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# Can a Warranty Contract Be Considered "Insurance" Under State Law?

By Andrew J. Weill and Kellen Furlin, *Weill & Mazer*

Can a warranty contract be considered "insurance" under state law? This question constantly arises in the automobile market when a manufacturer, retailer, or third-party offers after-market products such as anti-theft devices, paint protection, or dent repair, among others. In these examples, the line between what constitutes insurance and what constitutes a warranty is blurred. If a conflict arises out of the coverage of these products, it is important to know which law will govern. Will the product be regulated as a warranty or require more strict compliance as insurance?

Broadly defined, "insurance" is a contract by which one party, for a compensation called the premium, assumes particular risks of the other party and promises to pay to such other party or his or her nominee a certain or ascertainable sum of money on a specified contingency.[1] Federally, warranties will not be considered insurance. Since insurance contracts, by way of the McCarran-Ferguson Act, are largely governed by the individual states, there is no uniform definition of insurance, which has resulted in frequent confusion. The following is a brief collection of definitions and common themes among the few states that have addressed this issue.

A contract's classification is important, not only for choice of law issues, but for compliance issues as well. Contracts that fall under a state's insurance definition are generally more highly regulated than warranties, because the "particular risks" being assumed are larger and/or monetarily greater.[2]

Under state law, first-party warranties are generally not insurance, as they come standard with the product and either expressly or impliedly guarantee the quality of the product and promise to replace or repair defective parts. "A warranty relates in some way to the nature or efficiency of a product or service."[3] The "particular risks" here are those associated with the manufacture or design of the product.

Under certain circumstances, however, a warranty can be considered insurance under state law and therefore governed by state insurance regulations. This, of course, requires a state-by-state analysis for each product, but some common themes arise when distinguishing a warranty from insurance.

Some states and articles suggest ways in which a warranty *will not* be considered insurance. One opinion issued by the New York Insurance Department suggested that if the maker of a contract has a relationship to the product or service, or does some act that imparts knowledge of the product or service to the extent of minimizing, if not eliminating, the element of chance or risk, the contract will not be considered insurance.[4]

Another article indicates that if the product is incidental to the sale of a product or service, it is not negotiated separately from that sale, separate consideration is not charged, and the benefit provided is limited to repair or replacement of the product or a refund, the warranty will not be considered insurance.[5] Other attributes a warranty should lack in order to avoid classification as insurance include the obvious as well: no payment of premiums, no case by case underwriting of risk, or no adjustment of claims.

An obligation that arises upon the occurrence of a "fortuitous risk" nearly always guarantees the inclusion of a warranty as insurance.[6] For example, the New York Department of Insurance determined anti-theft devices were insurance and not warranties as the "[o]bligation to pay a purchaser a benefit of pecuniary value [was] upon the happening of a fortuitous event."[7] The Court of Appeals for the District Court of Columbia noted that "hazard is essential" to distinguishing and defining a contract of insurance.[8]

The Washington Department of Insurance pulled from three different out-of-state cases[9] and concluded, "[I]f an automobile manufacturer, dealer, or anyone else, agrees to indemnify an automobile owner against loss or damage resulting from theft, fire, collision, or any other risk not related to the quality or fitness of the

parts or workmanship involved in the vehicle itself, the result will be an insurance contract."[10] Here, the defining line between a warranty and insurance was whether the particular risks covered were within the control of the insurer.

Some guidance may also be found from case law relating to service contracts. Bear in mind, however, that there are important distinctions between service contracts and insurance contracts, and therefore the principles of the following cases offer, at most, arguments by analogy. The Supreme Court of Ohio, in *Griffin Systems, Inc. v. Ohio Dept. of Ins*., held that vehicle service contracts do not constitute insurance as long as they compensate for repairs necessitated by mechanical breakdown resulting exclusively from failures due to defects in motor vehicle parts.[11] On the other hand, the Supreme Court of Oklahoma in *McMullan v. Enterprise Financial Group, Inc*. held that vehicle service contracts meet the definition of and are designed to function and perform as "insurance" because the purchasers of these contracts were paying a specific amount, like a premium, upon determinable contingencies.[12] The contracts discussed in *Griffin*, compared to those in *McMullan*, do not promise to reimburse for loss or damage resulting from particular risks associated with perils outside of and unrelated to defects in the product itself.

Although states generally vary on their definitions of warranty versus insurance, the common thread should be noted: If the particular risks covered by the contract are within the control of either party involved in the transaction, where the obligation arises from an occurrence related to the product itself, rather than to a fortuitous event, the contract will most likely remain a warranty under state regulation. ■

**References**


1. 43 Am. Jur. 2d Insurance § 1.
2. *McMullen v. Enterprise Financial Group, Inc*., 247 P.3d 1173 (Okla. 2011).
3. Ops. Gen. Counsel N.Y. Ins. Dept. No. 08-02-21 (Feb. 2008).
4. Ops. Gen. Counsel N.Y. Ins. Dept. No. 03-09-03 (Sep. 2003).
5. Joseph T. Holahan, *What is Insurance Anyway*?, <http://mmmlaw.com/media-room/publications/newsletter/what-is-insurance-anyway> (Mar. 21, 2014).
6. "[T]he maker of the contract undertakes an obligation involving a fortuitous risk, and the agreement is an insurance contract and constitutes the doing of an insurance business." Ops. Gen. Counsel N.Y. Ins. Dept No.08-02-21 (Feb. 2008).
7. Ops. Gen. Counsel N.Y. Ins. Dept. No. 05-03-17 (Mar. 2005).
8. *Jordan v. Group Health Ass'n*, 71 App.D.C. 38, 44 (1939).
9. *State v. Standard Oil Co*., 35 N.E.2d 437 (1941); *Ollendorff Watch Co. v. Pink*, 17 N.E.2d 676 (1938); *State v. Western Auto Supply Co*., 16 N.E.2d 256 (1938).
10. Wash. Atty. Gen. Letter Op. 1976 No. 17, p. 6 (1976).
11. 575 N.E.2d 803 (1991).
12. 247 P.3d 1173, 1178 (2011).



*Andrew J. Weill is a Principal with Weill & Mazer, a leading complex litigation firm in San Francisco. Mr. Weill's practice includes complex business, tax and estate disputes across the nation.*