2897

GUARANTY; GOOD WORKING CONDITION OF AUTOMOBILE—NO VENDOR-VENDEE RELATIONSHIP—DISTRIBUTION OF LOSSES AMONG SUBSCRIBERS—§3905.42 R.C.

SYLLABUS:

Where by contract one party guarantees another that certain enumerated parts of an automobile are in good working condition, and, with normal usage, will not require repairs or replacements for a specified length of time, and where there is no vendor-vendee relationship between the parties but the guarantor has entered the business of issuing such contracts as an integral part of a general scheme for distributing losses among subscribers, such contract is one of insurance within the meaning of Section 3905.42, Revised Code.

Columbus, Ohio, October 15, 1958

Hon. Arthur I. Vorys, Superintendent of Insurance
Department of Insurance, Columbus, Ohio

Dear Sir:

I have before me your request for my opinion which reads as follows:

"There are four corporations doing business in Ohio engaged in selling automobile warranties or so-called 'certificates of inspection,' to used car dealers who use the warranties in conjunction with the sale of used automobiles. The method of operation of each company is essentially the same.

"Each company, through employees or agents in Ohio, inspect automobiles inventoried by used car dealers. Such inspection is visual, but also utilizes operation or road tests of the used automobile. The inspection is carried out in accordance with a specific procedure devised by each company. Company manuals outlining such procedures will be submitted to you for your consideration. After the inspection is completed, a report of the condition of the automobile is made to the used car dealer, who pays a fee therefore. If the report calls for repairs, such repairs as are specified by the report are made by the vendor. If the automobile is repaired in accordance with the report, or if the report did not call for repairs, a one-year warranty or certificate of inspection is issued to the vendor and thereafter assigned to the purchaser of the automobile. In some instances, the warranty or certificate of inspection is issued to the purchaser immediately following his purchase of the inspected car. The fee for this warranty, charged to the vendor, is passed on to the purchaser as a part of the purchase price of the automobile. In some cases, however, the fee is charged directly to the purchaser.

"The automobile warranties, or certificates of inspection, used by each company read as follows:

"COMPANY A

"Automobile Warranty

"The .... Corporation, having inspected and tested the motor vehicle described on the reverse side hereof, hereby certifies that the parts specified below are in good working order and condition and, with normal usage, will require no repairs or replacements for one year from the date of purchase indicated on the reverse side hereof.

* * *

> "The .... Corporation will, subject to the terms and conditions set forth below, protect the owner named on the reverse side hereof, from the cost of all repairs or replacements, including labor, which may become necessary with respect to the above listed parts in the normal use of said vehicle.
>
> * * *
>
> "This warranty does not cover the cost of repairs or replacement of parts not listed above, adjustments or tune-ups, damage to property or persons caused by said vehicle, whether or not related to any parts herein warranted, consequential damage of whatever nature, however caused, damage arising out of or revealed by collision or any other hazard that could be insured under the comprehensive coverage of a standard physical damage insurance policy, regardless of any contention that such damage was not caused by such a hazard, nor for any repairs or replacements of the above listed parts that might be required because of neglect, mis-use, or major alteration not specifically recommeded by the manufacturer of the described vehicle."

After setting forth the contracts of three other companies—since they are substantially identical to the contract issued by Company A, I shall not quote them—and quoting Sections 3905.42 and 3941.02, Revised Code, your inquiry continues as follows:

> "* * * Your opinion is respectfully requested as to whether, pursuant to Section 3905.42, Revised Code, the warranties above set forth constitute insurance agreements and therefore establish the companies issuing them as engaging in the business of insurance in this state and subject to licensing by this Department."

It is well settled in Ohio that the business of insurance is impressed with a public interest and, consequently, is regulated by statute in great detail to protect the general public. *State, ex rel. Herbert, Attorney General v. The Standard Oil Company,* 138 Ohio St., 376; *State, ex rel. Duffy, Attorney General v. Western Auto Supply Company,* 134 Ohio St., 163.

