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REGULATE EXTENDED SERVICE CONTRACTS

House Bill 5361 (Substitute H-3) Revised First Analysis (6-9-98)

Sponsor: Rep. A.T. Frank
Committee: Consumer Protection

THE APPARENT PROBLEM:

Almost everyone who has purchased a home appliance or electronics product recently has probably had a service contract or extended warranty pitched to them. These service contracts and extended warranties are routinely offered on everything from dishwashers to toasters to stereo equipment. The warranty is sold as extra protection to cover the product or appliance beyond the manufacturers' warranty. However, unlike the manufacturers' warranties, extended warranties cost extra. Extended warranties, like warranties, are intended to cover repairs or maintenance for a specific period of time, usually to start after the conclusion of the manufacturer's warranty, although that is not always the case. These service contracts or extended warranties are sold to consumers as a type of repair insurance that is bought separately from the product and are usually described as protecting the consumer or providing peace of mind. Unfortunately, not all those who sell these contracts or warranties behave in an entirely scrupulous fashion. Some people who have purchased these contracts have found it difficult to attempt to enforce them. Although the contract may be sold by a store, many times the consumer later finds that the contract is not owned by the store but is instead owned by another company, out-of-state or even out-of-business. It is believed that given the increasing popularity of these contracts, better regulation is needed to protect consumers.

THE CONTENT OF THE BILL:

The bill would create an act to regulate extended service contracts. The bill would, among other things, require that certain information be provided in an extended service contract and require companies that offer extended service contracts to file a registration form and either maintain insurance or file a bond with the secretary of state. The bill would affect all extended service contracts entered into on or after the bill's effective date.

Extended service contracts. An extended service contract would be defined as a contract or agreement for which specific consideration was paid and that provides for the repair or replacement of covered components that fail due to a defect or normal wear and tear. Maintenance agreements or manufacturers' warranties would not be included, nor would the act apply to contracts regarding new or used motor vehicles, new or used watercraft, or mobile homes.

All extended service contracts would be required to be signed by the provider and would have to include all of the following information:

- Identification of the product covered under the contract.
- A statement of the service that would be provided under the contract.
- A step-by-step explanation of the procedure the consumer should follow to obtain service under the contract.
- The specific time period that the extended warranty will cover.
- That the retailer will provide a written document identifying the consumer's rights and obligation under the contract.
- That the contract is in addition to any manufacturer's warranty.
- The person or persons responsible for servicing the product and the responsible party's legal name and address.
- That the consumer has up to 10 days to accept or decline the extended service contract and if he or she

decides to accept it that he or she has up to 10 days to rescind the contract.

-- Whether the contract could be transferred, and if so, any conditions or limits that would be placed on that transfer.

Consumers. A consumer would have a 10-day grace period from the date that the contract was purchased to decline the contract, provided that he or she had not filed a claim under the contract during that period. Unless the contract provided a longer time period, a consumer would also be allowed to rescind the contract within 10 days after it was received. Generally, if a consumer chose to rescind the contract in a timely fashion, he or she would be entitled to a full refund of the contract price. However, if the consumer had made a claim under the contract during the 10-day period, the refund would be prorated based on either the amount of time that had passed or an objective measure of use, at the provider's option. In addition, the provider would be allowed to assess a cancellation fee not to exceed the lesser of 10 percent of the cash price of the contract or \$25. The provider of the extended service contract would have 30 business days after a contract cancellation to give the consumer his or her refund.

Any claim on an extended service contract made by the consumer would be considered valid unless the provider notified the consumer otherwise within 10 business days from the date the provider received the claim.

Providers. A person licensed under the Forbes Mechanical Contractors Act, the Electrical Administrative Act, or Public Act 266 of 1929, relating to plumbing, or a provider under the Michigan Telecommunications Act, would not be considered a provider under the bill, nor would a retailer whose annual sales of goods or services were \$1,000,000 or less.

In order to offer extended service contracts to consumers in this state, the bill would require an extended service provider to file an approved registration form with the secretary of state. The provider would also have to file either a liability policy issued by an insurer authorized to do business in Michigan or a bond issued by a surety authorized to do business in this state. The amount of the bond would be \$25,000 for a provider that had not previously sold extended warranty contracts in this state or if the provider's gross receipts from selling such contracts did not exceed \$100,000 during its last fiscal year. For each additional \$100,000 or fraction thereof of gross receipts, the provider would have to pay an

additional \$25,000; however, the amount of the bond could not exceed \$500,000. The bonds would be issued in favor of the people of this state for the benefit of a consumer injured in the event that an extended warranty provider failed to provide a refund after proper cancellation of a contract.

Penalties. A violation of the bill's provisions would be a civil infraction punishable by a civil fine of not more than \$5,000 for each violation. In addition, a person who suffered a loss because of a violation of this act could bring a civil action for damages. The person could recover the greater of his or her actual damages, or \$250, plus costs and reasonable attorney fees.

FISCAL IMPLICATIONS:

Fiscal information is not available.

ARGUMENTS:

For:

According to consumer advocates, most extended warranty contracts are rip-offs. Generally, electronic devices, for example, have very low failure rates. In fact, appliances and electronic equipment that break down usually do so early in their service life, while the product is generally still covered under the manufacturer's warranty. Furthermore, the prices of these contracts are generally much higher than amounts paid to third parties to cover the costs of the repairs that are actually provided. According to Consumer Reports, sales of service contracts can generate more profit for retailers than sales of their products because less than twenty percent of the consumers who purchase service contracts ever use them, and retailers only incur 4-15 cents in services costs for every dollar paid for such contracts.

Against:

The bill is unlikely to improve the problems that some people have with these types of contracts. Consumers who do not read through or pay attention to the details of such contracts will continue to find themselves in the unenviable position of not knowing what they paid for or how to make use of the contract should the necessity arise. Unscrupulous retailers or others will continue to make it difficult for consumers to make use of these contracts and the bill's only effect will be to increase the costs of doing business in this state.

A consumer who spends \$50 for a service contract on a \$25 appliance is undoubtedly a fool, but it is unfair to blame the service contract provider for that decision. On the other hand, spending the same \$50 to protect a \$2,500 item doesn't seem so unwise, particularly if the item breaks down and can be replaced under the contract terms. Many of the people who complain about paying for service contracts are likely to be those who end up not having to rely on them -- if the product doesn't break down during the period of the contract, then the money may seem to have been wasted -- just as one's automobile insurance seems wasted if you don't have an accident. Information is already given to customers to allow them to make wise decisions; if they do not choose to read or consider all of the information that should not be the provider responsibility. The consumer should make his or her decision about purchasing a service contract based on repair and/or replacement costs of the item.

POSITIONS:

The Michigan Consumer Federation supports the bill. (5-27-98)

The Michigan Boating Industries Association supports the bill. (5-27-98)

The Michigan Chapter of Air Conditioning Contractors of America supports the bill. (5-27-98)

The Metropolitan Detroit Chapter of Sheet Metal and Air Conditioning Contractors Association supports the bill. (5-27-98)

The Michigan Plumbing and Mechanical Contractors Association supports the bill. (5-27-98)

Ameritech supports the bill. (5-27-98)

Analyst: W. Flory

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.