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To: Special Committee on Financial Institutions and Insurance

From: Whitney Howard, Research Analyst

Re: 2017 HB 2104—Uninsured and Underinsured Motorist Coverage and Insurance Setoff

2017 HB 2104—UNINSURED AND UNDERINSURED MOTORIST COVERAGE AND INSURANCE SETOFF

This memorandum discusses current law and statutory changes proposed by 2017 HB 2104 related to uninsured motorist (UM) and underinsured motorist (UIM) coverage and insurance setoff in Kansas, as well as various approaches taken by select states. “Setoff” generally refers to an automobile insurance company’s ability to reduce any amount payable under UM/UIM coverage to an injured policyholder by all sums paid by or on behalf of the other motorist’s insurance coverage.

Statutory Setoff in Kansas and Changes Proposed by 2017 HB 2104

Kansas motorists are required to have both UM and UIM coverage. The relevant statute, KSA 40-284(b), states:

“Any uninsured motorist coverage shall include an underinsured motorist provision which enables the insured or the insured’s legal representative to recover from the insurer the amount of damages for bodily injury or death to which the insured is legally entitled from the owner or operator of another motor vehicle with coverage limits equal to the limits of liability provided by such uninsured motorist coverage to the extent such coverage exceeds the limits of the bodily injury coverage carried by the owner or operator of the other motor vehicle.”

Since Kansas motorists are required to have a minimum auto liability of \$25,000 for bodily injury to or death of one person in any one accident, they are also required to have \$25,000 in UM/UIM coverage. UIM coverage is insurance the policyholder has with his or her own insurer. However, this does not mean that in an accident, a policyholder will access \$25,000 from the negligent motorist and \$25,000 from the motorist’s own UIM coverage for a total of \$50,000 in coverage. In *Halsey v. Farm Bureau Mut. Ins. Co.*, 275 Kan. 129, 143, 61 P.3d 691, 700 (2003), the court stated “the plain and unambiguous language of KSA 40-284(b) requires a limits-to-limits comparison in determinations as to whether UIM coverage exists. In

those cases where the UIM coverage exceeds the limits of the bodily injury coverage carried by the owner or operator of the other motor vehicle, UIM coverage exists. However, in those cases such as the case we now consider, where the UIM coverage equals or does not exceed such limits no UIM coverage exists.”

Consequently, to access any benefits under UIM coverage, the injured motorist must have bodily injury damages more than the negligent motorist’s liability coverage and the negligent motorist’s available liability coverage must be less than the injured motorist’s available UIM coverage. When both motorists have the minimum coverage liability policies, there is no UIM coverage available to the injured motorist. The insurer may reduce the policyholder’s UIM coverage limits by the limits of the negligent motorist’s insurance coverage, known as a “setoff” or “credit.”

HB 2104 would eliminate this “setoff” so that a motorist could access their auto liability limits and UIM coverage. The amendatory language to KSA 40-284(b) appears below:

“Any uninsured motorist coverage shall include an underinsured motorist provision with coverage limits equal to the limits of liability provided by such uninsured motorist coverage which enables the insured or the insured’s legal representative to recover from the insurer the amount of damages for bodily injury or death to which the insured is legally entitled from the owner or operator of another motor vehicle ~~with coverage limits equal to the limits of liability provided by such uninsured motorist coverage~~ to the extent such coverage exceeds damages exceed the limits of the bodily injury coverage carried by the owner or operator of the other motor vehicle. In no event shall the amount of available underinsured motorist coverage be reduced because of any payment by or on be of the owner or operator of the other motor vehicle or any third party.”

During the 2017 bill hearing in the House Committee on Insurance, proponents of the bill stated current law permits a “loophole,” of which injured motorists are paying a premium for UIM coverage they do not receive. Proponents stated the amendment to the statute would permit motorists to access the coverage they are required to purchase. Opponents stated that insurance companies setoff payments from other sources so the claimant recovers the full amount of the claim. However, if companies are not allowed to setoff other sources of payments, there could be a possibility of the injured motorist recovering twice for their injuries. Opponents also stated this could have the effect of increasing the price of UIM coverage.

