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COMMERCIAL AUTHORIZED 56
FEDERAL TRADE COMMISSION

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Seattle, Washington 98174
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April 6, 1987

Representative Chuck Sides
Oregon State Legislature
Capitol Building
Salem, Oregon 97310

Dear Representative Sides:

The Federal Trade Commission's Seattle Regional Office is pleased to respond to your invitation to comment on House Bill 3284, which would modify existing law regulating the sale of prearranged funeral plans in Oregon.¹ In these comments, we discuss three matters: 1) certain aspects of the proposal to certify persons selling prearranged funeral plans; 2) the requirement that money paid for pre-need plans be held in trust; and 3) the use of a performance bond in lieu of trusts.

This letter describes our concern that the certification procedure might be misused to restrict entry into the pre-need sales business and supports elimination of the 100% trust requirement. Pre-need sellers should be allowed to choose among trusts, performance bonds, and insurance arrangements. We believe that changes in the law along these lines will allow the pre-need sales business to operate more efficiently while still providing consumers with effective protection.

The Federal Trade Commission seeks to promote competition among members of the professions to the maximum extent compatible with other legitimate state and federal goals. For several years we have had a program addressing restrictions on the business practices of professionals, including optometrists, dentists, physicians, lawyers, funeral directors, and others. Our goal has been to identify and seek removal of restrictions that impede competition and increase costs without providing countervailing benefits to consumers.

¹ These comments represent the views of the Seattle Regional Office and of the Bureau of Competition, Consumer Protection, and Economics of the Federal Trade Commission, and not necessarily those of the Commission. The Commission has, however, voted to authorize submission of these comments.

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The Commission has actively pursued this goal in the funeral industry.² The Commission's Trade Regulation Rule Concerning Funeral Industry Practices ("Funeral Rule"), 16 C.F.R. 453, became fully effective on April 30, 1984. The Rule was designed to promote increased competition and consumer choice in the funeral industry by facilitating informed purchase decisions. Among other things, the Funeral Rule requires providers of funeral goods and services to give prospective purchasers detailed information about prices and the relevant legal requirements.

As we understand it, current Oregon law permits the sale of funeral goods and services and burial plans on a pre-need basis if certain trust requirements are observed.³ At present, 100% of the payments made for most such goods and services, including interest and earnings, must be placed in trust until the anticipated death occurs.⁴ House Bill 3284 would amend the Act to require deposit into a trust fund of only 50% of the sales price attributable to funeral and cemetery merchandise, 75% of the sales price attributable to funeral and cemetery services, and 35% of the sales price received for undeveloped interment, entombment, or cremation spaces. As an alternative, House Bill 3284 would allow sellers to ensure the availability of funds by obtaining a performance bond equal to the total trust requirement that would otherwise apply. The bill would also require sellers of prearranged funeral plans to obtain a certificate before doing business in Oregon.

A. General Comments

This is a particularly appropriate time to address the sale of pre-need funeral plans. Sales of such arrangements have been increasing throughout the country. In 1960, only about 20,000 such plans were sold nationwide. In 1985, by contrast, 600,000 pre-need sales were made. It is estimated that 700,000 plans were sold in 1986,⁵ and that steady growth will continue in the

² Commission staff has previously commented favorably on proposals to alter 100% trusting requirements in letters of February 14, 1986 to the Kansas Legislature and of April 7, 1986 to the Michigan Legislature.

³ Ore. Rev. Stat. 128.410 et seq.

⁴ Only 66% of funds received for cemetery vaults and markers must currently be placed in trust.

⁵ Rockwood, Batesville Responds to Questions About Forethoughts, Mortuary Management, November 1986, at 25.

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future. Thus, a major shift in funeral purchasing behavior, from "at-need" to "pre-need" arrangements, may be underway.

Pre-need sales of funeral goods and services may offer consumers significant advantages. For example, pre-need arrangements enable consumers to make buying decisions without the time or emotional pressures associated with at-need purchases. They also allow individuals to pre-select their own arrangements.

Although we are not aware of any systematic statistical evidence on the extent of consumer problems with pre-need funeral contracts, we have learned that ThanacAP, a national dispute resolution service for the funeral industry, classified 14% of the consumer complaints it received in 1986 in the category, "pre-need, insurance, or trust."⁶ An informal survey of consumer and industry groups conducted by our Bureau of Economics suggests that pre-need complaints can be classified roughly into four categories: 1) the buyer relocates and discovers that the pre-need contract is not transferable; 2) the buyer dies and his survivors are unhappy with the terms of the contract; 3) the seller goes out of business leaving purchasers uncompensated; and 4) the seller defrauds or deceives the buyer. The remedies contained in the proposed bill might be appropriate to address complaints of the last two types.

