

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

CALVERT FUNERAL HOMES, LTD.,
CLANCY-GERNON FUNERAL HOMES,
INC., AARON TODD DEAN D/B/A BASS
PATTON DEAN FUNERAL HOME AND
TOBERMAN-DEAN FUNERAL HOME,
FRED C. DAMES FUNERAL HOMES,
INC., MCCRACKEN-DEAN FUNERAL
HOME, INC., KNAPP FUNERAL HOMES,
INC., DERIVATIVELY ON BEHALF OF
THE ILLINOIS FUNERAL DIRECTORS
ASSOCIATION AND I.F.D.A. SERVICES,
INC.

Plaintiffs,

-AGAINST-

ROBERT W. NINKER, PAUL G. DIXON,
KEVIN BURKE, ROB KONZELMANN,
JAMES D. BOSMA, GEOFFREY W.
HURD, CHARLES S. CHILDS, JR., BRENT
M. DAVIS, DEREK S. JOHNSON, JACK R.
KYNION, KING SUTTON, RANDALL L.
EARL, DAVID M. MCREYNOLDS,
DENNIS R. DAVISON, RICHARD D.
YURS, ERIC R. TRIMBLE, CHRIS
WOOLDRIDGE, DONALD HENDERSON,
STEVEN DAWSON, MICHELLE
HARRISON, MICHAEL SAYLES, VICKIE
DIEDRICH, LINDA ALLAN, MARK K.
CULLEN, MERRILL LYNCH, PIERCE,
FENNER & SMITH, INC., AND EDWARD
SCHAIKNER,

Defendants,

-AND-

ILLINOIS FUNERAL DIRECTORS
ASSOCIATION, I.F.D.A. SERVICES, INC.,

Nominal
Defendants.

Civil Action No. 091138824

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DERIVATIVE COMPLAINT

Plaintiffs, Calvert Funeral Homes, Ltd., Clancy-Gernon Funeral Homes, Inc., Aaron Todd Dean d/b/a Bass Patton Dean Funeral Home and Toberman-Dean Funeral Home, Fred C. Dames Funeral Homes, Inc., McCracken-Dean Funeral Home, Inc., and Knapp Funeral Homes, Inc. (collectively “Plaintiffs”), derivatively on behalf of the Illinois Funeral Directors Association (“IFDA”) and I.F.D.A. Services, Inc. (“IFDA Services”), bring this lawsuit against Robert W. Ninker, Paul G. Dixon, Kevin Burke, Rob Konzelmann, James D. Bosma, Geoffrey W. Hurd, Charles S. Childs, Jr., Brent M. Davis, Derek S. Johnson, Jack R. Kynion, King Sutton, Randall L. Earl, David M. McReynolds, Dennis R. Davison, Richard D. Yurs, Eric R. Trimble, Chris Wooldridge, Donald Henderson, Steven Dawson, Michelle Harrison, Michael Sayles, Vickie Diedrich, Linda Allan (collectively the “Director and Officer Defendants”), Mark K. Cullen,¹ Merrill Lynch, Pierce, Fenner & Smith, Inc. (“Merrill Lynch PFS”), and Edward Schinker (“Schinker”) (all are collectively “Defendants”). For their Derivative Complaint (“Complaint”), Plaintiffs allege upon personal knowledge as to their own acts, and as to all other matters upon information and belief based upon, *inter alia*, the investigation conducted by counsel, as follows:

INTRODUCTION

1. As part of their efforts to serve their communities by providing as many options as possible in the face of impending grief and great emotional need, duly licensed funeral homes across Illinois, including Plaintiffs, have offered contracts to individuals allowing them to plan ahead for their funerals. These contracts, referred to as Preneed Contracts, enable people to plan

¹ Mr. Cullen has been outside legal counsel for IFDA and the Trust for many years, possibly over two decades, but also acted as Managing Staff Director of IFDA for a period in 2008. For those actions Mr. Cullen undertook as part of his duties as Managing Staff Director, he is included in the defined term “Director and Officer Defendant.”

and pay for their funerals in advance of their death, thus eliminating many of the difficult decisions and financial burdens facing family and friends when a loved one passes away. Customers of funeral homes who signed Preneed Contracts are referred to in this Complaint as “preneed funeral planning customers.”

