

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
SCHAIKER,

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 Schainker (“Schainker”) (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, Schainker 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.

34. Defendant Paul G. Dixon was the Executive Director of IFDA from approximately 1998 – January of 2008, when he either resigned or was terminated from IFDA. He is believed to be a resident of Springfield, Sangamon County, Illinois.

35. Defendant Kevin Burke is a Certified Public Accountant and has been the IFDA's Controller from approximately 1999 – 2001 and 2007 – mid-2008. Upon information and belief, Mr. Burke is no longer employed by the IFDA. Mr. Burke is a resident of Chatham, Sangamon County, Illinois.

36. Defendant Rob Konzelmann is a Certified Public Accountant and was the IFDA's Controller from approximately 2001 – 2007. Mr. Konzelmann is a resident of Williamsville, Sangamon County, Illinois.

37. Defendant James D. Bosma, is the current President of the IFDA and IFDA Services' Board of Directors, an appointment that will end in June 2009. Mr. Bosma was a member of the Preeed Trust Committee from June 2007- June 2008, and was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the Board. Mr. Bosma is a resident of Morrison, Whiteside County, Illinois.

38. Defendant Geoffrey W. Hurd was the President of the IFDA and IFDA Services' Board of Directors from June 2007- June 2008 and serves on the Audit Committee. Mr. Hurd was also present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the Board. Mr. Hurd is a resident of Knox County, Illinois.

39. Defendant Charles S. Childs, Jr. was President of the IFDA and IFDA Services' Board of Directors from June 2006 – June 2007, was a member of the Trust Committee from June 2007-2008, and has been a member of the Audit Committee since June 2007. Mr. Childs

was also present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the Board. Mr. Childs is a resident of Chicago, Cook County, Illinois.

40. Defendant Brent M. Davis was President of the IFDA and IFDA Services' Board of Directors from June 2005 – 2006, and has been a member of the Audit Committee since June 2006. Mr. Davis was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the Board. Mr. Davis is a resident of Carlinville, Macoupin County, Illinois.

41. Defendant Derek S. Johnson was President of the IFDA and IFDA Services' Board of Directors from June 2004 – June 2005 and was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the Board. Mr. Johnson is a resident of Benton, Franklin County, Illinois.

42. Defendant Jack R. Kynion was President of the IFDA and IFDA Services' Board of Directors from June 2003 – June 2004, was a member of the Investment Committee from June 1999 – June 2000, and the Audit Committee from June 1999 – June 2000 and since June 2006. Mr. Kynion is a resident of Northbrook, Cook County, Illinois.

43. Defendant King Sutton was President of the IFDA and IFDA Services' Board of Directors from June 2002 – June 2003, and was a member of the Audit and Investment Committees from June 1999 – June 2000. Mr. Sutton is a resident of Paris, Edgar County, Illinois.

44. Defendant Randall L. Earl was President of the IFDA and IFDA Services' Board of Directors from June 2001 – June 2002, and was a member of the Audit and Investment Committees from June 1999 – June 2000. Mr. Earl is a resident of Decatur, Macon County, Illinois.

45. Defendant David M. McReynolds was the President of the IFDA and IFDA Services' Board of Directors from June 2000 – June 2001, was a member of the IFDA Audit and Investment Committees from June 1999 - June 2000, and has been on the Audit Committee since June 2006. Mr. McReynolds was a member of the Trust Committee from June 2007 – June 2008. Mr. McReynolds was also present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the Board. Mr. McReynolds is a resident of Marion, Williamson County, Illinois.

46. Defendant Dennis R. Davison was President of the IFDA and IFDA Services' Board of Directors from June 1998 – June 1999, and was a member of the Audit and Investment Committees from June 1999 – June 2000, and June 2006 – June 2008. Mr. Davison is a resident of Decatur, Macon County, Illinois.

47. Defendant Richard D. Yurs was President of the IFDA and IFDA Services' Board of Directors from June 1991 – June 1992, and was a member of the Audit Committee from June 2006 – June 2007. Mr. Yurs is a resident of Geneva, Kane County, Illinois.

48. Defendant Eric R. Trimble was a member of the IFDA's Audit Committee from June 2006 – June 2007, and the Trust Committee from June 2007 – June 2008. Mr. Trimble is a resident of Moline, Rock Island County, Illinois.

49. Defendant Chris Wooldridge was the Vice President of IFDA's Board of Directors from June 2007 – June 2008, and currently serves as President Elect, a position he will hold until June 2009. Mr. Wooldridge was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the Board. Mr. Wooldridge is believed to be a resident of Brighton, Jersey County, Illinois.

