The Service Contract Industry in California

Market Trends and Policy Issues

State of California

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OVERVIEW

The Department of Consumer Affairs (DCA) publishes this report with the cooperation and input of interested parties, including both the businesses regulated by the Bureau of Electronic and Appliance Repair (BEAR) and the consumers under its protection. This document offers an accounting of the origins and development of the service contract, and provides a snapshot of current market trends in the industry. DCA has also taken stock in these pages of the policy issues that have arisen, either from shortcomings in existing regulations or from the maturation of the industry in an unforeseen manner.

Finally, this report offers alternatives and recommendations to alleviate the mounting regulatory problems facing the service contract industry. Providing improved protection for consumers and repairing the regulatory machinery are reachable goals.

INTRODUCTION

California's service contract industry has developed rapidly and continues to grow. The experiences of the Bureau of Electronic and Appliance Repair, along with the numbers and analyses that follow in this report, confirm these facts. Consumers, through their purchasing decisions, have shown a certain demand for service contracts to cover an expanding list of products. Encouragingly, the survey conducted as a contributor to this report reveals that Californians have met with relative success when using these contracts to effect repairs.

Millions of California's homes contain products covered by service contracts. The dynamic growth of this industry and the vastness of its customer base reaffirm the Legislature's request for this report, and establish the broad impact of regulatory protection for the public. Changes, if any, in the regulation of service contracts will likely have an impact on consumers in more than half of the households in the state.

While the expanding availability and popularity of service contracts is clear, the "home service contract" is not defined in law and the current regulatory scheme is distressingly clouded. Members of the business community must contend with the fact that service contracts are regulated by multiple agencies in California; furthermore, they are regulated in an altogether different manner in some other states. Consumers, meanwhile, are largely unaware that many products are not covered by any regulations: the microwave on the kitchen counter is within the jurisdiction of a state agency, but the food processor beside it is not. For both consumers and businesses, the state of regulatory oversight is confusing at best, and self-defeating at worst. It discourages some businesses from entering the market, and it risks misleading consumers about the extent of protection and recourse provided by California's government. Relief from these conditions is necessary, prudent, and achievable.

1. BACKGROUND

1.1. Legislative Requirements for this Report

Senate Bill 2075[1] was approved by the Governor of California on September 30, 1998 and became law on January 1, 1999. The statute added § 9855.05 to the Business and Professions Code and amended § 12741 of the Insurance Code in order to redefine the methods and means of regulating home service contracts in California. The Bill generally adds responsibilities for the regulation of home service contracts offered by companies regulated by the Public Utilities Commission to those responsibilities already assigned to the Department of Consumer Affairs (DCA), Bureau of Electronic and Appliance Repair (BEAR) and amends such regulatory responsibilities for home protection contracts mandated to the Department of Insurance (DOI).

Specifically, the statute provides that:

a. On or after January 1, 2000, service contracts subject to regulation by DCA/BEAR include service contracts offered or issued by a person or affiliate of a person whose business is regulated by the Public Utilities Commission if the following conditions are met:
   1. the regulated person, or affiliate of the regulated person, or parent company of the regulated person, must act as the guarantor of any service contract to be assigned to the regulatory authority of DCA/BEAR regardless of whether the service is to be performed by the regulated person or an affiliate;
   2. the service contract term is for one month or less, and
   3. the person issuing or offering the service contract does not engage in the business of a home protection company.

The Bill sets a sunset date of January 1, 2004 for the amendments made to Section 12741.

The Bill mandates that "*. . . the Department of Consumer Affairs, in consultation with the Department of Insurance, representatives of the service contract and home warranty industries, and other interested parties, conduct an in-depth study of the evolving marketplace related to home service contracts and report its findings to the Legislature.*" The mandate stipulates that the report "*. . . shall include a recommendation regarding regulation of home service contracts and the appropriate form of regulation if regulation is determined to be necessary.*"

1.2. History of the Regulation of Service Contracts in California

The Bureau of Electronic and Appliance Repair was established in 1963 as a result of the enactment of the Electronic Repair Dealer Registration Law. The bureau's original name was the Bureau of Repair Services, and that name was changed to its current form in the early 1970s.

The Electronic Repair Dealer Registration Law primarily was the result of a combined effort by three groups: the California State Electronics Association, the Governor's Consumer Council, and the Department of Professional and Vocational Standards Advisory Committee. At the time, the stated intent of those groups was to provide protection to California Consumers against fraud and negligence in the repair business for home electronics. Home electronics consisted mainly of radios and television sets, although the law also regulated the repair of stereo components.

[1]See Appendix

By the late 1950s and early 1960s, fraud and negligence in the television repair industry were becoming increasingly visible concerns to consumers and law enforcement agencies. The television industry experienced tremendous growth through the 1950s, although a television set was a relatively expensive household purchase. Because replacement was not a viable option for most families when a television set broke down, the demand for TV repair services was quite high. However, television technology still was new by the 1960s, and most consumers had very little knowledge of the mechanics of the costs of TV repair. That placed consumers at a disadvantage when they had to deal with the firm offering repair service. Consumers were vulnerable to unethical businesses through fraud and negligence. It became increasingly common for consumers to complain of repair businesses charging too much for repair services; or charging for services that were unnecessary; performed poorly, or not performed at all.

Fraudulent and/or negligent TV repair practices became among the most frequent complaints to the Better Business Bureau. Safety was a concern, since negligent repair could lead to fire, shock, picture tube implosion, and other safety hazards. In response, the legitimate repair industry and consumer groups sought regulatory protection from the State. State oversight of the industry has been so successful that the Legislature has continued to assign responsibility to DCA/BEAR. A chronology of the extension of BEAR's jurisdiction demonstrates the confidence of the Legislature in the ability of BEAR to provide regulatory oversight of the industry.

June	1973	Major home appliances
June	1975	Appliances in private motor vehicles
January	1979	Microwave ovens
January	1983	Installation and repair of auto radios
January	1983	Personal computers
January	1983	Satellite antennas and related equipment
January	1984	Video monitors
January	1987	Mandatory written estimates
June	1988	Cite and fine authority
January	1991	Installation and repair of auto burglar alarms
January	1993	Home office products
January	1993	Disconnection of telephones
January	1993	Issuance of infractions
January	**1994**	**Service contracts**

The addition of "service contracts" to BEAR's regulatory responsibilities in 1994 stemmed from the fact that many of these contracts provided for the maintenance, repair and/or replacement of electronics and appliances by organizations which BEAR already regulated. Service contracts are also referred to as *extended warranties* or *maintenance agreements*. They assure consumers that, if something goes wrong with an electronic or appliance product covered under the terms of the contract, it will be repaired or replaced.

The main force behind California's regulation of service contracts has been the occurrence of defaulting on contracts by service warranty providers. In the early 1990s, consumer complaints about defaults by service warranty companies increased considerably. A number of warranty companies simply went out of business or moved out of state, leaving consumers without the protection for which they had paid. Consumers also complained that contracts sold to them simply duplicated repair services already covered by the manufacturer's warranty. By duplicating coverage, service contract providers were charging consumers extra money for services that were already included in their purchases, since manufacturers' warranties are included in the purchase prices of products.

The basis of service contract regulation is to provide the following consumer safeguards:

- •Clear disclosure of the terms and duration of the contract;
- •Identification of responsible parties and financial obligors;
- •Protection against default of service contract sellers and administrators;
- •Confidence that the terms of the service contract will be satisfied by the obligor;
- •An avenue for mediation and remedies of consumer complaints; and
- •Reasonable assurance of the financial backing of the contract.

1.2.1. Service Contracts and Insurance

While service contracts appear to be insurance contracts because they mitigate the risk of loss, there are substantial differences:

- Insurance contracts indemnify the contract holder. Money is paid to the contract holder based on a stipulated method of calculating the value of the loss. The contract holder who has purchased an insurance contract as a hedge against loss will need to make their own arrangements regarding recovery. Failure in the ability of a contractor to live up to the agreement is based on financial condition and business policy. Risk is measured by a contractor using actuarial or statistical algorithms designed to assure the company's continuing sound financial condition. The actuarial and statistical algorithms can be measured and business practices observed by regulators to assure that contractors permitted to do business in California meet certain standards of practice, financial condition, and risk sharing. Insurers can be discretionary in the risks they assume. Those insured must invariably meet a minimum standard established by the insurer as a condition of assuming the risk.
- Service contracts provide the contract holder with a contractual guarantee that the covered product will be maintained, repaired and/or replaced. The option as to which service is provided may lie with the contract provider. The contract holder is assured that the product will be made whole. Since the risk to the service contractor lies with the covered product or system, the conditions upon which such contracts are entered into are substantially different.
- Federal law regarding service contracts consists of:
    - The Magnuson-Moss Consumer Warranty Act which defines service contracts as "a contract in writing to perform, over a fixed period of time or for a specified duration, service relating to the maintenance or repair (or both) of a **consumer product.**" This Act's primary requirement is that the seller or obligor list conspicuously all terms and conditions in simple and readily understood language.
- California law regulating service contracts is contained in three statutes:
    - The Song-Beverly Consumer Warranty Act of 1970, contained within the California Civil Code, mandates terms and conditions of service contracts. This statute defines a service

contract as "a contract in writing to perform, over a fixed period of time or for a specified duration, service relating to the maintenance or repair of a **consumer product,** except that this term does not include a policy of automobile insurance, as defined in Section 116 of the Insurance Code."

- The Home Protection Act (Insurance Code §12740 et seq.) which regulates home protection contracts through the Department of Insurance.
- The Service Contractors Registration Act (Business and Professions Code § 9855 et seq.) which regulates service contracts on specific consumer products through the Department of Consumer Affairs, Bureau of Electronic and Appliance Repair. This statute defines a service contract as "a contract in writing to perform, over a fixed period of time or for a specified duration, services relating to the repair of a **set or appliance** as defined by this chapter."

1.2.2. Definition of a Home Protection Contract

As codified in § 12740 of the California Insurance Code, a Home Protection Contract is:

> *. . . a contract or agreement whereby a person, other than a builder, seller, or lessor of the home which is the subject of the contract, undertakes for a specified period of time, for a predetermined fee, to repair or replace all or any part of any component, system or appliance of a home necessitated by wear and tear, deterioration or inherent defect, arising during the effective period of the contract, and, in the event of an inspection conducted pursuant to subdivision (b) of § 12761, by the failure of that inspection to detect the likelihood of any such loss.*

Subsection (b) of § 12761 stipulates . . .

> *. . . a home protection company may require an onsite inspection as a pre-qualification for the issuance of a home protection contract, and in such event offer a report on the inspection in connection with a bona fide application for the issuance of such contract even though the issuance of a contract on the property which is the subject of the inspection does not occur.*

When these statutes were originally enacted, regulations were promulgated to facilitate the licensing process of the home protection companies covered. These regulations delineate the intent of the legislation by the following definition: "home protection contracts (more commonly known as home warranties), ...are contracts sold to sellers of residential properties with protection against hidden or undisclosed defects in specified appliances, heating, plumbing and electrical systems of those properties for a period of one year following sale. Normally, the contracts are marketed through the assistance of real estate brokers and salesmen who, without any remuneration or any other compensation to themselves, serve as the primary marketing vehicle for the sale of these contracts at the time the property is listed with the real estate broker for sale. Should defects necessitating repairs or replacement of the appliances or other items specified in the contract surface, either during the listing period or within one year following the sale of the property, the home warranty company undertakes to make the repairs or reimburses the contract holder for such repairs..." (Ruling No. 230, File No. RH-206, In the Matter of the Proposed Regulations of the Insurance Commissioner Relating to Home Protection Companies, February 1979).

