SUTHERLAND

LEGAL ALERT

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Constitutional Challenge to Kentucky's Death Master File Statute Rejected

A Kentucky state trial court has rejected a challenge to a state statute requiring life insurers to search the Social Security Administration Death Master File (DMF) and attempt to locate potential beneficiaries, holding that the law is a valid exercise of the legislature's powers to regulate the insurance industry. In its April 1, 2013 decision, the trial court ruled in the state's favor on cross motions for summary judgment, holding that the statute neither violated any rules against retroactive application nor impaired any vested contractual rights. *United Ins. Co. of Am. v. Kentucky* (Ky. Cir. Ct. April 1, 2013) (Click here for a copy of the opinion.)

The Kentucky statute at issue, which took effect January 1, 2013, mandates that insurers search the DMF on a quarterly basis for potential deaths of their insureds.[1] The statute further requires insurers to follow up on matches by making good faith efforts to confirm deaths, determine whether benefits are due, locate the beneficiaries, and facilitate claims submissions. The Kentucky statute is based on a Model Unclaimed Life Insurance Benefits Act prepared by the National Conference of Insurance Legislators (NCOIL). A version of the NCOIL Model Act or legislation having a similar effect has been enacted in six states—Kentucky, New York, Alabama, Maryland, and most recently Montana and New Mexico—and legislation has been introduced in several other states.

Before the statute took effect, three insurers filed a declaratory judgment action challenging the constitutionality of certain aspects of the new Kentucky statute.[2] The plaintiff insurers sought a declaration that the statute applies only prospectively to policies issued after the statute's effective date and not retroactively to in-force policies. The complaint alleged that "[t]he Act effects a significant change in the manner in which life insurers acquire proof of an insured's death and settle and pay the resulting claims" and that it "impos[es] for the first time [an] affirmative duty to seek out evidence that insureds have died where no claim has been received from a beneficiary or the insured's estate." The insurers sought declaratory relief on three grounds: (1) that the Act only applies prospectively, consistent with a state law presumption against the retroactive operation of new statutes; (2) that if the Act were construed to have retroactive effect, it substantially impairs insurers' contractual rights under in-force policies and thereby violates the Contract Clauses of the Kentucky and United States Constitutions; and (3) that the Act only applies to life insurance policies issued in the Commonwealth and not those issued in other jurisdictions. The suit did not challenge the Act's prospective effect on newly issued policies, but instead contested its potential retrospective interference with insurers' legitimate contractual expectations, including the pricing

[1] Kentucky Rev. Code § 304.15-420.

[2] The suit was filed November 8, 2012, in the Franklin County Circuit Court by United Insurance Company of America, The Reliable Life Insurance Company, and Reserve National Insurance Company against the Commonwealth of Kentucky and the Kentucky Department of Insurance. *United Ins. Co. of Am. v. Kentucky* (Ky. Cir. Ct. filed Nov. 8, 2012)

of in-force policies and the costs and administrative burdens of searching for deaths where no claim has been received. The parties filed cross motions for summary judgment.[3]

On April 1, 2013, the court issued an order rejecting the insurers' challenge and granting summary judgment for the state. First, the court held that, because the statute merely confirms beneficiaries' rights to proceeds based on premiums already paid by insureds, the statute must be construed as a remedial or procedural requirement not subject to the prohibition against retroactive legislation. And although insurance companies have a reasonable expectation that the state will not alter its contractual obligations, the court further stated that a company "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." The court stated:

> [T]he 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 databases and to take "good faith" steps to notify beneficiaries.

The court also held that the law does not impair vested contractual rights because, under the statute, "[n]o 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." Rather, "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." For this reason, the court concluded the statute was "well within the scope of the legislature's police powers to regulate the business of insurance," regardless of whether the statute was the "best or most efficient way" to do so. Even if the statute did impair a contractual right, the court believed that it would be justified by the public purpose of "ensuring that beneficiaries who are lawfully entitled to [insurance proceeds] receive their money in due course."

Rejecting the insurers' position that a beneficiary has a contractual duty to provide the notice of death under the insurers' contracts, the court found that "notice is not a duty assigned to either party in any of the [insurers'] contracts." Instead, the court decided that "[r]egardless 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 court further discounted the insurers' arguments regarding the costs of searching for death where no claim has been received, characterizing the alleged injury as "speculative" and "insufficient to sustain a facial challenge to the statute."

The court reiterated, however, that the statute "leaves intact the contractual burden of proving proof of death," a burden which remains on the beneficiary or other claimant. "[T]he claimants must still file a proof of death … [and] the Court interprets the statute to require insurance companies to take reasonable

[3] On January 30, 2013, the National Alliance of Life Companies (NALC) and the American Fraternal Alliance (AFA) filed an amicus brief in support of the insurers' motion for summary judgment. The Life Insurers Council (LIC) separately submitted an amicus brief in support of the motion on the same date.

steps to provide notice to potential beneficiaries; it does not require contractual rights regarding proof of death to be disturbed." The plaintiff insurers have filed an appeal of the decision.

This decision comes at a time when unclaimed property issues facing insurance companies are continuing to play out in ongoing audits and litigation. Insurance industry practices regarding the use of the DMF are under scrutiny by state officials in multistate market conduct examinations and unclaimed property audits. Numerous insurance companies are subject to unclaimed property audits by multiple states, and a number of state insurance regulators are investigating insurers' practices with respect to DMF searches and payment of death benefits under life insurance policies.

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