STATE OF KANSAS

Office of the Attorney General

1st Floor, State Capitol Bldg. (913) 296-2215 Topeka, Kansas 66612

Curt T. Schneider
Attorney General

December 6, 1976

ATTORNEY GENERAL OPINION NO. 76-372

The Honorable Norman E. Gaar
State Senator
2340 West 51st Street
Westwood, Kansas 66205

Re: Insurance--Motor Vehicle Service Contracts--Warranty

Synopsis: A motor vehicle service contract, offered by registered Kansas motor vehicle dealers to purchasers of motor vehicles, providing for the repair or replacement of specified mechanical breakdowns, or reimbursement therefor, and for payment or reimbursement of towing charges and car rental use incidental to such breakdowns, does not constitute a contract of insurance subject to the Kansas insurance code.

* * *

Dear Senator Gaar:

You inquire whether a vehicle service contract, or warranty, which is proposed to be sold in this state by registered automobile dealers constitutes a contract of insurance which is subject to Kansas insurance laws and the jurisdiction of the Commissioner of Insurance.

You enclose a copy of the agreement, which is styled a "Vehicle Service Contract," between the issuing dealer and the vehicle owner, known as the "contract holder." The contract provides threefold coverage, for mechanical breakdown, car rental and towing. The first is described thus in pertinent part:

> "The Contractor agrees to repair, replace or reimburse you for reasonable costs to repair or replace, any of the components listed if required due to a mechanical breakdown. Mechanical breakdown is defined as a failure of a defective part, or faulty workmanship as supplied by the manufacturer, but does not include gradual reduction in operating performance due to normal wear and tear. . . . All claims under this coverage are subject to a $25. deductible for each repair, for each component."

Rental car and towing coverage is described thus:

> "The Contractor agrees, in the event of a mechanical breakdown of a covered component, to furnish or reimburse you for substitute transportation. Such expense shall be limited to $10. per calendar day, and $50. per occurrence. . . ."
>
> "The Contractor agrees, in the event of a mechanical breakdown of a covered Component to reimburse you for reasonable towing charges, not to exceed $20. per occurrence."

In *State ex rel. Londerholm v. Anderson*, 195 Kan. 649, 408 P.2d 864 (1965), the state challenged the operation of a pre-need burial plan on several grounds, among them that a so-called family protection provision in the purchase contract constituted a contract of insurance. Under this provision, the seller agreed that if the purchaser died during the life of the contract, before the full balance was paid, the balance due would be cancelled, and the seller would provide the services or goods due under the contract, provided a minimum portion of the total balance had been paid, and certain other conditions were satisfied. The court observed thus:

> "While the definition of insurance must perforce be a very broad general one, it does not necessarily follow that every contract

which contains some technical element of indemnity or insurance is an insurance contract for the purpose of state regulation.

In 44 C.J.S., Insurance, § 59, at page 528, we find this:

'Whether a company is engaged in the insurance business depends . . . on the character of the business that it transacts . . . and whether the assumption of a risk, or some other matter to which it is related, is the principal object and purpose of the business.'

In *Jordan v. Group Health Ass'n*, 107 F. 2d 239, the court in considering whether a group health association was conducting an insurance business said this:

'That an incidental element of risk distribution or assumption may be present should not outweigh all other factors. If attention is focused only on that feature, the line between insurance or indemnity and other types of legal arrangement and economic function becomes faint, if not extinct. This is especially tur when the contract is for the sale of goods or services on contingency. But obviously it is not the purpose of the insurance statutes to regulate all arrangements for assumption or distribution of risk. That view would cause them to engulf practically all contracts, particularly conditional sales and contingent service agreements. The fallacy is in looking only at the risk element, to the exclusion of all others present or their subordination to it. The question turns, not on whether risk is involved or assumed, but on whether that or something else to which it is related in the particular plan is its principal object and purpose. . . . "Care must be taken to distinguish mere contracts to render service on the happening of a contingency from true contracts of insurance. . . . The cases have failed to declare a satisfactory rule for distinguishing between the two types of agreements, but it would seem that the contract should not be classed as insurance if the paramount purpose in its formation was to be the rendition of the services rendered. . . . However, it should be

> insurance if the chief purpose of the agreement is the protection against the risk involved. . . . "'"

Applying this analysis to the facts before it, the court stated thus:

> "Upon the facts presented in this record we think the principal object and purpose of the business of defendants is basically that of selling cemetery lots, burial vaults and markers, and not that of assumption of risks; the latter being merely incidental to the former, or as the parties themselves put it, a 'sales gimmick' or an inducement to the potential customer to buy the merchandise." 195 Kan. at 663.

The analysis followed by the court in this case fairly follows that applied in like cases from other jurisdictions. In *State ex rel. Duffy v. Western Auto Supply Co.*, 134 Ohio St. 163, 16 N.E.2d 256 (1935), the court considered whether an automobile tire guaranty was a warranty or a contract of insurance. The court distinguished the two thus:

> "A warranty promises indemnity against defects in the article sold, while insurance indemnifies against loss or damage resulting from perils outside of and unrelated to defects in the article itself." 16 N.E.2d at 259.

