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DEFENDER

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In this Issue:

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Sunday Sales Laws and Motor Vehicle Dealerships

By Gregory C. Mitchell, *Brydon Swearengen & England, P.C.*

Similar to many other states[1], Missouri law prohibits the sale of most motor vehicles on Sunday.[2] Specifically, Missouri's Sunday sales law, Mo. Rev. Stat. § 578.120, provides:

1. Notwithstanding any provision in this chapter to the contrary, no dealer, distributor or manufacturer licensed under section 301.559, RSMo., may keep open, operate, or assist in keeping open or operating any established place of business for the purpose of buying, selling, bartering or exchanging, or offering for sale, barter or exchange, any motor vehicle, whether new or used, on Sunday. However, this section does not apply to the sale of manufactured housing; the sale of recreational motor vehicles; washing, towing, wrecking or repairing operations; the sale of petroleum products, tires, and repair parts and accessories; or new vehicle shows or displays participated in by five or more franchised dealers or it towns or cities with five or fewer dealers, a majority.

2. No association consisting of motor vehicle dealers, distributors or manufacturers licensed under section 301.559, RSMo., shall be in violation of antitrust or restraint of trade statutes under chapter 416, RSMo., or regulation promulgated thereunder solely because it encourages its members not to open or operate on Sunday a place of business for the purpose of buying, selling, bartering or exchanging any motor vehicle.

3. Any person who violates the provisions of this section shall be guilty of a class C misdemeanor.

This statute, dating from 1985, has thus far survived threatened legal challenges and spirited debate about its continuing viability. Primarily, motor vehicle dealers located along the state's borders have asserted they are at a competitive disadvantage to dealerships in adjoining states which *do* allow Sunday sales of vehicles.

The Missouri Legislature has just passed amending language which also exempts from Section 578.120 the sale of *"motorcycles . . . motorized bicycles, all-terrain vehicles, . . . utility vehicles, personal watercraft, or other motorized vehicles customarily sold by [licensed] powersports dealers . . . ."*[3] Missouri continues to prohibit the sale of "motor vehicles" on Sunday, but exempts from this prohibition the sale of recreational vehicles, manufactured housing, and now, assuming Governor Nixon signs the new legislation into law, motorcycles, all-terrain vehicles, and related "powersport" vehicles.

Over the years, there have been constitutional challenges to similar statutes in other states. Summarily, it would appear that Sunday closing laws for motor vehicle dealerships have

generally fared well over the past several decades. In some cases they have survived constitutional challenge even in states which had already stricken or repealed "blue laws" affecting other types of business. This article examines the decisions interpreting various states' Sunday sales laws.

State Court Challenges

Of all reported cases located, the following opinions appear most instructive on this issue, and provide guidance in challenging or defending the most likely constitutional claims that could be raised in opposition to a particular state's Sunday closing law.[4]

Cases Upholding the Constitutionality of Sunday Closing Laws

A. Illinois – *Fireside Chrysler-Plymouth-Mazda, Inc. v. Edgar*, 464 N.E.2d 275 (Ill. 1984)

In 1984 the Supreme Court of Illinois issued an opinion upholding the constitutionality of that state's Sunday closing law for motor vehicle dealers. The plaintiff, a franchise new vehicle dealership, claimed the Sunday closing law, which related only to motor vehicle dealers, violated his constitutional guarantees to equal protection under the law, and due process. The trial court concluded that the law amounted to unconstitutional "special legislation." The Supreme Court, however, disagreed, rejecting the plaintiff's claims and holding the law to be valid because it was part of a comprehensive scheme of regulation directed specifically to motor vehicle dealers, and because the law affected all dealers equally (even though it did not affect all *businesses* equally). In other words, because the Illinois legislature had enacted a number of other laws relating only to motor vehicle dealers, the Sunday closing law was seen by the Supreme Court as simply being part of that overall scheme of regulation created because of the many unique aspects of the motor vehicle sales industry, as compared with other businesses. The Court also suggested that the law bore a "rational relationship" to the state's goal of "promoting a common day of rest," even though it applied only to motor vehicle dealerships.

