

BEFORE THE
INSURANCE COMMISSIONER
STATE OF CALIFORNIA

In the Matter of:

POWERTRAIN WARRANTY, INC.

and

GUILLERO D. JALIL, President of
POWERTRAIN WARRANTY, INC.,

Respondents.

File Nos. VSC 162-AP
and
VSC 174-AP

OAH No. N2003110165

PROPOSED DECISION

Administrative Law Judge Robert Walker, State of California, Office of Administrative Hearings, heard this matter in Oakland, California, on March 17, 24, and 25 and April 1, 2004.

Kathleen L. Morgan, Staff Counsel, represented the Insurance Commissioner of the State of California.

Walter J. R. Traver, Attorney at Law, represented the respondents, Powertrain Warranty, Inc., and Guillero D. Jalil, President of Powertrain Warranty, Inc.

The record was held open to provide respondents with an opportunity to submit a brief. By a letter dated April 6, 2004, counsel for respondents advised that respondents chose not to file a brief. The letter was received by fax on April 6, and the record was closed.

SUMMARY AND ISSUES

Pursuant to Insurance Code section 790.05,¹ the Insurance Commissioner served respondents with an order to show cause. In the order, the commissioner alleged that

¹ All references to the Code are to the Insurance Code unless otherwise specified.

Respondent Powertrain – by transacting the business of insurance without a license – had engaged in an unfair method of competition. The commissioner ordered Powertrain to show cause why the commissioner should not assess a civil penalty pursuant to Code section 790.035.

The commissioner amended the order to show cause to allege that, in addition to Powertrain’s liability for a civil penalty, Respondent Jalil, Powertrain’s sole shareholder, should be personally liable for that penalty.

In the order to show cause, the commissioner also alleged that, pursuant to Code section 1748.5, there is cause to remove Jalil from his office or employment.

The commissioner also served respondents with a cease and desist order pursuant to Code section 12921.8. The commissioner ordered Powertrain to stop offering warranties. Code section 12921.8, subdivision (a), authorizes the commissioner to impose a fine if a cease and desist order is violated, and there is an issue as to whether Powertrain violated the cease and desist order. (The commissioner did not amend to allege that Respondent Jalil should be personally liable for a fine if one were imposed.)

The hearing in this matter was a consolidated hearing. It was a hearing pursuant to section 790.05 on the order to show cause. It was a hearing pursuant to section 1748.5 on the removal allegation. And it was a hearing pursuant to section 12921.8 on the cease and desist order.

The commissioner has authority to issue an order to show cause pursuant to section 790.05 only if he or she has reason to believe that someone has engaged in an unfair method of competition or unfair or deceptive act or practice defined in Code section 790.03. There is an issue as to whether the commissioner alleged and proved that respondents were engaged in such conduct.

Code section 1748.5 has to do with the commissioner’s authority to remove a person from his or her office or employment in the insurance industry after finding that the person has engaged in misconduct. The commissioner has authority to remove a person who has participated in the business of a production agency or a person who is licensed as a producer. A production agency means a person or organization licensed by the commissioner. With regard to the matter of removing Respondent Jalil, there is an issue as to whether the commissioner alleged and proved that Powertrain or Jalil is licensed.

With regard to the cease and desist order, the ultimate issue is whether respondent Powertrain was transacting “the business of insurance without having been issued a

certificate of authority.”² And the resolution of that issue turns on whether Powertrain was manufacturing the products it sold.

If Powertrain was transacting the business of insurance, there is an issue as to whether it violated the cease and desist order.

If Powertrain did violate the cease and desist order, there is an issue as to whether a fine should be imposed and, if so, in what amount.

FACTUAL FINDINGS

BACKGROUND

1. In connection with selling a new or used vehicle, automobile dealers may offer additives or lubricants that often are represented as being designed to prolong the useful life of lubricated parts. The additives generally are backed by a warranty.

2. Code section 116 requires anyone who issues certain automobile service contracts – including warranties and guaranties – to be licensed by the Insurance Commissioner. Code section 116.5 makes it clear that manufacturers of motor vehicle additives, if they satisfy certain conditions, may offer warranties without being licensed. Thus, section 116.5 creates an exception to the licensure requirement of section 116, but the exception is available only to manufacturers.

3. Since April of 2003, Respondent Powertrain has sold motor vehicle additives with warranties. It uses agents to solicit automobile dealers to act as vendors to sell its products to people who buy vehicles.

