

Clayton Smart

preneed funeral scandal has huge consequences

It seems Clayton Smart, the oilman from Oklahoma, is on a bit of a losing streak since trying his hand at funeral service.

First, Tennessee Chancellor Arnold Goldin temporarily froze the assets of Forest Hill business accounts. Goldin expressed displeasure when Smart attempted to obtain a \$140,000 check from the frozen assets. State officials saw that move as a blatant disregard of a court order. Smart's lawyer, Cannon Allen, called it a misunderstanding.

On Jan 22, the day before a scheduled hearing before the Tennessee Commissioner of Commerce and Insurance, the 67-year-old Smart – who owns 95 percent of Forest Hill Funeral Home – and minority co-owner Stephen W. Smith, filed for bankruptcy in U.S. Bankruptcy Court in the Eastern District of Oklahoma. Both have been accused of embezzling millions of dollars from funeral and cemetery trusts in Tennessee and Michigan. The states claim that \$76.5 million is missing.

The bankruptcy filing was a late, unexpected move. Smart and Smith, the oilman's attorney and friend of 15 years, filed a motion in Memphis federal court seeking to stay all proceedings in Tennessee until

bankruptcy proceedings took their course and it was determined how their assets would be affected. Tennessee canceled its hearing despite the eagerness of state officials to mete out some punishment to Forest Hill, which owns three funeral homes and

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cemeteries in the Memphis area and had told more than 13,000 people who had prearranged their funerals that they had to pay an additional \$4,000. In his defense, Smart has said that inflation and mismanagement of funds by previous parties demanded that he charge more for the prepaid funerals. He is suing Forethought Life Insurance,

Forethought Federal Savings Bank and Prime NOFOS, seeking a shortfall of about \$9 million in insurance policies. Forethought denies any wrongdoing.

But the bankruptcy filing didn't stop the Internal Revenue Service from raiding the offices of Trailer World of America in Muskogee, Okla., which is owned by Christopher Smart, the son of Clayton Smart. The IRS has declined to elaborate on the raid, but Tennessee officials have publicly alleged that Smart and Smith used shell companies to embezzle the millions that are now missing.

On Jan. 31, the bad news for Smart continued. Goldin ordered that the state take partial control of Forest Hill, and he added that he thought money tied to the business remained in danger from being taken by its owners. At that same hearing, Goldin extended the freeze on the pair's assets. The freeze covers their individual assets and the assets of Indian Nation LLC, one of the companies Smart and Smith control. The three funeral homes Smart controlled in Tennessee have gone into receivership and are still operating, though some in the funeral industry have wondered if the business can survive considering that it is operating at a deficit.

"The court has little confidence in the veracity of Mr. Smart or Mr. Smith and little confidence that they will - given any opportunity to get to these funds and use their funds and dissipate funds, that they would - that they would do so," Goldin said in court.

When contacted by phone, Smart was at his home in Oklahoma. He said he doesn't care if he has access to his money. "That's a kangaroo court, and it can't put a hardship on me," he said. "If you will wait, the whole story is going to come out in bankruptcy court, and when it gets through and everything is all cleared up, I think I will be totally exonerated," Smart said.

Unfortunately for Smart, his troubles are not just confined to Tennessee. In Michigan, his 28 cemeteries were seized and his assets there were frozen as well. Michigan has taken over operation of the cemeteries.

Allen, the attorney representing Smart and Smith, protested that his clients were innocent at the Jan. 31 hearing and asked how they could maintain their livelihoods when they couldn't access their assets. Goldin replied that any requests for expenses must be submitted to state officials.

Past Troubles

While Smart may find himself in hot water now, it isn't the first time he's been forced to defend himself in court. An article published in the Tulsa World newspaper details Smart's troubles in the past. World Projects Editor Ziva Branstetter searched her paper's archives and found that Smart had some other run-ins with the law - some of which were unrelated to his business dealings.

For instance, in 1981, Smart assaulted a volunteer Tulsa youth soccer coach, Herman Lipe. News accounts stated Smart was upset because the coach was not playing his 11-year-old son. A jury awarded the coach \$16,000, the newspaper reported.

And in 1988 - four years after Smart borrowed \$90,000 from a former business partner - he was sued for failing to repay the loan. Smart ended up declaring Chapter 7 bankruptcy but

it is unclear if he ever repaid the former business partner, the paper reported.

