The Commissioner has also moved for summary judgment on the issue of fines. There are still genuine issues of material fact as to whether Mr. Hirsch even committed any violations of the Act, and if he did, as to when the violations occurred and the number of violations. Therefore, summary judgment on the issue of fines is inappropriate.

An Order reflecting the above analysis is attached.

_____ _____

Date Kaye A. Allison
Judge

MELANIE SENTER LUBIN,	*	IN THE
Plaintiff	*	CIRCUIT COURT
v.	*	FOR
BENEFICIAL ASSURANCE, LTD., *et al.*	*	BALTIMORE CITY
Defendants	*	Case No.: 24-C-02-006515

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ORDER

Upon Consideration of the Commissioner's Motion for Reconsideration of this Court's December 19, 2005 Order Granting Mr. Hirsch's Motion for Summary Judgment and Denying the Commissioner's, Mr. Hirsch's opposition, the Commissioner's Reply thereto, both parties' Motions for Summary Judgment including the oppositions and reply briefs, and all supplemental briefs filed in association with the Motion for Reconsideration and Motions for Summary Judgment, and after two (2) hearings, it is this _____ day of July 2006, by the Circuit Court for Baltimore City, for the reasons set forth in the accompanying Memorandum of Law, hereby

ORDERED that this Court's December 19, 2005 Order granting Mr. Hirsch's Motion for Summary Judgment and denying the Commissioner's is hereby **VACATED**; and it is

FURTHER ORDERED that the Commissioner' s For Reconsideration is **GRANTED**; and it is

FURTHER ORDERED that the Commissioner's Motion for Summary Judgment is hereby **DENIED**; and it is

FURTHER ORDERED that Defendant Hirsch's Motion for Summary Judgment as to Counts I and II is hereby **GRANTED**; and it is

FURTHER ORDERED that Defendant Hirsch's Motion for Summary Judgment as to liability as a control person under Md. Code, Corporations and Associations, § 11-703 (a)(1)(ii) is hereby **GRANTED**; and it is

FURTHER ORDERED that Defendant Hirsch's Motion for Summary Judgment as to Count III is hereby **DENIED** for the reason that he may be held primarily liable, discussed more fully in the accompanying Memorandum of Opinion; and it is

FURTHER ORDERED that Defendant Hirsch's Motion for Summary Judgment in all other respects is hereby **DENIED**.

_____
Kaye A. Allison
Judge