State Approaches to Insurance Setoff

According to the Insurance Information Institute, about 20 jurisdictions require UM coverage and only a handful of states require motorists to purchase UIM coverage.¹ Provisions related to UM and UIM coverage vary by state. It is difficult to make meaningful comparisons due to the state-by-state nature of insurance law, including the state statutory construction, legislative activity, and court decisions. Each state’s approach to automobile insurance has its

¹ Insurance Information Institute, “Background on: Compulsory Auto/Uninsured Motorists,” July 3, 2017, <http://www.iii.org/article/background-on-compulsory-auto-uninsured-motorists>, accessed September 20, 2017.

own nuances and points of interest. Consequently, the remainder of this memorandum will focus on select states allowing setoffs in automobile insurance policies and select states prohibiting these setoffs.

Select States Allowing Setoff

Alabama

Under Ala. Code § 32-7-23, motorists must be offered UM/UIM coverage²; however, the motorist has the right to reject the coverage in writing. In *Guess v. Allstate Ins. Co.*, 717 So. 2d 389, 390 (Ala. Civ. App. 1998), the court found a reduction clause in an automobile insurance policy stating the UIM benefits will be reduced by liability insurance payments requires setoff, even though Ala. Code § 32-7-23 neither provides for setoff or precludes setoff. The court noted the insurance policy at issue was clear and unambiguous as to the setoff provision.

In April 2010, the Alabama Commissioner of Insurance issued an insurance bulletin addressing the enforceability of automobile insurance policy setoff provisions.³ The bulletin first noted that setoff provisions and their application must account for two Alabama Supreme Court decisions, *McKinney v. Nationwide Mut. Fire Ins. Co.*, 33 So. 3d 1203 (Ala. 2009) and *Nationwide Mut. Fire Ins. Co. v. Austin*, 34 So. 3d 1238 (Ala. 2009). The Alabama Insurance Department interpreted these two decisions to mean that “the application of a policy UM ‘setoff’ provision violates public policy if, under the particular circumstances, the effect is to reduce the amount of UM benefits paid to the insured below the statutory minimum.” Further, “in the Department’s view, the ‘public policy’ being advanced in these decisions is that an insured realize not less than the statutory minimum in UM benefits in those instances where the insured’s damages exceed the total payments by the tortfeasor’s insurer, the insured’s UM coverage, and medical or other payments made to the insured and within the scope of the policy ‘setoff’ provision.”

Alaska

In Alaska, an offer of automobile insurance must contain the option for UM and UIM coverage; however, the motorist may waive this coverage. Alaska Stat. Ann. § 28.20.445 provides that UIM coverage cannot be drawn upon until “the limits of liability of all bodily injury and property damage liability bonds and policies that apply have been used up by payments, judgments or settlements.” Therefore, an insured must use up, or “exhaust,” available underlying liability policy limits before he or she can pursue UIM benefits.⁴ Moreover, the statute provides that the maximum liability of a UIM carrier is the lesser of: the difference between the amount of the covered person’s damages and the amount paid to the covered person by or for a person who is or may be held legally liable for the damages; and the applicable limit of liability of the UM and UIM coverage.

2 In 1984, the Alabama Legislature amended the term “uninsured motor vehicle” to include “underinsured” motor vehicle. See § 32-7-23(b)(4).

3 Ridling, Jim, Commissioner of Insurance, Bulletin No. 2010-04, “Uninsured/Underinsured Motorist Coverage - Enforceability of Policy ‘Setoff’ Provisions,” April 20, 2010.

4 *Coughlin v. Gov’t Employees Ins. Co. (GEICO)*, 69 P.3d 986, 989 (Alaska 2003).

In *Sidney v. Allstate Ins. Co.*, 187 P.3d 443 (Alaska 2008), the Alaska Supreme Court noted that under the state's statutory UIM scheme, a provider of UIM coverage is liable for only that portion of damages in excess of available liability insurance. The court also noted it would be unreasonable for there to be no setoff in this scenario because then the UIM award would fail to reflect the receipt of underlying benefits.

California

Insurers are required to offer UM/UIM coverage to motorists; however, the motorist may choose whether or not they would like to purchase this coverage.⁵ The issue of setoff is addressed by Cal. Ins. Code § 11580.2(p)(4), which states:

“When bodily injury is caused by one or more motor vehicles, whether insured, underinsured, or uninsured, the maximum liability of the insurer providing the underinsured motorist coverage shall not exceed the insured's underinsured motorist coverage limits, less the amount paid to the insured by or for any person or organization that may be held legally liable for the injury.”

