

IN THE MATTER OF

GRIFFIN SYSTEMS, INC., ET AL.

FINAL ORDER, OPINION, ETC., IN REGARD TO ALLEGED VIOLATION OF
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT*Docket 9249. Complaint, Oct. 8, 1991--Final Order, April 29, 1994*

This final order prohibits the respondents from making misrepresentations about any material terms or conditions of any automobile service contract, from canceling service contracts when they have not disclosed that they have a right to do so before selling the contract, from substantially hindering customers from performing a condition on obtaining a benefit, from denying valid claims, and from refusing to comply promptly with any term or condition of any service contract they sell. In addition, the order requires the respondents to disclose to potential buyers whether the contracts cover the full cost of repairs, whether they include a rental car allowance, and the number and total dollar value of claims that may be submitted.

Appearances

For the Commission: *Lawrence M. Hodapp.*

For the respondents: *Philip Z. Vogel, Cleveland, OH.*

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, as amended, 15 U.S.C. 45 *et seq.*, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Griffin Systems, Inc. ("Griffin"), a corporation; and Gennaro J. Orrico, Robert W. Boughton and Alfonso S. Giordano, individually and as officers of said corporation (hereinafter collectively referred to as "respondents"), have violated certain provisions of said Act in states where their practices are not "regulated by State law" as the "business of insurance" within the meaning of 15 U.S.C. 1012(b), and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges as follows:

PARAGRAPH 1. Respondent Griffin is an Ohio corporation with its office and principal place of business located at 4019 and

4101 Prospect Avenue, Cleveland, Ohio. Respondent Griffin also does business from offices located at 741 and 745 U.S. Highway 1, North Palm Beach, Florida.

Respondent Gennaro J. Orrico is the current president of Griffin. Respondent Robert W. Boughton was the president of Griffin from the date of Griffin's incorporation through an undetermined time in 1988 or 1989, when Mr. Orrico became president. Respondent Alfonso S. Giordano is the executive vice president and treasurer of Griffin.

Individual respondents Gennaro J. Orrico and Alfonso S. Giordano have their offices and principal places of business at 741 and 745 U.S. Highway 1, North Palm Beach, Florida. Said individual respondents also do business from the Cleveland office of respondent Griffin. Individual respondent Robert W. Boughton currently resides in Hato Rey, Puerto Rico.

At all times relevant to this complaint, the individual respondents have formulated, directed and controlled the acts and practices of respondent Griffin, including the acts and practices hereinafter set forth. The individual respondents cooperate and act together in carrying out the acts and practices hereinafter set forth.

PAR. 2. Respondents for some time in the past have been engaged in the promotion, marketing and sale of vehicle service contracts to new and used vehicle buyers. Respondents also are now and for some time in the past have been engaged in the administration and payment of claims submitted by consumers pursuant to those service contracts.

PAR. 3. At all times relevant to this complaint, respondents have maintained a substantial course of business, including the acts and practices set forth herein, in or affecting commerce, as "commerce" is defined by the Federal Trade Commission Act.

PAR. 4. During the course and conduct of their business, respondents have disseminated and caused the dissemination of promotional materials for their service contracts by various means in and affecting commerce, including direct solicitations distributed by the mail and across state lines, for the purpose of inducing and which were likely to induce, directly or indirectly, the purchase of said service contracts. Among these promotional materials are the documents attached as Exhibit A.

PAR. 5. Through the promotional materials discussed in paragraph four, respondents have represented, directly or by

implication, that respondents' service contracts fully protect consumers against repair costs and that respondents reimburse purchasers of their service contracts for the full cost of repairing or replacing the enumerated "covered parts" of the consumers' vehicles.

PAR. 6. In truth and in fact, respondents' service contracts do not fully protect consumers against repair costs, and respondents do not reimburse purchasers of their service contracts for the full cost of repairing or replacing the enumerated "covered parts" of the consumers' vehicles. Instead, in numerous instances respondents pay for only a portion of said repair or replacement costs. Therefore, the representations set forth in paragraph five were, and are, false and misleading.

PAR. 7. Through the promotional materials discussed in paragraph four, respondents have represented, directly or by implication, that purchasers of respondents' service contracts are paid a rental car allowance if, due to a mechanical breakdown of a covered part eligible for payment, the consumer's vehicle has to be kept overnight at a repair facility.

PAR. 8. In truth and in fact, respondents' service contracts impose significant limitations on the rental car allowance, including, but not limited to, limiting said allowance to the actual working time on the repair of the vehicle, excluding all time in which the repair facility waits for parts or for any other delays beyond the control of the repair facility, and only paying such allowance if the total repair time on the vehicle is eight hours or more. In light of the representations set forth in paragraph seven, the respondents' failure to disclose these significant limitations on the rental car allowance is misleading and deceptive.

PAR. 9. Through the promotional materials discussed in paragraph four, respondents have represented, directly or by implication, that purchasers of respondents' service contracts may submit an unlimited number of claims pursuant to those contracts.

PAR. 10. In truth and in fact, purchasers of respondents' service contracts may not submit an unlimited number of claims pursuant to those contracts. In fact, in numerous instances respondents deny claims and/or unilaterally cancel the service contracts of consumers who file multiple claims. Therefore, the representation set forth in paragraph nine was, and is, false and misleading.

PAR. 11. During the course and conduct of their business, respondents have entered into valid service contracts with consumers. Among those service contracts is the one attached as Exhibit B.

PAR. 12. During the course of administering claims submitted by the purchasers of respondents' service contracts, respondents have engaged in a pattern or practice of breaching their promise to reimburse claims under the terms of these contracts by:

1. Unilaterally canceling consumers' contracts, even though the terms and conditions of these contracts do not reserve to or create in the respondents a right to engage in such unilateral cancellation; and
2. Refusing to pay valid repair claims on the asserted ground that consumers had failed to obtain prior authorization from respondents. In fact, respondents routinely hindered consumers' ability to obtain prior authorization for repairs by, for example, failing to answer the toll free number that consumers are required to call in order to obtain such authorization.

Respondents' conduct as set forth above has caused substantial injury to consumers that is not outweighed by any countervailing benefits to consumers or competition and is not reasonably avoidable by consumers. This conduct was, and is, an unfair practice.

PAR. 13. The acts and practices of respondents alleged in this complaint have constituted and now constitute deceptive or unfair acts or practices in or affecting commerce in violation of Section 5(a) of the Federal Trade Commission Act. The acts and practices of respondents, as herein alleged, are continuing and will continue in the absence of the relief herein requested.

EXHIBIT A



GRIFFIN SYSTEMS, INC.

Local (216) 881-8787
 Toll Free National 1-800-442-2886
 Toll Free Ohio 1-800-821-4204
 Toll Free Canadian 1-800-458-2277

Protect your new car from the ...

GENERAL MOTORS' FACTORY EXTENDED
WARRANTY FOR YOUR NEW CAR
SOUNDS GREAT —

BUT IT ISN'T!

IT LEAVES A COSTLY GAP BETWEEN
THE REGULAR 12/12 NEW CAR
WARRANTY AND THE "FACTORY
EXTENDED WARRANTY"

— THE AUTOGAP!



Dear New General Motors Owner:

It is true that your General Motors Factory Extended Warranty covers the drive train on your car for 60,000 miles. It is also true that those parts are designed to last more than 100,000 miles — and usually do!

What General Motors hasn't told you is that the Extended Warranty leaves an AutoGap — a wide crevice you don't want your car to fall into. In that crevice are your water pump, fuel pump, electrical system, cooling system, brakes, high tech options — and more.

Yes, most of the parts that sooner or later break down are not covered!

And that's where the Griffin VPP — Vehicle Protection Plan — steps in. It insures against the AutoGap, gives you added protection against the thousands of dollars of repairs your General Motors vehicle could need after the 12 month/12,000 mile warranty expires. Protection your General Motors Extended Warranty doesn't give you.

Check the chart on the reverse of this letter. Then take a minute to read the brochure. You'll see why Griffin VPP is one of the most comprehensive warranty programs on the market today to protect you against the costly AutoGap.

With Griffin VPP coverage you'll drive your new General Motors vehicle worry-free, safe in the knowledge that you are fully protected against high repair costs.

Fill out and mail the registration form today and be sure you're protected against having to pay thousands of dollars in repair bills.

Sincerely yours,

GRIFFIN SYSTEMS, INC.

Christine A. Knowles
 Christine A. Knowles
 Business Manager

P.S. Best of all, with Griffin VPP most claims are handled with one toll-free call for authorization.

Exhibit A
 Page 1

Complaint

117 F.T.C.

EXHIBIT A


**AUTOGAP
GENERAL MOTORS COMPARISON CHART**

Item Covered		New Car Warranty 1 Year or 12,000 Miles	Factory Established Warranty 3 Years or 60,000 Miles	Gettin VPP AutoGap Coverage
DRIVE TRAIN:	Engine	Yes	Yes	Yes
	Transmission	Yes	Yes	Yes
	Differential	Yes	Yes	Yes
COOLING/ FUEL SYSTEMS:	Radiator	Yes	No	Yes
	Fan and Clutch	Yes	No	Yes
	Engine Fan Motor	Yes	No	Yes
	Fuel Tank	Yes	No	Yes
	Fuel Pump	Yes	No	Yes
	Water Pump	Yes	No	Yes
FRONT/ REAR WHEEL DRIVE:	Drive Housing/Parts	Yes	Yes	Yes
	Axle Shafts	Yes	Yes	Yes
	Hub Bearings	Yes	Yes	Yes
	Prop Shafts	Yes	Yes	Yes
	Seals & Gaskets	Yes	Yes	Yes
	Universal Joints	Yes	Yes	Yes
STEERING:	Gear Housing & Parts	Yes	No	Yes
	Power Steering Pump	Yes	No	Yes
	Main Shaft	Yes	No	Yes
	Intermediate Shaft	Yes	No	Yes
	Couplings	Yes	No	Yes
	Seals and Gaskets	Yes	No	Yes
FRONT SUSPENSION:	MacPherson Struts	Yes	No	Yes
	Control Arms	Yes	No	Yes
	Shafts and Bushings	Yes	No	Yes
	Ball Joints	Yes	No	Yes
	Steering Knuckles	Yes	No	Yes
	Bearings and Seals	Yes	No	Yes
	Stabilizer Shaft	Yes	No	Yes
	Stabilizer Linkage	Yes	No	Yes
HEATING AND AIR COND.:	Heater Core	Yes	No	Yes
	Compressor	Yes	No	Yes
	Clutch & Pulley	Yes	No	Yes
	Condenser	Yes	No	Yes
	Evaporator	Yes	No	Yes
	Accumulator	Yes	No	Yes
BRAKES:	Temp. Control	Yes	No	Yes
	Gaskets & Seals	Yes	No	Yes
	Master Cylinder	Yes	No	Yes
	Assist Boosters	Yes	No	Yes
	Wheel Cylinders	Yes	No	Yes
	Combination Valve	Yes	No	Yes
ELECTRICAL:	Hydraulic Lines	Yes	No	Yes
	Disc Calipers	Yes	No	Yes
	Seals & Gaskets	Yes	No	Yes
	Starter Motor	Yes	No	Yes
	Starter Solenoid	Yes	No	Yes
	Generator	Yes	No	Yes
	Alternator	Yes	No	Yes
	Voltage Regulator	Yes	No	Yes
	Distributor	Yes	No	Yes
	Wiring Harness on Covered Parts	Yes	No	Yes
HIGH TECHNOLOGY FEATURES:	Windshield Wiper Motors	Yes	No	Yes
	Electronic Parts	Yes	No	Yes
	Heater Blower Motor	Yes	No	Yes
	Power Window Motors	Yes	No	Yes
ADDITIONAL BENEFITS:	Power Seat Motor	Yes	No	Yes
	Door Lock Motors	Yes	No	Yes
	Cruise Control	Yes	No	Yes
	Sun Roof Motor	Yes	No	Yes
DEDUCTIBLE:	Rental Car Allowance	Yes	No	Yes
	Towing Allowance	Yes	No	Yes
	Transfer	Yes	Yes	Yes
		No	\$100 each claim	\$25 each claim

Note: This chart is for comparison purposes only and is not meant to be a definitive listing of benefits which are thoroughly explained in your service agreement.

Exhibit A
Page 2

Complaint

EXHIBIT A

Vehicle Protection Plan

FULL REFUND WITHIN 60 DAYS IF NOT COMPLETELY SATISFIED

During the first 60 days of plan ownership, if you have the option to cancel the plan for a full refund, you must cancel the plan for a full refund. If you have filed a claim or have owned the plan for more than 60 days, cancellation is not available. The plan is subject to the Rule of 75 (See Section of Digest Method) which is the basis for the calculation of time or mileage, whichever is the lesser.

To participate in this program, simply request a refund by completing the enclosed agreement, registration and returning it with your check, credit card or money order. We will refund your money within 60 days of receipt of your refund request.

GRIFFIN SYSTEMS, INC.
P.O. Box 5190
Cincinnati, Ohio 45201-0190

CLEVELAND AREA (216) 861-8787
OHIO, WISCONSIN (800) 442-2885
INDIANA (800) 442-2885
CANADIAN WISCONSIN (800) 442-2885

The coverage, refund and other details of this program are set forth in the Vehicle Protection Plan Agreement. The Service Agreement details all conditions and terms.



MR. FIXIT recommends

VEHICLE PROTECTION PLAN

WHAT IS THE VEHICLE PROTECTION PLAN?

Q. What is the Vehicle Protection Plan?
A. A Mechanical Services Contract which pays for parts and labor on the major mechanical areas of your vehicle. (See COVERED COMPONENTS). The plan also provides reimbursement for car rental as well as towing expenses. (See ADDITIONAL BENEFITS)

Q. Why do I need the Vehicle Protection Plan?
A. Because most major repairs occur after the manufacturer's warranty has expired, the most common repair for your vehicle is to "top" your vehicle. You will have protection when you most need it.

Q. What do I do if my vehicle breaks down?
A. You may choose to have it repaired at any reputable dealer, shop or service center. Your Service Agreement lists the phone numbers to use to obtain help and instructions.

BACKING BY A MAJOR INSURANCE PROGRAM
The Griffin Systems Vehicle Protection Plan is fully insured by a major insurance company. This is not an individual insurance program.

Vehicle Protection Plan

EXHIBIT A

Exhibit
Page 4

Complaint

Call toll free
OUTSIDE OHIO (800) 442-2886
IN OHIO (800) 821-4204
CLEVELAND AREA (216) 881-8787
CANADA (800) 458-2277

OWNER INFORMATION WOCOD J CRISAFI - 5004 FLOWERDALE CLEVELAND OH 44144	VEHICLE INFORMATION <i>(Verify and correct if necessary)</i> Year Make Model 1967 OLDSMOBILE CALAIS Vehicle Identification Number 163N1F14L7MM304025						
Please indicate Current odometer reading <table border="1" style="display: inline-table; vertical-align: middle;"> <tr> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px; text-align: center;">X</td> </tr> </table>						X	Original "DELIVERY DATE" of your vehicle. (Date your vehicle was put into use by its first owner, lessee or, if a Demo, first day of service) MONTH _____ DAY _____ YR _____
					X		
DO NOT enter a figure in tenths-of-mile box.							

Coverage starts on the "DELIVERY DATE" of the vehicle described above. Coverage remains in effect for the number of months or the number of miles (whichever comes first) applicable to the plan YOU SELECT below.