It is also noteworthy that in 1962 the Supreme Court of Illinois found the previous version of the state's dealer Sunday closing law to be unconstitutional, despite that statute's being essentially identical to the statute upheld in 1984.[5] In the more recent opinion, the Court circumvented the earlier opinion by finding that it was not required to follow its 1962 decision as notions of constitutionality are "elastic" and that their decisions about such issues must "keep pace with human progress."[6] Essentially, the Supreme Court of Illinois seemed in 1984 to be motivated by some unstated factor to keep the law in place and found justification for doing so in spite of striking down the same law twenty-two years earlier. Justice Simon's dissent in the 1984 case points out the inconsistencies between the Court's 1962 and 1984 decisions on the same issues, and argues the 1984 decision should have also held the statute to be unconstitutional.

Nonetheless, the *Fireside Chrysler-Plymouth-Mazda* opinion is encouraging for proponents of Sunday closing laws, because it shows the Court reversing itself in modern times to uphold a Sunday closing law.Given the number of cases from around the country striking down Sunday closing laws affecting other types of businesses, it is encouraging for proponents of similar Sunday dealer closing law that Illinois, and the other states discussed below, have found a basis for keeping their similar laws on the books.

B. Michigan – *McDonald Pontiac-Cadillac-GMC, Inc. v. Prosecuting Attorney of Saginaw,* 388 N.W.2d 301 (Mich. Ct. App. 1986)

In 1985 the plaintiff, a franchise new motor vehicle dealer, lost his suit before the trial court in which he claimed that Michigan's Sunday closing law, applying only to dealers selling passenger vehicles and trucks, was unconstitutional because it denied his rights to equal protection and due process. The plaintiff argued other types of motor vehicle dealerships located near his business, including dealers selling motor homes and motorcycles, were allowed under the Michigan statute to remain open and make sales on Sunday, while he was prohibited from doing so.

On appeal, the Michigan Court of Appeals affirmed the trial court's judgment rejecting the dealership's claims, thus upholding the statute. The Court of Appeals noted that the correct legal standard for reviewing the dealership's constitutional claims was, under these facts, the "rational basis" analysis, which provides that a statute dealing only with an economic interest will not be found unconstitutional under equal protection/due process principles so long as it bears some rational relationship to a legitimate state purpose or interest. The use of the "rational basis" analysis in these cases means that the plaintiff has a more difficult burden to meet in proving a constitutional violation. In the scheme of equal protection litigation, it is relatively more difficult to win a case when this analysis is called for than when other, more sensitive and stringent tests are used.[7]

In the *McDonald* case, several possible purposes were suggested in support of the Michigan Sunday closing statute. The "day of rest and recreation" purpose was noted, as were the difficulty of checking vehicle title and lien records, the inability to obtain insurance and financing, and the inability to perform mechanical service work on Sundays, as well as the "greater burden on police agencies due to potential auto theft." The Court of Appeals explained that "all of these may constitute purposes of the statute to which being closed on Sunday reasonably relates."[8] In this case, as in the others discussed herein, the reviewing courts did not know with any certainty why the Michigan legislature had enacted a Sunday closing law narrowly tailored to cover only motor vehicle dealers (and in this case, only certain motor vehicle dealers). They could only speculate as to reasons provided them by the parties defending the laws, at which point the

courts simply considered whether the law in question is "rationally related" to those supposed legitimate purposes. The Michigan Court of Appeals summarized:

> [W]e find that the classification in question violates neither due process nor equal protection guarantees. The classification, while it may appear harsh to automobile dealers, affects all members of *that class* equally and is not arbitrary as it stands. We cannot say that the government's interest in regulating automobile sales on Sundays has no rational basis and *we are not going to be tempted to open the floodgates to declare all regulatory legislation of Sunday sales unconstitutional.*[9]

This holding may therefore reveal, as well as any, just how difficult it can be for plaintiffs who sue to have these laws struck down on the basis of constitutional principles. The highlighted language may also reveal that some courts are reluctant to strike down these Sunday laws affecting dealers because of the precedential effect such a decision could have on other Sunday closing laws, at least in states having other types of blue laws still on the books.