2. THE HOME SERVICE CONTRACT INDUSTRY AND MARKET TRENDS

The home service contract market is complex. This section of the report will provide an understanding of the current players in the market, distribution channels, marketing methods, types of home service contracts and characteristics, business relationships that may be involved in the selling, marketing, administration and servicing of home service contracts, as well as other related services underlying the industry.

2.1. Current Participants in the Home Service Contract Industry

Retailers
Manufacturers
Insurance Companies
Utility Companies
Repair Service Providers
Banks
Credit Card Companies
Mortgage Companies
Real Estate Companies
Home Builders
Home Security Companies
Home Service Companies
Home Warranty Companies

2.2. Roles in the Home Service Contract Market

The home service contract industry is comprised of a variety of distinct and sometimes separable market functions that result in the delivery of a home service contract. The following are definitions of those functional entities and their roles:

A. The Marketer is a person or business entity that markets the home service contract to a potential customer. This person or business entity may be the seller of the home service contract.

B. The Seller is a person or business entity that sells the home service contract to a customer.

C. The Administrator is a person or business entity that handles or arranges for the handling of the day-to-day responsibilities and management of the home service contracts. Administrators are engaged because of their expertise in payment processing, claims handling, customer service, licensing and regulatory compliance.

D. The Underwriter is a person or business entity that underwrites the financial risk of the home service contract. The Underwriter may be an insurance company.

E. The Service Provider is a person or business entity that performs the actual maintenance, repair and/or replacement to the covered product(s).

F. The Obligor is a person or business entity that is financially and legally obligated to the contract holder under the terms and conditions of the home service contract.

2.3. Configurations and Business Relationships of the Parties

While a single business entity may fill all the roles identified above, most often the roles are divided among several entities. For example:

> A retailer sells a product to a consumer and sells a home service contract to cover that product at the point of sale. The retailer may sell the contract with its own label, or the product manufacturer's label, or another party's label. The home service contractor may be self-insured, or underwritten by an insurance company. In this example, the retailer provides the marketing of the home service contract along with the covered product(s). However, marketing can be done in other ways. Marketing can be accomplished by telemarketing, mail, or as advertising inserts in the product's packaging. The retailer may issue a standard form of home service contract at the point of sale or may use the services of another business entity that will issue a home service contract customized for the consumer and delivered after the sale. The retailer may either administer the home service contract or engage a third party to administer the program. The administrator would, if engaged, take the repair calls from contract holders and dispatch service providers. The retailer may provide the service for the covered product(s) or may contract with outside service providers.

Initially, service contracts were offered and sold by the manufacturer of the product, or by the retailer who sold the product. However, some providers found the contracts too complex to administer efficiently, and a growing number of providers turned to third-party firms to handle their service contract programs. Such firms are paid by the retailers and manufacturers to handle the daily responsibilities of managing service contracts and providing assistance to consumers.

Although the participants may vary, these configurations and business relationships are applicable to the litany of business entity types referred to previously.

2.4. Sales Channels and Marketing Methods

Home service contracts typically are sold to consumers at retail stores in conjunction with the purchase of a product. Increasingly, however, the litany of potential business relationships referred to above is compounded by the variety of permutations available to the enterprising marketer of home service contracts. The following is a list of potential sales channels available to the marketing of home service contracts:

A. The Distributor is an agent that signs up accounts that will in turn sell home service contracts to customers.

B. The Direct Mail Solicitation is a mailer that goes to a consumer whose name and address have been acquired.

C. The Monthly Billing Statement Insert is a mailer that is inserted in a customer invoice. Invoicers may include mortgage companies, credit card companies, banks and utility companies.

D. Outbound and Inbound Telemarketers make or invite telephone calls for an opportunity to sell home service contracts.

E. The Technician may offer a consumer a home service contract while repairing a product.

F. The Internet provides a new means of offering home service contracts via web pages for a variety of business participants who wish to act as a seller.

G. Home Builders solicit home service contracts as a service to their clients and as an added source of revenue.

H. Inboard Solicitations are inserts in product packaging. Such inserts may invite the product's purchaser to call an "inbound telemarketer." (See "D" above).

I. Mail Order Catalogs for potentially covered products may offer service contracts.

J. Third Parties, not associated with the sale of products or a real estate transaction, who have the potential to expand on another business relationship to the customer, or whose interest lies solely with the sale of the home service contract.

2.5. The Characteristics and Features of Home Service Contracts

Home service contracts may vary significantly in their coverage, terms and conditions. They provide for the repair and/or replacement of items, systems or components found in or around a home. Because home service contracts may provide coverages which duplicate warranty provisions, the marketing structures and business entities offering them are natural candidates for regulatory oversight.

The duration of coverage of a home service contract is typically from one to five years from the date of contract purchase. Payment methods include full payment at the time of purchase, installments, and monthly billing statements. Home service contracts may provide additional coverage including, but not limited to, power surge protection, preventive maintenance, technical support, pre-loaded software support, food loss protection, and parts cleaning. In addition, many home service contracts may be transferred from the original covered product owners to a subsequent owner.

Common types of home service contracts are:

A. Consumer Goods: Service contracts of this type provide coverage for a variety of consumer goods, including appliances, electronic equipment, lawn and garden equipment, jewelry, etc. These type of contracts are most often sold by a retailer at the point of sale, or a manufacturer after the point of sale, so there is a specific tie between the product and the service contract. Coverage usually includes parts and labor. Coverage is typically sold in annual increments, anywhere from one to five years. Sometimes these contracts restrict coverage to only specific components within the item, and often for parts only. Examples might be the compressor in a refrigerator or the picture tube in a television. This type of contract falls under BEAR's statutory authority for certain products, while other products are covered only by the Song-Beverly Consumer Warranty Act.

B. Multiple Products Contained in the Home: Home service contracts of this type provide coverage for major appliances within the home, and are often offered by utility companies or third parties. These offerings will cover existing items in the home, such as kitchen appliances, heating and air conditioning units, water heaters, and garage door openers, regardless of make, model or age of the equipment. These contracts do not cover structural components of the home, such as plumbing or electrical systems, which are commonly provided under home protection plans. As items are replaced in the home by new or additional equipment, the contract is normally amended to reflect coverage of the new or additional items. Coverage typically includes parts and labor. The duration of these contracts is typically one year, but may be as short as one month, with automatic renewal. These offerings, if offered by a utility company or its affiliate, regulated by the PUC, as outlined in Insurance Code Section 12741, will come under BEAR's authority as of January 1, 2000. Offerings by any utility company that does not meet the criteria or any other type of company will remain under the regulatory authority of DOI.

2.6. The Economic Size of the Service Contract Industry in California

The relative economic size of the Service Contract Industry in California cannot be precisely measured. Industry participants rightly consider information regarding their own market size as proprietary. A reasonable "order of magnitude" value can be estimated using the results of the consumer survey undertaken for this report[2] which places the number of service contracts extant at 1.4 per California family; the industry's estimated value of a service contract as being between $50 and $200; and, the number of California families at approximately 12 million. Based on these figures the economic size of the service contract industry in California would therefore be between $170,000,000 and $672,000,000 annually.

3. CONSUMER PERSPECTIVE

To assess the perspective of California consumers, a telephone survey of California residents was conducted between July 20 and August 2, 1999 by the professional research firm of J.D. Franz Research, Inc. The margin of error for the survey was ± 4.7 percent. Findings from the survey are presented here in the same order in which the questions were posited to respondents. Readers who are interested in the precise phrasing of the inquiries will find the questionnaire in the Appendix of this report.

3.1. Familiarity with the Concept of Service Contracts

The majority of respondents (83 percent) said they are familiar with the concept of an extended warranty, maintenance agreement, or service contract. However, only about a quarter of those who said they are familiar with the concept (24 percent) were able to define it correctly. Slightly over half (52 percent) gave a more or less correct answer, and slightly less than a quarter (23 percent) gave a wrong answer.

3.2. Prevalence of Purchase of Service Contracts

Close to half the respondents (45 percent) said they had purchased an extended warranty, maintenance agreement, or service contract on a major appliance or consumer electronics product in the

[2]See Appendix for Survey Questionnaire

five years preceding the survey. (Respondents who said they were unfamiliar with the concept or who were unable to define it correctly were read a definition before they were asked this question.) In addition, one percent said they had purchased such a contract on an item not under the jurisdiction of BEAR.

3.3. Reasons for Not Purchasing Service Contracts

The most prominent reasons for not purchasing a service contract were not having made an applicable purchase (29 percent), finding such contracts a waste of money (21 percent), and viewing them as unnecessary (17 percent).

3.4. Products Covered

Products most likely to be covered by an acquired service contract were televisions (41 percent), washers (37 percent), refrigerators (36 percent), dryers (28 percent), computer systems (28 percent), VCRs (27 percent), and stereo systems (22 percent).

3.5. Reasons for the Purchase of a Service Contract

Most likely to be offered as reasons for purchasing a service contract were that it seemed like a good idea because the product might break down (44 percent) and not wanting to spend extra money on repairs (22 percent).

3.6. Service Contract Costs

Because these data are not considered to be reliable due to absent or faulty recall, they are included by reference only. Other sources were used to determine the average cost of a contract in order to derive an order of magnitude for the service contract market in California.

3.7. Service Contract Use

Forty-seven percent of respondents who purchased service contracts said they had tried to use them. Of these (n=94), most reported positive experiences. Close to half (47 percent) said the provider was helpful and they had no problems. Over a quarter (26 percent) said they obtained repairs when they needed them, more than one in ten (12 percent) said they received replacements when they needed them, and one in ten (10 percent) said they received maintenance or service. One in nine (9 percent) said they had trouble getting service, five percent said they didn't get service, and three percent said the product broke again shortly after it was repaired.

3.8 Prevalence of Contracts on Other Items

Over a quarter of respondents (29 percent) indicated that they had been asked to purchase a service contract on something other than a major appliance, consumer electronic product, vehicle, or boat. Of these, close to a third (31 percent) said they made the purchase.

3.9. Attitudes Toward Service Contracts

Consumers are divided on whether service contracts are a good idea or not, are inclined to disagree on whether such contracts are worth the price, and generally agree that salespeople often pressure customers too much to buy them. *We note that the percentage of respondents who believe that service contracts are a good idea has declined slightly from a survey conducted in 1995.*

3.10. Analysis of the Results of the Consumer Survey

Analysis of the survey's key substantive questions by respondent demographics yielded a number of statistically significant results. These in turn yielded the following insights:

Familiarity with the concept:

- The more educated people are, the more likely they are to be familiar with the concept ofa service contract.
- Only those in the youngest age group (18 to 24) are noticeably less likely to be familiar with the concept than respondents in other age groups.
- Familiarity with the concept is lowest among Latinos or Hispanics, highest among Caucasians, and in between among African-Americans and Asian-Americans.
- The higher consumer's household incomes are, the more likely they are to be familiar with the concept.

Purchases

- People under the age of 35 are more likely to have purchased service contract than those older than that; the most likely purchasers are those under 25.
- Purchases are most prevalent among those with household incomes of between $15,000 and $29,000, least prevalent among those with lower incomes, and in between among those with higher incomes.

Attitudes

- As people get older, they are less likely to agree strongly that service contracts are a good idea.
- As household incomes rise, people tend to be less likely to agree strongly that service contracts are a good idea.
- Those aged 18 to 24 are the only ones to agree strongly that service contracts are worth the price charged for them.
- Those with household incomes of between $15,000 and $29,000 are the only ones to agree strongly that service contracts are worth the price charged for them.
- Those with less than a high school education are less likely than the more educated to agree with the statement that salespeople often pressure customers too much to buy service contracts.

3.11. Conclusions and Recommendations Resulting from the Consumer Survey

Clearly the service contract industry in California is a major enterprise. Close to half of all households report having purchased one or more such contracts in the past five years. Moreover, the total number of recent contracts represented by the respondents is an average of 3.2 per purchasing household or 1.4 per California household.

Therefore, the extent and manner in which this enterprise is regulated has an effect on a substantial segment of the State's population. In addition, effective regulation appears to have the greatest effect on consumer segments that are particularly vulnerable, namely, the relatively young and those of modest means.

The importance of the manner in which regulation is handled is further underscored not only by the reach of the contracts under BEAR's jurisdiction, but also by the existence of contracts on items that may not be regulated. According to the results of this survey, close to one in ten California households have purchased service contracts on items not regulated by the Department of Consumer Affairs.

Respondents' experiences using their service contracts, they have generally been positive. Regulation appears to be working very well. At the same time, however, there have been problems: nine percent of households have had trouble getting service or repair, and five percent report getting no assistance at all.

4. HOME SERVICE CONTRACT LAW

4.1. What is a "Home Service Contract?"

Home service contracts may vary significantly in their coverage and terms and conditions. As defined for purposes of this study, they provide for the repair or replacement of items, systems or components found in or around a home. Senate Bill 2075 will expand BEAR's regulatory authority, as of January 1, 2000, to include home service contracts offered by a utility company and/or its affiliate whose business is regulated by the Public Utilities Commission, when certain conditions are met.

While California law defines "service contract" and "home protection contract," it does not currently define a "home service contract." "Service contract" and "home protection contract" are considered to be distinct types of contracts and are currently regulated by separate agencies, the Department of Consumer Affairs and the Department of Insurance, receiving their Legislative regulatory authority from two distinct and separate statutes located in different State codes, the Business and Professions Code and the Insurance Code, respectively. While each statute regulating home service contracts provides significant consumer protections, those regulating the home service contract business do not provide clear guidance, do treat competitors differently, and hinder market entry.

4.2. Status of Present California Law

The California Legislature has determined the form of regulation of service contracts:

A. All service contracts sold in California must comply with the mandates of the *Song-Beverly Consumer Warranty Act*;

B. Service contracts on specifically identified appliances and consumer electronic sets must comply with BEAR regulations, which sunsets January 1, 2003;

C. Home protection contracts are regulated by the DOI and must comply with the *Home Protection Act*;

D. BEAR and DOI regulatory schemes each provide for financial reserve requirements for the businesses subject to their regulation;

In regulating home service contracts, the Legislature has recognized the distinctions between home protection contracts and service contracts. It has classified home service contracts according to their underlying purpose, rather than by concepts such as "shifting the risk" and "outside the retail chain of distribution."

4.2.1. The Song-Beverly Consumer Warranty Act

The first statutory scheme to regulate consumer warranties in California was the Song-Beverly Consumer Warranty Act, Stats. 1970, c. 1333, § 1. Song-Beverly considers service contracts on consumer goods to be extended warranties. The only recourse provided to consumers by the Song-Beverly Act is via civil action. The Act did not establish licensing, enforcement or regulation. The courts have set forth the Legislature's intent in enacting Song-Beverly to be "to eliminate misleading sales gimmicks and to ameliorate consumer frustration caused by inability to obtain promised repair services."[3]

Song-Beverly applies to consumer goods that are used, bought or leased for use primarily for personal, family, or household purposes. Civil Code § 1791(o) defines **"service contract" to mean a contract in writing to perform, over a fixed period of time or for a specific duration, services relating to the maintenance, replacement, or repair of a consumer product.** Service contracts are purchased by owners of consumer goods from people in the business of manufacturing, selling, and/or servicing such goods.

4.2.2. The Home Protection Act

The Home Protection Act, Stats. 1978, c. 1203, (SB 2222), was enacted in 1978 for a specific purpose in a specific market. Legislative findings set forth the need for an effective program for protecting buyers of existing homes from hidden or undisclosed defects in the appliances or electrical or mechanical systems of those homes. "Home protection contracts [are] in most instances concluded in relationship to the transfer of residential properties, or for limited terms and are usually not renewed, and the services incident to the production and servicing of such contracts differ from that in most traditional insurance contracts."

[3] Reveles v. Toyota by the Bay (App. 4 Dist. 1997) 67 Ca. Reptr. 2d 543, Cal App 4th 1139, rehearing and review denied.

The Home Protection Act is clear about its application and purpose: protecting home buyers from hidden or undisclosed defects in specified appliances and systems in the homes they buy. Home protection contracts are typically purchased by the seller of a home from a home protection insurance company, to assure the home sale is completed and to protect the seller and agent from litigation arising out of the transaction. The purchaser of the home and its contents is essentially a third party beneficiary of the home protection contract. Home protection contracts are regulated by DOI, but because of possible overlapping application, the Home Protection Act carves some (but not all) service contracts from its coverage, and for the most part, these contracts are now regulated by BEAR.

4.2.3. The Service Contractor Registration Act

Except for Song-Beverly's disclosure requirements, California did not regulate sellers and administrators of service contracts until 1993 with the Service Contractor Registration Act, Stats.. 1993, c. 1265 (SB 798). This Act attempted to close the gap in the State's regulation of service contracts by giving BEAR regulatory authority over sellers and administrators of service contracts on specific electronic and appliances.[4]

In 1998, the Legislature amended the Act and Song-Beverly in Stats. 1998, (AB 2704), to include the "obligor" as the entity financially and legally obligated under the terms of the service contract and to revise the definitions of "service contract seller" to include an obligor. This legislation also revised the definition of service contract to include replacement of consumer products and expanded the definition of "home appliances" as they relate to consumer warranties and service contracts.

4.2.4. California's Service Contract Participants as Defined in Law

The service contract industry is comprised of a variety of distinct and separable functional entities. These generally consist of the contract seller, the retailer, the manufacturer or builder, the contract administrator, the processor, the insurer, and the repair service provider. Occasionally, a single business entity performs most or all of these roles, more often the roles are divided between multiple business entities. While these terms are commonly used in the industry, only five terms are defined in law:

A. A <u>Service Dealer</u> is the legal term used for a "repair service provider." A service dealer may engage in only four activities: servicing electronic sets; installing or servicing equipment or alarms in motor vehicles; installing or servicing residential satellite receiving equipment; and servicing major appliances.[5]

B. A <u>Service Contract Seller</u> is the person or business that "sells or offers to sell a service contract to a service contractholder, including a person who is the obligor under a service contract sold by the seller, manufacturer, or repairer of the product covered by the service contract."[6]

[4]See Appendix for a list of covered and typical non-covered items.

[5]Business and Professions Code §9855.

[6]Business and Professions Code §9855(c).

C. The Service Contract Administrator is a business that executes and manages service contracts on behalf of retailers, manufacturers and/or others. The function and business segment has developed because of the heavy administrative burden of managing extended service plans. A growing number of retailers and manufacturers are turning to third-party firms to fill this function.[7] These firms are paid by the retailer or manufacturer to be responsible for managing service contracts and providing assistance to the consumer. Third-party administrators can offer the retailer service management options that include service contract marketing, customized call taking, training, point-of-purchase support and after-market sales support via direct mail and telemarketing. Third-party administrators now handle between 50 and 70 percent of the total market.[8] This is a market of substantial size and scope as we shall shortly demonstrate.

D. The Service Contractor is an interchangeable term for a service contract seller or a service contract administrator and can include both functions.

E. The Obligor is the entity financially and legally obligated under the terms of a service contract. An obligor may be the retailer, manufacturer, or service dealer who offers a service contract, or may be a third party who has been contracted to assume the obligations of the service contract. Typically a "third party" obligor is a company owned by an insurance company or the retailer for the specific purpose of preventing an onerous tax burden. A service contract administrator may not be an obligor under California law.

We note that the convoluted relationships between functional entities, particularly those that may be separate businesses allied under separate contracts and/or agreements that are not always clearly delineated within the language of the service contract, invite regulation and oversight.

There are two other terms referred to in law that are not specifically defined. The functions they represent are essential to understanding California's regulatory approach:

F. The Insurer is the person or business entity who assumes the financial risk of loss. The function of the insurer, as it relates to service contracts, indemnifies the obligor if the obligor's loss exceeds parameters defined in the insurance contract. *We note that the company that provides such an insurance contract must be "permitted" to do business in California and must be regulated by the California Department of Insurance.*

7. The Processor is the person or business entity who provides services to a contract administrator. The function of the processor is to assist in the technical work of processing contracts, claims and billing. Processors are not liable in any way for fulfilling the terms of a service contract.

4.2.5. Problems with Existing California Law

With respect to home service contracts, existing California law imposes a number of problems on industry, consumers and the regulatory agencies:

[7] The new York Times, July 23, 1995.

[8] This Week in Consumer Electronics (TWICE), September 30, 1996

- Definitions of contract types are not clear when compared to types of services presently being offered in the marketplace. Industry is bringing out increasingly diversified types of service contract offerings that are not directly tied to a specific product, but cover multiple items within a group, such as kitchen products.
- Definitions of participants are unclear or conflicting when compared to types of participants presently in the market and the types and permutations of relationships between the participants.
- Definition of jurisdiction, i.e., who (DCA, DOI, or the civil justice system) has regulatory authority relative to the types of contracts being sold is not always clear to either the consumer or the industry. Part of this lack of clarity stems from how current law is structured. For example, the Insurance Code has not been updated for several years to meet the current offerings in the market, but DOI considers all types of offerings that are not expressly exempted from the Home Protection Act as being within their jurisdiction. DCA understands that more firms would like to offer service contracts to California consumers if jurisdictional issues were resolved, e.g., a service provider was no longer required to be a licensed insurance carrier for replacement or repair of certain products.
- Current regulations enforced by BEAR are expressly limited to cover only certain types of products. The static list of covered items is increasingly outdated as new products are introduced. As a result, significant gaps exist, and are growing, in regulatory coverage of items often contained in service contracts. Examples of items not covered by BEAR include lawn mowers, power tools, water heaters, food processors, etc. Because no clear premise or rationale exists for the coverage of some items and the omission of others from coverage, consumers are unaware of these inconsistencies when they purchase products or service contracts. Therefore, these gaps in regulatory coverage place consumers at risk.
- Specific conflicts exist between California's laws. For example, SB 2075 requires service contracts offered by utility companies and the affiliates with a duration of one month or less to fall under the jurisdiction of BEAR. This conflicts with provisions of the Song-Beverly Consumer Warranty Act which provides that a consumer be able to request a prorata refund of the contract after 30 days if they are not satisfied. Compliance with this statute is not possible if the contract duration is less than 30 days. In addition, contracts with a duration of one month or less are open-ended and automatically renew unless either the buyer or the seller requests the contract to terminate. This open-ended policy is not consistent with Song-Beverly requirements that a contract must be of a fixed duration.

4.3. Regulation in Other States

Service contract regulation has been enacted in several states as a result of consumers nationwide experiencing the same types of problems as have been apparent in California with the failure of service contract providers. The service contract industry has actively supported regulation in individual states and industry leaders have promoted the use of the National Association of Insurance Commissioners (NAIC) Model Act for service contracts.

The following is a summary of the form of regulation in all states, including the District of Columbia:

- **10 states** have enacted laws which specifically address service contracts on consumer products
- **5 states** have enacted laws which combine service contracts on consumer goods with home warranties and automobile service contracts
- **21 states** regard service contracts on consumer goods as insurance, based on whom the obligor is on the contracts
- **15 states** currently have no regulation regarding service contracts on consumer goods

A detailed chart of regulation in all states is included in the Appendix.

In most instances, regulation is under the purview of that state's Department of Insurance, when the state does not have a dedicated consumer protection agency such as DCA–even in those states that do not define service contracts as insurance. Many of these states have adopted a form of the NAIC Model Act for service contracts.

