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

FRED C. DAMES FUNERAL HOMES, INC., et al.,	)	
	)	
Plaintiffs,	)	
	)	
v.	)	**No. 09 CH 21989**
	)	
DANIEL W. HYNES, et al.,	)	
	)	
Defendant.	)	

MEMORANDUM OPINION AND ORDER

Plaintiffs, funeral homes representing a putative class of licensed funeral directors in the State of Illinois, commenced this action against defendants Daniel W. Hynes, Illinois Office of the Comptroller ("IOC" or the "Comptroller"), Michael T. McRaith, Illinois Department of Insurance ("DOI" or the "Director"), Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch PFS"), Merrill Lynch Life Agency, Inc. ("ML Life Agency"), Merrill Lynch Life Insurance Company ("ML Life Insurance"), and Merrill Lynch Bank and Trust Company FSB ("ML Trust"). Plaintiffs participate in the Illinois Funeral Director Association's ("IFDA") Pre-Need Trust and seek a declaration that certain aspects of a Stipulation and Consent Order ("Consent Order") entered into between DOI and ML Life Agency are invalid and unenforceable. Plaintiffs also seek a declaration that DOI and IOC acted outside the scope of their respective statutory authority in negotiating and implementing the Consent Order.

The court invited the parties to file cross-motions for summary judgment addressing the legal authority of DOI to enter into the Consent Order with ML Life Agency and the legal authority of both DOI and IOC to participate in the administration of the Consent Order,

including the required Release and Commitment Letter. For the reasons set forth below, the court grants the plaintiffs' motion and denies defendants DOI, IOC, and ML Life Insurance's respective cross-motions.

Pursuant to the Illinois Funeral or Burial Funds Act, 225 ILCS 45/1 et seq. ("Burial Act"), funeral homes offer customers the ability to purchase pre-need contracts to pre-pay funeral and burial expenses. A duly authorized trustee holds the money used to pay for pre-need contracts in the Pre-Need Trust until the customer or entity withdraws the funds or the funds are used for funeral, burial, or memorial services. 225 ILCS 45/4. The Act vests oversight responsibilities in IOC.

Two types of pre-need contracts fund the Pre-Need Trust, guaranteed and non-guaranteed. A guaranteed pre-need contract provides that in exchange for either a lump sum payment or installment payments by the pre-need customer, the funeral home agrees to pay all contracted funeral and burial expenses. In the event the contract payments plus any interest earned thereon are insufficient to cover the contracted services, the funeral home must bear the loss. In other words, the funeral home assumes the risk related to investment of the contract proceeds. Under a non-guaranteed contract, the funeral home agrees to pay only for funeral and burial expenses to the extent covered by the customer's payments plus any interest earned or less any losses. If the contract payments are insufficient to cover the services purchased, the contract holder must make up the difference. Under a non-guaranteed contract, the customer assumes the risk associated with the investment.

From 1980 to 2008, the IFDA, through its wholly-owned subsidiary IFDA Services, Inc. ("IFDA Services"), managed the Pre-Need Trust. In September 2005, IOC began an audit of IFDA Services to examine whether IFDA Services was in compliance with the Burial Act. IOC's audit revealed a number of irregularities, including that IFDA Services took unauthorized

excessive fees from the Pre-Need Trust and the Trust was underfunded. As a result of the audit, IOC revoked the license issued to IFDA Services under the Burial Act. In October 2008, defendant ML Trust became trustee of the Pre-Need Trust.

From 1986 to 1999, ML Life Agency, through its agent Edward L. Schainker, provided insurance services and financial consultation to IFDA Services in its capacity as Trustee of the Pre-Need Trust. On the advice of ML Life Agency, the Pre-Need Trust invested in insurance policies on the lives of certain IFDA Services officers, directors, and board members. After IOC notified DOI[1] of the irregularities in the Pre-Need Trust, DOI commenced an investigation, pursuant to 215 ILCS 5/401(b), into whether ML Life Agency violated the Illinois Insurance Code. Specifically, the Director alleged that ML Life Agency violated Section 500-70 of the Insurance Code. Section 500-70 prohibits insurance producers such as ML Life Agency from, among other things, violating any insurance laws or rules, misappropriating or converting funds received in the course of its business, intentionally misrepresenting the terms of an insurance contract, or committing any unfair trade practice or fraud.