50. Defendant Donald Henderson has been a Regional Director on the IFDA's Board of Directors since 2005 and was present at the June 25, 2008 meeting in which Plaintiffs made a

demand upon the Board. Mr. Henderson is believed to be a resident of Pekin, Tazewell County, Illinois.

51. Defendant Steven Dawson has been a Regional Director on the IFDA's Board of Directors since 2005 and was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the Board. Mr. Dawson is believed to be a resident of Franklin Park, Cook County, Illinois.

52. Defendant Michelle Harrison is believed to be a Regional Director on the IFDA's Board of Directors and was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the Board. Ms. Harrison is believed to be a resident of Blue Island, Cook County, Illinois.

53. Defendant Michael Sayles has been a Regional Director on the IFDA's Board of Directors since approximately 2006 and was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the Board. Mr. Sayles is believed to be a resident of Joliet, Will County, Illinois.

54. Defendant Vickie Diedrich has been a Regional Director on the IFDA's Board of Directors since 2007 and was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the Board. Ms. Diedrich is believed to be a resident of Springfield, Sangamon County, Illinois.

55. Defendant Linda Allan has been a Regional Director on the IFDA's Board of Directors since 2007 and was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the Board. Ms. Allan is believed to be a resident of Collinsville, Madison County or St. Clair County, Illinois.

56. Defendant Mark K. Cullen of Sorling, Northrup, Hanna & Cullen is and has been both the IFDA and the Preneed Trust's counsel for many years, possibly for over two decades. He was the acting Managing Staff Director of the IFDA beginning in February 2008 for an unknown period of time. Mr. Cullen was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the Board. Mr. Cullen is believed to be a resident of Springfield, Sangamon County, Illinois.

57. Defendant Merrill Lynch PFS is a Delaware corporation that maintains its headquarters in New York and has offices around the world. Its registered agent is located in Chicago, Cook County, Illinois. Upon information and belief, Merrill Lynch PFS and its agent Schainker sold IFDA Services the life insurance policies at issue in this lawsuit. Merrill Lynch PFS continues to maintain offices and conduct business within the state of Illinois.

58. Defendant Edward Schainker is an employee of Merrill Lynch PFS and is based in its Springfield, Illinois office. Schainker has been the financial advisor for the Preneed Trust fund since approximately the mid-1980s and, upon information and belief, has acted as an agent for Merrill Lynch PFS, and sold IFDA Services the life insurance policies at issue in this lawsuit. Mr. Schainker is a resident of Springfield, Sangamon County, Illinois.

SUBSTANTIVE ALLEGATIONS

59. IFDA is a not-for-profit corporation that was originally founded in 1881. It is currently one of the largest state funeral directors associations in the country, with over 750 members statewide. Its stated goal is to provide resources to support its members and make them professionally, ethically, and operationally superior, and to advocate for the funeral service profession.

60. IFDA Services was incorporated in 1976, and is a wholly-owned subsidiary of IFDA. It is a for-profit corporation that offers funeral directors services targeted to the needs of

their business, including the IFDA Preneed Trust program. IFDA Services acted as trustee of the Preneed Trust Program for decades until, in September of 2007, the Illinois Comptroller's Office *ab initio* stripped IFDA Services of its license to act as a trust business, and on May 30, 2008 the Illinois Department of Financial and Professional Regulation issued IFDA Services an Order to Cease and Desist, finding that it was unauthorized to conduct a trust business. Shortly thereafter, Merrill Lynch Bank and Trust Co. FSB ("MLBTC") took over as temporary trustee, a position that became permanent on November 3, 2008.

61. Plaintiffs are all well-respected funeral homes which are family-owned and operated and have been serving their communities for generations. They are highly dedicated to the families and communities they serve, and are fully aware of the important role they play in providing dignified funeral and memorial services.

62. Most funeral homes, including Plaintiffs', offer customers the ability to plan ahead for their funeral services, merchandise choices, and costs through the use of preneed contracts. Doing so alleviates the burdens placed on families upon the passing of a family member by eliminating the financial burden of a funeral and minimizing the number of difficult decisions to make in preparation for the memorial and funeral service.

63. The sale of funeral and burial services on a preneed basis is governed by Illinois' Funeral or Burial Funds Act, 225 ILCS 45/1 *et seq.* ("the Burial Act"). Under this statute, when a consumer pays for a preneed contract, the funds are to be held in trust by a duly authorized trustee until the individual either withdraws the funds or the funds are used for their funeral and burial services.

