Approved: May 23, 1994
Date

MINUTES OF THE HOUSE COMMITTEE ON JUDICIARY.

The meeting was called to order by Vice-Chairperson Tim Carmody at 3:30 p.m. on March 8, 1994 in Room 313-S of the Capitol.

All members were present except:
Representative Tom Bradley - Excused
Representative Mike O'Neal - Excused
Representative Candy Ruff - Excused
Representative Joan Wagnon - Excused

Committee staff present:
Jerry Ann Donaldson, Legislative Research Department
Jill Wolters, Revisor of Statutes
Cindy Wulfkuhle, Committee Secretary

Conferees appearing before the committee:
Barkley Clark,
Bill Caton, Kansas Consumer Credit Commission
Lane Williams, Kansas Legal Services
Ron Smith, Kansas Bar Association
John Peterson, Kansas Association of Professional Psychologists
Chip Wheelen, Kansas Medical Society
John Wine, Secretary of State's Office
Jennifer Wentz, Secretary of State's Office
Joe Lieber, Kansas COOP Council
Jim Magg, Kansas Bankers Association
Jamie Corkhill, Kansas Department of Social & Rehabilitation Services
Kay Farley, Office of Judicial Administration

Others attending: See attached list

Hearings on **SB 564** - Authorizing recovery of collection costs including attorney fees in consumer credit transactions, were opened.

Barkley Clark appeared before the Committee in support of the proposed bill. He stated that Kansas is one of a few states that adopted the American Rule, which prohibits any prevailing party collecting attorney fees unless allowed by statute or contract. Kansas prohibits attorney fees in credit contracts, promissory notes, installment contracts, open accounts, and real estate mortgages or guaranties. This bill would repeal the prohibition against the collection of reasonable attorney fees in consumer credit transactions, bills of exchange, bonds and mortgage instruments and would give authorization to permit consumer credit transactions under the Uniform Consumer Credit Code to provide for payment by the debtor of reasonable costs of collections, but not limited to court costs, attorney fees and collection agency fees. The passage of this bill would encourage settlements, (see attachment 1).

Representative Wells questioned how many states have a limited amount of attorney fees that could be collected. Mr. Clark stated that most states do not have a set limit and some limit it to a percentage of the unpaid balance.

Representative Heinemann questioned if Section 1 was uniform language. Mr. Clark replied that the language was patterned after a number of consumer protection bills in other states. There were two options in the consumer credit code; the first would be to do away with attorney fees altogether or follow the Colorado statute, which would be 15% of the unpaid balance could go towards attorney fees.

Representative Garner stated that with the passage of this bill Kansas would be the most generous in our banking region. Mr. Clark commented that this bill would make Kansas consistent with other states where attorney fees can't exceed 10 or 15% of the unpaid balance.

Bill Caton, Kansas Consumer Credit Commissioner, appeared before the Committee in support of the bill. He commented that consumers affected by this proposed legislation would have adequate notice and protection. A consumer credit transaction is when a transaction either charges interest or allows a person to make at least 4 monthly payments, (see attachment 2).

A number of proponents did not ask to testify but requested that their written testimony be included in the Committee minutes, (see attachments 3 - 9).

Lane Williams, Kansas Legal Services, appeared before the Committee as an opponent to the bill. He stated that there were four reasons why they objected to these changes. First, it would allow creditors to collect attorney fees for collection costs and would protect the creditors and give them a windfall. Secondly, it would penalize consumers for defaulting; this is usually involuntary and beyond their direct control. Next is that it deprives consumers of a valuable statutory protection which they lack the power to obtain by contractual bargaining. The last reason was because it would be counterproductive to the overall purpose of the Kansas Uniform Consumer Credit Code, (see attachment 10).

Ron Smith, Kansas Bar Association, appeared before the Committee and stated that the Bar Association takes no position at this time.

Hearings on **SB 564** were closed.

Hearings on **SB 741** - Evaluations of and notice to guardians and conservatory by psychologist, were opened.

John Peterson, Kansas Association of Professional Psychologists, appeared before the Committee in support of the bill. He commented that this would add psychologists to three sections of law that deals with Kansas Guardianship & Conservatorship Act. Currently, courts are requiring that petitions be accompanied by a letter stating whether the person is disabled or not, (see attachment 11).

Representative Everhart stated that she thought that psychologists are currently doing this. Mr. Peterson stated that he would agree that this is happening right now.

Chip Wheelen, Kansas Medical Society, appeared before the Committee as an opponent to the bill because it could deny a person who is alleged to be disabled the benefit of a medical diagnosis. He stated that if the Committee recommends the bill he suggested an amendment that would guarantee a medical evaluation prior to a decision by the court, (see attachment 12).

Hearings on **SB 741** were closed.

Hearings on **SB 477** - Civil procedure for limited actions, Form No. 16, were opened.

No one appeared to testify either as a proponent or an opponent of the bill.

Hearings on **SB 477** were closed.

Hearings on **SB 580** - Annual reports for certain business organizations.

John Wine, Secretary of State's Office, appeared before the Committee as a proponent of the bill. He stated that this bill would increase consistency in business requirements. Domestic & foreign corporations have been allowed to keep their balance sheet information on annual reports confidential and this proposed bill would extend this to other forms of business organizations, (see attachment 13).

Hearings on **SB 580** were closed.

Hearings on **SB 581** - Articles of organization of limited liability companies, articles of incorporation of corporations and annual reports of domestic cooperative association, were opened.

Jennifer Wentz, Secretary of State's Office, appeared before the Committee as a proponent of the bill. She stated that this bill is a clean-up bill. It addresses the time which a domestic cooperative must file its annual report is at the same time the Kansas income tax return is due, authorizes a corporation to reinstate after it has been forfeited for failure to designate a new resident agent after the previous resident agent had resigned, and would allow a member or manager to sign the amendment to a limited liability company's articles of organization, (see attachment 14).

Joe Lieber, Kansas COOP Council, appeared before the Committee as a proponent of the bill. He stated that this is clean-up legislation, (see attachment 15).

MINUTES OF THE HOUSE COMMITTEE ON JUDICIARY, Room 313-S Statehouse, at 3:30 p.m. on March 8, 1994.

Jim Magg, Kansas Bankers Association, appeared before the Committee on **SB 581** to offer an amendment. The Banker's Association requested amending in the provisions of **SB 369** which would establish the Kansas Fictitious Name Act, (see attachment 16).

Ron Smith, Kansas Bar Association, appeared before the Committee in support of amending **SB 369** into **SB 581** and stated that this is really a public fairness issue. Over half of the states have enacted some sort of a fictitious name legislation.

Hearings on **SB 581** were closed.

Hearings on **SB 464** - Enforcement of support; income withholding, were opened.

Jamie Corkhill, Kansas Department of Social & Rehabilitation Services, appeared before the Committee as a proponent of the bill. She stated that this cleans-up some requirements of federal law that are aimed at assuring child support payments through payroll deductions. These changes would keep the State in compliance and would not effect the federal funds that the State is currently receiving. (see attachment 17).

Kay Farley, Office of Judicial Administration, appeared before the Committee in support of the proposed bill. The bill designates the Clerks of the District Court as the income withholding agency for IV-D cases. They requested that District Court Trustees also be included into the bill, (see attachment 18).

Hearings remained opened on **SB 464**.

The Committee meeting adjourned at 5:30. The next meeting is scheduled for March 9, 1994.

GUEST LIST

HOUSE JUDICIARY COMMITTEE

DATE March 8, 1994

NAME	ADDRESS	ORGANIZATION
Ron Smith	Topeka	Ks Bar Assoc
Danny Bothwell	Topeka	SOS
Jerry [illegible] Wertz	"	"
John Vine	"	"
Kay Farley	"	OJA
Paul Shelby	"	OJA
Jamie Corkhill	"	SRS
Bill Caton	"	Consumer Credit
Jim Maag	"	KBA
Kathy Taylor	"	"
Jeff Sonnich	"	KNLSI
[illegible] Humphrey	"	KMHA
[illegible]	"	[illegible]
John Peterson	"	Ks Assn of Prof Psychologists
KEITH R LANDIS	"	CHRISTIAN SCIENCE Comm ON PUBLICATION FOR KS
Ben Coates	"	KPA
William L. Albott Ph.D	"	Ks Psy Assoc.
Lane Williams	"	KLS
[illegible]	"	KTLA
Joe Lieber	"	Ks Co-op Council
Ed Field	"	Lindburg & Vogel Chtd
George Barbee	"	KAFS

Ron Clarke	St Louis, Mo	Household Financial Group, Ltd
Elwaine F Pomeroy	Topeka KS	Kansas Collectors Ass'n Inc and Kansas Collection Attorneys
Jurel Wright	Topeka Ks	Ks Credit Union Assn.
John Shirley	Manhattan	Ks Advocacy & Protective Services
Ken Bahr	Topeka	Ks. Assn of Prof. Psychologists

A memorandum to the Judiciary Committee
of the Kansas House of Representatives

REFORM OF KANSAS LAWS PROHIBITING ATTORNEY'S FEE CLAUSES IN COMMERCIAL AND CONSUMER CREDIT AGREEMENTS

Barkley Clark
March 7, 1994

I.
THE NEED FOR STATUTORY REFORM

Kansas is one of the few states in the country that flatly prohibits any attorney's fee clauses in credit contracts, including promissory notes, installment contracts, open accounts, real estate mortgages, or guaranties. The source of this prohibition is an ancient (1876) statute now codified at K.S.A. 58-2312. Under the Kansas statute, it makes no difference that the debtor is clearly in default. It makes no difference that the debtor is a sophisticated corporation. The creditor is forbidden from being compensated for its costs in collecting the debt. The 1876 statute was intended to protect unsophisticated consumer debtors (see Young v. Nave, 135 Kan. 23 (1932)), but it applies across the board. There is no civil penalty for including an attorney's fee provision in a commercial contract; it is simply unenforceable.

In 1973, as part of the Uniform Consumer Credit Code (U3C), the Kansas legislature enacted K.S.A. 16a-2-507, which forbids attorney's fee clauses in consumer credit contracts. Although the U3C provision is redundant in the sense that K.S.A. 58-2312 is already on the books, violation of the U3C provision triggers creditor liability for a civil penalty and attorney's fees in favor of the consumer. U3C § 5-201(8). So we have a complete double standard in the U3C.

With enactment of the U3C, the Consumer Protection Act, and other consumer protection statutes, there seems little reason to keep the 1876 law on the books. Yet it still sits there. The legislative trend over the last 15 years has been to deregulate business and agricultural credit agreements, such as by freeing them from any limits on interest rates. See K.S.A. 16-207(f). Yet attorney's fee clauses continue to be prohibited. Although there is no empirical evidence, it seems likely that the prohibition against attorney's fees in both commercial and consumer credit contracts means an increase in the interest rate of all borrowers to cover that cost of collection. In this way, the borrowers who pay on time subsidize those who go into default. Repeal of K.S.A. 58-2312 and amendment of K.S.A. 16a-2-507 would eliminate this hidden subsidy. Debtors who default should pay.

Current Kansas law encourages forum-shopping and choice-of-law provisions in an effort to "locate" a credit transaction in a neighboring state such as Missouri. In addition, Kansas' restrictive rules on collection costs probably hurt in the economic development area, deterring national credit grantors from locating in the state.

The time has come to modernize the Kansas law on attorney's fees provisions in credit agreements, by repealing the 1876 statute and altering the U3C prohibition.