SELECT ONE PLAN	MONTHS	TERM MILES	PLAN COST
☐ A	36	50,000	\$314.00
☐ B	48	50,000	\$322.00
☐ C	60	55,000	\$330.00
☐ D	60	65,000	\$346.00
☐ E	72	80,000	\$490.00
☐ F	12	90,000	\$570.00

THE COST OF THE PLANS IS GUARANTEED UNTIL

UC1 25 1967

COST MAY CHANGE AFTER DATE SHOWN ABOVE

25 1907
23
MAY CHANGE
TER DATE
OWN ABOVE

22 Apr '87

☐ By CHECK, for the full amount of \$ _____, made payable to Griffin Systems, Inc.
(Please remember to enclose check when you return this Registration)

☐ CHARGE 'o ☐ VISA ☐ MASTERCARD ☐ AMERICAN EXPRESS

CREDIT CARD ACCOUNT NO. _____ EXPIRES _____

☐ EASY PAYMENT PLAN

A service charge of \$30.00 is added to the plan cost chosen above. The sum is to be paid in 8 installments. THE FIRST PAYMENT is to be enclosed with this registration. United States Acceptance Corporation will issue a payment book for the 7 remaining payments due. Should you decide to cancel the plan prior to its expiration, the \$30.00 service charge is non-refundable.

8 MONTHLY PAYMENTS OF

PLAN A	PLAN B	PLAN C	PLAN D	PLAN E	PLAN F
\$43.00	\$44.00	\$45.00	\$47.00	\$65.00	\$75.00

I understand that coverage under the Vehicle Protection Plan I have selected above will begin upon Griffin's approval of this registration and Griffin's processing of my payment of the required charge.

I hereby warrant that the vehicle described above is in good working condition, to the best of my knowledge.

SIGNATURE X DATE SIGNED _____

Phone Number Area Code () - -

Sign date and mail this original using envelope enclosed or send to above address.

ORIGINAL
TO BE RETURNED TO GRIFFIN

Exhibit A
Page 5

EXHIBIT A

I — COVERAGE ELIGIBILITY

If the answer to any of the following four (4) questions is "YES," the vehicle described on the reverse of this form is not eligible for registration under the Vehicle Protection Plan. —

- | | YES | NO |
|---|--------------------------|--------------------------|
| 1. If you have not had a trailer tow package installed by the factory, or your dealer — will you be pulling a trailer weighing more than 2500 pounds? | ☐ | ☐ |
| 2. If your vehicle is a truck, is its gross vehicle weight rating (GVWR) more than 10,000 pounds? | ☐ | ☐ |
| 3. Will your vehicle be used as a police car, ambulance, or other emergency vehicle? | ☐ | ☐ |
| 4. Will your vehicle be used for daily rental, livery or taxi? | ☐ | ☐ |

If your vehicle does not have a Manufacturer's Warranty enforceable in the U.S. or Canada, it is not eligible for coverage.

II — FOR STATISTICAL PURPOSES

Your answer to the questions listed below will enable us to complete our records on your vehicle

- A. Are you the vehicle's
- ☐ First owner?
 - ☐ Second owner?
 - ☐ Third owner?
- B. Was your vehicle
- ☐ Purchased?
 - ☐ Leased?
- C. Was your vehicle a Dealer Demonstrator? Yes ☐ No ☐
- D. Does your vehicle have:
- | | |
|---|---|
| ☐ Standard Transmission | ☐ Factory or Dealer Installed Air Conditioning |
| ☐ Automatic Transmission | ☐ Electric Power Seats |
| ☐ Diesel Engine | ☐ Electric Power Windows |
| ☐ Turbo Charged Engine | ☐ Electric Power Door Locks |
| ☐ Four Wheel Drive | ☐ Electric Power Antenna |
| ☐ Cruise Control | ☐ Electric Power Sun Roof |

Upon our receipt and approval of this Registration, we will prepare and mail to you a Service Agreement which details the Conditions and Terms of the Plan you selected

THANK YOU FOR YOUR PATRONAGE!

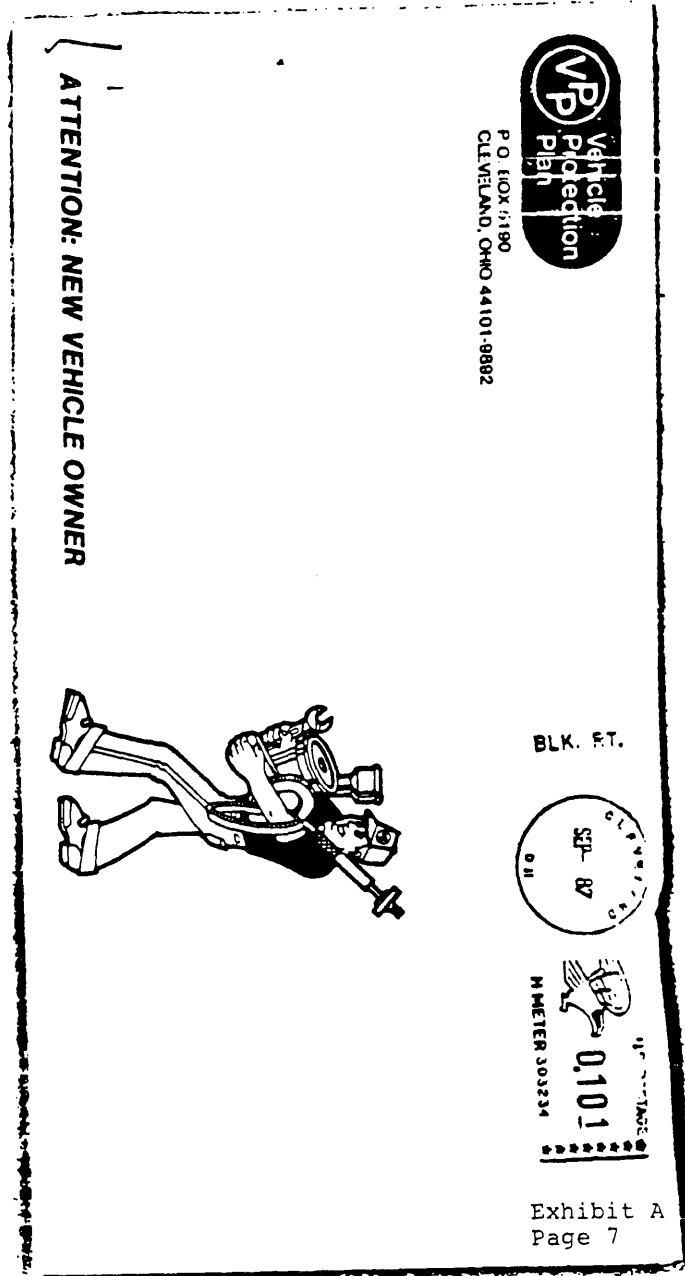


The Vehicle Protection Plan

Exhibit A
Page 6

Complaint

EXHIBIT A



Complaint

117 F.T.C.

EXHIBIT B

976

**VEHICLE
PROTECTION
PLAN**

SERVICE AGREEMENT

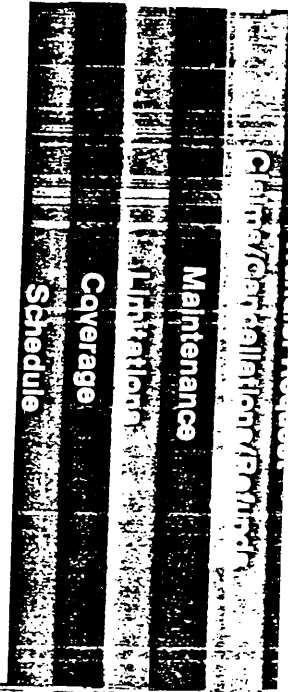


Exhibit B

EXHIBIT B



Your protection against costly
mechanical breakdown.

I. Service Agreement

Please read this agreement carefully to become familiar with all its contents.

This Service Agreement (agreement) is between the purchaser (you) named in the Schedule and Griffin Systems, Inc. (we,us). This agreement is transferable. This agreement begins on the effective date shown in the Schedule and remains in effect for the term or mileage also shown in the Schedule (whichever occurs first).

Statements contained in your Agreement Registration are incorporated herein by reference.

Complaint

117 F.T.C.

EXHIBIT B

I. Schedule

PURCHASER NAME AND ADDRESS

AGREEMENT NUMBER

PLAN COST

VEHICLE INFORMATION

Year

Make

Model

Vehicle Identification Number

Class

Effective date of
this Agreement (1)Term
(months)Issue date of
this AgreementOdometer reading at
registration date (2)Agreement expires
when odometer reads

1. The "Effective date of this Agreement" is the original "Delivery Date" of your vehicle as indicated by you on the Agreement Registration

2. The "Odometer reading at registration date" is the number of miles registered by your odometer as indicated by you on the Agreement Registration

II. What is Covered**A. Mechanical Breakdown**

We agree to pay for the reasonable cost of repair or replacement of parts/units within the components covered by this agreement. Such repair or replacement must have arisen from the failure of defective parts/units, which failure may occur during the normal use of your vehicle.

Schedule

EXHIBIT B

II. What is Covered (cont'd)

In no event will our liability exceed the actual cash value of your vehicle prior to the time of the mechanical breakdown. This actual cash value will be determined by the published wholesale value of the vehicle. Replacement may be made with like kind and quality and depreciation or betterment applied.

B. Covered Components:

Only the components/units/parts listed below are covered.

**1. Engine****Gasoline Engine**

Cylinder block, heads, all internal lubricated parts, manifolds, timing gears, timing gear chain or belt and cover, flywheel, harmonic balancer, valve covers, oil pan, oil pump, vacuum pump, engine mounts, water and fuel pumps, turbocharger housings and internal parts, valves, seals and gaskets.

Diesel Engine

All of the above listed parts, plus diesel fuel injection pump, lines and nozzles.

**2. Transmission**

Case, all internal lubricated parts, torque converter, vacuum modulator, seals, gaskets and transmission mounts. Includes transfer case on four wheel drive vehicles, all internal parts, seals and gaskets.

**3. Front Wheel Drive**

Final drive housing and all internal parts, axle shafts, constant velocity joints, front hub bearings, rear axle hub bearings, seals and gaskets.

4. Rear Wheel Drive

Axle housing and all internal lubricated parts, propeller shafts, "U" joints, axle shafts, bearings, supports, seals and gaskets.

Complaint

117 F.T.C.

EXHIBIT B

**5. Cooling and Fuel**

Radiator, fan and clutch, engine fan motor, fuel tank and fuel lines.

**6. Steering**

Gear housing and all internal parts, power steering pump, steering main and intermediate shafts, couplings, seals and gaskets.

**7. Front Suspension**

MacPherson struts, upper and lower control arms, control arm shafts and bushings, upper and lower ball joints, steering knuckle, wheel bearings and seals, stabilizer shaft, stabilizer linkage and bushings.

**8. Heating and Factory Approved Air Conditioning**

Heater core, compressor, clutch and pulley, condenser, evaporator, accumulator, temperature control programmer and seals.

**9. Brakes**

Master cylinder, assist boosters, wheel cylinders, combination valve, hydraulic lines and fittings, disc calipers, seals and gaskets.

**10. Electrical**

Starter motor and/or solenoid, generator, alternator, voltage regulator, distributor, wiring harness for covered component parts, manually operated switches for covered component parts, windshield wiper motors, electronic level control compressor, its sensor and limiter valve, Electronic fuel injection sensors, control module and injectors, electronic module, Electronic spark control detonation sensor and controller, Heater blower motor.

**11. High Tech Features**

Power window motor, power seat motor, door lock motors, factory installed cruise control, power antenna motor and sun roof motor.

EXHIBIT B

II. What is Covered (Cont'd) – Additional Benefits**C. Rental Reimbursement**

In the event of a mechanical breakdown caused by parts or units within the components covered by this agreement, we agree to pay for the cost of substitute transportation. The payment will be for the rental fee, to a maximum of \$20.00 per day, for a maximum of 5 days or \$100.00 per occurrence. In computing the rental amount due you, we will consider only the actual working time on the repair of your vehicle, as follows: One day's transportation expense will be due for each 8 hours of flat rate time, provided that your vehicle must be retained overnight for the repair of covered parts eligible for payment.

This provision excludes:

1. Down time waiting for parts or any other delays beyond the control of the repair facility.
2. Down time for routine maintenance repairs.

The deductible amount of \$25.00 does not apply to this provision.

**D. Towing Reimbursement**

In the event that your vehicle becomes disabled due to the mechanical breakdown of a covered part, or unit eligible for payment, we will pay for the cost of towing your vehicle to a repair facility. We will pay for the actual towing charge to a maximum of \$35.00 per occurrence. The deductible amount of \$25.00 does not apply to this provision.

**E. Free Transfer Provision**

If you should decide to sell your vehicle before your plan expires, you may transfer the remaining term of your plan to the new owner at no charge. A "Transfer Request" is included at the back of this Agreement.

Complaint

117 F.T.C.

EXHIBIT B

III. What is Not Covered

If your vehicle becomes disabled due to any of the circumstances listed below, we will not pay for the cost of repair or replacement of any part/unit, towing charges and/or rental charges.

Exclusions

1. Any part/unit not listed in part II-"B. Covered Components" of this agreement.
2. Any part/unit which is damaged, in any way, due to your vehicle having been used to pull a trailer weighing more than 2500 pounds, unless manufacturers authorized "Trailer Tow Package" is installed.
3. Any part/unit covered by a warranty issued by the vehicle's manufacturer.
4. Any part/unit damaged by fire, water, freezing, riot, windstorm, hail, lightning, earthquake, theft, nuclear contamination, collision, upset, malicious mischief or vandalism.
5. Any part/unit damaged because of your negligence, misuse or failure to have your vehicle maintained as suggested in your Manufacturer's Owner Manual.
6. Any part/unit damaged because of alterations made to your vehicle, when said alterations were not recommended by the manufacturer of your vehicle.
7. Any part/unit of your vehicle's odometer if it has been altered so that actual mileage of your vehicle is not shown.
8. Any part/unit, mechanically defective, for which the vehicle's manufacturer has publicly announced responsibility to recall the vehicle for correction of the defective part/unit.
9. Any part/unit which is damaged after the repossession of your vehicle.
10. Any part/unit if your vehicle is used for commercial livery, delivery purposes, racing or competitive speed.
11. Any loss of your time caused by delays in the repair or maintenance of your vehicle.
12. Any loss of any kind that occurs to your vehicle while your vehicle is out of your care and custody or rented to others.
13. Any loss, expenses or charges resulting from the length of time necessary to repair your vehicle, such as hotel accommodations, meals, telephone charges, loss of goods of any kind, loss of salaries, loss of life or loss due to accident or bodily injury.
14. Any fluids, lubricants, shop supplies and taxes.

EXHIBIT B

IV. Maintenance Procedure

Your Vehicle Protection Plan requires you to maintain your vehicle according to the minimum required maintenance intervals as specified in your owners manual which came with your vehicle at the time of delivery. Maintenance need not be performed by a dealership or service facility. If you elect to perform your own maintenance retain the receipts for parts and fluid you buy for maintenance.

We have provided a Maintenance Register for you to record the required maintenance of your vehicle.