The right to transact the business of insurance is no longer a private right by a franchise, *Robbins v. Hennessey, et al.,* 86 Ohio St., 181; *State, ex rel. v. Ackerman,* 51 Ohio St., 163. The legislature, having the authority to grant or withhold a franchise, has asserted this authority, with respect to the business of insurance, in Section 3905.42, Revised Code, which provides as follows:

"No company, corporation, or association whether organized in this state or elsewhere, shall engage either directly or indirectly in this state in the business of insurance, or enter into any contracts substantially amounting to insurance, or in any manner aid therein, or engage in the business of guaranteeing against liability, loss, or damage, unless it is expressly authorized by the laws of this state, and the laws regulating it and applicable thereto, have been complied with."

In the *Western Auto Supply Company* case, *supra,* the court at pages 168, 169, defines the term "insurance" as follows:

"* * * 'Broadly defined, insurance is a contract by which one party, for a compensation called the premium, assumes particular risks of the other party and promises to pay to him or his nominee a certain or ascertainable sum of money on a specified contingency. As regards property and liability insurance, it is a contract by which one party promises on a consideration to compensate or reimburse the other if he shall suffer loss from a specified cause, or to guarantee or indemnify or secure him against loss from that cause.' 32 Corpus Juris, 975. It is a contract 'to indemnify the insured against loss or damage to a certain property named in the policy by reason of certain perils to which it is exposed.' State, ex rel. Sheets, Atty. Genl., v. Pittsburgh, C., C. & St. L. Ry. Co., 63 Ohio St., 9, 30, 67 N. E., 93, 96 Am. St. Rep., 635, 64 L.R.A., 405; State, ex rel. Physicians' Defense Co., v. Laylin, Secy. of State, 73 Ohio St., 90, 97, 76 N. E., 567.

"It seems well settled that to constitute insurance the promise need not be one for the payment of money, but may be its equivalent or some act of value to the insured upon the injury or destruction of the specific property. * * *"

The various contracts contained in your inqury are within the terms of this definiton. The companies, on the payment of a consideration, promise to render an act of value, which will hold harmless, against loss, the owner of an automobile on the happening of a specified contingency—the repair or replacement of certain enumerated parts necessitated by normal usage. Obviously, the owner of an automobile, by virtue of his ownership, is subject to such risk, and under the contracts in question, this risk is assumed by the companies.

In Vance on Insurance 3rd Ed. (1951) at page 2, the five elements which distinguish insurance from other contracts are stated as follows:

"(a) The insured possesses an interest of some kind susceptible of pecuniary estimation, known as an insurable interest.

"(b) The insured is subject to a risk of loss through the destruction or impairment of that interest by the happening of designated perils.

"(c) The insurer assumes that risk of loss.

"(d) Such assumption is part of a general scheme to distribute actual losses among a large group of persons bearing somewhat similar risks.

"(e) As consideration for the insurer's promise, the insured makes a ratable contribution, called a premium, to a general insurance fund.

"A contract possessing only the three elements first named is a risk-shifting device, but not a contract of insurance, which is a risk-distributing device; but, if it possesses the other two as well, it is a contract of insurance, whatever be its name or its form."

Each of the above five elements are present in the contracts here under consideration. The owner of an automobile obviously possesses an insurable interest. It cannot be questioned that such owner is subject to a risk of loss which would occur upon the necessary repair or replacement of parts. This risk is assumed by the companies under the what obviously is a general scheme to distribute actual losses among many owners of automobiles. The price paid for this assumption is a premium in that it is a contribution to a general fund from which the amount of actual loss of all contributors will be paid.

It is obvious, under the above definitions, that the various contracts contained in your inquiry are contracts of insurance, and that companies who propose to issue such contracts must comply with the insurance laws of Ohio as required by Section 3905.42, *supra,* quoted above.

