

Business

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LEGAL CHECK ✓

LEGAL CASE
STUDY #3

Who Is Entitled to Preneed Growth?

Scenario: Rico Funeral Home & Cremations has been successfully growing market share since it first started serving the community in southern Ohio over six years ago. Owner/operator Bernardo (“Bernie”) Rico had primarily focused on serving at-need calls because of his operational growth strategy and because of its immediate impact on cash flow. However, Bernie’s families had been inquiring more and more about preplanning and preneed, so Bernie partnered with a third-party preneed insurance provider a little less than two years ago.

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Bernie's strategy was to actively sell preneed to areas of town or zip codes where his business was not already drawing at-need business and more passively to parts of the community where the at-need business was already coming from. Results have been pretty good, with Rico Funeral Home & Cremations building up a solid backlog of its preneed book of business.

Recently, a widow by the name of Marianne Schechter passed away. Marianne had been one of the first to purchase a preneed contract from Bernie when he had started his preneed program. Bernie had served her when her husband, Norman, passed about five years ago. Marianne's two grown children, Karen and Kent, met with Bernie, who oversaw Marianne's services personally and had collected money from Karen for the non-guaranteed cash advance items.

The community came out in force to remember and honor Marianne, and her traditional service went beautifully. As customary, about a month later, Bernie sent a statement to Karen (who had been the signer on Marianne's converted at-need contract and had resided in Michigan) showing that nothing was owed now that the preneed insurance proceeds had come through.

About two weeks later, Bernie received a notice letter from Karen stating that the interest growth (roughly \$450) on her mother's life insurance policy for the preneed contract was owed to her. Bernie tried calling Karen in an attempt to explain but had no luck in reaching her.

Another two weeks passed, and with how busy Bernie was, he let it slip his mind to continue his attempts to reach out to Karen. He then received a demand letter from her, stating that she rightfully was owed this money from the growth of the preneed contract and threatened to take legal action if she was not paid.

Bernie tried calling Karen again and again, but his calls were all ignored. Bernie, not wanting any potential controversy over this matter, ultimately relented and cut a

check for the interest growth on Marianne's preneed contract and sent it to Karen at her address in Michigan.

A year later, Bernie was about to serve Mrs. Kemper at her passing. Mrs. Kemper's service was also a preneed to at-need conversion, and her daughter Courtney was the signer on her mother's converted at-need contract. During the arrangement conference, Courtney made it clear to Bernie that her friend, Karen, had advised her to demand the interest growth on her mother's life insurance policy upfront from Bernie, or else he would try to keep this money for himself. At this point, Bernie is at a quandary of what to do next with Courtney and Mrs. Kemper's cases.



So, Is The Funeral Home Entitled To Keep Interest Growth on Preneed Contracts?

The general answer to this sub-heading question is yes, most likely based on what sparse facts we know about the scenario along with some standard assumptions. However, no legal analysis is complete without first establishing a definition of the topic at-hand as well as some high-level parameters surrounding preneed.

What is a "preneed funeral contract?" In general, a "preneed funeral contract" is a written contract to provide either funeral services or funeral goods – and in most instances nowadays both funeral services and goods together – well in advance of when a death occurs (i.e., not imminent). Regulatory requirements aside, contract law is governed either by Common Law or the Uniform Commercial Code (UCC).

Contracts for sale of goods (in excess of \$500) fall under Article 2 of the UCC while contracts for services (along with real estate, sales of businesses, intangibles, etc.) are covered by Common Law. Therefore, preneed contracts today, which most often have guaranteed items for both services and merchandise, will be governed by both Common Law and the UCC for each specific portion.

This preneed contract can either be revocable or irrevocable. A revocable preneed contract allows for the buyer to receive his/her money back if there is a change of mind or heart, even after some time has passed. Whereas with irrevocable preneed contracts, there is no such refund available. Certain terms surrounding preneed contracts are regulated by both state (e.g., licensing in order to sell) as well as federal regulations (i.e., the "Funeral Rule" by the FTC, which we will not delve into here).

There is always a funding method used to pay for preneed contracts, and the two common funding methods are either in the form of an insurance product or a trust product. Insurance licensing is required in order for a person to sell insurance in any state, and in Ohio (like many other states), a preneed seller of life insurance also needs to be a licensed funeral director when funeral services are concerned.

And while most states (like Ohio) do not dictate whether a funeral home is required to offer either an insurance product or a trust product, the required trusting laws for any particular state may make insurance more advantageous than trusting, or vice versa for the funeral home owner/operator to decide which option is best for business.

