COMMONWEALTH OF KENTUCKY
FRANKLIN CIRCUIT COURT
DIVISION I
CIVIL ACTION NO 12-CI-1441

UNITED INSURANCE COMPANY OF AMERICA;
THE RELIABLE LIFE INSURANCE COMPANY, and
RESERVE NATIONAL INSURANCE COMPANY **PLAINTIFFS**

v. **OPINION AND ORDER**

COMMONWEALTH OF KENTUCKY,
KENTUCKY DEPARTMENT OF INSURANCE,
SHARON P. CLARK,
in her official capacity as Commissioner of the
KENTUCKY DEPARTMENT OF INSURANCE **RESPONDENT**

INTRODUCTION

This action is before the Court on Cross-Motions for Summary Judgment. The case arises out of a facial challenge to KRS § 304.15-420, which requires life insurance companies to make a good faith effort to determine whether benefits are due based on the Social Security Administration's Death Master File, and if so, attempt to locate beneficiaries and inform them of the claims procedure. Plaintiffs are insurance companies that argue the statute amounts to an unlawful retroactive regulation of their pre-existing life insurance contracts, which were formed without contemplating these requirements. Plaintiffs further argue that the statute violates the Contracts Clause of the Kentucky and United States Constitution. The Department of Insurance and Commissioner Sharon Clark argue that the statute is a valid exercise of the state's police power, and that the legislation is a necessary and appropriate measure to protect the interests of consumers, policyholders and beneficiaries. The Department further argues that the Plaintiffs

have failed to show any impairment of a vested or substantive right. Having reviewed the record, heard the arguments of counsel, and otherwise being sufficiently advised, this Court hereby **GRANTS** summary judgment for the Commonwealth for reasons more fully discussed below.

FACTUAL BACKGROUND

This case arises out of a dispute over whether insurance companies that are licensed to sell coverage in Kentucky should be required to check their list of insureds against the Social Security Administration's Death Master File. If a match is identified, the insurer must make a good faith effort to determine any benefits due, and locate the beneficiaries to inform them of the claim procedures. KRS § 304.15-420.

The Plaintiffs, life insurance companies[1] that do business in Kentucky, have "roughly 11,000 policies in force…from age zero to age 100." (Myers Deposition, p. 100) Currently they have about 3,000 non-premium paying policies in force in the State of Kentucky with insureds older than 70. In order to comply with this new statute, Plaintiffs:

> "would need to acquire the Death Master File. We would need to perform the match, and based on potential matches, go through steps outlined in 1 and 2 of the statute, which is more than we do today. So we would likely need to hire personnel, train personnel to do the search; one, to confirm the death, two, to locate beneficiaries and to evaluate whether or not the individual potential matches are actually our insured. And then to confirm the death."
> (Myers Testimony, P.94-95)

Plaintiffs testified that "the database itself is not expensive to acquire, and the number of policies we have in force would not be costly to run the match against." (Myers Testimony, p. 96-97) After running the search, the Plaintiffs estimate "statute is likely to more than double the

[1] Plaintiff insurance companies are smaller companies who do business mainly in Kentucky. National life insurance companies have engaged in multi-state global settlement with the government that requires them to check the Death Master File and notify beneficiaries of deceased insureds. (http://www.lifehealthpro.com/2012/11/19/john-hancock-companies-settle-with-6-states) Plaintiffs' in-force policies have lower face amounts than those offered by many other, national life insurance companies. The average face amount of United and Reliable's life insurance policies in force is approximately $4,800 with a $16 monthly premium, and Reserve's average is about $8,000 with a $37 monthly premium. (Plaintiffs' Motion for Summary Judgment, p. 4)

effort required to adjudicate policies as defined. So my rough guess is we likely would spend probably about 20 hours per match in order to meet the requirements of the statute." (Myers Testimony, P. 98-99) This would result in an estimated $20,000 to $40,000 cost, although the estimates in time and cost were admitted by Plaintiffs as being based purely on speculation of IT and senior management. (Schallhorn Testimony, p. 80; p. 93) Regardless of its application to existing policies, the companies will still be required to put the technology and procedures in place to access the Death Master File for prospective application. (Schallhorn Testimony, p. 97)