Maintenance Register

Date	Mileage	Services Performed	Services Performed by
1			
2			
3			
4			
5			
6			
7			
8			
9			
10			
11			
12			

Complaint

117 F.T.C.

EXHIBIT B

Maintenance Register

Date	Mileage	Services Performed	Services Performed by
13			
14			
15			
16			
17			
18			
19			
20			
21			
22			
23			
24			
25			
26			
27			
28			
29			

J. Roy Smith

8

Maintenance

515

Complaint

EXHIBIT B

Maintenance Register			
Date	Mileage	Services Performed	Services Performed by
30			
31			
32			
33			
34			
35			
36			
37			
38			
39			
40			
41			
42			
43			
44			
45			
46			

Complaint

117 F.T.C.

EXHIBIT B

Maintenance Register

Date	Mileage	Services Performed	Services Performed by
47			
48			
49			
50			
51			
52			
53			
54			
55			
56			
57			
58			
59			
60			
61			
62			
63			

515

Complaint

EXHIBIT B

V. Claims**1. To Report a Claim**

In the event of a mechanical breakdown of your vehicle, please call one of the following number(s) for instructions

1-800-228-9096

Great Plains Insurance Company, Inc
4019 Prospect Ave
P.O. Box 6298
Cleveland, Ohio 44101

Whenever possible return your motor vehicle to the dealership where you bought it or the most convenient repair facility of your choice anywhere within the continental United States and Canada. Request that the Service Manager call the appropriate number listed above. Our Claims Manager will authorize the repair by phone.

2. Deductible

When your first claim occurs, we will deduct \$25.00 from the amount due you. This \$25.00 is a one-time deductible amount. Any claims you submit after the first one will have no deductible amount.

3. Conditions

- a. Once a loss occurs, you must protect the vehicle from further damage.
- b. No claim will be paid unless the amount to be paid has been previously authorized by telephone or in writing.
- c. We reserve the right to examine, adjust, inspect or investigate any claims.
- d. Claims must be submitted within sixty (60) days of the date of loss.

EXHIBIT B

EXHIBIT B

VI. Cancellation and Refunds**A. Cancellation**

This Service Agreement may be cancelled by you at any time during its term by completing the "Cancellation Request" included on the reverse side of this page. Upon completion of the "Cancellation Request", please mail this entire agreement back to us.

GRIFFIN SYSTEMS, INC.
Administrators
4101 Prospect Avenue
P.O. Box 5190
Cleveland, Ohio 44101-0190

B. Refunds**1. Within the first 60 days**

Within 60 days of its Issue Date, we will refund 100% of the amount paid. PLEASE NOTE that if you chose our Finance Plan, the \$30.00 is NON-REFUNDABLE.

2. After the first 60 days

After the first 60 days of its Issue Date, we will refund the lesser of two sums based upon the Rule of 78ths calculation of elapsed time and mileage. If you have an unlimited mileage plan, calculated refunds will be based on elapsed time or a total of 60,000 miles.

EXHIBIT B

Cancellation Request

To cancel this Agreement, please complete the following information

1 Agreement number (as it appears on page 2 "SCHEDULE") _____

2 Current Odometer reading on the vehicle ☒ IMPORTANT - DO NOT enter a figure in tenths-of-mile box

3 Reason for cancellation _____

4 Do you wish to apply the refund (if any) towards the cost of a new Agreement for your new vehicle? YES ☐ NO ☐

If "yes" please indicate: YEAR _____ MAKE _____ MODEL _____
of your new vehicle. Upon our receipt of this information, we will promptly mail you an Agreement Registration and details of the transaction. If "no", the the refund amount (if any) will be sent to you.

5 Your signature _____ Date Signed _____

Please mail this Agreement to:

If you have any questions, please call us at:

GRIFFIN SYSTEMS, INC
Administrators
4101 Prospect Avenue
P.O. Box 5190
Cleveland, Ohio 44101-0190

Cleveland area 216-881-8787
In Ohio 1-800-821-4204
National WATS 1-800-442-2886
Canadian WATS 1-800-458-2277

Complaint

117 F.T.C.

EXHIBIT B

Transfer Request

To transfer this Agreement, please complete the following information:

1. Agreement number (as it appears on page 2 "SCHEDULE") _____

2. Effective date of the transfer: _____

3. Odometer reading at date of transfer:

					X
--	--	--	--	--	---

IMPORTANT - DO NOT enter
a figure in tenths-of-mile box

4. Vehicle transferred to:

Name of purchaser: _____

Address: _____

City: _____ State: _____ Zip: _____

SIGNATURE of Vehicle Purchaser: _____ Date Signed: _____

SIGNATURE of Vehicle Seller: _____ Date Signed: _____

Please mail this Agreement to:

If you have any questions, please call us at:

GRIFFIN SYSTEMS, INC.
Administrators
4101 Prospect Avenue
P.O. Box 5190
Cleveland, Ohio 44101-0190

Cleveland area: 216-881-8787
In Ohio: 1-800-821-4204
National WATS: 1-800-442-2886
Canadian WATS: 1-800-458-2277

INITIAL DECISION

BY JAMES P. TIMONY, ADMINISTRATIVE LAW JUDGE
JUNE 30, 1993

On this date, I granted the renewed motion for sanctions, the motion for default judgment, and the motion for summary decision filed by counsel supporting the complaint. Those orders shall be the Initial Decision in this case by Rule 3.38(b), Rule 3.12 (c), and by Rule 3.24 (a)(2).

ORDER GRANTING DEFAULT JUDGMENT
AGAINST ROBERT W. BOUGHTON

By motion filed October 5, 1992, complaint counsel seek default judgment, pursuant to Rule 3.12(c), against individual Robert W. Boughton. For the reasons stated therein, and in the supporting papers, the motion is hereby granted.

ORDER GRANTING COMPLAINT COUNSEL'S RENEWED
MOTION FOR SANCTIONS

By motions dated August 11, 1992 and January 29, 1993, complaint counsel moved, pursuant to Section 3.38(b) of the Commission's Rules of Practice, for sanctions against respondents Griffin Systems, Inc., Gennaro J. Orrico and Alfonso S. Giordano ("the named respondents") for their failure to comply with outstanding discovery requests of complaint counsel. Based on the reasons set forth in those motions and supporting memorandum, said motion is granted.

It is therefore ordered that the following sanctions are imposed on the named respondents:

(1) Pursuant to Section 3.38(b)(1), for the purpose of this proceeding it shall be inferred that all evidence withheld by the named respondents would have been adverse to them;

(2) Pursuant to Section 3.38(b)(2), for the purpose of this proceeding the following facts are established:

(a) In numerous instances the named respondents denied claims and/or unilaterally canceled the service contracts of consumers who filed multiple claims;

(b) The named respondents have, in a substantial number of instances, engaged in a pattern or practice of breaching their promise to reimburse claims under the terms of the contracts by unilaterally canceling consumers' contracts; and

(c) The named respondents have, in a substantial number of instances, engaged in a pattern or practice of refusing to pay valid repair claims on the asserted ground that consumers have failed to obtain prior authorization from the named respondents;

(3) Pursuant to Section 3.38(b)(3), the named respondents cannot introduce into evidence or otherwise rely upon, in support of any claim or defense, the requested service contract records; and

(4) Pursuant to Section 3.38(b)(4), the named respondents may not be heard to object to the use of secondary evidence to show what the withheld evidence would have shown.

SUMMARY DECISION

INTRODUCTION

This case involves the sale of vehicle service contracts throughout the United States. Respondents allegedly misrepresent the terms of their Vehicle Protection Plan which promised automobile purchasers protection against high repair costs on over 100 parts of the car. The complaint describes several broken promises to consumers: respondents promise to protect fully consumers against repair costs but pay only a portion of those costs; respondents promise to pay a rental car allowance while their car is being repaired but deceptively limit payments under that promise; respondents promise consumers may submit an unlimited number of claims but many times deny claims and cancel the contracts of consumers who file multiple claims; respondents refuse to pay repair claims for failure to obtain prior authorization and hinder consumers' ability to obtain prior authorization by failing to answer the telephone.

Complaint counsel filed a motion for summary decision. Respondents opposed. The parties stipulated that there is no genuine issue as to the following material facts:

I. STIPULATED MATERIAL FACTS

1. Complaint counsel has submitted exhibits to its trial brief, filed October 5, 1992, including deposition transcript excerpts. Throughout this stipulation of facts, the abbreviation "CX" refers to Commission Exhibit number, and the abbreviation "(Name) Dep." refers to the deposition of the person identified. The following table lists the numbers for these disposition transcript excerpts, as well as a brief description of the deponent.

Orrico CX 1	Gennaro J. Orrico, named respondent.
Giordano CX 2	Alfonso S. Giordano, named respondent.
Canitia CX 3	Al Canitia, Great Plains and Griffin claims manager, employed from 1987 through 1992.
Stoudmire CX 4	Colleen Stoudmire, Griffin claims supervisor, employed from 1987 through 1990.
Molzan CX 5	David Molzan, Griffin claims supervisor, employed for approximately two years from either 1987 or 1988.
Cassidy CX 6	Kathleen Cassidy, Griffin claims supervisor, employed from November 1986 through 1988 or 1989.
Knowles CX 7	Christine Knowles, Griffin office manager, employed from October 1986 through March 1988.
Sender CX 8	Kathy Janko-Sender, Griffin customer service representative, employed prior to 1982 through August 1, 1991.
Biederman CX	Judith Biederman, Griffin customer service representative, employed for three or four years ending approximately in 1986.

A. The Respondents

1. Griffin Systems, Inc.

2. Griffin Systems, Inc. ("Griffin"), incorporated on April 2, 1984, is an Ohio corporation with its office and principal place of business located at 4101 Prospect Avenue, Cleveland, Ohio. Respondents' Answer to Complaint at paragraph 1(a); Commission Exhibit ("CX") 12-1; CX 30; Orrico Dep. at 13.

3. From the time of its incorporation through at least 1988, Griffin engaged in the promotion, marketing and sale of vehicle service contracts, called the "Vehicle Protection Plan" or "VPP," to new and used vehicle buyers. Respondents' Answer to Complaint at paragraph 2; Respondents' Answers to Interrogatories, CX 10, at paragraphs 4(a) and (b).

4. From the time of its incorporation through at least November 1991, Griffin also administered and paid claims submitted by consumers pursuant to those service contracts. Respondents' Answer to Complaint at paragraph 2.

5. The average retail price of Griffin service contracts was \$315. CX 10 at paragraph 4(e).

6. Throughout its history, Griffin sold over 96,000 service contracts, with total gross sales of approximately \$29 million. CX 10 at paragraph 4(f); Griffin's answer to Commission staff access letter, CX 12, at paragraph 5(b). Consumers asserted more than 43,000 claims during that period of time. CX 10 at paragraph 4(g). Of those claims asserted, Griffin paid between \$6.8 million and \$10 million on over 32,000 claims, and denied over 8,000 claims. CX 10 at paragraph 4(k); CX 12 at 41, 45.

7. Griffin paid various insurance companies an underwriting fee on each service contract sold. In April 1985, that premium was \$190 per plan for unlimited mileage plans, and \$130 per plan for all others. In return for this fee, the insurance companies agreed to pay all claims that were submitted pursuant to the service contracts. The remainder was left for Griffin to administer the program, which included claims administration and answering plan holders' questions. Giordano Dep. at 72-74; CX 39.

8. Great Plains Insurance Company ("Great Plains"), headquartered in Nebraska, was one insurance company that underwrote Griffin service contracts. Orrico Dep. at 94-101. Great Plains also

administered claims on behalf of Griffin. *Id.* Griffin began to do business with Great Plains in 1982, *id.* at 94, and Griffin ultimately purchased Great Plains in December 1986. *Id.* at 101; CX 11-6.

9. Great Plains began to sell "mechanical breakdown insurance" ("MBI") policies on its own behalf after Griffin acquired the firm. Orrico Dep. at 107-09. An MBI policy differs from a service contract in that the former must be approved by a state department of insurance, and is in fact an insurance policy, while the latter is simply a contract between two parties. Giordano Dep. at 138-42. The solicitation materials for the Great Plains MBI policies were similar to the Griffin solicitation materials. Compare CX 135 with CX 14 at 3-6 and CX 17 at 3-4.

10. Griffin currently has no employees, although the firm still exists in corporate form. Respondents' Supplemental Answers to Interrogatories, CX 11, at 6.

2. Gennaro J. Orrico

11. Gennaro "Jerry" Orrico was the sole owner of Griffin at the time of its incorporation in 1984 and from at least 1988 to the present. CX 10 at paragraph l(d); Orrico Dep. at 11-12. As the owner of Griffin, Orrico also was the ultimate owner of Great Plains. Orrico Dep. at 101-03.

12. From 1982 to the date of Griffin's incorporation, Orrico sold service contracts as a sole proprietorship under the name "J. Orrico trading as Griffin Systems." Orrico Dep. at 11-12. Orrico briefly served as president of Griffin from the date of its incorporation through at least the end of 1984, and again from July 15, 1990 through the present. He also served as vice-president from 1986 through July 1990. CX 11 at 2-5; Respondents' Answer to Complaint at paragraph l(b); Orrico Dep. at 47-48.

13. Orrico was responsible for the preparation and dissemination of the Griffin solicitation materials. CX 10 at paragraph 6. In addition, Orrico had the responsibility for establishing or promulgating Griffin's methods, procedures and standards for recording, allowing, granting, paying, disallowing, rejecting or resolving claims; for canceling any of its service contracts; and for refunding any money paid by purchasers of its service contracts upon cancellation of the contract. *Id.* at paragraph 15.

14. Orrico developed Griffin's initial marketing strategy. Giordano Dep. at 52. Orrico also regularly signed checks on behalf of the respondents, and sent and received letters and memoranda concerning the day-to-day operations of the firm. *See* CX 84 - CX 109.

15. In addition to Griffin and Great Plains, Orrico also owned United States Automobile Warranty Association ("USAWA"), a company formed with the intention of selling service contracts in a manner similar to Griffin. Orrico Dep. at 118. The USAWA solicitation materials were virtually identical to the Griffin solicitations. Compare CX 130 with CX 14 at 3-6. USAWA never sold any policies, however. Orrico Dep. at 118.

3. Alfonso S. Giordano

16. Alfonso S. Giordano was a director, vice president and treasurer of Griffin from 1985 through 1987, when he moved to Florida to become the vice president and a director of Great Plains. CX 11 at 2-5; CX 48; Giordano Dep. at 8-9. Giordano remained the vice president and a director of Great Plains from 1987 through early 1991, when he resigned to become the president of Metro General Insurance Agency, an insurance company related to Great Plains. Giordano Dep. at 214-17.

17. Giordano had no ownership interest in Griffin. Throughout the period of time relevant to the complaint, Giordano's compensation was based upon a set salary.

18. During his initial employment with Griffin from May 1985 through sometime in 1987, Giordano worked regularly at the firm's Cleveland office. Giordano Dep. at 7-9. He helped to organize the company and establish the formal, step-by-step administrative procedures for the office. *Id.* Giordano said his job included office manager functions, as well as "everything else that came along -- the administration part." Giordano Dep. at 206-07.

19. Giordano monitored the inventory of solicitation and contract forms used for mailings, and he had the authority to order the printing of those forms and to instruct Griffin personnel which forms to use in certain mailings. Giordano Dep. at 25-27; CX 56.