2. Preneed Contracts are likewise attractive to funeral home directors, whose mission it is to compassionately serve their respective communities’ families during their most difficult, grief-stricken, and often confusing times. Preneed Contracts serve this purpose by enabling funeral directors to handle a decedent’s funeral arrangements without burdening his or her family with the myriad choices, decisions and financial costs associated with an appropriate, dignified funeral.

3. A vast majority of funeral homes in Illinois, including Plaintiffs, are members of the IFDA. In 1979, IFDA’s wholly-owned subsidiary IFDA Services established the IFDA Preneed Trust (“Preneed Trust”), intended to provide an effective vehicle for preneed funeral planning customers to pre-finance their Preneed Contracts. The Preneed Trust program was intended to protect the funds deposited by preneed funeral planning customers by providing “optimum growth plus safety for [their] prefinanced funeral arrangements.” <http://www.ifda.org/benefits/indbenefits.php?b=15>.

4. In 1986, the Preneed Trust program was supplemented by the creation of a tax-exempt fund, which was to provide clients the option of having their preneed account grow on a tax-free basis (the “Preneed Trust Tax-exempt Fund”). IFDA explained to its members that the tax-exempt options required long-term commitments by the Preneed Trust, so each deposit commitment was to be for at least five years unless, in the interim, the preneed funeral customer died or, in the case of revocable Preneed Contracts as explained below, requested withdrawal in

writing. This option was and remains the preferred choice for approximately 75% of preneed funeral planning customers.

5. One of the benefits of tax-exempt funds is to avoid reminding the preneed funeral planning customer of his or her own mortality with an annual mailing of an interest reporting form (Form 1099). The mortality concept is critical to the satisfaction of the preneed funeral planning customer insofar as it allows choices to be made while sparing families the emotional and financial obligations associated with a funeral.

6. This lawsuit concerns the Preneed Trust Tax-exempt Fund. Thus, unless otherwise indicated, each future reference to "Preneed Trust" in this Complaint refers only to the Preneed Trust Tax-exempt Fund.

7. During the period relevant to this Complaint, Plaintiffs and other IFDA Members, acting as agents of IFDA, sold Preneed Contracts to their preneed funeral planning customers through IFDA Services, which acted as Trustee of the Preneed Trust for decades. The Illinois Comptroller's Office stripped IFDA Services of its trustee status in September 2007, and it was ordered to stop performing all activities related to the Preneed Trust on May 30, 2008.

8. During the decades that IFDA Services acted as Trustee of the Preneed Trust, it was the entity that made investment decisions and otherwise managed and administered the IFDA Preneed Trust program. In order to invest their preneed planning customers' funds in the Preneed Trust, funeral directors were required to sign a Participating Member Firm Agreement. Upon information and belief, the Preneed Trust currently has approximately 600-650 participating funeral home members, and the Preneed Trust currently holds the funds of approximately 49,000 preneed funeral planning customers across the State.

9. While IFDA Services was Trustee, the Preneed Trust program worked as follows: Once an IFDA Member funeral home signed a Preneed Contract with its preneed planning customer, the funds collected (where applicable, net of the up to 5% amount that the funeral director is allowed to retain by law) were invested in the Preneed Trust. The Preneed Contract specified whether the funds were to be deposited in the taxable or tax-exempt Preneed Trust. The preneed funeral planning customers could elect to have a Preneed Contract that was revocable or irrevocable, and guaranteed or non-guaranteed, options that are explained in detail below. When an individual with a Preneed Contract died, the Preneed Trust transferred that individual's funds, plus the interest earned thereon, and less administration fees, back to the IFDA Member funeral home, which used the funds to pay for their preneed planning customer's funeral. The net interest was to be available to account for any increased costs that may have been associated with the services and products (such as the casket) that were contracted for in advance, possibly many years earlier. In the case of a non-guaranteed contract, monies deposited would be applied toward the purchase price of the funeral, although the total price for the goods and services was not guaranteed. Typically, in the case of a non-guaranteed contract, merchandise and services were selected by the legal next of kin when the customer actually passed away. Any excess funds were then transferred to the decedent's estate, or if the preneed funds were insufficient to pay for the merchandise and services, the decedent's family would pay the difference. Thus, for both guaranteed and non-guaranteed contracts, the intention was that regardless of inflation, the principal and accrued interest would pay for the entire funeral or, for non-guaranteed contracts, possibly a portion thereof depending on the amount deposited by the preneed planning customer and the accumulated interest.

