SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: Banking and Insurance Committee

BILL:	CS/SB 2498
SPONSOR:	Banking and Insurance Committee and Senator Campbell
SUBJECT:	Warranty Associations
DATE:	April 13, 2005 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Knudson	Deffenbaugh	BI	**Fav/CS**
2.			JU	
3.				
4.				
5.				
6.				

I. Summary:

Committee Substitute for Senate Bill 2498 creates an exception to certain specific penalty provisions for any violation of ch. 520, ch. 521, and part I of ch. 634, F.S., relating to the sale or the failure to disclose in a retail installment contract or lease, a vehicle protection product or agreement that provides for vehicle protection expenses as defined in s. 634.011(7)(b)1., F.S. The failure to disclose must have occurred prior to April 23, 2002, the date on which the legislation became effective classifying vehicle window etching as a vehicle protection product authorized to be sold under a motor vehicle warrant contract. The exception only applies if the sale of the product, contract, or agreement was otherwise disclosed to the consumer in writing at the time of the purchase or lease of the automobile.

In the case of a violation of these sections for which the statutory penalties of ch. 520, ch. 521, and part I of ch. 634, F.S., do not apply, the court must award actual damages and costs, including a reasonable attorney's fee. Nothing in the bill shall be construed to require the application of the referenced statutory penalty provisions where this subsection is not applicable.

The bill also expands the definition of a "service warranty" that may be sold by a licensed service warranty association. Currently, service warranties cover "repair or replacement" of a consumer product. The bill expands the possible coverage to include normal wear and tear, power surge damage, and accidental damage from handling. But, any warranty contract that includes coverage for accidental damage from handling must be covered by a contractual liability policy purchased by the warranty association covering 100 percent of its total claim exposure. The bill also revises the definition to cover warranties of 1 year or longer. The current definition refers only to warranties that are longer than 1 year.

The bill applies retroactively to January 1, 1998. The effect of the retroactivity provision will be to potentially reduce the damages available under lawsuits brought against automobile dealers who sold vehicle protection products such as window etching and did not disclose and itemize such products as an "insurance product" in accordance with ch. 520 and ch. 521, F.S.

This bill substantially amends the following sections of the Florida Statutes: 634.271 and 634.401.

II. Present Situation:

Warranty Associations

Warranty associations are regulated by the Office of Insurance Regulation (OIR) under ch. 634, F.S., and include motor vehicle service agreement companies, home warranty associations, and service warranty associations. However, the Department of Financial Services is authorized to regulate the salespersons and representatives who sell warranties (as part of the department's authority to license and regulate insurance agents).

Motor Vehicle Service Agreements

Motor vehicle service agreement companies sell motor vehicle service agreements that indemnify a service agreement holder for a motor vehicle against loss caused by failure of any mechanical or other component part that does not function as it was originally intended.[1] Motor vehicle service agreement companies are regulated exclusively under part I, ch. 634, F.S., except as otherwise provided in that part.[2] Motor vehicle service agreement companies must file their rates and premiums with OIR, but they are not subject to disapproval by OIR.[3]

Motor vehicle service agreement companies must be licensed through the Office of Insurance Regulation (OIR) to conduct business in the state. Such companies must meet financial solvency, marketing and sales requirements, and be examined by the department every 3 years.

The purchaser of a motor vehicle service agreement must receive a copy of the motor vehicle service contract within 45 days of purchase and may cancel it within 60 days of purchase. A motor vehicle service agreement must contain the following in conspicuous boldfaced type:[4]

- A statement that a motor vehicle service agreement is assignable in a consumer transaction and all conditions on the right of such transfer;
- Any statement or clause that places limitations or restrictions on the service agreement;
- A statement of the intention of the motor vehicle service agreement company to use remanufactured or used replacement parts; and
- The terms and conditions of any rental car provision.

[1] Section 634.011(7), F.S.
[2] Section 634.023(1), F.S.
[3] Section 634.1216, F.S.
[4] Section 634.121, F.S.