There are several different ways to reform the Kansas law in this area. (1) The most "pro-creditor" approach would be simple repeal of both K.S.A. 58-2312 and K.S.A. 16a-2-507. This would bring the law back to the American Rule, where the creditor can collect attorney's fees if they are provided for in the credit agreement. (2) The next alternative would be simple repeal of K.S.A. 58-2312 governing commercial transactions, with retention of the U3C provision governing consumer transactions. This would draw a very sharp line between commercial and consumer credit, on the ground that there is more limited "freedom of contract" in a consumer credit setting. (3) The third alternative is to repeal K.S.A. 58-2312 and modify the U3C provision so that attorney's fees are more closely regulated in consumer credit transactions without being prohibited. (4) The fourth alternative is to repeal K.S.A. 58-2312 and to replace it with a rule allowing recovery by the "prevailing party" in commercial transactions, but to leave the U3C provision as is. (5) The fifth alternative is to move to a "prevailing party" approach

for commercial transactions, and to amend the U3C so that attorney's fees are tightly regulated rather than prohibited.

SB 564 embodies alternative (3). This approach recognizes the distinction between commercial and consumer transactions, and the need to limit freedom of contract where consumer debtors are involved. The proposal retains K.S.A. 16a-5-201(8), which awards attorney's fees to the debtor when the creditor violates the U3C. The proposed legislation does not cover areas of the law outside credit agreements. It is strictly limited to modifying the present rules under K.S.A.. 58-2312 and K.S.A. 16a-2-507, both of which deal exclusively with attorney's fee provisions in credit agreements. There is no intent to change the rules governing collection of attorney's fees in tort actions or non-credit contract actions.

II.
CURRENT KANSAS LAW ON ATTORNEY'S FEES CLAUSES IS CAUSING GREAT CONFUSION IN THE COURTS

The two Kansas statutes prohibiting attorney's fees (K.S.A. 58-2312 and K.S.A. 16a-2-507) are creating substantial litigation, confusion, and tension in the relationship between federal and Kansas law.

Confusion in Interpreting the 1876 Law. K.S.A. 58-2312 flatly prohibits attorney's fee clauses in "any note, bill of exchange, bond or mortgage". The scope of this language is unclear. Would it cover a revolving charge account? A 30-day open account? An equipment lease with an option to purchase? A UCC security agreement? In Iola State Bank v. Biggs, 233 Kan. 450 (1983), the Kansas Supreme Court extended the statute to continuing guaranties of notes, even though the language needed to be stretched to reach that result. In Oak Park Investment Co. v. Lundy's, Inc., 6 Kan. App. 2d 133 (1981), the Kansas Court of Appeals said that the language does not cover a commercial real estate lease. Given these two cases, what other contracts are covered and what are excluded? Why should attorney's fees be recoverable under a commercial real estate lease but not a commercial real estate mortgage? We can expect continuing litigation on the scope of the prohibition, particularly because so many types of contracts contain attorney's fee provisions.

Confusion in Interpreting the U3C Provision. The 1876 statute is confusing enough, but the U3C prohibition has in the last several years generated even greater confusion in the courts and the lending community. In Halloran v. North Plaza State Bank, 17 Kan. App. 2d 840 (1993), the Kansas Court of Appeals dealt with a provision in a security agreement that authorized the lender to apply proceeds from the sale of collateral to attorney's fees "if permitted". The bank in that case argued that the phrase "if permitted" limited the impact of the clause, making it conditional, so that it was of no effect in a U3C state like Kansas. The court rejected the bank's argument, holding that the statutory prohibition was "unqualified" in nature. Moreover, the court concluded that the U3C penalizes inclusion of an attorney's fee provision regardless of whether the creditor actually collects it. In this case, there was no attempt by the bank to collect attorney's fees. The court concluded that the mere presence of the clause in the contract was enough to trigger civil penalties against the bank under the Kansas U3C.

The bank in Halloran argued that the Kansas U3C prohibition squarely conflicts with § 506(b) of the Bankruptcy Code, which allows an oversecured creditor to apply any surplus to attorney's fees, so long as they are provided for in the security agreement. The bank argued that this Bankruptcy Code provision preempts state law prohibitions on attorney's fees, particularly in its requirement that they can't be collected in bankruptcy unless they appear in the security agreement. To prohibit an attorney's fee clause under state law would conflict with the federal law grant of authority and frustrate the policy of the Bankruptcy Code to allow an oversecured creditor to get full recovery on its secured claim. The bank contended that the conditional attorney's fee clause was the only way to recognize the state prohibition, yet allow its use in bankruptcy. Moreover, the bank pointed to solid legislative history that federal law preempts conflicting state law on this point. See 124 Cong. Rec. 17406 (Oct. 6, 1978) ("If the security agreement between the parties provides for attorney's fees, it will be enforceable under [the Bankruptcy Code] notwithstanding contrary law...")

The case law supports the idea that the Bankruptcy Code preempts state law on attorney's fees. See, e.g., In re Hudson Shipbuilders, Inc., 794 F.2d 1051 (5th Cir. 1986). Moreover, the Kansas bankruptcy courts have concluded that attorney's fee provisions in security agreements are allowable under

§506(b) of the Bankruptcy Code notwithstanding the Kansas statutory prohibitions in the 1876 law and the U3C. In re American Metals Corp., 31 B.R. 229 (Bankr. D. Kan. 1983). See also Clark, The Law of Secured Transactions Under the Uniform Commercial Code, ¶ 6.01.

Because of the need to take advantage of the bankruptcy provision, creditors in Kansas have generally included in their contracts clauses allowing attorney's fees "to the extent permitted by law" or "to the extent permitted by the Bankruptcy Code", or "except as prohibited by law." Such "conditional clauses" are used frequently when a creditor has transactions in Kansas and in neighboring states that don't have such a prohibition. Many national form companies offering their products to creditors in all states, use such conditional clauses as a mater of course. Even in Kansas, such clauses are inserted in the hope that the law will change.

Another Kansas Court of Appeals decision that conflicts with Halloran is Credit Union One of Kansas v. Stamm, Case No. 90-LA-408, an unpublished opinion decided in 1992. In that case, the court held that the attorney's fee language used by the credit union in its form credit agreement ("Foreclosure costs) may include the cost of storing the property, preparing it for sale and attorney's fees to the extend permitted under state law or awarded under §506(b) of the Bankruptcy Code") did not violate the Kansas U3C because of its conditional character. A decision in the Stamm case, has now been handed down by the Supreme Court and will be discussed in my testimony to the committee.

So we have two completely conflicting decisions in Kansas, not to mention a conflict between a Kansas state court decision and a Kansas bankruptcy court decision. In the meantime, there are a number of other Kansas cases in the pipeline on the same issue. Some of these cases involve slight variations in the conditional language of the attorney's fee provision. As far as we can determine, Kansas is the only state in the country that is plagued by this type of litigation.

In response to Halloran, a number of Kansas creditors went so far as to send a "correction notice" to all their consumer debtors indicating that their conditional attorney's fee provision was never intended to be enforced in Kansas. With respect to future transactions, mot creditors have deleted any reference to attorney's fees in their contracts, thereby completely losing the benefit of §506(b) of the Bankruptcy Code. Creditors are uncertain whether they should delete conditional language from their commercial credit agreements, in light of Halloran. The entire matter has created mass confusion.

In order to put an end to this sorry state of affairs, Kansas law should be reformed to expressly authorize "to the extent permitted by law" attorney's fee provisions, in addition to authorizing limited attorney's fees provisions in consumer credit (and commercial) transactions.

Confusion in the Student loan Program. The current prohibitions against attorney's fee clauses have also created confusion in collecting delinquent student loans under the Federal Student loan Program. A federal statute (20 U.S.C. §109a(b) states that, notwithstanding any state law to the contrary, a borrower who has defaulted on a student loan will be liable for reasonable collection costs, including attorney's fees. The federal regulations (34 CFR Part 682) require that collectors of these notes use "due diligence", including attempts to recover attorney's fees. However, in spite of this clear federal mandate, courts throughout Kansas routinely invoke the U3C prohibition against attorney's fees on consumer debts. So here we have another conflict between federal and state law, just as with bankruptcy under the Halloran case. We can expect additional federal loan programs that follow the student loan model, creating more conflicts between federal and state law in the future.

Confusion under the Uniform Commercial Code. Under § 9-504(1)(a) of the Uniform Commercial Code, collateral securing a debt can be sold and the proceeds applied to the costs of foreclosure, including attorney's fees "to the extent provided for in the agreement and not prohibited by law." In almost all states, a creditor foreclosing under Article 9 of the UCC can recover front-end costs including reasonable attorney's fees to compensate for the cost of foreclosure. But not in Kansas. The same conflict appears under § 9-506 of the UCC, dealing with redemption.

Confusion in Bank Credit Card Programs. Under current law, a federally insured commercial bank headquartered in another state may issue a credit card to a Kansas resident and include an attorney's fee provision that preempts the Kansas prohibitions. Greenwood Trust Co. v. Massachusetts, 971 F.2d 818 (1st Cir. 1992); 12 U.S.C. § 85. This is another example of federal law preempting conflicting state law. Although there are no reported Kansas cases so far, litigation on this preemption issue for interstate credit cards has come up in other states and is certain to plague Kansas in the future.

III.
THE PROHIBITION REGARDING CREDIT AGREEMENTS IS OUT OF LINE WITH THE TREND TOWARD RECOVERY OF ATTORNEY'S FEES IN KANSAS

The anti-attorney's fee rules in K.S.A. 58-2312 and K.S.A. 16a-2-507 stick out like a sore thumb when viewed in the context of other Kansas laws in this area and the historical trends. Two excellent law review articles discuss this topic. The first is a 1979 article in the Washburn Law Journal by Mark Furney, "Recovery of Attorney Fees in Kansas", 18 Wash. L.J. 535 (1979). The second is a 1984 article in the Journal of the Kansas Bar Association by Ron Leslie, "Recovery of Attorney Fees--An Historical Perspective", JKBA, Fall 1984, at p. 154.

Early on, Kansas adopted the American Rule, which denies the prevailing party attorney's fees unless expressly allowed by statute or contract. Stover v. Johnnycake, 9 Kan. 367 (1872). This put Kansas at odds with the English Rule, which allows attorney's fees to the prevailing party, even in the absence of any contractual provision. The American Rule still applies in Kansas to all contracts not involving credit transactions.

Yet almost from the beginning, the Kansas legislature was chipping away at the American Rule and moving toward the English Rule in some areas. The Leslie article, written in 1984, found 75 Kansas statutes allowing recovery of attorney's fees in litigation, usually at the discretion of the trial judge. Some of the statutes impose sanctions, including attorney's fees, for actions which courts consider frivolous. See, e.g., K.S.A. 60-2007. Other statutes award attorney's fees to particular classes of plaintiffs who prevail in various types of litigation. See, e.g., K.S.A. 16a-5-201, which gives attorney's fees to a consumer who shows that a creditor violated the U3C. Leslie put the 75 statutes into various substantive groups: civil procedure, consumer rights, domestic relations, motor vehicles, public utilities and common carriers, railroads, real estate, unfair commercial practices, and miscellaneous. A copy of his listing is set forth below. The common denominator of all these statutes is that the Kansas legislature made a policy decision to allow attorney's fees to be awarded in a wide variety of settings.

By contrast, the Furney article identifies only three statutes that prohibit attorney's fees: (1) The Uniform Landlord Tenant Act, K.S.A. 58-2547(a)(3), prohibits an attorney's fee provision in a residential real estate lease. (On the other hand, the Kansas Court of Appeals, in Oak Park Investment Co. v. Lundv's, Inc., 6 Kan. App.2d 133 (1981), held that an attorney's fee for the prevailing party was okay in a commercial real estate lease.) (2) The U3C, K.S.A. 16a-2-507, prohibits attorney's fee clauses in consumer credit contracts. (3) The 1876 statute, K.S.A. 58-2312, prohibits attorney's fee provisions in any note, bill of exchange, mortgage or bond. These three statutes stand in stark contrast to the general legislative treatment of attorney's fees.