10. Each Plaintiff is a member of the IFDA, with voting rights and other benefits. As members of the IFDA, they were eligible to and did participate in the Preneed Trust program offered by IFDA Services.

11. Plaintiffs were informed and reasonably believed that the funds invested in the Preneed Trust were invested in safe and tax-exempt investment vehicles such as laddered AAA municipal bonds. As set forth in at least one version of the Participating Member Firm Agreement between IFDA Services and IFDA Members, the trust funds were to be placed in “high grade investments selected to provide earnings commensurate with safety of principal.”

12. Similarly, a letter from IFDA Services to IFDA Members entitled “IFDA Preneed Trust” promised that:

[w]e will invest your funds predominantly in quality, fixed income securities, such as U.S. Treasury securities, government agency obligations, certificates of deposit, corporate bonds, etc. A portion of the funds will also be placed in equities or mutual funds. These investments are used in an effort to enhance the yield available on fixed income securities. The mix of investments will change in accordance with financial and economic conditions.

IFDA Preneed Trust letter to IFDA Members, dated December of 1999.

13. These representations were in line with the objective shared by Plaintiffs and participating funeral homes of solving in advance many of the planning and financial concerns faced by preneed funeral planning customers. The ability to provide for safety of principal and a reasonable return to account for inflation enabled IFDA Members to ease the minds of their constituents.

14. IFDA’s representations were, however, false and part of a uniform course of conduct intended to attract the funds of preneed funeral planning customers for the benefit of the defendants and to the detriment of both IFDA Members and their customers. Specifically, instead of investing money to preserve principal and provide a safe return, IFDA Services

invested over \$190 million, constituting a substantial majority of the total Preneed Trust funds, in variable universal life insurance products issued by at least seven insurance companies, including over 120 “Merrill Lynch Investor Life” policies, policies that were sold to IFDA Services by an agent of Merrill Lynch PFS.

15. Upon information and belief, many of these insurance policies are modified endowment contracts; a fact which potentially destroys the tax-exempt status of the “investments” because it effectively prohibits the ability to access the value of the policies prior to the date of death of the insured. Modified endowment contracts, or “MECs,” are subject to an excise tax if they are terminated or if funds are withdrawn or borrowed before the insured reaches 59½ years old, in addition to the regular income tax that may be triggered upon accessing the policy proceeds prior to the death of the insured. Upon information and belief, the MEC policies insure the lives of key IFDA funeral director members whose customers, in the aggregate, made large deposits into the Preneed Trust as well as certain officers and directors of IFDA (“key man policies”). That key man policies were to be purchased as the primary “investment” of Preneed Trust monies was never disclosed to Plaintiffs or other participants in the Preneed Trust.

16. These insurance policies do not comport with the IFDA Services’ promises of using safe, high-grade, and tax-exempt investment vehicles. Among other problems, the policies that are MECs are not liquid investments because of the substantial adverse tax consequences incurred if a MEC policy’s proceeds are borrowed or withdrawn prematurely. Moreover, there is no connection between the expected life spans of the insureds and the need for funds with which to pay the funeral expenses of preneed funeral planning customers. For example, upon information and belief, the average age of the insureds currently is in the mid-60s and such

average age was much lower when the Preneed Trust purchased the policies. On the other hand, the average time period from the date that funds are deposited into the Preneed Trust to the date of the customer's death is approximately 7 to 9 years. As a result, the timing of the "maturity" of the trust assets (i.e., the date of death of the insureds) did not, and foreseeably would not, match the timing of the Preneed Trust's liabilities (i.e., paying for the funeral costs of the deceased customers).