So, now that definitions and the major corresponding parameters have been established, let's address whether Bernie should have been able to keep the interest growth in the Schechter service and how he should be able to retain the interest growth with the Kemper service as well.

Karen is correct in identifying that there is a life insurance product involved with her mother's preneed contract. However, the types of life insurance policies associated with preneed funeral contracts are very specific in their purpose – which is to underwrite and fund the face value amount of the guaranteed items for services and goods on a preneed contract.

This is NOT a general life insurance policy that someone would independently purchase to provide general death benefits to one's family (or beneficiary) in case of an untimely demise. The buyer of a preneed contract by way of the preneed life insurance policy assigns ownership of the paid-up policy to the funeral home. There should be language in both the preneed contract and the underwriting policy that spells this out in every state.

In this case, we know that Mrs. Schechter purchased a preneed contract from Bernie (or a contracted, licensed third-party representative). So, this was not a general life insurance policy that her late husband might have, or she would have taken out for herself. There most definitely would have been language in the preneed contract and insurance policy addressing who the owner or beneficiary of this contract assignment would be – Rico Funeral Home & Cremations. The same set of facts would apply to Mrs. Kemper's service and her daughter, Courtney, as well. So, from a legal standpoint based on what we know about the scenario, Bernie – and the funeral home – is entitled to keep the interest growth relating to the preneed contracts that they fulfill.

Things The Funeral Home Could Have Done Better

Here are the areas where Bernie could have done better regarding, both in the first conflict with Mrs. Schechter's daughter and then again with Mrs. Kemper's daughter, Courtney:

- **Know the law and the language that is in your contracts.** We can only go by what we know from the scenario, and it appears that Bernie was not prepared in the first place and then he did not go back to review what the preneed contract and the insurance policy stated. It is always better to respond than to react. From what we can tell here, Bernie reacted when he received the letters from Karen instead of reviewing all his options and properly responding to the situation. We may never know how a phone conversation(s) with Karen would have been like since Bernie was unsuccessful in ever reaching her. However, it appears as if Bernie was caught flat-footed again when confronted by Courtney.

- **Being upfront and transparent during the arrangement conference.** Here is where there is indication that Bernie was not prepared and knowledgeable (perhaps, even inexperienced) during the arrangement conference with Karen and her brother, Kent, for Mrs. Schechter. Certainly, there is no indication that Bernie was trying to be deceptive or exclusionary of any facts. However, by being well-prepared and knowledgeable of possible preneed pitfall scenarios, Bernie could have proactively been transparent, consultative, and educational when he met with Karen and Kent by explaining how preneed arrangements worked from beginning to end. There is absolute value to the consumer when they feel as though they understand how processes and things work after it has been explained to them, and this was a missed opportunity for Bernie.

- **Documented communications.** When Bernie failed to reach Karen by phone following receipt of her first letter, he should have written an official letter in response to Karen's notice letter. He could have explained the benefits of how preneed contracts worked – in allowing the buyer to preplan and establish exactly how and what Mrs. Schechter wanted for her funeral and prices were locked and service and

merchandise items guaranteed with the preneed contract. In doing so, the funeral home bears the risk by way of assignment of the insurance policy that any potential interest growth might very well be less than the rising costs and inflationary effects of time and money. He also could have pointed out the funeral home's legal rights per the preneed contract and the underwriting insurance policy.

- **Confront the issue.** Confrontation does not always have to have a negative connotation. In fact, one of the definitions of "confront" is "to cause to meet" or "to meet face-to-face." In this sense, Bernie did not face the issue (or Karen) head-on. Instead, he relented and paid her the interest growth that legally and rightfully should have been his to keep. This also set a slippery precedent for any future issues with client families arising from interest growth on preneed insurance, just like where the scenario above cuts off in Bernie's situation with Courtney, who had improperly been "informed" by Karen.

Bernie was right in wanting to avoid any potential legal entanglements. But he also could have responded in a much more steadfast manner rather than reacting the way that he did. Understandably, having a legal right does not always guarantee a practical right for business owners having to make tough decisions.

There have also been state regulations passed over the past few years (California, Connecticut, Massachusetts, etc.) that have shifted greater consumer rights toward the interest growth on preneed arrangements than for the funeral home.

However, with more consumers in 2022 being open to prearranging and purchasing preneed contracts than ever before, the best thing for funeral directors to do is become even more educated in the laws and regulations surrounding preneed contracts and become even more consultative, educational, and transparent with preneed client families. This will allow you to be prepared, proactive, and responsive should any issues ever arise. •