KANSAS ASSOCIATION OF DEFENSE COUNSEL
825 S Kansas Avenue - Suite 500, Topeka, KS 66612
Telephone: 785.232.9091 Fax: 785.233.2206 www.kadc.org

TO: Senate Standing Committee on Judiciary
FROM: Timothy Finnerty and Nathan Leadstrom
Kansas Association of Defense Counsel
DATE: January 21, 2015
RE: 2015 Session SB 16

Chairman King, members of the committee, we thank you for this opportunity to submit written testimony about SB 16 concerning an amendment to K.S.A. 40-908, an attorney's fee statute that applies to law suits over property damage insurance claims brought by policyholders against their insurers. We are members of the legislative committee of the Kansas Association of Defense Counsel, a state-wide association of lawyers who defend civil lawsuits and business interests.

KADC strongly endorses amending K.S.A. 40-908 to correct what we regard as an unanticipated and unwarranted expansion of the statute that has crept into Kansas appellate court decisions over a number of years resulting in its dramatic misapplication. This misinterpretation has caused the award of attorney's fees in cases in which that result was never intended. Originally, this statute was meant to protect policyholders when they attempted to collect on specific types of property damage claims from their insurance companies. Most recently in *Bussman v. Safeco Insurance Co. of America*,[1] the Kansas Supreme Court took the statute in a vastly different direction and awarded a policyholder attorney's fees in a non-property damage case. In making its decision, the Court acknowledged that limiting the reach of K.S.A. 40-908 to property damage claims "just makes sense," but cited the legislature's failure to amend the statute's broad language as a reason for expanding its application.[2] While we are in favor of SB 16 in its current form, we feel we should alert the committee to the fact that its language does not include automobile property claims. In other words, if an automobile is damaged by hail, SB 16 would not be available to protect an insured. Automobile property claims were not excluded in the original version of the statute. *See Boyd Motors, Inc. v. Employers Insurance of Wausau*, 766 F.Supp. 998 (D.Kan. 1991) (applying K.S.A. 40-908 to a car dealership's claim for hail damage to its motor vehicles). For the committee's consideration, language that would include automobile property damage is attached to this testimony. We urge the amendment of the statute to restore its originally

[1] 298 Kan. 700, 317 P.3d 70 (2014).
[2] 298 Kan. at 729, 317 P.3d at 89.

intended operation.

Quick history of developments: How we got here from there

In 1927, this legislature enacted the predecessor to current K.S.A. 40-908. The statute has remained unchanged since it was adopted.

The statute allows attorney fees to a policyholder who sues his or her insurer on a property damage claim due to "fire, tornado, lightning or hail."[3] The statute was meant to apply to so-called first-party claims like those resulting from a house destroyed by fire, a roof damaged by a tornado or an auto damaged by hail. (Such claims are called first-party claims because they are between the policyholder and the insurer. Other claims, known as third-party claims, involve injury to another person or his or her property caused by a policyholder.)

The purpose of K.S.A. 40-908 is clear. First, it leveled the playing field in property damage disputes between policyholders and their insurers by allowing recovery of attorney's fees when the insured was successful.[4] Second, because the insured was required to prevail by obtaining a recovery from the insurer that *exceeded the insurer's presuit offer*, it required evidence of a genuine dispute between the two parties over a substantial difference in the valuation of the loss. Because of the features of the statute, it tended to reduce litigation by giving insurance companies the incentive to fairly compensate property damage claims, while giving insureds incentive to file only meritorious law suits.

For the first 70 years after its enactment, the K.S.A. 40-908 was employed essentially as intended by the legislature; that is, in lawsuits based on property claims initiated by policyholders against their insurers. More recently, however, Kansas courts have applied the statute's language without accounting for its history or the manner in which insurance policies have changed over the decades. This has resulted in the award of attorney's fees in cases never contemplated by the original drafters of the statute.

The expansion leapt forward dramatically in a 2006 case. In *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, [5] the Kansas Supreme Court extended the statute for the first time to third-party claims. In this case, the Court applied the statute to award attorney's fees to a contractor who was sued by homeowners for defective construction of their home. The Court applied K.S.A. 40-908 to award attorney's fees even though the controversy was between homeowners and their contractor – a classic third-party claim. The Court applied K.S.A. 40-908 because the Court did not take into account certain historical developments in the way insurers issued their policies.

Prior to the mid- to late 1950s, insurers issued first-party policies (for example, fire insurance) in a stand-alone format. They also issued stand-alone third-party liability policies (for example, auto policies covering an auto owner's liability for injury to another in a motor vehicle

[3] *Hamilton v. State Farm Fire and Cas. Co.*, 263 Kan. 875, 881, 953 P.2d 1027, 1031-32 (1998).
[4] Among the reasons for limiting the statute to property damage claims is that property damage claims are more easily reduced to specific monetary amounts.
[5] 281 Kan. 844, 137 P.3d 486 (2006).

825 S Kansas Avenue, Suite 500 • Topeka, Kansas 66612
(785) 232-9091 • FAX (785) 233-2206 • www.kadc.org

accident). In the mid- to late 1950s, insurers began to combine first- and third-party coverages into a single package. This gave us what we know today as homeowner's and auto package policies. In today's auto policy, one section insures against physical damage to the car from hail, in another section from damage due to collision and, in yet another section, an owner's liability to others if he or she injures someone by his or her operation of a car.

While these changes were going on in the way insurers were packaging their insurance policies, no changes occurred to K.S.A. 40-908 to take these changes into account. As a consequence, the Kansas Supreme Court in the *Lee Builders* case and, very recently, in the *Bussman v. Safeco Ins. Co.of America*[6] case, have applied K.S.A. 40-908 resulting in the award of substantial attorney's fees. In both of these cases, if the insurers had issued separate, stand-alone policies, the Court could not have considered K.S.A. 40-908 as the basis for the award of attorney's fees. Instead, the Court would have had to consider the requested award under a different statute adapted to these cases, K.S.A. 40-256. If that statute been applied by the Court, we are confident it would not have awarded attorney's fees – a dramatically different result than actually occurred.

Without amendment of K.S.A. 40-908, misapplication of the statute will continue to occur resulting in the increase of litigation and the award of attorney's fees where neither of these had occurred before.

Why Amending K.S.A. 40-908 Makes Sense

There are at least five reasons to amend K.S.A. 40-908 to return it to its original purpose.

First, the proposed amendment reverses the expansion of the application of K.S.A. 40-908 to third-party claims, something the statute was never intended to do. The proper application of the statute to only first-party claims is reflected in the decades of consistent court decisions until the *Lee Builders* case in 2006.

Second, the proposed amendment honors not only the purpose of K.S.A. 40-908 but also that of a separate statute, K.S.A. 40-256. The expansion of K.S.A. 40-908 has effectively repealed its sister statute, K.S.A. 40-256, a statute of general application that also awards attorneys fees, but only when an insurance company fails to pay "without just cause or excuse."

Third, because of the way first- and third-party insurance coverages are constructed, it is virtually impossible to unfairly force the insurer to pay an inflated or unjustified first-party property claim. However, the incorrect application of this statute has produced a race to the courthouse to file suits against insurers on first-party property claims without any notice to the insurer at all that a claim was even going to be made. The current expansion of the statute tends to foment unjustified litigation.

Fourth, first-party property claims are easier to value than third-party claims. It is fairly obvious that the reasonable value of a house destroyed by fire or a roof damaged by hail ought to have a fairly narrow range of possible value. In these cases, policyholder and insurer ought to be

[6] 298 Kan. 700, 317 P.3d 70 (2014).

825 S Kansas Avenue, Suite 500 • Topeka, Kansas 66612
(785) 232-9091 • FAX (785) 233-2206 • www.kadc.org

able to come to an agreement about what that value is. When that does not happen, K.S.A. 40-908 provides a reasonable mechanism to protect the policyholder from a low-ball payment from his or her insurer while it also protects the insurer from exaggerated claims.

Fifth, and perhaps most importantly, before the *Lee Builders* case, this statute was never applied to a third-party personal injury claim (for example, a person who became a paraplegic because of another's negligent driving). When this statute is applied to such claims, the insurer can be (and has been) confronted with a lawsuit claiming substantial damages before it has any notice that the claim exists or a chance to evaluate the claims of the injured person. If the insurer never has a chance to make an offer to the injured party before that person even makes a claim, the injured person recovers not only his damages awarded by a jury but his attorney's fees, too. In the past, before such a person could collect attorney's fees, he was required to show the Court that the insurer had failed "to pay the claim without just cause or excuse." When K.S.A. 40-908 is applied to this situation, the award of attorney's fees is automatic if there is no presuit offer. Whether the insurer acted reasonably in evaluating the injured person's claim simply has no bearing on the award of attorney's fees. Until the *Lee Builders* case, this outcome could not occur.

Conclusion

On behalf of the Kansas Association of Defense Counsel, we appreciate the opportunity to provide our views on SB 16. Thank you for your time and consideration of the proposed amendment.

825 S Kansas Avenue, Suite 500 • Topeka, Kansas 66612
(785) 232-9091 • FAX (785) 233-2206 • www.kadc.org

KADC's proposed amendment of K.S.A. 40-908

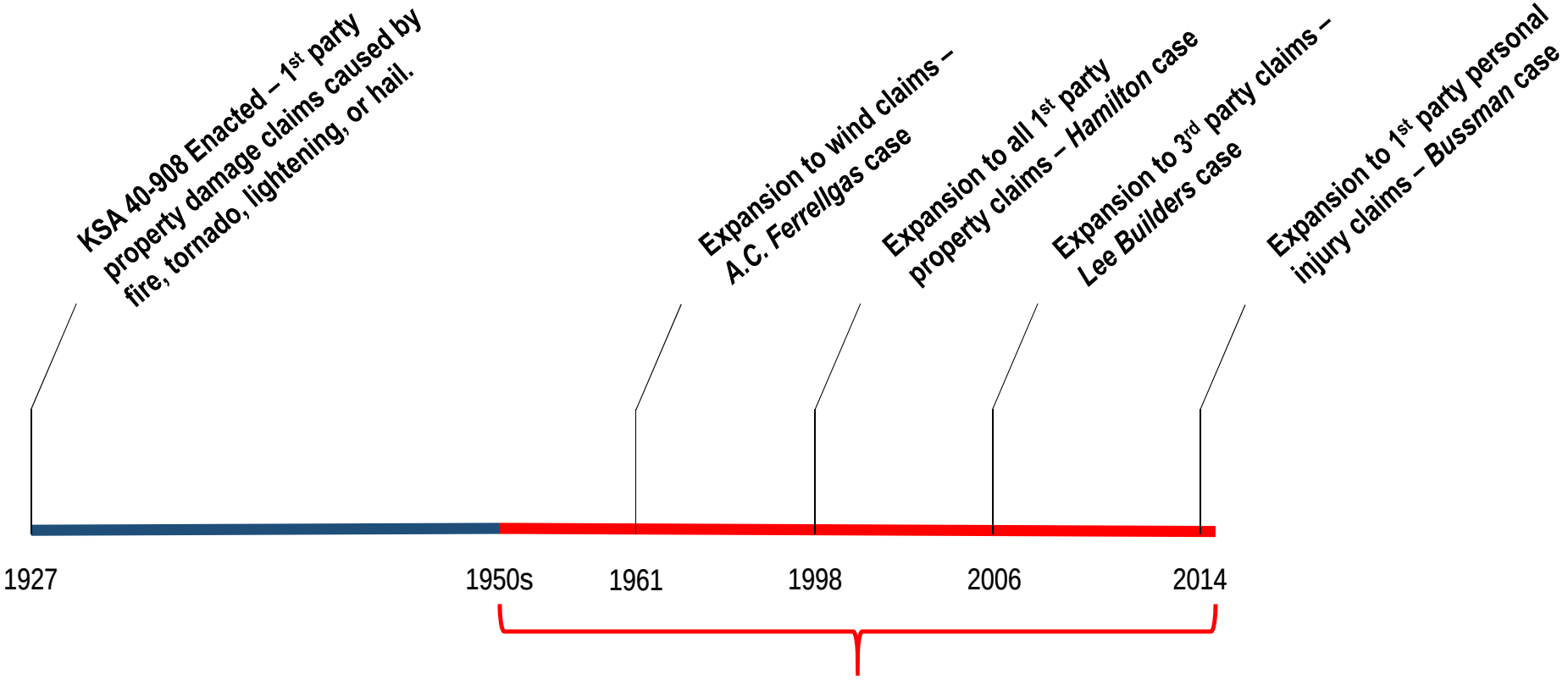
Be it enacted by the Legislature of the State of Kansas:

Section 1. K.S.A. 40-908 is hereby amended to read as follows: 40-908. ~~That in~~In all actions now pending, or hereafter commenced in which judgment is rendered against any insurance company on ~~any policy given to insure any property in this state against~~ any first-party insurance claim for damage to property caused by loss by fire, tornado, lightning or hail, the court in rendering such judgment shall allow the plaintiff a reasonable sum as an attorney's fee for services in such action including proceeding upon appeal to be recovered and collected as a part of the costs~~: *Provided, however*, That~~, except that when a tender is made by such insurance company before the commencement of the action in which judgment is rendered and the amount recovered is not in excess of such tender no such costs shall be allowed.

Section 2. K.S.A. 40-908 is hereby repealed.

Section 3. This act shall take effect and be in force from and after its publication in the statute book.

825 S Kansas Avenue, Suite 500 • Topeka, Kansas 66612
(785) 232-9091 • FAX (785) 233-2206 • www.kadc.org



HISTORY OF KSA 40-908