20. Giordano supervised the employees who worked in the Griffin computer room, including supervision of the receipt by Griffin of the computer tapes from the state departments of motor

vehicles. Giordano Dep. at 31-32. Giordano also directly supervised Christine Knowles, the office manager. Knowles Dep. at 7-8; Giordano Dep. at 206-07. For the first few months after she was hired in October 1986, Giordano supervised Knowles on a day to day basis, getting her familiar with the contracts Griffin sold, helping her understand how the firm handled calls from consumers who received Griffin solicitation materials, and "the basics of what we did on a day to day basis there with the calls, with the claims, with processing the contracts that came in." Knowles Dep. at 7-8.

21. Giordano routinely advised Griffin personnel of the policies and practices of the firm, "insofar as the solicitation and mailings." Giordano Dep. at 44-45. *See e.g.* CX 50; CX 54; CX 55; CX 57-CX 62; CX 64. Moreover, Giordano "put in writing" detailed instructions for the Griffin clerks to follow when they received a contract application from a consumer who filled out the application incorrectly or incompletely. Giordano Dep. at 96-97; CX 47.

22. Giordano was a signatory to various Griffin bank accounts, including payroll accounts, during the entire period of time he worked for Griffin in Cleveland and after he moved to Florida in 1987. Giordano Dep. at 14-16, 23-25, 157-61, 197-98; CX 76 - CX 82. He thus had the authority to sign paychecks to Orrico and even to himself. CX 76 at 1-2. As of January 1990, over two years after he left Griffin, Giordano still had signing authority for a Griffin checking account that was located in Florida. CX 72 at 9. Giordano stated that Griffin claims checks may have been paid from this account. Giordano Dep. at 197-98.

23. While in Cleveland, Giordano authorized the payment of all routine bills of Griffin. Giordano Dep. at 46-47.

24. Giordano was involved in redesigning both the Griffin solicitation materials and contract packages mailed to consumers. Giordano Dep. at 56-58, 147. He stated that his assistance was mostly limited to "format,, design and color,, rather than content." Giordano Dep. at 147. *See also* Sender Dep. at 13-14. One of his functions when he was hired was to make these materials "more attractive." Giordano Dep. at 56-58. In the solicitation materials, changes were made in the wording and content as well as in the format and design. Giordano made some of those content changes. *Id.* Giordano continued to review new Griffin solicitation materials and contracts after he moved to Florida as part of Great Plains. Giordano Dep. at 163-64.

25. Giordano was involved in the revision of United States Automobile Warranty Association solicitation materials as well. CX 132.

26. Commission Exhibits 31 and 34 are Giordano's handwritten copies of a solicitation letter and an agreement registration form sent to consumers, while CX 37 is his handwritten copy of the service contract. Giordano Dep. at 59-60, 66-68. Giordano stated that he did not "draft" these documents. Instead, he merely "wrote a great deal of things, simply because I have a very legible handwriting." Giordano Dep. at 59-62, 64-68.

27. Giordano signed various cover letters to the solicitation materials and other documents distributed by the respondents to consumers. CX 18-CX 20; CX 22.

28. Giordano, Orrico and Boughton, as a group, had the authority to change the costs of Griffin service contracts, and decided what the costs of the plans should be. Giordano Dep. at 37-39. When new costs went into effect, Giordano reviewed applications received under the old prices to determine what plans the firm would accept without asking the consumer for the additional fee. *Id.*; CX 58 at paragraph II.

29. Giordano interviewed people for various positions at Griffin, including the position of office manager. Giordano Dep. at 11-13, 206-07; Knowles Dep. at 6; CX 52. As part of a group decision with Orrico and Boughton, Giordano had the authority to hire employees and set the salary of "anybody who worked for the organization." Giordano Dep. at 10-11; Knowles Dep. at 6; CX 51. The same group would annually evaluate all employees "associated with" Griffin. Giordano Dep. at 190-91; CX 45-2 at paragraph i.

30. As part of "prudent management," Giordano conducted an "auditing function" of claims received in the mail from consumers, to ascertain the number of claims Griffin received each day. Giordano Dep. at 47-48; CX 63.

31. On a regular basis while he worked for Griffin in Cleveland, Giordano would receive a list of "claims to be paid today," along with the claims checks. He usually would countersign those checks with Boughton. Giordano Dep. at 48-49. Moreover, when he worked for Griffin and Great Plains, Giordano would make the determination of whether those firms had sufficient cash to release all of the Griffin claims that were processed to be paid on any particular day. He would then inform the Griffin claims manager of the amount of

claims that could be paid. Giordano Dep. at 115-16; 154-57; Canitia Dep. at 85-87.

32. Giordano created by hand detailed cost analyses of the Griffin contracts, CX 38 - CX 39, analyses of the number of plans sold for each make and model of automobile, CX 40 at 1-2, and analyses of the costs of claims from each make and model of auto. *Id.* at 3. *See* Giordano Dep. at 68-74, 98-101; Orrico Dep. at 39-40. At the request of either Boughton or Orrico, Giordano also created a detailed flow chart showing assumptions that could be made if various companies were formed. Giordano may have told these individuals how some of these relationships could be established. CX 46; Giordano Dep. at 101-05.

33. At the end of the negotiation process by Griffin to purchase Great Plains, Giordano audited Great Plains' books to determine if Great Plains' reserves, liabilities and assets "were what they purported to be." Giordano Dep. at 137-38. He signed the minute of the directors meeting in which Griffin authorized the purchase of Great Plains, CX 53, and he "was directly involved in going physically to Omaha, Nebraska to effect the transaction with the Department of Insurance of the State of Nebraska." Giordano Dep. at 227-30.

34. After Giordano began working for Great Plains, Universal Security Insurance Company, an independent Florida firm, approached Great Plains to administer an MBI program on its behalf, since Great Plains was familiar with these plans. Giordano Dep. at 209-14. Giordano "specifically" assisted Universal Security in creating their solicitation brochures, *Id.* at 213, which were similar to those used by both Great Plains and Griffin in both form and content. Compare CX 133 with CX 135 and CX 14 at 3-6. Griffin sent out solicitation brochures on their behalf, but less than 200 service contracts were sold by that company. Orrico Dep. at 119-20.

35. From 1988 through at least May 1992, Giordano also was vice president and a director of American Southeastern Warranty Association ("ASWA"), a Florida company that, like Griffin, sold automobile service contracts through the mail. CX 11 at 2-5. *See also* CX 136; CX 137. Giordano had no ownership interest in ASWA. In July 1984, Colleen Orrico, wife of Gennaro Orrico, purchased a 50 percent ownership interest in ASWA. Great Plains purchased the other 50 percent interest in 1988, after Griffin acquired

it. CX 11 at 6; Orrico Dep. at 112-118. ASWA limited its sales to Florida residents. CX 11 at 6.

B. The Respondents' Method of Sales

36. At all times relevant to the complaint in this matter, the respondents have maintained a substantial course of business in or affecting commerce, as "commerce" is defined by the Federal Trade Commission Act. Respondents' Answer to Complaint at paragraph 3.

37. The respondents sent promotional materials and direct solicitations for their service contracts to consumers through the mail. Respondents' Answer to Complaint at paragraph 4; Orrico Dep. at 15.

38. The solicitation materials which the respondents mailed to consumers typically consisted of a cover letter, a descriptive brochure, and an "Agreement Registration" form. Commission Exhibit 14, which is a copy of Exhibit A to the complaint, is a representative sample of one of the respondents' solicitation packages. Orrico Dep. at 36-38; Giordano Dep. at 142. The cover letter to the solicitation materials varied from time to time and often was tailored to reflect the manufacturer of the vehicle owned by the consumer. See CX 14; CX 15; CX 17-CX 19.

39. In order to prepare their solicitation mailing lists, the respondents obtained from state divisions of motor vehicles, typically by purchasing computer tapes, the names and addresses of consumers who recently purchased new automobiles, as well as the make and model of the automobile they purchased. Orrico Dep. at 15-16; Giordano Dep. at 31-32; Knowles Dep. at 11.

40. The respondents mailed solicitation packages virtually on a daily basis; between October 1986 and March 1988, the peak mailing was approximately 500,000 solicitations per month, Knowles Dep. at 11, or "millions and millions" of solicitations each year. Orrico Dep. at 39.

41. The respondents sold service contracts in at least the following 25 states: Alabama, Arkansas, California, Colorado, District of Columbia, Florida, Georgia, Illinois, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Mississippi, Missouri, New York, North Carolina, Ohio, South Carolina, Tennessee, Texas, West Virginia and Wisconsin. CX 10 at 4(c).

42. The respondents could not sell service contracts throughout the country because many states have privacy laws which prohibit companies from obtaining information about state residents from the state government. Giordano Dep. at 42-43. In other states, including Florida, service contracts are considered a form of insurance, to be sold only by licensed insurance companies. Since Griffin was not an insurance company, the firm was prohibited from selling contracts in those states. *Id.*

43. In contesting law enforcement actions brought by at least two states, Maryland and Ohio, the respondents have maintained they were not engaged in the business of insurance. Instead, they claimed that their sale of service contracts was subject to federal regulatory jurisdiction under the Magnuson-Moss Warranty Act. *See e.g.* CX 139; CX 141.

44. The Griffin solicitation materials stated that the Vehicle Protection Plan was not an individual insurance program. CX 14 at 3; CX 17 at 3.

C. The Representations Made by the Respondents

45. Certain solicitation materials which the respondents mailed to consumers stated that purchasers of the Vehicle Protection Plan were "fully protected against high repair costs." CX 14 at 1. *See also* CX 15 at 1.

46. Certain brochures accompanying the solicitation materials stated that Griffin would pay "the cost of repair or replacement of covered parts on the major mechanical areas of your vehicle." CX 14 at 3. *See also* CX 17 at 3. Over 100 automobile components were listed as "covered" by the plan. CX 14 at 4; CX 17 at 4.

47. These solicitation brochures also stated that all service contracts were subject to a single deductible of \$25, which the owner paid only once during the lifetime of the plan. CX 14 at 4; CX 17 at 4. The solicitation materials did not mention any other deductible or other limitation on the amount Griffin would pay for the repair or replacement of a covered part. CX 14; CX 17.

48. Certain solicitation materials also stated that Griffin would pay consumers a rental car allowance of up to \$20 per day if, "due to the mechanical breakdown of a covered part eligible for payment, your vehicle has to be kept overnight at the repair facility." CX 14 at 4; CX 17 at 4.

49. Finally, certain solicitation materials stated that there was no limit to the number of claims a plan holder may submit, and that the owner should use the plan "as often as necessary." CX 14 at 3; CX 17 at 3. *See also* Respondents' Answer to Complaint at paragraph 9.

50. The solicitation materials noted that the coverage discussed was for informational purposes only, and that the service agreement detailed all conditions and terms of the plan. CX 14 at 3; CX 17 at 3. However, the service agreement was not sent to consumers as part of the solicitation materials. CX 14 at 6; CX 15 at 6; Knowles Dep. at 11.

51. The solicitation materials also noted that consumers would receive a "full refund within 60 days if not completely satisfied." CX 14 at 3; CX 17 at 3. The materials stated:

During the first 60 days of Plan ownership, you have the option to cancel the plan for a full refund, provided no claim has been filed. If you have filed a claim or have owned the plan for more than 60 days, cancellation refunds will be made under the Rule of 78's (The Sum of Digits Method) based on expiration of time or mileage, whichever is the lesser.

CX 14 at 3; CX 17 at 3.

52. Once consumers decided to purchase the Vehicle Protection Plan, they filled out the Agreement Registration Form. CX 14 at 5-6; CX 15 at 2. Consumers chose the term of the contract and the method of payment, and signed the registration form. *Id.* Coverage under the contract began upon the respondents' approval of the registration and processing of the payment. *Id.*; CX 17 at 2.

53. After the respondents approved the consumer's registration form, the purchaser received the service agreement, which listed in detail the terms of the contract. Commission Exhibit 23, which is a copy of Exhibit B to the Complaint, is a sample of the respondents' service agreement. Respondents' Answer to Complaint at paragraph 11. Other versions of the respondents' service agreements are included as CX 24 through CX 29. The relevant terms of these contracts are virtually identical.

54. A section of the respondents' service agreement, entitled "What Is Covered," states the following:

We agree to pay for the reasonable repair or replacement of parts/units within the components covered by this agreement. Such repair or replacement must have

arisen from the failure of defective parts/units, which failure may occur during the normal use of your vehicle.

In no event will our liability exceed the actual cash value of your vehicle prior to the time of the mechanical breakdown. The actual cash value will be determined by the published wholesale value of the vehicle. Replacement may be made with like kind and quality and depreciation or betterment applied.

CX 23 at 2-3. Similar, if not exact language was used in the respondents' other service agreements. *See* CX 24 - CX 29.

D. The Respondents' Acts and Practices

55. As a standard practice, the respondents applied a depreciation deduction to the value of all parts installed in a vehicle. CX 110-CX 119; Orrico Dep. at 70-72; Giordano Dep. at 117; Molzan Dep. at 43-44; Sender Dep. at 29-30; Stoudmire Dep. at 23; Canitia Dep. at 23-30.

56. The depreciation deduction typically amounted to one percent for each 1,000 miles driven, once the vehicle had 15,000 miles or more on the odometer. CX 111. In most instances, the depreciation deduction never exceeded 50 percent. CX 112; CX 115; CX 116; CX 119.

57. In describing how the rental car allowance would be calculated, the respondents' service agreements stated:

In computing the rental amount due you, we will consider only the actual working time on the repair of your vehicle, as follows: One day's transportation expense will be due for each 8 hours of flat rate time, provided that your vehicle must be retained overnight for the repair of covered parts eligible for payment.

This provision excludes:

1. Down time waiting for parts or any other delays beyond the control of the repair facility.

2. Down time for routine maintenance repairs. CX 23 at 4. *See also* CX 24 at 4; CX 25 at 6; CX 26 at 4; CX 27 at 3; CX 28 at 2; CX 29 at 2.

58. According to a former Griffin customer service representative, the following is a practical effect of the limitations on the rental car allowance, as set forth above. If a repair facility worked on a consumer's vehicle for three hours on Monday and three hours on

Tuesday, the consumer would not receive a rental car reimbursement, even though the car was kept in the repair facility overnight, because only six hours were spent on the repairs. Sender Dep. at 85-86.

59. Neither the respondents' solicitation materials nor their service agreements stated that the respondents had the right to cancel a service contract, for any reason whatsoever, once Griffin approved the consumer's agreement registration. *See* CX 14; CX 15; CX 17; CX 22 - CX 29.

60. The documents included as Commission Exhibits 120 and 121 show at least 12 consumers whose claims were denied and contracts were canceled either because the consumer had submitted too many claims, or for "underwriting" purposes. *See also* CX 12 at 5, 15.

61. Orrico stated that during 1990, someone from Great Plains instructed Griffin to cancel all unlimited mileage service contracts. Orrico Dep. at 84-87. According to Orrico, Griffin proceeded to cancel all of these unlimited mileage contracts unless the consumer stated that they wanted the contract to continue. Consumers who cashed their refund checks "went away." Orrico Dep. at 84-87.

62. Volume IV of the Commission's Trial Exhibits, CX 146, includes approximately 100 letters from the respondents to consumers, canceling the consumers' service contracts for either no stated reason or because the respondents purportedly were experiencing "continuing operating losses." *See also* CX 123.

63. Commission Exhibit 124 is a printout of contract holder information maintained on the respondents' computer system. Compare CX 124 with CX 12 at 4 through 22 (Griffin's response to Commission staff's access letter). This document shows three consumers whose contracts were canceled due to "End of Business."