In May 2009, following DOI's investigation of ML Life Agency, DOI and ML Life Agency executed the Consent Order with the purpose to resolve "all matters raised by the investigation without the necessity of an administrative hearing." The Consent Order established a Settlement Fund, funded by a deposit of $18 million by ML Life Agency and administered by an independent escrow agent. ML Life Agency agreed to establish the Settlement Fund without admitting to any liability. According to the Consent Order, the $18 million is not to be regarded as a civil forfeiture, fine, or penalty. No evidence has been provided to the court as to how the

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[1] IOC notified the Department of Financial and Professional Regulation, which, at that time, exercised regulatory authority over the insurance industry through its Division of Insurance. DOI became an independent state agency in 2009.

$18 million figure was calculated or what it represents, except that DOI avers that it is not intended to compensate for losses sustained by the Pre-Need Trust, but rather was an amount determined by ML Life Agency to be "reasonable . . . given the possible revocation of [its] producer license."[2]

The Consent Order sets forth how the escrow agent will disburse the Settlement Fund. IFDA funeral directors may receive their proportional shares of the Settlement Fund if they (1) execute a Discharge and Satisfaction (the "Release") of any claims against ML Life Agency and other Merrill Lynch entities and (2) execute a Commitment Letter with IOC. In the event a funeral director elects not to seek payment from the Settlement Fund, the escrow agent will communicate directly with that funeral homes' non-guaranteed pre-need customers and advise them of the ability to obtain their proportionate share of the Fund. Finally, if any funds remain after the escrow agent makes payments to funeral directors and customers with non-guaranteed contracts, the Director will disburse the residual amount to funeral directors and/or customers in his discretion.

The purpose of the Release is to settle all matters in dispute, defined as "claims, disputes, debts, liabilities or causes of action, whether direct, indirect, or derivative in nature, whether known or unknown, suspected or unsuspected, at law or in equity, asserted now or in the future, relating to the IFDA Trust and/or to any activity or omission of the parties with regard thereto." By signing the Release, a funeral director "waives, relinquishes, abandons, surrenders, covenants not to sue, and forever discharges" any such matters in dispute against ML Life Agency, Merrill Lynch PFS its "agents, representatives, officers, directors, shareholders, servants, employees, attorneys, successors, parent, assigns, subsidiaries, divisions, affiliates, related entities, and all

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[2] Notwithstanding DOI's disavowal of the purpose of the Fund, it has nevertheless touted it as the product of the Director's efforts to protect 47,000 pre-need customers.

other persons in privity with [ML Life Agency] or [Merrill Lynch PFS], including any unnamed individuals and entities."

Regarding the second condition - the Commitment Letter - the form Commitment Letter distributed to funeral directors explained that the directors wishing to avail themselves of the Settlement Fund must "memorialize their commitment to fulfill all IFDA Pre-Need Trust contracts." By signing the Commitment Letter, a funeral director agrees to "render [his or her] commitment to fulfill each guaranteed contract as statutorily required and each non-guaranteed contract to the extent of each consumer's deposits plus an annual interest rate of 3.0805%." The interest rate is a blended rate of average interest rates for the past 22 years and is to be credited to non-guaranteed contracts retroactive to the date of their inception.

On January 18, 2009, funeral directors in Cook County filed a derivative suit seeking to restore lost monies to the Pre-Need Trust.[3] Merrill Lynch PFS, ML Life Agency, and Schainker are among the named defendants. On June 26, 2009, funeral directors in Cook County filed a class action, which has been removed to the Northern District of Illinois, seeking damages caused by the directors having to make up the difference for pre-need customers whose funds decreased below the cost of funeral goods and services.[4] The plaintiffs named the Merrill Lynch companies, Schainker, and two additional Merrill Lynch affiliated individuals as defendants. Two additional class actions have been filed on behalf of pre-need customers: *Dunkle v. IFDA Services.*, No. 08 L 682 (filed in Kane County) and *Tipsword v. IFDA Services.*, No. 3:09-cv-00390 (filed in the Southern District of Illinois).

On July 7, 2009, after receiving the Release and Commitment Letter, plaintiffs filed a complaint seeking a declaration that "the release contained in the Consent Order . . . is invalid

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[3] *Calvert Funeral Homes Ltd. v. Ninker*, No. 09 CH 03624.