The Tulsa World also uncovered details about Smart's 1996 divorce from his wife of 36 years, Judith. Clayton Smart listed assets of more than \$1 million in court papers but only had "surplus income" of \$290 per month. A protective order filed by Judith Smart against her husband stated that he once "grabbed me from behind and tried to break my neck and choke me to death." Records show a judge granted Judith Smart the protective order, the newspaper reported.

A former officer of Quest Energy also sued Smart. In a deposition related to that lawsuit, Smart said he "lived off the land" and that his corporate title was "janitor." He yelled at attorneys, left the room repeatedly and slammed doors during the deposition, according to the Tulsa World. Smart was fined and sanctioned for his behavior. The former officer eventually won a \$70,000 judgment against Smart.

Smart and companies tied to him were also sued in 2005 by a Texas financial company that claimed it lent him \$3 million to buy propane that was never repaid.

A Maze of Money

According to court papers filed by the State of Tennessee in the Chancery Court of Shelby County, here are some pertinent details related to the Forest Hill acquisition that allegedly allowed Smart and Smith to embezzle millions:

- When Indian Nation acquired Forest Hill, the funeral service business had 12 trusts with about \$29.5 million in assets.

- Most of the assets in the trusts were life insurance policies that had a face value of \$22 million.

- In December 2004, Smart removed Forethought as trustee and appointed Community Trust Investment of Noblesville, Ind. At that point, Smart converted the trusts from an independent trustee that makes investment decisions to a self-directed trust.

- Community Trust told Forethought to cash in 13,465 preneed funeral

policies that had a cash surrender value of about \$12.3 million, which led to a loss of about \$9.55 million in preneed funeral contracts trust principal.

- After the cashing in of the policies, the trusts were left with about \$18.4 million in cash that was transferred from Forethought to Community Trust.

At that point, Smart and Smith had taken \$29.5 million in assets and whittled those assets down to about \$18.4 million. But now the pair had \$18.4 million to do with what they pleased. This, according to authorities, is when the embezzling began. The alleged ploy was described in court papers:

- Smart directed Community Trust to buy a \$10.7 million debenture that was issued by Quest Mineral & Exploration, a Nevada limited liability company based in Muskogee, Okla.

- Smart also directed Community Trust to invest \$6.7 million in trust funds with Citigroup/Smith Barney in Topiary Hedge Funds.

- Smart has denied that he has an ownership interest in Quest, but state officials state at least one transfer order indicates that he is the company's managing member.

- Once funds were received into the accounts mentioned above, money was then sent to other entities that Smart owned or controlled.

- Smart sent large amounts of money to the son of one of his former business partners.

- Quest was used as a vehicle to cover payment obligations that allowed Smart to buy 28 Michigan cemeteries. The funds were used to satisfy obligations on a promissory note that Smart agreed to assume in connection with the purchase.

According to investigators, this tangled web of financial maneuverings enabled Smart and Smith to siphon away millions of dollars in trust money that was supposed to pay for preneed funerals. There are other allegations, as well. An affidavit filed by Tennessee Investigator Trey King states that Smith and Smart wired money - apparently from Forest Hill trust funds - to Akiva Leyton of Los Angeles, whose father,

William Leyton, was busted for a wire fraud scheme that defrauded companies out of more than \$30 million. William Leyton is serving time in federal prison in Miami for the scheme. The two businessmen wired Akiva Leyton about \$1 million.

William Leyton reportedly helped Smart and Smith buy the 28 cemeteries in Michigan. Andrew Armstrong, who is serving a prison term in Texarkana, Texas, for embezzlement and failure to account for and pay employment taxes, was also among Smart's entourage when he met with Bloomfield Hills attorney Craig Bush, the owner of the cemeteries, in May 2004, according to a document filed with the Ingham County Court in Michigan.

Despite the fact that the businessmen submitted a forged \$100 million Treasury note that showed their ability to pay for the Michigan cemeteries, Bush continued to talk to them. On Jan. 25, Ingham County Circuit Court Judge James Giddings ruled that Bush couldn't touch more than \$22 million in his account. Investigators have said they believe Bush knew Smart intended to get the \$31 million he needed to buy the cemeteries from funds that were supposed to be used for cemetery operations. Michigan has appointed a conservator to operate the 28 cemeteries.

