Opinion No. 78-20

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OPINION OF: Toney Anaya, Attorney General

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TO: Manuel A. Garcia, Jr., Superintendent of Insurance, State of New Mexico, P.O. Drawer 1269, Santa Fe, New Mexico 87501

FACTS

1. A home appliance service company has solicited a real estate company to act as its agent in offering an optional nonrenewable plan to home owners who contract for the real estate company's brokerage services. The contract fee is one-half percent of the selling price of the house. The benefits or guarantees provided by the plan accrue to the future home buyer, and include the repair of certain home appliances and equipment during one year of normal operation. The home buyer only pays a nominal charge for each service call made by a repairman or contractor of the service company's choice. The company performs an operational check on the items covered on the seller's property to verify their condition, and the total liability per service contract is limited to $2,500.00.

2. A corporation offers an optional renewal plan, for a fee, to home owners. The benefits or guarantees provided by the plan include the maintenance and repair of certain home appliances and equipment during one year of normal operation. The home owner pays a fee for the service contract which is renewable annually. The company does not perform an inspection of the appliances and equipment prior to entering the contract, and does not charge for service calls, maintenance, repair or replacement parts.

QUESTIONS

Do these service contracts constitute a form of insurance?

CONCLUSIONS

Yes.

ANALYSIS

Section 58-1-1, N.M.S.A. 1953 Comp. of the New Mexico Insurance Code defines "insurance" as ". . . any form of insurance, bond or indemnity contract the issuance of which is legal in the State of New Mexico." As stated in Opinion of the Attorney General No. 71-82, issued July 8, 1971, this definition "appears to express an intent that the term 'insurance' not be restrictive."

OPINION

The term "insurance" is commonly understood as a contract whereby a promisor (insurer), for a consideration, becomes obligated to compensate the promisee (insured) or one designated by him, for loss or damage from stated causes in a definite or ascertainable amount. **State v. Standard Oil Co.,** 138 Ohio St. 376, 35 N.E.2d 437 (1941).

Opinion of the Attorney General No. 71-82, **supra,** sets forth the following elements of the insurance transaction:

a. the contract has to be for security against a risk of loss which, originally resting with the insured, is shifted and assumed by the insurer;

b. the risk of loss must be covered by a general fund consisting of deposits made by persons having similar contractual arrangements with the insurer; and

c. the insurer must indemnify the insured upon the happening of the contingency.

While earlier judicial decisions required indemnification by the payment of money to constitute an insurance transaction, this idea was refuted in **Ollendorff Watch Co. v. Pink,** 279 N.Y. 32, 17 N.E.2d 676 (1938). In **Ollendorff,** an agreement to replace lost or stolen goods was permitted to give rise to an insurance contract, with the court saying, in effect, that an agreement to indemnify by the rendition of services may likewise constitute insurance.

If we were to end our analysis here, it would be proper to label the contracts described in the facts given as insurance.

Many courts, however, have been reluctant to extend, by judicial construction, the insurance laws to govern every contract involving an assumption of risk or indemnification of loss. Rather, when the issue arises, each contract is to be tested by its own terms as they are written, as they are understood and intended by the parties, and as they are applied to the particular circumstances. **Transportation Guarantee Co. v. Jellins,** 174 P.2d 625 (Cal. 1946); **Jordan v. Group Health Ass'n.,** 107 F.2d 239 (D.C. 1939). And, if an agreement is in substance insurance, that determination cannot be defeated by giving it another name such as a warranty, guarantee, or service contract. See **People v. Roschli,** 275 N.Y. 26, 9 N.E.2d 763 (1937).

In distinguishing insurance from a true guarantee, the so-called "control" test and the "major" or "primary purpose" test are most often applied to the facts. See, Patterson, 46 Colum. L. Rev. (1946) 349; Essentials of Insurance Law (2d Ed. 1957), pp. 10-12; 15 N.C. L. Rev. (1937) 417-419; 48 Yale L.J. (1938), 117, 120; 33 Ill. L. Rev. (1939) 593, 594; **Jordan v. Group Health Ass'n, supra,** 36 Mich. L. Rev. (1937) 311, 316; 25 Va. L. Rev. (1938) 238.