What does this tell us? It says that Kansas upholds the American Rule allowing attorney's fee clauses in every type of contract except the three described above. In commercial transactions, K.S.A. 58-2312 is the only statute on the books in Kansas that rejects the American Rule and freedom of contract. In consumer transactions, the U3C prohibition is one of only two exceptions to the American Rule. In all three cases, the statute runs counter to the clear trend in Kansas toward allowing recovery of reasonable attorney's fees.

In the area of credit agreements, the Kansas legislature has refused to adopt the American Rule allowing attorney's fee clauses in private contracts. Instead, the two statutes in question completely tie the creditor's hands and reject freedom of contract. The present situation in Kansas is nicely summarized by Furney in his Washburn Law Journal article, at pp. 544-545:

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> The pattern and effect of these statutes is clear. Consumers, mortgagors, and commercial borrowers shall never pay an attorney fee in any transaction "evidenced by debt." The fee provisions also are entirely one-sided. If a creditor must sue, judgment on a valid debt will not include attorney expenses. However, a creditor violating the Uniform Consumer Credit Code shall pay an attorney fee.
>
> Is Kansas' stringent restriction on contractual freedom necessary? Further, is it wise public policy? The questions are relevant in two areas: consumer protection and general commercial law.
>
> Consumer advocates support Kansas' restriction. They contend allowing contractual debtor fee obligations would unfairly penalize debtors having legitimate defenses on the underlying transaction and unreasonably inflate the amount due upon default. Creditors argue generally higher interest rates result from passing such expenses on to innocent debtors. Mutuality rather than absolute denial of fees to creditors could resolve this conflict. By shifting emphasis from protecting debtors from all fee awards, to protecting debtors from unreasonable fee payments not reflecting services required, the interest of both debtors and creditors could be fairly compromised.
>
> There appears little rationale for limiting freedom of contract for fees in the commercial context. Presumably, bargaining power disparity and unconscionable conduct are not pervasive problems. Protection in the commercial context should focus on protecting debtors from paying exorbitant fees. Repeal of K.S.A. § 58-2312 should be considered. The statute may have outlived its usefulness. When it was passed in 1876 there was not a body of regulatory law protecting consumer interests and granting remedies for oppressive conduct [as there is now with the U3C, the Consumer Protection Act, and other consumer legislation]. Replacement legislation balancing debtors' protection from unreasonable fees and creditors' and society's interest in reduced default expenses is suggested.

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When viewed in historical context, in contrast to the American Rule governing most contracts, and against the background of other legislative activity in this area, the continued prohibition against attorney's fees in credit agreements does indeed stick out like a sore thumb. Moreover, as the Washburn Law Journal article points out, it is contrary to sound public policy.

[75 Kansas statutes permitting recovery of attorney's fees]

Statute	Date	Description
1. Civil Procedure.		
60-211	1982	Attorney willfully signs pleading without good grounds.
60-230	1963	Failure of a party to attend a deposition.
60-237	1963	Failure to allow discovery.
60-256(g)	1963	Use of affidavits in bad faith in summary judgment proceeding.
60-721	1978	Answer to a garnishment contraverted without good cause.
60-905(b)	1963	Posting of a bond to cover damages and attorney fees for a temporary injunction.
60-910(b)	1963	Motion to vacate permanent injunction not in good faith.
60-2007	1982	Court determines that an action, pleading, or component of a case was frivolous in nature.
61-1713	1969	Refusal to admit truth of facts or genuineness of documents under limited actions procedures.
61-2709	1979	To an appellee successful on an appeal from a small claims decision.
2. Consumer Rights.		
16a-5-201	1973	Consumer Credit Code violated by creditor.
16a-5-203	1973	Disclosure provisions of the Consumer Credit Code violated by the creditor.
50-634	1973	Supplier found guilty under the Consumer Protection Act, or where the consumer has brought a groundless action.
50-639	1973	Supplier disclaims implied warranties under Consumer Protection Act.
50-715	1973	Reporting agency willfully fails to comply with the provisions of the Fair Credit Reporting Act.
50-716	1973	Reporting agency negligently fails to comply with the provisions of the Fair Credit Reporting Act.
3. Domestic Relations.		
38-131	1971	Visitation rights by grandparents are denied.
38-1103	1970	Complaining witness in a paternity case prevails and has been represented by private counsel.
38-1307	1973	Moving party has selected a clearly inconvenient forum under the Uniform Child Custody Jurisdiction Act.

38-1308	1978.....	Jurisdiction under the uniform act declined by reason of conduct of the petitioner.
38-1315	1978.....	A party violates a custody decree of another state, making it necessary to enforce the decree in this state under the uniform act.
60-1610	1963.....	Fees to either party in a divorce action.
4. Insurance.		
40-256	1931.....	Insurance company refuses without just cause to pay a claim.
40-908	1927.....	Insuring against fire, tornado, lightning, or hail fails to pay insured.
40-1517	1927.....	Mutual hail insurance company fails to pay insured.
40-2004	1949.....	Unauthorized or foreign insurer fails to pay claim.
5. Labor Relations		
44-119	1897.....	Employer blacklisting.
44-831	1975.....	Right to work provisions violated.
6. Motor Vehicles.		
40-3111(b)	1974.....	Insurance company fails to make timely payments on P.I.P. benefits.
60-2006	1969.....	Automobile negligence case involving damages of less than $750.00
7. Public Utilities and Common Carriers.		
17-1917	1974.....	Failure of a public utility to move lines when requested.
66-176	1923.....	Utility or common carrier violating regulatory laws.
8. Railroads.		
66-165	1901.....	Unauthorized charges.
66-203	1905.....	Failure to supply railroad cars.
66-233	1885.....	Damages caused by fire.
66-259	1893.....	Failure to give bill of lading.
66-266	1898.....	Causing death to cattle in transit.
66-269	1905.....	Failure to allow owners or agents to accompany shipments of livestock.
66-296	1874.....	Death of livestock.
66-305	1911.....	Failure to pay damages upon demand.
66-310	1885.....	Refusal to build fence.
66-318	1909.....	Shipment delays.
66-322	1907.....	Confiscation or diversion of coal.
9. Real Estate.		
26-509	1972.....	Jury award exceeds appraisers' award in condemnation.

29-303	1868.....	Party failing to rebuild partition fence.
29-305	1868.....	Failure to erect or maintain assigned part of partition fence.
29-310	1868.....	Failure to divide land where a partition fence should be built.
29-404	1868.....	Failure to repair a partition fence.
55-202	1909.....	Failure to release an oil and gas lease within 60 days of forfeiture.
58-2257	1941.....	Failing to return real estate document in possession to rightful possessor.
58-2309a	1971.....	Failure to release mortgage when required.
58-3410	1973.....	Under Marketable Record Title Act against one slandering title to real estate.
60-1003(c)	1963.....	Against owners of land in a partition action.

10. Unfair Commercial Practices.

17-1268	1967.....	Selling securities in violation of law.
16-720(b)	1972.....	Pawn brokers refusing to redeliver stolen property on presentation of proper evidence of ownership.
34-229	1931.....	Surety on a warehouseman's bond fails to pay on demand.
41-701(4)	1974.....	Suppliers of alcoholic liquor, beer, or cereal malt beverage who fix the resale price.
50-108	1897.....	Against those involved in unlawful trusts, agreements, or other combinations in restraint of trade.
50-130	1899.....	Injunction violated relating to illegal futures dealings.
50-137	1887.....	Grain dealers and buyers who unlawfully agree to pool prices.
50-505	1957.....	Unfair practices involving dairy products.
50-801	1973.....	Violations of any section of Chapter 50 of Kansas Statutes Annotated.
58-3316(a)	1967.....	Selling subdivided lands in violation of the Uniform Land Sale Practices Act.
65-741	1961.....	Violation of dairy regulatory laws.
83-121a	1963.....	Using inaccurate or false weighing devices.
83-140	1905.....	Grain dealer underweighing grain.
84-7-601	1965.....	Bailee losing a warehouse receipt or bill of lading.

11. Miscellaneous.

16-207(d)	1975.....	Lenders exceeding the maximum interest rate.
22-2518	1974.....	Unlawful interception of wire and oral communications.
40-3114	1977.....	Against employers, doctors, and hospitals, for failure to furnish required information to insurers.
42-389	1891.....	Requiring that illegal consideration be paid as a condition to a right to obtain water.
44-512a	1943.....	Against an employer failing to pay compensation to an injured workman when due under the worker's compensation law.

Note: Any Kansas contract other than a credit agreement may provide for attorney's fees, under the American Rule first embraced by the Kansas supreme court in 1872.

IV.
THE PROHIBITION REGARDING ATTORNEY'S FEES IN CREDIT AGREEMENTS IS OUT OF LINE WITH THE REST OF THE COUNTRY

Commercial Credit Transactions. Under the "American Rule" followed by most states, reasonable attorney's fees may be collected if allowed by (l) statute or (2) contract. With respect to commercial credit transactions such as business and ag loans, all states allow attorney's fee provisions in credit agreements except (l) Kansas (by statute), (2) Michigan (by old case law refusing to accept the American Rule), (3) Nebraska (by old case law), (4) North Dakota (by statute), (5) Ohio (by old case law), (6) South Dakota (by statute, though attorney's fees may be collected in real estate mortgage foreclosures), and (7) West Virginia (by old case law). See the attached "Rollcall of the States." So Kansas is one of only seven states that flatly prohibit attorney's fee provisions in commercial credit contracts such as promissory notes, security agreements and mortgages. Moreover, Michigan, Nebraska, Ohio and West Virginia have old judicial decisions that reject the American Rule, leaving Kansas as one of only three states in the country that has a statutory prohibition. In Oak Park Investment Co. v. Lundy's, Inc., 6 Kan. App.2d 133 (1981), the Kansas Court of Appeals made the point that attorney's fee provisions are not generally against public policy in Kansas; in the absence of a prohibitory statute, they will be upheld. The Oak Park case upheld an attorney's fee provision in a commercial real estate lease. In short, Kansas is in a tiny minority of states that prohibit attorney's fee clauses in commercial agreements by statute. The legislature imposed the prohibition when it enacted K.S.A. 58-2312 over 117 years ago. It is time for the legislature to lift it and return to the American Rule.

Consumer Credit Transactions. Research indicates that a large number of states regulate attorney's fee provisions in consumer credit contracts, even though they allow freedom of contract in commercial credit. But only in Iowa and Wisconsin does the consumer credit legislation flatly prohibit attorney's fees (in both of those states, attorney's fees provisions are permitted for business and agricultural credit transactions). See the attached "Rollcall of the States."

The consumer credit regulation around the country generally takes two forms: (1) in a number of states, attorney's fees may not be collected by a salaried employee of the creditor, and (2) in some states, the statutes impose a dollar or percentage threshold on transactions where attorney's fees can be collected. For example, Indiana prohibits attorney's fee provisions where the consumer loan has an original principal balance of $2700 or less. As another example, under the U3C as enacted in Colorado, attorney's fees are limited to a maximum of 15% of the unpaid balance of the debt. Regulation such as this seems reasonable.

Set forth below is a state-by-state summary of attorney's fee regulation, with emphasis on consumer credit transactions. The picture that emerges is that Kansas is out of the national mainstream.

