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COMMISSION AUTHORIZE

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March 28, 1994

The Honorable David Wright
Chairman, Consumer Affairs Committee
Pennsylvania House of Representatives
South Office Building
Room 206
Harrisburg, PA 17120-0028

Dear Chairman Wright:

The staff of the Federal Trade Commission¹ is pleased to offer this comment on House Bill No. 2347.² This bill would regulate sellers of pre-need cemetery or funeral goods or services. Among other things, it would require that pre-need sellers deposit into a trust fund all (or nearly all) of the proceeds of such sales. This escrow requirement aims to protect the consumer against the risk that funds will be unavailable at the time they are needed. In assessing how best to address that concern, however, the risk that funds might be unavailable should be balanced against the risk that a too-stringent "trusting" requirement could reduce competition.

¹ These comments are the views of the staff of the Federal Trade Commission, and do not necessarily represent the views of the Commission or any individual Commissioner.

² Representative Christopher McNally requested that we submit comments on this bill. U.S. Representative George Gekas has also requested our comments on it.

L Interest and Experience of the Federal Trade Commission.

The Federal Trade Commission is empowered to prevent unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.³ Consistent with this statutory mandate, the Commission and its staff work to identify restrictions that hinder competition and increase costs without providing countervailing benefits to consumers.

The Commission and its staff have gained experience with the funeral industry through an FTC Trade Regulation Rule that is intended to promote increased competition and consumer choice in the funeral industry by facilitating informed purchase decisions.⁴ In addition, the Commission has taken law enforcement actions against allegedly anticompetitive acquisitions in the funeral industry.⁵ The staff has previously commented on other states' proposed legislation involving the funeral industry,⁶ and the staff testified in 1989 before the Pennsylvania House of Representatives on another bill to regulate pre-need funeral sales.⁷

³ 15 U.S.C. § 41 *et seq.*

⁴ The FTC rule governing Funeral Industry Practices, 16 C.F.R. § 453, became effective April 30, 1984. Among other things, the rule requires funeral providers to disclose to consumers detailed information about prices. The Commission has recently approved amendments to this rule, to be effective July 19, 1994, as part of a mandatory review procedure. 59 Fed. Reg. 1592 (January 11, 1994).

⁵ See Service Corporation International, Dkts. C-3372 (consent order, February 25, 1992), C-3440 (consent order, June 15, 1993).

⁶ See comments to Executive Director, Louisiana Board of Embalmers and Funeral Directors, January 14, 1994; Wisconsin State Assembly, September 13, 1993; Virginia Delegate Franklin P. Hall, February 9, 1989; Oregon State Representative Chuck Sides, April 6, 1987; Illinois Department of Registration and Education, May 9, 1986; Kansas State Representative Ginger Barr, February 14, 1986; and Alabama Representative Arthur Payne, January 16, 1986. The staff of the Commission has also testified generally on regulatory issues in this industry; see Statement to California Assembly Committee on Consumer Protection, Governmental Efficiency and Economic Development, October 17, 1991.

⁷ See testimony of Bureau of Competition Assistant Director Michael McNeely to the Pennsylvania House of Representatives Committee on Business and Commerce, August 29, 1989.

II. Description of H.B. 2347.

This bill would enact a comprehensive system of regulation for pre-need contracts. It establishes a regulatory structure, including annual seller registration⁸ and reports⁹ and a fund for making whole consumers who have suffered defaulted contracts.¹⁰ It requires several disclosures and notifications to consumers about terms of contracts and disposition of funds.¹¹ By making pre-need contracts cancelable and transferable¹² and requiring that trust accounts be placed in federally-insured institutions and that profits on them accrue to the buyer or the buyer's estate,¹³ the bill makes pre-need contracts similar to personal savings accounts.

The bill would resolve an inconsistency in the treatment of different kinds of pre-need sellers. Under Pennsylvania's Funeral Director Law,¹⁴ funeral directors that enter into pre-need contracts must deposit 100 percent of the money received into an escrow or trust account. By contrast, under the Future Interment

⁸ H.B. 2347, § 4.

⁹ H.B. 2347, § 22(i).

¹⁰ H.B. 2347, § 19.

¹¹ H.B. 2347 § 6(d) (solicitations), § 6(g) (advertisements), § 7(c) (FTC Funeral Industry Practices Rule disclosures), § 7(d) (investment details, for contracts without guaranteed prices), § 8 (contract specifications, including itemization of goods and services and their prices, method of funding, details about trust or insurance arrangements, procedure for filing complaints with the state Bureau of Consumer Protection, payment into contract guarantee fund, and 30-day cancellation and refund rights), § 10(b) (costs of credit life insurance), § 12(a)(2) (amounts removed from trust, for contracts with guaranteed prices), § 13(e) (details about insurance arrangements), § 13(g) (advice about cancellation rights if not satisfied with the policy's projected financial terms), and § 15 (cessation or transfer of seller's business).

¹² H.B. 2347, § 9.