Motor vehicle service agreement forms must be filed with and approved by the OIR; however, a company's rates need only be filed with the office. A service agreement form must be disapproved if the form does not clearly indicate the method for calculating the benefits to be paid, the terms of the agreement, whether new or used cars are eligible for the vehicle protection product, and that the service agreement holder must have comprehensive vehicle insurance coverage in force at the time of loss as a condition precedent to requesting payment of vehicle protection expenses. Under the provisions of s. 634.282, F.S., the unfair or deceptive act provisions apply to motor vehicle service agreement companies and to persons who market and sell the service agreements. The deceptive act provisions apply to the advertising, sale, or delivery of motor vehicle service agreements.

In 2000, the Department of Insurance[5] stated that if companies who were marketing theft protection agreements to consumers, were selling insurance and were therefore subject to regulation by the department.[6] Representatives from the Department of Insurance stated at the time that the department had not received any consumer complaints as to the sale of the theft protection agreements and had not initiated any administrative actions in this area. In 2002, the Legislature passed SB 2102, which requires a motor vehicle service agreement company to be licensed to market and sell certain guarantees associated with vehicle theft prevention products. These theft prevention agreements can be sold only on a vehicle that is covered by a comprehensive motor vehicle insurance policy and does not take the place of regular theft coverage under a comprehensive insurance policy, but instead supplements such insurance. As a result of SB 2102, such products were not considered insurance, but rather classified as a warranty.

Theft prevention products are installed in a motor vehicle and could include car alarms, window etching of vehicle I.D. numbers, and other applications that deter theft of automobiles. If a theft does occur, the consumer may receive certain benefits in the event their car is stolen and not returned within a specific time period. Such benefits may include the costs above what an automobile insurer pays as the actual cash value and the amount of the actual cost of a new or used replacement vehicle, and may also include payment of incidental expenses such as a rental vehicle, vehicle registration and sales tax. Alternatively, some products pay a flat dollar amount. The legislation was passed because some motor vehicle service agreement companies offered vehicle theft protection agreements to auto dealerships which in turn sold them to both new and used car purchasers. The theory behind classifying a theft prevention product as a "warranty" is that the product did not function as originally intended, and the service agreement company honors its warranty on the product by paying the costs to "make the consumer whole" by assuring there are no out of pocket expenses the consumer would have to pay. Consumers pay for anti-theft guarantees depending on the year and mileage of the vehicle.

Representatives of the Florida Automobile Dealers Association (Association) have indicated that motor vehicle dealers who sold a product known as "etch"—the etching of a vehicle identification number into the vehicle's window—are facing large potential liability losses because of the penalty provisions of s. 520.12, F.S.,[7] and s. 521.006, F.S.[8] Because such products

[5] Now the Office of Insurance Regulation within the Department of Financial Services.
[6] See Department of Insurance Memorandum of June 12, 2000, regarding Alexico's Corporation Theft Gard.
[7] This section states that any person who willfully or intentionally violates the grounds for Office of Financial Regulation disciplinary action in s. 520.995, F.S., or acts as a retail investment seller without a license commits a first degree

were considered insurance by the Department of Insurance prior to their classification as a warranty, violations from the sale of such products are potentially governed by penalty provisions regarding the sale of insurance products in retail installment purchases or automobile leases.

Representatives from the Association provided to staff an example of the high liability faced by auto dealers. Prior to the April 23, 2002 classification of vehicle etching as a service warranty, many dealers sold the etch product and made disclosure to the customer of the Buyer's Order. Under s. 520.07(3)(d), F.S., a separate itemization of the amount financed must be provided for insurance benefits. Failure to separately itemize the "etch" product could be found to be a willful violation of s. 520.12, F.S., thus subjecting the automobile dealer to the penalties including reimbursement of finance charges and fees charged to the buyer because of delinquency, plus attorney's fees and costs. In this example, if a dealer sold 100 cars costing $18,000 each that were financed with an 8 percent interest rate, the finance charge recoverable per car would be $3,898. Over a four-year period, the dealer's exposure to an etch class action lawsuit could exceed $18.7 million (the finance charge of $3,898 per month is applied for each month—48—of the four year period, multiplied by the 100 financed vehicles).