[4] *Clancy-Gernon Funeral Homes, Inc. v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*, No. 1:09-cv-04550.

and unenforceable and an impermissible encroachment on this Court's powers to adjudicate matters properly reserved to the judicial branch." Plaintiffs also challenge the Commitment Letter as imposing obligations on funeral directors beyond those imposed by the Burial Act or the non-guaranteed pre-need contracts. Finally, plaintiffs request a declaration that the actions by DOI and IOC to enforce the Consent Order are "unlawfully outside the scope of their statutory and constitutional authority."

On July 15, 2009, plaintiffs moved to enjoin implementation and enforcement of the Release and the Commitment Letter. On July 22, 2009, Jack Flowers, for the benefit of Amelia M. Flowers, moved to intervene in the case. Flowers executed a non-guaranteed pre-need contract with a member of the IFDA for the benefit of his mother and is a member of the consumer class in the *Tipsword* and *Dunkle* cases currently pending. The court granted Flowers' motion to intervene on September 30, 2009.

On July 29, 2009, the Comptroller and IOC and the Director and DOI filed motions to dismiss raising issues relating to sovereign immunity and plaintiffs' standing. ML Life Insurance also moved to dismiss arguing that it was not a proper defendant. On August 10-12, 2009, the court held hearings on the plaintiffs' motion for preliminary injunction and defendants' motions to dismiss. The court denied the motions to dismiss and entered and continued plaintiffs' motion for preliminary injunction. DOI and ML Life Agency also agreed to extend the deadlines related to the Consent Order.

At the court's suggestion, the parties agreed to brief the issue of the legal authority of DOI and IOC to enter into the Consent Order and participate in its administration. The court also

invited the parties to raise additional issues that could be resolved as a matter of law. The court has now reviewed the briefs submitted by the parties and heard the arguments of counsel.[5]

DISCUSSION

Summary judgment is appropriate "if the pleadings, depositions, and admissions on file, together with affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." 735 ILCS 5/2-1005(c). For purposes of summary judgment, the court should construe the facts strictly against the movant and liberally in favor of the opponent. *Adams v. Northern Illinois Gas Co.*, 211 Ill. 2d 32, 43 (2004). The purpose of a summary judgment proceeding is not to try an issue of fact, but to determine whether any genuine issue of material fact exists. *Happel v. Wal-Mart Stores*, 199 Ill. 2d 179, 186 (2002). Summary judgment should not be granted unless the right of the moving

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[5] DOI, IOC, and ML Life Insurance again assert that plaintiffs lack standing because they have not suffered any legally cognizable injury that is fairly traceable to defendants' conduct. DOI and IOC also assert that the doctrine of sovereign immunity bars plaintiffs' claims. The court previously rejected defendants' standing and sovereign immunity arguments in the context of their various motions to dismiss and rejected those same arguments advanced in opposition to plaintiffs' motion for preliminary injunction. Once again, the court rejects these arguments. Plaintiffs have standing to pursue a claim for declaratory relief. As entities that can assert a claim pursuant to the Consent Order, they clearly have standing to challenge its terms. Plaintiffs have a direct and immediate interest in the Consent Order. Plaintiffs' participation entails releasing claims they either have asserted or could assert in pending litigation against the Merrill Lynch entities, and conversely, their non-participation exposes them to potential claims by their pre-need customers. Finally, a member of a class of pre-need customers who have sued was granted leave to intervene in this case. As both DOI and IOC have taken the position that the Settlement Fund and Commitment Letter are for the benefit of pre-need customers, these parties clearly have standing to sue. Further, the sovereign immunity doctrine does not bar the relief plaintiffs seek. The complaint seeks a declaration that DOI and IOC acted outside the scope of their authority in entering into the Consent Order. Such a claim is an exception to the sovereign immunity doctrine. Finally, because ML Life Insurance has not disclaimed the intent to assert the Release in any pending or contemplated litigation and plaintiffs have alleged wrongdoing by ML Life Insurance in the complaint, the court finds that it is a proper party to this declaratory judgment action.

party is clear and free from doubt. *Horwitz v. Holabird & Root*, 212 Ill. 2d 1, 8 (2004); *Purtill v. Hess*, 111 Ill. 2d 229, 240 (1986).

Any actions taken by DOI and IOC must be pursuant to the authority granted to the agencies by the legislature. An administrative agency is a creature of statute and "any power that the agency claims must find its source in the statute that created the agency." *Department of Public Aid ex rel. Hartigan v. Hokin*, 175 Ill. App. 3d 646, 652 (1st Dist. 1988). Although "[a]n express legislative grant of power or authority to an administrative agency includes the grant of power to do all that is reasonably necessary to execute that power or authority," *id.*, administrative agencies possess no common law powers.

