IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT, CHANCERY DIVISION

HUIZENGA MANAGERS FUND, LLC,	)	
	)	
Plaintiff,	)	
	)	
v.	)	**NO. 07 CH 9626**
	)	
A. R. THANE RITCHIE, *et al.*,	)	
	)	
Defendants.	)	

MEMORANDUM ORDER AND JUDGMENT

This cause comes before the Court for decision after trial. The trial covered all or part of 26 days, with 21 witnesses and thousands of exhibits (plaintiffs' exhibit list includes over 2,500 exhibits, though not all were offered or admitted, and defendants' list runs to more than 250). In addition, the parties presented evidence depositions. There was extensive post-trial briefing and a full day of closing argument, including hundreds of power point slides. The factual and legal issues are complex, even nuanced.

In the following pages, the Court's intent is to cover, or at least outline, the material factual and legal issues in a way which will explain the Court's rulings. Of necessity this Memorandum Order will drastically summarize, compress, and omit. In arriving at this ruling, however, the Court has carefully reviewed its notes, the transcripts (which the parties kindly supplied), the admitted exhibits, the pleadings, and the parties' multiple sets of briefs.

Introduction

It is an economic (and biblical: *see* Luke 19:11-25) truism that investment entails risk. One who keeps cash in the mattress, or buries money in the ground, may feel safe; but the safety – the risk avoidance – is at the cost of profit. To profit, one must risk. It is also an economic truism that in a rational market, risk and reward are linked. A risky loan carries a higher interest rate. Adventure capitalism may bring great rewards, but it is not for the faint-hearted.

Both plaintiff Huizenga Managers Fund LLC and the defendant Ritchie entities[1] are "hedge funds." That term is "notoriously difficult to define." *Goldstein v. Securities & Exchange Commission,* 451 F.3d 873, 874-75 (D.C. Cir. 2010). Generally it is "a catch-all for 'any pooled investment vehicle that is privately organized, administered by professional

[1] The four entity defendants are Ritchie Risk-Linked Strategies, L.L.C.; Ritchie Partners, L.L.C.; Ritchie Capital Management, L.L.C.; and Ritchie Capital Management (Bermuda), Ltd. In addition, there are four individual defendants: A.R. Thane Ritchie, Douglas R. Rothschild, Duncan Goldie-Morrison, and Paul Wolfe. Each individual had some role at one or more of the Ritchie entities.

investment managers, and not widely available to the public.'" *Id.* at 875. That hints at a key point: among other things, a hedge fund "is a private investment vehicle that is not subject to the full range of restrictions on investment activities, disclosure obligations, and other regulations imposed by federal law on investment companies." Shadab, *Hedge Fund Governance*, 19 Stan. J. L. Bus. & Fin. 141, 143 n.1 (2013).

Hedge funds are not regulated under the Investment Company Act, 15 U.S.C. § 80a-1 *et seq. See Goldstein, supra,* 451 F.3d at 875. Hence they "engage in very different investing behavior than their mutual fund counterparts." *Id.* at 875. One way to characterize that behavior is that hedge funds are risk enterprises. They look for "alpha" – that is, for growth and return on investment greater than routinely available in the stock market. Thus, they tend to seek out investment opportunities riskier than the norm, hoping for greater than normal rewards.

Ideally, that greater risk does not flow merely from known weakness (for instance, buying a bundle of mortgages already in default). A weakness which is accurately known can be accurately discounted, which is what efficient markets do. Not much alpha there. Rather, the sort of risk to which hedge funds gravitate is the risk of the unknown – the risk inherent in being an early entrant in a market, or as the parties here tend to call it, a "space," not yet fully explored or understood. Such terra incognita is, in the jargon, an inefficient market; and, like the unexplored wilds of the Pacific Northwest from the viewpoint of a 1700s fur trader, the brave-hearted and steel-nerved may find alpha in such a setting.

This case is about "life settlements." As Thane Ritchie testified in this case, in the early 2000s, "life settlements" were such an inefficient market, or investment "space." The nascent "life settlement" industry recognized that some owners of life insurance policies (both insureds and third-party owners) would be willing to sell the policies in order to obtain value from them during the insured's life, rather than deferring the payout until the insured's death and having to pay the policy carrying costs in the meantime. They could, of course, do so by obtaining the cash surrender value from the insurer; but that value, set by the insurer, was often unproductively low. A life settlement company could offer a substantially higher price to the policy owner, but still make a profit on the transaction by collecting the policy proceeds when the insured died.

Any such transaction begins with a period of negative cash flow. One must buy the policy, which is cash out the door up front. Usually one must also continue to pay premiums from the time of purchase until the insured dies, which is more cash out the door. No cash comes in, however, until the insured dies and the proceeds are paid.

A moment's thought shows that the life settlement company's biggest risk in such a transaction is that the insured will live longer than expected. This puts heavy emphasis on two things. First, before buying the policy one must obtain the best possible assessment of the insured's then state of health. One cannot rely on the insurance record for that; the insurer's medical underwriting may have taken place decades earlier. Second, one must also have available mortality tables which permit an accurate evaluation of how long the insured is likely to live. Both of these elements are critical to pricing the policy, and to determining how much cash from other sources will be needed to service the policy until the insured dies.

The Key Facts

A. Ritchie's Entry into Life Settlements

As of early 2005, defendants (collectively "Ritchie") had no experience with life settlements. They had no internal expertise of their own regarding health examinations, life expectancy determinations, or mortality tables. They did, however, have Jeff Mulholland, who was eager to get Ritchie into the life settlement "space" and confident that he was smart enough to appraise and evaluate the risks, even though he had never priced, nor closed, a life settlement transaction. Mulholland was also eager – a better word might be "determined" – to bring about the first successful securitization of life settlements. That by then there had been over 50 unsuccessful attempts, it is fair to infer, simply whetted his appetite: So many attempts meant that others agreed it was worth doing, and Mulholland wanted the cachet of being the first to succeed. Throughout, Mulholland was Ritchie's point person, or quarterback, regarding life settlements. He had, or seemed to have, more knowledge about that than his Ritchie colleagues.

Mulholland also found comfort in the prospect of working with Coventry First. Coventry was the largest provider, or "originator," of life settlements (that is, had the largest portfolio of policies purchased from their owners and available for resale), and in Mulholland's view "were regarded as the best people in the origination and life settlement markets." They had the expertise Ritchie did not yet possess. In May 2005 Mulholland told Coventry that "we like the idea of aligning our interests and are prepared to pay you for your expertise in the market."

That "alignment" was not just for expertise, however. In part, Mulholland wanted to corner the Coventry market, so to speak, enabling Ritchie to exploit the life settlement opportunity before other entrants could gain a solid foothold in the "space." It is a fair inference from the record that Mulholland had, and conveyed to others at Ritchie, a sense of urgency about reaching a deal with Coventry before someone else did. Mulholland presented his proposal to Ritchie's Investment Committee in a May 14, 2005 memorandum. Less than a month later, on June 7, 2005, a Term Sheet between Coventry and Ritchie had been executed, intended to give Ritchie an assured supply of life settlements. By June 30, 2005, a formal Coventry-Ritchie agreement had been signed. Even though Ritchie had yet to sell a single life settlement, let alone securitize them, in October 2005 Mulholland told Thane Ritchie and Duncan Goldie-Morrison that Coventry was receptive to Ritchie's "interest in a long-term mutually beneficial strategic partnership," and to Ritchie's potential interest in buying into Coventry itself.

Because hedge funds tend to look for inefficient markets, it may be inferred that they tend to move quickly. The June 30, 2005 Ritchie-Coventry agreement – which, as will be seen, bound Ritchie to what later seemed onerous terms – was signed less than two months after Mulholland first presented the idea to Ritchie. Some of Ritchie's own decision makers were uncomfortable with the haste, and also with, in effect, giving Mulholland a virtual blank check to negotiate on Ritchie's behalf with Coventry. Given the nature and ambience of hedge funds, noted earlier, it is fair to infer that the speed and the element of uncertainty were not, in themselves, unprecedented. Nevertheless the approach was certainly aggressive. Mulholland – on whom Ritchie relied for most of its dealings in the life settlement "space," but who had

cautioned less than a month earlier that "we still have a lot to learn in this market" – aclnowledged that he himself did not "have all the material [Coventry] terms done until the day [he, for Ritchie] signed the deal on June 30, 2005."

Three points, which figure in later developments, must be noted here.

1. Mortality Tables and Pricing

Among the key elements of the Coventry deal, the mortality table that would be used to value and price Coventry life settlements to be purchased by Ritchie was not decided upon until (to quote Mulholland) "at least" June 30, 2005. Though Coventry had previously suggested to Mulholland that the AVS-2 mortality table, a bone of contention in this litigation, should be used, and Mulholland was aware that Coventry had played a role in devising the AVS-2 table, Mulholland did not actually see it until after the formal Coventry-Ritchie agreement had been signed. A July 12, 2005 internal Coventry memorandum notes that the AVS-2 table applies an "improvement factor" to the mortality rate each year, which is "compounded" annually for 25 years. Before signing the Coventry agreement, Ritchie's only modeling had been based on a different mortality table (the LS3 table), given to Ritchie by Coventry. Applying the LS3 table skewed life expectancies in Coventry's favor. *See* PX 88.[2] Mulholland knew in mid-May 2005, however, that Fasano, the medical underwriters Coventry said it was using (and whom Mulholland touted to prospective investors as "the most conservative medical underwriters"), considered the less aggressive VBT mortality tables as "right on the money."

Fasano's life expectancies were pegged to the VBT tables. Subsequently, Ritchie had difficulty reproducing Coventry's pricing numbers because Coventry's prices used Fasano's life expectancies but not the VBT tables. This produced a sort of "apples and oranges" effect, as both Anne Zissu and Faye Albert testified – an "apples and oranges" that worsened due to what Faye Albert testified was the tendency of the VBT 2001 tables themselves to overstate deaths at older ages. The effect was to make the (in hindsight) already over-aggressive VBT output even more over-aggressive by using the AVS-2 tables.

Mulholland testified that he did not consider it fraud to "us[e] one mortality table in connection with purchasing the life settlement from the insured, and us[e] a different mortality table in connection with selling the life settlement to a prospective investor." The present concern is different, however. Mulholland was asked about two different transactions. The "apples and oranges" problem here, however, concerned a *single* transaction – the sale of a policy to Ritchie. Using AVS-2 tables with Fasano life expectancies resulted in mis-pricing the policy by artificially lessening the risk that the insured would live longer. Defendant's expert Dr. Vadiveloo acknowledged that the effect of this "apples and oranges" is to "distort" the result.

Though in hindsight the distorted results may appear deceptive, Coventry did not conceal the use of the AVS-2 tables. By July 2005, Lem and Mulholland were aware that Coventry was using AVS tables. By September 2005, Lem had told Coventry not to send Fasano life expectancies because he could not make them fit with Coventry's AVS-based pricing. But it

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[2] Ritchie's modeling, itself a complex process, had not begun until after Mulholland's presentation to the Ritchie Investment Committee, and less than three weeks before the Coventry Term Sheet was signed.

seems from, for instance, PX 166 (in February 2006), that what Lem and Mulholland did was to treat Coventry's pricing as a given – or, perhaps, to treat Coventry's AVS-2 tables as a given – and then change the life expectancies to fit. Ms. Albert and actual experience both indicate that that approach was backwards. Lem testified that the use of the AVS-2 tables, and the use of Fasano's mortality ratings but not Fasano's life expectancies, may also have presented problems in dealing with Moody regarding securitization – Mulholland's, and Ritchie's, ultimate goal.

The Private Placement Memorandum ("PPM") given to Huizenga, JX 2, stated at page 30 that many "valuations" of "risk-linked instruments" are "dependent on the use of models" – "not financial models, but models designed to estimate the risk of various insured events occurring." The PPM cautioned that these models "are materially less certain or accurate than the typical financial models used for valuation purposes," and "involve an entire dimension of uncertainty which an option or bond pricing model does not." Hence, the PPM warned, "material misstatements of the fair value of the Fund's Risk-Linked portfolios are possible on a level of magnitude that is typically not found in securities portfolios." *See also Id.* at 31 (mentioning "actuarial analysis"), 36. But the PPM did not tie these general observations to modeling life settlement transactions (though at page 45 it did note "Imprecision in Life Expectancy Estimation Methodology"), and did not identify the existence of the Lem/Mulholland model.

2. Coventry Fees

In addition to Coventry's pricing, another key point, also recognized more fully in hindsight, was the aggressive fee structure of the Coventry deal. The Ritchie-Coventry Term Sheet, PX 89, gave Coventry not only a profit on each policy sold to Ritchie, but also a yearly "origination and administration fee" equal to 3.75% of the outstanding junior debt, and in addition a 20% "profit participation" in whatever profits Ritchie made. Taken together, these made the policies Ritchie purchased more expensive than appeared on the surface. Ritchie could not hedge against this by buying fewer policies. The June 30, 2005 Coventry deal effectively committed Ritchie (that is, some Ritchie entity) to buy whatever conforming policies Coventry chose to sell. *See* PX 253. Coupled with Mulholland's aggressive approach to securitization (he had a second securitization under way before the first had even been rated), this raised the potential of a Ritchie "cash crunch." Thane Ritchie commented on this in an e-mail on the same day the Coventry deal was signed, projecting February 2006 as the "crunch" point.

3. Coventry Reputation Risk

Based on the lack of record evidence about "originators" other than Coventry, there do not seem to have been all that many in the mid-2005 time frame. Coventry appears to have been the largest, though not the only, occupant of that niche. But neither the niche nor Coventry itself enjoyed a stellar reputation. The niche suffered from an earlier trafficking in so-called "viatical" life settlements – quasi-deathbed purchases from ailing insureds with less than a two-year life expectancy, such as AIDS victims. Viatical settlements had been the subject of private litigation, as well as public regulation by some 40 States. *See* JX 3 at 46. Though Coventry did not engage in such purchases, a dubious odor lingered over the subject. Defendants' expert witness Tsvetan Beloreshki testified that for Ritchie's purposes, "trying to pull off the [first] securitization of its kind," its life settlement originator – Coventry – needed to be free of reputational problems.

Coventry had its own problems, however. Apparently as part of a public relations strategy intended to separate it from the viatical wrongdoers, Coventry aggressively proclaimed its purity, even to the point of acting as a self-appointed sheriff. In November 2004, Coventry sued an entity called 21st Services, alleging wrongdoing with regard to life settlements. In February 2005, 21st Services counterclaimed, accusing Coventry of, *inter alia,* a form of bid-rigging whereby Coventry and AVS "manipulate the life expectancy data used by the various purchasers of life insurance policies," and that "AVS does this by providing differing life expectancies for bidders other than Coventry for the same policyholders," "so that Coventry has a competitive edge in bidding for the ... policies."

These allegations, made "on information and belief," appear from 21st Services' pleading to have been based on admissions by AVS rather than facts about Coventry. But in March 2005, soon after 21st Services filed its counterclaim, Coventry made a FRCP 68 offer of judgment to 21st Services, whereby Coventry would agree to a $10 million judgment against Coventry. The tactics behind the Rule 68 offer may have had little to do with the merit of 21st Century's allegations. Still, the circumstances – which Coventry disclosed to Ritchie in March 2005, *see* PX 77 – could not have aided Coventry's efforts to distinguish itself from the disreputable pack.[3]

Also, one might expect that the claim of collusion between Coventry and AVS, made known to Ritchie in March 2005, would lead to closer examination of the AVS-2 table Coventry imposed on Ritchie. But the record suggests otherwise. By January 2006, IFA, hired by Ritchie to study AVS, had advised Mulholland and Lem that AVS tended to overpredict deaths; that is, "actual number of deaths is significantly below expected for all segments of the portfolio considered." IFA did not specifically evaluate AVS-2, however, due to lack of data. For that reason, and because Coventry responded to IFA's concerns by claiming that AVS-2 was actually more conservative than the tables IFA examined, Mulholland and Lem – and therefore Ritchie – did not pay much attention to the IFA analysis.

That is problematic. Neither Ms. Albert nor defendants' expert, Dr. Vadiveloo, had seen so-called "adjustments" of the kind Coventry used to justify the creation of the AVS-2 table in the face of IFA's doubts, and Ms. Albert pointed out that "there was no experience basis for" the "adjustments." In other words, those "adjustments," made by Coventry rather than by AVS, were arbitrary. Neither Ms. Albert nor Dr. Vadiveloo supported Coventry's argument that a lack of medical records justified the adjustments. To the contrary, the evidence suggests that older policyholders – the category involved in most life settlement transactions – tend to have substantial medical records, particularly if they are health-impaired and thus likely to die sooner.

B. Ritchie Creates a Structure and Begins Marketing

Having assured itself of a supply of life settlements by means of the Coventry deal, Ritchie, quarterbacked by Mulholland, began looking for investors. As early as June 30, 2005, Thane Ritchie had cautioned that "we might run into a cash crunch in Feb[ruary] [20]06 unless

[3] As defendants point out, in February 2006, 21st Century announced the settlement of the Coventry litigation and the withdrawal of 21st Century's counterclaims. That, of course, was well after Ritchie had become committed to its Coventry deal, and after Huizenga had invested.

we raise money for," among other things, "risk linked." "Risk-linked" was Ritchie's label for its foray into insurance, including life settlements. The need to raise money was driven by, first, Ritchie's commitment to Coventry to keep buying settlements if they met the agreed-on criteria; and second, Ritchie's need to service settlements it had already purchased so that the underlying policies remained in force. As will be noted later on, as early as August 2, 2005, Ritchie needed another $10 million in "equity" – that is, invested capital – to meet its Coventry obligations.

One possible way to handle the investment would be simply to buy settlements, service them, and hold them until maturity, *i.e.*, until the insured died and the policy paid out. In theory, that should yield a profit; it would not make sense for the purchase price to be so high that holding the settlement till maturity would lose money.

But "buy and hold" was not Ritchie's strategy. Among other things, such an approach would require a source of substantial interim funding, since the settlements themselves generated no money (but had significant costs) until the insured died. Instead, Mulholland was bent on securitization – that is, selling securities backed by a pool of life settlements (similar in principle to securities backed by, say, a bundle of mortgages). In mid-2005, Ritchie created a structure to facilitate that.

To begin with, under the overall aegis of Ritchie Capital Management, LLC, Ritchie created Ritchie Risk-Linked Strategies Trading, Ltd. That was the "master fund" for Ritchie's life settlement activities. Ritchie also created two "feeder funds" to provide funding to the "master fund." Ritchie Risk-Linked Strategies, LLC was the "onshore feeder fund;" Ritchie Risk-Linked Strategies, Ltd. was the "offshore feeder fund."

In its June 2005 presentation to Huizenga, JX 1, Ritchie described the next step. The risk-linked feeder funds would provide funds with which to buy life settlements from the "originator" (Coventry, which had acquired the policies from policyholders) and transfer ownership of the purchased settlements into a "special purpose entity." For tax and accounting reasons, the special purpose entity, also referred to as a "warehouse," turned out to be an Irish company, often called the "Irish warehouse" but actually named Ritchie Risk-Linked Strategies Trading (Ireland), Ltd. *See* PXs 239, 253. In a June 22, 2005 internal memorandum, PX 101, Ritchie's Ron Kenny diagrammed an "initial structure" and an "anticipated structure" involving the Irish company. Common to both was that the onshore feeder fund would provide direct funding for the Irish warehouse, while funding by the offshore feeder fund would be indirect. Also common to both was that the onshore fund would hold the equity position ("subordinated securities") in the Irish warehouse, while the offshore fund's contribution would be as part of junior debt. This meant that the offshore fund investors, holding junior debt, might stand a better chance of recovering their investment than the onshore fund equity investors.