C. Louisiana – *Lakeside Imports, Inc. v. State*, 639 So.2d 253 (La. 1994)

The Supreme Court of Louisiana opinion resulted from plaintiff's (a franchised new motor vehicle dealer) appeal of the trial court's dismissal of its lawsuit against the state, seeking a ruling that Louisiana's Sunday closing law for motor vehicle dealers was unconstitutional. Similar to the previous cases examined, the dealership argued that the Sunday closing law violated its right to equal protection and deprived it of a property right without due process of law. The plaintiff further argued the Sunday closing law amounted to "special legislation," in violation of Louisiana's state constitution. The Court rejected all of these arguments.

The Court found the dealership failed to prove one of its key contentions– that the Sunday closing law had caused it to suffer significant monetary losses via the inability to open on Sunday. The dealership's key witness on this point, its general manager, could identify no firm profit or loss figures related to not being allowed to open on Sunday and, when asked to articulate an estimate of lost sales of vehicles and parts, answered, "Ask me in six months."[10] Based on this lack of evidence, the Court found that the Sunday closing law

did not interfere with the dealership's ability to conduct business and therefore there was no due process violation.[11]

As to the dealership's equal protection arguments, the Louisiana Supreme Court found three interesting "legitimate purposes" for the state's Sunday closing law, relating as it did only to motor vehicle dealers. First, the Court found that the law could protect small rural dealerships from unfair competition by large metropolitan dealerships. Second, it found that the law had the potential to protect consumers from higher priced vehicles and service brought on by higher overhead resulting from Sunday sales. Third, the Court found the law would protect the welfare of commissioned auto salesmen, by removing the strong incentive there would otherwise be for them to work seven days per week. The Court concluded that the dealership failed to prove that Louisiana's Sunday closing law did not bear any rational relationship to the purposes. It also noted that the law affected equally all persons engaged in the business of selling new and used vehicles, and did not invidiously discriminate among classifications of persons. Accordingly, the Court held the Sunday closing law did not violate the dealership's constitutional due process or equal protection rights.

Finally, the Court rejected the dealership's claim that the law amounted to "special legislation," because it found that the Sunday closing law operated "on a subject in which the people at large are interested and affects people throughout the state, even if some only indirectly."[12]

The Louisiana Supreme Court's treatment of that state's Sunday closing law for dealers is helpful to proponents and defenders of similar state statutes. This case provides three additional "legitimate" purposes to which such Sunday closing laws may be "rationally related." Notably, this case shows a state's Supreme Court agreeing with evidence indicating that dealers do not suffer financially by being prohibited from opening up on Sundays, and that smaller dealerships could, in fact, be harmed financially by being forced to open on Sunday in order to compete with larger metropolitan dealerships.

D. Maine – *Kittery Motorcycle, Inc. v. Rowe*, 320 F.3d 42 (1st Cir. 2003)

This case involves a lawsuit filed by a franchise motorcycle dealership challenging Maine's Sunday closing law. The opinion is noteworthy in part because it was issued by the United States Court of Appeals for the First Circuit, rather than a state court. The factual setting of this case is also of interest because the dealership's arguments included the claim that he was losing significant sales to competing motorcycle dealerships located across the border in New Hampshire, which has no Sunday closing law relating to motorcycles.

Noting that "Sunday closing laws may be vestiges of a bygone era," the First Circuit nonetheless upheld the constitutionality of Maine's Sunday closing law despite the dealership's claim that the law violated his rights to equal protection and due process of law, afforded by the United States Constitution.[13] In reaching its decision, the First Circuit applied the same "rational basis" test used in the state court opinions previously discussed, noting that there was no fundamental right or "suspect" classification involved, and thus a "strict scrutiny" review was not required.