In 2011, AB 1063 was introduced to expand the scope of UIM coverage by repealing certain statutory limitations on the scope of coverage. The bill would have amended Cal. Ins. Code § 11580.2(p)(4) to repeal the statutory setoff allowing an insurer to reduce its maximum liability pursuant to UIM by the amount paid by a person or organization liable to the injured party.

According to the official bill analysis published by the California State Assembly Committee on Insurance, the bill sponsor stated the setoff provision of the statute denies the motorist the full benefit of their insurance policy. A main source of contention of the bill was the cost implications. The Department of Insurance provided a rough estimate that, on average, the bill would result in a 10 percent increase in UIM costs. A proponent of the legislation, Consumer Watchdog, looked at one State Farm rate filing and concluded the increased losses under the bill would be minor based on State Farm's reported losses. In turn, State Farm disputed these conclusions because the analysis failed to take into consideration the correct developed loss data. State Farm concluded, similarly to other insurers, that the cost of UIM coverage would approximately double under the bill. The Association of California Insurance Companies presented data suggesting a 9 percent increase in overall automobile liability premiums. Ultimately, there was uncertainty about how much costs would increase, and which policyholders would experience greater or lesser impacts. The bill was not enacted.

Also in 2011, a bill was introduced to require the California Law Revision Commission to conduct a survey comparing the key provisions of California's UIM coverage laws with the laws of other states. This bill was not enacted.

In 2013, AB 862 was introduced, which would have authorized an automobile insurer the option to offer, as an alternative to the statutorily mandated setoff UIM coverage, a non-setoff version of coverage. An insurer is not authorized by law to make other alternatives available, so the bill created a statutory authorization for an insurer to add coverage options for its customers. Proponents of the bill argued that motorists are not receiving a sufficient range of options for

5 Cal. Ins. Code §11580.2(a)(2)

UIM coverage existing under law. Additionally, under the existing structure, a person's right to recover under UIM coverage depends on the "luck of the draw" of who happens to hit them and 2013 AB 862 would allow the motorist another choice when purchasing their policy. Opponents of the bill argued the bill is not necessary and there is no evidence of motorist demand for this type of enhanced UIM coverage. They also asserted that if a motorist believes a particular coverage level under the current rules does not provide adequate protection, then that motorist can buy a higher coverage level. Ultimately, the bill was not enacted.

Delaware

Del. Code Ann. Tit. 18, § 3902 governs UM and UIM coverage. Delaware law mandates the insurer make a "meaningful offer" of UM/UIM coverage to the insured. The statute further provides that "every insurer shall offer to the insured the option to purchase additional coverage for personal injury or death up to a limit of \$100,000 per person and \$300,000 per accident or \$300,000 single limit, but not to exceed the limits for bodily injury liability set forth in the basic policy." The elements of a "meaningful offer" are: (1) an explanation of the cost of the coverage; and (2) a communication that clearly offers the specific coverage in the same manner and with the same emphasis as was on the insured's other coverage."⁶

The Delaware Supreme Court invalidated policy provisions allowing UM coverage reductions based on payments from third parties in *Hurst v. Nationwide Mut. Ins. Co.*, 652 A.2d 10 (Del. 1995), and UIM coverage reductions in *Nationwide Mut. Auto. Ins. Co. v. Peebles*, 688 A.2d 1374 (Del. 1997). Third-party payments from any source, however, will be reduced from the total value of the insured's damages to determine the amount of accessible UM/UIM coverage under the policy.⁷ In *Peebles*, the court noted that a reduction for other insurance policies available to the insured must be setoff against the claimant's total damages for bodily injury, rather than being setoff against the limits of the claimant's UIM coverage. The rationale is that under Del. Code Ann. Tit. 18, § 3902, once an insured accepts additional coverage under UM and UIM, this coverage pays for bodily injury damage the insured is legally entitled to recover from the motorist of an underinsured motor vehicle.⁸

Indiana

Ind. Code Ann. § 27-7-5-5 establishes the minimum and maximum amount an insured may recover for UM/UIM. See *Kinslow v. GEICO Ins. Co.*, 858 N.E.2d 109, 114 (Ind. Ct. App. 2006.) However, the method for calculating setoffs that fall within the permissible range of recovery will depend upon the language of the policy's setoff provision.⁹ Indiana courts have held that policies containing ambiguous reduction language should be interpreted to mean that the amounts paid by other sources shall be subtracted from the total damages, while policies containing unambiguous language should be interpreted to mean that amounts paid by other

6 *Mason v. United Servs. Auto. Ass'n*, 697 A.2d 388, 393 (Del. 1997).