Another example of alleged fraud is contained in court papers filed by Tennessee, which state that since November 2006, Smart or his attorney, Allen, have repeatedly demanded that an \$836,265.66 distribution from Forest Hill trusts be made. On one occasion, Smart actually told First Hope Bank that Tennessee had ordered the distribution be made, and on another occasion he argued that he would be unable to continue operating the cemetery business without the money. Court papers state: "First Hope Bank has declined all of these requests and demands. Monies held in cemetery and funeral trust funds should only be accessed in accordance with state law."

But keep in mind, there are two sides to every story. Smart blames his troubles on Forethought Life Insurance, Forethought Federal Savings Bank,

Prime NOFOS, mismanagement and even inflation. In a March 8, 2006, interview taken on behalf of the Tennessee Department of Commerce and Insurance, Smart squarely pointed the finger at others. In that interview before several state investigators, Smart explained:

"Originally there was - we were - it was represented to us that there was \$23,155,504.84 in cash sitting at Forethought, OK? When we got to investigating that, we found out that there was no cash there, that those - that cash had been converted to insurance, OK?"

He went on to say: "That was before us. This Prime Succession did this. We don't know the time frame; we suspect it was early to mid-2003. It could have been before then."

When questioned whether there were 13,465 insurance policies, Smart answered no. He added, "It was all trust money. There's \$23,155,000 worth of trust money that Forethought and Prime Succession converted to insurance."

At that point, Kevin Harden, a certified public accountant, asked: "So that \$9 million loss, that wasn't a reduction in the face value?"

And Smart answered: "Well, there was no \$9 million loss, technically, because it was not - that was - the deal was that that was the cash value of the policies. Turn around and rewrite the insurance. But what happened, there really was \$23 million in there, OK? It was converted to insurance policies, and somebody pocketed between \$9 and \$10 million in Prime Successions. ... Commission. So to me, it was literally stealing from the people."

In that same March 2006 interview, investigators also showed particular interest in Quest Minerals and Smart's relationship to that firm. When asked what relationship he had to Quest, Smart said, "None. Never owned a piece of it; never was a stockholder in it. I did run it for them for awhile, OK?"

When pressed about the owner of the company, Smart said it was Erma Huckstep, or E.L. Huckstep. Investigators pointed out that Huckstep

was his next door neighbor, and Smart corrected them, stating that although he owns a house next to Huckstep, he no longer lives there, so she was his former next-door neighbor. When asked whether E.L. Huckstep owned 100 percent of the company, Smart answered in the affirmative.

After an investigation, auditors in Michigan determined that Huckstep is actually the aunt of Smart's wife, according to published reports.

Tennessee investigators have repeatedly said that Quest Minerals and Exploration is a virtually worthless company that has been used as a means to transfer money to Smart and his circle of friends. Officials say the company does not produce oil or gas. In an affidavit, King, one of the state investigators, stated: "I found nothing to indicate that payments were being made to seriously explore, develop or produce any oil or gas. Based on my review of the records, it appears that Smart and Smith used the (Quest) account primarily to move money from one or more accounts to accounts at other banks, and brokerage houses."

One of the main arguments between Smart and authorities is the question of the \$10.7 million debenture from Quest, which the government argues is worthless. Court papers filed by Tennessee state that at the end of 2004, the company had a negative net worth and a net operating loss. Court papers also state that the fair market value of its mineral leases is, at most, \$106,000. The Quest debenture has no market value, the state argues.

Smart Defends Himself

Smart and his representatives, however, said Quest has mineral rights that are worth millions of dollars and that the fixed-income security is worth a substantial amount. So while the state argues that millions have been plundered, Smart disputes that charge.

Bob Pipkin, a public relations consultant working for Smart, said that Michigan hired a geologist that says the Quest debenture collateralized by

oil and gas assets is worthless. "But Clayton Smart has a geologist that says that's worth a lot of money," he said.

Smart noted that the geologist Pipkin speaks of said the mineral leases backing up the Quest debenture are worth \$67 million. "And I'll get a third-party engineering firm to substantiate that," he added. "Even if he's 50 percent wrong, who cares?"

When Tennessee questioned Smart during summer 2006 about the appropriateness or safety of certain ventures, Smart offered all three funeral homes in Memphis as collateral to insure the ventures, Pipkin explained. The true value of the Quest assets behind the debenture is in question. "But what I can tell you is that the debenture is also backed by three funeral homes and three cemeteries that are valued slightly over \$15 million," Pipkin said.