A. Explanation of the Various Preneed Contracting Options

64. During the time IFDA Services acted as Trustee of the Preneed Trust, it offered two principal kinds of contracts: guaranteed and non-guaranteed. As explained by the Illinois Comptroller's Office:

- A guaranteed contract is a pre-need contract in which you pay for the goods and services you have selected in full at the same time you sign the contract. This ensures that the price you have paid is fixed, and that there will be no additional charges at the time of need, provided you do not add any goods or services in the future. Though the seller does absorb the interest earned on this money between the time it is paid and the time it is needed, he/she also absorbs the increasing cost of the goods and services, which typically rise over time.²
- A non-guaranteed contract is a pre-need contract in which prices are not fixed. Since this contract does not lock in specific prices, any money paid on it is simply a deposit to be applied to the total bill at the time of need. If the money paid on the contract exceeds the cost of the goods and services contracted for, the excess funds are returned to the consumer.

(<http://www.ioc.state.il.us/office/CCBT/index.cfm?Fuseaction=showPage&PageID=90>).

65. Within each guaranteed and non-guaranteed contract, the other preneed contracting options include: a) taxable or tax-exempt trust options; and (b) revocable or non-revocable contracts. As explained in an IFDA letter to its members:

- Taxable versus Tax-exempt: The Preneed Trust was created in 1986, and allowed preneed funeral planning customers to have their trust accounts grow tax-free. The main difference from the taxable trust is that, “[s]ince the tax-exempt program requires long-term commitments by IFDA Preneed Trust, *your deposit commitment must be for a minimum of five years*, unless the client dies or requests a withdrawal in writing.”

² For guaranteed contracts, the excess interest earned on the preneed planning customer's funds, if any, may be retained by the funeral home. Some funeral homes, including some of those owned and operated by Plaintiffs, return any excess interest above and beyond that required to pay for the contracted funeral services and merchandise.

IFDA Preneed Trust letter to members, dated December of 1999 (emphasis in original).

- Revocable versus Non-revocable: Revocable contracts can be cancelled for any reason upon a request in writing from the preneed funeral planning customers. Non-revocable contracts cannot be canceled at any time, and as the Preneed Contracts explain, non-revocability is “necessary for certain federal, state, or local benefits eligibility.” See Funeral Trust – Guaranteed Form contract, ¶5.

B. Participating Member Firm Agreements

66. To facilitate funeral pre-planning programs, Plaintiffs and approximately 600-650 other IFDA members signed Participating Member Firm Agreements (“PMF Agreements”) with IFDA Services during its time as Trustee.

67. According to at least one version of the PMF Agreement, each funeral home was an authorized agent of IFDA Services. At all times, however, Plaintiffs and other similarly situated funeral homes were authorized to accept Preneed Trust contracts on behalf of the IFDA.

68. The Preneed Contracts created by IFDA Services as Trustee but signed by participating funeral homes and their preneed funeral planning customers provided that the funds would be held in the Preneed Trust until the beneficiary’s death. At that time, the contract required that the funeral home “shall provide a funeral with the [specified] merchandise and services.” As allowed pursuant to the Burial Act, the contract also entitled the funeral home provider to charge administrative fees in an amount ranging from 1-5% of the principal and/or 1-25% of the earnings on the invested funds, depending on the terms of the contract.

C. Promises Made and Broken

69. While acting as the Trustee and investing the Preneed Trust funds, IFDA was required to “exercise the judgment and care under the circumstances then prevailing that persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in

regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital.” Burial Act, 225 ILCS 45/4a.

70. Similar duties and requirements are set forth in Illinois’ Prudent Investor Rule for Trustees, also applicable to IFDA Services, which include:

(1) The trustee has a duty to invest and manage trust assets as a prudent investor would considering the purposes, terms, distribution requirements, and other circumstances of the trust. This standard requires the exercise of reasonable care, skill, and caution and is to be applied to investments not in isolation, but in the context of the trust portfolio as a whole and as a part of an overall investment strategy that should incorporate risk and return objectives reasonably suitable to the trust.

(2) No specific investment or course of action is, taken alone, prudent or imprudent. The trustee’s investment decisions and actions are to be judged in terms of the trustee’s reasonable business judgment regarding the anticipated effect on the trust portfolio as a whole under the facts and circumstances prevailing at the time of the decision or action. The prudent investor rule is a test of conduct and not of resulting performance.

(3) The trustee has a duty to diversify the investments of the trust unless, under the circumstances, the trustee reasonably believes it is in the interests of the beneficiaries and furthers the purposes of the trust not to diversify.

(5) The trustee has a duty to pursue an investment strategy that considers both the reasonable production of income and safety of capital, consistent with the trustee’s duty of impartiality and the purposes of the trust. Whether investments are underproductive or overproductive of income shall be judged by the portfolio as a whole and not as to any particular asset.

(6) The circumstances that the trustee may consider in making investment decisions include, without limitation, the general economic conditions, the possible effect of inflation, the expected tax consequences of investment decisions or strategies, the role each investment or course of action plays within the overall portfolio, the expected total return (including both income yield and appreciation of capital), and the duty to incur only reasonable and appropriate costs.....