17. Not only were the investment practices contrary to what had been promised, but IFDA Services engaged in a pattern and practice of deceit which involved periodically sending IFDA Members statements reflecting the prospective rates of return for taxable and tax-exempt Preneed Trust funds for an anticipated period of time. The interest rates reflected in these statements, however, were systematically inflated and had absolutely no relationship to the actual Preneed Trust earnings or performance. Consequently, Plaintiffs and participants in the Preneed Trust program were led to believe, falsely, that the Preneed Trust was performing well and as expected, when it was not.

18. The statements provided to IFDA members likewise failed to mention that the net asset value of the Preneed Trust was rapidly decaying, and that the primary reasons for the losses were because: (1) of the inappropriate and risky investment decisions made with respect to the deposited funds, particularly given the relatively short-term nature of those deposits; and (2), much like a Ponzi scheme and the escapades of Bernard Madoff, IFDA Services had been paying interest rates well above actual earnings for years, taking new deposits to pay returns to, and death claims of, pre-existing preened funeral planning customers. In addition, IFDA Services had been paying for the funeral costs of deceased customers whose deposits were used to pay premiums for insurance policies that would not likely mature for many years after the deposits

were made. Consequently, Plaintiffs have learned (beginning in the fall of 2007 through the spring of 2008) that the net asset value of the Preneed Trust began diminishing in 2001 and its losses have only accelerated dramatically since.

19. It was not in the IFDA's interest to apprise its members of these facts, however. As actually happened when the facts were made known, disclosure to IFDA members and others would have caused the level of new deposits made to the Preneed Trust to fall precipitously, thereby highlighting the cash flow crisis caused by choosing to invest substantially all of the trust assets into the insurance policies which did not match the Preneed Trust's liabilities and, in the case of the MECs, were highly illiquid.

20. Despite these numerous and significant problems, on information and belief, the Preneed Trust's financial adviser, Schinker of Merrill Lynch, Pierce, Fenner & Smith, Inc., and the current IFDA Board of Directors, were recommending continued investment in the Preneed Trust through much of 2008. Eventually, however, as the true financial condition of the Tax-Exempt Preneed Trust and Defendants' shenanigans came to light, an investigation believed to have begun with the Illinois Office of the Comptroller in 2006 revealed that, as of May 31, 2005, the tax exempt portion of the Preneed Trust had a deficit in excess of \$38.0 million. The situation has only become worse since then, with the current deficit being approximately \$ 59.0 million.

21. As a result of this enormous and avoidable deficit, there currently are insufficient funds in the Preneed Trust to pay what were supposed to be the prefinanced funeral expenses of preneed funeral planning customers. Plaintiffs are still morally, ethically, and contractually committed to perform the funeral services requested by their preneed funeral planning customers, even if at a significant loss. Indeed, Plaintiffs have, where necessary, supplied the

funds to make up for the deficit in the Preneed Trust, performing services and providing merchandise for which the Preneed Trust was supposed to pay, but for which it did not.

22. The purpose of this suit is to restore to the Preneed Trust the funds which have been dissipated and, in some circumstances, spirited away as a result of the Defendants' conduct. Plaintiffs are long-standing and highly respected funeral directors whose concern is for the well-being and peace of mind of their customers and customers' families. They are dedicated to their communities, and by making the Preneed Trust whole, Plaintiffs seek to fulfill the needs of their preneed funeral planning customers and further their commitment to easing the pain of the death of a loved one to the greatest extent possible, the very purpose of the Preneed Trust from its inception.

JURISDICTION AND VENUE

23. This Court has jurisdiction over this derivative action under 735 ILCS 5/2-209(a), 5/2-209(b) and 5/2-209(c) of the Illinois Code of Civil Procedure. Plaintiffs are businesses registered or incorporated under the laws of Illinois, and Defendants are Illinois corporations, residents, and/or have otherwise submitted to the jurisdiction of this Court by transacting business in Illinois, acting as a fiduciary in Illinois, breaching a fiduciary duty in Illinois, and acting as a director or officer of an Illinois corporation.