Rollcall of the States

The following is a list of state lending laws permitting collection of attorneys' fees in consumer transactions:

Alabama	- Mini-Code, Sec. 5-19-10 - permitted for closed-end loans where amount financed is over $300 and open-end loans where unpaid balance exceeds $300, not to exceed 15% of the unpaid debt after default.
Alaska	- No prohibition against attorneys' fee provisions.
Arizona	- Consumer Loan Act, Sec. 6-656 - reasonable attorneys' fees assessed and fixed by the court are permitted. - Mortgage Bankers Law, Sec. 6-941 - reasonable attorneys' fees after default are permitted, by implication. - Consumer Lender Law, Sec. 6-674(A)(3) - reasonable attorneys' fees assessed and fixed by the court are permitted.
Arkansas	- Permitted, not to exceed 10% of principal plus accrued interest. Sec. 4-56-101.
California	- Consumer Finance Lenders Law, Secs. 24451, 24502, 24454(a) - permitted on loans of $5,000 or more. No limit.
Colorado	- Uniform Consumer Credit Code, Sec. 5-2-413 - maximum 15% of unpaid balance permitted if attorney is not salaried employee.
Connecticut	- Secondary Mortgage Loan Act, Reg. Sec. 36-239-15(i) - reasonable fees permitted. - Small Loan Law, Sec. 36-233b(c) - permitted on revolving loans only if the attorney is not a salaried employee, up to 15% of the amount of any judgment entered against the customer.
Delaware	- Licensed Lenders Law, Title 5, Secs. 2223, 2236 - reasonable fees permitted, provided the attorney is not a salaried employee of licensee.
D.C.	- Money Lenders; Licenses, Sec. 26.708 - permitted, but not to exceed 10% of the amount due in foreclosure.
Florida	- Usury Act, Sec 687.06 - permitted if reasonable; fee not exceeding 10% of principal is presumed reasonable. - Consumer Act, Sec. 516.031(3)(a)(5) - permitted, fees as determined by the court.

Georgia	- Industrial Loan Act, Sec. 7-3-15 - permitted for collection of contracts in default.
	- Interest and Usury Act, Sec. 7-4-2(a)(1)(A) - permitted.
Hawaii	- 25% limit. Sec. 607-17.
Idaho	- No prohibitions.
Illinois	- Usury Act, Ch. 17, Sec. 6406(a) - permitted.
	- Consumer Installment Loan Act, Sec. 5419(3) - permitted.
	- Financial Institutions Development Act, Sec. 7004 - permitted as a general charge if contained within the written agreement.
Indiana	- Uniform Consumer Credit Code, Sec. 24-45-3-514 - permitted, except for loans with a principal balance of $2,700 or less.
Iowa	- U3C Sec. 537.2507 - attorneys' fee provisions generally enforceable except for salaried employee of creditor. Flat prohibition in consumer credit transactions.
Kentucky	- Consumer Loans Act, Sec. 280.530(10) - reasonable attorneys' fees are permitted in connection with the collection of the loan.
	- Banking Act - Revolving Credit Plans, Sec. 287.750(3) - reasonable attorneys' fees are permitted, provided the attorney is not a salaried employee.
Louisiana	- Sec. 9:3534 - permitted, but not in excess of 25% of the unpaid debt after default.
Maine	- Consumer Credit Code, 9-A, Sec. 2-507 - reasonable fees permitted for consumer credit transactions, except for supervised loans, not to exceed 15% of the unpaid debt after default.
Marvland	- Credit Grantor Closed-end Provisions, Sec. 12-1011(a) - reasonable fees permitted.
	- Credit Grantor Open-end Provisions, Sec. 12-911(a) - reasonable fees permitted.
	- Consumer Loan Law, Sec. 12-307.1 - permitted with court costs, the total of which not to exceed 15% of the amount due. On loans of $2,000 or less, the court must set the amount of attorneys' fees.
Massachusetts	- No prohibitions.

Michigan	- All attorneys' fee provisions invalid. Curtis v. Mueller, 150 NW 847 (Mich. 1915).
Minnesota	- Industrial Loan and Thrift Company Act, Sec. 56.131.1(f)(6) - permitted for foreclosure. - No prohibitions.
Mississippi	- Loans, Sec. 75-67-121 - reasonable fees permitted for attorney investigating title. - No prohibitions.
Missouri	- Second Mortgage Loan Act, Sec. 408.233.5 - permitted if not handled by a salaried employee and not exceeding 15% of the unpaid amount due. - Consumer Finance Act, Sec. 408.120(6) - permitted if not handled by a salaried employee and not exceeding 15% of the amount due and payable. - No other prohibitions.
Montana	- Consumer Loan Business, Sec. 32-5-407 - reasonable fees permitted.
Nebraska	- No statute on point, but case law prohibits all attorneys' fee provisions. Dow v. Updike, 7 NW 857 (Neb. 1881).
Nevada	- Installment Loan and Finance Act, Sec. 675.365 - permitted for closed-end loans if the contract so provides.
New Hampshire	- Attorneys' Fees in Consumer Cases permitted, Chap. 361-C:1.
New Jersey	- Consumer Loan Act, A.B. 1194 - reasonable attorneys' fees are permitted as defined under the New Jersey Rules of Professional Conduct. - Secondary Mortgage Loan Act, Sec. 17:11A-46(g), 17:11A-53(c) - permitted, as provided in the note or loan agreement. The attorney must not be a salaried or commissioned employee of the licensee. Fees shall not exceed 15% of the first $500, 10% of the next $500, and 5% of the excess due.
New Mexico	- Bank Installment Loan Act, Sec. 58-7-6 - reasonable attorneys' fees are permitted in proceedings for collection. - Usury Law, Sec. 56-8-9 - reasonable attorneys' fees are permitted.

New York	- Banking Department Regulations, Part 80.8(f), (h) - reasonable attorneys' fees are permitted as follows: (1) actual fees charged to the lender by an outside attorney in connection with the closing are permitted, and (2) not in excess of 15% of the unpaid debt in the event of default if a mortgage is referred to an attorney who is not an employee for collection.
N. Carolina	- General Interest Law, Sec. 24-8 - permitted.
N. Dakota	- Attorneys' fee provisions void. Sec. 28-26-04.
Ohio	- No statutory prohibition, but case law prohibits attorneys' fee provisions. Miller v. Kyle, 97 NE 372 (Ohio 1911).
Oklahoma	- Uniform Consumer Credit Code, Secs. 3-514, 2-413 - permitted for credit sales if principal balance is more than $3,000. Fees may not exceed 15% of the unpaid debt and referral must be to an attorney not a salaried employee. No 15% or $3,000 limit for loans.
Oregon	- Consumer Finance Act, Sec. 725.340(4) - permitted if attorney is not licensee's salaried employee. - No other prohibitions.
Pennsylvania	- Consumer Discount Company Act, Sec. 6213(P) - permitted. - Secondary Mortgage Loan Act, Sec. 6609(a)(4) - permitted for attorneys licensed to practice in the Commonwealth. - No other prohibitions.
Rhode Island	- Small Loan Business, Sec. 19-25-28 - reasonable fees permitted, provided attorney is not a salaried employee of licensee. - Interest and Usury, Sec. 6-26-2(c) - permitted. - Secondary Mortgage Loans, Reg. 87-3(c) - permitted for foreclosures; maximum is $750 unless the court awards a greater amount. - No other prohibitions.
S. Carolina	- Consumer Protection Code, Secs. 37-3-514, 37-2-404 - permitted, however, loan agreements may not provide for attorneys' fees on loans with finance charges exceeding 18% where principal is $2,300 or less. Attorneys' fees may not exceed 15% of the unpaid balance and referral to an attorney may not be to a salaried employee.

S. Dakota	- All attorneys' fee provisions void (Sec. 15-17-10) except mortgage foreclosures.
Tennessee	- Industrial Loan and Thrift Companies Act, Sec. 45-5-403(6) - reasonable and actual fees permitted.
	- No prohibitions.
Texas	- Credit Code, Sec. 3:15(8), 4:01(7) - permitted, fees assessed by court.
Utah	- Consumer Credit Code, Sec. 70C-2-105 - reasonable fees permitted following default, provided the attorney is not a salaried employee of lender.
	- No other prohibitions.
Vermont	- No prohibitions.
Virginia	- Open-end Loan Law, Sec. 6.1-330.72 - permitted by general real estate sections for real estate loans.
	- No other prohibitions.
Washington	- Attorneys' fees generally permitted. If clause is included, fees will be awarded to prevailing party. Sec. 4.84.330.
West Virginia	- All attorneys' fee provisions void, by case law and statute. First National Bank of Pineville v. Sanders, 88 SE 187 (W. Va. 1916).
Wisconsin	- Consumer Act, Sec. 422.411 - permitted only with refinanced first or purchase money real estate loans with 12% or less interest rate and then fees may not exceed 5% of judgment or $100.

KANSAS

Office of CONSUMER CREDIT COMMISSIONER

Joan Finney
Governor

Wm. F. Caton
Commissioner

HOUSE JUDICIARY COMMITTEE
MARCH 8, 1994
TESTIMONY OF BILL CATON
SENATE BILL 564

Thank you for the opportunity to testify behalf of Senate Bill 564. I am Bill Caton, Consumer Credit Commissioner. I believe the proposed changes to the Kansas Uniform Consumer Credit Code have merit and should be favorably reported by your committee.

I have had the opportunity to interact with the consumer credit industry regarding the recovery of reasonable attorney fees in certain collection activities. They have allowed me to recommend changes which I feel are necessary to notify and protect the consumer by including a statement in the Write to Cure Notice, disclosing potential responsibility for attorneys' fees. These recommendations are reflected in the proposed legislation and I am comfortable that consumers affected by this proposed legislation will have adequate notice and protection.

I am charged by statute to maintain a fair balance between borrowers and lenders by encouraging fair credit practices while protecting the consumers' interests. I believe these proposed changes maintain that balance and will induce lenders to implement positive lending policies and practices that will benefit the vast majority of consumers in Kansas.

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3-8-94

JAYHAWK TOWER, 700 S.W. JACKSON, SUITE 1001 / TOPEKA, KANSAS 66603 / (913) 296-3151

The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

March 8, 1994

TO: House Committee on Judiciary

FROM: Kathleen A. Taylor, Associate General Counsel
Kansas Bankers Association

RE: **SB 564: Allowing for Attorney's Fee Clauses in Credit Agreements**

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear before the Committee on the matter of amending Kansas law as it relates to attorney's fee clauses in commercial and consumer credit agreements. This bill is drafted to address the confusion and inconsistency that exists in our state laws in two areas:

1. Commercial credit agreements. It repeals the current prohibition on contracting for attorney fees in any note, bill of exchange, bond or mortgage (KSA 58-2312). In effect, this will allow parties to a business or agricultural transaction to provide for the recovery of the reasonable costs of collection by mutual agreement.

2. Consumer credit agreements. The Uniform Consumer Credit Code would be amended to prohibit the collection of reasonable collection costs for those consumer transactions with an unpaid balance on the debt at the time of default of $2,000 or under. For those unpaid balances over $2,000, the consumer credit loan or installment sales agreement could provide for reasonable collection costs. The provision in the Code allowing the consumer to collect attorney fees as part of a civil penalty if the creditor violates a provision of the Code is not changed.

The proposal also contains language that addresses confusion created by conflicting case law as described below.

Many states allow promissory notes to contain a particular clause providing for the recovery of attorney fees by the bank. In fact, the Uniform Commercial Code does provide that the first item to be paid out of the proceeds from a sale of collateral is "reasonable attorneys' fees and legal expenses incurred by the secured party" unless such action is prohibited by other state law. Accordingly it would be legal to contract for attorney fees in connection with the collection of a loan that is secured by personal property.