The control test distinguishes legitimate warranties on goods manufactured or sold by the warrantor, thereby relating to the quality of the goods and thus to events under the seller's control, from insurance. Insurance will attach to the warranty of goods, and concern events substantially outside of the seller's control. Simply stated, one may always guarantee the accuracy or proficiency of his own work, or of the particular goods he chooses to sell, and such guarantee is not insurance.

Turning to the second test, it is sometimes said that where the major purpose of a contract is other than to indemnify the insured, there is no insurance. **Jordan v. Group Health Ass'n, supra.** As such, a contract that contains an indemnity provision to replace gears broken during normal driving conditions when a certain grease is used is not considered an insurance contract. The indemnity is ancillary to the contract of the sale of the grease. **Evans & Tate v. Primer Ref. Co.,** 31 Ga. App. 303, 120 S.E. 553 (1923).

The guarantees given by firms specializing in repair and replacement services are closely related to guarantees given by manufacturers and sellers. However, unlike the manufacturers' and sellers' guarantees, service contractors assume the risk of fortuitous events over which the servicing company has had no control. Accordingly, a guarantee that is considered not to be insurance when applied to goods sold can be held as insurance if the same person grants it for goods neither manufactured nor sold by him. However, by inspecting the guaranteed property, the guarantor can succeed in reaching the same standing as the seller of goods.

Since a contingent service contract may give rise to insurance, it must now be determined when this does in fact occur; i.e. whether the parties intended that the consideration be paid for the rendition of services, or for the assumption of a fortuitous risk.

Where the agreement contemplates the rendering of all needed services and repairs for a given period and a fixed consideration, the intention is the assumption of the risk of repairs rather than to approximate the amount of services which will be required, and to place an evaluation thereon. The home owner fears that the possibility of repairs may become too financially burdensome. Thus, he seeks to escape that risk by shifting it, for a fixed sum, to the servicing company which assumes the risk. That company, by accepting many such obligations, each for a given fee, expects to profit through the workings of the law of averages rather than by any exercised control on its part.

Should the company, for the fixed fee, obligate itself to regularly inspect and perform repairs, the contract is one for the rendition of services and is not insurance. The regular service calls constitute a fair basis upon which to approximate the value of services which will be rendered. Here it may be presumed that the parties intended the fee to be in consideration of such services rather than for the assumption of any risk of repair.

Where the company performs such affirmative acts as inspection or repair, it may guarantee its work by a form of ancillary service contract requiring the rendering of all

services necessary to maintain the quality of the act. There then exists a present control over the continued performance of the repaired item, and the ancillary service contract entered is a guarantee, not insurance.

Such guarantee, however, may not obligate the servicing company to replace parts since the present control extends only to workmanship and not to the materials of the item. Had the company installed a new part into an appliance, the guarantee may include its replacement if found defective since, in effect, the company is then in the position of a dealer with respect to that part.

From the foregoing, we conclude that the servicing programs described constitute the transaction of insurance. The fees paid as consideration by the home owner are not determined on the basis of an approximation of the cost of maintenance, service, or repair which may reasonably be expected on an individual basis. Rather, the fee charged is based on the fair market value or the selling price of the individual home where the insured items exist. While an operational check on the items covered is made under the first described program to verify that those items are in working condition, no maintenance or service is initially performed on which a guaranty of proficiency can be placed. The second servicing program described in the facts given does not provide initial maintenance or repair work. Thus, these two programs do not guarantee the accuracy or proficiency of their own work done prior to issuing the service contract, nor are the companies offering this program in the position of the seller or distributor of the covered items.

Further, it cannot be said that the major purpose of these servicing contracts is other than to indemnify the insured in the event of normal failure of certain household products. The contracts are not issued by the manufacturer of the items, nor by the home seller. The first servicing contract is issued by an agent of the real estate broker, who is the home seller's agent. The other contract is that of a company which will issue such contract to presumably any home owner who will pay the required consideration.

Section 58-18-25, N.M.S.A. 1953 Comp. classifies the many forms of insurance which may be lawfully transacted in this state. Although the forms of insurance described in this Opinion are not specifically referred to in that section, they do constitute an example of casualty insurance since, in essence, they protect against injury to property. Thus, they may be properly classified as a "class 2" form of insurance under Section 58-18-25, **supra,** as "Class 2. Casualty . . . (h) Other casualty risks. Insurance against any other casualty risk not otherwise specified which may lawfully be the subject of insurance and may properly be classified under Class 2."

ATTORNEY GENERAL

Toney Anaya, Attorney General