24. Venue is proper in this Court under 735 ILCS 5/2-101(1) and (2) because Defendants Charles S. Childs, Jr., Michelle Harrison, and Jack Kynion are located in this judicial district, as is the registered agent for Merrill Lynch, PFS. In addition, a portion of the transactions from which the causes of action arose took place in this judicial district.

THE PARTIES

25. Plaintiff Calvert Funeral Homes, Ltd. is an Illinois corporation with its principle office in Clinton, DeWitt County, Illinois; it operates six funeral homes in DeWitt, Piatt and

Macon Counties, Illinois. Calvert Funeral Homes, Ltd. is a member of IFDA, is a participant in the IFDA Preneed Trust program, and has deposited preneed planning customers' funds in the Preneed Trust.

26. Plaintiff Clancy-Gernon Funeral Homes, Inc. is an Illinois corporation operating four funeral homes across the state of Illinois, with its headquarters in Bourbonnais, Kankakee County, Illinois. Clancy-Gernon Funeral Homes, Inc. is a member of IFDA, is a participant in the IFDA Preneed Trust program, and has deposited preneed funeral planning customers' funds in the Preneed Trust.

27. Aaron Todd Dean operates Bass Patton Dean Funeral Home as a sole proprietorship in Hillsboro, Montgomery County, Illinois. The Bass Patton Dean Funeral Home is a member of IFDA, is a participant in the IFDA Preneed Trust program, and has deposited preneed planning customers' funds in the Preneed Trust. Mr. Dean also operates the Toberman-Dean Funeral Home as a sole proprietorship in Coffeen, Montgomery County, Illinois. The Toberman Dean Funeral Home is a member of IFDA, is a participant in the IFDA Preneed Trust program, and has deposited preneed planning customers' funds in the Preneed Trust.

28. Fred C. Dames Funeral Homes, Inc. is an Illinois corporation that operates a funeral home in Joliet, Will County, where it also maintains its headquarters. It also operates another funeral home in Morris, Grundy County, Illinois. Fred C. Dames Funeral Homes, Inc. is a member of IFDA, is a participant in the IFDA Preneed Trust program, and has deposited preneed planning customers' funds in the Preneed Trust.

29. McCracken-Dean Funeral Home, Inc. is an Illinois corporation that operates a funeral home and maintains its headquarters in Pana, Christian County, Illinois. McCracken-

Dean Funeral Home, Inc. is a member of IFDA, is a participant in the IFDA Preneed Trust program, and has deposited preneed planning customers' funds in the Preneed Trust.

30. Knapp Funeral Homes, Inc. is an Illinois corporation operating eight funeral homes across the state of Illinois, and maintains its headquarters in Watseka, Iroquois County, Illinois. Knapp Funeral Homes is a member of IFDA, is a participant in the IFDA Preneed Trust program, and has deposited preneed planning customers' funds in the Preneed Trust.

31. Nominal Defendant Illinois Funeral Director's Association is an Illinois not-for-profit corporation headquartered in Sangamon County, Illinois. Its street address is: 215 South Grand Avenue West, Springfield, Illinois 62704. IFDA is one of the largest state funeral directors associations in the country, with over 750 members statewide. Each of IFDA's Directors is also on the Board of Directors of its subsidiary IFDA Services.

32. Nominal Defendant IFDA Services is an Illinois corporation with its headquarters in Sangamon County, Illinois. Its street address is: 215 South Grand Avenue West, Springfield, Illinois 62704. IFDA Services offers funeral directors services including the IFDA Preneed Trust Program, for which it acted as trustee until late 2007 or early 2008 when it was found to be without a valid license. IFDA Services is a wholly owned subsidiary of the IFDA. IFDA Services' Board of Directors is made up of the same individuals as the IFDA's Board of Directors.

33. Defendant Robert W. Ninker was the Executive Director of IFDA from approximately 1971 to 1998, and is currently believed to be a resident of both Springfield, Sangamon County, Illinois and Marco Island, Collier County, Florida.