7 Rhoads, Melissa, "Uninsured Motorist and Underinsured Motorist Coverage Compendium: Delaware," http://webcache.googleusercontent.com/search?q=cache:6O8T6prLfUMJ:www.tighecottrell.com/docs/2016_03_UMUIM_Delaware.pdf+&cd=1&hl=en&ct=clnk&gl=us

8 Del. Code Ann. Tit. 18, § 3902(b)(1)

9 Trimble, John, et. al, "Uninsured Motorist and Underinsured Motorist Coverage Compendium: Indiana," www.lewiswagner.com/9C8985/assets/files/News/00829969.PDF

sources shall be taken from policy limits. See *Sutton v. Littlepage*, 669 N.E.2d 1019, 1022 (Ind.Ct.App.1996.)

Missouri

Under Mo. Ann. Stat. § 379.203, UM coverage is required “in not less than the limits for bodily injury or death set forth in § 303.030, for the protection of persons insured thereunder who are legally entitled to recover damages from owners or operators of uninsured motor vehicles because of bodily injury, sickness or disease, including death, resulting therefrom.” Section 303.030 refers to an amount of \$25,000 for bodily injury or death of one person in one accident, and \$50,000 because of bodily injury or death of two or more persons in an accident. In *Cano v. Travelers Insurance Company*, 656 S.W.2d 266 (Mo. 1983), the Missouri Supreme Court found that the insurance policy reducing UM liability by the amount of workers compensation benefits was “ineffective because of the public policy implicit in § 379.203” and the insurer was not entitled to setoff workers compensation benefits paid out against the insurer’s liability under UM coverage. Therefore, the opinion stated, it appears that a provision in an insurance policy purporting to setoff to reduce UM coverage below the limit is considered invalid.

Missouri courts have found that setoffs are permitted to the extent that such provisions did not reduce coverage below minimum amount authorized by statute. In *Am. Standard Ins. Co. of Wisconsin v. Bracht*, 103 S.W.3d 281 (Mo. Ct. App. 2003), the court found that the “set-off provision in UM section of automobile insurance policy, which stated that any amount payable to or for an injured person under policy would be reduced by any payment made under liability coverage portion of policy, did not violate public policy as long as the uninsured motorist coverage provided after the set-off was applied was equal to or greater than the minimum insurance coverage a motorist was required to have under Motor Vehicle Financial Responsibility Law (MVFRL), despite the fact that policy did not specifically require that the set-off provision would only apply above minimum limits set by the MVFRL. V.A.M.S. § 379.203, subd. 1.”

In that case, the insured had a higher limit for bodily injury than required by state statute. The insured had liability coverage of \$50,000/\$100,000, and UM coverage of \$25,000/\$50,000. The insurer had a declaration in the terms of the insurance policy permitting setoff. The court found that the “insurer who charged a higher premium for \$50,000/\$100,000 bodily injury automobile liability coverage than for the statutory minimum coverage of \$25,000/\$50,000 was not unjustly enriched by set-off provision in policy which reduced amount payable under liability portion of policy by any amount paid on UM portion of policy, where UM coverage was for the minimum limits required by statute, insured would receive the benefits of the increased liability coverage limits except if payments were made under the UM coverage, and there was no evidence indicating insurer offered a policy without the set-off provision, making it unclear whether a premium for a policy without the set-off provision would be higher than one with it. V.A.M.S. §§ 303.030, subd. 5, 379.203.” The court also noted insurance contracts that do not violate public policy will be enforced as written and stated the setoff provisions in the insurance policy were clear and unambiguous.