The June 22, 2005 private placement memorandum (or PPM) provided to Huizenga, JX 2, was for the onshore fund, Ritchie Risk-Linked Strategies, LLC. The PPM noted that the performance of the onshore and offshore funds "may differ materially," for instance because the onshore fund might hold equity and the offshore fund might hold debt, and stated: "There can be no assurance that the Offshore Fund will not materially outperform the [Onshore] Fund."

Though Huizenga was given a number of updates to the PPM, *see* JX 4, this cautionary language did not change.

Elliott Lem conceded that based on his and Mulholland's modeling, it was apparent early on that the equity position would take a loss – perhaps a total loss – on a "buy and hold" strategy. "Buy and hold was not our strategy, though," he said. (But *compare* Mulholland's September 29, 2005 statement to David Bradley, *et al.*, that "if the policies were not sold, they could be held to maturity, and the equity would have a high single-digit rate of return." *Tr.*, 4/26/10, at 148.) It appears that the equity position was at risk on other strategies as well, however. A May 31, 2005 memo from Mulholland to Ritchie's David Govrin noted that on Ritchie's proposed strategy "the returns are great unless the mortality is bad" – that is, unless insureds outlive their expected mortality dates – "but the junior debt ends up being protected on that." The equity was not so fortunate. This tendency to protect junior debt at the expense of equity persisted. It was also a feature of the "contingent forward" (discussed below) which Moody sought to exact as a price of its willingness to rate Ritchie's proposed life settlement securitization.

This impeded Mulholland's efforts to sell the equity part of the investment opportunity to third parties. In July 2005, one potential investor, Silver Creek, told Mulholland that they were "interested" in participating in the Junior Notes, but felt that "they do not understand the underlying mortality risk well enough to participate in the equity of the deal." PX 125. The significance of this comment is twofold. First, it highlights the importance of accurately estimating mortality risk – an accuracy which was undercut, as noted earlier, by Ritchie's acceptance of the Coventry-massaged AVS-2 mortality table. Second, the comment highlights the greater vulnerability of the Risk-Linked equity investors. Though Mulholland "shopped" the life settlement investment vigorously, in late July 2005 he reported to Thane Ritchie and others that "we need an additional $10 million of equity in the Coventry First deal," and suggested obtaining the funds "from the U.S. feeder in the way previous amounts have been contributed." PXs 125, 1184. A few weeks earlier, however, on July 11, 2005, Ritchie's Mike Allara had cautioned about the "exposure created to the on-shore vehicle [*i.e.*, Huizenga, as it turned out] by the Coventry transactions," warning in the same memo about lack of diversification. PX 811.

In itself, the greater risk of the equity investors was not a surprise to Huizenga. On September 28, 2005, Matt Demaray asked Mulholland "Who holds the longevity risk of the portfolio?," and answered his own question: "I'm assuming it's the security holders." PX 309. But Huizenga argues strenuously that it was not aware of Elliott Lem's "equity loses" modeling, nor of the actual dynamics of the Coventry purchases and ongoing commitments.

C. The Huizenga Transaction

JX 1, a June 2, 2005 e-mail to P.J. Huizenga and Matt Demaray, attached a 23-page .pdf presentation, under the auspices and on the letterhead of Ritchie Capital Management LLC, which Ritchie's David Zirin and Brian Murphy had "walked through" with Huizenga earlier that day. Three weeks later, on June 22, 2005, Zirin sent Messrs. Huizenga and Demaray JX 2, the then-current version of the 85-page (plus Appendix) PPM for the onshore fund.

The JX 1 presentation, like the PPM, is rife with warnings – "speculative," "high degree of risk," "high degree of leverage," "concentrated portfolio," and "illiquid," to mention only the phrases on the first page of the presentation (which, in varying combinations and to varying degrees, are repeated thereafter). But the warnings are leavened with more comforting language; for example, "portfolio-level diversification benefits" appears no fewer than three times on the second page of the presentation.

Diversification was a selling point for Ritchie, at least in Mike Allara's view; *see* PX 811. It is something of a theme in the JX 1 presentation, as is the similar-sounding idea of "dynamic allocation." Life settlements are presented as just one of six different "illustrations" of the sort of investment "opportunities" at which the fund is to be aimed, "optimiz[ing] the portfolio through the dynamic allocation of capital to the highest-valuation opportunities." The other five featured "opportunities" are life insurance and annuity arbitrage; catastrophic mortality; property and casualty (usually termed "P&C")/catastrophe; P&C/private equity; and P&C/distressed. Carrying forward the diversification idea, a pie chart offers "illustrative strategy allocations," aiming at a total of 67% in "life" opportunities, versus 33% in P&C opportunities; life settlements themselves are allocated 33%. But the page with the pie chart itself explicitly warns that "the examples contained herein are not meant to be indicative or reflective of the specific portfolio," and that "there is no guarantee" that the fund "will in fact make such allocations." In fact, it does not appear that at any time Ritchie had any actual investment in any "life" opportunities other than life settlements.

Let us turn to the actual, or formal, transaction documents between Ritchie and Huizenga, and to the actual investments Huizenga made.

1. The PPM

The PPM, JX 2, carries forward both the diversification theme and the no-promises panoply of warnings. At page 2, the PPM refers to "a broad spectrum of ... opportunities within the Risk-Linked Markets including both property and casualty as well as life insurance exposures," and touts a "wide, and currently expanding, range of Risk-Linked Market strategies;" page 3 adds that the "Managing Member anticipates materially expanding the number and type of Risk-Linked Market Strategies that the Managing Member will implement in the near future." The same page states that "Diversification is, of necessity, the Managing Member's primary risk control option." That point is repeated on pages 16, 28. At page 18 we are told that "the Fund will pursue opportunities across a broad spectrum of insurance and reinsurance, including, but not limited to, property and casualty, aviation, workers compensation, pensions, annuities, life insurance and other insurance-related risks." At page 19, we learn that "over time," Ritchie:

"expects the fund will participate in most, if not all, of the following strategies:

"▪ Life Settlements

"▪ Life Insurance Premium Financing

"▪ Structured Products and Arbitrage Opportunities within the Life, Annuity, and Pension Sectors

"▪ Traditional Insurance and Reinsurance Markets, including, but not limited to, catastrophic and non-catastrophic property, aviation, short-tasil liability, mortality and related insurance and reinsurance coverage

"▪ Insurance-Linked Securities and Derivatives

"▪ Strategic Investments in both Private and Public Companies

"▪ Risk-Linked Market Inefficiency, Regulation and Taxation."

The following PPM pages (pages 19-24) expatiate on these variegated possibilities. At the end, the PPM – though confessing that "to date," Ritchie has been "limited to investments within the property and aviation catastrophe market" – repeats that Ritchie "is in the process of dramatically expanding the range of its Risk-Linked Market strategies." *See also, e.g., Id.* at 61, speculating that "[t]he broad diversification of the Fund's portfolio from time to time may create certain material valuation issues in determining its Net Asset Value."

But no promises. Though Ritchie "will attempt to manage the overall risk profile of the Fund's portfolio through diversification and selectivity," the PPM specifically notes at page 23 that Ritchie "has complete discretion," that the Fund "will not follow strict risk control or diversification policies," and that (in italics) "*There can be no assurance that a substantial portion of the Fund's positions may not, from time to time, exhibit a high degree of positive correlation, abrogating the risk control benefits of diversification.*" Similarly, the PPM states at page 35 that there are "No Restrictions on the Fund's Portfolio Allocations;" and on the same page, "anticipates" that "perhaps as much as two-thirds or more" of the Fund's capital "will be committed to the Life Sectors," "[o]ne aspect" of which is "Life Settlements." At page 38, the PPM again emphasizes that the Fund has "No Formal Diversification Policies," "is not restricted" as to how much may be invested in any strategy, "will not maintain any fixed requirements" in that regard, and "may concentrate" its "holdings." And the last page of the PPM Appendix reiterates that "There is no material limitation on the Fund's trading and investing within the general constraint of its focus on the Risk-Linked Markets" – though that is coupled with an implied reference to diversification: "Over time, the Fund can be expected to trade in a wide range of as yet unanticipated markets, instruments, and strategies, subjecting the Fund to as yet unanticipated risks."

The PPM was amended at least twice after the June 22, 2005 version which is JX 2. *See* JXs 3 (tendered July 28, 2005), 4 (dated October 1, 2005; tendered November 18, 2005). Huizenga was given, and assented to, each amended version. *See* JX 5.

2. The Subscription Agreement

In ¶ 2(r) of the Subscription Agreement (included in JX 3) through which Huizenga invested in the Fund, Huizenga specifically "warranted" that notwithstanding any other

information it might have received from Ritchie, Huizenga "has relied only on the information in the [PPM] and the other Material Contracts in determining to subscribe for Interests."

In ¶ 2(t) of the Subscription Agreement, Huizenga also specifically agreed that "the foregoing representations and warranties ... may be used as a defense in any actions relating to the Fund, any RCM Party or the offering of the Interests, and that it is only on the basis of such representations and warranties ... that the Fund may be willing to accept the Subscriber's subscription for Interests." (*But see* § 9.26(b) of the Operating Agreement, noted below.)

3. The Operating Agreement

One of the Material Contracts, referenced in both the PPM and the Subscription Agreement, was the Ritchie Risk-Linked Strategies, L.L.C Operating Agreement, as amended. *See* JX 4. Pursuant to the Operating Agreement, the Fund was a Delaware limited liability company, and § 9.15 of the Operating Agreement provides that it is governed by Delaware law. Section 9.23(a) of the Operating Agreement provides that "Any action, suit, claim or proceeding brought by any Member against the Fund or the Managing Member [Ritchie Partners, L.L.C.] or any RCM Party, by or on behalf of the Fund or any Member shall be barred" unless commenced within one year from the date the Member knew or should have known of "the event which is the subject matter of such action, suit, claim or proceeding." Section 9.23(b) of the Operating Agreement provides that a Member who "fails to prevail" in such a suit "shall pay the legal fees and costs incurred by the opposing party or parties."

The Operating Agreement identifies "Ritchie Capital Management, Ltd., a Cayman Islands company," as the Fund's "investment manager." *See* JX 4 at page HMF006132. Section 2.8(b) of the Operating Agreement provides that no "RCM [Ritchie Capital Management] Party" (which includes, *inter alia,* the Managing Member and its employees) "shall have any liability to ... any Member or any former Member" except for acts or omissions "Finally Determined to constitute fraud, bad faith, gross negligence or reckless or intentional misconduct." Under § 2.8(c) of the Operating Agreement, no "RCM Party" shall have any liability to the Fund or a Member or former Member even for "a violation of Law," if the RCM Party "reasonably believed such conduct to be in the interest of the Fund at the time of such conduct."

Section 9.26(b) of the Operating Agreement states, however, that "No Member, by becoming party hereto or by executing and delivering a Subscription Agreement, shall be deemed to have in any respect waived any of such Member's rights under any federal or state securities laws."

4. Huizenga's Investments

After the June 2, 2005 presentation by Ritchie noted above (*see* JX 1), there was substantial interchange between Huizenga and Ritchie. This included a sort of sales brochure (the June 24, 2005 "Generating Alpha" document, PX 1143) and a late July 2005 meeting in

New York which lasted several hours (*see* PXs 275, 696), in addition to the PPM and Material Contract documents. On August 1, 2005, Huizenga invested $6 million in the Fund. PX 1164.[4]

Even then, David Bradley testified, Huizenga contemplated increasing its investment. Huizenga sought a variety of "diversified" investments, preferably "uncorrelated." Insurance-related investments, such as Ritchie's proposal, were attractive to Huizenga because they were not correlated with the broader market. *Tr.* 4/26/10 at 113. Another meeting occurred in September 2005, *see* PXs 295, 702, with a follow-up teleconference, *see* PXs 304, 706. The discussions focused on life settlements. Before September 28, 2005, Huizenga knew who Coventry was (though not "Coventry's process for originating policies"). *See* PXs 302, 304. On September 29, 2005, Mulholland e-mailed Matt Demaray a "waterfall cash flow" (PX 309) based on the Lem/Mulholland model, but, as Bradley testified, not a complete iteration of that model since, among other things, it did not include the underlying assumptions or operations. *See Tr.* 4/26/10 at 153-54. Mulholland also brought up Coventry. Bradley testified (*Id.* at 143):

> "This is the first time we had heard the name 'Coventry,' and he said: 'The policies are being serviced by Coventry, and they are being paid a fee of 15 basis points on face per year.' Beyond that, Coventry is investing 15 million in the equity structure mentioned below. So then he says: 'There's a senior lender which has provided a facility to lend 260 million. There's 150 million in senior and junior notes, and then an equity component, which is 64 million. Coventry, the servicer, is investing $15 million in the equity and the fund is investing $20 million.'"

Asked "which fund are you referring to," Bradley responded (*Id.* at 144):

> "The fund that we were invested in, and the onshore fund – I mean and the offshore fund because he told us for tax reasons the equity had to be owned by the on and the offshore funds, and the junior notes for tax reasons could not be owned by the onshore fund."

In this September 29, 2005 telephone conference (*see* PX 706), the Huizenga participants were also told that the onshore-fund equity position in which Huizenga had invested was "more risky" than the Senior and Junior Notes. *Tr.* 4/26/10 at 146-47. But Bradley testified that this was conveyed in a reassuring way (*Id.*): "For the first time we were told that our fund would own a portion of the equity, that that was being done for tax reasons, and that because the equity was more risky our fund would own less of it, and it would be, quote, sized appropriately." Mulholland then described a "targeted timeline to sell the life settlement policies" – 25% in 6 months, 50% in a year, the last 25% within 18 months – and said that "if the policies were not sold, they could be hold [*sic*] to maturity, and the equity would have a high single-digit rate of return." Mulholland did not offer much information about Coventry, *see Id.* at 148-50. He did note that the "biggest risk" would be "[i]f policies can't be sold and people live longer than expected." *Id.* at 151. But he smoothed that over (*Id.*): "[H]e had communicated to us in this

[4] The two months between the June 2, 2005 presentation to Huizenga and Huizenga's August 1, 2005 decision to invest is a bit longer than the 1 ½ months between Mulholland's first presentation to Ritchie's Investment Committee and Ritchie's commitment to the Coventry deal. Of course the two situations are not entirely parallel.

meeting and in prior meeting that they were using the most conservative life expectancy assumptions because he said those were critically important and that they were partnered with blue ribbon kind of premier organizations that were (indicating) squeaky clean in a sometimes dirty industry." This was not entirely candid. As to the conservative mortality assumptions, by then Mulholland knew the information described at pages 3-4 *supra*. As to "squeaky clean," Mulholland did not mention the 21st Services counterclaim, *see* pages 5-6 *supra*.

After the September 29, 2005 call with Mulholland, plaintiff "decided to make an additional investment." On October 1, 2005, plaintiff invested another $5 million.

During the September 29, 2005 call, Demaray had asked Mulholland to provide the model Ritchie was using to estimate cash flows. Mulholland agreed to do so. The result was PX 309, which plaintiff received sometime shortly after making the additional $5 million investment. PX 309 was not satisfactory. It was "not a complete model." "You couldn't see the assumptions, you couldn't see the sensitivities, it could not be manipulated, and so Matt [Demaray] was tasked with going back and requesting the full model and not just the cash flows." *Tr.* 4/26/10 at 153-54. The full model was never provided. (In August 2006, Lehman's David Wadler similarly asked for the "securitization model." Wadler was "trying to tie out my model but the results look very bad for the equity." He thought he might have made a mistake. Mulholland responded "Please do not give them the securitization model." PX 657.)

D. The Next Year: Ritchie's Securitization, Huizenga's Doubts

In the ensuing year, Ritchie (meaning primarily Mulholland and Lem) – pressured by Coventry, as will be seen – not only aggressively pursued securitization of the life settlement portfolio, but also used that prospect (always "just around the corner") to deflect attention from Ritchie's complete failure to achieve any life settlement sales or attract any other investors to the risk-linked fund, which led to internal frictions between Mulholland and others at Ritchie. Meanwhile Huizenga, which as early as November 2005 began to wonder "why aren't we making any money?" (PX 711), became increasingly disenchanted with its investment.

1. Ritchie's Internal Events

Using hundreds of internal e-mails and other documents, at trial plaintiff sought to paint a copiously detailed, almost pointillist, portrait of Ritchie's internal events from the Huizenga investment in late 2005 until "Spitzer Day," the October 26, 2006 end of the securitization idea. Of necessity, what follows drastically summarizes and abstracts that evidence. Running through it, in the Court's view, are four main threads or "drivers," which will be sketched below.

a. Coventry Pressure

A significant theme, and a problem, lay in Coventry's aggressive pushing of ever greater life settlement sales to Ritchie. Defendants dispute plaintiff's claim that the June 30, 2005 deal with Ritchie effectively committed Ritchie to buy as many life settlements as Coventry chose to sell. But even if the deal itself did not create that pressure, competitive considerations did. By early October 2005, just days after plaintiff's second investment, Coventry was pushing to

"double-size" the original deal. PX 854. There was skepticism within Ritchie. *See, e.g.,* PXs 840, 858, 859, 862 ("[D]o we really want to double BEFORE we get a sale 90% paid?"). Some Ritchie people, among them David Govrin, were not convinced the original deal itself would sell out profitably (*see* PX 858). In addition, just a week earlier Govrin – paralleling Thane Ritchie's "cash crunch" concern, but finding the crunch point even earlier – had told Mulholland that they "could not transact more as we have no capital left to use as collateral." PX 840.

Despite the skepticism about doubling an unproven bet and the funding concerns, by October 12, 2005 Thane Ritchie had decided to go ahead with the Coventry double-sizing: "On [C]oventry I think we need to tell them yes now and then get the capital over the next few months ... Or we risk adverse selection and/orc [*sic*] hurting the relationship..." PX 866; *see Tr.,* 5/14/10, at 2732-33. This aggressive competitiveness, even at the risk of prudence, was a bit of a theme, perhaps generic to hedge funds rather than unique to Ritchie.

b. Internal Competition and the Search for Funds

At least in part, Govrin's "no capital left" concern reflected a tug of war over available funds between the "life" side (Mulholland, Lem) and the "P&C" side (Govrin, Murphy, Geiger) rather than a complete lack of funds. *See, e.g., Tr.*, 4/27/10, at 271-72, 278-79, 294-95. That tug of war, intensified by Mulholland's demands for more compensation, increased during 2006.

Originally Ritchie's insurance-related enterprise had been a single "risk-linked group" with two collaborating teams, Mulholland and Lem for the "life" portion and Govrin, Murphy, and Geiger for the "P&C" portion. Govrin's testimony indicates that there was a single "basket," both for compensation and for funding. *See, e.g., Tr.,* 4/27/10 at 276, 278. But Mulholland's need for funds for life settlement purchases (particularly if the original deal was to be "double-sized"), and his personal drive for greater turf and greater compensation, created increasing tension between the "life" and "P&C" teams. By September 2005 there was a "divorce." It was driven by Mulholland's side: "And the life-settlements team, in September 2005, said, you know, 'This is so good. We're going to, you know, keep it all ourselves, and good luck with your P&C stuff.'" *Id.* at 278-79. The two teams "effectively split into two different businesses." *Id.*

This was based largely on Mulholland's demand for greater compensation (*Id.*), itself a source of continuing tension because Mulholland's compensation was based on unrealized rather than actual profits. *See Id.* at 283-86; *see also Id.* at 291, characterizing PX 146 and the PX 854/PX 859 e-mail chains about Mulholland's compensation as "the event that triggered the divorce." Rothschild wrote in January 2006 that "[o]f course" Mulholland's supposed returns (based on which he was paid) are "all funny money." That is because, as stated by (*e.g.*) Paul Nibbio and Ron Kenny, "Life is unrealized, P&C realized." PX 604.