On the ground that the alleged warranty in question in that case extended beyond defects in the merchandise itself, but provided for indemnification to the purchaser for damage to the tires resulting from adventitious hazards, such as road defects, collisions and the like, the court held it to be a promise of indemnity tantamount to a contract of insurance.

In *Ollemdorff Watch Co. v. Pink*, 279 N.Y. 32, 17 N.E.2d 676 (1938), the court considered the nature of a certificate which was issued by a watch manufacturer to the purchaser of each watch, undertaking to replace the watch with one of like quality if the first watch

was lost through burglary or robbery within one year of purchase. The court held this to go beyond the bounds of a warranty or guaranty:

> "This goes further than a guaranty or warranty. For instance, a warranty would relate in some way to the nature or efficiency of the product sold -- in this case, that the watch would work or was of a certain make and fineness. A warranty would not cover a hazard having nothing whatever to do with the make or quality of the watch. A guaranty is an undertaking that the amount contracted to be paid will be paid, or the services guaranteed will be performed. It relates directly to the substance and purpose of the transaction.
>
> "This contract goes much further. It has nothing whatever to do with the sale of the watch or the contract of sale. It is an extraneous inducement to procure sales. If the watch is stolen the seller will replace it. In other words, he takes a chance for a risk of theft from his customers; that is, he insures them for a year against such risk." 17 N.E.2d at 677.

In *State ex rel. Herbert v. Standard Oil Co.*, 138 Ohio St. 376, 35 N.E.2d 437 (1941), the Ohio Supreme Court again considered the nature of an automobile tire warranty, although one which differed in its terms from that considered earlier in *State ex rel. Duffy, supra*. Here, the warranty provided for repair or replacement without charge, except for certain adjustments, if the tire failed to give satisfactory service under usual conditions of wear and tear. Failure of the tire due to other than defects in materials, workmanship or construction, such as punctures, damage from fire, wreck or collision, and similar external causes were excluded from the warranty. The court considered this to be only a warranty, and not a contract of insurance:

> "We find difficulty in construing this agreement as more than a representation that the tires being sold are so well and carefully manufactured that they

> will give satisfactory service under ordinary usage for a specified number of months, excluding happenings disassociated from imperfections in the tires themselves." 35 N.E.2d at 441.

The court observed that the Ohio insurance 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." 35 N.E.2d 437.

The court expressly declined to overrule *State ex rel. Duffy, supra*, but also declined to extend its holding to the distinguishable promise before it in the later case.

Whichever of the analyses used in any of these cases is applied here, the so-called vehicle service contract here is, in my judgment, not a contract of insurance. In *State ex rel. Londerholm, supra*, the court emphasized the importance of the "principal object and purpose" of the seller of the contract, certain provisions of which were challenged as insurance. The principal object there being found to be the sale of burial lots, vaults and markers, the incidental and limited assumption of risk was regarded as no more than a collateral commercial inducement to potential customers to purchase pre-need burial contracts. In *State ex rel. Duffy, supra*, the court emphasized that the risks against which the purported warranty offered protection extended beyond defects in the merchandise itself, and included loss or damage to the merchandise from extraneous causes. In *State ex rel. Herbert v. Standard Oil, supra*, the court emphasized, as did our own court, the use of the indemnity agreement as a commercial inducement or a device by which the seller represents to potential customers its confidence in the integrity of its product.

The "principal object and purpose" of the seller of the vehicle service contract here is obviously the sale of motor vehicles. The offering of the contract is an implied representation by the seller that the vehicle will provide satisfactory service free from mechanical breakdowns, but that if such breakdowns do occur, the seller will bear the reasonable cost of repair or

replacement of the components found to be defective, or reimbursement therefor. Applying the "inside defects/outside perils" distinction, the contract clearly satisfies even the strict test applied in *Duffy*. The mechanical coverage covers breakdowns of the components of the vehicle itself. The rental car and towing coverage merely protect against eminently foreseeable costs which the purchaser may incur in the event of a mechanical breakdown, the principal coverage afforded by the contract. The contract is distinguishable from those involved in the cited cases on one count, that is, presumptively, the purchaser of the automobile must pay a seperate charge for the contract, in addition to the cost of the motor vehicle. This fact does not, in my judgment, alter the nature of the agreement, or convert what is otherwise clearly a commercial merchandising device tantamount to a warranty into a contract of insurance. Purchase of the contract remains incidental to the vehicle purchase, the offering of the contract continues as a merchandising device which may be used to induce vehicle purchases, and the risks borne by the seller under the service contract remain restricted to the satisfactory operation of the vehicle which is the subject of the principal transaction.

Accordingly, it is my judgment that the vehicle service contract described above does not constitute a contract of insurance which is subject to the Kansas insurance code, and the jurisdiction of the Commissioner of Insurance.

Yours very truly,

Curt Schneider

CURT T. SCHNEIDER
Attorney General

CTS:JRM:kj

cc: The Honorable Fletcher Bell
Commissioner of Insurance
Kansas Department of Insurance
1st Floor - State Office Building
Topeka, Kansas 66612