I.

THE DIRECTOR OF INSURANCE DOES NOT POSSESS THE LEGAL AUTHORITY TO ENTER INTO THE CONSENT ORDER AND PARTICIPATE IN ITS ADMINISTRATION

DOI contends that Illinois courts have recognized the Director's authority to enter into settlements.[6] However, the Director's authority to enter into settlements with regulated entities is not the issue before the court.

The issue here is whether the Insurance Code grants the Director the authority to affect the rights and liabilities of non-regulated entities and persons through the execution of a "settlement agreement" with an entity engaged in the business of insurance. It is undisputed that ML Life Agency and its agent, Schainker, are properly within the scope of the Director's

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[6] Defendants append two settlements between DOI and private insurance entities to demonstrate that DOI settlements can and do include provisions that require third parties to execute releases to receive benefits. Apart from the fact that the circumstances of each settlement differ materially from this case, these settlements do not establish DOI's authority to affect the rights of third parties through a settlement with a regulated entity, as neither was subject to a legal challenge on that ground.

regulatory authority under the Insurance Code. However, the Consent Order purports to resolve claims by and against third parties who are not subject to regulatory supervision by DOI. In particular, several of the Merrill Lynch entities such as Merrill Lynch PFS, "its affiliates, subsidiaries, employees, and agents" are not subject to regulation by DOI, but are nevertheless included within the scope of the Release required as a condition of participation in the Settlement Fund. Further, while the conduct of funeral homes is subject to regulation by the Comptroller under the Burial Act, neither they nor their pre-need customers are subject to DOI regulation. Yet, the Consent Order and particularly the Release, clearly impact their rights.

The Insurance Code grants the Director the authority to regulate the business of insurance, including insurance companies and licensed business entities. 215 ILCS 5/500-70(c). The Director is "charged with the rights, powers, and duties appertaining to the enforcement and execution of all insurance laws of this State." 215 ILCS 5/401. The Insurance Code grants the Director various powers, including the authority to: (1) make reasonable rules and regulations necessary to make the insurance laws effective, 215 ILCS 5/401(a); (2) conduct investigations as may be necessary to determine whether any person has violated any insurance laws, 215 ILCS 5/401(b); and (3) "conduct such examinations, investigations and hearings . . . as may be necessary and proper for the efficient administration of the insurance laws of this State." 215 ILCS 4/401(c).

During the investigation of ML Life Agency, the Director alleged that ML Life Agency violated Section 500-70 of the Insurance Code by marketing and selling to IFDA "purportedly tax-exempt variable universal life insurance policies as investment vehicles within" the Pre-Need Trust. Section 500-70 authorizes the Director to take a number of actions as a result of an investigation of a regulated entity, including suspending, revoking or refusing to renew a

regulated entity's license. The Director may also impose a civil penalty, but such a penalty is limited to a maximum of $100,000. 215 ILCS 5/500-70(d).[7]

Pursuant to the Insurance Code, after the Director investigated ML Life Agency's licensed activities, the Director had the option to impose a fine or penalty and/or suspend or refuse to renew ML Life Agency's license. But the $18 million fund established pursuant to the Consent Order does not fall into any of the foregoing categories. Rather, it is an apparently arbitrary sum determined by ML Life Agency to be "reasonable" (in some unspecified context) and that ML Life Agency and the Director together want to use as a part of a quasi-judicial common fund to resolve the claims of funeral directors and pre-need customers. Further, the precondition to participation in distributions from the Fund requires applicants (whether funeral directors or pre-need customers) to release not only the entity regulated by DOI, but non-regulated entities as well.

The Insurance Code does not expressly or by necessary implication grant the Director the authority to regulate non-insurance entities or persons or enter into settlement agreements with non-regulated entities or persons. No provision authorizes DOI to create a "Settlement Fund" for the benefit of pre-need customers under the Burial Act or to condition the receipt of settlement funds on a broad release of rights a party may have against non-regulated entities, such as the Merrill Lynch affiliates.

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[7] The Director may also suspend, revoke, or refuse to renew a regulated entity's license if "the Director finds, after a hearing, that an individual licensee's violation was known or should have been known by one or more of the partners, officers, or managers acting on behalf of the partnership, corporation, limited liability company, or limited liability partnership and the violation was neither reported to the Director nor corrective action taken." 215 ILCS 5/500-70(c).