However, this 20th century law is pre-empted in Kansas by a 19th century law first adopted in 1876 (K.S.A. 58-2312), which prohibits a bank from contracting for the payment of attorney fees in any note, bill of exchange, bond or mortgage. In addition, there is a provision in the Uniform Consumer Credit Code which prohibits an agreement involving a consumer credit transaction from providing for the payment by the consumer of attorney fees. (However, the UCCC does allow a debtor to recover attorney fees from a creditor found to be in violation of the provisions of the Code.)

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House Judiciary
Attachment 3
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Regarding the prohibition against contracting for attorney fees under the UCCC, there is potential conflict under the Federal Bankruptcy Code. Section 506(b) of the Bankruptcy Code allows a creditor to collect attorney's fees, if that creditor is oversecured and if attorney's fees are provided for in the security agreement. So that, should a creditor which has lent money to a borrower for consumer purposes ever find itself in an oversecured position in Bankruptcy, that creditor must have a provision in the security agreement allowing for attorney fees in order to be so entitled to their collection.

In order to preserve this right in Bankruptcy, many creditors used clauses in their security agreements that authorized the creditor to apply the proceeds from the sale of collateral to their attorney's fees "if permitted by law". The Kansas Supreme Court has very recently addressed the issue of whether such a clause is in violation of the UCCC prohibition against contracting for attorney's fees. The Supreme Court found that such a clause was lawful. The last two sentences of Section 1 of the proposed legislation codify this decision.

The law as it exists in Kansas is grossly unfair to the creditor and is just one more factor which all creditors must consider when determining the costs of credit to borrowers. The Bank Management Committee of the Kansas Bankers Association commissions an annual study of bank facts and figures. One of the areas studied in the past five years is of the legal fees paid by banks for outside counsel. From 1988 through 1992, the total annual amount for legal fees paid by all Kansas banks has ranged from $6.7 million to $12 million.

We truly believe that it is time for the Legislature to review this antiquated law, and we believe **SB 564** is the most reasonable way of addressing the issue.

Kansas Credit Union Association

The trade association and financial services provider for credit unions

8410 West Kellogg
Wichita, Kansas 67209-1896
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Fax 316-729-0857

Written Testimony on Senate Bill 564

Concerning Costs of Collection Including Attorney Fees

Presented to the

House Judiciary Committee

March 8, 1994

Mr. Chairman and members of the Committee:

I am Jerel Wright, Governmental Affairs Director for the Kansas Credit Union Association which represents 98% of all Kansas credit unions. Kansas credit unions support the passage of SB 564.

Authorizes Collection of Attorney Fees

Section 1 of SB 564 will give credit unions something never before provided by Kansas law, the ability to recover reasonable attorneys fees when a debtor forces the credit union to take collection action to recover a debt. This change allows credit unions to place the responsibility of attorneys fees where it belongs, on the debtor who causes the expense.

Credit Unions Support Change in Policy

Kansas is one of a handful of states which prohibit lenders from recovering attorneys fees when collection actions are required to recover a debt. The legislature should recognize the need to change this law to help a lender to collect as much of the debt as possible.

While Kansas has traditionally restricted recovery of attorneys fees, the legislature has selectively approved changes in many other statutes which allow for recovery of attorneys fees. We believe it to be time to bring Kansas consumer credit law in line with other statutes as well as most other states.

For these reasons, we ask the committee to approve SB 564.

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House Judiciary
Attachment 4
3-8-94

Kansas-Nebraska League of Savings Institutions

Jeffrey D. Sonnich, Vice-President

Suite 512
700 Kansas Avenue
Topeka, Kansas 66603
(913) 232-8215

March 8, 1994

TO: House Judiciary Committee
FROM: Jeffrey Sonnich
RE: S.B. 564; Recovery of creditor attorney's fees

The Kansas-Nebraska League of Savings Institutions appreciates the opportunity to express our support for S.B. 564 which would make amend the UCCC to allow creditors to recover the costs of attorney's fees in civil actions brought against debtors who are subject to loans under default.

Savings institutions are full service lenders, but the primarily focus is on 1-4 family mortgage lending. In 1992 Kansas' twenty-six Kansas based savings institutions provided in excess of $3.54 billion in credit for homeownership in Kansas.

While the savings industry has been and will continue to be successful at meeting the home lending needs of Kansans, certain statutory and regulatory impediments exist that increase costs to both lenders and borrowers.

Among these impediments are, increased regulatory intervention, lengthy redemption periods, and the inability for mortgage lenders to recover attorney's fees that result from judicial foreclosures. In 1992 Kansas' savings institutions totaled foreclosures of $29.6 million and as of September 1993 that number had already reached $18.6 million. As a result the industry incurred in excess of $816 (YTD 9/93) thousand in legal fees....in 1992 the costs exceeded $1 million. These increased costs are passed on to borrowers via increased interest rates.

A statutory repeal of K.S.A. 58-2312 and amendments to the Uniform Consumer Credit Code to allow recovery of reasonable attorney's fees would begin the process of removing these lending barriers.

The Kansas-Nebraska League of Savings Institutions appreciates the opportunity to express our views and respectfully requests the House Judiciary Committee consider favorable passage of S.B. 564.

Jeff Sonnich
Vice President

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Attachment 5
3-8-94

Community
Bankers
Association of Kansas

913-271-1404
FAX 913-271-1508

Statement to the House Judiciary Committee

March 8, 1994

On behalf of the members of the Community Bankers Association (CBA), thank you Mr. Chairman and Members of the Judiciary Committee for the opportunity to comment in favor of Senate Bill 564.

For the past several years, the State Legislative Committee of the Community Bankers Association has polled our members on issues which we believe of significant interest or concern to our members. Among the numerous issues presented to our bank members this year was whether the collection of attorney fees in credit agreements should be allowed in judicial foreclosures. Of our members which responded to the issue poll, 82% approved of such a measure (12% undecided, 7% were opposed).

Senate Bill 564 permits a loan agreement or contract which allows recovery of reasonable collection costs, including attorney's fees, if litigation for loan repayment becomes necessary. It equalizes the approach for consumer credit transactions. The creditor could now collect reasonable fees if the unpaid balance at the time of default exceeds $2,000, while the consumer still has the right collect fees as a part of a civil penalty if the creditor is shown to be in violation of the UCCC, 16-5a-201(8).

By legalizing recovery of attorney fees in judicial foreclosures, it sets a positive incentive for the borrower to make repayment before litigation becomes necessary. Passage of SB 564 will eliminate much confusion and conflicting statutes regarding this issue.

The Community Bankers Association of Kansas appreciates your positive consideration of this issue and respectfully requests the Judiciary Committee consider favorable passage of the proposed Senate Bill 564.

(s\testmny.564)

• 5605 S.W. Barrington Court, Suite 100 • Topeka, Kansas 66614

House Judiciary
Attachment 6
3-8-94

The Kansas Association of Financial Services
George Barbee, Executive Director
Jayhawk Tower, 700 SW Jackson, Suite 702
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913/233-0555 Fax: 913/357-6629

Statement to:
House Judiciary Committee on
Senate Bill 564

Mr. Chairman and members of the committee, the consumer finance company members of the Kansas Association of Financial Services (KAFS) are appreciative to you for giving serious consideration to the attorney fee issue relative to consumer credit transactions. These companies have approximately 100 consumer finance service offices in the state of Kansas, offering valuable financial services in the area of consumer loans for such items as automobiles and appliances, small business line of credit loans and second mortgage loans to name a few.

KAFS is part of the coalition being represented by Mr. Barkley Clark. We are in total support of the solution proposed by Mr. Clark to correct the problem in Kansas that prohibits attorney fee clauses in consumer credit agreements. You have accurately been told that Kansas is one of a very few states that prohibit attorney fee clauses because of an 1876 statute and a redundant UCCC clause that even imposes creditor liability if such a clause is included in a loan agreement.

There are presently 75 Kansas statutes that allow collection of attorney fees on many other subjects. It is time to add one more and follow the lead of the majority of other states that already allow the collection of attorney fees in credit agreements. It is time to introduce a solution by repealing K.S.A. 58-2312 and modifying the UCCC as suggested by Mr. Clark. There is no decision or intent to change any rules regarding collection of attorney fees in tort actions or non-credit contract actions.

You are now aware of the confusion created by the Kansas statutes, federal law and court interpretations, and the two court cases; Halloran and the Hudson Shipbuilders, Inc. We urge you to put this confusion to rest by acting favorably on our suggested legislation.

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MID-AMERICA LUMBERMENS ASSOCIATION

TESTIMONY BEFORE THE HOUSE JUDICIARY COMMITTEE

Senate Bill #564 Rm: 313-S March 8, 1994

Mr. Chairman, members of the House Judiciary Committee, it is my pleasure to visit with you today as a proponent of Senate Bill #564. This bill allows for recovery of attorneys' fees and court costs in relation to consumer credit transactions.

As the bill states, a consumer credit transaction with an unpaid balance of more than $2,000 is subject to attorneys' fees and court costs, along with the debt and the finance charges, all to be paid by the debtor.

We see a correlation between this type of civil remedy and the civil liability for a worthless check that was passed in the 1991 session. K.S.A. 60-2610 states: If a person gives a worthless check as defined, the person shall be liable to the holder of the check for the amount of the check, the incurred court costs and the service charge and costs of collection, including, but not limited to, attorney fees.

If you would look at me as a small business person for a second, I would pose this situation to you: I have an unpaid debt of $2,000 from a consumer credit transaction, or I also have a bad check for $2,000 outstanding. I feel that if I am allowed to collect attorneys' fees and court costs for the bad check, I should be allowed the same for the consumer credit transaction.

Opponents would argue that if a consumer is deep in debt and cannot pay the bill, how on earth can they pay the attorneys' fees? We would argue that when the worthless check statute got tougher language, the incidents of worthless checks started

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to decline. The essence of S.B. #564 we feel provides a very strong deterrent, and would make one more cautious in their financial transactions. We have found that when good, conscientious folks have gotten in a financial bind, and yes, we all know in life this can happen, they will seek out their creditors and work out an arrangement agreeable to both to satisfy outstanding obligations. While not a perfect solution, we will certainly as a membership work with a person who is willing to work with us. It is that minority that always hurts the majority, that makes us as a business community seek remedies such as this to try and deter them from the shameless business activities they utilize, and for them, not the poor innocent caught in a financial bind they are trying to work out of, we see this as another tool to try and dissuade such disreputable business practices.

With a companion Senate Bill, #595, which would raise the floor on small claims from $1,000 to $2,000, we see a good one-two punch for the small business community to address their debt collection problems. Without attorney involvement, a small business person could take these matters of debt collection up to $2,000 to Small Claims Court, knowing that if there was a consumer credit transaction above that level of $2,000, they could pursue that avenue of retrieving the debt, and receive compensation for attorneys' fees in the process, along with incurred court costs.

I have attached an article from one of our trade periodicals which shows where Kansas stands in relation to other states in the area of small claims caps, strictly as a matter of information for the committee.

This concludes my testimony on Senate Bill #564. I thank you for the opportunity to address you on this matter today, and stand ready to answer your questions or address any comments you may have.

Businesses seek higher small-claims court caps

by Gary S. Ruderman

NATIONAL REPORT — Dealers and wholesalers are reporting that one of their lowest-cost legal options for recovering monies from non-paying accounts is effectively closed.

With few exceptions nationwide, creditors are averaging only slightly more than $2,400 in settlement awards, when they sue a debtor in small claims court. That's because most states continue to have relatively low limits on the size of claims these courts will handle (*see chart*).