The conflict between "life" and "P&C" was exacerbated by the lack of outside investment in the life settlements program. When originally approved by Ritchie's Investment Committee, the program had securitization as an ultimate goal, but was expected to generate funds by selling life settlements and/or by inducing third parties to invest in the risk-linked funds. Indeed, the Coventry double-sizing was originally supposed to be contingent on Mulholland making some sales from the existing portfolio. *See Tr.,* 5/14/10, at 2717, 2728-29;

Tr., 6/25/10, at 3774-78; PXs 152, 866, 1192. But by February 2006 (Thane Ritchie's presciently predicted "cash crunch" point), Mulholland had not sold a single life settlement and had not obtained any other investors.[5] Instead, he was developing "Ritchie II," which required still more funds with which to buy life settlements from Coventry, before "Ritchie I" had even gotten off the ground. (This was not supposed to happen, Geiger wrote in January 2006. "Jeff has to sell policies in Ritchie I prior to funding Ritchie II." PX 896.) On February 22, 2006 Geiger told Govrin that Mulholland "needs $25 million tomorrow" to meet "his required March 1st funding request for Coventry." Govrin responded: "I heard him panicking with Coventry last week. I hope that Thane and Mike [Allara] don't come up with the money." PX 922.

By late August 2006, Mulholland, Thane Ritchie, and other senior Ritchie managers knew that, though (in Mulholland's words) Coventry "have the legal right to demand the funding" for more life settlement purchases, the funds were not available. This included $11 million onshore and $45 million offshore for "Ritchie IV," plus a "minimum" of "$26.1 million of onshore funds for the equity for the securitization during September (Ritchie III)." PX 199. Some of this flowed from Thane Ritchie's October 2005 decision to go ahead with the Coventry "double-sizing." Some may have been due to Mulholland's own aggressiveness. On August 31, 2006, Kim Cullotta, noting that "Jeff continues to ask for funding for Coventry and has been told no," added: "Mark [Morris] went back thru notes from I/C [Ritchie's Investment Committee] from July 05 to make sure what the I/C had and had not approved. For instance the I/C did not approve Ritchie II, rather Jeff has a side conversation with Duncan [Goldie-Morrison] to push this through. Getting involved in Ritchie II essentially committed us to Ritchie IV which Jeff had another side conversation instead of going to I/C. Mark just pointed out that the I/C is not over a barrel because they didn't make these approvals formally and Jeff has to figure out how he is going to make this work." PX 204. *But see Tr.*, 5/7/10, at 1591 (Paul Wolfe, stating that the Investment Committee did approve multiple Coventry fundings in 2006); PX 177 (referencing a May 2, 2006 Investment Committee meeting about Life Settlements).[6]

c. The Moody Rating; the Contingent Forward; "Spitzer Day"

Throughout this period, Mulholland and Lem, and thus Ritchie overall, were heavily focused on obtaining a Moody's rating for the proposed life settlement securitization. That had been the goal from the beginning. By April 2006, securitization was perceived almost as a panacea – "returns should increase substantially," "our leveraging terms should improve," "liquidity" will improve (otherwise, "[t]he policies are relatively illiquid assets"), and securitization "greatly reduces our risk of not being able to sell the policies." PX 177. That in turn would reduce or perhaps eliminate another serious risk: "If we end up owning the policies there is the risk that the policyholders live longer than the mortality experts have predicted." *Id.*

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[5] It is not clear why there had been no life settlement sales. Certainly Mulholland was far more interested in a securitization, which would have been a significant coup since many previous tries at securitization by others had failed. It is a bit more clear why there had been no further investors. Though there had been several nibbles, doubts about the modeling (which, as noted, Mulholland did not wish to show anyone), the industry, and the fate of an equity investment had cooled any interest. *See, e.g.*, PX 127, concerning Silver Creek; PX 167, concerning Phoenix.

[6] PX 177 shows Goldie-Morrison as "Deal Sponsor." Goldie-Morrison testified that this cannot have been correct. *Tr.*, 5/14/10, at 2793. He did not, however, disavow the meeting or the PX 177 proposal.

So during this period the entire "business model is to accumulate policies and then to sell them via future securitizations and total return swaps." *Id.* To the extent this is perceived as realistic, it glosses over or excuses Mulholland's continuing failure to sell any policies in any other manner. It also glosses over the mortality risk (and what was by the spring of 2006 the sore point of Coventry's "apples and oranges" mixing of mortality tables, *see* page 4 *supra,* and *see Tr.,* 5/14/10, at 2776-78, 2811), because if the policies are securitized, that risk is effectively offloaded to the buyers of the securities. Thus Mulholland had two reasons to push securitization: it was his goal, and it diverted attention from the life settlement problems just noted. A third reason was that, apart from the notion of selling policies direct from the Irish warehouse (the Phoenix proposal, *see Tr.,* 5/14/10, at 2748-49, which had failed in February 2006, PX 167),[7] the only real alternative to securitization was to hold the policies to maturity, which was seen as a last resort with, as Mulholland told Bradley (*Tr.,* 4/26/10, at 148), only a "high single-digit" return. *Tr.,* 5/14/10, at 2724-25. That would not generate "alpha."

The Moody rating process was lengthy, not least because of modeling difficulties and Moody's lack of comfort with Coventry's or Mulholland's mortality numbers. In mid-February 2006, "Moody's came back asking for further analysis on mortality shocks etc., this will take a few days to provide" and "delays the rating," not expected until March. PX 913. Even at the time of PX 913 (February 17, 2006), Goldie-Morrison warned that the initial "proceeds from a bond issue" (*i.e.,* a securitization) "go to pay off the senior lender [and will] not give us back the cash;" to get cash "[w]e will have to subsequently re-lever the assets." *Id.* But (*Id.*) "[f]urther deal flow need cash, $25mm for the end of February alone."

Despite the travails, "beginning on April 1" Mulholland "came to the conclusion that the securitization market will certainly exist for life settlements." PX 632. But as of May 1, 2006 "[t]he Investment Committee is concerned that we have not received the preliminary rating from Moody's." PX 628. The initial Moody's rating was issued four days later, on May 5, 2006. PX 631. This was a first. No one else had succeeded in getting Moody's to rate a life settlement securitization. But the actual rating was a disappointing Baa – not the A Mulholland had expected (PX 184) – and it came with a very high (42%) requirement of subordination to senior debt. "[N]ot good news." *Tr.,* 5/14/10, at 2801. Since the mark-to-model Ritchie had been using to compensate Mulholland and woo investors had been premised on a more favorable rating, the actual rating meant "a mtm markdown of 7 million." PX 184; *Tr.,* 5/14/10, at 2801-02. "I believe it should cost us roughly 7 million on the mtm of the subordinated securities," Mulholland wrote. PX 963.

Ritchie believed that with further information Moody's might change its rating to A3. PX 636. The capital structure Moody's rated included $197 million of Senior Notes (the rated securities), $106 million of Junior Notes, and $35 million of Equity. *Id.* Ritchie proposed to change the structure by moving $5 million from Senior Notes to Junior Notes ("i.e. increasing the [already high] amount of subordination for the Senior Notes"). *Id.* But Ritchie would also

[7] The securitization would also involve the warehouse. As Mulholland explained it in December 2005, Ritchie III would sell Moody-rated securities; it would buy policies from Ritchie I and Ritchie II, each a "warehouse." PX 596; *Tr.,* 5/14/10, at 2743-46. Phoenix would also have bought policies from a warehouse, but only policies that were not Moody-rated and thus not part of a securitization. *See* PX 913.

need an "LE contingent forward past the average life of the Senior Notes that protects the portfolio from adverse deviations in mortality" (*Id.*) – that is, a facility which in effect guarantees the mortality expectations underlying the Senior Notes by "writing a put on the portfolio at the value of the senior notes." *Tr.*, 5/14/10, at 2814-15. This would require a new "counterparty" with at least an A3 rating. PX 636. It appears that as of June 28, 2006 Moody's was likely to change its rating to A3 if the contingent forward was put in place. DXs 82, 178.

Trying to put the LE contingent forward in place, and trying to find a willing "counterparty," took months. Goldie-Morrison's September 29, 2006 "to do list," PX 214, shows that even then the job was still not done, for reasons involving both Coventry and Ritchie:

- As to Coventry, "Securitization leads UBS [who by then "do not like us" anyway] and Lehman need to get comfortable with the intersection of Fasano and VMS. This is the old position where we worked out Coventry had Fxxxed us." That was a constant sore point. Huizenga argues that this problem could be directly tied to Coventry's original apples-and-oranges approach to mortality in valuing the policies it sold to Ritchie. *See, e.g., Tr.*, 5/14/10, at 2817-20. Goldie-Morrison eventually conceded that "the Fasano problem was literally a matter of contract," because "you [Ritchie] were contractually obliged to take Fasano's mortality rating and apply it to an AVS table resulting in the mispricing that you [Goldie-Morrison] described." *Id.* at 2882-83. Still, Goldie-Morrison testified, all was not lost. "It was built into the contract, but then we twisted Coventry's arm." *Tr.*, 5/14/10, at 2883. Despite wondering in PX 214 "How do we extract ourselves from the Coventry relationship as they are fundamentally not trustworthy?," Goldie-Morrison reasoned that an immediate break with Coventry would not be wise: "As long as we were buying policies from them in – at a price and a yield that was okay [,] and we were now – let's say our level of diligence had clicked up one because of this issue – then they're okay. They are a policy at a price with a yield which then goes to create a portfolio and then you sell. If you stopped in the middle, you would end up with something that you are now going to be holding for an extended period." *Tr.*, 5/14/10, at 2818-19.

- As to Ritchie, as of September 29, 2006 "Barclays, who were to provide the contingent forward, have backed off. Credit was comfortable but the business backed off as they believe RCM [*i.e.*, Ritchie] will not survive." PX 214. That was a reference to a firestorm during 2006 stemming from the perception that Ritchie was badly overextended – the "cash crunch," but applying to much more than life settlements. Goldie-Morrison's PX 214 itself flags "RCM issues" with reference to Murphy's P&C Royal Palm venture and Producers Ag ("Jiggy about RCM") as well as life settlements. At this point, Ritchie had "quite a few redemption requests" – as much as 20% of the firm's assets – unrelated to life settlements. *Tr.*, 5/14/10, at 2825-26; *Tr.*, 6/25/10, at 3805. The Multi-Strategy Fund had begun a "restructuring." *Id.*, at 3808; *see* DX 81. Though Thane Ritchie balked at the term "liquidity problems," he admitted to "shorter-term redemptions and longer-term assets" during this period. *Id.* at 3806. He also admitted to "negative press" in mid-2006. *Id.* at 3804-05. *See* PX 1311, an internal July 2006 document noting a "tarnished brand," "inability to raise capital," and "poor liquidity profile."

Whether because of the life settlement problems or because of across-the-board funding issues, on July 19, 2006 Mulholland's request for $43.2 million Coventry funding due August 1 was turned down flat. PX 647. Oddly, however, only a few days later essentially the same

request, by Lem, was approved by the Investment Committee. PX 653. Apparently the decision was made to fund August, but to condition September on the securitization getting done by September 1st. PX 656. Coventry had a right to the funds, *see* PX 201, but Ritchie was willing to bet that Coventry would not insist, because Coventry as well as Ritchie would lose "by putting us in default." PX 656; *see Tr.*, 5/14/10, at 2830-31, 2863-64.

Goldie-Morrison testified that by October 25, 2006 "I think we had Barclay's back in writing the contingent forward." *Id.* at 2860, 2884; *see also* DX 82, Demaray's note of a conversation with Mulholland on October 25, 2006. But Goldie-Morrison conceded that there had never been a written commitment to provide either the contingent forward or the liquidity facility, *Tr.*, 5/14/10, at 2885-86. In addition, even if Barclay's did the contingent forward, UBS clearly would not do the liquidity facility. *See* PX 228. That was a problem because, according to Coventry's Buerger a month earlier, "without a firm commitment from UBS we are not going forward." PX 212. (Mulholland's response was: "I don't know what to say. The deal will crater and so will we as a funding source." *Id.*).

By then, time had run out. On the next day, October 26, 2006 – "Spitzer Day" – Eliot Spitzer, the New York Attorney General, announced a suit against Coventry. PX 1070. Though the Complaint specifically focused on a small number of life settlements, part of the requested relief was a judgment giving "the right of rescission to all Sellers who entered into Purchase Agreements with Defendant Coventry from 2001 to the present." *Id.*, at page 32. That potentially called into question every policy Ritchie held. Moody's promptly withdrew its rating. PX 498. Five days later, on October 31, 2006, Thane Ritchie wrote that his plan was "to sell the policies and shut down the fund." "[T]hat is what all the investors want." PX 236.

At that point Ritchie's Risk-Linked onshore feeder had roughly $73 million in the Life Strategies onshore feeder, all "invested in the subordinated securities (a/k/a equity) of the Irish companies which own the life insurance policies purchased from Coventry." PX 1078. This included all of Huizenga's investment.

d. Reporting to Plaintiff and Other Investors

During this time period, October 2005 through October 2006, Ritchie's regular reporting to plaintiff and other Risk-Linked investors was fairly perfunctory. Regular monthly investor letters were issued for August 2005 (PX 1144), September 2005 (PX 1147), October 2005 (PX 1150), and November 2005 (PX 1153). These letters lagged by a month or so; for example, the August letter (PX 1144) was sent in October, and the November letter (PX 1153) in January. After the November 2005 letter, reports were issued quarterly, *see* PX 1347, so the next was issued April 28, 2006 for the first quarter of 2006. PX 1159. Another was issued July 27, 2006, for the second quarter of June 2006. PX 1161, PX 195.

The letters were general and formulaic. Though the letters issued in 2005 did not, the April 2006 and July 2006 letters included a pie chart headed "Approximate Portfolio Allocation." The April 2006 pie chart showed "Life Settlements" at 33% (presumably of the "Ritchie Risk-Linked Strategies, LLC Fund" portfolio, since that was the subject of the report). PX 1159. The July 2006 pie chart showed "Life Settlements" at 40%. PX 1161. Defendants

argued that these charts were intended to represent possibilities, not actual allocations, but that is not the impression the charts conveyed.

The actual allocations differed substantially from the pie charts. As earlier noted, throughout this period Ritchie's inventory of policies had increasing input (because contractually Coventry essentially had a "put" option) but no output (because Mulholland was unable to sell any of the policies). In addition, there was little or no outside source for the funds to buy the policies; despite Mulholland's optimism (*e.g.,* PX 1184), neither "sell[ing] policies out of the deal" nor recruiting outside investors was succeeding. Thus, in August 2005 Thane Ritchie opted to use the onshore feeder to fund increased Coventry demands. PX 1184. That meant that the life settlements share of the risk-linked "pie" rose consistently. In November 2006 Ron Kenny calculated the "percentages for onshore exposure to life settlements" as: "August 2005 – 62%; December 2005 – 78%; June 2006 – 91%; October 2006 – 100%." PX 1092.

There was some internal pressure (mostly from Govrin and the P&C side, by then in a head-to-head struggle with Mulholland) to correct the pie chart, and the supposed life settlement "returns," portrayed in the April 2006 report. See PXs 956, 959. But though there was some later adjustment of the returns, it is not clear that the pie chart was corrected. The July 2006 pie chart also occasioned some contemporaneous comment, albeit more indirect. It pegged life settlements at 40%. But on June 14, 2006 Ron Kenny told David Govrin, "RE: Risk-Linked Results for April 2006," that in fact "[t]he US feeder has less than 20% of its capital invested in the property and casualty segment," meaning that the life settlement segment was at least 80%.

The disparity between the pie charts and reality is not trivial. Disclosures matter. These disclosures were important, plaintiff says, because plaintiff was consistently concerned with investment diversification as a risk-reducing factor. Some Ritchie personnel had themselves expressed general concern about the gap between Ritchie's touting of diversification and a potentially more concentrated reality. *See, e.g.,* PX 811. But the importance of the disclosure disparity can be overstated. First, the Court concludes that plaintiff has not proved that the disparity in the reports during 2006 (before "Spitzer Day") was the result of deliberate, orchestrated deception by Ritchie. On close inspection and in context, Thane Ritchie's "Transparency is a horrible thing" comment in March 2006 (DX 133) is less sinister than plaintiff claims. The comment seems to mean two things: (*i*) that the Ritchie enterprise should control the narrative, which requires at least some information management ("spin" is the buzzword), rather than just "letting it all hang out;" and (*ii*) that one should not give away trade secrets or proprietary information. Both meanings are legitimate, particularly in the securities context, where leaks or partial information may be worse than silence.

Further, in and after March 2006, as Ritchie's crisis atmosphere worsened, Ritchie personnel faced genuine problems crafting disclosures. Accurately describing (let alone analyzing) a crisis from the inside, while it is happening, is proverbially difficult. Only in hindsight does vision become 20-20. In such an atmosphere, silence or temporizing may seem less misleading than saying the wrong thing. We know from *SEC v. Texas Gulf Sulphur Co.,* 401 F.2d 833, 844-45, 849 (2d Cir. 1968) (*en banc*), *cert. denied,* 394 U.S. 976 (1969), that dispelling rumors is a risky business. Especially in a crisis atmosphere, "materiality" as a disclosure trigger can be a complex balancing of probability and significance; so "companies do

not have to disclose immediately all information that might conceivably affect stock prices" because "the burden and risks to management of an unlimited and general obligation would be extreme," and such a duty "could easily disadvantage shareholders." *In re Boston Scientific Corp. Securities Litigation,* 686 F.3d 21, 27-28 (1st Cir. 2012), citing *Texas Gulf Sulphur, supra.* That point is similar to, though more tactfully put than, Mr. Ritchie's "transparency" comment. This partly explains (though it does not excuse) Ritchie's inaccurate pie charts.

2. Huizenga's Withdrawal

Just over a month after Huizenga's second investment, Bradley expressed skepticism. "Why aren't we making any money?" PX 711. He testified that it was hard to match Ritchie's "optimistic" letters with the "flat" reality. (But he thought successes with life settlements might be masked by hurricane losses in P&C. *See* PX 711 at page HMF004700.)

Bradley's doubts, coupled with concerns over the "future of the [Ritchie] firm," continued through his April 10, 2006 meeting with Ritchie. *See* PXs 719, 720. He was concerned that plaintiff had not yet received a K-1, despite promises. He was also concerned about "value leakage:" "[W]e were being told by the risk-linked team and investor updates and in-person meetings that the portfolio in total was doing well, that the life sector investments were doing well, P&C investments were doing well, yet we weren't seeing that in the performance, and we were concerned that what was being reported to us wasn't – wasn't matching the performance that we were seeing." *Tr.,* 4/27/10, at 341.

The doubts not assuaged, on June 2, 2006 Huizenga formally notified Ritchie that it would fully redeem its investment, effective September 30, 2006. DX 61; *Tr.,* 4/27/10, at 342-43. But almost immediately thereafter, "Matt Demaray had a call I believe from David Zirin at Ritchie who advised him that the life settlement area had received a preliminary rating, told him that this was exceptionally good news for the fund, that the rating was very positive, and that this would have a significant positive impact on the portfolio, and he highly encouraged us to stay invested in the fund and to not redeem." *Id.* at 343-44 (Bradley). Demaray (who said it was Sterioti who called) described the call somewhat differently: "... a call from Rick Sterioti basically saying, 'Great news. We just got the Moody's rating, you know. According to Jeff [Mulholland], this all but guarantees a securitization." *Tr.,* 5/12/10, at 2206-07.

In hindsight, the primary difference between the two versions of the phone call is that though Demaray's and Bradley's version both recount Sterioti's optimism about a securitization, Bradley's version adds optimism about "the fund" and "the portfolio" which seems directed specifically at Huizenga's investment. That matters because of the likelihood that a securitization would not improve, or produce, returns for the equity holder (Huizenga). *See* page 16 *supra,* noting PX 913 and Goldie-Morrison's concerns as early as February 2006 that an initial securitization would not benefit the equity holder.

