

[Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—III. App.: Misrepresentations about mortality prove fatal in life settlement suit, \(Jan. 4, 2017\)](#)

Securities Regulation Daily Wrap Up

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By [John M. Jascob, J.D., LL.M.](#)

A hedge fund that invested heavily in life settlements has been held liable for misrepresenting or omitting material facts concerning the composition and concentration of the fund's portfolio. The Illinois Court of Appeals held that the Delaware Securities Act did not require the plaintiff to prove reliance on claims that the defendants' materially failed to disclose: (1) their use of less-conservative mortality tables to price the policies; and (2) the existence of sales contracts obligating them to invest the fund's assets in life settlements for the foreseeable future (*Huizenga Managers Fund, LLC v. Ritchie*, December 29, 2016, Connors, M.).

Life settlements. Huizenga Managers Fund, LLC had invested approximately \$10.5 million in defendant Ritchie Risk-Linked Strategies, LLC (the Fund), an onshore hedge fund created by Ritchie Capital as part of a foray into the life settlement market. In order to obtain an assured supply of life settlements, the defendants entered into a purchase agreement with Coventry First, the largest provider of life settlements. The Fund was 100 percent invested in life settlements by October 2006.

In October 2006, however, New York Attorney General Elliot Spitzer announced an action for rescission against Coventry First, potentially calling into question every policy held by the defendants and causing Moody's to withdraw the Fund's Baa rating. Huizenga then filed suit, alleging that the defendants had violated the Delaware Securities Act by, among other things, failing to disclose their use of certain mortality tables provided by Coventry First to price the policies, resulting in artificially shortened life expectancies and overpayment for the vast majority of the policies. The trial court awarded Huizenga approximately \$9.2 million (including prejudgment interest) in connection with its second investment, but denied Huizenga relief for its initial \$6 million purchase, finding that the defendants had not yet become aware of how badly Coventry had taken advantage of them until a few weeks later.

Reliance not required. On appeal, the defendants contended that while Huizenga brought a cause of action under only Section 7323(a)(2) of the Delaware Securities Act for misrepresentation, it must be read together with Section 7303, which is modeled after Rule 10b-5 and, therefore, Huizenga was required to prove reliance. The appellate court rejected this argument, however, noting that while there are cases that suggest that a claim brought under Section 7303 must be read together with Section 7323, there is no such authority suggesting that a claim brought under Section 7323 must be read together with Section 7303.

Moreover, the court declined the defendants' invitation to look beyond the plain language of Section 7323(a)(2) to read a reliance requirement into the Delaware Securities Act. Unlike the implied cause of action under federal Rule 10b-5, a cause of action under the Delaware statute has express elements and it would be inappropriate for the court to define these elements when the legislature has already done so.

Materiality. The appellate court reversed, however, the trial court's finding of a lack of materiality with respect to any misrepresentations or omissions by the defendants concerning the first investment. The court noted that the same facts deemed to be material concerning the second investment were also present before the initial investment: a sales agreement that gave Coventry great leverage to force defendants to buy; a mandated pricing feature which could not be squared with "conservative" life expectancy assumptions; knowledge that conservative life expectancy assumptions were critically important; and a corresponding decreasing likelihood of any actual investment diversification. Even if the defendants were not yet "painfully aware" of direness of the

facts, there was still a substantial likelihood that these facts would have been viewed by a reasonable investor as having significantly altered the "total mix" of information. Accordingly, the appellate court entered judgment in Huizenga's favor on the initial investment in the amount of \$6 million.

The case is [No. 1-15-2733](#).

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Companies: Huizenga Managers Fund, LLC

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