64. Commission Exhibit 125 are printouts of summary information concerning Griffin contract cancellations. Those printouts state that during the period January 1, 1982 through December 31, 1988, 2,494 contracts were canceled. CX 125 at 1. During the period April 1, 1989 through May 31, 1989, 2,494 contracts were canceled. CX 125 at 3. Finally, the printouts state that on May 20, 1990, 8,499 contracts were canceled. CX 125 at 4.

65. According to the terms of the respondents' service contracts, consumers were required to obtain prior authorization for repairs by calling a toll-free number. *See, e.g.,* CX 23 at 7. When consumers called in for authorization of a repair, they were told to take their

vehicle to the repair facility of their choice, and to have the service manager call back the respondents for authorization. CX 10 at paragraph 7; Molzan Dep. at 25-26; Orrico Dep. at 54-56.

66. A number of former Griffin employees indicated that in many instances, consumers found it difficult, if not impossible, to get through to Griffin on the telephone. Molzan Dep. at 24-25, 53, 81-82; Stoudmire Dep. at 12-14, 60-64, 100-01; Cassidy Dep. at 18, 20-21; Knowles Dep. at 19-20; Biederman Dep. at 52, 56.

67. The respondents' telephone records indicate that in many months, thousands, and even tens of thousands, of telephone calls to the respondents' toll free numbers were not answered. *See* Danielson declaration, CX 142, at paragraph 10 and the attachments thereto. *See also* CX 143 and CX 145.

68. The Commission has received 1,278 complaints from consumers concerning the respondents' acts and practices. CX 142 at paragraph 5. Of those 1,278 complaints, at least 710 consumers complained about the difficulty in reaching Griffin by telephone, including at least 211 consumers who complained specifically that they had been unable to reach Griffin in order obtain prior authorization. *Id.* at paragraph 6.

69. In some of the complaints received by the Commission, consumers speak of calling the respondents numerous times in a day, for many days in a row, only to reach a busy signal or a tape recording stating that no one is in the office, or to be put on hold for periods of over one hour, only to be disconnected in the end. CX 142 at paragraph 6.

70. The respondents also received complaints, both orally and in writing, from consumers who could not get through on the telephone lines to obtain authorization. Stoudmire Dep. at 67-69; Molzan Dep. at 26-28, 56.

71. In numerous instances where prior authorization was not received, the respondents denied the claims of those consumers who attempted to reach the company but were unable to do so, thus failing to obtain the necessary authorization prior to the initiation of repairs. Canitia Dep. at 36-37; Cassidy Dep. at 27-28; Molzan Dep. at 26-28.

72. Volume V of the Commission's Trial Exhibits, CX 147, includes approximately 100 form letters from the respondents to consumers, denying the consumers' claims because they failed to obtain a pre-authorized claim number before sending in the claim. Each of these letters is followed by the consumer's written response,

stating in detail the difficulty the consumer experienced in obtaining such authorization over the telephone from the respondents. *See also* Molzan Dep. at 56; CX 142 at paragraph 12.

73. The Commission has received at least 100 consumer complaints about the delay in receiving from Griffin cancellation refunds which were due them, and at least 89 consumer complaints that the amount of their cancellation refund from Griffin was substantially less than what they had expected. CX 142 at paragraph 7.

II. DISCUSSION

In their solicitation materials, respondents stated that purchasers of the Vehicle Protection Plan were fully protected against high repair costs, and that the firm would pay the cost of repair or replacement of covered parts on the major mechanical areas of the consumer's vehicle. (F. 45, 46.) Over 100 automobile components were covered by the plan. (F. 46.) The solicitation brochure stated that all policies were subject to a single deductible of \$25, which the owner paid only once during the lifetime of the plan. (F. 47.)

Respondents made two other significant promises in their solicitations. They stated that they would pay consumers a rental car allowance of up to \$20 per day if, "due to the mechanical breakdown of a covered part eligible for payment, your vehicle has to be kept overnight at the repair facility." (F. 48.) And, they stated that there was no limit to the number of claims a plan holder may submit, and that the owner should use the plan "as often as necessary." (F. 49.)

Respondents did not pay the entire cost of replacing a covered part. They applied a depreciation deduction to the value of all parts installed in a vehicle. (F. 55.) This deduction was one percent for each 1,000 miles driven, once the vehicle had 15,000 miles or more on the odometer. (F. 56.)

Respondents' solicitation materials promised the rental car allowance whenever the vehicle had to be kept overnight at the repair facility. The service agreement limited this coverage to "the actual working time on the repair of your vehicle," excluding down time waiting for parts "or any other delays beyond the control of the repair facility." (F. 57.) Consumers received a rental car reimbursement only if the total repair time on the vehicle was eight hours or more, even if the repair took more than one day. (F. 58.)

Respondents' solicitation materials stated that there was no limit to the number of claims that a consumer may submit. In fact, the respondents denied claims and canceled policies solely on the grounds that a consumer had submitted too many claims in the past. (F. 60.)

Respondents' misrepresentations were likely to deceive consumers who were acting reasonably. *Cliffdale Associates*, 103 FTC 110, 164-65 (1984), *appeal dismissed sub nom, Koven v. FTC*, No. 84-5337 (11th Cir. October 10, 1984). There was no disclosure in respondents' solicitation materials that would put consumers on notice that they would be reimbursed for parts only on a depreciated basis. Nor were there any statements indicating a restriction on the rental car allowance or a limit on the number of claims that may be presented. Most of the misrepresentations were express and contrary to the terms of the contract.¹ The reasonable consumer would rely on the information presented in the solicitation materials and would therefore be deceived. *Cliffdale Associates*, 103 FTC at 178.

The misrepresentations were material to the purchasing decisions. A material claim is "likely to affect [consumers'] choice of, or conduct regarding, a product." *Id.* at 165. Express claims are presumptively material, *Id.* at 178-182. Respondents' claims went to what the consumers received for the money they paid. The misrepresentations therefore influenced consumers' decisions to purchase the service contracts.

Respondents breached their service contracts with many customers. The respondents unilaterally canceled service contracts, even though neither the solicitations nor the service agreements gave respondents that right. (F. 60-64.) Thousands of consumers' policies were canceled. (F. 64.) The respondents canceled service contracts that had an unlimited mileage term. (F. 61.)

Respondents also breached their service contracts by denying the claims of consumers who failed to obtain prior authorization for repairs, even though respondents hindered consumers' ability to obtain such authorization. (F. 66-70.) According to the terms of the service contract, respondents required consumers to obtain prior

¹ The explanation in the service agreement of the depreciation deduction on parts and the limitation on the rental car allowance does not negate the deceptions in the solicitation materials. When the first contact between a seller and a buyer occurs through a deceptive practice, the law may be violated even if the truth is subsequently made known to the purchaser. *Cliffdale Associates*, 103 FTC at 180.

authorization for repairs by calling a toll-free number. (F. 65.) Respondents made it difficult for many of these consumers to get through on the telephone lines to obtain the required authorization. Griffin employees' telephone records and consumer complaints confirm that many consumers could not get through to respondents in order to obtain prior authorization. (F. 66-70.)

The respondents failed to honor the terms of their contracts. They unilaterally canceled consumers' contracts without the express right to do so. Unilateral cancellation is a breach of contract. *Rochdale Village, Inc. v. Public Service Employees Union, Local No. 80*, 605 F.2d 1290, 1297 (2d Cir. 1979), citing *Restatement of Contracts* Sections 317, 318.

Respondents breached their contracts by establishing a condition precedent to the consumer's receipt of payment by requiring consumers to obtain an authorization from the firm prior to the initiation of repairs, and then wrongfully hindering the consumer's ability to perform that condition. Although a condition precedent must be performed before a contract can be enforced, where the promisor prevents the performance by the other party, the condition is negated. *District-Realty Title Ins. Corp. v. Ensmann*, 767 F.2d 1018, 1023 (D.C. Cir. 1985); *Ethyl Corp. v. United Steelworkers of America*, 768 F.2d 180, 185 (7th Cir.), *cert. denied*, 475 U.S. 1010 (1985); *Shear v. National Rifle Ass'n*, 606 F.2d 1251, 1254-55 (D.C. Cir. 1979). Consumers who fail to perform a condition precedent to a contractor's obligation may still recover performance under that contract when their ability to perform has been wrongfully hindered by the conduct of the other party. *Rohde v. Mass. Mutual Life Ins.*, 632 F.2d 667, 670 (6th Cir. 1980). By denying the claims from such consumers, respondents have breached their service contracts and deceived the public.

Respondents' acts were not only deceptive but unfair. To justify a finding of unfairness the injury to consumers: "must be substantial; it must not be outweighed by any countervailing benefits to consumers or competition that the practice produces; and it must be an injury that consumers themselves could not reasonably have avoided." *Orkin Exterminating Co. v. FTC*, 849 F.2d 1354, 1364 (11th Cir. 1988), *cert. denied*, 488 U.S. 1041 (1989).

The substantial consumer injury caused by respondents is "harmful in its net effects." *International Harvester Co.*, 104 FTC 949, 1061 (1984). The respondents' conduct produced no

countervailing benefits to consumers or competition. Rather, the respondents obtained an unfair competitive advantage by making claims of extended service coverage and then not providing such coverage. "The market forces that reward efficient competitors would be impaired if a seller is allowed to gain a competitive edge by unilaterally changing the bargains it has made." *Orkin Exterminating Co.*, 108 FTC 263, 365 (1986).

Respondents' breach of their service contracts was a unilateral act which consumers could not have avoided "through the exercise of consumer choice." *International Harvester*, 104 FTC at 1061. "Consumers may act to avoid injury before it occurs if they have reason to anticipate the impending harm and the means to avoid it, or they may seek to mitigate the damage afterward if they are aware of potential avenues toward that end." *Orkin*, 849 F.2d at 1365, quoting 108 FTC at 366.

In this case, consumers could not act to avoid injury before it occurred because they could not avoid it. While the Vehicle Protection Plan offered a 60 day money-back guarantee to all purchasers, this guarantee was limited only to those consumers who did not submit a claim during the 60 day period. For those consumers who did file a claim during that period, or who owned the plan for more than 60 days, refunds were based on the Rule of 78's.² (F. 51.)

Since all of the unfair practices in question became evident only after a claim was filed, this 60-day refund policy was of limited value to consumers in curing these problems. The only method of mitigating any damage would be to attempt to obtain a refund from the respondents. Most consumers had no available means fully to mitigate their damages once the respondents breached their contracts.³

In summary, respondents solicited business by promising that purchasers of their Vehicle Protection Plan were fully protected against high repair costs due to mechanical breakdown. (F. 45-54),

² The Rule of 78's is a mathematical formula used to refund unearned interest when an installment note is paid before maturity and in which the majority of the interest is assessed at the beginning of the loan. By using this type of refund calculation, the respondents limited the amount of refunds they would have to pay since the majority of the "value" of the VPP was consumed at the beginning of the contract, when the least number of claims would be submitted. (CX 126-1, 2); *Draper v. American Funding Ltd.*, 285 Cal. Rptr. 640, 642 n.2, 234 Cal. App. 3rd 345, 348 n.2 (C.A. 2nd Dist. 1991).

³ When consumers requested and received a refund, those payments were inadequate and delayed. (F. 73.)

including a rental car allowance (F. 48), and the right to file claims as often as necessary (F. 49). These promises were false, misleading, and deceptive because, in fact, respondents applied depreciation deductions to the cost of the parts (F. 55, 56), limited the rental car allowances (F. 57, 58), and canceled the contracts of consumers who submitted too many claims (F. 59-64). Moreover, respondents unfairly broke their promises by these unilateral cancellations and by interfering with the attempts of consumers to obtain prior authorization for repairs. (F. 59-72.)

III. RESPONDENTS' AFFIRMATIVE DEFENSES

Respondents argue that the practices of Griffin Systems, Inc. are outside the jurisdiction of the Commission because they constitute the "business of insurance" and are "regulated by State law" within the meaning of the McCarran-Ferguson Act, 15 U.S.C. 1012. They also argue that Alfonso S. Giordano is not liable under the Federal Trade Commission Act.

A. The "Business of Insurance"

Respondents' service contracts are not "automobile breakdown insurance policies," which are treated as the "business of insurance" by the FTC's regulations under the Magnuson-Moss Warranty Act, 16 CFR 700.11. A mechanical breakdown insurance ("MBI") policy "differs from a service contract in that the former must be approved by a state department of insurance, and is in fact an insurance policy, while the latter is simply a contract between two parties." (F. 9.) Griffin sold service contracts, not MBI policies. (F. 6.)

In MBI policies, applications, rates and other relevant documents are subject to approval by the insurance departments of every state where they are sold. Orrico Dep. at 108; Giordano Dep. at 139. This gives purchasers the protection of the states' insurance regulations. Orrico Dep. at 108. No state regulatory authority approved Griffin's service contracts. (Giordano Dep. at 140.)

In analyzing the practices of a company that issued health insurance policies, the United States Supreme Court has identified three criteria relevant to the determination of whether a practice involves the "business of insurance."

[F]irst, whether the practices has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry. None of these criteria is necessarily determinative in itself

Union Labor Life Ins., Co. v. Pireno, 458 U.S. 119, 129 (1982), citing *Group Life & Health Ins., Co. v. Royal Drug Co.*, 440 U.S. 205 (1979). See also *Metropolitan Life Ins., Co. v. Mass.*, 471 U.S. 724, 743 (1985).

Applying these criteria to the present case, respondents' service contracts only cover the risk of loss from defects within the automobile itself, rather than from damages or losses unrelated to vehicle defects, such as accidents, vandalism, negligence, natural disasters, or other similar occurrences. The risk of loss from product defects is more properly classified as a warranty rather than insurance. And the third criteria is not met in this case, since the practice of selling service contracts is not limited to entities within the insurance industry.⁴

No federal court has ever determined whether automobile service contracts like those sold by the respondents constitute the "business of insurance" within the meaning of the McCarran Ferguson Act. Respondents, in state litigation, claimed that their plan was not insurance and that Griffin was subject to FTC regulatory jurisdiction under Magnuson-Moss. (F. 43.) The Supreme Court of Ohio, the state from which Griffin conducted its business,⁵ accepted this argument. *Griffin Systems, Inc. v. Ohio Dept. of Insurance*, 61 Ohio St. 552 (1991).⁶ The Court distinguished between contracts like respondents' vehicle protection plan which indemnifies against defects in parts of the automobile, and contracts of insurance indemnifying against loss or damage resulting from perils outside of and unrelated to defects in the article covered by the contract. The Court held that respondents' "motor vehicle service agreement which promises to compensate the promisee for repairs necessitated by mechanical breakdown resulting exclusively from failure due to

⁴ This fact alone is not dispositive. *Union Labor Life*, 458 U.S. at 133. (F. 2.)

⁵ (F. 2.)

⁶ The slip opinion is CX 140. But see *Griffin Systems, Inc. v. Ins. Commissioner*, No. 88203036/CL84396 (Baltimore City Cir. Ct. December 20, 1988) (included as CX 138-13); *Griffin Systems, Inc. v. Washburn*, 153 Ill. App. 3d 113, 505 N.E.2d 1121 (Ill. App. Ct. 1987). In both of these cases, the courts determined that Griffin was engaged in the business of insurance in the States of Maryland and Illinois, respectively.

defects in the motor vehicle parts does not constitute a contract 'substantially amounting to insurance'. . ." 575 N.E.2d at 808.⁷

Providers of service contracts cannot avoid FTC jurisdiction over such contracts by relabeling them as mechanical breakdown insurance: An agreement must be actively regulated by state law to be insurance. 42 Fed. Reg. 36111 (July 13, 1977). Griffin only sold its service contracts in states where they were not considered insurance. (F. 42.) Griffin's office was located in Cleveland, Ohio. (F. 2.) Griffin was not licensed as an insurance company. (F. 42.) The states other than Ohio where Griffin sold its service contracts had no greater ability through licensing or direct presence of person or property to enforce their laws. Ohio found that Griffin's service contracts were not insurance. Griffin was not regulated by state law in any state in which it sold service contracts, and it is not exempt from Commission jurisdiction. *Travelers Health Association v. FTC*, 298 F.2d 820, 824-25 (1962).

