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**ICCFA Magazine
author spotlight**

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REGULATORY ISSUES

What happens when a problem is found with a funeral home or cemetery trust? Regulatory agencies are not equipped to run funeral homes or cemeteries. What's needed is a 'white knight' who can step in and take over these operations.

The role of the white knight in turning around a distressed cemetery or funeral home

The laws of most states provide a comprehensive regulatory framework governing cemetery and funeral home operations, cemetery and funeral home trusts relating to preneed contracts and cemetery trusts relating to endowment care.

Despite these extensive regulations, state regulators too often find themselves confronting situations where trust funds have been dissipated by bad or impermissible investments, diverted by operators for improper purposes or inappropriate schemes or even embezzled.

Whether the magnitude of the problem is small or many millions of dollars, it can leave state regulators in a quandary.

While the state statutes and regulations under which cemeteries and funeral homes operate allow a regulator to identify trust shortfalls and impermissible activities, state law does so after the fact and does not always provide a good remedy to resolve these situations, to recover missing trust funds or to make whole the customers of a poor or even disreputable operator.

This can be especially unfortunate for customers of limited means who in their later years have tended to their final arrangements to provide themselves with peace of mind and to avoid being a burden to their families.

Under most state regulatory requirements, a cemetery or funeral operator who has sold preneed goods or services is required to place in trust some portion of the purchase price until death, until the goods are delivered or until the services are performed.

Similarly, state law typically requires a cemetery operator to set aside in trust a

portion of the monies from the sale of a burial space (typically around 15 percent) with the income used for maintenance and upkeep of the cemetery.

State law also mandates requirements for the trust arrangements, including who may serve as trustee, how trust funds may be invested and what may be paid to the operator and when.

Despite these safeguards, trust funds can prove a tempting target to an operator facing financial difficulties or an operator who seeks to make improper use of the money. Even in the absence of irregularities surrounding trust funds, the performance of a cemetery or funeral home may suffer from a poor operator or an operator who has not made plans for succession, which, in turn, may leave the property distressed.

Simply put, states are not equipped to take over the operation of distressed cemeteries or funeral homes, to maintain them or to provide funds to perform preneed contracts. Even the appointment of a state receiver can prove expensive and unhelpful.

Finding a 'white knight' to help

The key to resolving these situations is for the regulator to find a responsible operator who can work with the regulator as a "white knight" to structure an arrangement to turn around the distressed property.

Many challenges arise when a white knight works with a regulator to turn around a distressed property. These challenges include:

1. incomplete records—financial and operational;
2. unrecorded cemetery or funeral home contracts;
3. trust shortfalls resulting from failure to make trust deposits, impermissible trust

investments, illiquid or poorly performing investments or impermissible trust withdrawals;

4. impermissible liens such as factoring arrangements;
5. deferred maintenance;
6. deferred capital expenditures;
7. delinquent contractual liabilities and accounts payable;
8. uninsured losses;
9. outstanding liens and other security interests;
10. customer complaints and litigation; and
11. regulatory non-compliance.

In addressing the foregoing issues, the regulator and the white knight may consider the following:

1. Interim operator. In dealing with a distressed property, time is of the essence. Where possible, the regulator, the white knight and the operator should quickly put in place an interim arrangement to allow the white knight to secure the operations of the cemetery or funeral home on an interim basis.

Where the white knight has not been identified, there are companies that will work with state regulators on an interim basis to preserve and maintain the property to prepare it for sale or other turn-around arrangement. Whether an interim operator or a white knight is involved, any associated cost is either paid out of the assets of the distressed property or by the white knight.

2. Receivership. Almost all states have laws providing for the appointment of a receiver, and there has been recent precedent involving appointment of a receiver for distressed cemeteries and funeral homes.

In these instances, the receiver reports to a receivership court.

The receiver will try to turn around the distressed property, sell the distressed property as an ongoing business or liquidate and sell the assets of the distressed property. It may use an interim operator or a white knight for this purpose and to reduce the costs of receivership.

Again, costs associated with the receivership are either paid from the assets of the distressed property held by the receivership, by the white knight or both.

3. Turning around a distressed property. A white knight can be key to a receiver who is trying to turn around a distressed property. A management arrangement and an operating arrangement are two methods. In the former, the white knight receives a management fee paid from operating revenues of the distressed property. In the latter, the white knight is responsible for all expenses and keeps all revenues.

The management or operating arrangement may be short-term or long-term. A short-term management arrangement is frequently tied to a sale, as discussed below. A long-term management or operating arrangement may be particularly well suited to a nonprofit cemetery.

Key to these arrangements are the termination provisions and what the white knight will receive as a fee in the event of termination. These might include net receivables, increases in the merchandise trust less merchandise liabilities and unamortized costs related to equipment and capital improvements.

4. Sale of the distressed property.

a. Sale of assets. In certain instances, sale of a distressed property can prove to be an ideal result. The sale typically will take the form of an asset purchase. If a receivership is in place, the white knight may agree to serve as a stalking horse in an auction with the white knight receiving a breakup fee if it is not the successful bidder.

In a distressed sale, the consideration paid by the buyer is used to fund trust shortfalls and discharge outstanding liabilities, including fees related to oversight of the distressed property by a regulator or fees related to the receivership.

If the purchase price proves insufficient to cure trust shortfalls and outstanding liabilities, the buyer can post a performance bond securing performance of certain agreed obligations with the regulator setting the amount of the bond and ensuring performance. The receivership court, as part of its sale order, can provide protection against unasserted claims of creditors or customers of the distressed property.

b. Misappropriation claims. Important assets a buyer may receive in an asset purchase of a distressed property are claims against third parties who have been complicit in improprieties surrounding trust funds. Recoveries from misappropriation claims can be an important tool in completing a sale, including satisfying trust shortfalls or discharging outstanding liabilities.

In sum, a responsible operator working with a state regulator and a receiver, if appointed, can be helpful in effecting a turn-around of distressed cemeteries and funeral homes. 