Because the settlement prospects are low, some attorneys won't handle small claims anymore. And unless a claim is over $10,000, it's generally too costly—in terms of legal fees and the time it takes to go through the legal process—for a creditor to bring litigation to an appellate court, the next step up from small claims in most states.

Consequently, some companies have found themselves in the unenviable position of reducing credit extension, hiring a collection agency or writing off the bad debt.

Debt exceeds small claims

Small claims has historically been a preferred remedy for individuals and companies that didn't want to employ a lawyer and wanted a quick settlement. But with the prolonged recession, and with a record number of companies and people filing bankruptcy in 1992, debt often exceeds small claims-award caps.

Right now, only Florida and Tennessee allow small claims awards up to $10,000. But many states recognize this is a problem, and are trying to accommodate creditors by keeping small claims as a viable option for legal redress.

Ohio, for one, has a recovery ceiling of $2,500, and efforts to raise the maximum recovery to $10,000 have been rejected. But the Ohio Council of Retail Merchants and the Ohio Association of Wholesale Distributors are working with lawmakers to draft legislation to set up a two-tier system.

The Council proposes a slight increase in the maximum for individuals and a separate $10,000 maximum for small businesses and sole proprietorships.

Dennis Downer, acting president of the North American Wholesale Lumber Association and an Idaho distributor, said NAWLA's American-based members are looking for ways to get their respective state legislatures to raise their small claims ceilings to $10,000.

For Downer's company—Downer's Intermountain Orient Inc.—such a change would eliminate the expense of collection agents and attorney's fees for its distribution centers in Alabama and New Mexico.

Walt Minick also favors raising the small claims ceiling. Minick is credit manager of Brown-Graves Lumber, a $52 million retailer with two yards in Ohio.

Minick said to collect a $2,500 debt, collection agencies charge anywhere from 25 percent to 50 percent of the debt. And the process could take as long as eight months.

He added that retaining an attorney—at $130 per hour plus 33 percent of the settlement award—also isn't financially practical on such a debt, especially if it takes nine to 18 months for a case to come to court.

Because most of Minick's debtors are small builders, such a long wait could jeopardize the likelihood of collection. "The small builder is generally in trouble and in a year or 18 months they'll close up and you're out. The money is worth cents on the dollar after 18 months."

Small claims not an option

For some retailers, small claims isn't a concern or even considered an option.

Terry Hill, spokesman for The National Federation of Independent Businesses, a 600,000-member group of small- and medium-sized business owners, including wholesalers, said there hasn't been an inquiry from members concerning small claims courts in the last few years.

Sydney Katz, chief financial officer of Grossman's Inc., a 140-store chain in the Northeast, prefers to turn any debt problems over to collection agents and attorneys.

"It's not time-beneficial for us to go into small claims court," Katz said.

Even in Florida, Fort Lauderdale's Causeway Lumber prefers to use attorneys, according to the retailer's credit manager.

Tom Palie is credit manager of Allied Plywood Corp., a 14-branch lumber and building materials distributor based near Boston. Palie said a hike to $10,000 in the small claims cap (from Massachusetts' current $1,500) would mean he'd be going to that court for 90 percent of his cases, versus the 90 percent of the cases which now go to attorneys for litigation in a higher court.

Palie and his branch managers use the small claims courts to go after delinquent debtors like cabinet shops. He usually gets a court date within 30 days and, most times, gets a default judgment when the defendant fails to show. The small claims court process costs his company $30 to $40.

Sometimes Palie has to get a court order for payment or a lien on the debtor's assets in order to collect. "You have to do a lot of work yourself rather than an attorney," said Palie.

Last year, the law firm Allied had been using for these cases notified the company it would no longer handle cases where the potential award was less than $5,000.

"Attorneys don't want to waste time on small claims," said Paul Mignini, president of the 60-member state and regional National Association of Credit Managers. At present, Mignini said, his association was not focusing efforts on the federal level, leaving it to the state and regional affiliates to work for change. In late November, he said there was very little being done on the state level.

Maximum small claims court awards by state

State	Amount
Alabama	$ 1,500
Alaska	5,000
Arizona	1,000
Arkansas	300
California	5,000
Colorado	2,000
Connecticut	1,000
Delaware	2,500
Dist. of Columbia	2,000
Florida	10,000
Georgia	5,000
Hawaii	2,500
Idaho	2,000
Illinois	2,500
Indiana	3,000
Iowa	2,000
Kansas	1,000
Kentucky	1,500
Louisiana	2,000
Maine	1,400
Maryland	4,000
Massachusetts	1,500
Michigan	1,500
Minnesota	2,000
Mississippi	1,000
Missouri	1,500
Montana	2,500
Nebraska	1,800
Nevada	2,500
New Hamoshire	1,500
New Jersey	1,500
New Mexico	5,000
New York	2,000
North Carolina	1,500
North Dakota	2,000
Ohio	2,500
Oklahoma	3,000
Oregon	2,500
Pennsylvania	4,000
Rhode Island	1,500
South Carolina	2,500
South Dakota	2,000
Tennessee	10,000
Texas	2,500
Utah	1,000
Vermont	2,000
Virginia	1,000
Washington	2,000
West Virginia	3,000
Wisconsin	2,000
Wyoming	2,000

Can't handle higher volume

The judiciary's opposition to higher claims caps has to do with an overcrowded docket. "Small claims courts can't handle the volume $5,000 and $10,000 cases would generate," said Arthur C. Kellman, a White Plains, N.Y., City Court judge and chairman of the American Bar Association's small claims committee.

"Our own state's limit is $2,000 and that's probably sufficient. Some states are $5,000 and $10,000. That is an unreasonably high cap," Judge Kellman said.

Responding to business pressure, New York State opened commercial claims courts in 1991 for claims from partnerships, associations and proprietorships, but limited the number of cases in each venue to a maximum of five per month. "Otherwise, we get innundated by collection agencies," Kellman said.

8-3

KANSAS MANUFACTURED HOUSING ASSOCIATION

MEMORANDUM

TO: House Judiciary Committee
Representative Michael O'Neal, Chairman

FROM: Terry Humphrey, Executive Director
Kansas Manufactured Housing Association

DATE: March 8, 1994

RE: Senate Bill 564

On behalf of the Kansas Manufactured Housing Association, I want to express our support for SB 564. SB 564 repeals the prohibition against the collection of attorney's fees in consumer credit transactions and will help lenders reduce their costs of collection. Today collection costs are shouldered by borrowers who pay on time.

In the manufactured housing industry some retailers are on recourse with banks and if the home loan is in default, the retailer buys back the home and attempts collection. SB 564 will help the retailer collect too.

Please support SB 564. Thank you.

House Judiciary
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3-8-94

112 S.W. 6TH • SUITE 204 • TOPEKA, KS 66603 • 913/357-5256

TESTIMONY OF LARRY R. RUTE
KANSAS LEGAL SERVICES, INC.
(913) 233-2068

HOUSE JUDICIARY COMMITTEE

REPRESENTATIVE MICHAEL O'NEAL, CHAIRPERSON
TUESDAY, MARCH 8, 1994

I would like to thank the Chairperson and members of the Judiciary Committee for the opportunity to appear before you today to discuss SB No. 564. I am the Litigation Director and Deputy Director for Kansas Legal Services (KLS). As you are probably aware, KLS is a private, non-profit corporation dedicated to providing free or low-cost legal services to low and moderate income Kansans throughout the state. A significant portion of our clientele receive representation and advice to resolve consumer credit related issues. On behalf of the low-income clients whom we represent, I wish to testify in opposition SB No. 564.

SB No. 564 does basically two things. First, it amends K.S.A. 58-2312 to permit any note, mortgage or other credit agreement to provide for payment of reasonable attorney or collection agency fees, unless otherwise provided by law. Second, it amends K.S.A. 16a-2-507 of the Kansas Uniform Consumer Credit Code (UCCC) to permit a consumer credit agreement to provide for payment by the debtor of reasonable collection costs, including attorney fees and collection agency fees if the unpaid principal balance at the time of default exceeds $2000. Although I do not support either provision, I will direct my comments primarily to the latter one.

I oppose the amendment to K.S.A.16a-2-507 for four primary reasons:

1. It is not necessary to protect the legitimate interests of creditors and will result in an unwarranted windfall to them;
2. It penalizes consumers for defaulting, although this is usually involuntary and beyond their direct control;
3. It deprives consumers of a valuable statutory protection which they lack the power to obtain by contractual bargaining; and
4. It will be counterproductive to the overall purposes of the Kansas UCCC.

I do not dispute the notion that a creditor should have an opportunity to recover the reasonable costs of collecting on a defaulted credit agreement. The Kansas UCCC does not deny creditors that opportunity. Rather, the Kansas Comment to the current provision in K.S.A. 16a-2-507 prohibiting consumer credit contracts from requiring the payment of attorney's fees by the consumer makes it clear that this section reflects a deliberate policy decision to treat attorney's fees, as well as other collection expenses, as part of the creditor's cost of doing business. The Comment further notes that the interest rate ceilings and provisions for additional charges in the Kansas UCCC "are generous enough to justify this treatment of attorney's fees and collection costs as part of general overhead."

SB No. 564 would skew this deliberately struck balance in favor of the creditor. A creditor would be permitted to charge reasonable collection costs of any sort directly to the consumer, while at the same time continuing to charge the high interest rates permitted by the UCCC. There is no evidence to suggest, and it would be naive to believe, that creditors will simply reduce their interest rates if they are permitted to charge attorney's fees and other collection costs directly to the consumer. This bill would in effect increase the return which a creditor is permitted

to receive on a consumer credit transaction in Kansas. At this time when interest rates are at historically low levels, there is no evidence to suggest that this would be anything other than a windfall to creditors.

The American rule is that attorney's fees are generally not recoverable as damages unless specifically authorized by statute or an enforceable contract provision. Proponents of SB No. 564 note that K.S.A. 16a-2-507 creates an exception to this rule by prohibiting the parties in a consumer credit transaction from agreeing for the payment of attorney's fees by the consumer, and argue that this statute is inconsistent both with the generally prevailing American rule and with the trend toward permitting recovery of attorney's fees by statute.

However, the American rule implicitly assumes that parties to a contract have roughly equal bargaining power and can agree upon an attorney's fee provision in good faith. In contrast, the consumer protection provisions of the Kansas UCCC are a clear recognition of the fact that most consumer credit contracts are adhesion contracts. They are not bargained for at arm's length. Instead, they are presented by the creditor to the consumer on preprinted forms on a take-it-or-leave-it basis, are full of boilerplate, and, in the absence of statutory restrictions, are heavily weighted in favor of the creditor. The American rule cannot function as intended in a context where the bargaining strength of the parties is so unequal.

This bill would deprive consumers of a valuable protection without giving them anything in return. If it becomes law, clauses providing for payment by the consumer of reasonable attorney's fees, collection agency fees and other costs of collection will become commonplace in consumer credit contracts. On the other hand, it is certain that these clauses will not contain corresponding provisions requiring the creditor to pay the debtor's attorney's fees if the creditor breaches the contract. Consumers are simply powerless to negotiate such provisions. Consequently, if the consumer breaches the contract by defaulting, the creditor may recover all costs of collection directly from the consumer. However, if the creditor fails to honor a warranty or unlawfully repossesses the property, the consumer must pay his or her own attorney's fees in any action against the creditor unless the cause of action can be fitted into some statute specifically providing for fees. Introduction of this sort of imbalance into the consumer-creditor relationship is neither warranted nor desirable.