760 ILCS 5/5 (1), (2), (3), (5), (6).

71. Accordingly, in the PMF Agreements between IFDA Services and participating funeral homes, IFDA Services, as Trustee of the Preneed Trust, committed to “plac[ing] trust funds in high grade investments selected to provide earnings commensurate with safety of principal,” and agreed to “to manage the funds using a prudent investment philosophy to provide a reasonable rate of return.”

72. The following are among the many representations made by IFDA Services to IFDA members in a letter that appears to be dated December, 1999, sent in connection with its role as Trustee:

- [IFDA Services] will invest [the Preneed Trust] 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 these 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.
- Interest earnings will be based on projected rates specified for the time period in which the funds are received. Since 1980, when the [taxable Preneed Trust] program began, [IFDA Services has] been fortunate that the earnings always met projections, although that may not always be the case.
- The designated rate of earning is projected for a one year period. At the end of the period, [IFDA Services, Inc. will notify participating members] of the anticipated rate which will be valid for the next investment period.
- [IFDA Services] will provide a report on all trust accounts to you and to the Office of the Comptroller on an annual basis, so that you do not have to keep track of trust principal, interest, withdrawals and totals.
- In summary, [the preneed planning customer] has protection of the principal and the anticipated earnings, and [the participating funeral home is] released from much of the administrative responsibility.

The letter makes no mention of the purchase or holding of insurance policies.

73. Contrary to these promises and unbeknownst to funeral homes and their clients depositing money in the IFDA Preneed Trust, IFDA Services, through the Director and Officer Defendants, made a “significant investment” of a “large pool of IFDA assets” in key man life insurance policies in addition to a variety of equity and bond investments. *See* IFDA Trust Update Memo, dated May 13, 2008; *See also* IFDA Questions and Answers, <http://www.ifda.org/trustupdate.html>.

74. At an unknown time, IFDA Services engaged Merrill Lynch PFS and its agent and employee, Schainker, as an investment or financial advisor. Upon information and belief, Schainker recommended to IFDA Services that the Preneed Trust invest in the key man life insurance policies referred to above and ultimately sold it policies not only on lives unrelated to the preneed funeral planning customers, but also that did not confer a fixed death benefit. Rather, the policies purchased by IFDA offer a death benefit pay-out dependent on the performance of the investments made within the policies. Upon information and belief, Schainker and perhaps others were paid significant commissions in connection with the sale of the insurance policies to the Preneed Trust. Such commissions, in effect, should have comprised moneys in the Preneed Trust but were instead used to pay premiums in respect of such policies, further depleting the available trust assets.

75. Upon information and belief, many of these insurance policies are modified endowment contracts, or “MECs,” that are subject to a 10% excise tax if they are terminated or if funds are withdrawn or borrowed before the insured reaches 59½ years old. Such policies are also subject to the regular taxes that may be triggered on any deferred gain inside of the policies if they are liquidated for any reason prior to the death of the insureds. Among other problems, because of the tax consequences of such a transaction, these MECs seriously impede IFDA

Services' ability to liquidate the investments to pay death claims or otherwise reinvest the funds in more appropriate investment vehicles.

76. Based on documents available to Plaintiffs and their counsel, it appears as though a substantial portion of the total tax-exempt Preneed Trust fund is currently invested in life insurance policies, many of which are believed to be MECs. As of May 2007, the Preneed Trust Fund possessed approximately 300 life insurance policies issued by seven insurance companies, including over 120 "Merrill Lynch Investor Life" policies.

77. Until the fall of 2007, Plaintiffs and other funeral directors had no reason to suspect any problems with the administration of, or investment practices utilized by, the Preneed Trust during the time IFDA Services acted as Trustee. For years, just as promised, IFDA Services, through the Director and Officer Defendants, provided participating funeral directors with annual statements reflecting the total principal, interest, withdrawals and totals for their preneed funeral planning customers' accounts deposited in trust. These statements made no mention of the fact that key man life insurance policies, much less MECs, were being used in lieu of reliable and responsible tax-exempt investment vehicles such as tax-exempt bonds.

78. As Trustee, IFDA Services, through the Director and Officer Defendants, likewise sent member funeral homes periodic notifications of the Preneed Trust's anticipated interest rate of return for a given period, with earnings posted in each account on the last day of that period. These rates, by and large, were presented as being very competitive with those generally available in the marketplace, which was consistent with the member funeral homes having been told that the Preneed Trust held "laddered" municipal bonds.

79. The funeral directors did not know – and had no way of knowing – that a significant portion of the trust funds were tied up in life insurance policies, many of which were,