4. On October 31, 2003, the insurance commissioner caused two orders to be served on Respondents Powertrain and Jalil. One was a cease and desist order served pursuant to Code section 12921.8 in which the commissioner ordered them not to sell products with warranties. The other was an order to show cause served pursuant to Code section 790.05. The commissioner alleged that Powertrain – by transacting the business of insurance without a license – had engaged in an unfair method of competition. The commissioner ordered respondents to show cause why the commissioner should not impose a monetary penalty and to show cause why he should not prohibit Respondent Jalil from participating in the business of insurance in California. The orders were dated October 29, 2003. They were delivered by certified mail on November 3.

² Ins. Code, § 12921.8(a).

ARE THE PRODUCTS MANUFACTURED BY POWERTRAIN?

5. Steve Whitesides, National Sales Director for Powertrain, testified as follows: Powertrain engages in private label manufacturing. Powertrain has a branded label, which means that no one else sells the product it sells. We decided not to mix and bottle the Powertrain products. We decided to outsource that work. In this respect we are like Clorox. Clorox outsources the mixing and bottling of its product. And according to the Private Labeling Manufacturing Association, we are engaged in manufacturing. We contracted with Muscle Products Corporation in Butler, Pennsylvania, for them to mix and bottle the Powertrain products. Muscle Products uses Powertrain's recipes. They do not use the same recipes for anyone else. Many manufacturers outsource part of their manufacturing process.

6. It is found that Respondent Powertrain does not manufacture the products it sells and warranties. Powertrain does not make or fashion anything. It does not turn any raw material into something. It buys the products it sells. It buys them from Muscle Products Corporation. Thus, Powertrain, without qualifying for the exception to the licensure requirement, engaged in the business of insurance without being licensed.

POWERTRAIN'S SALES AFTER THE CEASE AND DESIST ORDER

7. Powertrain sells a package that contains three bottles of additives – a coolant fluid, an engine fluid, and a transmission fluid. Powertrain engages agents who solicit automobile dealers to contract with Powertrain as vendors. In a vendor contract, a vendor agrees to recommend Powertrain's additives to customers who are buying new and used vehicles. Some vendors actually stock the additives. Most do not. When a vendor who stocks the additives makes a sale for Powertrain, the vendor installs the additives, sends Powertrain a certificate verifying that it has installed the additives, and sends Powertrain a check. The vendor agreement provides that the vendor will remit to Powertrain all forms and money due once a week, but some vendors send a check only once a month. When a vendor who does not stock the additives makes a sale, the vendor notifies Powertrain of the sale and sends Powertrain a check. Powertrain then causes the additives to be shipped directly to the consumer, who becomes responsible for having a certified mechanic install the additives and send a certification to Powertrain saying that he or she has installed the additives. Approximately 70% of Powertrain's sales are by dealers who do not stock the additives.

8. Thus, Powertrain sells its product to consumers through vendors with whom it contracts to make the sales. The role of Powertrain's agents is not to sell the product. The role of Powertrain's agents is to solicit automobile dealerships to become vendors. When a dealership makes a sale for Powertrain, part of the sales price goes to the agent who engaged that dealership. Also, part of the sales price goes to Powertrain's national sales director.

9. On November 8, 2003, which was five days after respondents received the cease and desist order, Powertrain sent a memorandum to its California agents who solicited vendors. Powertrain advised the agents of the order and instructed them not to solicit any more vendors. Powertrain, however, did not advise its vendors of the cease and desist order. And vendors continued to make sales on Powertrain's behalf. Powertrain acknowledges that, after the commissioner caused his order to be served, there were approximately 284 sales. The evidence suggests that there may have been more than that. The most recent sale was on February 22, 2004. Thus, Powertrain violated the cease and desist order.

FINANCIAL GAINS FROM VIOLATING THE ORDER

10. Powertrain charges the dealers a fixed price. The dealers, however, sell the additives with Powertrain's warranty for whatever price the dealers choose.

11. Powertrain pays Warranty America \$65 per contract to administer the warranty that accompanies the sale of the product. Some of the warranties last for as long as five years. Warranty America merely administers the program. It is up to Powertrain to pay claims.