B. Mr. Giordano's Liability

Respondents argue that Mr. Giordano should not be held liable because he did not own stock in Griffin and did not have ultimate and sole control of the corporation. Mr. Giordano helped in "organizing the company," and setting up "the formal, step by step procedures" for the office, (F. 18), and he was the person in charge of administration of Griffin. *Id.* Mr. Giordano interviewed people for various positions at Griffin and had the authority, as part of a group, to hire employees and set the salary of "anybody who worked for the organization," (F. 29); he supervised various Griffin employees, including the office manager, (F. 20), and he routinely advised Griffin personnel of the policies and practices of the firm, "insofar as the solicitation and mailings." (F. 21.)

Mr. Giordano signed for Griffin bank accounts, including the payroll accounts, (F. 22), he conducted an "auditing function" of claims received in the mail from consumers, (F.30), and he received

⁷ The Court explained the difference between insurance and a warranty by referring to two earlier cases involving guarantees by tire companies. The first, which the Court found to be insurance, guaranteed against defects in the tire, without limit as to time, and also, for a limited time, against loss or damage for cuts, bruises, under-inflation, faulty brakes or other hazards that may render the tire unfit. The second, which the Court found to be a warranty and not insurance, guaranteed only repair or replacement for a limited time for defects in the tire and excluded damages, and did not cover punctures, collisions, fire, etc. 575 N.E.2d at 806.

a daily list of claims to be paid and countersigned the claims checks. (F. 31.) Mr. Giordano determined if Griffin or Great Plains had funds to pay claims. *id.* Mr. Giordano created detailed cost analyses of the Griffin contracts, analyses of the number of plans sold for each make and model of automobile, and analyses of the costs of claims from each make and model of auto. (F. 32.)

Mr. Giordano also was involved in redesigning Griffin solicitation material and contract packages mailed to consumers. (F. 24.) In the solicitation materials, changes were made in the wording and content as well as in the format and design. Mr. Giordano made some of those content changes. *Id.* CX 31 is Mr. Giordano's handwritten copy of a solicitation letter sent to consumers; CX 37 is his handwritten copy of the service contract. (F. 26.)⁸ Mr. Giordano signed cover letters to the solicitation materials and other documents distributed by the respondents. (F. 27.)

Mr. Giordano also assisted other companies in the sale of service contracts by using solicitation materials similar to Griffin's, containing many of the same misrepresentations. USAWA was formed with the intention of selling service contracts in a manner similar to Griffin. (F. 15.) Mr. Giordano was involved in the revision of its solicitation materials, (F. 25.), which were virtually identical to the Griffin solicitations. (F. 15.) Great Plains began to sell MBI policies on its own behalf after Griffin acquired the firm. (F. 9.) Mr. Giordano was an officer and director of the firm. (F. 16.) The Great Plains solicitation materials, like the USAWA materials, were substantially similar to Griffin's. (F. 9.)

Universal Security Insurance Company approached Great Plains to administer its MBI program since Great Plains was familiar with these plans. Mr. Giordano assisted Universal Security in creating their solicitation brochures, which were similar to those used by Great Plains and Griffin. (F. 34.) From 1988 through at least May 1992, Mr. Giordano was vice president and director of ASWA, a Florida company that, like Griffin, sold automobile service contracts through the mail. (F. 35.)

In *Standard Distributors, Inc. v. FTC*, 211 F.2d 7, 13-15 (2nd Cir. 1954), a corporate officer was held liable for the deceptive acts of the corporation's salesmen because he was "in top control of the activities that the Commission finds to have violated the Act"

⁸ Mr. Giordano claims that he did not "draft" these documents, and merely "wrote a great deal of things, simply because I have a very legible handwriting." (F. 26.)

although he had "acted in good faith, with due diligence, to prevent the misrepresentations made by the salesmen." 211 F.2d at 13, 15. Similarly, a corporate officer in *Benrus Watch Co. v. FTC*, 352 F.2d 313 (8th Cir. 1965), *cert. denied*, 384 U.S. 939 (1966), was held liable despite his assertion that he did not formulate, direct or control any of the acts and practices alleged in the complaint, or have knowledge of such acts and practices. 352 F.2d at 324-25. The Eighth Circuit held that he "did not deny that he was an officer of Benrus which, standing alone, justifies the inference that he had something to do with policy." 352 F.2d at 325.

Under the principle of *Standard Distributors and Benrus Watch*, complete ownership and control is not an essential element, and liability could be imposed on Mr. Giordano as an officer. However, Mr. Giordano has participated to a substantial extent in the operations of Griffin, including the deceptive practices charged in the complaint.

Mr. Giordano was one of three persons, including Mr. Orrico and Mr. Boughton, who controlled the operations of Griffin. (F. 16-35.) Mr. Giordano personally reviewed and revised the solicitation materials containing deceptive representations. (F. 24.) He wrote by hand the contract containing provisions that conflict with representations made in the solicitation materials. (F. 26.) He decided when claims would be paid. (F. 31.) He participated in the acts and practices of Griffin, and controlled them to the extent needed to impose individual liability under Section 13(b) of the FTC Act.

Mr. Giordano claims that he only did what he was told. As an officer in control of the unlawful activities, this does not shield him from liability. Mr. Giordano participated in deceptive practices of which he was aware. This is sufficient to impose liability under the FTC Act.

CONCLUSIONS OF LAW

1. The Federal Trade Commission has jurisdiction over the respondents and the promotion, marketing and sale of their vehicle service contracts under Section 5 of the Federal Trade Commission Act.
2. Respondents' use of false, misleading and deceptive representations, and respondents' failure to disclose material facts, as herein found, were likely to mislead reasonable consumers into believing that such representations were true and induced them to

purchase respondents' service contract by reason of those mistaken beliefs.

3. The acts and practices of respondents as herein found were all to the prejudice and injury of the public and constitute unfair and deceptive acts or practices in or affecting commerce in violation of Section 5(a) of the Federal Trade Commission Act.

4. The accompanying order is necessary and appropriate under applicable legal precedent and the facts of this case.

ORDER

DEFINITIONS

For the purposes of this order, the following definitions shall apply:

1. "*Service contract*" shall mean a written agreement to perform, over a fixed period of time or for a specified duration, any service relating to the maintenance or repair (or both) of a vehicle, which contract is sold to consumers for separate consideration than the vehicle in question.

2. "*Covered*" vehicle, repair or part shall mean any vehicle, repair or part which is subject to the terms of a service contract.

I.

It is ordered, That respondents Griffin Systems, Inc., a corporation, its successors and assigns, its officers, and Gennaro J. Orrico, Robert W. Boughton, and Alfonso S. Giordano, individually and as officers of said corporation, and respondents' agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the promotion, advertising, offering for sale, sale, distribution or administration of any service contract in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, do forthwith cease and desist from orally, visually, in writing, or in any other way misrepresenting, directly or by implication, any material term or condition of such service contract, including, but not limited to, the following:

A. That any purchaser of such service contract will be paid the full cost of repairing or replacing any covered part of a covered vehicle;

B. That such service contract will fully protect the purchaser against repair costs;

C. That any purchaser of such service contract will receive a rental car allowance if, due to a mechanical breakdown of a covered part, a covered vehicle has to be kept overnight at a repair facility; and

D. That any purchaser of such service contract may submit, as often as necessary, an unlimited number of claims pursuant to those contracts.

II.

It is further ordered, That respondents Griffin Systems, Inc., a corporation, its successors and assigns, its officers, and Gennaro J. Orrico, Robert W. Boughton, and Alfonso S. Giordano, individually and as officers of said corporation, and respondents' agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the promotion, advertising, offering for sale, sale, distribution or administration of any service contract in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, do forthwith cease and desist from failing to disclose clearly and conspicuously, in the first written communication with, or solicitation of, a prospective purchaser of a service contract, the following material terms and conditions of such service contract:

A. Whether the purchaser of the service contract will be paid the full cost of repairing or replacing a covered part of a covered vehicle and, if not, the depreciation factor or other device that will be used in determining the amount that the purchaser of the service contract will receive for such a repair or replacement;

B. Whether the purchaser of the service contract will be paid a rental car allowance if a covered vehicle is subject to repairs and, if so, the precise manner in which said rental car allowance is calculated; and

C. The number and/or total dollar value of claims that may be submitted by the purchaser of the service contract.

III.

It is further ordered, That respondents Griffin Systems, Inc., a corporation, its successors and assigns, its officers, and Gennaro J. Orrico, Robert W. Boughton, and Alfonso S. Giordano, individually and as officers of said corporation, and respondents' agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the promotion, advertising, offering for sale, sale, distribution or administration of any service contract in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, do forthwith cease and desist from failing to provide to each prospective purchaser of such service contract, prior to the prospective purchaser making any payment, agreeing to make any payment or signing any document for the purchase of such service contract, the full text of the contract along with a clear and conspicuous statement that the prospective purchaser is under no obligation to purchase the service contract unless the prospective purchaser agrees to the terms contained therein.

IV.

It is further ordered, That respondents Griffin Systems, Inc., a corporation, its successors and assigns, its officers, and Gennaro J. Orrico, Robert W. Boughton, and Alfonso S. Giordano, individually and as officers of said corporation, and respondents' agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the promotion, advertising, offering for sale, sale, distribution or administration of any service contract in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, do forthwith cease and desist from:

A. Unilaterally canceling such service contract without the express right to do so clearly and conspicuously disclosed to a potential purchaser of the service contract prior to the sale of such a contract;

B. Preventing or substantially hindering the purchaser of such service contract from performing any condition precedent, established in the service contract, for the purchaser's obtaining any

benefit provided for under the terms of the service contract, including, but not limited to, the obtaining of prior authorization for such repair or replacement;

C. Denying the valid claims of a purchaser of such service contract when such purchaser was unable, due to the acts or practices of the respondents, to perform any condition precedent; and

D. Refusing to comply promptly with any term or condition of any such service contract.

V.

It is further ordered, That respondents, their successors and assigns shall distribute a copy of this order to each present and future officer, agent, representative and employee having sales, advertising, policy making or administration responsibilities for any service contract, and shall secure from each such individual a signed statement acknowledging that he or she has received and read this order.

VI.

It is further ordered, That for at least three (3) years following the date of service of this order, respondents, their successors and assigns shall maintain and upon request make available to the Federal Trade Commission for inspection and copying:

A. A sample copy of every service contract offered for sale, sold or administered by the respondents, their successors and assigns;

B. A sample copy of every promotional material relating to the offering for sale, sale or administration of service contracts disseminated by the respondents, their successors and assigns;

C. A complete contract history for each purchaser of a service contract, including, but not limited to, the identity of the type of service contract purchased by the consumer, a record of any and all claims submitted, the amount of those claims, the date when those claims were first submitted, the response to those claims, the amount paid on each claim, the amount of any rental car allowance that was paid, and the date when each payment was sent to the claimant;

D. A record of every service contract canceled by the respondents, their successors and assigns, the reason for the

cancellation, and the amount refunded to the purchaser of the service contract because of the cancellation;

E. A record of the number of telephone lines used by respondents, their successors and assigns to answer calls regarding claims for repairs placed pursuant to service contracts, the number of employees present on a daily basis who are responsible for answering telephone calls from claimants, the number of employees present on a daily basis who are responsible for authorizing the repairs requested by the claimants, and the number of employees present on a daily basis authorized to process and pay claims to claimants; and

F. The originals of the signed statements required by Part V of this order.

VII.

It is further ordered, That the individual respondents named herein, for a period of 10 years from the date of service of this order, shall promptly notify the Commission of any discontinuance of their present business or employment and of their affiliation with any new business or employment, each such notice to include the respondent's new business address and a statement of the nature of the business or employment in which the respondent is newly engaged as well as a description of the respondent's duties and responsibilities in connection with that business or employment.

VIII.

It is further ordered, That the respondents, their successors and assigns, shall notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondent such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation which may affect compliance obligations arising out of this order.

IX.

It was further ordered, That the respondents shall, within sixty (60) days after service upon them of this order, file with the

Commission a report, in writing, setting forth in detail the manner and form in which they have complied with this order.

X.

It is further ordered, That to the extent than any provision of this order is predicated on the commission of acts and practices that are “regulated by State law” as the “business of insurance,” as specified in 15 U.S.C. 1012(b), and case law thereunder, that provision shall not apply in those States in which said acts or practices are so regulated.

OPINION OF THE COMMISSION

BY AZCUENAGA, *Commissioner*:

Griffin Systems, Inc. (“Griffin”), Gennaro J. Orrico, and Alfonso S. Giordano (collectively, “respondents”) have appealed Administrative Law Judge (“ALJ”) James P. Timony’s Initial Decision granting complaint counsel’s motion for summary decision.¹ The ALJ concluded that respondents engaged in unfair and deceptive acts and practices in connection with Griffin’s automobile service contracts in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45 (1993). We affirm.

On October 8, 1991, the Commission issued a complaint against the respondents alleging that they had violated Section 5 of the FTC Act. The complaint alleged that the respondents made deceptive representations to persuade consumers to purchase their automobile service contracts. The complaint also alleged that the respondents had engaged in the unfair practice of refusing to reimburse valid claims under their automobile service automobile contracts. After pretrial discovery, complaint counsel and the respondents made cross-motions for summary decision based on stipulated material facts. On June 30, 1993, the ALJ issued an order, which constitutes the Initial Decision, granting complaint counsel’s motion for summary decision.

The respondents raise two arguments on appeal. The respondents argue that Griffin’s activities are regulated as the business of

¹ Robert W. Boughton was also named in the complaint. On June 30, 1993, the ALJ granted default judgment against Mr. Boughton. Mr. Boughton has not appealed.

insurance under state law, and therefore its activities are exempt from Commission jurisdiction under the McCarran Ferguson Act. 15 U.S.C. 1011 *et seq.* The respondents also contend that it was inappropriate to hold Mr. Giordano individually liable.

FINDINGS OF FACT

On May 10, 1993, the parties submitted stipulated facts in connection with their notions for a summary decision. The ALJ adopted these stipulated facts as his findings of fact in the Initial Decision, and neither party challenges the findings on appeal. We adopt the ALJ's findings of fact.²

I. The Respondents

Griffin Systems, Inc. ("Griffin"), is an Ohio corporation with its principal place of business in Cleveland.³ From 1984 to 1988, Griffin marketed and sold a service contract to vehicle buyers.⁴ Griffin administered and paid claims submitted under its service contracts from 1984 to 1991.⁵ Griffin continues to exist in corporate form, but it has no employees.⁶

In December 1986, Griffin purchased Great Plains Insurance Company ("Great Plains"), which was headquartered in Nebraska.⁷ After being purchased by Griffin, Great Plains sold mechanical breakdown insurance policies, and it used solicitation materials that were similar to Griffin's solicitation materials.⁸

Gennaro J. Orrico is the sole owner and president of Griffin.⁹ Mr. Orrico developed Griffin's marketing strategy and was responsible

² All references to findings of fact ("FF") in this opinion are to the findings of fact contained in the Initial Decision.