Oregon has a legitimate interest in protecting against the fraudulent or deceptive practices of pre-need plan sellers. Because many pre-need purchasers pay a substantial sum of money for goods or services that may not be provided for many years, consumers may benefit if the state ensures that funds and providers are available to deliver these goods and services at the time they are required. However, the Legislature should be aware that the regulations may also cause consumer injury if they have the effect of inhibiting price competition, innovation, or the availability of services.

The appropriate way to achieve the optimal balance between protecting pre-need purchasers on the one hand, and facilitating competition and innovation on the other, is to identify the least restrictive means of protecting consumers against fraud, deceptive practices, and the provider's insolvency. Such a balanced approach will assure that consumers receive adequate protection while allowing maximum freedom for market forces. In a relatively new and growing industry like pre-need funeral

⁶ By itself, this number does not enable us to determine whether there are significant consumer problems associated with pre-need arrangements.

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sales, unnecessary regulation, may have a disproportionately adverse impact on innovation.⁷

It is against this general background that we provide the following comments on specific provisions of House Bill 3284.

B. Certification Requirement

Section 4 of the bill would make it unlawful to sell prearranged funeral plans without obtaining a valid certificate issued by the State Mortuary and Cemetery Board. Before a certificate will be issued, the applicant must file a statement of assets and liabilities with the Board and report on any civil or criminal proceedings involving the applicant in which fraud was charged. The certificate may be revoked for any one of several reasons, including insolvency of the seller, misrepresentation, or failure to provide pertinent data to the Board. A civil penalty may be imposed in lieu of revoking the certificate.

We are concerned with the certification requirement for several reasons. First, the bill is unclear as to whether the Board may exercise discretion to withhold certification or must issue the certificate automatically upon the filing of required information. It may be appropriate to allow the Board to withhold certification of an applicant who has been convicted of fraud, but this authority should be confined to that or other specified circumstances.

Second, we are concerned about Section 5(1)(e), which requires applicants to file "such information as the Board may require to determine the qualification of the applicant." This provision allows the Board to exercise unfettered discretion in levying informational requirements on certificate applicants and assessing their qualifications. Such a provision could be used to obstruct entry into the business of pre-need sales, or otherwise raise the cost of entry to the point where competition would be adversely affected. We suggest instead that the Legislature specify the types of information that should be filed. These could include items such as insolvencies, legal actions filed against the applicant (along with the result), and the names of states in which the applicant has been admitted to sell pre-need plans.

⁷ An example of such innovation is a plan that protects both the seller and the buyer of pre-need funeral arrangements. The fact that the market has, on its own, produced a plan of this type suggests the need for the government to exercise caution that it not overly regulate pre-need sales by imposition of trusting or performance bond requirements.

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Third, the likelihood of the potential problem noted above may be increased where, as here, several members of the certifying Board are potential competitors of pre-need sellers seeking certification. For this reason, the Legislature might consider removing the Board from the certification process and simply require filing the necessary information with the Oregon Secretary of State, or some other appropriate office.

Fourth, the bill appears to impose unnecessary constraints on cemetery operators and certain associations. Section 7(8) would prevent cemetery operators from engaging in pre-need sales unless they or their predecessors have been in continuous operation for at least 24 months. No such requirement of continuous operation is imposed on potential entrants that are not currently engaged in the cemetery business. Section 5(1)(c) requires that certificate applications reveal fraud convictions against any member of an applicant association. This requirement may be excessively burdensome to organizations such as senior citizens groups or burial societies with large numbers of members. Section 7(8) should be deleted and consideration should be given to limiting Section 5(1)(c) so that it will not apply to all the members of large organizations.

C. Trust Requirements

Several states have imposed trust requirements to protect pre-need consumers' investments from fraud and deception.⁸ However, a trust requirement -- particularly a 100% trust requirement -- can have unintended anticompetitive consequences that injure consumers.

From our experience with the pre-need sales industry, it appears that the current 100% trust requirement in Oregon may restrict competition in the sale of pre-need goods and services without providing countervailing consumer benefits. Under 100% trust fund laws, the seller's recovery of front-end and administrative expenses is made less certain and more costly. Instead of covering these expenses with funds paid by consumers, sellers must use their own capital or third-party financing for a lengthy, indefinite period of time. These added costs and the uncertainty of such arrangements may discourage competitors from

⁸ All consumers who make pre-need funeral purchases in their homes receive some protection under the Federal Trade Commission's Trade Regulation Rule Concerning Cooling-Off Period for Door-to-Door Sales, 16 C.F.R. 429. Among other things, that Rule requires sellers to give consumers three days in which to rescind home solicitation sales.