In reaching this conclusion, I am neither unmindful of the merchandise-warranty cases, nor of the fact, especially in these cases, that the courts have often disregarded the risk shifting—risk distributing distinction, and have attempted to erect other criteria designed to assist in the determination of whether a given transaction falls within the purview of the insurance laws.

In 30 Ohio Jurisdiction, 2d, 46, the writer, in considering the general principles determining whether a business or a contract is insurance, at page 46, said:

"Whether a corporation or association is engaged in the insurance business must be determined by the particular objects which it has in view, and not by abstract declarations of general purposes; the business which the organization is actually carrying on, rather than the mere form of the organization, is the test for determining whether it is carrying on an insurance business. * * *"

The fourth paragraph of the syllabus of *The Standard Oil* case, *supra,* provides:

"* * * 4. A warranty or guaranty issued to a purchaser in connection with the sale of goods containing an agreement to indemnify against loss or damage resulting from perils outside of and unrelated to inherent weaknesses in the goods themselves, constitutes a contract substantially amounting to insurance within the purview of Section 665, General Code. (State, ex rel. Duffy, Atty. Genl., v. Western Auto Supply Co., 134 Ohio St., 163, followed.)"

The court, in reaching this conclusion, said at pages 381 to 383:

"* * * There can be little doubt that the primary purpose of the quoted statute, although broad in language, is to prevent or discourage the unregulated and unlicensed from carrying on within the borders of Ohio the general type of business described in the foregoing definition of insurance, thus protecting the public from surrendering its money in exchange for questionable or worthless pieces of paper denominated insurance policies. * * *

"Relating to the sale of commodities, a warranty has been defined as a statement or representatioin having to do with the kind, quality, variety or title of the goods sold. On the other hand, a number of courts have announced the rule that if the vendor of goods guarantees them against hazards disconnected with defects in the articles themselves, such guaranty is equivalent to a contract of insurance.

"This was the view taken in State, ex rel. Duffy, Atty. Genl., v. Western Auto Supply Co., supra. * * *

"It need hardly be said that we are living in a highly competitive age. If the manufacturer or distributor of a certain brand of automobile tires can advantageously issue a warranty of the kind involved in this case for the benefit of customers and without additional charge, his competitors are at liberty to do likewise, and if their tires are of equal or better value, they should also be able to interest buyers and profit from increased sales. Furthermore, they may exercise their ingenuity and devise other methods, within the law, to attract prospective purchasers and stimulate a desire and demand for their product.

"In the event dishonest or deceitful practices should develop, remedial legislation could be passed by the legislature to eliminate the evils, or relief might be had from another source on the ground that unfair trade practices were being pursued.

"Certainly, Section 665, General Code, was not designed to apply to purely commercial transactions connected with which warranties are made for the purpose of inducing sales and creating good will, and that section should be invoked with discrimination in the merchandising field."

From the above quoted portions of *The Standard Oil* case, *supra,* it is clear that the court is there considering a limited field, *i.e.* guaranties issued by a seller as a means to stimulate a desire and demand for his product. There is a definite distinction between (1) those cases in which the seller wishes to make his merchandise more desirable by guaranteeing its quality or its use for a certain period, where the guarantee is limited to happenings actually connected with imperfections in the articles themselves, and (2) those cases where the sole objective is to sell contracts designed to *distribute* risks among many purchasers. On this point it seems to me that the merchandise-warranty cases are clearly distinguishable from the transactions here under consideration.