5. CONCLUSION

Because service contracts afford established businesses an opportunity to diversify their portfolios of available products and services, the service contract industry continues to change and grow. The complexity of the interaction between various functional business entities in the industry is evident.

In California, the Legislature has determined that extended warranties and service contracts in which the consumer is indemnified by maintaining, repairing and/or replacing consumer goods, including homes and systems which are incidental to homes, are substantially different from insurance contracts in which the consumer is indemnified with money. As a consequence, the Legislature has provided different regulatory protection schemes previously described in this report.

Nevertheless, existing California law leaves significant gaps, conflicts and differences in understanding relative to administrative jurisdiction, products and services covered, consumer risk, and industry activities. All of these factors are made especially significant considering that most California households have purchased service contracts, and will likely continue to do so in the future. The California consumer is at risk due to the disorganized state of regulatory authority. The conclusion of this report is that regulation of home service contracts is necessary, and that such regulation should be developed within a comprehensive review and restructuring of all related California service contract law.

The following section considers alternatives for appropriate jurisdiction of home service contract regulations.

6. ALTERNATIVES

Alternatives discussed below are:

a. Maintain the status quo - no change;

b. Clarify and assign all home service contract regulation to DCA; and,

c. Clarify and assign all home service contract regulation to DOI.

6.1. Maintain Status Quo

This alternative maintains the current regulatory scheme under three separate statutes. Although this alternative requires no statutory or regulatory change, it has several significant drawbacks:

a. It does not address the current gaps and confusion in regulation for the public, the industry or state government.

b. For some products and service offerings, consumer protection is limited or non existent. Consumer recourse for certain products would be limited to civil court action.

c. Industry members offering "cross-over" service contract products would be subject to licensure and regulation by multiple entities.

d. As new products and plans are marketed, there would not be an adequate statutory foundation on which to adopt regulations to protect consumers.

6.2. Assign jurisdiction of home service contracts to DCA (separating regulation of financial insurance from repair and replacement services)

Develop clear and consistent treatment of jurisdictional authority, with DOI responsible for contracts insuring against loss via financial payment, while retaining jurisdiction over home protection companies and automobile contracts, and with DCA responsible for contracts against loss via repair and/or replacement of consumer goods. Assignment of these responsibilities within DCA could either be accomplished by creating a new entity to regulate all service contracts on consumer goods, by increasing BEAR's authority to encompass the additional contracts, or by assigning the responsibility to another existing entity within DCA.

This alternative clarifies and strengthens the policy of separation already determined by the Legislature.

The advantages are:

a. Consistent consumer protection - one statute with supported regulations.

b. DCA is equipped to handle individual consumer complaints and offers mediation and investigative services on a case-by-case basis.

c. DCA is experiences in regulating the consumer electronic and appliance service contract industry. Industry is familiar with the current regulatory structure–including service contract requirements and financial backing alternatives. In addition, many companies engaged in selling or administering service contracts are already licensed with DCA for associated business activities.

The disadvantages are:

a. Current law would have to be amended to bring all parties that offer various service contract products under regulation.

b. Regulatory costs would be increased. While there would be some increase in revenue by the addition of businesses currently regulated by DCA, many of the existing businesses are already involved in the sales of contracts on products that are not regulated or currently fall under DOI's jurisdiction, and the level of revenue achieved would not cover the increased cost of regulation.

c. The current funding mechanism is inappropriate for this type of activity. Registration fees are $75 per business location for the sales or administration of service contracts. BEAR estimates that to properly fund registration and enforcement of this program, it would take a budget of approximately $750,000. Revenue from the service contract program for 1998/99 was approximately $215,000. Alternative fee structures that would more adequately fund the program and provide a more equitable balance based on the volume of contracts an entity sells or issues would be explored.

6.3. Assign regulation of all service contracts to Department of Insurance

As in the previous alternative, this option would also require establishment of new law, regulations, and financial structure. It also assumes clarification and simplification of statutes and regulations, and broadening of regulatory scope.

The advantages are:

a. Consistent consumer protection - one statute with supported regulations.

b. Precedent has been set in other states via the National Association of Insurance Commissioners Model Act, as supported by the Service Contract Industry Council which has been modified by various states to meet their specific regulatory structure, often under the jurisdiction of a state department of insurance when the state does not have a dedicated consumer protection agency such as DCA.

c. DOI currently regulates automobile service contracts and home protection companies, which offer products that are somewhat similar in nature to service contracts offered on other consumer goods

The disadvantages include:

a. Would require significant reorientation/education of the public, industry and the courts at considerable disruption, financial cost and consumer risk.

b. Diverges from the path already adopted by the Legislature.

c. DOI's structure is focused on insurance transactions of indemnification, such as life, home and auto insurance, where there is a specific monetary relationship based on claim.

d. DOI is not geared toward retail sales in a specific product area, nor the associated repairs that may be incurred following a sale.

7. RECOMMENDATION

The recommendation is alternative number 6.2 (above): maintain and clarify the Legislature's separation of regulation of insurance from product repair/replacement, and broaden the scope of such jurisdiction to accommodate industry and consumer service contract market trends. The resulting laws should add clarity to a very complex industry. In general, industry members support some type of consistent regulation in order to maintain an appropriate level of consumer protection, while allowing fair competition within the industry without onerous requirements.

The recommendation to assign responsibility to DCA, instead of DOI, is due in part to the primary mission of DCA, which is to protect California consumers. DCA is already very effectively organized to respond to individual consumer complaints, and the nature of its regulatory authority lends itself as an appropriate place to administer this type of program.

METHODOLOGY & ACKNOWLEDGEMENTS

The information contained in this report was developed from information gathered from a variety of sources. A significant portion of the research and data was provided by BEAR's Ad Hoc Advisory Council, chaired by Fay Wood of Wood Technologies International, and a voluntary Service Contract Task Force, comprised of national and state industry members, representing manufacturers, retailers, third party administrators, and insurance companies. Meetings open to all interested parties, were also held, to discuss consumer, industry, and regulatory issues related to the service contract market in California. Participants included other consumer protection agencies, various industry members, utility companies, and the California Department of Insurance.

The following is a list of research activities engaged in, in order to effectively respond to the Legislatures request for information:

- a complete evaluation of DCA/BEAR Service Contract Task Force documents and reports,
- a review and analysis of relevant laws and regulations,
- a review and analysis of SB 2075,
- interviews with:
  - BEAR management and staff,
  - Department of Insurance management and staff,
  - industry members, and
  - utility representatives,
- a review of utility district documents to determine current business practice and intent to enter the service contract industry,
- a review of trade and consumer publications,
- a review of BEAR documents including complaint information,
- an analysis of budget data and comparable fee structure, and
- a consumer survey.

Periodic meetings were conducted between BEAR staff, the consultancy firm engaged to assist BEAR, the research firm engaged by the consultant to conduct the consumer survey, and the Service Contract Task Force designated by BEAR to assist and inform BEAR and consultancy project team members during the research and analysis phases of the project. Meetings were facilitated by the consultancy firm and were used primarily as a source of information during the discovery portion of the study and to confirm understanding during the analytical portion of the study.

The consumer survey research findings presented in this report were derived from a telephone survey of residents of the State of California. The survey encompassed 429 completed interviews between July 20 and August 2, 1999. The margin of error for the survey is ±4.7 percent. The primary purposes of the survey were to determine the extent to which Californians are familiar with service contracts, the degree to which they are purchasing them, and whether they are having problems when they attempt to use them.

APPENDIX 1

SB 2075

Senate Bill No. 2075

CHAPTER 1075

An act to amend Section 9873 of, and to add Section 9855.05 to, the Business and Professions Code, and to amend Section 12741 of the Insurance Code, relating to service contracts, and making an appropriation therefor.

[Approved by Governor September 30, 1998. Filed with Secretary of State September 30, 1998.]

LEGISLATIVE COUNSEL'S DIGEST

SB 2075, Polanco. Appliance and electronics service contracts.

The Electronic and Appliance Repair Dealer Registration Law provides for regulation by the Bureau of Electronic and Appliance Repair of service contracts relating to the maintenance or repair of appliances and electronic sets, defined to include televisions, radios, computer systems, video equipment, photocopiers, facsimile machines, and other related products.

This bill would provide, on or after January 1, 2000, that service contracts subject to regulation under these provisions include service contracts offered or issued by a person or affiliate of a person whose business is regulated by the Public Utilities Commission if specified conditions are met.

Existing law provides for an initial registration fee and an annual registration renewal fee for service contractors of not more than $75 for each place of business.

This bill would provide, on or after January 1, 2000, for an initial registration fee established by the director in an amount not to exceed the actual and direct costs associated with the regulation of service contractors, but in no event to exceed a specified amount. It would also state legislative intent that the amount of the annual registration renewal fee be evaluated and set by the Legislature.

Existing law provides for the regulation of home protection contracts by the Department of Insurance, but excludes from regulation service contracts, guarantees, or warranties covering a home appliance, system, or component, under certain circumstances.

This bill would exempt service contracts offered or issued by a person or affiliate of a person whose business is regulated by the Public Utilities Commission if specified conditions, including regulation by the Bureau of Electronic and Appliance Repair, are met.

The bill would also require the Department of Consumer Affairs, in consultation with the Department of Insurance and other entities, to conduct a study relating to home service contracts, and to report to the Legislature on or before May 1, 1999. The bill would appropriate the sum of $50,000 from the Electronic and Appliance Repair Fund, a special fund, to the Department of Consumer Affairs for those purposes.

Appropriation: yes.

The people of the State of California do enact as follows:

SECTION 1. Section 9855.05 is added to the Business and Professions Code, to read:

9855.05. On and after January 1, 2000, for the purposes of this chapter, "service contract" also includes a service contract as described in subdivision (e) of Section 12741 of the Insurance Code.

SEC. 2. Section 9873 of the Business and Professions Code, as amended by Section 55 of Chapter 401 of the Statutes of 1997, is amended to read:

9873. The fees prescribed by this chapter shall be set by the director by regulation, according to the following schedule:

(a) (1) The initial registration fee for an electronic repair industry service dealer or for an appliance repair industry service dealer is not more than one hundred sixty-five dollars ($165) for each place of business in this state. The initial registration fee for a service contractor is not more than seventy-five dollars ($75) for each place of business in this state.

(2) The initial registration fee for a person who engages in business as both an electronic repair industry service dealer and an appliance repair industry service dealer is not more than three hundred twenty-five dollars ($325) for each place of business in this state. The initial registration fee for a person who is a service contractor and engages in business as either an electronic repair industry service dealer or an appliance repair industry service dealer is not more than two hundred forty dollars ($240) for each place of business in this state.

(3) The initial registration fee for a person who engages in both the electronic repair industry and the appliance repair industry as a service dealer and is a service contractor is not more than four hundred dollars ($400) for each place of business in this state.

(4) On or after January 1, 2000, the initial registration fee for a service contractor described in subdivision (e) of Section 12741 of the Insurance Code shall be set by the director in an amount not to exceed the actual and direct costs associated with the regulation of those service contractors, but in no event more than fifty thousand dollars ($50,000).

A service dealer or service contractor who does not operate a place of business in this state, but engages in the electronic repair industry, the appliance repair industry, or sells, issues, or administers service contracts in this state shall pay the registration fee specified herein as if he or she had a place of business in this state.

(b) (1) The annual registration renewal fee for an electronic repair industry service dealer or for an appliance repair industry service dealer is not more than one hundred sixty-five dollars ($165) for each place of business in this state, if renewed prior to its expiration date. The annual registration renewal fee for a service contractor is seventy-five dollars ($75) for each place of business in this state, if renewed prior to its expiration date.