Pipkin echoed what Smart told American Funeral Director in an earlier interview: that his client would have never bought Forest Hill in the first place had he known to what degree the prepaid funerals were underfunded.

While many have criticized Smart's investments as risky, Pipkin pointed out that those investments were yielding about 15 percent a year until they were liquidated at the request of the current trustee. Asked whether it was appropriate to put some money from funeral trusts into a hedge fund, like Smart did, Pipkin said, "The particular hedge fund in which he invested was a very conservative hedge fund. They were making very careful and prudent investments. The word hedge fund is very loaded."

Pipkin stuck up for Smart as a good man who is doing the best he can to help families in need. "Here's what's not getting out ... If you read the media coverage, you would think that when somebody goes to Forest Hill, Clayton Smart tells them they are out of luck, that it will cost \$7,000 to bury you. That's not what's happening. If you go there with a prepaid plan, he says this plan was underfunded when I purchased the home. The actual value of your portion of the plan is worth whatever - typically \$800 to \$1,200 - it could

be more or less depending on when you bought the policy. So he will give you that and bury you at the cost of \$4,000 minus the true value of your policy."

Pipkin explained that while the state contends there was \$22 million in trust funds when Smart bought the business, they are decidedly wrong. "That \$22 million was the face value of the life insurance - not the present value," he said. "It was paying 2 percent a year. When the policies were purchased in 1998, Forethought Life Insurance paid a \$3 million commission to the then ownership of Forest Hill for buying the life insurance through Forethought. So basically, 18 percent of the value of the trust fund which was underfunded anyway went as commission to previous owners. There was no way to ever catch up."

The Quest debenture is paying 4 percent a year compared to the paltry 2 percent that was being paid on the Forethought life insurance policies, Pipkin added. The 2 percent was a ridiculously small return when you consider that when the policies were bought in 1998, federal treasuries were paying 5 percent, Pipkin said.

Smart, for one, is adamant that the wrong that was perpetrated on customers was not his doing, but rather Forethought's and the previous owner of Forest Hill, Prime Succession. "Would you think it's wrong to convert almost \$20 million in cash to \$14 million in life insurance and pay off Prime people over \$3 million in commission?" he asked. "Well, we have proof that all of that occurred."

Smart sees the day the full truth comes out as a dreary day for funeral service - especially in Tennessee. "What they are afraid of is that I'll continue to pursue this Forethought thing, and it'll get a hell of a lot bigger, and it will," he said. "I'll say a lot of funeral homes converted cash to insurance policies in the 1990s, which was illegal until 2002. I'd say it's going to raise a big stink in Tennessee. They might be extremely embarrassed."

Pipkin blasted state investigators for having an unrealistic idea of how much money was in trust when Smart took over the funeral homes and cemeteries. "You can't look at an account like that and say you have \$19 or \$20 million when in point of fact that was the face value of life insurance and not the present value. It's like having a savings bond. You don't wake up on Christmas morning and say you have \$500. That \$500 won't be there for a long time."

It is unfortunate that media coverage has made such a villain out of Smart, Pipkin said. "(Media accounts) say he's failing to honor the contracts. While that may literally be true - because they have a contract to pay for it all and show up and they have to pay for something - but that gives you the impression that nothing is being done to try to meet the needs of these policy holders when in fact the proportional value of the trust funds are being credited to their account, and they are providing funerals at their cost. The typical price in Memphis is around \$7,000, but they are providing funerals for \$4,000 less the amount in trust. Forest Hill and Clayton Smart have been doing what they think is prudent by eating the profit on every funeral, and they are engaged in litigation with previous trustees trying to recover what they feel are shortages in the trust fund," Pipkin said.

Smart said that the media is about "sensationalism." He added, "If they knew the trust story and would report the true story, which they have been given, it would be nice."

So, what's next for Smart? "I don't know what I'll do. I'll do something," he said. "But who knows what the next opportunity is. I'll get through all of this. I'm not necessarily going to be totally out of the funeral and cemetery business."

The Death Industry Reacts

Most funeral directors agree that Smart has given a black eye to funeral service. The scope of the scandal and the breadth to which it has been publicized have undoubtedly made it a little bit harder to sell a customer a preneed

funeral today than it was to sell the same policy a year ago.