Plaintiffs current claims procedures upon receipt of notice of death is to ask the person who contacted them to provide a copy of the death certificate, as well as a statement surrounding the death, and the original policy form. (Schallhorn Deposition, p. 38) In most cases, the only information the insurance companies have for beneficiaries is their name. (Myers Testimony, P. 96) In order to locate beneficiaries of a claimed insurance policy, Plaintiffs "first of all, talk to whoever it was that filed the claim and try to find out from them if they … knew any information about the beneficiary… and then if they were unsuccessful there, they would probably do an internet search just to look for the beneficiary." (Schallhorn Deposition, p. 106-107) When asked if Scallhorn thought that would constitute a good faith effort, he responded "Yes." (Id.) The Plaintiffs interpret the law to require them "to go search for deaths…and claims. It puts the burden of proving death in order to pay a claim on the company instead of on the policyholder of the beneficiary, which could open the company up to all sorts of other potential litigation, I would think." (Schallhorn Testimony, p. 120). The Department of Insurance, in oral arguments, stated its interpretation of the law is not to require companies to prove the death with a death certificate, but rather merely to make a good faith effort to learn of deaths through the Death Master File and make a good faith effort to attempt to give notice to potential beneficiaries. The

claims process would remain otherwise unchanged, which would require any beneficiary to follow the company's procedures detailed above.

Plaintiffs have brought an action in this Court for a Declaration of Rights to declare the law unconstitutional. The Plaintiffs argue the statute is facially invalid because no law can be retroactive in application under KRS § 446.080(3). They argue that the law effectively re-writes the terms of the contract to shift the burden in the claims process described above from the client to the insurer. In the alternative, they argue that the statute is unconstitutional under the Kentucky and United States' Constitution's Contracts Clause, which prohibits a law from substantially impairing a contractual relationship unless it serves a significant public purpose and is a narrowly tailored means of achieving that purpose. The Commonwealth disputes these arguments and submits that the statute is a valid exercise of the state's regulatory power over the business of insurance, and that it is an appropriate means of protecting the interests of consumers who are the beneficiaries of these insurance policies. (Defendant's Cross-Motion for Summary Judgment, p. 2)

STANDARD OF REVIEW

Summary judgment is granted when the court concludes there is no genuine issue of material fact for which the law provides relief. CR 56.03. Only when it appears from the facts that the nonmoving party cannot produce evidence at trial in favor of a judgment on his behalf should summary judgment be granted. Steelvest, Inc. v. Scansteel Serv. Ctr., Inc., 807 S.W.2d 476 (Ky. 1991). The record must be viewed in the light most favorable to the party opposing the motion for summary judgment and all doubts are to be resolved in his favor. Id. A summary judgment movant has the initial burden of showing that no genuine of material fact exists,

whereupon the burden shifts, as a party opposing supported summary judgment motion cannot defeat it without presenting at least some affirmative evidence showing that there is a genuine issue of material fact for trial. Hibbits v. Cumberland Valley Nat'l Bank and Trust Co., 977 S.W.2d 252 (Ky. Ct. App. 1998).

Any statute in the Commonwealth "carries a presumption of constitutionality." Commonwealth v. Halsell, 934 S.W.2d 552, 554 (Ky. 1996); Brooks v. Island Creek Coal Company, 678 S.W.2d 791, 792 (Ky. App. 1984). When a court reviews the constitutionality of a statute, it is obligated "to give it, if possible, an interpretation which upholds its constitutional validity." Halsell, at 554–555, *citing* American Trucking Ass'n v. Com., Transp. Cab., 676 S.W.2d 785, 789 (Ky. 1984); Gurnee v. Lexington-Fayette Urban County Gov't, 6 S.W.3d 852, 856 (Ky. Ct. App. 1999). "To succeed in a typical facial attack, [a plaintiff] would have to establish that no set of circumstances exists under which [the statute] would be valid, or that the statute lacks any plainly legitimate sweep." Disc. Tobacco City & Lottery, Inc. v. United States, 674 F.3d 509, 522 (6th Cir. 2012), *citing* United States v. Stevens, 559 U.S. 460 (2010) (internal citations and quotation marks omitted). Facial challenges are disfavored by the courts because they often rest on speculation, thereby risking "premature interpretatio[n] of statutes on the basis of factually barebones records." Id.