¹³ H.B. 2347, § 12(m).

¹⁴ Pa. Stat. Ann. tit. 63, § 47913(c).

Law,¹⁵ other vendors of pre-need contracts, such as cemeteries, must deposit only 70 percent.¹⁶ H.B. 2347 would eliminate this disparity by requiring pre-need vendors of all kinds to place proceeds in trust in the same proportions.

The trusting requirement would generally be 100 percent.¹⁷ For contracts in which prices are guaranteed, the bill would permit pre-need sellers to withdraw up to 10 percent of the trust amount;¹⁸ thus, the effective trusting requirement for such contracts would be 90 percent. For both guaranteed-price and non-guaranteed-price contracts, the bill would permit funds held in trust to be used to pay trustee fees, administrative expenses, and taxes.¹⁹ The bill would require disclosure to the consumer of the amounts put in trust, the amounts retained by the seller,²⁰ and any amounts later withdrawn from the trust account.²¹

As an alternative to funding a pre-need contract by payment into a trust fund, the bill would permit payment by means of an insurance policy.²²

III. Possible Competitive Effects of H.B. 2347's "Trusting" Requirements.

Pre-need sales of funeral goods and services respond to a consumer demand for the opportunity to shop and select funeral goods and services without the pressures of time and emotion that can attend purchases made at the time of need. Pre-need purchases may also allow consumers to hedge against price increases by "locking in" prices at the purchase date. Growth of pre-need sales has increased the competitive pressure on providers that sell at-need services.

¹⁵ Pa. Stat. Ann. tit. 63, § 480.2(a).

¹⁶ See Pennsylvania Funeral Director's Ass'n v. Comm. State Bd. of Funeral Directors, 494 A.2d 67 (Commonw. Ct. Pa. 1985), aff'd, 511 A.2d 763 (1986).

¹⁷ H.B. 2347, § 11(b); § 12(a)(3).

¹⁸ H.B. 2347, § 12(a)(2).

¹⁹ H.B. 2347, § 12(k), § 9(b).

²⁰ H.B. 2347, § 8(h)(3).

²¹ H.B. 2347, § 12(a)(2).

²² H.B. 2347, § 13.

One effect of H.B. 2347 would be to "level the playing field" by subjecting all sellers of pre-need funeral contracts to the same requirements. When different regulatory standards apply to competing sellers of the same goods and services, the result can sometimes be anticompetitive. The sellers held to the more stringent standards may incur higher costs and find competing more difficult, so consumers may lose the benefits of the disadvantaged sellers' otherwise active competition. The stiffer requirements could nonetheless be warranted, despite that loss, if the sellers subject to them threatened a greater risk of consumer harm. By treating all pre-need providers alike, H.B. 2347 would imply a determination that the likely difference in risk of consumer harm is insufficient to justify different rules for funeral directors than for cemeteries.

If all pre-need sellers must conform to the same regulatory standards, it remains to be determined what those uniform standards should be. That the trusting requirements now differ suggest that the legislature has, at different times, made different judgments about the appropriate degree of protection. We do not know what Pennsylvania's experience with the two different trusting levels may have taught about their relative effect on the risk of consumer harm.

We are concerned, though, that a 100-percent trusting approach may unintentionally retard the introduction and development of innovative forms of competition and lower cost alternatives. If all funds must remain in trust, the seller cannot recover its overhead, selling, or administrative expenses and make a profit until an unknown and possibly distant future date. Some sellers and potential sellers may choose not to offer pre-need contracts because of the higher costs that those contracts would entail. If a 100-percent trust requirement increased the costs of serving the pre-need market, consumers could be denied the lowest prices and full array of pre-need alternatives and pricing options.

H.B. 2347 would reduce the risk of such side effects by allowing for 90 percent trusting in some circumstances and by permitting the deduction from trust proceeds of "reasonable" administrative fees and expenses. But reducing the trust requirement by 10 percent may not necessarily be the best solution, for that trust requirement could still buy more protection than consumers would actually prefer. The bill's alternative funding method, insurance contracts, also fails to correct the problem that 100 percent trusting could present. Insurance contracts, like escrow accounts, could assure consumers that the necessary funds would be available at the time of need. But the pre-need seller anticipating eventual payment from an insurance contract, just like the seller holding all funds in trust, would still be unable to recover overhead, selling, and administrative expenses and make a profit until the time of death when the services are provided.

The provisions of H.B. 2347 that permit retention of fees and expenses may help resolve these problems. Sellers might be able to include in their prices certain separate, identified amounts that would not be subject to the trusting requirements or could be deducted from the trust in the event of cancellation and refund.²³ Neither of the Pennsylvania statutes that now govern trusting clearly permits deducting or excluding fees and expenses from trust amounts. It is unclear how these two provisions of H.B. 2347 would apply in practice. But providing explicitly for amounts to cover expenses could overcome the problems described above.