Service Warranties for Consumer Goods

Service warranty associations sell service warranties that indemnify a warranty holder against the cost of repair or replacement of a consumer product.[9] Service warranty associations are regulated exclusively under part III, ch. 634, F.S., except as otherwise provided in that part. There is no statutory requirement for service warranty associations to file their rates and premiums with OIR.

Under s. 634.406, F.S., a service warranty association must have a method to ensure that the association has the resources to satisfy claims on its service warranties. These methods include an unearned premium reserve or contractual liability insurance. Also, an association must not allow its gross written premiums in force to exceed a 7-to-1 ratio to net assets, and the association must maintain a minimum amount of net assets or a contractual liability policy.

An unearned premium reserve is an authorized method by which a service warranty association may ensure that it is able to fulfill warranty claims. Using an unearned premium reserve, a service warranty association will hold aside a certain percentage of the premiums it receives in an unearned premium reserve account.[10] A service warranty association that uses an unearned premium reserve must also make a reserve deposit with the Office of Insurance Regulation in an amount equal to 10 percent of the gross written premiums for all warranty contracts in force.[11]

misdemeanor. If the violation is willful, the buyer may recover an amount equal to any finance charge plus fees charged to the buyer because of delinquency, plus attorney's fees and costs.

[8] A motor vehicle retail lessor must disclose the lease agreement to the lessee in accordance with the provisions of s. 521.004, F.S. A lessor that fails to do so is liable for actual damages sustained, a civil penalty of up to $1,000 per lease violation, and attorney's fees and costs.

[9] Section 634.401(13), F.S.

[10] Section 634.406(1), F.S.

[11] Section 634.406(2), F.S.

A service warranty association that does not maintain the unearned premium reserve described above must maintain a contractual liability insurance policy that will cover 100 percent of its claim exposure.[12] The insurer issuing a contractual liability insurance policy must agree to take over the administration of claims and payment of refunds from the warranty association.

Generally, a service warranty association must not allow its gross written premiums in force to be more than a 7-to-1 ratio to its net assets.[13] The term "net assets" means total statutory assets in excess of liabilities, except that assets pledged to secure debts not reflected on the books of the service warranty association shall not be included in net assets. [14] The net assets of a service warranty association include cash, certain investments, certain items of personal property, inventories, and the liquidation value of prepaid expenses.[15] The net assets of a service warranty association do not include goodwill; patents; debts owed by officers, directors, or controlling shareholders to the association; or stock of the association.[16]

III. Effect of Proposed Changes:

Section 1. Amends s. 634.271, F.S. This section of the Florida Statutes contains the civil remedies available for persons damaged by a violation of the laws governing motor vehicle service agreement companies.

The bill adds a new subsection (5) which creates an exception to the penalty provisions of ss. 520.12, 521.006, F.S., and 634.271, F.S. The exception is for any violation of ch. 520, ch. 521, and part I of ch. 634, F.S., that involves the sale or failure to disclose in a retail installment contract or lease, a vehicle protection product or agreement that provides for vehicle protection expenses as defined in s. 634.011(7)(b)1., F.S. The failure to disclose must have occurred prior to April 23, 2002, the date on which the legislation became effective classifying vehicle window etching as a vehicle protection product. The exception only applies if the sale of the product, contract, or agreement was otherwise disclosed to the consumer in writing at the time of the purchase or lease of the automobile.

In the case of a violation of these sections for which the statutory penalties of ch. 520, ch. 521, and part I of ch. 634, F.S., do not apply, the court must award actual damages and costs, including a reasonable attorney's fee. Nothing in the bill shall be construed to require the application of the referenced statutory penalty provisions where this subsection is not applicable.