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making pre-need sales.⁹ Fewer sellers and the resulting reduced competition can injure consumers by depriving them of the lowest prices for the goods and services they wish to purchase and limiting the array of alternatives and pricing options that would otherwise be available.

The bill attempts to address these problems by reducing the amount that must be placed in trust. Nonetheless a trusting requirement that is less than 100% must still be approached with care. If the amount of money exempt from the trust requirement is less than the seller's front-end and administrative outlays, then recovery of a portion of the outlays is made less certain and more costly. This will raise the price that sellers need to charge consumers in order to earn a competitive return. If this increase in price is not offset by an added benefit to consumers (e.g., a reduction in the risk of non-performance), then consumers will be worse off under the trust requirement.

We believe that by lowering the percentage of the sale that must be placed in trust, House Bill 3284 will encourage more sellers to offer pre-need goods and services and thus facilitate competition in this area. The optimum level to be placed in the trust fund should take into account the actual costs incurred for overhead, marketing, administrative expenses, and the like.

D. Performance Bonds

Section 14 of the bill would allow a pre-need seller, in lieu of the trust requirement, to purchase a performance bond in an amount equal to the trust requirements that would otherwise apply. We think this alternative has much to recommend it. It provides an effective means of protecting the consumers from seller default due to fraud or insolvency, but does not pose the same anticompetitive risks as trust fund requirements.

In analogous "future services" sales, where delivery is deferred or occurs over an extended time, performance bonds have been an effective means of protecting the consumer's investment. In three recent Commission cases, for example, health spa businesses were charged with, among other things, failing to fulfill contracts with consumers and retaining membership fees without

⁹ The Association of Funeral Service Professionals, Inc., has informed us that since 1981, when the 100% trusting requirement was first passed, about \$15 million has been paid into trust. By contrast, if House Bill 3284 passes, the two largest sellers of pre-need plans expect to be able to sell plans in Oregon jointly costing about \$12 million each year.

offering or making refunds.¹⁰ The judgments in those cases prohibit the spa operators from accepting any payment for a membership in advance of providing the promised services unless performance bonds have first been obtained. The judgments specify that the bond amount must be for at least \$50,000 or enough to provide refunds to all health spa members in the event that a spa fails to open, or if it closes before all the services have been provided.

A performance bond may be written to ensure that the goods and services will be available if the seller cannot provide them, so that the consumer is protected from seller default whether caused by fraud or by insolvency. In addition, because sureties compete among themselves for the performance bond business, the price of these bonds and the requirements on sellers will be set in the most efficient manner by the market. Sureties will be able to determine requirements individually for each seller, and thus provide adequate protection at the lowest cost.¹¹

Although performance bonds appear to be less costly than trust requirements, there may be some instances in which the opposite is true.¹² We therefore agree that pre-need sellers should be permitted to choose between trusting and bonding. We recommend that the Legislature also consider permitting sellers to protect pre-need consumers through insurance arrangements.¹³ If each pre-need seller may choose the lowest-cost alternative available

¹⁰ FTC v. Lady Venus Centers, Inc., No. 3-84-0158 (M.D. Tenn. Feb. 16, 1984); FTC v. Tyler-Radcliffe Co., Inc., No. 3-84-0159 (M.D. Tenn. Feb. 16, 1984); FTC v. Thor Enterprises, Inc., No. 84-2121-MA (W.D. Tenn. Feb. 16, 1984).

¹¹ One particular seller may be a better risk than a second one, for example, because of a large fixed-asset base. If the lower risk seller is charged a lower fee for a performance bond, the seller can pass that savings along to consumers. In addition, sureties may put fewer restrictions (e.g., lower escrow deposit requirements) on the lower risk sellers. This can only be done if sellers are dealt with individually.

¹² For example, the American Association of Retired Persons' (AARP) Commentary on Model Law for Prepaid Funeral Arrangements (p. 29) suggests that performance bonds are "difficult and expensive to obtain."

¹³ The AARP Commentary suggests a state-sponsored insurance fund as an alternative to trusting and bonding. As noted above (see note 7) private insurance arrangements are already becoming available.

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to it, the Legislature will help assure that consumers pay the lowest possible price for protection.

In sum, we feel that permitting all pre-need sellers to obtain performance bonds or appropriate insurance in lieu of a trust fund arrangement is a viable, less costly, and procompetitive alternative.

E. Conclusion

We have focused our comments on the portions of House Bill 3284 that appear to have particular competitive impact. We express no opinion on the remaining provisions of the bill. We hope that our remarks concerning the competitive and consumer protection aspects of the bill will assist you in your deliberations. We appreciate having had the opportunity to present our views. If you have any questions, please call Dennis McFeely in this office.

Sincerely,

George J. Zweibel

George J. Zweibel
Regional Director
Seattle Regional Office