³ FF 2.

⁴ FF 3.

⁵ FF 4.

⁶ FF 10.

⁷ FF 8.

⁸ FF 9.

⁹ FF 11 and 12.

for preparing and disseminating Griffin's solicitation materials.¹⁰ He also was responsible for establishing Griffin's operating procedures and standards, including the standards and procedures used to evaluate submitted claims, to cancel contracts, and to make refunds.¹¹

Alfonso S. Giordano was a director, vice president, and treasurer of Griffin from 1985 to 1987.¹² During this period of time, Mr. Giordano worked regularly at Griffin's home office in Cleveland.¹³ Mr. Giordano administered the day-to-day affairs of that office. His duties included, among other things, hiring and supervising employees, advising employees about solicitation policies and practices, redesigning solicitation materials, and signing solicitation materials sent to prospective customers.¹⁴

In 1987, Mr. Giordano left Griffin to become the vice president and a director of Great Plains, an insurance company Griffin had purchased.¹⁵ Mr. Giordano remained with Great Plains until 1991, when he resigned to become the president of Metro General Insurance Agency, an insurance company related to Great Plains.¹⁶

II. The Business Practices in Question

Griffin purchased lists of new car buyers from state departments of motor vehicles, and then sent those buyers promotional materials about Griffin's service contract.¹⁷ Griffin mailed its promotional materials to prospective customers in 25 states. Griffin did not mail its promotional materials to prospective customers in other states either because the state would not sell lists of new car purchasers or because state insurance laws permitted only licensed insurance companies to sell the type of service contract Griffin sold.¹⁸

¹⁰ FF 13 and 14.

¹¹ FF 13.

¹² FF 13.

¹³ FF 18.

¹⁴ FF 18, 20, 21, 24, 26, and 27.

¹⁵ FF 16.

¹⁶ *Id.*

¹⁷ FF 39.

¹⁸ FF 42.

The promotional materials Griffin sent to prospective customers contained a number of representations about the service contract. These materials represented that Griffin would pay for the cost of repairing or replacing certain parts of the major mechanical areas of a vehicle, including over 100 automobile components.¹⁹ The materials also claimed that Griffin would pay a car rental allowance of up to \$20 per day if a customers vehicle had to be kept overnight at the shop to repair a covered part.²⁰ They also represented that there was no limit on the number of claims that customers could submit to Griffin.²¹

The promotional materials contained a registration form that prospective customers were instructed to submit along with their payment to apply for the Griffin service contract.²² Once Griffin had received the registration form and payment, Griffin would send a copy of its service agreement to the customer.²³ The service agreement contained the full terms and conditions of the Griffin service contract.

The service agreement contained significant restrictions and limitations that were inconsistent with the representations Griffin made in its promotional materials. For example, even though Griffin had simply claimed in its promotional materials that it would repair or replace vehicle parts, the service agreement revealed that Griffin would apply a depreciation deduction of up to 50% of the value of all parts installed in a vehicle.²⁴ Another example is that although Griffin's promotional materials represented that its customers would be paid up to \$20 per day as a car rental allowance if a customers automobile was in the shop overnight for the repair or replacement of a covered part, the service agreement imposed the additional condition that the total time to repair or replace a covered part was eight hours or more.²⁵ If a customer's car was in the shop overnight, but the total time to repair or replace a covered part was less than eight hours, Griffin did not pay for car rental.

¹⁹ FF 46.

²⁰ FF 47.

²¹ FF 49.

²² FF 52.

²³ FF 53.

²⁴ FF 55 and 56.

²⁵ FF 57.

Griffin's performance under its service contract also was inconsistent with the representations in its promotional materials. Griffin's promotional materials represented that there was no limit to the number of claims that a customer could submit. Griffin, however, denied claims simply because a customer had submitted too many claims.²⁶

In addition to making these misrepresentations to induce sales of its contracts, Griffin engaged in other practices that harmed consumers. Griffin had no right under its contract to cancel service contracts.²⁷ Nevertheless, Griffin canceled almost 14,000 contracts, including canceling the contracts of customers who submitted too many claims, contrary to the representations contained in Griffin's promotional materials.²⁸

Griffin also required its customers to obtain prior authorization for repairs by calling a toll-free number.²⁹ Former Griffin employees indicated that in many instances consumers found it difficult to get through to Griffin on the telephone; in fact, telephone records indicate that in many months up to tens of thousands of telephone calls to Griffin's toll-free number were not answered.³⁰ Although the respondents knew that many consumers³¹ were unable to obtain prior authorization for repairs because of problems with reaching Griffin through its toll-free number,³² they nevertheless denied repair claims for failure to obtain that authorization.³³

The respondents have stipulated that they engaged in these acts and practices. The ALJ concluded that the respondents had made misrepresentations about the amount of payment to be made for replacement of a covered part, the conditions imposed on obtaining rental car reimbursement, and the number of claims that could be submitted under the Griffin vehicle service contract.³⁴ The ALJ also concluded that the respondents engaged in unfair practices by

²⁶ FF 50.

²⁷ FF 59.

²⁸ FF 60 and 64.

²⁹ FF 65.

³⁰ FF 66 and 67.

³¹ The magnitude of this problem is readily apparent in that the Commission received 710 letters from consumers complaining that they were unable to reach Griffin via telephone for prior authorization. FF 68.

³² FF 70.

³³ FF 71 and 72.

³⁴ See Initial Decision at 13-14.

breaching their service contracts without any right to do so and by interfering with the attempts of consumers to obtain the prior authorization required under their contracts for repairs.³⁵

On appeal, the respondents do not challenge the ALJ's determination that Griffin engaged in these unfair and deceptive acts and practices in violation of Section 5. Instead, they argue that their activities are exempt from Commission jurisdiction under the McCarran Ferguson Act and that Mr. Giordano should not be held individually liable.

CONCLUSIONS OF LAW

I. McCarran Ferguson Act

The respondents argued in their motion for summary decision that their activities are exempt from Commission jurisdiction under the McCarran Ferguson Act, 15 U.S.C. 1011 *et seq.* The ALJ rejected this argument, concluding that the Commission had jurisdiction because Griffin's activities are not regulated as the business of insurance under state law. The respondents challenge this conclusion on appeal.

Before addressing the specific arguments raised in this appeal, it is instructive briefly to review the genesis of the McCarran Ferguson Act. The states traditionally have regulated the business of insurance, and the constitutionality of state insurance regulation was addressed in the early case of *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1869). In that case, an insurance agent was convicted under a Virginia statute for selling an insurance policy without a license. The insurance agent appealed his conviction, arguing that the Virginia statute was invalid because he was selling policies in Virginia issued by a New York fire insurance company, a form of interstate transaction that only the federal government could regulate under the Commerce Clause. The Supreme Court rejected the argument and upheld the Virginia statute, stating that issuing insurance policies was not a transaction of "commerce," even though the parties to a contract may be located in different states. *Id.* at 183. The Court also said

³⁵ See Initial Decision at 15-17. The ALJ apparently determined that these acts of breaching service contracts and hindering attempts to obtain prior authorization were deceptive as well as unfair. The Commission does not reach the questions of whether these acts were deceptive.

that insurance contracts are "local transactions, and are governed by the local law." *Id.*

The states developed extensive schemes of insurance regulation in response to the decision in *Paul* and similar cases. In 1944, however, the specter of federal insurance regulation displacing state insurance regulation was created by *United States v. Southeastern Underwriters Ass'n*, 322 U.S. 533 (1944). In *Southeastern Underwriters Ass'n*, an association of fire insurance companies allegedly fixed insurance premiums and monopolized fire insurance in certain states in violation of the Sherman Act, 15 U.S.C. 1 and 2. The association argued that the federal government did not have the authority under the Commerce Clause to apply the Sherman Act to its interstate activities. The Supreme Court rejected the argument, holding that Congress had the authority under the Commerce Clause to regulate interstate insurance activities as a form of "commerce." *Id.* at 553. The Court also held that the Sherman Act was applicable to the interstate insurance business.

Congress acted quickly in response to *Southeastern Underwriters Ass'n* to prevent federal regulation from precluding the states from regulating insurance. In 1945, Congress enacted the McCarran Ferguson Act to "turn back the clock" on insurance regulation. *SEC v. National Securities, Inc.*, 393 U.S. 453, 459 (1969); *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 429 (1946). Specifically, Congress enacted the McCarran Ferguson Act because "the continued regulation * * * by the several States of the business of insurance is in the public interest." 15 U.S.C. 1011.

In addition to other restrictions on the use of federal authority relating to insurance, the McCarran Ferguson Act expressly limits the Commission's jurisdiction over unfair or deceptive acts and practices. The McCarran Ferguson Act provides in relevant part:

[T]he Federal Trade Commission Act * * * shall be applicable to the business of insurance to the extent that such business is not regulated by state law.

15 U.S.C. 1012(b). Under this section of the law, the Commission's jurisdiction does not extend to those activities that are: (1) the "business of insurance"; and (2) "regulated by state law."³⁶ It follows

³⁶ Courts have treated this section of the McCarran Ferguson Act as requiring separate showings concerning "business of insurance" and "regulated by state law." See *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 134 n.9 (1982); *McIlhenny v. American Title Ins. Co.*, 418 F. Supp. 364, 367 (E.D. Pa. 1976).

that the Commission does have jurisdiction if the conduct in question either is not the "business of insurance" or is not "regulated by state law."

A. Business of Insurance

The respondents contend that their activities were the "business of insurance" for purposes of the McCarran Ferguson Act. The ALJ rejected this argument based on an application of the three part test for determining whether activities are the business of insurance in *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982).³⁷ On appeal, both respondents³⁸ and complaint counsel contend that an application of the Pireno factors supports their argument on this issue.

As an initial matter, before consideration of the Pireno factors, the Griffin vehicle service contracts must be "insurance" in order for the respondents' activities in connection with those contracts to be the "business of insurances." The question of whether the Griffin vehicle service contract is "insurance" for purposes of the McCarran Ferguson Act is a federal question. *SEC. v. Variable Annuity Co.*, 359 U.S. 65, 69 (1959); *Fry v. John Hancock Mutual Life Ins.*, 355 F. Supp., 1151 (N.D. Tex. 1973). No federal court, however, has addressed whether vehicle service contracts are "insurance" for purposes of the McCarran Ferguson Act. In addition, there is no uniformity in state court rulings on the issue of whether vehicle service contracts are "insurance" for other purposes,³⁹ as evidenced

³⁷ The three factors are: (1) whether the practice has the effect of transferring or spreading a policyholder's risk; (2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and (3) whether the practice is limited to entities within the insurance industry. *Union Labor Life Ins. Co.* 458 U.S. at 119.

³⁸ The respondents also argue that the Commission's interpretation in 16 CFR 700.11 (Interpretations of the Magnuson-Moss Warranty Act) acknowledges that contracts like the Griffin service contract are the "business of insurance." In 16 CFR 700.11, the Commission stated that the Magnuson-Moss Warranty Act applied to automobile breakdown insurance policies "only to the extent that they are not regulated in a particular state as the business of insurance." This phrase simply incorporates the requirements of the McCarran Ferguson Act. The respondent's argument based on 16 CFR 700.11 is unpersuasive because it assumes that the Griffin service contract is a form of "insurance," the very issue that is before us for decision. We also note that the respondents have stipulated that their service contract is not a mechanical breakdown insurance policy; it is simply a contract. FF 3 and 9.

³⁹ State court rulings may be instructive (because the concept of "insurance" developed under state law), but are not dispositive because this is a federal question. *Variable Annuity Co.*, 359 U.S. at 69; see *Dana Corp. v. Blue Cross & Blue Shield*, 900 F.2d 882, 888 (6th Cir. 1990).

by the split among the three state courts⁴⁰ that have addressed whether Griffin's contracts can be regulated under state insurance statutes.

We do not reach the questions of whether the Griffin service contract is "insurance" or whether the respondents' activities in connection with that contract were the "business of insurance." As discussed above, the respondents must show that their activities are both the "business of insurance" and "state regulated" to be exempt from Commission jurisdiction. Because we conclude that the respondents' activities are not state regulated, it therefore is not necessary for us to reach the question of whether they constitute the "business of insurance."⁴¹

B. State Regulation

The respondents' activities also must be "state regulated" in order to be exempt from Commission jurisdiction under the McCarran Ferguson Act. The Supreme Court first addressed the issue under the McCarran Ferguson Act of whether activities were state regulated in *FTC v. National Casualty Co.*, 357 U.S. 560, 564 (1958). In that case, the respondent insurance companies were licensed to sell insurance policies in many states. The insurance companies sent prepared advertising materials to their local agents who distributed them, as well as otherwise soliciting business, for the insurance companies.

The Commission issued a cease and desist order against the insurance companies requiring that they discontinue advertising practices that the Commission had concluded were deceptive. The Commission's order was intended to apply in all states, including those states with insurance statutes prohibiting deceptive insurance practices. The Court of Appeals set aside the order on the ground

⁴⁰ Griffin is permitted to sell its service contracts in Ohio because the Ohio Supreme Court has held that its service contract is not a "contract substantially amounting to insurance." *Griffin Systems, Inc. v. Ohio Dept. of Ins.*, 61 Ohio St. 3d 552, 575 N.E.2d 803 (Ohio 1991). In contrast, Griffin discontinued selling its service contract in other states when those states determined that its service contract was "insurance." See, e.g., *Griffin Systems, Inc. v. Ins. Comm'r*, No. 88203036/CL84396 (Baltimore City Cir. Ct. Dec. 20, 1988); *Griffin Systems, Inc. v. Washburn*, 153 Ill. App. 3d 113, 505 N.E. 2d 1121 (Ill. App. 1st Dist. 1987); cf. FF 41 and 42.

⁴¹ We note, however, that the respondents have argued that their activities are the "business of insurance," even though they have stipulated that Griffin was not an insurance company, see FF 42, and that their vehicle service contract is "simply a contract," unlike a mechanical breakdown insurance policy which is an "insurance policy." FF 9.

that the insurance companies were state regulated to the extent that they operated in those states with insurance statutes prohibiting deceptive insurance practices.

In its appeal, the Commission argued that, because of constitutional restrictions on the power of the states to regulate interstate insurance activity, the McCarran Ferguson Act should be construed to authorize federal regulation as a supplement to state regulation in cases of interstate insurance activity. *Id.* at 563. The Supreme Court concluded that it need not reach this issue because:

[r]espondents' advertising programs require distribution by their local agents, and there is no question but that the States possess ample means to regulate this advertising within their respective boundaries.

Id. at 564. The Court therefore held that the Commission order was inapplicable in those states with insurance statutes prohibiting deceptive insurance practices.

The scope of the state involvement necessary for state regulation to exist under the McCarran Ferguson Act was addressed again in *FTC v. Travelers Health Ass'n*, 362 U.S. 293 (1960). In that case, the Commission had issued a cease and desist order, against a Nebraska insurance company prohibiting it from making deceptive representations in solicitation materials mailed nationwide. The Court of Appeals for the Eighth Circuit set aside the order on the ground that the insurance company's activities were state regulated because a Nebraska statute prohibited the insurance company from engaging in unfair or deceptive practices in Nebraska or "any other state."