Demaray's, and ultimately Huizenga's, response to the phone call was to cancel the redemption request. "[S]o with that information, I [Demaray] ran back to the team and said, 'Look. We've got to try to rescind our redemption request because, you know, the securitization is imminent. We waited around this long, you know. Let's stick around another quarter to get,

you know – to participate in the profits.'" *Id.* at 2207. On June 6, 2006, Demaray wrote to the Huizenga team: "I suspect there is a chance that they will soon realize that if Huizenga does not come back into the partnership, [T]hane will get to keep the proceeds of the sale of the settlement securities. It is very likely in my opinion that these securities will likely get sold now with the preliminary approval of [M]oody's. If Ritchie does not let us rescind our redemption request, I estimate we will leave close to $3 million on the table." DX 63.

On June 7, 2006, Demaray wrote to Ritchie's Sterioti: "Given the new information on Moody's preliminary rating, I believe we are inclined to want to rescind our full redemption request." PX 390. Expressing "some concerns about the stability of Ritchie's back office," however, Demaray requested a meeting with Ritchie personnel. *Id.* Though he sought to "schedule" such a meeting "in the next few weeks" (*Id.*) and his message to Sterioti did not indicate urgency, just three days later Demaray wrote to Huzenga's team: "Ritchie has been radio silent. I am sick to my stomach about this investment as we might have just shot ourselves in the foot by sending in the redemption request." DX 64.

Huizenga's optimism did not last long, however. Huizenga thought the Moody's preliminary rating would lead to securitization within "days or weeks." *Tr.,* 4/27/10, at 347-48. But by late July 2006, nearly two months later, the securitization still had not occurred. In addition, despite multiple proddings Huizenga still had no K-1 or audit report for 2005 from Ritchie. "We were quite concerned ... that the back-office issues at Ritchie continued." *Id.* at 349. Ritchie's July 27, 2006 June investor letter, PX 1161, added to Huizenga's discomfort, both because it showed that "[t]he life settlements portion of the portfolio had grown to 40 percent" ("we knew that the onshore fund should have less than the aggregated total because the onshore fund was just buying the equity, ... [which] was, quote, 'higher risk'"), and because the reported annual return "didn't seem to reconcile" and the May and June numbers "seemed ... too round and arbitrary." *Id.* at 350-52. Huizenga's inquiries were not satisfactorily answered. Indeed, on August 3, 2006 Huizenga was instructed "no longer to have any direct communication with the [Ritchie] accounting staff." *Id.* at 355; PX 428. (Given Ritchie's internal turmoil at the time, this may not have been as sinister as plaintiff claims. But it certainly was not reassuring.)

By the end of August Huizenga had had enough:

> "[D]espite the encouraging news that they were telling us relating to the investment portfolio in total, we were uncomfortable with their back-office. They had failed to produce an audit and a K-1 in a timely manner. They were restricting whom we could talk to in the organization, and we said 'We have to withdraw.'"

Tr., 4/27/10, at 358; *see* PX 407. PX 456 is Huizenga's second withdrawal notice, dated August 31, 2006 and effective December 31, 2006.

Midway through that waiting period, on October 26, 2006, Eliot Spitzer announced his suit against Coventry, *see* PX 498, and Ritchie's life settlements venture effectively collapsed. DX 200, a chart sent by Ritchie's Rothschild to Demaray on November 13, 2006, shows that a sale of the life settlement portfolio would be a complete or partial loss for equity on any scenario.

It appears that in the end Ritchie, which ultimately provided some 80% of the onshore risk-linked funds' assets, lost more on life settlements than Huizenga did. *See Tr.*, 7/1/10, at 4401-05.

On November 2, 2006, during a telephone conference "update" with Thane Ritchie and other Ritchie personnel, Ritchie informed Huizenga that the risk-linked fund was 65% invested in life settlements, and that "Equity is in the onshore fund and has the most risk. Equity position is more at risk." PX 734; *Tr.*, 4/27/10, at 365-68. In his testimony, Bradley expressed shock at the 65% figure and at Ritchie's statement (which, Bradley said, "I'll never forget") that "[a]n inequity exists between the funds," *i.e.*, "Ritchie money is mostly in the offshore fund which has less life settlements than the 65 percent they're now telling us we own." *Id.* at 367-69. (But Bradley did not express surprise at being told that "equity is in the onshore fund." Huizenga had long known that that was where its investment was. Nor could it have surprised Bradley that Huizenga was the only onshore fund investor: *see* DX 51, noting that point in February 2006. *But see Tr.*, 7/1/10, at 4402, referring to "one outside investor besides Huizenga.") Twelve days later, on November 13, 2006, Bradley was told that "in aggregate," life settlements had been 40% of the fund in June 2006 but grew to 95% by November.[8] PX 736; *Id.* at 370-73. "What they were saying was the onshore fund made direct purchases of life settlement securities, and the bulk of our investment is now in life settlement securities and life settlement securities comprise 95 percent of our fund." *Id.* at 373-74. Bradley testified that his response was: "How could that possibly be?" *Id.* The response (from Ritchie's Fred Caruso) was that "onshore only invested in life settlements after our investment." *Id.* at 381.

Bradley's stated November 2006 surprise at the percentages must be compared with DXs 71 and 75, the draft and final 2005 K-1s sent to Huizenga in July and August 2006, which show that more than 75% of Huizenga's investment "went to Ritchie Ireland to buy life settlements." *Tr.*, 7/1/10, at 4398-4400; *Tr.*, 8/24/10, at 4627-29. The K-1s do not explicitly refer to life settlements, but they do show what went to Ritchie Ireland, and it does not appear that Ritchie Ireland had any business other than related to life settlements. In the same vein, Bradley's stated shock about the onshore fund's emphasis on life settlements must be compared with the consistent excitement on Huizenga's side (especially from Demaray) about the life settlement investment, particularly the securitization. For example, it seems to have been almost entirely the perceived life settlement upside, because of the Moody's rating (and thus the expectation of an imminent securitization), which led to the rescission of Huizenga's original withdrawal, and which was the basis for Demaray's concern that if the withdrawal stood, Huizenga would "leave close to $3 million on the table." *See also, e.g.*, DXs 24 and 25 (wherein Demaray reported to Bradley in October 2005 that "70% of Ritchie's Fund (currently) is Life Settlements, while the remaining 30% is largely property and casualty," and stated: "Ritchie's primary strategy within the life settlement book is to purchase, package & sell life settlement securities"); DX 26 (again Demaray: "To understand Ritchie's fund, you need to understand the Life Settlement Business (since this accounts for 70%+ of their exposure)...").

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[8] *See*, however, PX 1003, an internal Ritchie document indicating that as of mid-July 2006 "[t]he onshore feeder has an allocation roughly equal to 90/10, Life/PC," and that "80% is invested directly in the Irish company, meaning it has 80% exposure to the sub securities (equity tranche)." "[T]he other 20% is invested in the Master Fund which has roughly a 50/50 split Life/PC." These numbers are not exactly comparable to the percentages in the text, but they do indicate that the onshore fund was more than 40% invested in life settlements in June 2006.

The disparity between the actual level of life settlement investment, and what Huizenga (at least Bradley) thought the investment was, was not trivial. But was it "material," in the sense that if Huizenga had known the life settlement level was at 70% or 80% in June 2006, Huizenga would not have sought to redeem, or would not have canceled its redemption request? That is less than clear. After all, it was the (perceived) increased likelihood of securitization following the Moody's rating – a development which pertained only to life settlements – which excited Demaray and led Huizenga to undo its redemption. Telling Demaray that the life settlement investment level had increased might simply have led him to worry about "leav[ing]" even more than "$3 million on the table" as a consequence of the first redemption. Bradley's testimony about the investment level disparity was credible. But the noisy collapse of the life settlement prospect may have caused him, in retrospect, to overstate the degree of investment-level concern he felt at the time.

On the other hand, Huizenga held equity, not junior debt, with respect to the life settlement investment. The Mulholland/Lem modeling made clear that the equity holder would lose on a "buy and hold" strategy (though that was not Ritchie's intended strategy), and the increased equity risk of loss extended to other situations where "mortality is bad" in that insureds live longer than projected. *See* page 7 *supra.* Huizenga was at least generally aware of that risk. *See* page 8 *supra,* quoting PX 309. But it is disputed how *well* aware Huizenga was of the risk overall and of its component, perhaps synergistic, elements – including the risk-skewing effect of Coventry's lucrative fee structure and aggressive mortality tables. *See* pages 3-5, 6 *supra.*

Discussion

A. The Applicable Law and Burdens of Proof

It is undisputed that substantive Delaware law governs the remaining counts of Huizenga's Third Amended Complaint (Counts I, II, V, VII, and VIII). Though Illinois law governs the procedural question of which party bears the burden of proof on each issue, it is Delaware law which articulates what the burdens of proof are.

Illinois courts follow the RESTATEMENT (2D) OF CONFLICTS for choice-of-law issues. *See Safeco Ins. Co. v. Jelen,* 381 Ill.App.3d 576, 579 (3d Dist. 2008). Under the Restatement, "[t]he local law of the forum determines whether a party has introduced sufficient evidence to warrant a finding in his favor on an issue of fact, RESTATEMENT (SECOND) OF CONFLICTS § 135, unless 'the primary purpose of the relevant rule of the state of the otherwise applicable law is to affect decision of the issue rather than to regulate the conduct of the trial. In that event, the rule of the state of the otherwise applicable law will be applied.'" *Id.,* § 133.

When applying these rules, Illinois courts look to the foreign state's law to determine whether the purpose of its rule is to affect decision of the issue—*i.e.,* whether it is substantive rather than procedural. *Boersman v. Amoco Oil Co.,* 276 Ill.App.3d 638, 645 (1st Dist. 1995). If the foreign state considers its rule substantive, Illinois courts will apply it. *Id.* Delaware considers the burden of proof to be substantive. *In re IBP Shareholders Litigation,* 789 A.2d 14, 53 (Del. Ch. 2001) ("[T]he question of what the burden of proof is typically constitutes a policy judgment designed to affect the outcome of the court's decision on the merits."). Thus,

Delaware's burdens of proof will be applied here. This is particularly appropriate given the parties' own choice of Delaware law in the relevant governing documents.

B. Count-by-Count Analysis

1. Count I

3d Am. Cplt., Count I, is a rescission claim under Delaware Securities Act ("DSA") § 7323(a)(2) against Ritchie Risk-Linked Strategies, LLC and Ritchie Partners, LLC, as offerors and/or sellers of securities, based on pre-purchase communications both inside and outside the PPM. Under DSA § 7323(a)(2), "any person" (which includes entities, *see* § 7302(a)(12)) who:

> (2) Offers, sells or purchases a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they are made, not misleading (the buyer or seller not knowing of the untruth or omission), and who does not sustain the burden of proof that the person did not know, and in the exercise of reasonable care could not have known of the untruth or omission, is liable to the person buying or selling the security from or to him or her, who may sue either at law or in equity to recover the consideration paid for the security, together with the interest at the legal rate from the date of payment costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security, or for damages if he or she no longer owns the security.

Defendants first argue that the DSA applies only to registered securities offerings. Since the Fund sold unregistered securities to Huizenga, defendants say, the DSA does not apply. According to defendants, DSA § 7323(a)(1) indicates that only those who must register securities in Delaware may be found liable under § 7323(a)(2).

It is true that DSA § 7323(a)(1) applies to "any person" who "[o]ffers or sells a security in violation of § 7313, § 7304 or § 7311(b) of this title, or of any rule or order under § 7312 of this title which requires the affirmative approval of sales literature before it is used, or of any condition imposed under § 7306(d) of this title." But, contrary to defendants' assertion, on its face § 7323(a)(1) simply provides a cause of action against a person who violates certain DSA sections addressing securities registration. Its language cannot sensibly be read to tacitly overshadow the rest of the DSA by creating a requirement that a security be a registered security for any other provisions of the DSA to apply.

In this regard, defendants' citations to *Singer v. Magnavox Co.*, 380 A.2d 969, 981 (Del. 1977), *overruled on oth. gds., Weinberger v. UOP*, 457 A.2d 701 (Del. 1983), and *Bank of Am. Nat'l Trust & Sav. Ass'n v. GAC Properties Credit,* 389 A.2d 1304, 1309 (Del. Ch. 1978), miss the mark. Both of those cases involved DSA § 7303, not DSA § 7323. As Huizenga notes, there is no authority holding that either § 7323(a)(2) or § 7323(b) (under which *3d Am. Cplt.,* Count II

is brought) excludes unregistered securities. The DSA is modeled after the Uniform Securities Act. *Blinder, Robinson & Co. v. Bruton,* 552 A.2d 466, 475 (Del. 1989). DSA § 7323(a)(2) derives from Uniform Securities Act § 410(a)(2), which "applies regardless of whether the security is registered, exempted, or sold in violation of the registration requirements." Uniform Act § 410, cmt. subsec. (a), clause (2); *see also Anheuser-Busch Cos., Inc. v. Summit Coffee Co.,* 934 S.W.2d 705, 708 (Tex. Civ. App. 1996) (applying analogous versions of the Uniform Act and holding that "it is irrelevant that the subject transaction was private and secondary").

The parties next dispute the required elements of a DSA § 7323(a)(2) claim. Huizenga argues that it need only prove a material misrepresentation or omission by Defendants; in Huizenga's view, § 7323(a)(2) is virtually an absolute liability provision. According to defendants, however, Huizenga must also prove scienter, reliance, and loss causation.

As noted, DSA § 7323(a)(2) is modeled on Uniform Securities Act § 410(a)(2), which itself is modeled on §12(2) of the federal Securities Act of 1933 (the "1933 Act"). The question of what elements are required to state a claim under § 7323(a)(2) of the DSA has not yet been authoritatively addressed by the Delaware courts. However, as Huizenga argues, the majority of courts interpreting identical provisions in other states' versions of the Uniform Act have held that there is no reliance requirement, which also displaces any loss causation requirement. Under these decisions, a plaintiff need only show that it was ignorant of the actual facts that it claims were withheld or misrepresented, and that the facts were material (in the sense that a reasonable person might find them important, not in the sense that the particular plaintiff actually did rely on them). *See, e.g., Kronenberg v. Katz,* 872 A.2d 568, 598 (Del. Ch. 2004). *Kronenberg* considered § 1-501(a) of the Pennsylvania Securities Act (Pennsylvania's version of § 410(a)(2)), which provides in relevant part:

> Any person who: . . . (ii) offers or sells a security in violation of section 401 ... or otherwise by means of any untrue statement of a material fact or any omission 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, the purchaser not knowing of the untruth or omission, and who does not sustain the burden of proof that he did not know and in the exercise of reasonable care could not have known of the untruth or omission, shall be liable to the person purchasing the security from him, who may sue either at law or in equity to recover the consideration paid for the security.

Kronenberg found that § 1-501(a) creates an express cause of action for: (*i*) any violation of § 1-401 of the Pennsylvania Act (a cause of action similar to a claim under SEC Rule 10b-5), and (*ii*) any violation of the terms of § 1-501(a) itself, a cause of action which *Kronenberg* held identical to a 1933 Act § 12(2) claim. *Id.* at 597. Because § 1-501(a)'s own terms do not contain a reliance requirement, the court held that there was no such requirement. *Id.* at 598. The court noted that its holding was consistent with decisions of other states interpreting identical provisions in their versions of the Uniform Act, as well as with federal decisions holding that § 12(2) of the 1933 Act grants buyers the right to rescind without reliance. *Id.*

In *Marram v. Kobrick Offshore Fund, Ltd.*, 809 N.E.2d 1017, 1021 (Mass. 2004), the court considered Massachusetts's version of Uniform Act § 410(a)(2) (found in Mass. Gen. Laws c. 110A, § 410(a)(2)), which states in pertinent part:

> Any person who . . . offers or sells a security by means of any untrue statement of a material fact or any omission 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, the buyer not knowing of the untruth or omission, and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission, is liable to the person buying the security from him.

Reasoning that the purpose of that language (functionally identical to DSA § 7323(a)(2)) is to provide "a heightened deterrent against sellers who make misrepresentations by rendering tainted transactions voidable at the option of the defrauded purchaser, *regardless of the actual cause of the investor's loss,*" *Id.* at 1025 (emphasis added), the *Marram* court held that a plaintiff buyer need only show lack of knowledge of the truth underlying a misleading statement or omission to state an actionable claim, and did not need to prove reliance. *Id.* at 1027.

In *Dunn v. Borta*, 369 F.3d 421, 425 (4th Cir. 2004), the Fourth Circuit similarly held that Virginia's version of Uniform Act § 410(a)(2) does not require a plaintiff to prove reliance or causation. Section 13.1-522(A) of the Virginia Securities Law (Va. Code Ann. § 13.1-522(A)) provides that:

> any person who: (i) sells a security in violation of § 13.1-502 ..., or (ii) sells a security by means of an untrue statement of a material fact or any omission to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission) ...shall be liable.

The Fourth Circuit held that the only provision of the statute that could arguably be read to imply a requirement of reliance or causation is the phrase "by means of an untrue statement;" however, the "by means of" clause was not intended as a requirement that the buyer prove reliance. *Dunn, supra,* 369 F.3d at 432. The court also noted that § 13.1-522(A) claims are nearly identical to federal § 12(2) claims, which do not require the elements of reliance or causation. *Id.* at 433.

According to defendants, however, DSA § 7323 must be read together with § 7303 because the provisions of § 7303 make certain acts and practices unlawful, and the legal consequences of a violation are set forth in § 7322, which prescribes criminal penalties, and in § 7323, which establishes civil penalties. *See Singer v. Magnovox Co.*, 367 A.2d 1349, 1361 (Del. 1977), *overruled on oth. gds., Weinberger v. UOP,* 457 A.2d 701 (Del. 1983). Thus, in *Singer,* the court held that § 7303 and § 7323 "must be read together *when § 7303 is relied upon to state*

a cause of action, and consequently, to be actionable, the sale or purchase [of a security] must have been caused by the false representation or the material omission in the statements offered to induce the sale or purchase." *Id. (emphasis added); see also Cooper v. Celente,* 1992 Del. Super. LEXIS 370, *9 (Del. Super. Ct. Sept. 3, 1992) (discussing applicable limitations period "[w]here relief is sought under sections (a)(1) and (2) of Section 7323 for selling securities as an unregistered agent (Sect. 7313), selling unregistered securities (Sect. 7304), *and making misrepresentations of material facts (Sect. 7303)*" [emphasis added]); *Organ v. Byron,* 435 F. Supp. 2d 388, 393 (D. Del. 2006) ("Read together with 6 Del. C. § 7323, *§ 7303 has been held to create a cause of action* for misrepresentation" [emphasis added]).

Huizenga has the better interpretation here. As is suggested by the language highlighted in the foregoing quotations, defendants' cases all involve claims brought not under DSA § 7323(a)(2), but rather under DSA § 7303. Section 7303 states:

> It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly:
> (1) To employ any device, scheme or artifice to defraud;
> (2) 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 are made, not misleading; or
> (3) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

Section 7303 is virtually identical to § 1-401 of the Pennsylvania Securities Act, which *Kronenberg, supra,* explained is modeled on § 101 of the Uniform Act. Section 101 of the Uniform Act is, in turn, based on SEC Rule 10b-5, promulgated under the 1934 Act, which Rule is itself modeled on § 17(a) of the 1933 Act. *Kronenberg, supra,* 872 A.2d at 596. Thus, the *Kronenberg* court found that § 1-501(a) of the Pennsylvania Act creates two causes of action, each modeled on a different section of the federal securities laws—one for a violation of § 1-401, and one for a violation of the terms of § 1-501(a) itself. *Id.* at 597.