The Supreme Court has established a three part test to determine whether a state statute violates the Contracts Clause. First, the court must evaluate "whether the state law has, in fact, operated as a substantial impairment of a contractual relationship." Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400, 411 (1983). The severity of the impairment will increase the level of scrutiny. Id. "Total destruction of contractual expectations is not necessary for a finding of substantial impairment. On the other hand, state regulation that restricts a party to

gains it reasonably expected from the contract does not necessarily constitute a substantial impairment." Id. (internal citations removed) "In determining the extent of the impairment, we are to consider whether the industry the complaining party has entered has been regulated in the past." Id.

If the contractual relationship has been substantially impaired by the state regulation, the state must have a "significant and legitimate public purpose" to justify the regulation, such as remedying a broad and general social or economic problem. Id. The Court has indicated the public purpose need not address an emergency or temporary situation. Id. at 412. Finally, if a legitimate purpose exists, the court must determine whether the adjustment of contractual rights and responsibilities is based on reasonable conditions and "of a character appropriate to the public purpose justifying the legislation's adoption." Id. Unless the state itself is a contracting party, courts defer to legislative judgment as to the necessity and reasonableness of a particular measure. Id. at 413.

DISCUSSION

1. Statute Does Not Violate the Rule Against Retroactive Application

This statute does not alter the substantive contractual relations between the insured and the insurance company. Rather, it imposes regulatory (or remedial) obligations for the insurance company to identify and notify beneficiaries after the death on an insured. The expressed legislative purpose of the Act ("to require complete disclosure, transparency and accountability"[2]) is a valid exercise or the police or regulatory power of the state. Such remedial requirements "do no impair the rights a party possessed when he or she acted or give past conduct or transactions new substantive legal consequences, [and thus] they do not

[2] KRS 304.15-4200(1).

operate retroactively." Moore v. Sills, 307 S.W.3d 71, 81 (Ky. 2010). While the insurance company has a reasonable expectation that the state will not alter its contractual obligations, it has no reasonable expectation that the state will not impose reasonable regulatory requirements designed to enforce the pre-existing contract rights of insureds and beneficiaries.

Here, the legislature has sought to remedy the problem of insurance companies holding on to funds that should be paid to beneficiaries upon the death of an insured. The traditional industry practice allows insurance companies to stick their heads in the sand and ignore publicly available data regarding the deaths of their insureds, to the detriment of the beneficiaries (and the public). This statute remedies the problem by requiring insurance companies to check publicly available data bases and to take "good faith" steps to notify beneficiaries. While the statutory scheme enacted by our legislature may or may not be the best or most efficient way to achieve that goal, it is well within the scope of the legislature's police powers to regulate the business of insurance.

Applying such a remedial statute to claims that are pending at the time of its enactment does not violate the prohibition against retroactive legislation. Thornsberry v. Aero Energy, 908 S.W.2d 109 (Ky.App. 1995). As the Court of Appeals has explained, "when a statute is purely remedial or procedural and does not violate a vested right, but operates to further a remedy or confirm a right, it does not come within the concept of retrospective law nor the general prohibition against the retrospective operation of statutes." Miracle v. Riggs, 918 S.W.2d 745, 747 (Ky.App. 1996). Here, the statute remedies a significant problem in the regulation of the business of insurance, a business which is highly regulated in all aspects.

The statute merely confirms the right of beneficiaries to the money the insured's premiums have already paid for, and thus the statute must be construed as a remedial or procedural requirement not subject to the prohibition against retroactive legislation. The regulatory requirements of the statute do not impair the vested rights of the parties to the contract of insurance. No insurer will be required to pay more than it is already contractually obligated to pay, and no beneficiary will receive more than the insured paid premiums to obtain. But by operation of this statute, beneficiaries will obtain the funds to which they are entitled in a more timely fashion, a classic protection of the rights of consumers that is well within the legislature's power.