12. Powertrain has a basic warranty plan and a "Plus" warranty plan. It also charges a surcharge for certain types of vehicles. And consumers can choose warranties of one, two, three, four, or five years. The price Powertrain charges varies according to the length of the warranty. If, for example, a consumer chose a basic warranty for three years or 60,000 miles, Powertrain charged the dealer \$375 for the additives and warranty. (The dealer could charge the consumer whatever the dealer chose – whatever the traffic would bear. One dealer might charge \$500 for the \$375 package, and another dealer might charge \$1,200 for that same package.) A typical breakdown of the income from a \$375 sale is as follows:

Cost of goods and packaging	\$25
Shipping	6
Warranty America, the warranty administrator	65
Agent who obtained the vendor (between \$50 and \$125)	88
National sales director (between \$37.50 and \$75)	56
Reserve for paying claims	75
Powertrain's net profit (between \$4 and \$116)	60

13. Some of these figures are rough approximations, but they give one a fair sense of where the money went. And these figures are relevant in determining whether a fine should be assessed and, if so, what amount is appropriate.

THE ORDER TO SHOW CAUSE

14. The commissioner neither alleged nor proved that respondents engaged in any unfair method of competition or deceptive act or practice defined in Code section 790.03.

THE ALLEGATION THAT JALIL IS SUBJECT TO REMOVAL

15. The commissioner neither alleged nor proved that Jalil has participated in the business of an organization licensed by the commissioner. The commissioner neither alleged nor proved that Jalil is licensed by the commissioner.

LEGAL CONCLUSIONS

NO GROUNDS FOR ISSUING THE ORDER TO SHOW CAUSE

1. Code sections 790.05 and 790.06 provide two completely separate *and quite different* procedures for dealing with persons who are believed to be engaged in unfair methods of competition or deceptive acts or practices. The procedure outlined in section 790.05 concerns the methods, acts, and practices defined in section 790.03. The procedure outlined in section 790.06 concerns methods, acts, and practices other than those defined in section 790.03.

2. If one read section 790.05 alone, one might read it as concerning any unfair method of competition – whether or not defined in section 790.03. But sections 790.05 and 790.06 together make it clear that that reading would be incorrect. Section 790.06, subdivision (a) is explicit. It is section 790.06 that outlines the procedure that must be followed concerning unfair methods of competition not defined in section 790.03.

3. Code section 790.03 defines certain unfair methods of competition and certain deceptive acts or practices. The methods, acts, or practices defined in section 790.03 include misrepresentation; untruthful, deceptive, or misleading statements; unreasonable restraint of business; false statements regarding financial condition; false entries; willful omissions; unfair rate discrimination; statement of membership in CIGA; and unfair claims settlement practices. Transacting the business of insurance without a license is not one of the methods, acts, or practices defined in section 790.03.

4. According to section 790.05, when the commissioner has reason to believe that someone has engaged in methods, acts, or practices defined in section 790.03, the

commissioner *must* act. On the other hand, according to section 790.06, when the commissioner has reason to believe that someone has engaged in unfair methods of competition or deceptive acts or practices that are not defined in section 790.03, the commissioner has discretion to act.

5. In either case, that is, regarding methods, acts, or practices *defined* in section 790.03 and regarding those *not defined* in that section, the procedure involves the issuance of an order to show cause and a notice of hearing.

6. After that, however, the procedures diverge. Section 790.05 sets out the procedure regarding methods, acts, or practices *defined* in section 790.03. An order to show cause issued pursuant to that section must warn the person of his or her potential liability for a monetary penalty pursuant to section 790.035, which provides for substantial monetary penalties for engaging in any of the methods, acts, or practices that are defined in section 790.03. The purposes of the hearing are to determine whether the commissioner should impose a monetary penalty pursuant to section 790.035 and to determine whether the commissioner should issue a cease and desist order.

7. Section 790.06 sets out the procedure regarding unfair methods of competition or deceptive acts or practices that are *not defined* in section 790.03. (The monetary penalties provided for in section 790.035 do not apply to such methods, acts, or practices, so, of course, the order to show cause issued pursuant to section 790.06 should not refer to monetary penalties.) Also the purpose of the hearing is different. The purpose of a hearing noticed pursuant to section 790.06 is simply to determine whether the allegations are correct, that is, to determine whether the alleged methods, acts or practices should be declared to be unfair or deceptive. If the alleged methods, acts, or practices are found to be unfair or deceptive, the commissioner shall issue and serve a written report declaring that. If, in his or her report, the commissioner charges a violation of the insurance law and if 30 days after service of the report the party has not discontinued the act or practice of which the commissioner complains, the attorney general of California may file an action in the superior court. In such an action the commissioner may seek to enjoin and restrain the person from engaging in the act or practice of which the commissioner complains. Pending a resolution of the matter, the superior court has jurisdiction to issue writs ancillary to its jurisdiction to prevent injury to the public. After a trial, the superior court has authority to issue an order enjoining and restraining the method, act, or practice.