Although Missouri does require UM coverage, state law does not require UIM coverage. Since UIM coverage is not mandatory, the parties to an insurance contract are free to limit or expand the terms of coverage available under the automobile policy. However, a provision allowing for setoff must be free from ambiguity. In *Long v. Shelter Ins. Companies*, 351 S.W.3d

692 (Mo. Ct. App. 2011), the court found that the “automobile insurer was not entitled to set off of amount paid by tortfeasor against UIM limit of liability coverage for purposes of wrongful death action arising out of death of insured in motor vehicle accident; the discussion of the ordinary insured’s coverage on the declarations page of the policy was not limited by any language suggesting the limits were subject to set-off or reduction, there was thus no reason for the ordinary insured to look any further to form the reasonable belief that the insured has obtained UIM coverage in the maximum amount of \$100,000 per person/\$300,000 per accident available to cover any excess damages incurred over and above those paid by others liable.” The court noted that if a policy is ambiguous, the court will construe the policy in favor of the insured.

Ultimately, the Missouri courts permit setoffs for UM coverage, as long as the setoff provision does not reduce coverage below the minimum amount authorized by statute and are unambiguous. Setoffs are permitted for UIM coverage, so long as they are clear and unambiguous in the insurance policy. These courts have had an eye toward public policy from the statute and the terms of the insurance policies at issue.

Select States Prohibiting Setoffs

Arkansas

Under Ark. Code Ann. § 23-89-209, motorists must be offered UIM coverage; however, the motorist has the right to reject the coverage in writing. The state requires UIM coverage to be at least equal to the limits prescribed for bodily injury or death, which is \$25,000 because of bodily injury or death of one person in any one accident and \$50,000 because of bodily injury or death of two or more persons in any one accident.¹⁰ Further, coverage of the insured pursuant to UIM coverage cannot be reduced by the tortfeasor’s insurance coverage, except to the extent the injured party would receive compensation in excess of his or her damages.¹¹

Colorado

In 2007, the Colorado Legislature amended Colo. Rev. Stat. Ann. § 10-4-609 related to UM/UIM coverage in the state. Prior to January 1, 2008, an automobile owner could purchase UM/UIM coverage as part of the insurance policy. The UM/UIM insurance replaced the bodily injury liability coverage of the at-fault motorist. After January 1, 2008, instead of replacing bodily injury liability coverage, UI/UIM coverage would be in addition to medical payments coverage and health insurance, and could not be used to setoff any health care benefits. According to the fiscal note, the bill (SB 07-256) was assessed to have no fiscal impact.

The relevant language of Colo. Rev. Stat. Ann. § 10-4-609 is as follows:

“(1)(a) No automobile liability or motor vehicle liability policy insuring against loss resulting from liability imposed by law for bodily injury or death suffered by any person arising out of the ownership, maintenance, or use of a motor vehicle shall be delivered or issued for delivery in this

¹⁰ Ark. Code Ann. § 27-19-605

¹¹ Ark. Code Ann. § 23-89-209

state with respect to any motor vehicle licensed for highway use in this state unless coverage is provided therein or supplemental thereto, in limits for bodily injury or death set forth in section 42-7-103(2), C.R.S., under provisions approved by the commissioner, for the protection of persons insured thereunder who are legally entitled to recover damages from owners or operators of uninsured motor vehicles because of bodily injury, sickness, or disease, including death, resulting therefrom; except that the named insured may reject such coverage in writing.

(b) This subsection (1) shall not apply to motor vehicle rental agreements or motor vehicle rental companies.

(c) The coverage described in paragraph (a) of this subsection (1) shall be in addition to any legal liability coverage and shall cover the difference, if any, between the amount of the limits of any legal liability coverage and the amount of the damages sustained, excluding exemplary damages, up to the maximum amount of the coverage obtained pursuant to this section. A single policy or endorsement for uninsured or underinsured motor vehicle coverage issued for a single premium covering multiple vehicles may be limited to applying once per accident. The amount of the coverage available pursuant to this section shall not be reduced by a setoff from any other coverage, including, but not limited to, legal liability insurance, medical payments coverage, health insurance, or other uninsured or underinsured motor vehicle insurance.”

Oklahoma

Oklahoma does not permit setoff. Okla. Stat. Ann. Tit. 36, § 3636 states “any payment made by the insured tortfeasor shall not reduce or be a credit against the total liability limits as provided in the insured’s own uninsured motorist coverage.” Generally, the Oklahoma Supreme Court has been protective of an insured’s UM benefits by invalidating policy exclusions, limitations, or setoffs on the basis they violate Oklahoma’s public policy.¹²

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¹² *Bohannon v. Allstate Ins. Co.*, 1991 OK 64, 820 P.2d 787.