On appeal, the Supreme Court refused to construe as state regulation under the McCarran Ferguson Act extraterritorial regulation of an insurance company by a single state. The Court stated that Congress "viewed state regulation of insurance solely in terms of regulation by the law of the state where occurred the activity sought to be regulated." 362 U.S. at 300. The Court also said that permitting the law of one state to be used to protect the citizens of every other state was inconsistent with the purpose of the McCarran Ferguson Act in preserving state regulation because "the [s]tates were in close proximity to the people affected by the insurance business." *Id.* at 302. The Court therefore concluded:

[W]e cannot believe that this kind of law of a single state takes from the residents of every other state the protections of the Federal Trade Commission Act. In our

opinion, the state regulation which Congress provided should operate to displace this federal law means regulation by the state in which the deception is practiced and has its impact.

362 U.S. at 298-99. The Court vacated the decision of the Eighth Circuit and remanded for further proceedings.

On remand, the Eighth Circuit stated that an insurance company is only state regulated where the state exercises its sovereignty to enact legislative provisions that the state is capable of enforcing through its own powers. *Travelers Health Ass'n v. FTC*, 298 F.2d 820, 823 (8th Cir. 1962). The court also said that an insurance company is not state regulated where one state would have to rely for enforcement on the "provisions, processes, and instrumentalities of another state." *Id.*

The court then applied this distinction to the operations of the Nebraska insurance company. It held that the insurance company was subject to state regulation in Nebraska and Virginia because it was licensed and had representatives in those states. *Id.* at 823. The court also held that:

In the [other 48 states], the insurance company is without any license, agency relationships, commercial accounts, or other direct presence of person or property, upon which the state can auxiliary lay hands in enforcement compulsion. If its orders, decrees, and judgments are to be enforceable, the state must seek the aid of the statutes, instrumentalities and processes of another state. In its need to rely upon such outside means for effecting compulsion, we think that it must be held, as suggested above, that the state cannot conceptually in the situation be declared to possess ample means to regulate this advertising on the basis of its own law.

Id. at 824-25. The court therefore upheld the Commission's order, except as it applied to the Nebraska and Virginia activities of the insurance company.

The opinions in *National Casualty* and the *Travelers Health* cases establish the framework for analyzing whether activities are state regulated. *National Casualty* concludes that state regulation exists where a state can enforce a state insurance regulatory scheme against the agents of a company that are present in the state. The opinions in the *Travelers Health* cases clarify that the state regulation must be based on the law of the state in which the activities occur and that the regulating state cannot rely on the laws of another state for the enforcement of its regulatory scheme.

Applying these principles, we conclude that Griffin is not regulated by its home state of Ohio. Griffin has representatives and offices in Ohio. Because it maintains a presence in that state, Ohio is capable of regulating Griffin under its insurance statutes. The Ohio Supreme Court, however, has held that its insurance statutes do not apply to Griffin's activities because Griffin does not sell contracts substantially amounting to insurance. *Griffin Systems, Inc. v. Ohio Dept. of Ins.*, 575 N.E. 2d at 808. In view of the decision of the Ohio Supreme Court, we conclude that the respondents' activities in Ohio are not "state regulated" for purposes of the McCarran Ferguson Act.

We also conclude that Griffin is not state regulated for purposes of the McCarran Ferguson Act in any other state. Griffin is not licensed as an insurance company in any state, and it does not have representatives or property in any state other than Ohio. The only way that these other states can regulate Griffin is to seek Ohio's assistance in the extraterritorial application of their laws. Because these states must rely on Ohio's assistance to enforce their own statutes, Griffin is not state regulated in these other states.⁴²

Finally, we note that subjecting the respondents' activities to Commission jurisdiction is consistent with the purposes of the McCarran Ferguson Act. While the purpose of that Act is to protect state schemes for regulating the business of insurance, the respondents are not actually subject to any state regulatory scheme because Griffin is not licensed as an insurance company in any state and because Griffin discontinued selling contracts in any state that has decided its contracts could be regulated under state law as insurance. If the Commission does not prevent the respondents from continuing their unfair and deceptive activities, a regulatory gap would allow the respondents to escape both federal and state law enforcement. This is a result that we believe the Congress did not intend.

We conclude that the respondents are not exempt from Commission jurisdiction under the McCarran Ferguson Act.

⁴² The respondents have argued that it is inappropriate for the Commission to consider the "effectiveness" of state regulation. State regulatory activity need not be effective to constitute state regulation for purposes of the McCarran Ferguson Act. *See, e.g., Seasongood v. K & K Insurance Agency*, 548 F.2d 729, 734 (8th Cir. 1977); *Ohio AFL-CIO v. Insurance Rating Board*, 451 F.2d 1178, 1184 (6th Cir. 1971), *cert. denied*, 409 U.S. 917 (1972). We have concluded that Griffin's activities are not state regulated because no state (other than Ohio) could conduct any enforcement activity at all against the respondents under its own laws.

II. Individual Liability

The complaint named Mr. Giordano individually for the actions of Griffin. The ALJ determined that the cease and desist order against Griffin also should be entered against Mr. Giordano because of his position and role in Griffin's affairs. The respondents appeal, generally arguing that Mr. Giordano played such a minor role in Griffin's affairs that this imposition of individual liability for the actions of Griffin was inappropriate.

It is well-established that an individual can be held liable for a corporation's violations of Section 5 if the individual "formulates, controls or directs corporate policy." *Standard Educators, Inc. v. FTC*, 475 F.2d 401, 403 (D.C. Cir.), *cert. denied*, 414 U.S. 828 (1973); *Benrus Watch Co. v. FTC*, 352 F.2d 313 (8th Cir. 1965), *cert. denied*, 384 U.S. 939 (1966); *Standard Distributors v. FTC*, 211 F.2d 7 (2d Cir. 1954). Mr. Giordano was the executive vice president and treasurer of Griffin, a closely held corporation.⁴³ He shared authority with the other individual respondents to set prices for Griffin service contracts.⁴⁴ Mr. Giordano shared authority with the other individual respondents for hiring Griffin employees, and he supervised and evaluated employees.⁴⁵ He was actively involved in Griffin's solicitation of customers because he redesigned Griffin's solicitation materials and provided advice to sales personnel about solicitations.⁴⁶ Finally, Mr. Giordano was given the authority to sign checks drawn on Griffin's bank accounts.⁴⁷ We conclude that these undisputed facts amply demonstrate that Mr. Giordano was part of the inner circle that formulated, controlled, and directed Griffin, and therefore it is appropriate to place him under order.

In support of their argument that it is inappropriate to hold Mr. Giordano individually liable for the actions of Griffin, the respondents emphasize that Mr. Giordano was not in sole control of Griffin. We are not aware of any authority indicating that sole control of a company is necessary to establish individual liability.

⁴³ FF 11, 12, and 16.

⁴⁴ FF 28.

⁴⁵ FF 20 and 29.

⁴⁶ FF 21 and 24.

⁴⁷ FF 22, 30, and 31.

Indeed, there have been a number of cases in which more than one individual has been held to formulate, direct, and control the practices of a single corporation. See, e.g., *FTC v. Standard Education Society*, 302 U.S. 112, 119-20 (1937); *Benrus Watch Co.*, 352 F.2d at 324-25.

Griffin also argues that Mr. Giordano should not be held liable for the actions of Griffin because he was not its owner. An individual's ownership interest in a corporation is one factor that the Commission may consider in determining whether an individual should be held liable, but it is only one of the factors to be considered.⁴⁸ The stipulated facts discussed above provide a more than sufficient basis for holding Mr. Giordano individually liable for Griffin's actions, notwithstanding the fact that he is not an owner of Griffin.

In addition, the ALJ concluded that Mr. Giordano should be held liable for his own actions in violation of Section 5. Mr. Giordano participated in the preparation of the Griffin solicitation materials that contained misrepresentations, including making changes in the content of those materials.⁴⁹ He also signed cover letters sent to prospective customers along with these same deceptive promotional materials.⁵⁰ Accordingly, we conclude that Mr. Giordano should be held individually liable for his own actions in developing and distributing deceptive materials to consumers.

Our conclusion that Mr. Giordano should be held individually liable is reenforced by our concern about possible evasion of the order. As we have noted,

[w]here the corporate respondent is small and under the control of one or a few individuals, it becomes more likely that prohibited activities will recur if an order enters only against the corporation.

Virginia Mortgage Exchange, Inc., 87 FTC 182, 203 (1976). Mr. Giordano was one of the members of the inner circle that controlled the actions of Griffin, a closely held corporation. Moreover, Mr. Giordano has adapted Griffin's deceptive solicitation methods to other companies selling products similar to the Griffin service

⁴⁸ *Standard Education Society*, 302 U.S. at 120; *Standard Educators, Inc.*, 475 F.2d at 403; see also FTC Oper. Man. ch. 4.5.4.

⁴⁹ FF 24 and 26.

⁵⁰ FF 27.

contract.⁵¹ In these circumstances, we believe that it is necessary to name Mr. Giordano individually to prevent him from repeating the unlawful practices of Griffin while employed by another company.

CONCLUSION

The Commission adopts the factual findings contained in the ALJ's Initial Decision. On the basis of these facts and for the reasons articulated in this opinion, the Commission concludes that the respondents have engaged in unfair and deceptive acts and practices in violation of Section 5 of the Federal Trade Commission Act. The Commission also concludes that the activities of the respondents are not exempt from Commission jurisdiction under the McCarran Ferguson Act and that Alfonso Giordano is individually liable. The Commission issues the order contained in the Initial Decision.

CONCURRING STATEMENT OF COMMISSIONER DEBORAH K. OWEN

Under the McCarran Ferguson Act, the Federal Trade Commission Act is "applicable to (1) the business of insurance (2) to the extent that such business is not regulated by state law." 15 U.S.C. 1012(b) (clause numbers and emphasis supplied). While I concur in the finding of the Commission that Griffin's unfair and deceptive practices were not regulated by state law,¹ I would have gone further than the majority in analyzing the applicability of the McCarran Ferguson Act, 15 U.S.C. 1011 *et seq.* Specifically, I would have squarely addressed the question of whether Griffin's sale of its service contracts constituted the "business of insurance."

Analytically, the first and second prongs of Section 1012(b) are clearly interdependent; the reference in the second prong to "such business" refers back to the "business of insurance" in the first clause. Logically, then, it would seem that one could not come to a conclusion as to whether all of the elements of the second prong were met without determining whether Griffin's activities constitute "such business," *i.e.*, the "business of insurance." Thus, in my view, under the circumstances presented here, a finding on both elements of the test is mandated by the plain meaning of the statute.

⁵¹ FF 9 and 34.

¹ I also concur in finding individual liability on the part of Mr. Giordano.

The failure to address the issue is compounded by certain practical complications. I believe that the ALJ may very well have erred in finding that Griffin's activities were not the business of insurance, based on the factors mentioned by the Supreme Court in *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119 (1982). First, the contracts spread the contract holder's risk of loss. The fact that not every risk was covered does not appear to be relevant under Supreme Court precedent; insurance policies traditionally fail to cover many kinds of risks. Second, the practices at issue are an integral part of the policy relationship between the insurer (Griffin) and the insured (its clients); they are not incidental to other aspects of the insurer's business. Finally, as to the third test, while the sale of these auto service contracts is not necessarily limited to entities in the insurance industry in all states, the Supreme Court has indicated that each factor listed in *Pireno* is not, in and of itself, determinative. *Id.* at 129. In this instance, I believe that the third consideration is insufficient to outweigh the other two, more predominant, factors.

Although the Commission's opinion should not be read to condone the ALJ's conclusion on this question, the fact remains that by not opining, the Commission leaves the question open to future debate -- a debate that may be unduly influenced by the potentially erroneous conclusion of the ALJ, as may the results of future litigation. Whether the Commission majority agrees or disagrees with the ALJ will remain in doubt, and their silence perpetuates the lack of clear guidance in this area.

In sum, I concur in the well-reasoned majority opinion on the points that it reaches. I simply wish that it had addressed all of the issues before the Commission on appeal.

CONCURRING STATEMENT OF COMMISSIONER ROSCOE B. STAREK, III

I concur fully in the Commission's Opinion, Decision, and Order in this matter. I write only to emphasize that the Commission can dispose of the application of the McCarran Ferguson Act, 15 U.S.C. 1011 *et seq.*, by finding that the conduct in question is not regulated by state law. Determinations under the two prongs of 15 U.S.C.

1012(b) are not logically interdependent.¹ Instead, each is a necessary condition to finding that the Commission lacks jurisdiction by application of the McCarran Ferguson Act.² If no aspect of the conduct at issue is regulated by a state, then the jurisdictional prohibition of the McCarran Ferguson Act cannot apply, regardless of whether the conduct can be defined as "the business of insurance." In this matter, the Commission concludes that no aspect of the respondent's business conduct here at issue is regulated by a state. Thus, it is unnecessary to reach the "business of insurance" prong in order to conclude that the Commission has jurisdiction.

FINAL ORDER

This matter having been heard by the Commission on the appeal of respondents Griffin Systems, Inc., Gennaro J. Orrico, and Alfonso S. Giordano from the initial decision and on briefs and oral arguments in support of and in opposition to the appeal, for the reasons stated in the accompanying Opinion, the Commission has denied the appeal of respondents.

It is ordered, That the initial decision of the administrative law judge be adopted as the findings of fact and conclusions of law of the Commission except where it is inconsistent with the accompanying opinion.

It is further ordered, That the order contained in said initial decision be, and it hereby is, adopted as the order of the Commission.

¹ A logical equivalent agent of Section 1012 (b) is as follows: Z is true if and only if both (i) X is true and (ii) X is limited by Y. If X is not limited by Y, then one need not determine whether proposition X is true. A determination under the first prong is clearly independent of a determination under the second: one need not determine whether the conduct at issue is regulated by state law in order to determine whether the conduct constitutes "the business of insurance." And although the second prong refers to the first, a determination under the second prong is not dependent on a determination under the first.

² Conversely, finding in the negative on either prong is a sufficient condition to holding that the McCarran Ferguson Act does not deprive the Commission of jurisdiction.

IN THE MATTER OF

COLUMBIA HOSPITAL CORPORATION

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF
SEC. 7 OF THE CLAYTON ACT AND SEC. 5 OF
THE FEDERAL TRADE COMMISSION ACT

Docket 9256. Complaint, Feb. 18, 1993--Decision, May 5, 1994

This consent order, among other things, requires the respondent to seek prior Commission approval, for ten years, before consummating any partial or total merger of a Columbia hospital in the Charlotte County area with any other acute care hospital in that area, and also requires Columbia to give the Commission notice prior to completing a joint venture that satisfies specified criteria with any other acute-care hospital in the area.

Appearances

For the Commission: *Oscar Voss* and *Mark Horoschak*.

For the respondent: *Raymond A. Jacobson, Howrey & Simon*,
Washington, D.C.

COMPLAINT

The Federal Trade Commission, having reason to believe that the respondent, Columbia Hospital Corporation, a corporation subject to the jurisdiction of the Commission, has entered into an agreement to acquire Medical Center Hospital in Punta Gorda, Florida and related assets ("Medical Center") from Adventist Health System/Sunbelt Health Care Corporation and its affiliates; that the acquisition agreement violates Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45, as amended; that the proposed acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. 45; and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, the Commission hereby issues its complaint, pursuant to Section 11(b) of the Clayton Act, 15 U.S.C. 21(b), and Section 5(b) of the Federal Trade Commission Act, 15 U.S.C. 45(b), stating its charges as follows: