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# Sneed Law Firm, LLC

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## Memorandum

To: The Honorable Jeff Longbine, Chair  
Senate Financial Institutions and Insurance Committee

From: William W. Sneed, Retained Counsel  
The State Farm Insurance Companies

Date: March 14, 2018

RE: S.B. 362

Mr. Chairman, Members of the Committee: My name is Bill Sneed and I represent The State Farm Insurance Companies ("State Farm"). State Farm is the largest insurer of homes and automobiles in Kansas. State Farm insures one out of every three cars and one out of every four homes in the United States. Please accept this testimony as my client's opposition to S.B. 362.

State Farm respectfully submits that S.B. 362 is not consistent with the interests of Kansas insureds or the public interest. To the extent that the Legislature is concerned that insureds are not adequately paid after damage to a home or other insured structure, that concern should be set aside. Current Kansas law allows proper indemnification for "actual cash value," which is the current value, in money, of insured property in its condition just before a loss. Further, insureds are able to purchase policies with replacement cost benefits if they want to insure against the potential that repairing or replacing their properties will cost more than the property's current value.

By way of background, it is important to understand State Farm's current claim payment practices. State Farm's policies generally provide for a two-step loss payment process for damaged structures. Initially, and before repair, State Farm will pay the actual cash value of the damaged structure (or portion thereof). Then, *if* the insured pursues repair or replacement, State Farm will pay the additional, reasonable amount (if any) the insured may incur to complete repair or replacement. This two-step process is permitted and enforceable in Kansas. *See, e.g., Burchett v. Kan. Mut. Ins. Co.*, 48 P.3d 1290, 1291-92 (Kan. Ct. App. 2002) ("If the insured does not repair or replace the damaged

property, he or she is only entitled to actual cash value....[A]ctual repair or replacement is a precondition to recovery on a replacement cost policy.”).

As presently drafted, S.B. 362 appears to require that insurers pay the full cost for labor to replace damaged property at the point *when replacement cost benefits are owed* – in other words, at the *second* step of State Farm’s loss settlement process and when the insured is pursuing repair. That is unnecessary. At this second step, when an insured’s repair cost exceeds his initial payment, State Farm already pays the full, remaining amount charged for labor *and* materials based on the invoices an insured submits, *without* applying depreciation. And State Farm believes this is customary for other carriers that offer replacement cost benefits in their policies. Enacting S.B. 362 under these circumstances at best would accomplish nothing, and at worst would cause confusion. There is no need to require by legislation what already is done in practice under policy forms that have already been submitted to and allowed by the Kansas Insurance Department (“KID”).

If S.B. 362 is intended differently, and the goal is to require insurers to make up-front payment of an insured’s cost for labor to replace property, *before* repair is undertaken, such a requirement would be ill-advised and would place Kansas out of step with nearly every state in the country. The vast majority of jurisdictions allow insurers to apply depreciation to the *full* cost estimated for the repair or replacement of property when paying “actual cash value,” and that calculation method leads to fair results.

A simple example illustrates why. Assume that an insured has a roof comprised of 20-year shingles that would cost \$10,000 to construct today (\$6,000 for labor and \$4,000 for materials). When the roof is 16 years old, it is damaged by hail. Applying 80% depreciation *only* to the material component of replacement cost would yield an actual cash value of \$6,800 (\$6,000 for labor + \$800 for the depreciated value of materials). Common sense tells us that this is too high a value. Even though the roof has only 20% of its useful life remaining (4/20 years), it would be treated as having a value in cash equal to 68% of a brand new roof. In contrast, if depreciation is applied to full replacement cost, that yields an actual cash value of \$2,000, a value that is far more fitting and properly recognizes that the roof was nearing the end of its useful life and soon would have to be replaced.

State Farm has heard concern expressed that if labor costs are not paid up front, an insured may not be able to retain a contractor. What State Farm sees, however, is that contractors generally only ask for a *partial* payment to begin work, and the insureds’ initial payment generally will be

sufficient to cover that initial payment. Moreover, State Farm frequently pays replacement cost benefits when repair contracts are signed.

Insurance departments across the country have accepted insurance policies that provide for calculation of actual cash value just as that calculation presently is made in Kansas – with *all* components of estimated replacement cost subject to depreciation. Indeed, the KID recently allowed State Farm’s issuance of Endorsement FE-3650, which details that State Farm applies depreciation to all components of estimated replacement cost, including labor, when calculating actual cash value. This same endorsement has been approved in more than 40 other states. Likewise, many of the courts that have considered this question also have concluded actual cash value does not include up-front, full payment for labor. The Tenth Circuit Court of Appeals so held while applying Kansas law and stated that allowing depreciation of all components of replacement cost results in proper indemnification and prevents a windfall to the insured, while requiring up-front payment of labor costs in full would be an “unorthodox” and unreasonable approach. *Graves v. Am. Family Mut. Ins. Co.*, 686 F. App’x 536, 539 (10th Cir. 2017). That decision is consistent with several other decisions applying the laws of many other states, including Oklahoma, Minnesota, Nebraska, Missouri, Colorado, Pennsylvania, Texas, and Florida.<sup>1</sup>

State Farm acknowledges that some courts, including Arkansas’ Supreme Court, have required full payment of labor costs up-front, before repair, as part of actual cash value. *See, e.g., Shelter Mut. Ins. Co. v. Goodner*, 477 S.W.3d 512, 516 (Ark. 2015). Notably, however, the Arkansas Legislature moved swiftly to *counter* that decision by enacting a statute *allowing* insurers to apply depreciation to labor costs when calculating actual cash value, and bringing Arkansas back to the same position that Kansas presently occupies. ARK. CODE ANN. § 23-88-106 (2017).

Based upon the above, we respectfully request that the Committee not take action on S.B. 362.

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<sup>1</sup> *In re State Farm Fire & Cas. Co.*, 872 F.3d 567, 576 (8th Cir. 2017); *Redcorn v. State Farm Fire & Cas. Co.*, 55 P.3d 1017, 1021 (Okla. 2002); *Henn v. Am. Family Mut. Ins. Co.*, 894 N.W.2d 179, 190 (Neb. 2017); *Wilcox v. State Farm Fire & Cas. Co.*, 874 N.W.2d 780, 785 (Minn. 2016); *Basham v. United Servs. Auto. Ass’n*, Civil Action No. 16-cv-03057-RBJ, 2017 WL 3217768, at \*3-4 (D. Colo. July 28, 2017); *Papurello v. State Farm Fire & Cas. Co.*, 144 F. Supp. 3d 746, 770-71 (W.D. Pa. 2015); *Tolar v. Allstate Texas Lloyd’s Co.*, 772 F. Supp. 2d 825, 831-32 (N.D. Tex. 2011); *Goff v. State Farm Fla. Ins. Co.*, 999 So. 2d 684, 689-90 (Fla. Dist. Ct. App. 2008).

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I am available for questions at your convenience.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Will W. Sneed". The signature is fluid and cursive, with the first name "Will" and last name "Sneed" clearly distinguishable.

William W. Sneed

WWS:kjb