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Opinion 08-159

Contracts for termite inspection and protection

QUESTIONS

1. Whether the termite inspection and protection plan described below constitutes a contract of insurance under Tennessee law?

2. Whether the termite inspection and protection plan described below comes within the regulatory authority of the Department of Agriculture or any other state agency?

OPINIONS

1. No.

2. The Department of Agriculture has regulatory authority over the termite inspection and protection plan described below. Since the plan is a consumer contract, the Division of Consumer Affairs could also exercise authority over the plan if an unfair or deceptive act or practice occurred in connection with the plan.

ANALYSIS

The termite inspection and protection plan that is the subject of this opinion provides for the inspection of a structure, future treatment if necessary, and the repair of damages caused by termites. In pertinent part, the plan provides:

> For the sum of $_____, [pest control company] will provide a certified inspection to the identified property to identify subterranean termites (*Reticulitermes spp. Heterotermes spp*.) and Formosan subterranean termites (*Coptotermes spp*.). [Pest control company] will extend this Plan annually to the Purchaser for so long as Purchaser may own the property for $_____ per year payable on or before the end of the previous annual period. [Pest control company] will inspect the identified property annually or at any time the Purchaser requests it or if [pest control company] believes it is necessary. Future treatment and/or repairs, will be provided free of charge. After the second annual period and each annual period thereafter, [pest control company] reserves the right to revise the annual extension charge.

> This certified inspection is backed by our Protection Plan and provides protection against new subterranean and Formosan termite activity and damage to the structure and contents, occurring subsequent to the effective date of this agreement. After the inspection, during the term of this Plan, any treatment found necessary by [pest control company] will be performed free of charge. If new damage occurs during the term of this Agreement [pest control company] will, upon notification, inspect and arrange for the necessary repairs or replacement by a contractor chosen by [pest control company] and pay the entire cost of labor and materials. Such determination as to the need for treatment or repairs shall be made solely by [pest control company]. New damage is defined as damage done by covered subterranean and Formosan termites subsequent to the effective date of this Agreement: the definition excludes damage existing at that date. Unless live termites are found in the damaged area, the damage discovered is old damage and is not covered under this Plan.

The first question posed is whether this plan constitutes a contract of insurance. A "contract of insurance" is defined by statute as "an agreement by which one party, for a consideration, promises to pay money or its equivalent, or to do some act of value to the assured, upon the destruction or injury, loss or damage of something in which the other party has an insurable interest." Tenn. Code Ann. § 56-7-101(a). The Court of Appeals recently determined that this statutory definition is ambiguous. In *H & R Block Eastern Tax Services, Inc. v. State, Dep't of Commerce and Ins.*, ___ S.W.3d ___, 2008 WL 269514 (Tenn. Ct. App. 2008), *perm. app. denied* (hereinafter "*H & R Block*"), the Court of Appeals found the statutory definition of a "contract of insurance" inherently circular, reasoning as follows:

> Included in its definition of a "contract of insurance" is a requirement that the contract cover "something in which the other party has an *insurable interest*." Tenn. Code Ann. § 56-7-101(a) (emphasis added). The statute does not specify what types of interest are "insurable," which is surely a crucial question in determining what constitutes "insurance."

H & R Block, 2008 WL 269514 at *10.

The issue in *H & R Block* was whether H & R Block's "Peace of Mind" program ("POM program") constitutes a contract of insurance. H & R Block offers the POM program to its customers who hire H & R Block to prepare their tax returns. Essentially, H & R Block offers its customers the option of purchasing, for an additional fee, an enhanced version of H & R Block's basic guarantee of the accuracy of its tax-preparation services. H & R Block promises customers who purchase the POM program that, in the event H & R Block makes an error that results in the customer's tax liability being initially underestimated, it will pay up to $5,000.00 of the customer's newly revealed tax liability. *Id.* at *1.

After the Court determined that the statutory definition of a "contract of insurance" is ambiguous, it considered the legislative history of Tenn. Code Ann. § 56-7-101 and prior case law

interpreting the definition. *Id*. at *12. Finding neither helpful to the issue before it, the Court turned to prior Tennessee Attorney General opinions.