(2) The annual renewal fee for a service dealer who engages in the business as both an electronic repair industry service dealer and an appliance repair industry service dealer is not more than three hundred dollars ($300) for each place of business in this state.

(3) The annual renewal fee for a service dealer who engages in the electronic repair industry and the appliance repair industry and is a service contractor is not more than three hundred seventy-five dollars ($375) for each place of business in this state.

(4) It is the intent of the Legislature that the amount of the annual registration renewal fee for a service contractor described in subdivision (e) of Section 12741 of the Insurance Code shall be evaluated and set by the Legislature.

A service dealer or service contractor who does not operate a place of business in this state, but who engages in the electronic repair industry, the appliance repair industry, or sells or issues service contracts in this state shall pay the registration fee specified herein as if he or she had a place of business in this state.

(c) The delinquency fee is an amount equal to 50 percent of the renewal fee for a license in effect on the date of renewal of the license, except as otherwise provided in Section 163.5.

This section shall remain in effect only until January 1, 2003, and as of that date is repealed, unless a later enacted statute, which is enacted before January 1, 2003, deletes or extends that date.

SEC. 3. Section 12741 of the Insurance Code, as amended by Section 2 of Chapter 523 of the Statutes of 1997, is amended to read:

12741. This part does not apply to:

(a) Performance guarantees or service contracts given by either the builder of a home or the manufacturer or seller of an appliance or other system or component, whether or not an identifiable charge is made for such guarantee or service contract.

(b) A service contract, guarantee, or warranty intending to guarantee or warrant the repairs or service of a home appliance, system or component, provided the service contract, guarantee or warranty is issued by a person who has sold, serviced, repaired or provided replacement of the appliance, system or component at the time of, or prior to issuance of the contract, guarantee or warranty; and, provided, further, that the person issuing the service contract, guarantee, or warranty, does not engage in the business of a home protection company.

(c) The provider of a pest control service agreement pursuant to Section 8516 of the Business and Professions Code.

(d) A repair or maintenance program for a home electrical system, or a component of such a wiring system where the program is offered or issued by a person or affiliate of a person whose business is regulated by the Public Utilities Commission, provided that the repair or maintenance program is related to a service provided by the regulated person or affiliate of the regulated person, and that the regulated person, or affiliate of the regulated person, or parent company of the regulated person acts as the guarantor of any repair or maintenance program created under this subdivision regardless of whether the service is performed by the regulated person or an affiliate.

The company offering or issuing the program shall designate the company that will act as the guarantor of the program.

(e) On or after January 1, 2000, a service contract that is offered or issued by a person or affiliate of a person whose business is regulated by the Public Utilities Commission, provided that all of the following conditions are met:

(1) The regulated person, or affiliate of the regulated person, or parent company of the regulated person, acts as the guarantor of any service contract under this subdivision regardless of whether the service is performed by the regulated person or an affiliate.

(2) The service contract term is for one month or less.

(3) The person issuing or offering the service contract does not engage in the business of a home protection company.

The company offering or issuing the service contract shall designate the company that will act as the guarantor of the service contract.

(f) For purposes of subdivision (e), the person issuing or offering the service contract is subject to regulation by the Bureau of Electronic and Appliance Repair of the Department of Consumer Affairs.

(g) This section shall remain in effect only until January 1, 2004, and as of that date is repealed, unless a later enacted statute, that is enacted before January 1, 2004, deletes or extends that date.

SEC. 4. (a) The Department of Consumer Affairs shall, in consultation with the Department of Insurance, representatives of the service contract and home warranty industries, and other interested parties, conduct an in-depth study of the evolving marketplace related to home service contracts and report its findings to the Legislature on or before May 1, 1999. The report shall include a recommendation regarding regulation of home service contracts and the appropriate form of regulation if regulation is determined to be necessary.

(b) For purposes of complying with the requirements of subdivision (a), the sum of fifty thousand dollars ($50,000) is hereby appropriated from the Electronic and Appliance Repair Fund to the Department of Consumer Affairs.

O

APPENDIX 2

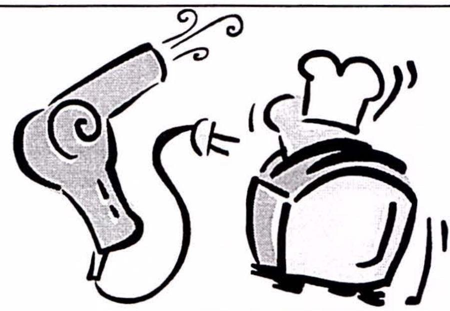
Survey Questionnaire

Interviewer:	Checked by:	Re-checked by:	Corrected by:	Correction Checked by:	Coded by:	Coding Checked by:

JDFR #934
FINAL

STATE OF CALIFORNIA

BUREAU OF ELECTRONIC AND APPLIANCE REPAIR



SURVEY ABOUT SERVICE CONTRACTS

Introduction and Screening

Hello, this is ________________ calling on behalf of the State of California. We are doing a survey of California consumers and would like to interview someone in your household who is involved in making decisions about major household purchases. Would that be you?

IF DECISION MAKER IS ON PHONE, CONTINUE.

IF DECISION MAKER IS AVAILABLE, REPEAT INTRODUCTION AND CONTINUE.

IF DECISION MAKER IS UNAVAILABLE, OBTAIN AND RECORD CALLBACK TIME.

Interview

Start Time: ___ ___:___ ___

1. First, are you familiar with the concept of an extended warranty, maintenance agreement, or service contract?

YES (CONTINUE) 1
NO (SKIP TO Q #3) 2
NOT SURE (CONTINUE) 9

☞**IF YES OR NOT SURE, ASK:**

2. (And) how would you define this concept? PROBE FOR CLARITY AND SPECIFICS. RECORD VERBATIM AND CODE.

____

____

CORRECT ANSWER	1
MORE OR LESS CORRECT ANSWER	2
WRONG ANSWER	3

3. (As it happens, an extended warranty, maintenance agreement, or service contract is an agreement you purchase when you purchase an item for your home or for personal use. It provides for maintenance, repair, or replacement of the item at no or limited charge after the original warranty runs out. Now that you know this,) Have you or has anyone else in your household purchased an extended warranty, maintenance agreement, or service contract on a major appliance or consumer electronics product in the last five years?

YES (SKIP TO Q #5)	1
NO (CONTINUE)	2
NOT SURE (SKIP TO Q #5)	9

☞**IF NO, ASK:**

4. Could you please tell me why not? PROBE FOR CLARITY AND SPECIFICS. PROBE FOR OTHER REASONS: Why else? RECORD VERBATIM.

____

____

____

____

SKIP TO Q #10, AFTER READING THE SENTENCE BELOW.

From now on, I am going to use the words "service contract" to represent extended warranties, maintenance agreements, and service contracts.

☞**IF YES, ASK:**

5a. On what major appliances or consumer electronics products have you purchased service contracts in the past five years? PROBE FOR OTHERS: What else? RECORD ALL THAT APPLY.

____

____

➢**ASK FOR ALL NOT MENTIONED:**

5b. Just to make sure we haven't missed anything, I'd like to ask you about some specific appliances and consumer electronics. In the past five years, have you purchased a service contract on ________. How about on ________?

5A	5B	
	Yes	No
Appliances		
Refrigerator 10	1	2
Freezer 11	1	2
Stove, Range, or Cooktop 12	1	2
Oven 13	1	2
Microwave Oven 14	1	2
Dishwasher 15	1	2
Trash Compactor 16	1	2
Washer 17	1	2
Dryer 18	1	2
Room Air Conditioner 19	1	2
Consumer Electronics		
Computer System 20	1	2
Computer System Component 21	1	2
Video Game 22	1	2
Television 23	1	2
Video Recorder or VCR 27	1	2
Stereo System 29	1	2
Video Camera 30	1	2
Satellite Dish 33	1	2
Home Photocopier 34	1	2
Home Fax Machine 35	1	2
Personal Cellular Phone 36	1	2
Other		

SUPERVISORS: IF "**OTHER**," GIVE TO JD.

6. And why did you purchase (this service contract) (these service contracts)? PROBE FOR CLARITY AND SPECIFICS. PROBE FOR OTHER REASONS: Why else? RECORD VERBATIM.

____

____

____

____

7. To the best of your recollection, how much did (this service contract) (these service contracts each) cost?

CONTRACT 1: ____________________ __ __ __

CONTRACT 2: ____________________ __ __ __

CONTRACT 3: ____________________ __ __ __

CONTRACT 4: ____________________ __ __ __

CONTRACT 5: ____________________ __ __ __

CONTRACT 6: ____________________ __ __ __

CONTRACT 7: ____________________ __ __ __

CONTRACT 8: ____________________ __ __ __

8. Have you ever tried to use (this) (any of these) service contract(s)?

YES (CONTINUE).. 1
NO (SKIP TO Q #10)... 2
DON'T RECALL (SKIP TO Q #10)............................... 9

☞**IF YES, ASK:**

9. Could you please tell me what happened when you tried to use the contract? PROBE FOR CLARITY AND SPECIFICS. PROBE FOR OTHER ANSWERS: What else? RECORD VERBATIM. INTERVIEWERS CODE AND SUPERVISORS CHECK NATURE OF EXPERIENCE. DETAILS TO BE CODED WITH CODEBOOK.

____

____

____

____

____

____

POSITIVE EXPERIENCE(S)..1
NEGATIVE EXPERIENCE(S) 3
MIXED EXPERIENCE(S) 2
NO RECALL...9

10. And have you ever been asked to purchase a service contract that covered items other than major appliances, consumer electronics products, vehicles such as cars or trucks, or boats. Examples would be contracts covering furniture or a lawnmower?

YES (CONTINUE) 1
NO (SKIP TO Q #13) 2
NOT SURE (SKIP TO Q #13)...9

☞**IF YES, ASK:**

11. And did you purchase it?

YES (CONTINUE) 1
NO (SKIP TO Q #13) 2
NOT SURE (SKIP TO Q #13)...9

☞**IF YES, ASK:**

12. To the best of your recollection, how much did it cost?

___ ___ ___ ___

13. (And) Have you ever been asked to purchase a service contract on multiple items in your house, such as all your major appliances, all your consumer electronic products, or both?

YES (CONTINUE)	1
NO (SKIP TO Q #16)	2
NOT SURE (SKIP TO Q #16)	9

☞**IF YES, ASK:**

14. And did you purchase it?

YES (CONTINUE)	1
NO (SKIP TO Q #16)	2
NOT SURE (SKIP TO Q #16)	9

☞**IF YES, ASK:**

15. To the best of your recollection, how much did it cost?

___ ___ ___ ___

16. Now I am going to read you three statements about service contracts in general. After I read each one, please tell me whether you agree or disagree with it on a scale of one to ten, where one equals strongly disagree and ten equals strongly agree. Here's the first one. START WITH STATEMENT CHECKED ☑.

	Strongly Disagree									**Strongly Agree**
☐ Service contracts are a good idea	1	2	3	4	5	6	7	8	9	10
☐ Service contracts are worth the price charged for them	1	2	3	4	5	6	7	8	9	10
☐ Salespeople often pressure customers too much to buy service contracts	1	2	3	4	5	6	7	8	9	10

17. Now I am going to read you two statements about service contracts. After I have read both of them, please tell me which one comes closest to your views. In general, would you say the financial risk to consumers is greater from START WITH STATEMENT CHECKED ☑.

❒ the possible malfunction or failure of an appliance or consumer electronics product 1

or

❒ the failure of the company that sells a service contract to honor the terms of the contract..2

(Which one of these comes *closest* to your views - the first statement or the second statement?)

Now in order to classify your responses along with others, I need to ask a few questions about you.