2. The Statute Does Not Impair Any Vested Contractual Right.

The Plaintiffs' claim that the statute unconstitutionally impairs the obligations of contracts must be reviewed in light of well established case law that provides that the language of the contracts clause is subject to "the inherent police power of the state 'to safeguard the vital interests of its people.'" Energy Reserves Group v. Kansas Power and Light, 459 U.S. 400, 410 (1983) (*citing* Home Bld'g and Loan Ass'n v. Blaisdell, 290 U.S. 398, 434 (1934)). Here, the Court finds that the legislation is well within the regulatory power of the legislature.

Plaintiffs cannot show that any vested right is abridged by KRS § 304.15-420. Without an abridgement of a vested right, Plaintiffs cannot claim a contractual impairment. "A right is vested, for these purposes, only if it has ripened into a secure entitlement to present or future enjoyment. The mere expectation of enjoyment is not enough." King v. Campbell County, 217 S.W.3d 862 (Ky. App. 2006). Although Plaintiffs argue they have a vested right in a potential beneficiary's burden of notice, their argument is based on a right to future enjoyment of

insurance premium investments made as the custodian of money otherwise properly payable to the beneficiaries of deceased insureds. A right, "in order to be vested (in the constitutional sense) must be more than a mere expectation of future benefits or an interest founded upon an anticipated continuance of existing general laws." Louisville Shopping Center, Inc. v. City of St. Matthews, 635 S.W.2d 307, 310 (Ky. 1982).

In effect, the Plaintiffs' expectation was that the legislature would not disturb the traditional industry practice of ignoring publicly available data about the deaths of insureds, and that the legislature would not impose any regulatory requirement to find or notify beneficiaries. The Supreme Court has decided similarly that a taxpayer had no vested right in the Internal Revenue Code as written. In a highly regulated industry such as insurance, companies should be aware that their rights are always subject to the regulatory power of the state to enact consumer protections such as the one at issue here. Such changes in statute do not violate vested rights, or due process. United States v. Carlton, 512 U.S. 26 (1994).

The beneficiaries of the deceased insured's policy have the ability to submit proof of death at any time, and Plaintiffs have no contractual right to continued custody of the funds at all. In fact, Plaintiffs never have a guarantee as to how long they would have custody of the funds or what benefit they would receive from them. (Plaintiff's Cross-Motion for Summary Judgment, p. 11). While Plaintiffs may have had some expectation that some percentage of the insurance payments would be left for an extended term, there was never any guarantee they would receive such a benefit. The regulatory requirement that the Plaintiffs make a good faith effort to identify and give notice to potential claimants does not impair a vested right.

The Plaintiffs' argument suggests that notice is a required condition precedent to coverage under the policies in question, and that the statute substantially alters this requirement.

(Plaintiff's Motion for Summary Judgment, p. 16). Yet, notice is never mentioned in the contracts. Further, both Myers and Schallhorn Depositions concede that notice may be received from any source. When notice *is* material to the contract, it is provided for expressly. The contractual obligation that forms the basis for these insurance contracts is proof of death, not a notice of claim (Schallhorn Dep., p. 119). Plaintiffs rely on Andrews v. Nationwide Mutual Ins., 2012 WL 5289946[3] for support of their position that the notice and proof of death requirement creates additional, non-contractual duties. However, this interpretation of the term "confirm the death" is the worst case scenario. The Department of Insurance does not take the position that insurance companies would be required to provide a death certificate upon request to "confirm the death," nor is such a strained reading of the statute justified.

The statute in question here may be read to allow the burden of proof of death to remain on any potential beneficiary. The statute imposes on insurance companies a requirement to check the Death Master File on a quarterly basis against their list of insureds and to attempt to notify listed beneficiaries. Regardless of the source of notice of the death of an insured, the current process insurance companies use to locate potential beneficiaries could be consistent with the statute's requirement to make a good faith effort to provide notice. The worst-case scenario of exorbitant costs of tracking down death certificates is entirely speculative. Such speculative injury is insufficient to sustain a facial challenge to the statute. Because notice is not a duty assigned to either party in any of the Plaintiffs contracts, there is no impairment of any contractual right in the statute's requirement for insurance companies to make a good faith effort to locate and notify beneficiaries of their right to receive funds.

