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Wreaths Across America
Photo courtesy of Arlington National Cemetery

Court Delivers Body Blow to Illinois FDA Ruling Takes Insurance Company Off the Hook For Liability Policies Stemming From Master Trust Debacle

CHICAGO – A federal judge ruled last week that the insurer for the Illinois Funeral Directors Association would not be responsible for claims resulting from litigation surrounding the association's beleaguered Master Trust.

In March 2009, Federal Insurance Company, which has provided up to \$5 million coverage in business insurance, including coverage for directors and officers of IFDA since 2005, filed suit against IFDA stating it should not have to pay the claims associated with the previous two lawsuits — one in Circuit Court of Kane County and the other by the six funeral directors in Cook County, which alleges mismanagement of the Preneed Trust the fund by IFDA that resulted in millions of dollars in losses. The insurer claimed that IFDA did not notify the company of claims in a timely manner.

In the U.S. District Court for the Northern District of Illinois, Judge Samuel Der-Yeghiayan sided with Federal Insurance Company ruling that IFDA failed to give the firm proper notice of claims against it.

Nearly five years ago, the Illinois Office of the Comptroller (IOC) conducted a compliance audit of the preneed trust, which revealed a deficit of \$39 million. The public accounting firm of McGladrey & Pullen was retained in February 2006 to

review the trust's finances. Two months later, IOC received the accountant's report, which verified the deficit in the preneed trust and charged that IFDA Services received \$8.6 million in excessive fees between 2000 and 2005.

According to the decision, IFDA received a letter from the IOC about the Trust discrepancies on June 21, 2006, but did not report it to Federal Insurance until Dec. 18, 2008. The letter alleged that, based on IOC's audits of IFDA, it appears that IFDA Services had taken "unauthorized excess fees of approximately \$8.6 million from fiscal year-end 2000 to fiscal year-end 2005." A copy of the comptroller's letter was not provided to Federal until Feb. 10, 2009. Since the policy required notice of the claim to be provided to Federal "as soon as practicable," the court found this two and half year gap as not meeting the requirements of the policy.

IFDA maintained that the comptroller's letter was not a claim because it did not set specific parameters for relief and was basically a summation of the audit.

"The undisputed facts show that Federal did not receive timely notice of [the] IOC letter," Der-Yeghiayan wrote in his opinion. He added that the defendants "have not pointed to sufficient evidence to show that they satisfied the notice of re-

quirements of the 2005 Policy, and thus, the policies do not provide coverage for the IOC letter, the litigation or the subpoenas.”

“That is \$5 million in coverage that basically evaporated,” said Edward Wallace, attorney from the firm of Wexler Wallace, Chicago, which is representing the six Illinois funeral directors suing IFDA. However, the \$5 million liability limit was far short of covering all of the losses suffered by funeral directors. “The trust could have benefitted from the infusion of \$5 million, certainly any money would have been welcomed by the funeral directors that have been harmed,” Wallace added. “This means that Chubb [parent of Federal Insurance Co.] is now off the hook pending an appeal on the issue.”

Failure to notify is a huge deal with insurance companies, according to David Nixon, Nixon Consulting, Chatham, Ill. “Since IFDA leadership at the time continually told its members, and myself as well directly under face-to-face questioning, that there was no problem, how could it have ended differently? Certainly the current IFDA board should have prepared for this possibility – what is their contingency plan in light of no coverage?” Nixon asked.

Duane Marsh, IFDA executive director, would not comment on the ruling other than to say that the association’s lawyers are considering whether to appeal the decision. The association has until Jan. 8, 2011, to make that determination.

“This could be devastating for IFDA since the legal costs to fend off these lawsuits will be staggering,” said T. Scott Gilligan, general counsel for the National Funeral Directors Association.

And there is more dark clouds on the horizon for IFDA with several lawsuits on the books. In late November 2008, two women in Kane County filed the first legal challenge against IFDA and IFDA Services, alleging violations of state consumer protection laws. Two months later, concerned about the fate of their investments and the impact upon their businesses, six funeral directors filed suit against IFDA, its past officers, directors and professionals, Merrill Lynch PFS, Merrill Lynch Life Agency, Merrill Lynch Life Insurance, Edward Schainker and other agents for Merrill Lynch, and several life insurance companies that sold or issued IFDA life insurance policies that were purchased with preneed trust funds. The complaint by the group that came to be known as the Illinois 6 was later amended in June 2009 based in part on financial records from the comptroller’s office obtained during discovery. It listed 19 causes of action against the defendants. It was on the heels of these two actions [March 2009] that federal Insurance filed its suit against IFDA.

“The summary judgment will be a disappointment to both the IFDA and the funeral homes that brought suit against the Association and Merrill Lynch,” said William Stalter, an Overland, Kan.-based attorney and founder of the Preneed Resource Company. “Litigation costs are mounting for both the IFDA and the plaintiff funeral homes, and the Association must continue to absorb those costs,” he added. “The plaintiff funeral homes hoped to recover a portion of their damages from the Federal insurance coverage. Now, the plaintiffs must look to Merrill Lynch for a recovery.”

Stalter noted that the survival of the IFDA may depend on its board taking the initiative to forge a settlement with the plaintiff funeral homes, Merrill Lynch [the fund’s trustee at the time] and the Comptroller’s office. “It is in the best interests of the association members, and the Comptroller, that the IFDA remain a viable voice for the industry,” Stalter said. “Federal was granted summary judgment because the IFDA failed to act promptly when faced with the Comptroller’s demands. Now without the prospect of recovering its legal expenses, the IFDA must cutoff the bleeding, and avoid one or more crippling judgments. The question will be whether the IFDA has the leadership to bring the requisite parties to the table.”

Also, the IOC has demanded that IFDA repay nearly \$10 million in administrative fees to the trust. State law caps fees trust administrators can take at 25 percent of earnings on those trust funds, but Dan Hynes, Illinois Comptroller, said an investigation by his office showed that IFDA Services took more than the legal amount from 2000-2006. “The IFDA was overcompensated by the trust,” Hynes said. “These excess management fees are a display of greed and a betrayal of the consumer trust that will not be tolerated. I am demanding that IFDA return the excess fees to the trust.”

Nixon further noted that there has yet to be a ruling on that payment. “Either one of these rulings could bankrupt the organization, in my opinion,” he added.

A ruling on other litigation against the association may be getting on track. According to Wallace, a hearing is scheduled for Monday (Dec. 20) in federal court, at which point the judge is going to set a discovery schedule and a potential trial date in the case of the six Illinois funeral directors suing IFDA. “If he sets a date for class certification that is sooner rather than later we will be quite pleased, and we’re going to push for it,” Wallace said. “The 20th is a big day for funeral directors.”

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