18. What was the last grade you completed in school?

LESS THAN HIGH SCHOOL	1
HIGH SCHOOL GRADUATE	2
VOCATIONAL/TRADE CERTIFICATE	3
SOME COLLEGE	4
TWO-YEAR DEGREE	5
FOUR-YEAR DEGREE OR HIGHER	6
REFUSED	0

19. And what is your age, please? _____ _____

20. We would also like to know your racial or ethnic background. Are you Caucasian, African-American, Asian-American, Latino or Hispanic, or some other ethnicity? (And what would that be?)

CAUCASIAN/WHITE	1
AFRICAN-AMERICAN	2
ASIAN-AMERICAN	3
LATINO/HISPANIC	4
OTHER ______________________________	8
REFUSED	0

21. Was your total annual household income before taxes in 1998 under or over $30,000?

UNDER ($0-$29,999) (ASK 22)	1
OVER ($30,001+) (ASK 23)	2
EXACTLY $30,000 (END INTERVIEW)	6
DON'T KNOW (END INTERVIEW)	99
REFUSED (END INTERVIEW)	10

☛IF UNDER $30,000 ASK:

22. And was it under or over $15,000?

UNDER ($0-14,999)	03
OVER ($15,000-29,999)	05
EXACTLY $15,000	04
DON'T KNOW	99
REFUSED	20

☛IF OVER $30,000 ASK:

23. Was it under or over $45,000?

UNDER ($30,001-44,999)	07
EXACTLY $45,000	08
OVER ($45,001+)	09
DON'T KNOW	99
REFUSED	30

THANK AND TERMINATE.

24. RECORD GENDER:

MALE	1
FEMALE	2

25. RECORD COUNTY CODE: ___ ___ ___

TIME ENDED: ___ ___ : ___ ___

ELAPSED TIME: ___ ___

DATE: ___ ___ / ___ ___ / 99

INT ID #: ___ ___ ___

REP: ____________________

PAGE: ____________________

LINE: ____________________

✂ ....

PHONE #: (   ) __________ - ______________

APPENDIX 3

Types of Products

Products Typically Covered by Service Contracts

Regulated by BEAR:

CD Players
Cellular Telephones
Dishwashers
Dryers
DVD Players
Freezers
Home Office Equipment
Microwave Ovens
Personal Computer Equipment
Ranges/Ovens
Refrigerators
Room Air Conditioners
Satellite Antennas
Stereo Equipment
Televisions
Trash Compactors
VCRs
Video Camcorders
Video Games
Washing Machines

Unregulated by BEAR:

Air Cleaners
Attic/Exhaust Fans
Burglar Alarm Systems
Ceiling Fans
Central Air Conditioning/Heating
Dehumidifiers
Door Bell Systems
Furnaces
Furniture
Garage Door Openers
Garbage Disposals
Gas Grills
Hot Water Heaters
Humidifiers
Jewelry
Lawn & Garden Equipment
Medical Equipment
Musical Equipment
Personal Care Products
Power Tools
Small Kitchen Appliances
Spa/Hot Tubs
Swimming Pools
Telephone Equipment
Water Softeners/Systems
Well Pumps
Whirlpool Tubs

APPENDIX 4

Other States Chart

SURVEY OF STATES REGULATING SERVICE CONTRACTS ON CONSUMER GOODS AND HOME WARRANTIES

State or Jurisdiction	All Products	Service Contracts - Consumer Goods				Home Protection Plans			
	Contract Specific Statute	Contract Specific Regulation	Insurance Regardless of Obligor	Insurance if 3rd Party Obligor	No Apparent Regulation	Contract Specific Regulation	Insurance Regardless of Obligor	Insurance if 3rd Party Obligor	No Apparent Regulation
Alabama	✓	✓				✓			
Alaska			✓				✓		
Arizona	✓	✓				✓			
Arkansas					✓				✓
California	✓	✓				✓			
Colorado		✓				✓			
Connecticut		✓				✓			
Delaware					✓				✓
D. Columbia					✓				✓
Florida		✓				✓			
Georgia		✓						✓	
Hawaii				✓				✓	
Idaho				✓				✓	
Illinois	✓			✓		✓			
Indiana					✓				✓
Iowa					✓	✓			
Kansas				✓				✓	

SURVEY OF STATES REGULATING SERVICE CONTRACTS ON CONSUMER GOODS AND HOME WARRANTIES

State or Jurisdiction	All Products	Service Contracts - Consumer Goods				Home Protection Plans			
	Contract Specific Statute	Contract Specific Regulation	Insurance Regardless of Obligor	Insurance if 3rd Party Obligor	No Apparent Regulation	Contract Specific Regulation	Insurance Regardless of Obligor	Insurance if 3rd Party Obligor	No Apparent Regulation
Kentucky		✓				✓			
Louisiana					✓				✓
Maine				✓					✓
Maryland				✓		✓			
Massachusetts					✓	✓			
Michigan				✓					✓
Minnesota				✓				✓	
Mississippi					✓	✓			
Missouri				✓				✓	
Montana				✓				✓	
Nebraska					✓				✓
Nevada				✓		✓			
N.Hampshire				✓		✓			
New Jersey				✓				✓	
New Mexico				✓				✓	
New York	✓	✓				✓			
N. Carolina		✓							✓
N. Dakota				✓				✓	

SURVEY OF STATES REGULATING SERVICE CONTRACTS ON CONSUMER GOODS AND HOME WARRANTIES

State or Jurisdiction	All Products	Service Contracts - Consumer Goods				Home Protection Plans			
	Contract Specific Statute	Contract Specific Regulation	Insurance Regardless of Obligor	Insurance if 3rd Party Obligor	No Apparent Regulation	Contract Specific Regulation	Insurance Regardless of Obligor	Insurance if 3rd Party Obligor	No Apparent Regulation
Ohio					✓	✓			
Oklahoma		✓							✓
Oregon		✓				✓			
Pennsylvania					✓				✓
Rhode Island					✓				✓
S. Carolina					✓				✓
S. Dakota			✓				✓		
Tennessee					✓				✓
Texas				✓		✓			
Utah		✓				✓			
Vermont				✓				✓	
Virginia		✓				✓			
Washington				✓				✓	
W. Virginia					✓				✓
Wisconsin	✓	✓				✓			
Wyoming			✓				✓		
Totals	5	15	3	18	15	21	3	12	15

APPENDIX 5

Home Protection Act

INSURANCE CODE
SECTIONS 12740-12764

12740. The definitions used in this section govern the construction and terms used in this part but shall not affect any other provisions of this code:

(a) "Home protection contract" means a contract or agreement whereby a person, other than a builder, seller, or lessor of the home which is the subject of the contract, undertakes for a specified period of time, for a predetermined fee, to repair or replace all or any part of any component, system or appliance of a home necessitated by wear and tear, deterioration or inherent defect, arising during the effective period of the contract, and, in the event of an inspection conducted pursuant to subdivision (b) of Section 12761, by the failure of that inspection to detect the likelihood of any such loss.

Such contract shall provide for a system of service for effectuating such repair or replacement and shall not include protection against consequential damage from the failure of any component, system or appliance.

(b) "Home protection company" means any person licensed pursuant to this part which issues home protection contracts.

(c) "Protection contract fee" means the consideration received, or to be received, by a home protection company for the issuance of any home protection contract.

A home protection contract fee shall be the fee established by a home protection company for coverage extending one year from the effective date of the contract. Where initial coverage is provided for a period in excess of one year, the home protection contract fee shall be the annual fee, plus a separately stated pro rata portion of the annual fee for the period of coverage which exceeds one year.

(d) "Home" or "residential property" as used in this part means any single or multiple unit or units, including mobilehomes, (as defined in Health and Safety Code Section 18211) used primarily for residential purposes.

12741. This part does not apply to:

(a) Performance guarantees or service contracts given by either the builder of a home or the manufacturer or seller of an appliance or other system or component, whether or not an identifiable charge is made for such guarantee or service contract.

(b) A service contract, guarantee, or warranty intending to guarantee or warrant the repairs or service of a home appliance, system or component, provided the service contract, guarantee or warranty is issued by a person who has sold, serviced, repaired or provided replacement of the appliance, system or component at the time of, or prior to issuance of the contract, guarantee or warranty; and, provided, further, that the person issuing the service contract, guarantee, or warranty, does not engage in the business of a home protection company.

(c) The provider of a pest control service agreement pursuant to Section 8516 of the Business and Professions Code.

(d) A repair or maintenance program for a home electrical system, or a component of such a wiring system where the program is offered or issued by a person or affiliate of a person whose business is regulated by the Public Utilities Commission, provided that the repair or maintenance program is related to a service provided by the regulated person or affiliate of the regulated person, and that the regulated person, or affiliate of the regulated person, or parent company of the regulated person acts as the guarantor of any repair or maintenance program created under this subdivision regardless of whether the service is performed by the regulated person or an affiliate.

The company offering or issuing the program shall designate the company that will act as the guarantor of the program.

(e) On or after January 1, 2000, a service contract that is offered or issued by a person or affiliate of a person whose business is regulated by the Public Utilities Commission, provided that all of the following conditions are met:

(1) The regulated person, or affiliate of the regulated person, or parent company of the regulated person, acts as the guarantor of any service contract under this subdivision regardless of whether the service is performed by the regulated person or an affiliate.

(2) The service contract term is for one month or less.

(3) The person issuing or offering the service contract does not engage in the business of a home protection company. The company offering or issuing the service contract shall designate the company that will act as the guarantor of the service contract.

(f) For purposes of subdivision (e), the person issuing or offering the service contract is subject to regulation by the Bureau of Electronic and Appliance Repair of the Department of Consumer Affairs.

12741. This part shall not apply to:

(a) Performance guarantees or service contracts given by either the builder of a home or the manufacturer or seller of an appliance or other system or component, whether or not an identifiable charge is made for such guarantee or service contract.

(b) Any service contract, guarantee, or warranty intending to guarantee or warrant the repairs or service of a home appliance, system or component, provided such service contract, guarantee, or warranty is issued by a person who has sold, serviced, repaired or provided replacement of that appliance, system or component at the time of, or prior to issuance of the contract, guarantee, or warranty; and, provided, further, that the person issuing the service contract, guarantee, or warranty does not engage in the business of a home protection company.

(c) The provider of any pest control service agreement pursuant to Section 8516 of the Business and Professions Code.

(d) This section shall become operative January 1, 2004.

12742. Home protection contracts and home protection companies, and all matters incident to or concerned with such contracts and companies, shall be exclusively subject to and regulated by the provisions of this part and, except as provided in Section 12743, shall not be governed by any other provision of this code.

12743. The following provisions of this code shall be applicable to home protection contracts and home protection companies:

(a) Sections 1 to 46, inclusive.

(b) Chapter 3 (commencing with Section 330) of Part 1, Division 1.

(c) Chapter 12 (commencing with Section 679.70) of Part 1, Division 1.

(d) These provisions of Chapter 1, Part 2, Division 1:

- (1) Article 1 (commencing with Section 680).
- (2) Article 1.5 (commencing with Section 685).
- (3) Article 2 (commencing with Section 690).
- (4) Section 699, 699.5, 700, 701, 704, 704.5, 704.7, 705, 705.1, 707, 708, 709, 710, 713, 714, 715, 716, 717, 718, 720, and 725 of Article 3 (commencing with Section 699).
- (5) Section 750.
- (6) Article 5.5 (commencing with Section 770).
- (7) Article 6.5 (commencing with Section 790).
- (8) Article 8 (commencing with Section 820).
- (9) Article 9 (commencing with Section 880).
- (10) Article 11 (commencing with Section 939).
- (11) Article 13 (commencing with Section 980).
- (12) Article 14 (commencing with Section 1010).
- (13) Article 14.5 (commencing with Section 1065.1).
- (14) Article 15 (commencing with Section 1070).
- (15) Article 16 (commencing with Section 1080).
- (16) Article 17 (commencing with Section 1100).

