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January 19, 2015

TO: Senator Jeff King, Chairman
Members of the Senate Judiciary Committee

FROM: N. Russell Hazlewood

DATE: January 19, 2015

RE: K.S.A. § 40-908 and S.B. 16

Mr. Chairman, thank you for the opportunity to testify today. My name is Russ Hazlewood. I am a lawyer from Wichita, Kansas. I graduated from KU Law School in 1997. Since that time, I have been continuously involved in insurance litigation, representing insurance policyholders in matters involving disputes over insurance coverage. I appreciate this opportunity to share my experience and reflections as they relate to the operation and effect of K.S.A. § 40-908 in hope that the committee will recommend no changes to current law.

Critical to the committee's consideration of this issue is an understanding that Kansas does not have a statutory or common law cause of action for the tort of bad faith in insurance contracts. A tort of bad faith cause of action would allow Kansas policyholders bring an action in tort to hold their insurance companies accountable for compensatory and exemplary damages for consciously failing to investigate a claim, failing to provide the benefits that are guaranteed by an insurance contract, or acting in a deceptive or misleading manner.

In Kansas, the only direct remedy for an insured with a first party claim against an insurance company is a breach of contract action. In other words, a company that wrongfully refuses to pay a claim is liable in damages only for the amount that it should have paid, plus statutory interest. However, we do have a legal mechanism that effectively discourages insurance companies from denying policyholders claims. That mechanism is the fee-shifting mechanism set out in K.S.A. § 40 908.

In essence, K.S.A. § 40-908 requires a district court to award a reasonable attorneys fee to a policyholder that successfully sues an insurance company for any coverage denial or refusal to pay, so long as the policy insures property in Kansas against loss caused by fire, tornado, lightning, or hail. The type of policy is the trigger for the statute's application. It does not matter whether the claim involves the listed perils. Notably, however, a fee must not be awarded if the policyholder fails to obtain a judgment for relief in excess of the insurance company's pre-suit tender.

In circumstances where it applies, K.S.A. § 40-908 encourages insurance companies to conduct thorough investigations of facts, research applicable law, and carefully consider the quality of the claim before denying a policyholder's claim. The acid test imposed by the statute is whether the policyholder can establish coverage under the insurance contract. If the insurer must be taught to interpret and apply its own policy contract, it will be required to pay tuition.

K.S.A. § 40-908 provides important protection for individual consumers and businesses alike. Its purpose is to level the playing field so that the economic power of insurance companies is not so overwhelming that injustice may be encouraged because people or businesses will not have the necessary means to seek redress in the courts. It should not be overlooked that many of the casualties that give rise to an insurance claim, *e.g.*, a burglary, a roof collapse, etc., directly and immediately impair the policyholder's cash flow and make it less likely that the policyholder will be able to afford protracted litigation with the insurance company.

It is important to note that the Courts have not expanded the scope of K.S.A. § 40-908. However, the insurance industry has repeatedly, unsuccessfully sought to convince the courts and the Legislature to limit the statute's application. In similar proceedings conducted by the Legislature in 2007, the Judicial Counsel issued a report agreeing with the courts' opinions: "The Committee concludes that the statutory history and case law are consistent with the interpretation that the "fire, tornado, lightning or hail" language in K.S.A. § 40-908 was intended to apply to the type of policy covering the loss, regardless of whether the loss occurred by one of the named causes or some other cause covered by the same policy." The Judicial Counsel discussed at length the statute's import with regard to the "very strong public interest in protecting consumers and encouraging insurance companies to pay claims promptly and fairly." The Committee unanimously recommended that no legislative action be taken to amend K.S.A. § 40-908.

Last year, an identical bill (H.B. 2678) was tabled by unanimous vote of the House Insurance Committee. At the hearing, the committee members expressed a concern that the bill could have a significant impact on the Kansas insurance market, and they didn't feel comfortable voting on the bill without a firm understanding of the consequence of the statutory change being requested.

It is unquestionable there must be a counter-balancing component of law that levels the legal playing field for insurance policyholders. In other states, the field is leveled by recognition of a policyholder's right to file a cause of action against the insurance company based on the tort of bad faith, in many cases with the attendant right to sue for punitive damages. As we speak, Kansas has not traveled that road. I respectfully suggest that the Legislature cannot, in the exercise of good public policy, restrict the scope of K.S.A. § 40-908 in the manner suggested without simultaneously putting another reasonable field-leveling mechanism in place to protect policyholders from arbitrary coverage denial. [1]

If changes are to be made to K.S.A. § 40-908, it should be noted the present system is not without defect. The shortcoming in the present system is that K.S.A.§ 40-908 does not cover all insurance products with equal vigor. Life insurance for example cannot be packaged with fire and casualty risks. Health and accident coverages are rarely, if ever packaged with fire and casualty risks. Consequently, K.S.A. § 40-908 never applies in disputes involving those coverages.

Some states, Florida for example, have statutory regulation schemes similar to K.S.A.§ 40-908 that are less restrictive than K.S.A. § 40-908 and apply across the board to all insurance products. The Florida statute states:

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[1] When this bill was presented in prior years, the proponent represented that another statute, K.S.A. § 40-256, affords adequate protection for Kansas policyholders. That isn't accurate. K.S.A. § 40-256 permits a court to award the policyholder its attorney's fee if it finds the insurance company's refusal to pay was "without just cause or excuse." Courts have interpreted the statute to permit a fee award only where the insurance company's position was "frivolous and unfounded" *See Clark Equip. Co. v. Hartford Acc. & Indem. Co.*, 227 Kan. 489, 494, 608 P.2d 903, 907 (1980). Under that standard, it is always uncertain whether a prevailing policyholder will recover its attorney's fees. By analogy, even where we can readily predict that the Wichita State University's basketball team will defeat a particular opponent, we cannot say the other team will go scoreless. Under K.S.A. § 40-908, the policyholder must win to recover a fee; under K.S.A. § 40-256, it must skunk the insurance company. Consequently, a policyholder can never reliably expect to recover its fee under K.S.A. § 40-256.

> Upon the rendition of a judgment or decree by any of the courts of this state against an insurer and in favor of any named or omnibus insured or the named beneficiary under a policy or contract executed by the insurer, the trial court or, in the event of an appeal in which the insured or beneficiary prevails, the appellate court shall adjudge or decree against the insurer and in favor of the insured or beneficiary a reasonable sum as fees or compensation for the insured's or beneficiary's attorney prosecuting the suit in which the recovery is had.

Fla. Stat. § 627.428(1).

Other states, such as Minnesota, have recently enacted statutes that permit policyholders to bring first-party bad faith claims. *See* Minn. Stat. § 604.18. Those statues provide additional remedies such as multiple damages, *in addition to attorney's fees*, to discourage insurance bad faith.

If the Legislature, in its wisdom, should amend K.S.A. § 40-908, and elect not to recognize a tort-based cause of action for insurance bad faith, it should replace K.S.A. § 40-908 with a statute similar to Florida's statute that applies across the board to give insurance consumers a remedy with respect to all coverages.

Yours very truly,

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