This distinction is pointed out in Vance on Insurance, 3rd Ed. (1951) at pages 4 and 5, in the following language:

"In every contract of risk-shifting, three elements are conspicuously present: First, one party possesses an interest susceptible of pecuniary estimation; secondly, that interest is subject to some well-defiined peril or perils, the happening of which will destroy or impair it, thereby causing loss to the risk-bearer; thirdly, there is an assumption of this guaranty, of indorsement, or of warranty on a sale of goods, an interest possessed by the creditor, the note holder, or the vendee, is exposed to impairment by the happening of contingent events, and the risk of the interest owner is assumed by the guarantor, indorser, or warranting vendor. But these are not contracts of insurance, which are more than risk-shifting devices. For the insurance contract, additional elements are required; that is, the contract for assuming the risk must be an *Integral part of a general scheme for distributing a loss* that may be suffered by any individual interest owner among a considerable group of persons exposed to similar perils, and the insured must make a ratable contribution, called a premium, to the general insurance fund. The same idea is expressed when we say that an indemnitor becomes an insurer only when he goes into the business of indemnifying. While a policy under seal for no premium paid would at common law be enforce-

able as an indemnity bond, it could scarcely be considered a proper insurance contract. (Emphasis added)

In the case at hand the issuer of these warranty contracts had definitely gone into the "business of indemnfying," and so has entered the field of insurance.

In reaching this conclusion I am not unmindful that contrary views of contracts of this sort have been expressed by the Attorneys General in certain sister states. In an opinion dated January 9, 1957, the Hon. Jacob K. Javits, Attorney General of New York, in my opinion addressed to the Superintendent of Insurance of that state said:

> "* * * Your own view is that the warranty in question is in fact an insurance contract because National's obligation thereunder is dependent upon the happening of a 'fortuitous event' within the meaning of the foregoing provision. National, on the other hand, through its attorneys contends that since its inspection is designed to determine whether the parts warranted will operate as expected, its obligation is not dependent upon a fortuitous event but is limited to matters essentially within its control. Thus, the underlying issue is whether National, upon its inspection of a vehicle, can be said to have perfomed an act constituting an exercise of control sufficient to eliminate the fortuitous event element. If yes, the warranty is not insurance; if no, it is. * * *"

This reference to a "fortuitous event", in describing the peril against which the vendee is indemnified, is to that term as used in the New York statute defining an "insurance contract." That definition, in Section 41 of the Insurance Law, is as follows:

> "The term 'insurance contract,' as used in this chapter, shall, except as provided in subsection two, be deemed to include any agreement or other transaction whereby one party, herein called the insurer, is obligated to confer benefit of pecuniary value upon another party, herein called the insured or beneficiary, dependent upon the happening of a fortuitous event in which the insured or beneficiary has, or is expected to have at the time of such happening, a material interest which will be adversely affected by the happening of such event. A *fortuitous event is any occurrence or failure to occur which is, or is assumed by the parties to be, to a substantial extent beyond the control of either party.*" (Emphasis added)

This definition was held to be such as to remove from the field of insurance those contracts of indemnity or warranty, involving risks over

which the indemnitor has some degree of control, even though they be issued as "an integral part of a general scheme for distributing a loss," and that to this extent the New York statute requires a restriction on the rule on this point quoted from Vance on Insurance, *supra*. What seems to be overlooked in the New York ruling is that to whatever extent the control of the risk is short of perfect then to that extent a peril is involved which is properly the subject of insurance.

The Ohio statutes contain no such restrictive definition of insurance contracts, but we cannot, in any event, concern ourselves with the care with which the indemnitor here selects its risks and thereby controls possible losses, for it is obviously contemplated by the parties that this control cannot be perfect and that some losses *will* occur.

Nor does this view of the matter in any way conflict with the court's holding in the *Standard Oil* case, *supra,* for in that case the warranty was made only by the vendor, and although the device was a risk *shifting* one it was not designed to operate as "a general scheme for *distributing* a loss," nor one designed to create a "general insurance fund."

Accordingly, it is my opinion and you are advised that where by contract one party guarantees another that certain enumerated parts of an automobile are in good working condition, and, with normal usage, will not require repairs or replacements for a specified length of time, and where there is no vendor-vendee relationship between the parties but the guarantor has entered the business of issuing such contracts as an integral part of a general scheme for distributing losses among subscribers, such contract is one of insurance within the meaning of Section 3905.42, Revised Code.

Respectfully,
WILLIAM SAXBE
Attorney General