(e) These provisions of Chapter 2, Part 2, Division 1:

(1) Article 1 (commencing with Section 1140).

(2) Article 2 (commencing with Section 1150).

(3) Article 3 (commencing with Section 1170).

(4) Article 4 (commencing with Section 1190).

(5) Article 4.7 (commencing with Section 1215).

(6) Article 7 (commencing with Section 1250).

(7) Article 8 (commencing with Section 1260).

(f) Article 4 (commencing with Section 1610) of Chapter 4 of Part 2 of Division 1.

(g) Article 3 (commencing with Section 1631) of Chapter 5 of Part 2 of Division 1.

(h) Sections 1850, 1850.5, 1852, 1853.5, 1853.7, 1853.8, 1857, 1857.2, 1857.3, 1857.4, 1857.5, 1858, 1858.05, 1858.1, 1858.15, 1858.2, 1858.3, 1858.4, 1858.5, 1858.6, 1858.7, 1859, 1859.1, 1860, 1860.1, 1860.2 of Chapter 9, Part 2, Division 1.

(i) Division 3 (commencing with Section 12900).

(j) In any references in the provisions made applicable to this part by subdivisions (a) to (i) inclusive of this section:

(1) "Insurer" shall mean home protection company.

(2) "Insured" shall mean a home protection contract holder.

(3) "Premium" shall mean protection contract fee.

(4) "Policy" or "insurance" shall mean home protection contract.

(k) When any provision of this code, other than this part, is applied to home protection companies, such provision shall be construed in accordance with the nature of home protection companies and the home protection business. In the event of any conflict between such other provision and this part, this part shall prevail.

12744. (a) No person shall issue or offer to issue home protection contracts in this state unless such person holds a home protection company license issued by the department, except as provided in subdivision (b) of this section.

(b) An insurer admitted for the class of insurance defined in Section 120 is authorized, in addition to the underwriting powers granted by such class, to issue home protection contracts, but the provisions of this part shall not be otherwise applicable to such insurers or their contracts.

(c) No license shall be granted to a foreign applicant that has not fulfilled the requirements of Sections 716 and 717. For purposes of this part, the term "class of insurance" as used in said sections shall mean the business of a home protection company. This section shall not prohibit the admission of a foreign home protection company which has actively transacted home protection business in its state of domicile for three years or more.

(d) The commissioner shall by regulation prescribe forms for applications for home protection company licenses consistent with the provisions of this part. Any reference to certificate of authority in Article 3 (commencing with Section 699) of Chapter 1 of Part 2 of Division 1, shall mean home protection company license.

12745. (a) Any insurance holding company subject to Article 4.7 (commencing with Section 1215) of Chapter 2 of Part 2 of Division 1, one of whose affiliates is a home protection company as defined in this part, may invest in or operate a corporation which provides home service contractor or dispatch services or appliance service or appliance repair services pursuant to a contract issued for that purpose. The corporation shall not be subject to licensing or regulation under this part except as set forth in this section, provided, that the contract shall not be sold in conjunction with, or otherwise attach to, the sale or any proposed sale of the real property to which it relates.

(b) At the time of filing its registration statement under Section 1215.4, and annually thereafter, each affiliate owning or operating such a corporation shall file as a supplement thereto, a statement of the financial condition of the corporation prepared according to generally accepted accounting principles, and a designated list of the name and addresses of all agents, employees, and independent contractors utilized to issue or sell those contracts. Each statement of financial condition and designated list shall be certified as correct by an officer of the corporation. The commissioner may prescribe the form for the statement or list.

12760. No home protection company shall pay a commission to any person as an inducement or compensation for the issuance, purchase or acquisition of a home protection contract, nor shall a home protection company or any other insurer either directly or indirectly, as a part of any real property transaction in which a home protection contract will be issued, purchased or acquired, require that a home protection contract be issued, purchased or acquired in conjunction with or as a condition precedent to the issuance, purchase or acquisition, by any person, of any other policy of insurance. The provisions of this section shall not prohibit payment of an override commission or marketing fee to an employee or commission sales agent who is the marketing representative of the home protection company or its parent, subsidiary, or affiliate on the sale or marketing of a home protection contract, provided such person is not a real estate licensee sharing in or entitled to share in, or affiliated with a real estate brokerage firm which is entitled to share in the real estate commission generated by the underlying real property transaction.

12761. (a) The furnishing of a home protection contract without charge to any person shall constitute a violation of this part. No home protection contract providing coverage prior to the time an interest in the home to which it attaches is sold shall be issued or delivered unless it provides for consideration. Such consideration may consist of a bona fide promise to pay the protection contract fee at the time of and only upon transfer of title.

(b) A home protection company may require an onsite inspection as a prequalification for the issuance of a home protection contract, and in such event offer a report on the inspection in connection with a bona fide application for the issuance of such contract even though the issuance of a contract on the property which is the subject of the inspection does not occur.

12761.1. (a) A home protection company which was licensed as such on December 31, 1988, and as of that date was a franchisor of entities authorized by Section 771.1 to solicit, negotiate, or effect home protection contracts, or a parent, subsidiary, or affiliate of such a franchisor, and continues to be such a franchisor or parent, subsidiary, or affiliate of such a franchisor, may provide coverage for a listing period.

(b) For the purposes of this section, a "listing period" means a period prior to the time an interest in the home to which the home protection coverage attaches is sold, during which there is in effect an exclusive right to sell listing as that term is defined in Section 1086 of the Civil Code, between the seller of that home and a franchisee of that franchisor.

(c) Home protection contracts providing listing period coverage issued pursuant to this section shall be exempt from the provisions of both of the following:

(1) Subdivision (c) of Section 12740, which requires a separately stated pro rata portion of the annual fee for the period of coverage which exceeds one year.

(2) Subdivision (a) of Section 12753, which requires reserves for unearned premiums applicable to the listing period coverage provided under those home protection contracts.

12762. (a) A home protection contract shall specify, in clear and conspicuous terms, the following information:

(1) Each of the appliances, systems and components covered by the contract.

(2) All exclusions and limitations respecting the extent of coverage.

(3) The period during which the contract will remain in effect, the protection contract fee and the renewal terms, if any.

(4) With respect to the performance of services by the home protection company, all of the following:

(A) The services to be performed by the company and the terms and conditions of such performance.

(B) The service fee or fees, if any, to be charged for such services.

(C) All limitations respecting the performance of services, including any restrictions as to the time period when or geographical area within which services may be requested or will be performed.

(D) A statement that services will be performed upon telephonic request therefor to the company, without any requirement that claim forms or applications be filed prior to the rendition of service.

(E) A representation that services will be initiated by or under the direction of the company within 48 hours after request is made for such services by any person entitled to make such request under the contract, or the agent of such person.

(b) The commissioner may adopt, pursuant to Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, such reasonable regulations as may be necessary to make more specific the provisions of this section. Those regulations may also establish such other contract form standards and requirements as the commissioner may deem necessary and appropriate in the public interest. However, this section does not authorize the commissioner to specify those appliances, systems, or components which must be covered by a home protection contract except to the extent necessary to guarantee the equity of the exclusions from coverage offered or provided under a contract, or to the extent necessary to avoid illusory coverage due to the nature or extent of exclusions from the contract.

12763. No home protection contract shall be issued or delivered until a copy of the form thereof is filed with the commissioner. The commissioner may charge a fee for the filing, which fee shall be established by regulation adopted pursuant to Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code.

12764. (a) Any home protection contract shall be noncancellable during the initial term for which it was issued, except for:

(1) Nonpayment of protection contract fees;

(2) Fraud or misrepresentation of facts material to the issuance of such contract; or

(3) Contracts providing coverage prior to the time that an interest in the residential property to which it attaches is sold, upon the contingency that such sale does not occur.

(b) Nothing in this section establishes a right of the contract holder to renewal of any contract.

APPENDIX 6

Industry Model Act

Industry Model Act

SERVICE CONTRACTS MODEL ACT
Based on NAIC Model 685

(Assumes legislation amends the state insurance code.)

§ 1. Scope and Purposes

A. The purpose of this Act is to create a legal framework within which service contracts may be sold in this state.

B. The following are exempt from Section 3 to Section 12, inclusive, of this Act:

(1) Warranties;

(2) Maintenance agreements;

(3) Warranties, service contracts and maintenance agreements offered by public utilities on their transmission devices to the extent they are regulated by [insert name of the state agency that regulates public utilities];

(4) Service contracts sold or offered for sale to persons other than consumers; and

(5) Service contracts on tangible property where the tangible property for which the service contract is sold has a purchase price of three hundred and fifty dollars ($350) or less, exclusive of sales tax.

C. The types of agreements referred to in subsection B of this section do not have to comply with any provision of the insurance law of this state.

§ 2. Definitions

As used in this Act:

A. "Administrator" means the person who is responsible for the administration of the service contracts or the service contracts plans or who is responsible for any filings required by this Act.

B. "Commissioner" means the Commissioner of Insurance of this state.

C. "Consumer" means a natural person who buys other than for purposes of resale any tangible personal property that is distributed in commerce and that is normally used for personal, family, or household purposes and not for business or research purposes.

D. "Maintenance agreement" means a contract of limited duration that provides for scheduled maintenance only.

E. "Non-original manufacturer's parts" means replacement parts not made for or by the original manufacturer of the property, commonly referred to as "after market parts."

F. "Person" means an individual, partnership, corporation, incorporated or unincorporated association, joint stock company, reciprocal, syndicate, or any similar entity or combination of entities acting in concert.

G. "Premium" means the consideration paid to an insurer for a reimbursement insurance policy.

H. "Provider" means a person who is contractually obligated to the service contract holder under the terms of the service contract.

I. "Provider fee" means the consideration paid for a service contract.

J. "Reimbursement insurance policy" means a policy of insurance that is issued to a provider to provide reimbursement to the provider or to pay on behalf of the provider all covered contractual obligations incurred by the provider under the terms of the insured service contracts issued or sold by the provider.

K. "Service contract" means a contract or agreement for a separately stated consideration for a specific duration to perform the repair, replacement, or maintenance of property or indemnification for repair, replacement, or maintenance, for the operational or structural failure due to a defect in materials or workmanship, or normal wear and tear, with or without additional provision for incidental payment or indemnity under limited circumstances, including, but not limited to, towing, rental, and emergency road service. Service contracts may provide for the repair, replacement or maintenance of property for damage resulting from power surges and accidental damage from handling.

L. "Service contract holder" or "contract holder" means a person who is the purchaser or holder of a service contract.

M. "Warranty" means a warranty made solely by the manufacturer, importer or seller of property or services without consideration, that is not negotiated or separated from the sale of the product and is incidental to the sale of the product, that guarantees indemnity for defective parts, mechanical or electrical breakdown, labor or other remedial measures, such as repair or replacement of the property or repetition of services.

§ 3. Requirements For Doing Business

A. A provider may, but is not required to, appoint an administrator or other designee to be responsible for any or all of the administration of service contracts and compliance with this Act.

B. Service contracts shall not be issued, sold, or offered for sale in this state unless the provider has:

(1) Provided a receipt for, or other written evidence of, the purchase of the service contract to the contract holder; and

(2) Provided a copy of the service contract to the service contract holder within a reasonable period of time from the date of purchase.

C. Each provider of service contracts sold in this state shall file a registration with the commissioner on a form prescribed by the commissioner. Each provider shall pay to the commissioner a fee in the amount of two hundred dollars ($200) annually.