The *Kronenberg* court's reasoning applies here as well. Defendants' cases all involve claims under § 7303 of the DSA. Section 7303 must be read together with § 7323(a)(2), because § 7323(a)(2) sets forth the legal consequences for violations of § 7303. But when a claim is brought under § 7323(a)(2), there is no need to look to § 7303 to define the prohibited conduct, because the unlawful conduct is already set forth in § 7323(a)(2). Section 7303 creates a claim similar to a Rule 10b-5 claim, while § 7323(a)(2) sets forth a cause of action analogous to a 1933 Act § 12(2) claim. *See Hubbard v. Hibbard Brown & Co.,* 633 A.2d 345, 348 (Del. 1993) (relying on case law applicable to SEC Rule 10b-5, as the language of § 7303(2) is "virtually identical" to that of Rule 10b-5).

Accordingly, this Court concludes that the Delaware Supreme Court would interpret § 7323(a)(2) consistently with the interpretations of other courts considering analogous provisions, as well as § 12(2) of the 1933 Act, and hence would not find reliance, *scienter*, or loss causation

necessary to a recovery under § 7323(a)(2). Such an interpretation is also consistent with the plain language of § 7323(a)(2), which does not contain any such requirements.

Defendants also assert that Huizenga's misrepresentation claims must be limited to statements contained in the PPM, because the PPM contained a "non-reliance clause" by which Huizenga, a sophisticated investor, agreed not to rely on any representations not contained in the PPM. Huizenga responds that the non-reliance clause is ineffective, with regard to any § 7323(a)(2) claims, because it is voided by DSA § 7323(g), which states: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this chapter or any rule or order hereunder is void."

The parties have provided no case law specifically addressing the question of whether a non-reliance, or "integration," clause provides a defense to a § 7323(a)(2) claim. Courts interpreting analogous statutes modeled on the Uniform Act have found that written contract terms, including an integration clause, cannot be construed to waive the plaintiff's rights. *See Marram, supra,* 809 N.E.2d at 1029. In *Marram*, the court found that the existence of an integration clause was a contract defense, and thus had no merit because the case involved the plaintiff's securities fraud claim, not a contract action. *Id.* at 1028. The court reasoned that the integration clause did not bar the plaintiff's claim under the Massachusetts statute because reliance and sophistication of the buyer were not elements of the statutory claim. *Id.* Moreover, the court explained, "to permit the seller of securities to discharge, or to defeat, his statutory obligation of truthfulness to the buyer merely by attaching an integration clause to a subscription agreement would enfeeble the statute." *Id.* The *Marram* court found further support for its conclusion that the integration clause could not exculpate the defendants in another provision of the Act, G.L. c. 110A, § 410(g), which contains language identical to DSA § 7323(g).

Similarly, in *Kronenberg, supra,* the court found that § 1-507 of the Pennsylvania Securities Act (which also contains identical language to DSA § 7323(g)) prevented an explicit non-reliance clause from acting as an absolute bar to the plaintiff's securities claims. 872 A.2d at 599. Instead, the court stated that even for purposes of a claim which requires proof of reliance, "such a clause should simply be considered as a factor in determining whether the plaintiff's reliance was reasonable." *Id.*, citing *AES Corp. v. Dow Chemical Co.*, 325 F.3d 174, 180-81 (3d Cir. 2003). Defendants, however, invoke *ABRY Partners V, L.P. v. F&W Acquisition LLC,* 891 A.2d 1032, 1056 (Del. Ch. 2006), arguing that Delaware courts generally honor clauses in which contracting parties have disclaimed reliance on extra-contractual representations when addressing agreements between sophisticated parties. However, ABRY involved a claim of common law fraud, not an action under the DSA.

Again, Huizenga has the better argument here. *ABRY Partners V,* on which defendants rely, involved a claim of common law fraud, not (like this case) an action under the DSA to which an express statutory non-waiver provision applies. The purpose of statutes like § 7323(a)(2) is to hold issuers of securities to high representational standards. Perhaps paradoxically, that is not much aided by the language of PPMs, which are notoriously bedecked with hedges, caveats, and qualifications. In many instances – specifically including this case – sellers invite prospective buyers to seek clarification and further explanation. That would be a hollow invitation if the seller could say whatever it wished in such a "due diligence" discussion,

immunized by a no-reliance clause from the consequences of any misstatements or overpromises. Because reliance is not an element of a § 7323(a)(2) claim, and in line with the courts which have held that § 7323(g)-like provisions prevent non-reliance clauses from barring securities fraud claims, this Court concludes that the PPM's non-reliance clause does not bar Huizenga's claims as a matter of law. (It may nonetheless be a factor in determining what significance Huizenga could sensibly give to a non-PPM statement by Defendants.)

Defendants further argue that Huizenga cannot base its claims on any alleged omissions (as opposed to misrepresentations) by Defendants. Defendants assert that they had no duty to disclose information to Huizenga, and argue that a defendant can only be held liable for failure to disclose information if the defendant has a legal duty to disclose such information. *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993) ("But a corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact. Rather, an omission is actionable under the securities laws only when the corporation is subject to a duty to disclose the omitted facts."). According to Defendants, Rule 502 of SEC Regulation D relieves them of any duty to disclose. Under Rule 502, which Defendants argue preempts contrary state law, a securities issuer must furnish specific information (listed in paragraph (b)(2) of the Rule) to certain purchasers. *See* 17 C.F.R. § 230.502(b)(1). However, the issuer is not required to furnish this information when it sells to an accredited investor. *See id.*

Defendants' argument here is unavailing. Defendants have not established that Rule 502 exempts a seller from the DSA or any other anti-fraud statute. Section 77r of the 1933 Act merely provides that the Act preempts conflicting state law, not all state law. *See Travelers Health Ass'n v. Commonwealth,* 51 S.E.2d 263 (1949), *aff'd*, 339 U.S. 643 (1950). Rule 502 exempts a seller from registration and prospectus delivery requirements, but there is no indication that this exemption overrides state or federal anti-fraud provisions. *See Anserphone of New Orleans, Inc. v. Protocol Communs., Inc.*, 2002 U.S. Dist. LEXIS 23536, 28 (E.D. La. Dec. 5, 2002) (for sellers "whose stock is not publicly traded and who have an applicable exception from the registration provision, only the antifraud provisions of the Securities Act apply"). In fact, Rule 502 itself notes: "When an issuer provides information to investors pursuant to paragraph (b)(1), it should consider providing such information to accredited investors as well, in view of the anti-fraud provisions of the federal securities laws." *Id.*

Allowing Huizenga to base its claims on material omissions by Defendants is in line with the purposes of the DSA. Section 7323(a)(2)'s analogous federal provision, § 12(2), "is designed to induce sellers to be assiduous in insuring full disclosure to the buyer by threatening the seller with liability almost as an insurer in the event that there has been any material inaccurate disclosure or nondisclosure in the sale traceable in any way to the seller's carelessness or affirmative wrongdoing." *Marram,* 809 N.E.2d at 1026 (quoting Kaminsky, *An Analysis of Securities Litigation under Section 12(2) and How it Compares with Rule 10b-5,* 13 Hous. L. Rev. 231, 239 (1976)). The 1933 Act "seeks not only to secure accuracy in the information that is volunteered to investors, but also, and perhaps more especially to compel disclosure of significant matters that were heretofore rarely, if ever, disclosed." *Id.* (quoting Shulman, *Civil Liability and the Securities Act,* 43 Yale L.J. 227, 227 (1933)).

Accordingly, in order to state a claim under DSA § 7323(a)(2), Huizenga need only prove: 1) that Defendants made an untrue statement of material fact or omitted a material fact in selling the Fund to Huizenga; and 2) that Huizenga did not know of the untruth or omission. Huizenga may base its claim on alleged misrepresentations and omissions both in and outside the PPM. In either case, of course, the misrepresentation or omission must have been material *at the time*, not just with the benefit of hindsight. A seller must disclose what it understands to be significant. A requirement to disclose everything, significant or not, would produce only a "data dump" which could be used to bury what actually matters. If Huizenga establishes such a misrepresentation or omission, Defendants bear the burden of proof that they "did not know, and in the exercise of reasonable care could not have known of the untruth or omission." DSA § 7323(a)(2); *see also Marram,* 809 N.E.2d at 1026.

DSA § 7323(a)(2) applies here to what Huizenga was told (or was not told) before it invested on August 1, 2005 and October 1, 2005 – *i.e.,* to communications by Ritchie when Ritchie was a seller dealing with a prospective buyer. That is when the seller must be particularly "assiduous in insuring full disclosure to the buyer." (That is also when it should be easiest for the seller to pay attention to that responsibility, since it is to some degree focused on the impending sale. Here, for example, Ritchie actively courted Huizenga. *See, e.g.,* JX 1.)

Before Huizenga's initial investment ($6 million on August 1, 2005), the PPM did not disclose, nor did Ritchie otherwise disclose, the existence or terms of the June 30, 2005 Coventry deal – particularly the feature which arguably (*see* pages 13, 14-15 *supra*) all but obligated Ritchie to buy whatever policies Coventry wanted to sell. Indeed, Coventry itself was not mentioned. The PPM also did not disclose, nor did Ritchie otherwise disclose, the fact (which Mulholland knew by at least July 2005) that Coventry was using Fasano life expectancies with the AVS mortality tables. This would soon become a major issue, particularly when coupled with the "put" feature of the Coventry June 30, 2005 deal and Coventry's ability to force Ritchie to use AVS2 life expectancies rather than Fasano life expectancies. *See Tr.,* 5/14/10, at 2282-83; *see also* PX 603, confirmed by Dan Zollars, and *see* Lem Dep. at 238-39, 293. And neither the PPM nor Ritchie disclosed the particular Mulholland-Lem model Ritchie was using; indeed, Huizenga never saw the full model.

The same nondisclosures were operative before Huizenga's October 1, 2005 $5 million investment, except that by September 2005 Huizenga knew who Coventry was. Before October 1, 2005, however, Ritchie (*i.e.,* Lem and Mulholland) had become painfully aware of the mismatch between Coventry's AVS-based pricing and Fasano's life expectancies, to the point where Lem told Coventry not to supply further Fasano life expectancies because he "can't square acquisition costs with Fasano LEs." Lem Dep. at 293. (Coventry's Buerger concurred, directing Mulholland to throw out the Fasano life expectancies and substitute the AVS2i versions.) Though Mulholland spoke with Huizenga on September 29, 2005, he did not mention this problem – indeed, he conveyed the opposite impression, "that they were using the most conservative life expectancy assumptions." *See* pages 11-12 *supra.* And despite saying he would do so in the September 29th conversation, Mulholland never provided the full model he and Lem were using. *See* page 12 *supra.* Further, though the investment had been pitched to Huizenga in a context emphasizing diversity of risk, both between life and P&C and within the life sector, the "put" element of the Coventry agreement underscored Thane Ritchie's concerns

(expressed as early as June 30, 2005) about a "cash crunch" to fund the Coventry deal, thus reducing the likelihood of diversification. Even before August 1st, Mulholland noted the need for "an additional $10 million of equity" for the Coventry deal. But Coventry was pushing for more. On October 12, 2005, less than two weeks after Huizenga's second investment, Thane Ritchie approved (despite reservations from other Ritchie personnel) "double-sizing" the Coventry position, without knowing where the funds would be found. "I think we need to tell them yes now and then get the capital over the next few months." *See* page 13 *supra.* That possibility, and its negative effect on any diversification, must have been apparent before October 1st. But Huizenga was not advised of it beforehand.

Were these nondisclosures material? "[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information. *Basic Inc. v. Levinson,* 485 U.S. 224, 240 (1988). A misrepresentation or omission is material if there is a substantial likelihood that it "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson,* 485 U.S. 224, 231-232 (1988). Importantly, "it is well-established that a material fact need not be outcome-determinative; that is, it need not be important enough that it would have caused the reasonable investor to change his vote. Rather, the information need only be important enough that it would have assumed actual significance in the deliberations of the reasonable shareholder. *Folger Adam Co. v. PMI Industries, Inc.,* 938 F.2d 1529, 1533 (2d Cir. 1991) (citing *TSC Industries, Inc. v. Northway, Inc.,* 426 U.S. 438, 449 (1976)).

Applying that standard, what Ritchie knew but did not tell Huizenga before the October 1, 2005 investment was clearly material. By late September 2005, one had to do little (if anything) more than connect the dots – a sales agreement which gave Coventry great leverage to force Ritchie to buy; a mandated AVS-based pricing feature, which could not be squared with "conservative" life expectancy assumptions; knowledge that "conservative life expectancy assumptions" were (as Mulholland told Bradley), "critically important;" and a corresponding decreasing likelihood of any actual investment diversification. From that same information, Goldie-Morrison later concluded that Coventry "had Fxxxed us" (and that Coventry "are fundamentally not trustworthy"). Even without considering the "model," a reasonable investor would not have thought that mix of information trivial. Especially at a time when securitization was not much more than speculative, these problems might have led a reasonable investor in Huizenga's position to decline the October 21, 2005 further investment. It is true that Ritchie consistently gave itself authority to avoid *any* diversification. Were a lack of diversification the only problem, one might question materiality. But in the context of the other concerns just described, a reduction in any prospects for diversification removed what the PPM itself called the "risk control benefits" diversification might have afforded.

As for the "model," Lem's own deposition testimony (not to mention Dr. Zissu) fully supports the inference that Mulholland's reluctance to disclose the full "model" – a reluctance repeated with Lehman in August 2006, PX 657 – stemmed from a concern that it might have a negative impact on a potential equity purchaser. That is, one may infer – and this Court finds – that he himself thought it was material. Even if Dr. Zissu's view that it predicted an equity loss 100% of the time is overstated, certainly the model predicted hard going for an equity investor. (Perhaps that is why Mulholland made the point, in his September 29, 2005 discussion with

Huizenga, that the onshore equity investment was "more risky." But even if left by itself that would not be a fair disclosure, any more than just saying a Powerball lottery ticket is "more risky" than betting on a coin toss. And Mulholland's statement was not left by itself. He paired it with what his own model would consider a misrepresentation, that a buy-and-hold strategy would give the equity a "high single digit rate of return.")

It is more difficult to determine whether the information not disclosed prior to the initial August 1, 2005 investment meets the § 7323(a)(2) materiality test. One must be able to perceive materiality at the time, not just in hindsight. The Court finds two key differences between what Ritchie knew before August 1, 2005 and what Ritchie knew before October 1, 2005. First, before October 1st Ritchie had learned that pairing Fasano life expectancies with Coventry's AVS-based pricing simply would not work. That called sharply into question the viability of the June 30, 2005 Coventry agreement. Also, even though Lem did not know at that point that Moody would balk at the same difficulty and thereby make securitization more difficult, Mulholland knew before August 1, 2005 that Silver Creek was unwilling to participate in equity because of doubts about "the underlying mortality risk." PX 125. Even then, Lem and Mulholland both knew that the Lem-Mulholland model did not bode well for equity if "the mortality is bad" (*see* pages 7-8 *supra*) – precisely the risk which was increased by Coventry's AVS-Fasano mismatch. Second, before October 1st Ritchie was under heavy pressure from Coventry's push to "double-size" the deal – the as yet unproven deal, as others at Ritchie pointed out – despite these problems, despite the lack of any obvious source of ready funds (note here Silver Creek's skepticism), and despite the corresponding loss of diversification possibilities.

In the Court's view, those two points were the equivalent of another shoe dropping between August 1st and October 1st. Given those points, there is little room for doubt that the other undisclosed information was material and should have been made available to a prospective buyer before the purchase. In their light, the risk suggested by the other undisclosed information was both more concentrated and less avoidable than would be true without them. But one cannot apply to August 1st the illumination of events in September. Lacking the two points just discussed, the Court cannot conclude that as of August 1st the other undisclosed information was "material" for purposes of DSA § 7323(a)(2) in light of the other information which was disclosed before August 1st.

Even though the Court does not conclude that § 7323(a)(2) liability applies regarding Huizenga's $6 million August 1, 2005 investment, however, the Court's conclusion that the disclosures in question were material for purposes of § 7323(a)(2) regarding Huizenga's $5 million October 1, 2005 investment – and therefore should have been disclosed – gives rise to the question of what the effect of such a disclosure would have been on Huizenga's contractual right to redeem its original $6 million investment. That will be further addressed below.

A final point must be addressed regarding Count I. Defendants also argue that Ritchie Partners is not a "seller" and therefore cannot be held liable under § 7323(a)(2). Defendants cite *Janus Capital Group, Inc. v. First Derivative Traders,* __ U.S. __, 131 S. Ct. 2296, 2303, 180 L.Ed.2d 166, 176 (2011), in which the Supreme Court held that a plaintiff could not state a securities fraud claim under SEC Rule 10b-5 against a fund's investment advisor for misstatements in the prospectus because it was the fund who was the "maker" of the statements,

not the advisor. The Court stated that "the maker of a statement is the entity with authority over the content of the statement and whether and how to communicate it." *Id.*

In this Court's view, Ritchie Partners cannot, *vis-à-vis* Ritchie Risk-Linked Strategies, claim the same distance as the *Janus* investment advisor could claim from its principal with respect to non-formal misrepresentations or omissions. To begin with, Ritchie Partners was not just an advisor, but the "Managing Member," of Ritchie Risk-Linked Strategies, LLC, the "Fund" which was formally the subject of the PPM, *see* JX 2, and the Subscription Agreement, *see* JX 3. The managing member of an LLC, the functional equivalent of a general partner, cannot disclaim responsibility for the LLC's conduct or communications. It is in (and atop) the chain of command, unlike an investment advisor whose role is more indirect. *See, e.g., Katris v. Carroll,* 362 Ill.App.3d 1140, 1144-45 (1st Dist. 2005), distinguishing between the authority and duties of a member and a manager (or member-manager) in an LLC. Here, the Fund's Operating Agreement, JX 4 at page 26, makes clear that Ritchie Partners had "full discretionary power and authority to manage the Fund's assets." (It also endeavors to exculpate Ritchie Partners from most possible liability; but because of DSA § 7323(g), as previously discussed, that cannot include liability under DSA § 7323(a)(2).)

In addition, the record shows that in practice the Ritchie organization was not rigidly compartmentalized. While the formal authors of a PPM are directly responsible for its contents, that cannot be used to disclaim responsibility for communications (such as Mulholland's or Thane Ritchie's communications with Huizenga) which come from a person with a role in multiple Ritchie entities, under circumstances in which it is not clearly identified for which entity he is speaking. Many, if not most, of the key pre-sale communications between Ritchie and Huizenga were oral and informal, not written in the PPM or Subscription Agreement. That was encouraged by the PPM. The individuals who made those communications on Ritchie's behalf did not take pains to parse with precision which Ritchie entity they were speaking for, but the PPM, JX 2 at Bates no. HMF030335-36, and the Subscription Agreement, JX 3 at Bates no. HMF004868, both make explicit that any such communications occur under the Managing Member's auspices:

> The Managing Member will answer all reasonable inquiries from prospective investors and/or their designated representatives or advisors concerning the Fund, the Master Fund, the Managing Member and any other matters relating to the organization and performance of the Fund and/or the Master Fund as well as the offering of the Interests. The Managing Member will afford to prospective investors and/or their representatives and professional advisors the opportunity to obtain any additional information (to the extent that the Managing Member possesses such information or can acquire it without unreasonable effort or expense) necessary to verify the accuracy of any representations or information set forth in this Memorandum....

In light of that statement in the Subscription Agreement and the PPM, Ritchie Partners cannot avoid responsibility for the very communications it undertook to facilitate and manage. The point may be somewhat academic, however. Under Count I, the remedy available to Huizenga is rescission. It does not appear that the direct involvement of Ritchie Partners in its

own capacity (as opposed to its role as Managing Member) is essential to effecting a rescission of Huizenga's October 1, 2005 investment. This will be further addressed below.

