Declaratory Ruling 95-113-M

Original equipment manufacturer warranty not insurance

January 24, 1995

I. BACKGROUND

RAMP Program Systems, Inc. ("RAMP") has developed a broadened warranty program ("Program") that an original equipment manufacturer ("OEM") will issue upon the sale or lease of a new vehicle. The Program will include damage repair coverage for the first year. By its letter of November 3, 1994, RAMP seeks a declaratory ruling by the Commissioner of Insurance ("Commissioner") as to whether the Program constitutes insurance.

II. ISSUE

At issue is whether a warranty issued by an original equipment manufacturer that includes damage risk assumption constitutes insurance where the damage risk assumption is not the principal object and purpose of the contract.

III. ANALYSIS

The Commissioner is authorized to issue this declaratory ruling by Section 63 of the Administrative Procedures Act of 1969, as amended, MCL 24.263; MSA 3.560(163), which provides:

> On request of an interested person, an agency may issue a declaratory ruling as to the applicability to an actual state of facts of a statute administered by the agency or of a rule or order of the agency. An agency shall prescribe by rule the form for such a request and procedure for its submission, consideration and disposition. A declaratory ruling is binding on the agency and the person requesting it unless it is altered or set aside by any court. An agency may not retroactively change a declaratory ruling, but nothing in this subsection prevents an agency from prospectively changing a declaratory ruling. A declaratory ruling is subject to judicial review in the same manner as an agency final decision or order in a contested case.

It is critical to RAMP to have a determination as to whether the Program is insurance. An OEM is not an insurer. If the Program constitutes insurance, only a licensed insurer may sell it. Section 402 of the Insurance Code of 1956, as amended ("Code"), MCL 500.402; MSA 24.1402, provides:

> No person shall act as an insurer and no insurer shall issue any policy or otherwise transact insurance in this state except as authorized by a

> subsisting certificate of authority granted to it by the commissioner pursuant to this code.

The Program consists of two elements. First, it will extend the mechanical defect and repair coverage an additional two or more years. Second, for the first year of the warranty, it will repair damage to eligible new vehicles, less a $500.00 charge to the owner or lessee.

This agency has long recognized that basic or extended warranties made by an OEM are not insurance. However, in this matter, the warranty includes a damage repair element along with warranty coverage. According to RAMP, this coverage is incidental to the OEM's central business [p 5]:

The damage repair coverage and defect repair coverage are incidental to the OEM's central business, which is the sale and lease of new vehicles; . . .

RAMP states that the damage repair element is not a principal object of the sale or lease of the vehicle or of the overall warranty to be issued [p 19]:

> …while it might be argued that there may be limited indemnification involved in the damage repair element, that indemnification is not a principal object of the transaction (the sale or lease) or even of the overall warranty to be issued but is merely incidental…Indeed, the predominant element of the transaction, and the one that gives the transaction its distinctive character, is the sale or lease of the new vehicle by the OEM to the purchaser or lessee…

The Commissioner's examination of this matter is greatly facilitated by advice given to this agency by two Assistant Attorneys General in a memorandum dated April 25, 1980. They had under consideration whether a limited warranty offered by an automobile glass manufacturer and installer was insurance. In addition to coverage that was clearly warranty coverage, such as guarantees against leakage, the manufacturer agreed to replace without charge a broken windshield. While this excluded collision damage, it included other road hazards, such as flying stones.

The Assistant Attorneys General found that the replacement provision of the warranty provided for a small degree of risk assumption, but that risk assumption was not the principal object and purpose of the glass sale contract. They concluded that the manufacturer would not be deemed to be an insurer in the courts.

In reaching this conclusion, the Assistant Attorneys General focused upon *Transportation Guarantee Co* v *Jellins*, 174 P2d 625, 629 (1946), where the Court stated:

That an incidental element of risk distribution or assumption may be present should not outweigh all other factors. If the attention is focused only on that feature, the line between insurance or indemnity and other types of legal arrangement and economic

function becomes faint, if not extinct. This is especially true when the contract is for the sale of goods or services on contingency. But obviously it was not the purpose of the insurance statutes to regulate all arrangements for assumption or distribution of risk. That view would cause them to engulf practically all contracts, particularly conditional sales and contingent service agreements. The fallacy is in looking only at the risk element, to the exclusion of all other present or their subordination to it. The question turns, not on whether risk is involved or assumed, but on whether that or something else to which it is related in the particular plan is its principal object and purpose. In the California Physicians' Service case it is held that (28 Cal. 2d —, 172 P.2d16.) 'Absence or presence of assumption of risk or peril is not the sole test to be applied in determining . . . status. The question, more broadly, is whether, looking at the plan of operation as a whole, "service" rather than "indemnity" is its principal object and purpose.

In its letter, RAMP also draws upon *Jellins* and other cases in support of this position. Further authority may be found in *12 Appleman Insurance Law and Practice* (1981), Section 7002, p 14, where the author states:

> A statute designed to regulate the business of insurance . . . is not intended to apply to all organizations having some element of risk assumption or distribution in their operations. The question of whether an arrangement is one of insurance may turn, not on whether a risk is involved or assumed, but on whether that or something else to which it is related in the particular plan is its principal object and purpose. [footnotes omitted]

A former Michigan Commissioner embraced this position in Bulletin 81-20, which was issued October 20, 1981. The Commissioner had under review questions regarding the unauthorized transaction of insurance by motor clubs. In determining whether indemnification for towing and emergency road services would be deemed insurance, the Commissioner stated:

> An agreement for provision of services will not be considered insurance because it provides for occasional reimbursement of expenses, if such reimbursement is only incidental to the operation of a plan which taken as a whole has as its principal object and purpose the provision of services rather than indemnity.

RAMP has stated as a matter of fact that its provision of coverage for damages is incidental to the OEM's sale and lease of vehicles and its overall warranty. In light of Bulletin 81-20, court precedent, *Appleman*, the advice of the Assistant Attorneys General, and the soundness of the underlying reasoning, the Commissioner should rule that the Program does not constitute insurance.

IV. RULING

Therefore, it is the Commissioner's ruling that a warranty issued by an original equipment manufacturer that includes a damage repair element as a risk assumed does not constitute

insurance where the damage repair risk assumption is not the principal object and purpose of the contract.

This ruling is limited to the facts which were presented by the applicant and the statutory sections identified by the applicant in its declaratory ruling request.

Patrick M. McQueen
Acting Commissioner of Insurance