8. Section 790.07 provides for a substantial monetary penalty for violating a cease and desist order that the commissioner issued pursuant to section 790.05 concerning methods, acts, or practices *defined* in section 790.03 or for violating a court order issued pursuant to section 790.06 concerning methods, acts, or practices *not defined* in section 790.03.

9. The commissioner neither alleged nor proved that respondents engaged in any method, act, or practice defined in Code section 790.03. By transacting the business of insurance without a license and without qualifying for the exception to the licensure requirement, Powertrain may have been competing unfairly with companies that went to the expense of getting a license or operating a manufacturing plant. But those are not methods, acts, or practices defined in Code section 790.03. Thus, there were no grounds to support issuance of an order to show cause, and there are no grounds for imposing a civil penalty.

10. The order to show cause should be dissolved and the prayer for a civil penalty pursuant to section 790.035 should be denied.

JALIL IS NOT SUBJECT TO REMOVAL

11. Code section 1748.5 authorizes the commissioner, after making certain findings of misconduct, to remove a person from his or her office or employment. That section, however, applies to the removal of only licensees, officers of licensees, and people who work for licensees. It does not apply to anyone else. The commissioner neither alleged nor proved that Jalil has participated in the business of an organization licensed by the commissioner. The commissioner neither alleged nor proved that Jalil is licensed by the commissioner. Thus, the request to remove Jalil from his office or employment pursuant to Code section 1748.5 should be denied.

FINE TO BE IMPOSED FOR VIOLATION OF THE CEASE AND DESIST ORDER

12. Code section 12921.8, subdivision (a), provides that the commissioner has “authority to issue a cease and desist order ... against any person ... transacting the business of insurance without having been issued a certificate of authority. The commissioner may issue a cease and desist order without holding a hearing.... And the commissioner may impose a fine of up to \$5,000 for each day the order is violated.”

13. Code section 116, subdivision (b), provides that a warranty that promises service, repair, money, or other indemnity in the event of loss of or damage to any part of a motor vehicle, is insurance if the warranty is made by a warrantor who, as such, is doing an insurance business. Subdivisions (c) and (d) exempt certain warranties covering materials and workmanship if the warrantor has an insurance policy with a licensed underwriting insurer. Subdivision (e) provides that doing “any business in substance equivalent to the business described in this section in a manner designed to evade the provisions of this section is the doing of an insurance business.”

14. Code section 116.5 provides an exception to the licensing requirement only if a product is manufactured by the party obligated on the warranty.

15. Powertrain was transacting the business of insurance without having been issued a certificate of authority and without qualifying for the exception to the licensure requirement. Thus, the commissioner properly issued the cease and desist order. And Powertrain violated that order.

16. The cease and desist order was delivered by certified mail on November 3, 2003. Powertrain did not notify its vendors to stop selling the additives and warranties.

17. Powertrain acknowledges that, after the commissioner caused the cease and desist order to be served, there were approximately 284 sales. The evidence suggests that there may have been more. The most recent sale was on February 22, 2004.

18. For a basic warranty for three years or 60,000 miles, Powertrain charged the dealer \$375 for the additives and warranty.

19. On such a sale, the agent who had obtained the vendor earned an average of \$88. The national sales director earned an average of \$56. And Powertrain's net profit averaged \$60.

20. For 284 sales, those three averages total \$57,936.

21. There were approximately 110 days between the date the cease and desist order was delivered to respondents and the date of the most recent sale.

22. On balance, it is determined that Powertrain should be fined \$750 per day for 110 days for a total of \$82,500. In view of the profits that the agents, the national sales director, and Powertrain reaped from the sales in violation of the commissioner's order, that level of fine is appropriate in order to deter Powertrain from engaging in further violations.

ORDER

1. The order to show cause of October 31, 2003, is dissolved.
2. The prayer for a civil penalty pursuant to section 790.035 is denied.
3. The prayer to remove Respondent Jalil from his office or employment pursuant to Code section 1748.5 is denied.
4. The cease and desist order of October 31, 2003, is upheld, and Respondent Powertrain is ordered to obey it.

5. Pursuant to Code section 12921.8, subdivision (a), Respondent Powertrain is fined \$750 per day for 110 days for a total of \$82,500. Respondent Powertrain shall pay that amount to the Department of Insurance.

DATED: June 15, 2004

Original signed by
ROBERT WALKER
Administrative Law Judge
Office of Administrative Hearings