2. Count II

3d Am. Cplt., Count II is a claim under DSA § 7323(b) against Ritchie Partners, Ritchie Capital, Ritchie Bermuda, Thane Ritchie, Rothschild, Goldie-Morrison, and Wolfe (the "Non-Selling Defendants") based on pre-purchase communications both in and outside the PPM. Section 7323(b) states:

> Every person who directly or indirectly controls a seller or buyer liable under subsection (a), every partner, officer, or director of such a seller or buyer, every person occupying a similar status or performing similar functions, every employee of such seller or buyer who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale or purchase are also liable jointly and severally with and to the same extent as the seller or buyer, unless the nonseller or nonbuyer who is so liable sustains the burden of proof that the person did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

According to Huizenga, DSA § 7323(b) imposes secondary liability for violations of DSA § 7323(a) on: 1) every partner, officer, or director of a seller by virtue of their status; 2) persons who directly or indirectly control the seller, or have the power to do so; and 3) other employees who materially aid the underlying sale.

The parties have not cited cases in which Delaware courts have addressed § 7323(b)'s liability provision. However, like § 7323(a)(2), § 7323(b) also has a Uniform Securities Act analog (§ 410(b)); thus, decisions of courts applying other states' versions of § 410(b) are informative. Courts in other states that have addressed this issue have held that partners, officers, or directors are liable by virtue of their status alone, regardless of whether they controlled the seller or participated in the violation. *See, e.g., Hines v. Data Line Systems, Inc.*, 787 P.2d 8, 17 (Wash. 1990) (listing cases); *Taylor v. Perdition Metals Group*, 766 P.2d 805, 809 (Kan. 1988) ("The states that have passed § 410(b) of the Uniform Securities Act have consistently interpreted the statute to impose strict liability on partners, officers, and directors unless the statutory defense of lack of knowledge is proven."). In *Lean v. Reed*, 876 N.E.2d 1104, 1107 (Ind. 2007), the court considered § 19(d) of the Indiana Securities Law, which states:

> A person who directly or indirectly controls a person liable under subsection (a), (b), or (c), a partner, officer or director of the person, . . . are also liable jointly and severally with and to the same extent as the person, unless the person who is liable sustains the burden of proof that the person did not know and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.

The court held that the Indiana law's effect "is that a director of a selling corporation who cannot sustain the reasonable care defense is liable for both registration and disclosure violations by the corporation." *Id.* The defendant, who had only been a director of the seller for thirty days at the time of the violation, argued, by analogy to federal case law, that he had no duty to inquire as to the adequacy of the seller's disclosures. *Id.* at 1108. But the court held (*Id.* at 1109) that his:

> ... reliance on federal case law is misplaced because derivative liability under 19(d) of the ISL is an instance where state laws generally and the ISL in particular impose a higher standard. Section 12(a)(2) of the Securities Act of 1933 by its terms imposes liability only on the seller and its "controlling persons" and describes the reasonable care defense differently. Directors are often, but not always, "controlling persons," and even if they are, under the federal statute they enjoy a much more generous defense. ... Unlike the Securities Act of 1933, which imposes liability on only the seller and controlling persons, the ISL also provides for derivative liability of "directors" and several others. The defenses available to these individuals are not uniform. Employees, broker-dealers, and securities agents of the seller must "materially aid" in the violation before they are liable under section 19(d) of the ISL. In contrast, Indiana's section 19(d) imposes absolute liability upon the director of a corporation to purchasers of securities sold in violation of the Securities Act based on his position as a director unless he proves the statutory defense.

Accordingly, the court held that purchasers of securities sold in violation of the Indiana law's § 19(d) need not prove that a director was a controlling person or participated in the violation in order to establish a claim under the Indiana law. *Id.*

Even *Lean* did not impose absolute *in terrorem* liability, however. The court enunciated a somewhat nuanced approach (*Id.* at 1110-11):

> Lean contends that the language of these cases [including *Hines, supra*] interpreting the counterparts of *section 19(d)* from other states may be taken as imposing too strict an obligation of affirmative action by a director. Relying on *Everts v. Holtmann, 64 Ore. App. 145, 667 P.2d 1028, 1035 (Ore. 1983)*, which applies Oregon's version of the Uniform Securities Act, Lean also argues that the "reasonable care" demanded of a director varies with the director's role in the transaction. We agree with Lean on these two points. Despite the differences between federal and Indiana law in standards of conduct and the persons who may be liable, ultimately, both turn on "reasonable" conduct or belief of the defendant. Federal cases interpreting the 1933 Act hold "outside" directors--those not engaged in the day to day management of the corporation--to a lesser standard of investigation. See *Laven v. Flanagan, 695 F.Supp. 800, 812 (D. N.J. 1988)*; *Feit v. Leasco Data Processing Equipment Corp., 332 F.Supp. 544, 577 (E.D. N.Y. 1971)* ("What constitutes 'reasonable investigation' and 'a reasonable ground to believe' will vary with the degree of involvement of the individual, his expertise, and his access to the pertinent information and data.") quoted in *In re WorldCom, Inc., 346 F.Supp.2d 628, 675 (S.D. N.Y. 2004)*. This principle is generally

> applicable under *section 19(d)* as well. Reasonable care demands more of a director charged with investigating and presenting a proposal to the board than it does of a director whose only role is to evaluate management's proposal.

In *Lean*, defendant Lean was himself a lawyer of considerable experience and "currently chairs the government relations practice of a large law firm in Toronto, Canada." *Id.* at 1112. This undercut his primary argument (*Id.* at 1108) that "as a matter of law, it is reasonable care for a director to assume that management and its advisers have taken the appropriate steps to comply with legal requirements." Also, the points at issue in *Lean* – including among other things the issuance of large amounts of unregistered stock – were factual, not questions of judgment, and hard to overlook if a director paid any attention at all (which Lean admitted he had not). The *Lean* court held that despite the draconian language of ISL § 19(d), "a director can reasonably rely on assertions from counsel and others with expertise as to some legal conclusions," *Id.* at 1111. But it concluded that Lean, himself a lawyer, was not entitled blithely to "assume compliance with all applicable laws with no explicit assurance from anyone, no documentation, and in the face of a number of facts that raise obvious points of inquiry." *Id.*

The statutory language of DSA § 7323(b) indicates the legislature's intent to impose liability on partners, officers, or directors regardless of their control person status or participation. If the legislature had wanted the "materially aids" qualification for employee liability to apply to partners, officers, and directors, there would not have been any need to list them as a separate category. Thus, the Non-Selling Defendants who held "partner, officer, or director" positions with the Fund or Ritchie Partners may be independently liable for defendants' violations of DSA § 7323(a)(2). However, the Non-Selling Defendants may prove that they "did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist."

That defense is more to the point here than it was in, for example, *Lean.* Here, the "facts by reason of which the liability is alleged to exist" are not the underlying facts themselves, but rather the pre-purchase misrepresentations and omissions discussed in connection with Count I – the § 7323(a)(2) claims. Those statements and omissions are not obviously "material" by themselves. They must be read in context and connected with other data to become material, and even then the "material" designation is to some degree a judgment call. In addition, it is apparent that not all of the Non-Selling Defendants knew, or had any reason to know, all of the same information at the same time, particularly with reference to non-PPM oral communications between other Ritchie personnel and Huizenga. In an organization as multifaceted and loosely structured as Ritchie, it would be unworkable to make every partner, officer, or director absolutely liable for every miscommunication between any employee and a potential investor.

In the context of this case, therefore, the Court interprets the statutory defense to permit an officer, director, or partner to escape liability if he or she could not with reasonable care have known of both the making, and the inaccuracy, of an actionable misrepresentation or omission. Following the approach of *Lean*, "reasonable care" will vary with the individual's "degree of involvement" (his or her job, relative to the conduct at issue), "expertise," and "access to the pertinent information." The latter two tests interact. Based on the record, for example, the Court concludes that most of Ritchie's personnel lacked the expertise to understand the intricacies of

the Mulholland-Lem model even if they had access to it. The Court also concludes that at the time of Huizenga's investments (though by mid-2006 this seems to have changed), there was little attempt to rigorously edit or police Mulholland's communications with potential investors. That was partly because such communications were his job, and partly because he was believed to have a better grasp of the life settlements securitization project than anyone else except Lem.

Applying that approach, defendants Rothschild and Wolfe are not liable under § 7323(b) for the Count I conduct found actionable under § 7323(a). They were not directly involved in the sales to Huizenga; their role, if any, was post-sale. Their jobs at the time did not give them the duty of policing the Huizenga sales, so "reasonable care" did not oblige them to volunteer or second-guess the handling of those transactions.

Though it is a closer call, the Court also finds that Goldie-Morrison is not liable under § 7323(b) for the Count I conduct found actionable under § 7323(a). Goldie-Morrison was involved in the life settlements transaction, through his role on Ritchie's executive committee and in dealing with Mulholland's requests of the executive committee, and he was also heavily involved in the contentious interaction between Mulholland and the P&C personnel, particularly Murphy. He seems to have grasped more quickly than others that Coventry had "Fxxxed us," and the method by which that was accomplished. But Goldie-Morrison's role was not in sales. He dealt with the substance of transactions, not their packaging or presentation to investors (except where the presentation involved substantive negotiations affecting the deal, as with the contingent forward). The Court finds that at the time of the Huizenga investments – which was before difficulties with Mulholland had gained traction, and at a point where the life settlements transaction appeared reasonably positive – it was not within Goldie-Morrison's ambit of "reasonable care" to police communications between Ritchie personnel and Huizenga. Further, it does not appear from the record that before October 1, 2005 Goldie-Morrison knew about, or had a reason to link to Huizenga disclosures, the key interacting developments discussed at pages 30-32 *supra*. Even later, Goldie-Morrison believed that the Coventry numbers were manageable, though not ideal. *See* pages 16-17 *supra.*

Thane Ritchie, however, cannot escape liability under § 7323(b). He was the ultimate, and hands-on, authority regarding the Coventry project. It was he who, on October 10, 2005, overruled others at Ritchie and insisted on double-sizing the Coventry project even though the funds were not in hand. Though he was no more expert than any other Ritchie personnel at unraveling the complexities of the Lem-Mulholland model, he was (as later events made clear) ultimately responsible for Mulholland's communications with potential investors, and he was personally involved in selling the life settlements investment to Huizenga. The Court does not find that Thane Ritchie knew the information given to Huizenga was inadequate. The Court does conclude, however, that as the undisputed captain of the Ritchie ship, Thane Ritchie had the § 7323(b) responsibility to find out, and that he has not demonstrated reasonable care in doing so.

This leaves Ritchie Partners, Ritchie Capital, and Ritchie Bermuda. It is difficult to apply § 7323(b) to entities as opposed to individuals, because it is unclear how an organization can prove that it "did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist." An organization is the sum of its individual members. Proving a lack of knowledge or opportunity for knowledge on

the part of every member of an organization is not easy, particularly when – as here – the organizations are to some degree interconnected. Given the foregoing discussion about individuals, it appears that the comparable test for an organization would also focus on the context of "reasonable care." If the organization's mandate, or job, does not extend to the circumstances of § 7323(a) liability, then the organization has no duty of "reasonable care" with respect to it and would not fall within the ambit of § 7323(b).

On that approach, Ritchie Bermuda escapes § 7323(b) liability here. It had a connection with the life settlement project, but more lateral (as a "sub-adviser") than hierarchical. The Court does not find that Ritchie Bermuda had, fairly speaking, any responsibility for what Mulholland (or other "main" Ritchie personnel) did or did not tell Huizenga.

That cannot be said of Ritchie Partners, however. For the reasons previously explained, Ritchie Partners, as the Managing Member of the Fund, has a duty of reasonable care regarding what the Fund – not to mention what Ritchie Partners itself, pursuant to the PPM and Subscription Agreement language quoted at page 33 *supra* – communicated to Huizenga. Ritchie Partners was tasked with overseeing those communications. It has not demonstrated that it could not reasonably have known of the facts on which Count I liability is based.

Ritchie Capital is in a somewhat different position. It was not formally tasked with overseeing communications between Huizenga and the Fund pursuant to the "access to information" provisions of the PPM and Subscription Agreement. Like Ritchie Bermuda, Ritchie Capital is described only as a "sub-adviser" of the Fund in the PPM and Subscription Agreement. But unlike Ritchie Bermuda, it was Ritchie Capital which made the first sales pitch to Huizenga, including providing Huizenga with Ritchie Capital "contact information." *See* JX 1. (It is hence a bit of a stretch to term Ritchie Capital a "non-selling defendant" except in a technical or formal sense.) Having thus chosen to inject itself into the sales process, Ritchie Capital necessarily undertook a duty of reasonable care with regard to that process. The record does not indicate that Ritchie Capital thereafter formally (or even informally) removed itself from any role in communicating with Huizenga.

Applying the same *Lean*-based approach to "reasonable care," the Court cannot conclude that Ritchie Capital so thoroughly distanced itself from the Huizenga sales process as to be absolved of any duty to pay attention to what was and was not said. In the circumstances of this case, Ritchie Capital's situation somewhat resembles that of the defendant in *Robertson v. White,* 635 F. Supp. 851, 871 (W.D. Ark. 1986), who, though not "technically" a corporate officer, "performed the duties of an executive officer of a corporation" and was therefore liable under the analogous provision of the Arkansas Securities Act. That approach is also consistent with *Lean,* which looks to the defendant's "degree of involvement" rather than solely its place on a formal organization chart. Accordingly, the Court cannot conclude that Ritchie Capital has met its § 7323(b) burden of proof regarding the Count I liability events under § 7323(a).

The Non-Selling Defendants also argue that their liability is limited by the Fund's Operating Agreement, which provides that Defendants shall have no liability to Huizenga except for actions that "constitute fraud, bad faith, gross negligence, or reckless or intentional

misconduct." Defendants point to § 18-1101(c) of the Delaware Limited Liability Company Act (the "LLC Act"), 6 Del. C. § 18-1101(c), which states:

> To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.

Defendants also cite § 18-303(a) of the LLC Act, 6 Del. C. § 18-303(a), which states:

> Except as otherwise provided by this chapter, the debts, obligations and liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company, and no member or manager of a limited liability company shall be obligated personally for any such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.

These statutory citations miss the mark. Both are general provisions. Neither indicates any intent to address securities law violations at all, let alone an intent to undercut (or in effect repeal outright, as to LLCs) the specific non-waiver requirement of DSA § 7323(g). On its face, LLC Act § 18-1101(c) is aimed at duties to persons who are already members of an LLC or parties to an LLC agreement, whereas DSA §§ 7323(a) and 7323(g) are aimed at persons who have not yet invested. Similarly, LLC Act § 18-303 merely prevents an LLC's general "debts, obligations and liabilities" from being *automatically* imputed to LLC members or managers. That provision cannot be read to effectively exempt LLCs from the scope of DSA § 7323(b), which imposes explicit and distinct liability on defendants other than the selling entity: its partners, officers, directors, and control persons are "also liable jointly and severally with and to the same extent as the seller" for violations of § 7323(a)(2). Had the Delaware legislature not enacted §§ 7323(b) and 7323(g), Defendants' argument here might be more convincing. The Operating Agreement and the LLC Act might then shield the Non-Selling Defendants from liability for the Count I violations of §7323(a)(2). However, in enacting §§ 7323(b) and (g), the legislature specifically imposed that separate liability on the Non-Selling Defendants.

3. Count V

3d Am. Cplt., Count V, alleges breach of fiduciary duty against the Fund, Thane Ritchie, Ritchie Partners, and Ritchie Capital for providing false and misleading reports about the Fund. Here Huizenga moves away from the circumstances of its initial investments, focusing instead on the Defendants' post-investment reporting. To establish a claim for breach of fiduciary duty, a plaintiff must demonstrate the existence of four elements: (1) a legal duty; (2) an act which breaches this duty; (3) a causal connection between the defendant's conduct and the plaintiffs'

injury; and, (4) damage to the plaintiffs. *Preston v. Preston,* 1981 Del. Ch. LEXIS 577, *6 (Del. Ch., Apr. 16, 1981).

Defendants challenge the existence of the first element, a legal duty owed to plaintiff. Defendants argue that the Fund's "advisers" (Ritchie Capital and Ritchie Partners) owe a fiduciary duty to the Fund only, not to its individual investors. Defendants correctly cite to *Goldstein v. Securities & Exchange Commission,* 451 F.3d 873, 881 (D.C. Cir. 2006), for that proposition. In general terms, *Goldstein* held that a hedge fund adviser owes fiduciary duties only to the fund, not to the fund's investors, because hedge fund investors are not clients of the fund adviser. *Goldstein* somewhat resembles the approach taken in *Janus Capital Group, Inc. v. First Derivative Traders, Inc.,* __ U.S. __, 131 S.Ct. 2296, 2303 (2011), which held that a plaintiff could not state a Rule 10b-5 claim against a fund's investment adviser for misstatements in the fund's prospectus because the fund, not the adviser, was the "maker" of the statements.

Goldstein is not as flat a pronouncement as Defendants suggest, however. Despite *Goldstein,* and indeed consistent with *Goldstein*'s actual holding, *United States v. Lay,* 612 F.3d 440, 442 (6th Cir. 2010), held that "a hedge fund adviser can, in some circumstances, have a fiduciary relationship with an investor." As *Lay* explained, 612 F.3d at 446-47, *Goldstein* – which invalidated a proposed SEC rule change – "did not hold that no hedge fund adviser could create a client relationship with an investor, but rather held only that the SEC 'had not justified treating *all* investors in hedge funds as clients.'"

It is true that in general "the duty of a hedge fund adviser" is "to the hedge fund" and thus typically "cannot be to the various investors in the fund." *Lay, supra,* at 445; *see Goldstein, supra,* at 879-80. For one thing, "[i]f the investors are owed a fiduciary duty and the entity is also owed a fiduciary duty, then the adviser will inevitably face conflicts of interest" because what is best for the fund may not be what is best for the investors. *Goldstein, supra,* at 881. But that is not the whole story. Even though ordinarily investors are not "clients" of the fund's adviser (which was why *Goldstein* vacated the proposed SEC rule), *Goldstein* itself, 451 F.3d at 881 n.6, acknowledged that "investors in a hedge fund may sustain an action for fraud against the fund's adviser," citing *Abrahamson v. Fleschner,* 568 F.2d 862, 877-78 (2d Cir. 1977), because "[t]he anti-fraud provision also applies ... to persons other than clients." Furthermore, if (as in *Lay*) a hedge fund adviser has an atypical relationship with a fund investor, then – as *Lay* held – nothing in *Goldstein* forbids concluding that a client relationship exists under those particular circumstances. In *Lay,* the unusual circumstances (summarized by the Sixth Circuit, 612 F.3d at 445-46; *see also* the District Court's discussion, *United States v. Lay,* 566 F.Supp.2d 652, 670-71 (N.D. Ohio 2008)) included that Lay "had a pre-existing fiduciary relationship with the [investor];" that the investor had invested in the fund because of that prior relationship, and specifically to "provide Lay with flexibility" in connection with the prior relationship; the investor "was not a passive investor" in the fund; the investor "had 'regular and direct' communication with Lay" about the fund; and the investor was the sole shareholder in the fund.

In this case, the facts are not as atypical as those in *Lay.* Here, Huizenga had no pre-existing relationship with Ritchie Capital or Ritchie Partners. Huizenga encountered them for the first time in the context of the investment at issue here. Further, the investment here was not created to be (nor sold to Huizenga as) a "flexibility" tool for Huizenga with respect to other

ongoing investments under the same umbrella. Also, though Huizenga could fairly be described as a questioning investor, it was "passive" in the sense that the advisers did not seek its input as to what to do. This case fits the *Goldstein* model better than the *Lay* exception. With regard to the conduct at issue in Count V, which is concerned with post-investment misreporting by defendants (notably with regard to the March 2006 and June 2006 investor updates), the Court accordingly concludes that Ritchie Capital and Ritchie Partners were not fiduciaries for Huizenga in connection with advice or decision making on behalf of the Fund.