Section 2. Amends s. 634.401(13), F.S., which contains the definition of a "service warranty." The bill specifies that a service warranty as defined by this section may include specified warranties of 1 year or longer. Current law requires the warranty to be longer than 1 year to meet the definition.

[12] Section 634.406(3), F.S.
[13] Section 634.406(4) and (5), F.S.
[14] Section 634.401(9), F.S.
[15] Section 634.4061(1), F.S.
[16] Section 634.4061(2), F.S.

The bill also expands possible coverage that a service warranty may provide. Currently, a service warranty may cover the cost of repairing or replacing a consumer product. The bill adds the following types of damage to a consumer product for which indemnification may be provided:

- Operational or structural failure due to a defect in materials or workmanship.
- Normal wear and tear.
- Power surge damage.
- Accidental damage from handling

Any contract that includes coverage for accidental damage from handling must be covered by the contractual liability policy referred to in s. 634.406(3), F.S., whereby a warranty association purchases a policy covering 100 percent of its total claim exposure.

Section 3. The act shall take effect upon becoming a law. It applies retroactively to January 1, 1998. The effect of the retroactivity provision will be to potentially reduce the damages available under lawsuits brought against automobile dealers who sold vehicle protection products such as window etching and did not disclose such products as an "insurance product" in accordance with ch. 520 and ch. 521, F.S.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

Because the bill is to be applied retroactively, there is the possibility that the statute could violate the Florida Constitution's right of access to courts and present Due Process concerns. Section 21, Art. I, of the Florida Constitution states that "[t]he courts shall be open to every person for redress of any injury, and justice shall be administered without sale, denial or delay." Generally, for a statute that affects substantive rights to apply retroactively, the Legislature must provide clear intent that the statute has retrospective application.[17] The retroactive application of a civil statute ordinarily has been found to violate legislative power, "if the statute impairs vested rights, creates new obligations, or imposes new penalties."[18] The Florida courts have allowed for retroactive application of a statute to pending court cases when the law is intended to be remedial in nature, if the law does not impair vested rights or create new obligations.[19] If a statutory change impairs an

[17] See *State Farm Mut. Auto. Ins. Co. v. Laforet*, 658 So.2d 55, 61 (Fla. 1995).
[18] See footnote 9.
[19] See *Arrow Air, Inc. v. Walsh*, 645 So.2d 422 (Fla. 1994).

expectant or contingent right, then it is less likely to trigger a constitutional question.[20] A right is vested when "the right to enjoyment, present or prospective, has become the property of some particular person or persons, as a present interest."[21] Rights are "expectant when they depend upon the continued existence of the present condition of things until the happening of some future event. They are contingent when they are only to come into existence on an event or condition which may not happen or be performed until some other event may prevent their vesting."[22]

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The bill may have the effect of reducing civil damages faced by automobile dealers who sold vehicle protection products in the manner covered by the exception created by this legislation. However, it may also reduce the damages recoverable by litigants in suits brought under the fact pattern covered in this bill.

The bill will increase the potential scope of a service warranty for consumer goods. Companies wishing to offer such a warranty providing indemnification for accidental damage from handling the consumer good will have to purchase a contractual liability policy that covers 100 percent of its total claim exposure.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

Section 3 provides that the act applies retroactively to January 1, 1998, which applies to both Section 1 and Section 2 of the bill. However, the intent appears to have been to limit the retroactive application to Section 1 only. The Legislature may want to consider an amendment to address this issue.

VII. Related Issues:

None.

[20] See *R.A.M. of South Florida, Inc. v. WCI Communities, Inc.*, 869 So.2d 1210, 1218 (Fla. 2nd DCA 2004).
[21] See *Pearsall v. Great Northern Ry. Co.*, 161 U.S. 646 (1896).
[22] See footnote 13.

VIII. Summary of Amendments:

None.