As an alternative to the difficult task of determining in advance an appropriate level of trust funding for the entire industry, the legislature may wish to consider a solution that relies in part on market forces to provide protection in individual cases. The law might permit pre-need sellers to provide a performance bond under which a third party guarantor would agree to pay the contract amount if the seller did not deliver at the time of need. Competition among guarantors could lead to bond prices and other terms that would be set by market forces and that could change in response to changes in market conditions. Moreover, bonding would mean that the appropriate level of protection could be determined for each seller individually. One seller may be a better risk than another, perhaps because its fixed-asset base is larger. If the guarantor charged the lower-risk seller a lower premium or subjected it to other terms that were less stringent and hence less costly, the seller could pass the savings along to consumers.²⁴ At least one state permits pre-need sellers of funeral goods and services to use performance bonds in

²³ H.B. 2347, § 8(j)(4) requires contract disclosure, by dollar amount or percentage, of any amount that "is not placed in trust," and cross-references to § 9(b), which permits "reasonable trustee fees, administrative expenses and taxes" to be deducted before refunding trust funds in the event of cancellation. It is unclear whether the amount that § 8(j)(4) requires the contract to disclose is identical to the items that § 9(b) permits the provider to retain. If so, what § 8(j)(4) permits as "not placed in trust" might be limited to these three categories, subject to a requirement that the amounts be "reasonable." Whether the amounts would be included in the trust but might be deducted from the refund in the event of cancellation, or whether they would not be placed in trust at all, could affect how much interest the consumer earns on trusted funds.

²⁴ To the extent that bonding risk depended on capitalization or creditworthiness, the performance bond alternative might have about the same effect as a trusting requirement on the competitive prospects of new or less well-capitalized firms.

lieu of trust funds.²⁵ Some states permit performance bonds in the sales of cemetery goods and services.²⁶ In other industries, performance bonds have been used to protect consumers' investments, where delivery of goods or services is deferred or occurs over an extended time.²⁷ Permitting pre-need sellers to obtain performance bonds, in lieu of requiring them to put funds in trust, could be a viable and procompetitive alternative that the legislature may wish to consider.

In addition, several sections of H.B. 2347 require that pre-need sellers itemize goods and services covered by pre-need contracts and that their prices conform to prices in the providers' price lists.²⁸ These requirements, taken together, might have the effect of prohibiting any pre-need sales of goods and services at a total price below the sum of their itemized individual prices. To prohibit this practice completely may result in increased costs and thus might harm consumers. Accordingly, the prohibition's possible costs should be weighed against its anticipated benefits. The Commission's Funeral Industry Practices Rule²⁹ and federal antitrust laws, such as the prohibition against "tying,"³⁰ already deal with situations where the practice could raise concerns. This possible effect of the bill might be avoided by providing that prices for separate items in pre-need contracts

²⁵ Iowa Code Ann. § 523A.7 (1988).

²⁶ E.g., S.C. Code Ann. § 39-55-225(d) (1976); Ill. Comp. Stat. Ch. 815, Art. 390, § 15(e) (1992).

²⁷ For example, the Commission has obtained performance bond requirements in orders against health spa operators charged with, among other things, failing to fulfill their contracts with customers. FTC v. Lady Venus Center, Inc., No. 3-84-0158 (M.D. Tenn., Feb. 16, 1984); FTC v. Tyler-Radcliff 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).

²⁸ H.B. 2347, § 5(d), § 8(c), § 12(1).

²⁹ The Commission's Funeral Industry Practices Rule considers it an unfair or deceptive act or practice to condition the furnishing of a funeral good or service on the purchase of some other funeral good or service, except as required by law or otherwise specifically permitted. 16 C.F.R. § 453.4(b)(1). The revised rule, to become effective this summer, also prohibits charging a fee as a condition of furnishing any funeral good or service, except as specifically permitted. 16 C.F.R. § 453.4(b)(1)(ii).

³⁰ See Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984).

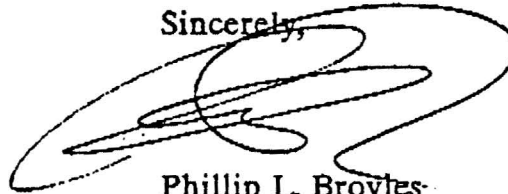
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must be no greater than (instead of identical to) the prices on the providers' price lists.

IV. Conclusion.

Setting the same trusting and other standards for all sellers of pre-need funeral arrangements could eliminate existing statutory anomalies and improve competition, which could in turn benefit consumers. If the trusting requirements are too stringent, however, they may unnecessarily restrict the sale of pre-need goods and services. In assessing how to balance the protection of consumers from supplier default against the risks of impeding competition and injuring consumers indirectly, the legislature may wish to consider allowing pre-need sellers to post performance bonds as an alternative to maintaining trust funds.

Sincerely,

A large, stylized handwritten signature in black ink, appearing to read 'P. Broyles', is written over the word 'Sincerely,'.

Phillip L. Broyles
Director