Boilerplate attorney's fees are a penalty on the debtor when they do not reflect the actual collection costs of the creditor. Because creditors currently recover costs of collection in the interest charged to the consumer, permitting the creditor to recover collection costs directly from the consumer as well would clearly penalize the consumer unless the creditor drops interest rates correspondingly. Moreover, the amount of the fees and other costs recoverable by the creditor under this bill would be limited only by the requirement that they be "reasonable." Court approval is not required, nor is recovery limited to judicial actions. A creditor who repossesses a car could simply deduct "reasonable" attorney's fees and other costs associated with the repossession in calculating any surplus or deficiency. The bill also appears to permit a collection agency to charge a "reasonable" fee for each dunning letter or telephone call, making it impossible for some debtors ever to pay off the debt.

Nor will court approval in judicial actions assure that "reasonable" attorney's fees are limited to the value of the services actually performed for the creditor. A large number of these cases are resolved by a default judgment without trial, involving little more than the sending of a form collection letter and the preparation of a form pleading, which is often done by a nonattorney. Yet the court routinely

approves fee requests in such cases which vastly exceed actual attorney costs. In Shawnee County, for example, it is not uncommon for the court to award $270 in attorney's fees in such cases under K.S.A. 60-2611, dealing with actions to collect on insufficient funds checks.

The Federal Trade Commission has found that default on a consumer credit contract is usually caused by something beyond the debtor's immediate control. The leading cause is unemployment or other loss of income. Debtor irresponsibility accounts for a very small percentage of cases. 48 Fed. Reg. 7747-48 (March 1, 1984). Making a defaulting debtor liable for attorney's fees in addition to the underlying debt is not likely to reduce the incidence of default. However, it will make it even more difficult for the debtor to get on his or her feet again financially. Penalizing the debtor by permitting the creditor a double recovery of collection costs, or by allowing the creditor to recover collection costs in excess of the actual costs incurred by the creditor, is totally unsupported by any reason in public policy.

Proponents of this bill contend that the Kansas UCCC currently sets a double standard by prohibiting creditors from requiring consumers to pay their attorney's fees, while at the same time requiring creditors to pay the attorney's fees of a consumer who successfully sues the creditor to enforce the provisions of the UCCC. See K.S.A. 16a-5-201(8). However, this argument compares apples to oranges and ignores the coherent structure of the UCCC. Interest rates and other charges are set high enough to enable the creditors to recover collection costs as part of their general overhead. The provision for consumer attorney's fees, on the other hand, is to enable consumers to act as private attorneys general in enforcing the protections given to them by the UCCC. The Kansas Comment to K.S.A. 16a-5-201(8) recognizes this provision as "an essential element if the consumer's rights provided by this act are to be enforced...." Enactment of this bill would undercut this purpose, as it would enable creditors to use the threat of attorney's fees to induce consumers to forgo legitimate claims and defenses and enter into settlements favorable to the creditor.

It may be true, as proponents suggest, that the trend in recent years has been to deregulate business. However, this does not always lead to salutary results, as the crisis in the savings and loan industry graphically illustrates. The reasons underlying K.S.A.16a-2-507 are still valid, and no convincing reason to change it has been demonstrated.

If the legislature nevertheless believes that some change is necessary, then it should consider: 1) maintaining the threshold at at least the $2000 level in the current bill; 2) restricting the award of attorney's fees to court awards; 3) making attorney fees available to whichever party prevails; and 4) limiting attorney's fees to the value of the time reasonably expended by the attorney, as K.S.A. 16a-5-201(8) already does.

Finally, with respect to the amendment of K.S.A. 58-2312, although some relaxation of the current law may be appropriate in truly commercial contexts, I would oppose extending this change to home mortgages. Consumers have no more ability to influence the provisions of these contracts than of other consumer credit contracts. If there is any public policy reason to support requiring a mortgagor to pay the mortgagee's attorney's fees in home mortgage transactions, and I can think of none, the Legislature should do it directly by statute.

Thank you for your consideration.

TESTIMONY OF JOHN C. PETERSON
KANSAS ASSOCIATION OF PROFESSIONAL PSYCHOLOGISTS
KANSAS PSYCHOLOGICAL ASSOCIATION
SB-741
HOUSE JUDICIARY COMMITTEE
March 8, 1994

Mr. Chairman, Members of the Committee, I am pleased to appear today on behalf of the Kansas Psychological Association and the Kansas Association of Professional Psychologists to urge your support for Senate Bill 741.

SB-741 deals with the Kansas Guardianship and Conservatorship Act and would add psychologists to three sections of that law. Psychologists are already included and have been for many years in the final adjudication phase. 59-3013 states:

> The court shall receive all relevant and material evidence which may be offered, including the testimony or written findings and recommendations of the hospital, clinic, physician or psychologist who has examined or evaluated the proposed ward or proposed conservatee...

Currently, when a case is initiated, the court may require that the petition be accompanied by a letter stating whether the person is disabled.

Section 1 (p 2, line 14) would add that a psychologist could write that initial letter.

Section 2 (p 4, line 40) clarifies that the court has the discretion to refer the person to a psychologist for a mental evaluation. This is purely discretionary with the Court. Currently the court can refer for a evaluation to a "general

hospital or a psychiatric hospital, an institution within SRS, mental health clinic, private psychiatrist or physician".

Section 3 merely clarifies that the court can ask the psychologist to deliver the legal paperwork to the patient.

The purpose of these determinations is not for a diagnosis, but to determine whether the person is disabled (unable to make reasonable decisions about their person or estate). Licensed psychologists are currently included as independent practitioners in our statutes in making decisions such as competency to stand trial, criminal insanity and mental illness under our civil commitment laws.

We would urge your support for SB-741.

KANSAS MEDICAL SOCIETY
623 SW 10th Ave. • Topeka, Kansas 66612 • (913) 235-2383
WATS 800-332-0156 FAX 913-235-5114

March 8, 1994

To: House Judiciary Committee

From: Chip Wheelen, KMS Director of Public Affairs

Subject: Senate Bill 741
Evaluations of Persons Alleged to be Disabled

The Kansas Medical Society is opposed to passage of SB741 because it could deny a person who is alleged to be disabled the benefit of a differential medical diagnosis. Because of the seriousness of a determination of disability for purposes of appointing a guardian or conservator, we believe the person under consideration deserves an evaluation by a person licensed to practice medicine and surgery.

This does not diminish the important role performed by a licensed psychologist who may test the person to measure cognitive skills. Such tests are extremely important when used in conjunction with medical tests which measure physiological characteristics or screen for indication of illness or disease. But only by taking into account the patient's overall condition may the physician conclude that the person is indeed disabled rather than temporarily suffering from an illness or condition that interferes with cognition.

A person who is suffering from an endocrine imbalance can sometimes develop symptoms of dementia or other mental disorder. Such medical conditions are usually treatable. Similarly, a person who is experiencing an adverse reaction to a medication or combination of drugs may exhibit mental abnormality. Diagnosis of such conditions requires blood work or other diagnostic tests which are within the statutory scope of medicine and surgery but are not within the statutory scope of the practice of psychology. While such patients may be temporarily disabled, the court's decision would certainly be different from a decision regarding a person who is suffering from untreatable dementia or a permanent mental disorder.

The most important feature of SB741 is section two which sets out the orders to be issued by the court when the original petition appears to have merit. If for some reason you decide to recommend passage of SB741, we urge you to first adopt the attached amendment which would guarantee a medical evaluation prior to a decision by the court.

Thank you for considering our comments on this subject. We respectfully request that you recommend that SB741 not be passed.

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appear at the time and place of the hearing unless the court enters an order that the presence of the proposed ward or proposed conservatee is injurious to the welfare of the proposed ward or proposed conservatee. The court shall enter in the record of the proceedings the facts upon which the court has found that the presence of the proposed ward or proposed conservatee at the hearing would be injurious to such person's welfare. Notwithstanding the foregoing provisions of this subsection, if the proposed ward or proposed conservatee requests in writing to the court or to such person's attorney that such person be present at the hearing then such person's presence cannot be waived.

(3) An order appointing an attorney to represent the proposed ward or proposed conservatee at all stages of the proceedings. The court shall give preference, in the appointment of the attorney, to any attorney who has represented the proposed ward or proposed conservatee in other matters if the court has knowledge of the prior relationship. The proposed ward or proposed conservatee shall have the right to choose and to engage an attorney and, in such an event, the attorney appointed herein shall be relieved of all duties by the court.

(4) An order that the proposed ward or proposed conservatee shall appear at a time and place that is in the best interest of the proposed ward or proposed conservatee to consult with the court appointed attorney, which time shall be prior to the execution of the order for mental evaluation, if one is to be issued, unless an order of protective custody provided for in K.S.A. 59-2912, and ~~acts amendatory thereof~~ *amendments thereto*, has been issued and detention of the proposed ward or proposed conservatee thereunder is in a place outside the jurisdiction of the court.

(5) A notice in the manner provided for in K.S.A. 59-3012 and ~~acts amendatory thereof~~ *amendments thereto*.

(6) An order for mental evaluation. Such order may be served on the proposed ward or proposed conservatee at the same time or after notice is given. It shall be served in the manner provided for in K.S.A. 59-3012 and ~~acts amendatory thereof~~ *amendments thereto*. It shall order the proposed ward or proposed conservatee to submit for a mental evaluation and to undergo such evaluation at a general hospital or a psychiatric hospital, an institution within the department of social and rehabilitation services, mental health clinic, private psychiatrist ~~or, physician or psychologist~~ designated by the court in the order. An institution within the department of social and rehabilitation services shall receive and evaluate any proposed ward or proposed conservatee ordered evaluated therein. At

amendment drafted by Chip Wheelen
Kansas Medical Society

12-2

or other physician

Bill Graves
Secretary of State

2nd Floor, State Capitol
Topeka, KS 66612-1594
(913) 296-2236

STATE OF KANSAS

Testimony in Support of Senate Bill No. 580
House Judiciary Committee
March 8, 1994

Since 1989, qualifying domestic and foreign corporations have been able to request that the balance sheet information on the corporate annual report be kept confidential. SB 580 would give other forms of business organization that same privilege.

Under current law qualifying general corporations are given the opportunity to keep their financial information confidential for ten years by paying a $20 fee and completing an application. The annual report requirements for professional corporations, limited partnerships and limited liability companies are otherwise similar to those of corporations. We request that they be treated alike in this respect also.

In addition, current law requires domestic corporations to report the name and address of investors owning five percent or more of the stock. There is no similar disclosure required of domestic limited partnerships or limited liability companies. Again, the law should treat these entities consistently and we request that limited partnerships and limited liability companies also be required to disclose investors owning at least five percent of the capital.

The effect of this bill is to require these alternative forms of business to provide more information to the public about who is involved with the business, but permit them to keep confidential their balance sheets if they meet certain financial tests. It makes business organization reporting in Kansas more consistent.

The Senate placed SB 580 on the Consent Calendar and adopted it with a 39 -0 vote. We ask that this committee favorably report SB 580 for passage.

John R. Wine, Jr.
General Counsel

Summary of SB 580

§ 1 Section 1 deletes the requirement that corporations report exactly how many shares each principal shareholder personally owns.

§ 2 Section 2 permits a member of a limited liability company to request a copy of the company's extension of time to file an annual report and therefore a copy of the company's confidential balance sheet.

§ 3 Section 3 amends the statute describing the requirements for filing a confidential balance sheet to include professional corporations, limited liability companies and limited partnerships.

§ 4 Section 4 requires limited liability companies to include on each annual report a list of the investors owning five percent or more of the capital of the company.

§ 5 Section 5 requires limited partnerships to include on each annual report a list of the partners owning five percent or more of the capital of the partnership.