The Court first noted that the Attorney General had considered whether "extended warranties and service contracts . . . fall within the definition of 'insurance' in Tenn. Code Ann. § 56-7-101." *Id*. (citing Op. Tenn. Att'y Gen. 85-038, 1986 WL 222674 at *1 (February 19, 1986)). The opinion specifically addressed automobile warranties and service contracts. The Attorney General opined that such warranties and contracts did not constitute insurance under Tenn. Code Ann. § 56-7-101 because they fail the service-indemnity test.[1] *H & R Block*, 2008 WL 269514 at *12.

The Court next observed that an earlier Attorney General opinion stated that "'[t]he definition of insurance . . . clearly contemplates that provision of future services constitutes insurance. Still, *it cannot be the case that every contract for future services is one of insurance*.'" *H & R Block*, 2008 WL 269514 at *12 (quoting Op. Tenn. Att'y Gen. 79-254, 1979 WL 33863 at *3 (May 23, 1979)) (emphasis added by Court). The Court also noted that this opinion said that it is "appropriate to consider the elements of a contract which mark it as one of insurance." *Id*. Indemnity and contingency are "essential elements of insurance." *Id*.

Finally, the Court observed that the Attorney General reaffirmed this stance in a third opinion.

> As pointed out in a previous opinion issued from this office, [the statute's] exceedingly broad definition might be read to include all contracts for future services. As also pointed out, however, *all arrangements which would fall literally within this definition should not perforce be treated as insurance* in legal contexts. It is necessary to determine whether the basic elements of insurance- contingency and indemnity - are dominant in the particular contract.
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> Tenn. Op. Atty. Gen. No. 81-068, 1981 WL 142731, at *1 (January 30, 1981) (citations omitted; emphasis added).

Id. at *12-13.

After examining these three Attorney General opinions, the Court stated that it agreed with the Attorney General that the statute's "exceedingly broad definition might be read to include all contracts for future services," yet such a reading would be absurd. *Id*. at *13.

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[1] The service-indemnity test and this 1986 Attorney General opinion are further discussed later in this opinion.

> [I]t seems clear that the statute implicitly incorporates some common-sense notion of what sort of contract can constitute insurance, and therefore it cannot have been the legislature's intent to include such contracts as simple product warranties offered by a retailer, which do not pass such a common-sense test.

Id.

In defining a "common-sense test" more precisely, the Court found that the service-indemnity test referenced in the 1986 Attorney General opinion is an excellent common-sense gauge of whether or not a contract is insurance. *Id*. at *14. The Court, however, disagreed with the Attorney General's application of the test in that opinion. The Court said that the Attorney General analyzed the service-indemnity question in terms of whether the benefit that the company provides to the customer is a "service" or pure "indemnity," *i.e.*, money. Specifically, the Court noted that the Attorney General determined that an automobile parts warranty is a promise of service because the purchaser is entitled to have a malfunctioning automobile part replaced or fixed. The purchaser does not receive a payment, *i.e.*, indemnity, if the part is not replaced or fixed. The Court found the Attorney General's focus on what the contract provides to the purchaser -- service or payment -- to be too narrow. *Id*. The Court said, "As stated in the California case quoted by the Attorney General in 1986, the focus should be on what 'proportion *of the business*' indemnity occupies, 'in the context of the plan as a whole.'" *Id*. (citing *Roddis v. California Mut. Assoc*., 68 Cal.2d 677, 68 Cal.Rptr. 585, 441 P.2d 97, 101) (emphasis original). In short, "[t]he question is whether the *contract*, as a whole, is primarily a service guarantee or a promise of indemnity." *Id*. at *15 (emphasis original).

The Court then proceeded to apply the service-indemnity test to the POM program by looking to the core essence of the contract itself. *Id*. In finding the POM program to be a service guarantee, as opposed to a promise of indemnity, the Court reasoned as follows:

> The POM program, which guarantees the accuracy of Block's tax-preparation services, is *inextricably linked* to those services. The fact that a customer desiring the POM guarantee must pay a separate fee to Block, above and beyond the normal tax-preparation fee that it pays to Block, does not divorce the POM program from its broader context - namely, Block's preparation of the customer's tax returns. If Block were not providing tax services, there would be nothing for its POM program to guarantee. Indeed, the stipulated facts specify that a customer cannot purchase the POM guarantee for taxes prepared by someone else; the program is available only to customers who have their taxes prepared by Block. Furthermore, the customer's "separate" payments to Block - the tax-preparation fee and the POM fee - must in fact be simultaneous: customers must purchase the POM program *at the same* time that they purchase the tax-preparation services. These characteristics make the POM program similar to a typical extended product warranty at an electronics retailer: both are optional add-ons, both cost extra money, yet neither can sensibly be viewed as independent of the underlying purchase that they

> guarantee, because they can only be obtained in connection with that larger purchase.