D. In order to assure the faithful performance of a provider's obligations to its service contract holders, each provider shall be responsible for complying with the requirements of one of the following subdivisions:

(1) Insure all service contracts under a reimbursement insurance policy issued by an insurer authorized to transact insurance in this state or issued pursuant to [insert code section permitting surplus lines business]; or

(2) (a) Maintain a funded reserve account for its obligations under its service contracts issued and outstanding in this state. The reserves shall not be less than forty percent (40%) of the gross consideration received, less claims paid, on the sale of the service contract for all in-force contracts. The reserve account shall be subject to examination and review by the commissioner; and

(b) Place in trust with the commissioner a financial security deposit, having a value of not less than five percent (5%) of the gross consideration received, less claims paid, on the sale of the service contract for all service contracts issued and in force, but not less than $25,000, consisting of one of the following:

(i) A surety bond issued by an authorized surety;

(ii) Securities of the type eligible for deposit by authorized insurers in this state;

(iii) Cash;

(iv) A letter of credit issued bv a qualified financial institution; or

(v) Another form of security prescribed by regulations issued by the commissioner; or

(3) (a) Maintain, or its parent company maintain, a net worth or stockholders' equity of at least $100,000,000; and

(b) Upon request, provide the commissioner with a copy of provider's or the provider's parent company's most recent Form 10-K or Form 20-F filed with the Securities and Exchange Commission (SEC) within the last calendar year, or if the company does not file with the SEC, a copy of the provider's or the provider's parent company's audited financial statements, which shows a net worth of the provider or its parent company of at least $100 million. If the provider's parent company's Form 10-K, Form 20-F or audited financial statements are filed to meet the provider's financial stability requirement, then the parent company shall agree to guarantee the obligations of the provider relating to service contracts sold by the provider in this state.

E. Service contracts shall require the provider to permit the service contract holder to return the service contract within 20 days of the date the service contract was mailed to the service contract holder or within 10 days of delivery if the service contract is delivered to the service contract holder at the time of sale or within a longer time period permitted under the service contract. Upon return of the service contract to the provider within the applicable time period, if no claim has been made under the service contract prior to its return to the provider, the service contract is void and the provider shall refund to the service contract holder, or credit the account of the service contract holder, with the full purchase price of the service contract. The right to void the service contract provided in this subsection is not transferable and shall apply only to the original service contract purchaser, and only if no claim has been made prior to its return to the provider. A 10 percent penalty per month shall be added to a refund that is not paid or credited within 45 days after return of the service contract to the provider.

F. Premium Taxes:

(1) Provider fees collected on service contracts shall not be subject to premium taxes.

(2) Premiums for reimbursement insurance policies shall be subject to applicable taxes.

G. Except for the registration requirement in § 3C, providers and related service contract sellers, administrators and other persons marketing selling, or offering to sell service contracts are exempt from any licensing requirements of this state.

H. The marketing, sale, offering for sale, issuance, making, proposing to make and administration of service contracts by providers and related service contract sellers, administrators and other persons shall be exempt from all other provisions of this state's insurance law.

§ 4. Required Provisions - Reimbursement Insurance Policy

A. Reimbursement insurance policies insuring service contracts issued, sold or offered for sale in this state shall state that the insurer that issued the reimbursement insurance policy shall reimburse or pay on behalf of the provider any covered sums the provider is legally obligated to pay or shall provide the service which the provider is legally obligated to perform according to the provider's contractual obligations under the insured service contracts issued or sold by the provider.

B. In the event covered service is not provided by the service contract provider within 60 days of proof of loss by the service contract holder, the contract holder is entitled to apply directly to the reimbursement insurance company.

§ 5. Required Disclosures - Service Contracts

A. Service contracts marketed, sold, offered for sale, issued, made, proposed to be made, or administered in this state shall be written, printed, or typed in clear, understandable language that is easy to read, and shall disclose the requirements set forth in this section, as applicable.

B. Service contracts insured under a reimbursement insurance policy pursuant to § 3D(1) shall contain a statement in substantially the following form: "Obligations of the provider under this service contract are insured under a service contract reimbursement insurance policy." The service contract shall state the name and address of the insurer.

C. Service contracts not insured under a reimbursement insurance policy pursuant to subdivision § 3D(1)) shall contain a statement in substantially the following form: "Obligations of the provider under this service contract are backed by the full faith and credit of the provider."

D. Service contracts shall state the name and address of the provider, and shall identify any administrator if different from the provider, the service contract seller, and the service contract holder to the extent that the name of the service contract holder has been furnished by the service contract holder. The identities of such parties are not required to be preprinted on the service contract and may be added to the service contract at the time of sale.

E. Service contracts shall state the purchase price of the service contract and the terms under which the service contract is sold. The purchase price is not required to be pre-printed on the service contract and may be negotiated at the time of sale with the service contract holder.

F. Service contracts shall state the existence of any deductible amount, if applicable.

G. Service contracts shall specify the merchandise and services to be provided and any limitations, exceptions, or exclusions.

H. Service contracts covering automobiles shall state whether the use of non-original manufacturer's parts is allowed.

I. Service contracts shall state any restrictions governing the transferability of the service contract, if applicable.

J. Service contracts shall state the terms, restrictions, or conditions governing cancellation of the service contract prior to the termination or expiration date of the service contract by either the provider or by the service contract holder. The provider of the service contract shall mail a written notice to the service contract holder at the last known address of the service contract holder contained in the records of the provider at least five days prior to cancellation by the provider. Prior notice is not required if the reason for cancellation is nonpayment of the provider fee, a material misrepresentation by the service contract holder to the provider or a substantial breach of duties by the service contract holder relating to the covered product or its use. The notice shall state the effective date of the cancellation and the reason for the cancellation.

K. Service contracts shall set forth the obligations and duties of the service contract holder, such as the duty to protect against any further damage and any requirement to follow owner's manual instructions.

L. Service contracts shall state whether or not the service contract provides for or excludes consequential damages or preexisting conditions, if applicable.

§ 6. Prohibited Acts

A. A provider shall not use in its name the words insurance, casualty, surety, mutual, or any other words descriptive of the insurance, casualty, or surety business; or a name deceptively similar to the name or description of any insurance or surety corporation, or to the name of any other provider. The word "guaranty" or similar word may be used by a provider. This section shall not apply to a company that was using any of the prohibited language in its name prior to the effective date of this Act. However, a company using the prohibited language in its name shall include in its service contracts a statement in substantially the following form: "This agreement is not an insurance contract."

B. A provider or its representative shall not in its service contracts or literature make, permit or cause to be made any false or misleading statement, or deliberately omit any material statement that would be considered misleading if omitted.

C. A person, such as a bank, savings and loan association, lending institution, manufacturer, or seller of any product, shall not require the purchase of a service contract as a condition of a loan or a condition for the sale of any property.

§ 7. Record Keeping Requirements.

A. Books and Records:

(1) The provider shall keep accurate accounts, books, and records concerning transactions regulated under this Act.

(2) The provider's accounts, books, and records shall include the following:

(a) Copies of each type of service contract sold;

(b) The name and address of each service contract holder, to the extent that the name and address have been furnished by the service contract holder;

(c) A list of the locations where service contracts are marketed, sold, or offered for sale;

(d) Written claims files which shall contain at least the dates and description of claims related to the service contracts.

(3) Except as provided in § 7B, the provider shall retain all records required to be maintained by § 7 for at least one year after the specified period of coverage has expired.

(4) The records required under this Act may be, but are not required to be, maintained on a computer disk or other record keeping technology. If the records are maintained in other than hard copy, the records shall be capable of duplication to legible hard copy at the request of the commissioner.

B. A provider discontinuing business in this state shall maintain its records until it furnishes the commissioner satisfactory proof that it has discharged all obligations to service contract holders in this state.

§ 8. Cancellation of Reimbursement Insurance Policy

As applicable, an insurer that issued a reimbursement insurance policy shall not terminate the policy until a notice of termination in accordance with [insert citation to the law that governs the termination of insurance contracts], has been mailed or delivered to the commissioner. The termination of a reimbursement insurance policy shall not reduce the issuer's responsibility for service contracts issued by providers prior to the date of the termination.

§ 9. Obligations of Reimbursement Insurance Policy Insurers

A. Providers are considered to be the agent of the insurer which issued the reimbursement insurance policy for purposes of obligating the insurer to service contract holders in accordance with the service contract and this Act. In cases where a provider is acting as an administrator and enlists other providers, the provider acting as the administrator shall notify the insurer of the existence and identities of the other providers.

B. The Act shall not prevent or limit the right of an insurer which issued a reimbursement insurance policy to seek indemnification or subrogation against a provider if the issuer pays or is obligated to pay the service contract holder sums that the provider was obligated to pay pursuant to the provisions of the service contract.

§ 10. Enforcement Provisions

A. The commissioner may conduct examinations of providers, administrators, insurers, or other persons to enforce this Act and protect service contract holders in this state. Upon request of the commissioner, the provider shall make all accounts, books, and records concerning service contracts sold by the provider available to the commissioner which are necessary to enable the commissioner to reasonably determine compliance or noncompliance with this Act.

B. The commissioner may take action which is necessary or appropriate to enforce the provisions of this Act and the commissioner's regulations and orders, and to protect service contract holders in this state.

(1) If a provider has violated this Act or the commissioner's regulations or orders, the commissioner may issue an order directed to that provider to cease and desist from committing violations of this Act or the commissioner's regulations or orders; may issue an order prohibiting that provider from selling or offering for sale service contracts in violation of this Act; or may issue an order imposing a civil penalty on that provider; or any combination of the foregoing, as applicable.

(a) A person aggrieved by an order issued under this section may request a hearing before the commissioner. The hearing request shall be filed with the commissioner within 20 days of the date the commissioner's order is effective.

(b) If a hearing is requested, an order issued by the commissioner under this section shall be suspended from the original effective date of the order until completion of the hearing and final decision of the commissioner.

(c) At the hearing, the burden shall be on the commissioner to show why the order issued pursuant to this section is justified. The provisions of [insert citation to statutes concerning hearings before the commissioner] shall apply to a hearing requested under this section.

(2) The commissioner may bring an action in any court of competent jurisdiction, for an injunction or other appropriate relief to enjoin threatened or existing violations of this Act or of the commissioner's orders or regulations. An action filed under this section also may seek restitution on behalf of persons aggrieved by a violation of this Act or orders or regulations of the commissioner.

(3) A person who is found to have violated this Act or orders or regulation of the commissioner may be ordered to pay to the commissioner a civil penalty in an amount determined by the commissioner of not more than five hundred dollars ($500) per violation and no more than ten thousand dollars ($10,000) in the aggregate for all violations of a similar nature. For purposes of this section, violations shall be of a similar nature if the violation consists of the same or similar course of conduct, action, or practice, irrespective of the number of times the act, conduct, or practice which is determined to be a violation of this Act occurred.

§ 11. Authority to Develop Regulations

The commissioner may promulgate reasonable rules and regulations necessary to implement this Act.

§ 12. Separability Provision

If any provision of this Act, or the application of the provision to any person or circumstances, shall be held invalid, the remainder of the Act, and the application of the provision to person or circumstances other than those as to which it is held invalid, shall not be affected.

§ 13. Effective Date

A. Service contracts entered into prior to January 1, 2000, and renewals thereof, may but are not required to comply with this Act. Providers and other persons are not required to comply with this Act until January 1, 2000. A provider or other person may, but is not required to, implement the requirements of this Act prior to January 1, 2000. The failure of a provider or other person to comply with this Act or otherwise to administer a service contract plan, in the manner required by this Act prior to January 1, 2000, shall not be admissible in any court, arbitration, or alternative dispute resolution proceedings or otherwise used to prove that the action of any person or the service contract was unlawful or otherwise improper.

B. This Act shall become effective immediately upon its passage and approval by the Governor, or upon its otherwise becoming a law.