That conclusion does not really address the gravamen of Count V, however. Though *3d Am. Cplt.,* Count VII challenges defendants' substantive decision-making, Count V is more concerned with defendants' reporting. That is a different topic, having to do with the accuracy of communications rather than the substantive correctness of decisions. As held in *Abrahamson v. Fleschner, supra,* even a non-fiduciary is not free to commit fraud. Here, as previously discussed, neither Ritchie Capital Management nor Ritchie Partners can avoid the impact of material misstatements and omissions in sales communications for which they had responsibility, either by acting as "salesman" (in the case of Ritchie Capital, *see* JX 1) or by formally and expressly assuming authority over communications with investors (in the case of Ritchie Partners, acting as Managing Member of the Fund).

Because it concerns communications rather than substantive decision-making, this point does not undercut the normal understanding of how hedge funds operate. As stated in *Goldstein, supra,* 451 F.3d at 876, hedge funds have a "distinctive" "management structure," in that they are "usually structured as limited partnerships to achieve maximum separation of ownership and management." There seems little difference between limited partnerships and LLCs in this context. *See, e.g., Id.* at 883, noting that the SEC's "safe harbor" rules apply to LLCs as well as limited partnerships. In both sorts of entity, the manager or managing member and the adviser may functionally overlap, and both are distinguished from investors. *See* Shadab, *Hedge Fund Governance,* 19 Stan. J. L. Bus. & Fin. 141, 150 n.28 (2013), using "the phrases hedge fund 'manager' and 'investment adviser'" "interchangeably." Thus, citing *Lay, supra,* Professor Shadab adds that "[o]nly under limited circumstances have hedge fund managers been found to owe a duty to investors directly." *Id.* at 151 n.34. *Lay* concerned an adviser who, under the circumstances, was also in charge and thus effectively a manager as well.

Both *Goldstein* and Professor Shadab address, however, the lack of a direct duty owed to investors by managers or advisers in the context of decision-making (*i.e.,* whether they have a duty to *act* in the investor's interest), not in the context of disclosure. One who has no substantive duty to speak at all may still be liable for volunteering misinformation, or for knowingly concealing obviously material information. Notwithstanding *Goldstein,* "[a]lthough an investment adviser may owe a statutory duty only to a mutual fund it advises, not to the fund's investors, if a defendant is responsible for including misleading language in a prospectus, that defendant may be found to have assumed a duty to persons to whom the prospectuses were distributed to correct any material omissions or misleading statements." *In re Mutual Funds Investment Litigation (Marini v. Janus Investment Fund),* 590 F.Supp.2d 741, 747 (D. Md. 2008). The quoted language speaks only of a statutory duty regarding a prospectus, and the case itself did not involve common-law claims: *see Id.* at 744 n.3. But the same point has just as much force in the context of a common-law claim about a periodic report rather than a

prospectus. As previously discussed, Ritchie Partners expressly controlled communications between Ritchie and Huizenga, and (in JXs 3 and 4) told Huizenga it would do so; and the record shows that the Ritchie reports which are the subject of Count V were, in fact, prepared by Ritchie Capital Management. *See, e.g.,* DX 59, as to the March 2006 investor letter, and PX 1018, as to the June 2006 investor letter. Ritchie Capital Management sent a draft of the March 2006 letter to Mulholland, who "believe[d]" he responded that its "pie chart was incorrect." *Mulholland Dep.* at 129. Ritchie Capital Management sent a draft of the June 2006 investor letter to Ron Kenny, who – based on communications with Jeff Hojnacki (*see* PX 1001) – testified that that pie chart was also "in error." No correction was made to either letter.

The Court accordingly declines to hold that Ritchie Partners and Ritchie Capital Management owed no Count V duty to Huizenga as a matter of law. No one doubts that ongoing disclosures are important. Investors in hedge funds generally "seek comprehensive, intelligible disclosures about risk, occurring anywhere from monthly to in real-time." Investors also want "detailed and frequent performance reporting, to have the fund precisely identify its investment strategy, and to monitor the manager's investments, preventing a deviation from the stated strategy." Shadab, *Hedge Fund Governance,* 19 Stan. J. L. Bus. & Fin. 141, 175 (2013). To be sure, despite these *desiderata,* the Court cannot hold that existing law requires Ritchie Partners and Ritchie Capital Management, simply because of their positions, to take direct responsibility for every communication emanating from Ritchie. Nevertheless, Ritchie Partners explicitly undertook the communications role, and Ritchie Capital's fingerprints are on the March 2006 and June 2006 investor letters.[9] They chose to be involved.

That all four Count V defendants have responsibility for the pie chart errors does not automatically result in Count V liability. First, the pie chart errors must have proximately caused Huizenga's injury, which requires that Huizenga's decision-making about withdrawing its investment and then rescinding the withdrawal must have relied on the allegedly inaccurate information. *See, e.g., Kling Meats, Inc. v. Baltimore Spice Co.,* 1988 Del. Super. LEXIS 576, *9 (Del. Super. Ct., Jan. 26, 1988). Second, even if proximate cause has been proved, as to Count V we must address the limitations of liability found in the Fund's governing documents.

As to proximate cause, Huizenga's fundamental argument is that if the pie charts had been accurate it would have been able to withdraw its investment before "Spitzer Day," when the Fund essentially collapsed. There are two difficulties with this. First, it is difficult to make a strong causation argument with respect to the March 2006 investor letter, because *after* that letter was sent, Huizenga *did* withdraw its investment – but then rescinded the withdrawal because it was told (accurately, if not altogether completely) that Moody had issued a preliminary rating for the securitization. Second, defendants strenuously dispute, and the record is murky about, whether the pie charts (*i.e.,* the "approximate portfolio allocation" of Huizenga's investment) were in themselves key to Huizenga's decision-making.

[9] Huizenga also complains more broadly of defendants' managing of Ritchie communications, which defendant argue was an attempt to hinder Huizenga's ability to find out what was going on. The Court cannot agree. Managing communications, including limiting the number of persons with authority to speak, is essential to consistency and even coherence in reporting. Particularly during Ritchie's mid-2006 internal turmoil, defendants arguably had an affirmative obligation to muzzle persons they believed to be "loose cannons." This does not relieve hedge fund "insiders" of responsibility for misstatements or omissions; arguably, it *increases* their responsibility, by acknowledging their authority over, and ability to control, what investors are told or not told.

Both points converge in Huizenga's statement during closing argument that "Had Ritchie told the truth" in the March 2006 pie chart, "Huizenga could have redeemed effective September 30, 2006, long before Spitzer." "Could have" does not mean *would* have. The difference is key to proximate cause. Even without pie chart "truth," Huizenga *did* redeem on June 2, 2006, effective September 30, 2006 – just what the closing argument thought desirable. But Huizenga then withdrew that redemption, for reasons which had nothing to do with "approximate portfolio allocation." Indeed, if Huizenga had been told in March that the life settlements slice of the pie chart was actually larger than shown on DX 59, that would seem to increase Demaray's concern about a redemption "leav[ing] close to $3 million on the table," because his calculation was based entirely on the prospect of a life settlement securitization.

Huizenga's closing argument sought to address that difficulty by asserting that in withdrawing its redemption, Huizenga was "misled about the Moody's rating and status of the securitization." But the information about the preliminary rating itself appears to have been substantially true. Huizenga complains that (on Bradley's version of what was said) Zirin said "the rating was very positive." The fact of any rating at all was indeed positive, however. The particular preliminary rating was not as good as Mulholland wanted, but it pushes disclosure obligations rather far to say that Ritchie had an obligation to report that some of its personnel were disappointed by that first step, which they were trying to improve. The assertion that "this all but guarantees a securitization" was believed to be true at that point. Even some months later, after the contingent forward issue ran into difficulties (mostly not directly related to the securitization itself, but rather due to concerns that Ritchie overall "will not survive"), Goldie-Morrison and others at Ritchie had not given up hope that it could be accomplished.

What was arguably more misleading about the securitization hoopla was Demaray's apparent belief that it would immediately and directly benefit Huizenga. In February 2006 Goldie-Morrison had been concerned that the initial securitization would only "pay off the senior lender." But more than one securitization was planned, and the record does not show that it would be demonstrably wrong to believe that if the first one could be done, others could follow. Goldie-Morrison did not assert in PX 913 that the entire securitization process would not, or could not, yield profits. In his view the primary sticking point was the Coventry mispricing, but he thought that had been adequately corrected by arm-twisting. *See* page 17 *supra.*

The Court draws two conclusions from this. First, Huizenga has not proved that merely correcting the March (or July) pie charts would in itself have caused Huizenga to act differently with regard to either its redemption requests or its withdrawal of the first redemption request. Second, what might have had more of a causal role – Goldie-Morrison's PX 913 concerns – was more at the predictive level than at the level of concrete fact, and was not the sort of information provided by the "pie chart" reports in any event. The defendants' post-investment disclosure obligation is not limited solely to provable facts, but it does not necessarily extend to internal apprehensions about possible adverse outcomes which are believed to be avoidable. If that were not so, hedge fund post-investment reporting obligations would be difficult to satisfy, having in mind that hedge fund investments are inherently riskier than the norm.

For the reasons stated, the Court concludes that Huizenga's "pie chart" claims in Count V fail on proximate cause grounds. They also fail because of the limitations of liability contained in § 2.8(b) of the Operating Agreement, quoted at page 11 *supra.* For purposes of Huizenga's claims in Count V, the Delaware LLC Act gives members of an LLC wide latitude to order their relationships, including the flexibility to limit or eliminate fiduciary duties. 6 Del. C. § 18-1101(e); *Bay Ctr. Apts. Owner, LLC v. Emery Bay PKI, LLC,* 2009 Del. Ch. LEXIS 54, *26 (Del. Ch., Apr. 20, 2009). *See also* Shadab, *Hedge Fund Governance,* 19 Stan. J. L. Bus. & Fin. 141, 151 & n.37 (2013). But, in the absence of a contrary provision in the LLC agreement, the manager of an LLC owes the traditional fiduciary duties of loyalty and care to the members of the LLC. *Bay Ctr. Apts.,* 2009 Del. Ch. LEXIS 54, *26. The LLC Act itself does not prescribe what fiduciary duties members of an LLC owe each other, leaving the matter to be developed by the common law. *See* 6 Del. C. § 18-1104; *Bay Ctr. Apts.,* 2009 Del. Ch. LEXIS 54, *27. The LLC cases have generally, in the absence of provisions in the LLC agreement explicitly disclaiming the applicability of default principles of fiduciary duty, treated LLC members as owing each other the traditional fiduciary duties that directors owe a corporation. *See Bay Ctr. Apts.,* 2009 Del. Ch. LEXIS 54, *27.

Here, however, because of § 2.8(b) of the Operating Agreement, in order to recover on Count V, Huizenga must show "fraud, bad faith, gross negligence, or reckless or intentional misconduct." *See ABRY Partners V, L.P. v. F&W Acquisition LLC,* 891 A.2d 1032, 1063 (Del. Ch. 2006); *McPadden v. Sidhu,* 964 A.2d 1262, 1273-1274 (Del. Ch. 2008). For the reasons already stated, the Court finds that Huizenga has not met that burden as to Count V. Defendants' post-investment disclosures (particularly the "pie charts") were incomplete, perfunctory, and poorly handled. But the Court does not find that defendants acted intentionally or recklessly. Rather, the causes appear to have been a combination of a complex and rapidly evolving investment project and Ritchie's other internal turmoils.

4. Counts VII and VIII

3d Am. Cplt., Counts VII and VIII, will be treated together because, unlike the other Counts discussed above, both Counts assert derivative claims and both Counts attack defendants' substantive conduct rather than their disclosure conduct. In Count VII, Huizenga asserts breach of fiduciary duty claims against Thane Ritchie, Ritchie Partners, Ritchie Capital Management, and the Fund, based on their conduct in investing the Fund's assets. Huizenga summarizes its Count VII: "[Defendants] intentionally invested the Fund in a single security contrary to the PPM and representations made to Huizenga. After Huizenga invested, Defendants intentionally and recklessly caused the Fund to incur increasing obligations so that they had to continue to invest virtually all of the Fund's assets in the Equity. Moreover, they did so without any meaningful due diligence – despite significant warning signs about the Coventry relationship and policy values – that they did not disclose to Huizenga." *Pltf. Post-Trial Mem. of Law,* at 24-25. In Count VIII, Huizenga brings a claim for breach of fiduciary duty against those four defendants based on their "fraudulently and recklessly charging excessive management fees." Here Huizenga takes aim at Ritchie's basing management fees on unrealized gains – on a "mark-to-market" modeling, rather than on actual sales transactions. "[B]ecause their models showed all along that the Equity would suffer a loss under any reasonable circumstances, Defendants should not have charged any management fees on life settlements to the Fund." *Id.* at 27-28.

As an initial matter, Defendants argue that Huizenga lacks standing to bring derivative claims because it is no longer a shareholder in the Fund. Huizenga contends that lack of standing is an affirmative defense, which Defendants waived by failing to plead, and, in any event, Huizenga is still a Member of the Fund. This question may be further complicated by the Court's holding that Huizenga is entitled to rescission as a remedy under *3d Am. Cplt.,* Count I.

Under Illinois choice-of-law rules, Illinois law governs which party bears the burden of proof on a given issue. Defendants' argument that standing is a substantive element of a derivative claim under Delaware law does not affect this settled principle. It is true that for choice-of-law purposes, Illinois courts will apply the substantive, but not procedural, rules of a foreign state whose law governs the controversy. But that does not alter the principle that the question of who bears the burden of proof is a procedural issue to which Illinois law applies.

Under Illinois law, lack of standing is an affirmative defense which a defendant bears the burden of pleading and proving. *See Alpha School Bus Co. v. Wagner,* 391 Ill. App. 3d 722, 746 (1st Dist. 2009). Recent decisions by the Illinois Supreme Court have made emphatically clear that standing, in itself, does not affect a court's jurisdiction to entertain a claim. *Lebron v. Gottlieb Memorial Hospital,* 237 Ill.2d 217, 252-53 (2010). "While a lack of subject matter jurisdiction cannot be forfeited, ... a lack of standing will be forfeited if not raised in a timely manner in the trial court." *Id.* Defendants undisputedly did not plead Huizenga's lack of standing as an affirmative defense. Accordingly, it has been waived as a matter of law. *Id.; see also, e.g., Hagan v. Stone,* 277 Ill.App.3d 388, 390 (1st Dist. 1995).[10]

Defendants also argue that in any event, the business judgment rule protects them from Huizenga's breach of fiduciary duty claims in Counts VII and VIII. The business judgment rule is a presumption that in making a business decision the directors (or, as here, the persons in control of the Fund) acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the corporation. *Aronson v. Lewis,* 473 A.2d 805, 812 (Del. 2005). (In the hedge fund context, the best interest of the fund may not be the same as the best interests of the investors in the fund. *See Goldstein v. Securities & Exchange Commission,* 451 F.3d 873, 881 (D.C. Cir. 2006): "If the investors are owed a fiduciary duty and the entity is also owed a fiduciary duty, then the adviser will inevitably face conflicts of interest.") Thus, directors' decisions will be respected by courts unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose, or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available. *Brehm v. Eisner,* 746 A.2d 244, 264 n.66 (Del. 2000). Directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. *Paramount Communications v. QVC Network,* 637 A.2d 34, 44 (Del. 1994).

[10] One might argue that "standing" for derivative suit purposes means something more substantive – more policy-based, perhaps – than ordinary procedural "standing," which, as in *Lebron, supra,* may have more to do with traditional notions of ripeness. But a number of recent mortgage foreclosure cases have treated challenges to a plaintiff's ownership of a mortgage and note (which would seem substantive elements of its claim) as merely forfeitable "standing" arguments. *See, e.g., U.S. Bank N.A. v. Sauer,* 392 Ill.App.3d 942 (2d Dist. 2009).

Huizenga bears the burden of proving by a preponderance of the evidence that the presumption does not apply. See *In re Walt Disney Co. Derivatives Litigation,* 907 A.2d 693, 756-57 (Del. Ch. 2005). Delaware courts will decline to apply the protections of the business judgment rule to an action by the board of directors that was "the product of a fundamentally flawed process and cannot be in the interests of the stockholders." *Id.* at 747, citing *In re Holly Farms Corp. Shareholders Litigation,* 1988 Del. Ch. LEXIS 164, *6 (Del. Ch., Dec. 30, 1988). *See also, e.g., Venhill Ltd. Partnership v. Hillman,* 2008 Del. Ch. LEXIS 67, *8 (Del. Ch., June 3, 2008), in which the court found a breach of fiduciary duty where no rational third-party would have made the investment at issue on the terms the defendant – for his own benefit – caused the limited partnership to accept. If the business judgment rule presumption has been rebutted, the burden of proof shifts to Defendants to prove by a preponderance of the evidence that the challenged transactions were fair. *See In re Walt Disney Co. Derivatives Litigation,* 907 A.2d 693, 756-57 (Del. Ch. 2005). It is a well-settled principle of Delaware law that where directors stand on both sides of a transaction, they have the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts. *Carlson v. Hallinan,* 925 A.2d 506, 529 (Del. Ch. 2006). But as noted earlier, in the hedge fund context that principle must recognize that the defendants' duty is to the Fund, not to investors in the Fund.

There is plenty to dislike about the Coventry transaction and defendants' handling of Huizenga's investment. The Court has already held, regarding Counts I and II, that Huizenga was not given a fair opportunity to avoid its risks. That does not mean, however, that defendants could not rationally choose to embrace its risks in search of "alpha." The basic timing of events prevents the Court from concluding that defendants engaged in deliberate wrongdoing, or in a way that no rational person could possibly accept. Defendants certainly have not shown that the Coventry transaction would have succeeded if Spitzer had not sued Coventry in October 2006. Indeed, defendants' own missteps played a role in preventing the transaction from being completed before "Spitzer Day." But neither has Huizenga shown that the Coventry transaction, albeit a long shot, was so obviously guaranteed to fail that defendants should have stopped it in mid-course (which was for practical purposes their only real alternative).

At the outset of the transaction, the fundamental idea – obtaining and then securitizing a bundle of life settlements – was certainly risky, but held the prospect of profit. Some 50 other such transactions had been floated (albeit not all the way to a successful securitization), demonstrating that the idea itself was not irrational. Nor, at the very early stages, could defendants have seen the crucial flaws except with prescience, which neither the business judgment rule nor § 2.8(b) or (c) of the Operating Agreement requires. Defendants had (as Huizenga knew) left themselves room to pump as much as they thought likely to succeed into the Coventry deal. Hindsight may tend to underscore both the lack of diversification ("dangerous territory," *per* PX 811, as early as July 2005) and the potential funding problems (Thane Ritchie's "cash crunch," PX 1315, in June 2005). But the record does not show that defendants intended at that point to put all their eggs in one basket, nor that they then knew that the basket might have holes. As for the cash crunch, betting on the eventual emergence of funding in June 2005 does not seem all that unusual. This was, after all, an inefficient market and therefore not one for which heavy funding could be guaranteed ahead of time.

The first point at which the risks appeared greater than expected was in September 2005, when Lem realized that the Coventry deal numbers were not working properly because of the mismatch between Fasano (VBT) and AVS2i. Before then the Court cannot say that Ritchie personnel had failed to inform themselves of all information *then known to be* material. But once the Coventry deal had been signed – incautiously, perhaps, but not in a way which evidenced fraud or self-dealing by Ritchie personnel – the existence and terms of the deal had to be reckoned with. The record does not indicate a realistic, ready alternative to Coventry as a supplier of life settlements. Ritchie's choice, then, was either to abandon the project based on the difficulty with the Coventry numbers, or to try to salvage it and move forward.

As matters then stood, Ritchie could rationally conclude that abandoning the project would mean exiting the life "space" at least in the short term, as well as facing possible litigation with Coventry. Ritchie could also rationally conclude that salvaging the project seemed possible, since from the outset Ritchie's goal had not been "buy and hold" but rather a quick securitization which (at that point, before Moody had demanded a "contingent forward") would have shifted the mortality risk from Ritchie to a group of securities buyers.