"If there is a bad egg in the state, it's going to make news, and if there is a bad egg in each state, people will hear about it once a week and it will be an issue," cautioned Curtis Rostad, executive director of the Indiana Funeral Directors Association, a former funeral home owner and an expert on preneed contracts. That's why it's more important than ever for funeral directors to be proactive when explaining how the preneed contract works and why it is a safe and worthwhile investment vehicle.

While some in the industry fear a widespread backlash among the consuming public and wonder whether they will want to insist on knowing how the prepaid money is invested, others, such as Quinn Eagan, president of Preneed Funeral Program, think the response will be rather muted. "I don't think those who want to know (how the money is invested) make up 1 percent of the purchasers unless there was a recent preneed scandal in their town," Eagan said. "Families believe in and trust funeral homes, and 99 percent of all funeral homes deliver on that well placed trust and confidence," he said.

Eagan added that the industry would be well served if it made preneed fraud a nonissue for consumers. He noted that thefts occur in all kinds of businesses, but that if there was bonding on the trust side to guarantee funds (which exists in some states) just like there are guarantees on the insurance side, the focus would be on the crooks rather than the defrauded customers. "With banks being robbed every week, should you not put money in them?" he asked. "By having the deposits safeguarded, a lot of mattress money and freezer money have migrated to banks."

In the Memphis area, reactions to the Clayton Smart scandal varied. Some funeral directors, such as Al Tacker, owner and president of Bartlett Funeral Home, in Bartlett,

Tenn., shied away from preneed and urged clients to take a wait-and-see approach regarding developments tied to Clayton Smart.

Others, such as Brent Taylor, president of Brentwood Funeral Services, ramped up their preneed programs and managed to boost their revenue. David Keller, president of High Point Funeral Chapel in Memphis, actually attributes much of his success to the Forest Hill debacle. About a year ago, when he learned that Forest Hill had stopped honoring the National Burial Policy, he was asked to assume that responsibility, and he was given a retainer to do so.

Keller set up an emergency transfer program to help the more than 13,000 people who had Westminster policies through Forest Hill. "We've not lost a dime on those funerals," Keller said. "We get the face value of the funeral, a retainer, plus the confidence of the entire family."

Keller added that most people who had National Burial or Westminster policies did not buy "Cadillac" policies and that many individuals actually upgrade the type of casket they want to be buried in. "So that allows us to do the funeral and not lose anything," he said.

Keller said under the emergency transfer package, his funeral home does not put any money into trust, but rather into insurance policies. "We encourage people to start making payments - \$20 or \$30 a month for a \$3,000 policy or so and get themselves under the umbrella of insurance."

Those who are affected by the Forest Hill scandal should not simply sit on their hands, Keller argued. "That's not wise," he said. "A class-action lawsuit takes on average 11 years to resolve. These people are dying now. You might not see those class-action lawsuits coming to fruition until 2014. Get yourself under an insurance policy."

Since opening his doors in July 2005, High Point Funeral Chapel has served about 550 families, Keller noted. He estimated that about half

of his customers were those affected by the Forest Hill mess. He also credits the fact that he offers funeral service at a discount to competitors - his services cost on average 60 percent less, he said. Keller has been so successful that he plans on opening a second funeral home in the immediate future to go along with his mortuary and flower service.

Despite recent problems relating to preneed, Keller still thinks members of the public should make what he said is a smart investment. "I think that people should prearrange because every year funerals go up," he said.

Joshua Slocum, executive director of Funeral Consumers Alliance, has continued to field a bevy of complaints relating to the Forest Hill situation. "I fear what will happen to customers who die before this is settled," he said. "The state hasn't given the public any indication at all what they may expect. Naturally, customers are apprehensive and desperate for information."

So far, although Tennessee has alleged that Smart has engaged in illegal activities, no criminal charges have been filed in the case. And Smart said he had no knowledge of any pending criminal charges. "They can do whatever they want to," he said. "There is only one thing in this world you gotta learn: You just worry about what you can control, not what you can't control. I just have to react to whatever they do."

While the debacle has created opportunities for some in the Memphis area, it has also made headlines across the country and throughout the world. Even if most funeral directors are doing their jobs and honestly serving their communities, there is no question that the Forest Hill situation - regardless of whose fault it is - has hurt funeral service as a whole. •

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