Bill Graves
Secretary of State

2nd Floor, State Capitol
Topeka, KS 66612-1594
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STATE OF KANSAS

House Judiciary Committee
Hearing on Senate Bill No. 581
March 8, 1994

Mr. Chairman and Members of the Committee: Thank you for the opportunity to appear before you to testify in support of Senate Bill No. 581, which was passed by the Kansas Senate 39-0.

This bill is a corporate "clean-up" bill addressing provisions on domestic cooperatives organized under the cooperative marketing act; the general corporation code; and the limited liability company act.

Section one of the bill addresses the time at which a domestic cooperative must file its annual report. Current law requires this report to be filed on the 15th day of the sixth month following the close of the tax year. The proposed amendment requires the report to be filed at the time the cooperative's Kansas income tax return is filed, which is nine and one-half months after the close of the tax year. This is a more practical due date, as a cooperative does not file its federal return or make distributions to its patrons until eight and one-half months after the close of its tax year.

Section two authorizes a corporation to reinstate after it has been forfeited for failure to designate a new resident agent following the resignation of its previous resident agent. The Delaware Code also permits reinstatement in this circumstance.

Sections three and four address the signature requirements for an amendment to a limited liability company's articles of organization. Current law requires all members to sign the amendment. This bill proposes that a member or manager may sign the amendment. This requirement is comparable to the signature requirements for an amendment to a certificate of limited partnership.

Thank you.

Jennifer Chaulk Wentz, Legal Counsel
Deputy Assistant Secretary of State

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SENATE BILL 581

House Judiciary Committee

Presented By: Ed Field, Lindburg & Vogel, Chartered

Cooperative Annual Report filing dates should be no earlier than the fifteenth day of the ninth month following the close of the taxable year.

1. IRC 1.6072-2 does not require Federal Tax Return of Cooperatives to be filed until such date due to calculation of patronage dividends. IRC 1.6072-2 states in part:

   a. Time for filing returns of corporations.--Paragraph (d) Cooperative organizations.

      The income tax return of the following cooperative organizations shall be filed on or before the fifteenth day of the ninth month following the close of the taxable year:

      (1) A farmers', fruit growers', or like association, organized and operated in compliance with the requirements of section 521 and 1.521-1; and

      (2) For a taxable year beginning after December 31, 1962, a corporation described in section 1381(a)(2), which is under a valid enforceable written obligation to pay patronage dividends (as defined in section 1388(a) and paragraph (a) of 1.1388-1) in an amount equal to or at least 50 percent of its net earnings from business done with or for its patrons, or which paid patronage dividends in such an amount out of the net earnings from business done with or for patrons during the most recent taxable year for which it had such net earnings. Net earnings for this purpose shall not be reduced by any taxes imposed by subtitle A of the Code and shall NOT be reduced by dividends paid on capital stock or other proprietary interest.

2. Earlier filing of Annual Report than Federal return would result in incorrect balance sheet on Annual Report as compared to Federal Return.

3. All other Annual Reports are required 30 days after Federal Tax Return filing dates.

4. Historically the fifteenth day of the ninth month following the close of the taxable year has been accepted by the Kansas Department of Revenue.

5. The Kansas Secretary of State office legal counsel has verbally indicated agreement with the filing date.

The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

March 8, 1994

TO: House Judiciary Committee
RE: Amendment to SB 581

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear before the committee to offer an amendment to SB 581. The KBA has no objection to the current provisions of the bill and we have talked with the Secretary of State's office concerning our proposed amendment.

We are requesting that the committee amend the provisions of SB 369 into SB 581. The former is a bill held over from the 1993 session and would establish the Kansas Fictitious Name Act. We believe the enactment of the provisions of SB 369 would be of considerable assistance to banking institutions in detecting fraudulent activity relating to sole proprietorship accounts. Currently there is no specific procedure or technique by which a bank can protect itself from being victimized by a disreputable corporate employee. While the Fictitious Name Act would not be a cure-all it would certainly provide a valuable method by which banks could garner needed information about sole proprietorships.

We believe the fiscal note which has been prepared on SB 369 is one involving reasonable fees which our industry would be willing to pay for access to this needed information. Therefore, we would respectfully request that the committee amend the provisions of SB 369 into SB 581 and report the bill favorably as amended.

James S. Maag
Senior Vice President

Office of Executive Vice President • 1500 Merchants National Building
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Department of Social and Rehabilitation Services
Donna L. Whiteman, Secretary

Before the House Judiciary Committee
March 8, 1994

Senate Bill 464
Related to income withholding

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The SRS Mission Statement

The Kansas Department of Social and Rehabilitation Services empowers individuals and families to achieve and sustain independence and to participate in the rights, responsibilities, and benefits of full citizenship by creating conditions and opportunities for change; by advocating for human dignity and worth; and by providing care, safety, and support in collaboration with others.

==========

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify today on behalf of Secretary Whiteman in support of Senate Bill 464, a bill relating to the Child Support Enforcement Program (CSE). SRS requested this measure amending the income withholding and interstate income withholding acts to insure compliance with state plan requirements under Title IV-D.

Background

The detailed income withholding requirements of federal law are aimed at assuring regular child support payments through payroll deductions. Although the Kansas laws meet nearly all federal requirements, there are some changes needed to insure full compliance with the final regulations issued under the Family Support Act of 1988. The needed changes are:

1. **Limit "good cause" grounds for denying an immediate income withholding order in a IV-D case.** The language added on page 4 (line 4) is taken from the federal regulation (45 CFR 303.100(b)(2)).

2. **Limit termination of income withholding before the support obligation ends.** The language added on page 5 (line 38) is taken from the federal regulation, 45 CFR 303.100(a)(7)(ii). It allows the court to terminate income withholding if it is the first termination and a written agreement for an alternative arrangement has been made.

   Kansas law presently requires that all past due support be paid in full before the court may allow termination of a withholding order. Also, the withholding order must have been in place at least 12 months regardless of the circumstances of the case. We believe the proposed change offers greater equity and flexibility, particularly in non IV-D cases, while insuring compliance with federal requirements.

3. **Delegate administrative activities in non IV-D cases (cases not administered by CSE).** Federal regulators have recently clarified the administrative requirements for non IV-D withholding cases (45 CFR 303.100(g)). States may either delegate the administrative duties to an appropriate entity or, if the IV-D agency administers all withholding, allocate costs between IV-D and non IV-D cases.

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In Kansas virtually all withholding payments in non IV-D cases are sent to a clerk of court or court trustee, credited to the account, and disbursed. This structure meets federal standards for non IV-D cases; the amendment on page 6 (line 27) clarifies that this is the option Kansas has chosen. No new duties for the clerks of court or the district court trustees are contemplated. Unless a court trustee assumes the burden, the parties themselves or their attorneys monitor payments and initiate legal actions.

4. **Make interstate income withholding available in non IV-D cases (cases not administered by CSE).** The federal requirement is found at 45 CFR 303.100(h). During the 1980's, states were permitted to limit interstate income withholding to IV-D cases. Although our interstate withholding act does not directly prohibit its use in non IV-D cases, it would be difficult to apply in a private case because of the current wording.

   In SB 464, the obligee (custodial parent) is generally designated as the person to take actions in non IV-D cases. The key changes are on page 7 (line 4), page 8 (line 18), page 9 (line 8), and page 10 (lines 3 and 14). The Senate Judiciary Committee amended the language in Section 5 (page 8, line 22), to clarify that an individual may file documents without an attorney.

   The bill also clarifies that the interstate income withholding act creates no attorney-client relationship between a IV-D attorney and an individual party to the case (page 7, line 24). This parallels 1993's changes to URESA (Uniform Reciprocal Enforcement of Support Act), and is meant to prevent attorney disqualifications due to conflicts.

Fiscal Impact

This measure is not expected to affect the revenues or operating costs of the Child Support Enforcement Program, the district court trustees or court clerks.

As noted earlier, the bill is intended to insure compliance with federal requirements. For reference, federal sanctions for failure to meet IV-D program requirements range from $600,000 per year (1% of AFDC funding) to $18,000,000 (all Title IV-D funding plus 5% of AFDC funding), with an ultimate penalty of $85 million per year (all Title IV-D funding and all AFDC federal funding).

Thank you for this opportunity to testify is support of Senate Bill 464.

Jamie L. Corkhill
Child Support Enforcement
296-3237

SENATE BILL NO. 464
House Judiciary Committee
March 8, 1994

Testimony of Kay Farley
Coordinator of Children and Family Programs
Office of Judicial Administration

Representative O'Neal and members of the committee:

Thank you for the opportunity to appear in support of Senate Bill No. 464.

This bill provides clean-up to the income withholding statutes regarding interstate cases and clarifies that there is no attorney-client relationship between attorneys representing the Department of Social and Rehabilitation Services and the recipients of Title IV-D services.

The bill also designates Clerks of the District Court as the income withholding agency for Non IV-D cases. Federal regulations require each state to designate such an agency. As the Clerks of the District Court currently perform the duties of the income withholding agency, which includes keeping the support payment records and tracking and monitoring support payments. As the income withholding agency duties are described in the federal regulations, we support the proposed designation for Kansas. We would, however, suggest that District Court Trustees also be included with the Clerks of the District Court. In the 9th and 10th judicial districts, the District Court Trustees have primary responsibilities for processing the support payments. I have attached a balloon for your consideration.

Thank you for the opportunity to appear before you today. I would be glad to answer any questions.

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because of the obligor's payment history or otherwise. If an income withholding order is terminated for any reason and the obligor subsequently becomes delinquent in the payment of the order for support, the obligee or public office may obtain another income withholding order by complying with all requirements for notice and service pursuant to this act.

(d) If support payments are undeliverable to the obligee, any such payments shall be held in trust by the court until the payments can be delivered.

(e) The clerk of court shall cause to be served on the payor a copy of any order entered pursuant to this section that affects the duties of the payor.

Sec. 3. K.S.A. 23-4,118 is hereby amended to read as follows: 23-4,118. *(a)* The department of social and rehabilitation services is designated as the state income withholding agency in title IV-D cases ~~and in all instances where the total amount of multiple income withholding orders for any one obligor exceeds the limits provided for under section 303(b) of the consumer credit protection act (15 U.S.C. &1673(b)), regardless of the IV-D status of the cases involved~~. For the purpose of keeping adequate records to document, track and monitor support payments in title IV-D cases and for the purpose of initiating the income withholding process in such cases, the department may contract for the performance of all or a portion of the withholding agency function with existing title IV-D contractors or any newly created entity capable of providing such services.

(b) In ~~all~~ other cases, the clerk of the district court is designated as the income withholding agency for the purpose of keeping adequate records to allow the obligor and obligee to track and monitor support payments; except that in judicial districts in which a court trustee office has been designated by the administrative judge to receive, process, and maintain records for moneys received under support orders, the court trustee is designated as the income withholding agency for the purpose of keeping adequate records to allow obligor and obligee to track and monitory support payments.

Sec. 4. K.S.A. 23-4,128 is hereby amended to read as follows: 23-4,128. *(a)* On behalf of any obligee or other person for whom the agency is already providing services pursuant to the provisions of title IV, part D, of the federal social security act (42 U.S.C. & 651 *et seq.*), as amended, the agency shall promptly request the agency of another jurisdiction in which the obligor of a support order derives income to enter the order for the purpose of obtaining income withholding. The agency shall compile and transmit promptly to the agency of the other jurisdiction all documentation required to enter a support order for this purpose. The agency also shall transmit immediately to the agency of the other jurisdiction a certified copy of any subsequent modifications of the support order. If the agency receives notice that the obligor is contesting income withholding in

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