The flaws in this were that Ritchie was heavily dependent on Mulholland to evaluate the feasibility, and pursue the strategy, of a securitization, and that (so far as appears from the record) Mulholland and Lem were the only Ritchie participants who really understood the infamous "model." As to the former, Mulholland's own interests were inextricably tied up in accomplishing a securitization – and sooner rather than later, given the mounting internal pressure against continuing to compensate Mulholland based on unachieved goals. It was not irrational to give Mulholland some time to show results. (And, though hindsight is not the test, he did in fact produce results.)

As to the latter, Dr. Zissu forcefully argued that the model showed 100% losses to equity on every scenario.[11] But the business judgment rule (or the Operating Agreement) does not require defendants to be experts of Dr. Zissu's caliber. Based on the record, the Court cannot conclude that either Lem or Mulholland was visibly unqualified to devise and use the model. They were not of Dr. Zissu's view regarding what it said. The defendants did not blindly trust them. They tested the model and the difference between the various contending life expectancy approaches. That their testing was itself flawed (according to Dr. Zissu) does not deprive them of credit for trying; they used what they reasonably thought to be skilled testers. The Court rejects Huizenga's argument (*Pltf. Post-Trial Mem. of Law,* at 25) that defendants "knowingly and intentionally" adopted false mortality rates. It appears that the rates were seriously overoptimistic, but the Court does not find that defendants were consciously perpetrating a fraud by using them.[12]

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[11] Her testimony was not flawless, and issues still remain about whether she used the proper model or fully understood its operation and implications. She made a persuasive case, however. Yet from a business judgment perspective, the question is not whether the model was flawed, or predicted an equity loss in every scenario. The question is rather whether the defendants, not obliged to be full-blown experts, could believe Lem and Mulholland's contrary views. It bears emphasis that neither Lem nor Mulholland is a defendant here.

[12] Indeed, Huizenga itself argues that the June 30, 2005 Coventry deal obliged Ritchie to use those rates. To have rejected them would, then, likely have resulted in litigation with Coventry, which (given its nature) would surely have ended the entire transaction regardless of how the litigation turned out.

Thane Ritchie's October 2005 doubling of the Coventry bet in the face of these concerns is more troubling. As the Court held with respect to Counts I and II, defendants had an obligation to disclose the September 2005 events to Huizenga, so that Huizenga could look more knowledgeably at whether to make a second investment (as it did on October 1, 2005). Those events were material, given the concerns they raised. Thane Ritchie was accordingly obligated to be aware of, and to consider, them. *See Brehm* and *Paramount, supra.* But that does not, *per se,* mean that Thane Ritchie could not decide – as he did on or about October 12, 2005 – to double down on Ritchie's Coventry investment, despite resistance from several Ritchie insiders. Mr. Ritchie's obligation was to make an informed decision, not necessarily a correct one. In the context of a hedge fund, where (because seeking alpha is the starting premise) greater than ordinary risks are to be expected, his decision cannot subject defendants to liability unless it was not only risky, but either uninformed or irrational. *See Brehm* and *Venhill, supra.*

This is a close question. The Court concludes that viewed from the perspective of the Fund (as it must be under *Goldstein, supra*), Mr. Ritchie's decision to double down was not irrational even in light of the difficulty with Coventry's pricing. His stated concern (augmented, no doubt, by Reid Buerger's canny salesmanship) was that if Ritchie did not lock up Coventry, someone else would, or at least impinge on Ritchie's role as the first entrant in the inefficient and potentially lucrative life settlement market. *See* PX 866.[13] That concern makes no sense unless the underlying belief is that the market can indeed be lucrative. Mr. Ritchie's belief in that prospect was not uninformed or irrational; even knowing what Lem knew, some of Ritchie's personnel shared Mulholland's optimism until far later in the course of events.

After the "double down" decision, the focus became even more heavily on securitization. If that could be achieved, it would, among other benefits, "greatly reduce[] our risk of not being able to sell the policies." PX 177. That was surely an accurate perception. During late 2005 and early 2006, Mulholland was active in pushing for a Moody rating, which had apparently been expected by March 2006. *See* PX 913. A rating was achieved by early May, though its Baa level and high subordination requirement were "not good news." But defendants' actions during this period could not be said to be irrational or inappropriate. There was a sort of push-pull: the obligation to buy Coventry policies was the push, the prospect of securitization was the pull. In retrospect, if the contingent forward had been put in place – a problem which, as earlier noted, was driven in significant part by Ritchie's internal turmoil rather than by anything specific to the life settlements deal – a Moody A3 rating might have been obtained before "Spitzer Day." *See* pages 17-18 *supra.* Even in hindsight, pushing forward with securitization seems Ritchie's best course, preferable to either "buy-and-hold" (as Goldie-Morrison said, "[i]f you stopped in the middle, you would end up with something that you are now going to be holding for an extended period") or attempting to halt the entire process. Despite Mulholland's lack of success in selling any of the policies, no one *knew* at that point that no such sale could be made. On the other hand, if Spitzer had not sued Coventry it appears probable that a contingent forward would, one way or another, have been accomplished.

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[13] At the risk of overdoing a previous analogy (*see* page 2 *supra*), an early explorer's or fur trader's fear that someone else will get there first may lead to more risk-taking than a later traveler would feel comfortable with. That is the nature of exploration, however. If one is funding the explorer, one should expect it.

Overall, the Court accordingly concludes that even though defendants' Count VII conduct was dubious in numerous respects, Huizenga has not proved that it fell outside the business judgment rule or the exculpatory provisions of the Operating Agreement.[14]

Count VIII is less complicated. Huizenga charges, in essence, that defendants' mark-to-market fee approach was unreasonable and (quoting Rothschild, *see* page 15 *supra*) "funny money." Rothschild's point, however, was not that the fees were illicit; rather, his point – made pejoratively with reference to Mulholland's compensation, not Ritchie's compensation overall – was that the fees were being charged on unrealized profits. *See Id.* But a moment's thought will show that such a fee structure is pretty much unavoidable in hedge funds. No doubt it can be something of a sore point. *See* Shadab, *Hedge Fund Governance,* 19 Stan. J. L. Bus. & Fin. 141, 163, 176 (2013), observing that because "[h]edge fund managers have an incentive to overstate performance to increase their performance-based compensation" as well as "an incentive to overstate asset values to increase management fees," "[w]hen it comes to valuation, investors expect that managers have external oversight and well-documented practices and controls." Still, hedge funds are not contingent-fee enterprises. The fund manager expects fees whether or not the investment ultimately succeeds. Investors can exercise some degree of control through contractual devices such as "high water marks" or "hurdle rates," *see Id.* at 179-80; though neither was in place here, "co-investment" – a manager's own investment in the fund, such as Ritchie's here – "can be a substitute investment alignment device." *Id.* at 181.

Here, Huizenga's argument appears to rest on two bases. The first is that defendants "should not have charged any management fees on life settlements to the Fund" because the equity, in which the Fund was invested, turned out to be "worthless." *Pltf. Post-Trial Mem. of Law,* at 28. That is really a contingent fee argument, and fails for that reason. Huizenga's other argument is that the management fees were actually fraudulent because the Fund's equity investment not only failed, but was guaranteed to fail. "[T]heir models showed all along that the Equity would suffer a loss under any reasonable circumstances." *Id.* at 28. As an example of this alleged fraud, Huizenga points to the initial Moody rating (*Id.* at 27):

> "...when Moody's finally gave Defendants an indication of a preliminary rating – which was less favorable than Defendants had been seeking for months – Mulholland acknowledged it 'cost us roughly 7 million' on the mark to model for Equity. DX 138. Rather than mark the Equity down to reflect this hit, Defendants ignored the warning sirens to serve their own self-interest in generating fees. Instead of marking Equity down, they fraudulently marked it up to generate even more fees."

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[14] It is worth observing, moreover, that even if the most troubling part of that conduct (Thane Ritchie's decision to double down) had not occurred, the effect on Huizenga or the Fund itself is not clear. Ritchie would still have been bound by the June 30, 2005 Coventry agreement, including its "put" and its pricing provisions. It would seem that the securitization process would have unfolded in approximately the same way, though with smaller numbers. From this perspective, it would seem that the end result of smaller numbers might have been adverse to Huizenga and the Fund. Though there was concern that the initial securitization would not produce a return for the equity holder, the subsequent securitizations (Ritchie II and so forth) might have been a means to get a benefit to the equity holder. If the entire transaction had been smaller, the subsequent securitizations might have been postponed or cancelled.

The Court does not see the fraud in that example, however. First, the pre-rating "mark to model" reflected Mulholland's anticipated rating. That turned out to be wrong, but it was not fraudulent; there is no showing that Mulholland expected the lower rating Moody initially assigned. Second, after the preliminary rating was issued, Mulholland and defendants expected to be able to improve it. That was the purpose of the "contingent forward," for example. Defendants were entitled to take into account the existence of *any* rating (a favorable "first" for a life settlement securitization), coupled with their expectation of improving it. Third, defendants have never agreed that equity *always* loses under the Lem-Mulholland model, particularly given the possibility (for which Defendants were already actively planning) of multiple securitizations.

Thus, marking the equity up was mistaken, but Huizenga has not established that it was fraudulent. This extends to the rest of Huizenga's argument about management fees. Though Defendants were wrong, and both the Fund and Huizenga ultimately lost (in part because "Spitzer Day" made it impossible to complete the securitization process), the Court cannot find that Defendants' errors fall outside the scope of the business judgment rule or the Operating Agreement's exculpatory provisions.

5. Limitations

Lastly, Defendants offer a one-paragraph argument (*Defts. Post-Trial Mem. Of Law,* at 29) that Huizenga's claims are time-barred by the one-year contractual limitations period:

> "Because Huizenga was aware of the facts that underlie its DSA (Counts I and II) and breach of fiduciary duty claims (Counts V and VII) for nearly two years, but waited until after the one-year contractual limitations period expired to bring those claims, those claims are now time-barred and should be dismissed. *See* PPM, Ex. 10 at 82; *In re Dean Witter P'ship Litig.,* 1998 Del. Ch. LEXIS 133 at *1-2 (Del. Ch. 1998)."

Huizenga responds (*Pltf. Post-Trial Mem. Of Law,* at 13-14) that it was not aware of the facts underlying its claims "until after the NYAG [Spitzer] sued Coventry and Defendants began giving Huizenga conflicting explanations." For example, Huizenga points to an internal e-mail indicating that as late as October 24, 2006 Huizenga still thought only 40% of the Fund was invested in life settlements. *Id.*

Despite the PPM's Delaware choice of law provision, Illinois law controls as to procedural matters. *See Belleville Toyota v. Toyota Motor Sales, U.S.A.,* 199 Ill. 2d 325, 351-352 (2002). Statutes of limitations are procedural. *Id.* Accordingly, Illinois law governs the timeliness of Huizenga's claims. In any event, both Delaware and Illinois have adopted the "relation back" approach of F.R. Civ. P. 15(c)(2), which is the key doctrine at issue here. *See Chaplake Holdings, Ltd. v. Chrysler Corp.,* 766 A.2d 1, 6 n.3 (Del. 2001); *Porter v. Decatur Memorial Hospital,* 227 Ill.2d 343, 359 (2008).

This suit was filed on April 6, 2007. The Court rejects Defendants' argument that Huizenga knew – or even was on "inquiry notice" of – all of the facts necessary to its claims on or before April 6, 2006. That date was before the April 2006 and July 2006 "pie chart" investor

letters (*see* Count V) had even been issued, for example. Nor does the record show that Huizenga knew the facts on which liability is based under Counts I and II before April 6, 2006. The same applies to the facts underlying Count VII. And though Huizenga knew that management fees were being charged (Count VIII) before April 6, 2006, it did not know before that date that the Fund's entire investment would be lost, nor that the Lem-Mulholland model arguably predicted that result. Any claim as to which Huizenga was not on inquiry notice before April 6, 2006 was not barred by limitations when this suit was filed on April 6, 2007.

That also applies to claims asserted in Huizenga's amended Complaints. 735 ILCS 5/2-616(b), which governs relation back of claims asserted in a later-filed amendment, provides in pertinent part:

> The cause of action, cross claim or defense set up in any amended pleading shall not be barred by lapse of time under any statute or contract prescribing or limiting the time within which an action may be brought or right asserted, if the time prescribed or limited had not expired when the original pleading was filed, and if it shall appear from the original and amended pleadings that the cause of action asserted, or the defense or cross claim interposed in the amended pleading grew out of the same transaction or occurrence set up in the original pleading, even though the original pleading was defective in that it failed to allege the performance of some act or the existence of some fact or some other matter which is a necessary condition precedent to the right of recovery or defense asserted, if the condition precedent has in fact been performed, and for the purpose of preserving the cause of action, cross claim or defense set up in the amended pleading, and for that purpose only, an amendment to any pleading shall be held to relate back to the date of the filing of the original pleading so amended.

The purpose of the § 2-616(b) relation-back doctrine is to preserve causes of action against loss by reason of technical default unrelated to the merits. *Porter v. Decatur Memorial Hospital,* 227 Ill. 2d 343, 354 (2008). Courts should liberally construe § 2-616(b) to allow resolution of litigation on the merits and to avoid elevating questions of form over substance. *Id.* Of importance here, both the statute of limitations and § 2-616(b) are designed to afford a defendant a fair opportunity to investigate the circumstances upon which liability is based while the facts are accessible. *Id.* Thus, the rationale behind the "same transaction or occurrence" rule is that a defendant is not prejudiced if his attention was directed, within the time prescribed or limited, to the facts that form the basis of the claim asserted against him. *Id.*

Here, the "basis" of Huizenga's original complaint was its investment experience with Ritchie, just as the basis of Porter's complaint was his hospital experience with Decatur Memorial Hospital. The "attention is directed" requirement does not mean that the prior complaint(s) must have specifically alleged the facts now sought to be raised; such a rule would render amending to add new facts all but impossible. Rather, the defendant's attention must have been directed to the *overall* claim asserted by the plaintiff. Citing *In re Olympia Brewing Co. Securities Litigation,* 612 F.Supp. 1370 (N.D. Ill. 1985), *Porter* held that "[A] new claim will be considered to have arisen out of the same transaction or occurrence and will relate back if the new allegations as compared with the timely filed allegations show that the events alleged

were close in time and subject matter and led to the same injury." "Same injury" is construed fairly broadly (though not without some limits). For example, in *Porter* a new Count III, alleging misreading of a CT scan by Dr. Cross, an "apparent agent" of defendant Hospital, related back, even though the claim was not asserted until 3 ½ years after Porter's injury and even though "there were no references in any of plaintiff's previous complaints to Dr. Cross or to the CT scan." The Supreme Court considered the newly asserted CT scan allegations to relate to Porter's underlying claim that the Hospital mismanaged his care and his neurological status, even though the prior complaints had focused on his care in the ICU rather than on the misreading of diagnostic tools. All of the complaints concerned his ultimate neurological injury.

In this case, all of Huizenga's complaints relate directly to its single (albeit two-step) investment experience with Ritchie pertaining to Coventry and life settlements. Count V, concerning post-investment disclosures, is a logical outgrowth of Counts I and II, concerning pre-investment disclosure conduct; the same disclosure complaints underlie both, though the timing and details of course differ. Counts VII, concerning substantive investment management, and VIII, concerning management fees, also concern the same investment, though from the substantive standpoint rather than the disclosure standpoint. From the outset, Huizenga sought redress for the loss of its investment, just as Porter sought redress for his ultimate neurological injuries. The superficially different "injuries" alleged in *3d Am. Cplt.,* Counts I, II, V, VII, and VIII are all subparts of that overall injury, just as Porter's complaint about Dr. Cross' misreading of the CT scan was a part of his overall injury claims.

C. Relief

For the foregoing reasons, under Counts I and II Huizenga is entitled to rescission of its October 1, 2005 investment. Because the Court has ruled in Defendants' favor on Counts V, VII, and VIII, Huizenga's claims for compensatory and punitive damages need not be addressed.

As indicated earlier, this gives rise to a question regarding Huizenga's initial August 1, 2005 investment. The Court has not concluded that Counts I and II directly afford relief for that initial investment. Nor do Counts V, VII, or VIII do so. But because the result of Counts I and II is to give Huizenga relief for the second investment – that is, to hold that Huizenga should have been given better information before the October 1, 2005 investment – one must ask whether providing that same information, in the same time frame, would not also have enabled Huizenga to rethink the initial investment and take steps to withdraw that initial investment. It would seem inconsistent to treat the omitted information as material for purposes of the second investment, but not material for purposes of considering withdrawal of the first investment.

That problem arises because of a "fundamental dynamic" of hedge funds: "the propensity of investors to 'pull the plug' and cash out of a fund if they are dissatisfied." Shadab, *Hedge Fund Governance,* 19 Stan. J. L. Bus. Fin. 141, 145 (2013). Professor Shadab takes the position that investor "exit rights" are not just "fundamental" to the nature of hedge funds, but a good thing; they are "the primary reason why hedge fund agency costs are low." *Id.* at 148. Investor exit rights are impaired, however, if investors are not given information material to a decision whether to withdraw the investment. Here, the record shows that Huizenga was well aware of its exit rights, and disinclined to be passive about them. It exercised its withdrawal right twice.

The Court cannot conclude that DSA § 7323(a)(2) itself applies to Huizenga's withdrawal rights, whether those rights concern its initial investment or otherwise. A right to withdraw is not itself a purchase or sale, and does not become such unless and until it is exercised. Substantial case law forbids applying statutes like § 7323(a)(2) (which applies to the offer, sale, or purchase of a security) to a non-transaction. That has long been true regarding SEC Rule 10b-5, for example. *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit,* 547 U.S. 71, 80 (2006), citing *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975). True, the precise rule of *Blue Chip Stamps* was based more on "policy" than on the strict wording of Rule 10b-5. *Merrill Lynch, supra,* 547 U.S. at 80-81. But even a broader reading of Rule 10b-5 still requires wrongdoing "in connection with the purchase or sale of any security," not just free-floating wrongdoing unconnected with any actual transaction. *Id.* at 85, citing *SEC v. Zandford,* 535 U.S. 813, 826 (2002). Presumably statutes like DSA § 7323(a)(2) should be read similarly. And a compelling reason thus to limit the reach of § 7323(a)(2) lies in its remedy. It allows for rescission. But one cannot rescind a non-transaction.

Despite the apparent conceptual inconsistency, therefore, the Court declines to extend its ruling that § 7323(a)(2) applies to Huizenga's *second* investment in order to apply the same ruling to Huizenga's right of withdrawal regarding its *first* investment. A contrary approach would risk extending the reach of § 7323(a)(2) to the entire life of a hedge fund investor's transaction, since some right to withdrawal likely exists throughout most hedge fund investments. Such a regime might impel fuller disclosures, but it would also have the same adverse policy implications – including years-later hindsight arguments about loss causation, based on unverifiable claims about what an investor *might* have done – as led to the *Blue Chip Manor* buyer-seller rule.

Conclusion

For the foregoing reasons, the Court enters judgment in Huizenga's favor and against Ritchie Risk-Linked Strategies, LLC and Ritchie Partners, LLC, jointly and severally, on *3d Am. Cplt.,* Counts I and II, and also enters judgment in Huizenga's favor and against defendants Thane Ritchie and Ritchie Capital Management, LLC, on Count II, for rescission of Huizenga's October 1, 2005 investment. The Court enters judgment in defendants' favor on the remainder of the Counts I and II claims (relating to Huizenga's initial August 1, 2005 investment), which includes judgment in favor of the remaining defendants on Count II. Finally, the Court enters judgment in defendants' favor and against Huizenga on Huizenga's claims under *3d Am. Cplt.,* Counts V, VII, and VIII.

This disposes of the remaining claims herein and constitutes the final judgment of the Court. The matter is, however, set for a status hearing on March 3, 2015, at 9:30 a.m., regarding implementation of the rescission.

DATED: January 27, 2015

ENTER:

Circuit Judge