Id. (emphasis original). In short, the Court found the POM program to be on the "service" side of the service-indemnity test because the core essence of the program is that of a tax-preparation service with an added guarantee. *Id*. at *16.

Additionally, the Court found the element of contingency lacking because the POM program provides protection against only H & R Block's errors, not errors committed by the taxpayer or a third party. *Id*. at *17. If the guarantee were offered by an entity independent of H & R Block in the event of a mistake by H & R Block, the Court said an entirely different question would be present because the guarantee would truly be independent of the tax-preparation service. Similarly, if the guarantee covered more than just H & R Block's own errors in preparing the customer's taxes, the Court said that it might potentially make more sense to treat it as insurance. *Id*. The stipulated facts, though, showed that the POM program only covers H & R Block's own errors; thus, the Court found the element of contingency absent. *Id*.

In analyzing the termite inspection and protection plan at issue in the same manner that the *H & R Block* Court analyzed the POM program, the plan does not appear to be a "contract of insurance" under Tennessee law. When the service-indemnity test is applied, the plan seems to fall on the "service" side of the test. The plan is one that guarantees the pest control company's inspection services, and it is "inextricably linked" to those services. Like the POM program, there would be nothing for the plan to guarantee if the pest control company were not providing inspection services. Moreover, the plan only protects the customer from new termite damage occurring subsequent to the effective date of the agreement. Consequently, the plan only guarantees inspections performed by the pest control company. Thus, the element of contingency is lacking as well.

For these reasons, we are of the opinion that the termite inspection and protection plan at issue is not a "contract of insurance." We also note that our opinion is consistent with the one case our research produced wherein a court examined a contract similar to the one you have presented. In *Boyle v. Orkin Exterminating Co.,* 578 So.2d 786 (Fla. App. 1991), the Florida Court of Appeals examined whether a lifetime termite damage guarantee was a contract of insurance. In this case, homeowners paid for a lifetime termite damage guarantee after treatment of their home by a pest control company. *Boyle*, 578 So.2d at 787. Under the guarantee, the pest control company assumed responsibility for re-treatment if termites later appeared, and it agreed to pay to replace damaged property. *Id*. The court concluded that the overall purpose of the guarantee was to add service to the "sale" of the pest control company's termite treatment program. *Id*. The court stated that the pest control company was not in the business of providing guarantees but in providing pest control service. *Id*. The court concluded its opinion by saying that the pest control company's guarantee was no more than a warranty of its service both as to the product itself and the method of application. *Id*. at 787. While a termite treatment is not necessarily applied under the plan at issue, we believe a Tennessee court would conclude, like the *Boyle* court,

that such a plan is simply a service contract backed by a guarantee, as opposed to a contract of insurance.

The second question posed is whether the termite inspection and protection plan at issue comes within the regulatory authority of the Department of Agriculture or any other state agency. We initially note that the Tennessee Application of Pesticides Act of 1978, Tenn. Code Ann. §§ 62-21-101, *et seq*., places certain requirements and restrictions upon those engaging in business as commercial pest control operators. Pertinent here, Tenn. Code Ann. § 62-21-103 prohibits any person from engaging in business as a commercial pest control operator until the person has obtained a charter from the Department of Agriculture, and Tenn. Code Ann. § 62-21-114 requires every chartered person to enter into a written contract for any service rendered in the category of wood destroying organisms. Pursuant to Tenn. Code Ann. § 62-21-118, the Commissioner of the Department of Agriculture is bestowed with the power and duty to administer Chapter 21 of Title 62 of the Tennessee Code. Accordingly, the Department of Agriculture has regulatory authority over the plan. Furthermore, as a consumer contract, the Division of Consumer Affairs could also exercise authority over the plan if an unfair or deceptive act or practice occurred in connection with the plan. *See* Tenn. Code Ann. §§ 47-18-101, *et seq*.

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