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[3] The Andrews case is an unpublished Ohio Appeals Court decision. Unpublished decisions, even within this jurisdiction, "shall not be cited or used as binding precedent in any other case in any court of this state..." CR 76.28. While the case may be cited in limited circumstances, the Court does not find it persuasive.

3. Even if the statute impairs a contractual right, it is justified by a significant and legitimate public purpose

Although this Court finds there is no contractual right to be impaired, even if the additional procedural step of periodically checking the Death Master File and notifying insured clients is considered to be a contractual impairment, this burden is justified by a significant and legitimate public purpose, as explained by the Supreme Court in Kansas Power & Light Co. As the Court held there, "[i]n determining the extent of the impairment, we are to consider whether the industry the complaining party has entered has been regulated in the past. ... The Court long ago observed: 'One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the state by making a contract about them.'" 459 U.S. at 411. There are few industries more highly regulated than the insurance industry, and all insurance companies have notice that the state may impose requirements on their operations to provide for the protection of policyholders and beneficiaries.

Many Kentucky citizens pay for insurance to help them plan for end of life costs. For insurance companies to attempt to keep the money through willful ignorance of the death of the insured amounts to unjust enrichment at the expense of some of the least privileged citizens in this state. On average, the life policies are for burial amounts of $4,800 with monthly premiums of $16. (Myers Deposition, p. 5). All but 42 of the policies at issue were sold door to door to people in lower socio-economic classes. (Id.) This Court finds legislative judgment on the necessity and reasonableness of this particular matter was well justified. In addition, the statute is narrowly tailored to serve the purpose of ensuring that beneficiaries who are lawfully entitled to these funds receive their money in due course.

This statute does not require the insurance companies to complete the claims process, despite Plaintiffs' argument to the contrary. The statute is narrowly tailored to give notice to

potential beneficiaries, but leaves intact the contractual burden of proving the death. This statute serves a significant public interest, and is narrowly tailored to address that interest. It cannot be considered a major impairment of any contractual right.

The Court has indicated the public purpose need not address an emergency or temporary situation. Id. at 412. Finally, if a legitimate purpose exists, the court must determine whether the adjustment of contractual rights and responsibilities is based on reasonable conditions and "of a character appropriate to the public purpose justifying the legislation's adoption." Id. Unless the state itself is a contracting party, courts defer to legislative judgment as to the necessity and reasonableness of a particular measure. Id. at 413.

The requirement to consult the Death Master File and give notice to beneficiaries does not shift any burden under these policies because no burden of notice was ever assigned in these contracts. Further, the claimants must still file a proof of death. When possible, a statute should be construed to be constitutional. Here the Court interprets the statute to require insurance companies to take reasonable steps to provide notice to potential beneficiaries; it does not require contractual rights regarding proof of death to be disturbed.

CONCLUSION

For the reasons stated above, the Commonwealth's Motion for Summary Judgment is **GRANTED** and the Plaintiffs' Motion for Summary Judgment is **DENIED.** In order to allow any party adversely affected by this ruling to seek post-judgment relief or obtain interlocutory relief regarding enforcement of the requirements of the statute, the Court *sua sponte* **ORDERS:**

1. Enforcement of the requirements of KRS 304.15-420 against the Plaintiffs in this action shall be **STAYED** pursuant to CR 62 for a period of ten (10) days from the entry of this

Opinion and Order to allow Plaintiffs to file any post-judgment motions or to seek interlocutory relief;

2. This stay of enforcement shall automatically dissolve at close of business on April 11, 2013 unless extended by the filing of a post-judgment motion under CR 59 or CR 60, or through relief under CR 62 or CR 65 by an appellate court of competent jurisdiction. So **ORDERED** this 1st day of April, 2013. This is a final and appealable order and there is no just cause for delay.

PHILLIP J. SHEPHERD, JUDGE
Franklin Circuit Court, Division I

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