The dealership's primary argument in this case was that the Maine legislature had, over many years, gutted the state's general Sunday closing law by creating numerous exceptions to the law, leaving only motor vehicle dealers (including motorcycle dealers) subject to the law. The dealership argued because the many exceptions to the law left only motor vehicle dealers subject to its terms, the Sunday closing law no longer bore any rational relationship to the state's purported purpose for the law– to promote Sunday as "a day of rest and relaxation." Thus, Kittery argued, dealerships were being unfairly "singled out."

The First Circuit rejected this argument, noting a previous opinion from the First Circuit in which it was held that states are allowed to include or exclude different types of businesses from their Sunday closing laws as the state legislatures may see fit to do on a step by step basis. It also rejected the argument that there was no rational basis for the law, noting that dealership sales personnel, who work on a commission basis, would feel compelled to work if dealerships were open on Sunday, thus undermining the state's goal of promoting a "day of rest." The First Circuit was also not swayed by the "border competition" argument.

Interestingly, the Maine Auto Dealers Association filed an amicus brief, in which it argued in support of keeping the Sunday closing law on the books. The opinion notes the Maine Association was the original sponsor of the Sunday closing law for motor vehicle dealers and over the years had "repeatedly lobbied against attempts to amend, repeal, or water down" the law.[14]

Cases Striking Down Sunday Closing Laws

There is only one appellate case from relatively recent times in which a Sunday closing law for motor vehicle dealers was held to be unconstitutional. One other court would have struck down such a law if the proper parties had been sued at the trial level.

A. Connecticut – *Fair Cadillac-Oldsmobile Isuzu P'ship v. Bailey*, 640 A.2d 101 (Conn. 1994)

In 1979 the Supreme Court of Connecticut struck down as unconstitutional Connecticut's "general" Sunday closing law, which applied to many businesses other than motor vehicle dealers. At that time the Court found the state's general Sunday closing law to be a violation of the plaintiff's constitutional right to substantive due process (*i.e.*, an unjustified impingement by the state on the plaintiff's property right to operate its business).

The 1979 case left only a few remaining vestiges of Connecticut's Sunday closing law, one of which was the requirement that motor vehicle dealers remain closed on Sunday. In the *Fair Cadillac* case, the dealership filed suit seeking a declaratory judgment finding the dealer portion of the law to be unconstitutional on substantive due process grounds, relying on the earlier case for support. As in the other cases examined, the Supreme Court of Connecticut agreed that the statute in question would survive the challenge if it passed the "rational basis" test, because it was not a statute that established a suspect classification or restricted a fundamental right. However, unlike the previous cases, the Court in this case found that the statute failed, and thus the statute was held to be unconstitutional.

The primary defendant, the Commissioner of Motor Vehicles, argued that the state's purpose in enacting the Sunday closing law related to motor vehicle dealers was to "create a common day of rest" and the law was rationally related to this purpose. Not only did this Court reject that argument but also refused to speculate as to other possible governmental purposes to which the statute might be rationally related. The Court did not follow the approach of the previous cases examined in that it did not look for any conceivable purpose to which the law could relate. Rather, based on the evidence, it found that the state's goal to promote a common day of rest was not advanced by forcing only motor vehicle dealers to remain closed on Sunday. The Court was moved to this conclusion in large part because nearly all other types of retail business were permitted to remain open on Sunday,

The Court also was moved by the fact that the Connecticut Sunday closing law for dealers was penal in nature. Connecticut dealers were subject both to fines and possible suspension of their dealers' licenses, if they violated the law. The Connecticut Court summarized as follows:

> [W]e conclude that the plaintiffs have proven beyond a reasonable doubt that [the Sunday closing law for motor vehicle dealers] is arbitrary and therefore violates…our state constitution. The current statutory scheme fails to provide a common day of rest for Connecticut's people, and we cannot discern any legitimate reason for providing a common day of rest for one narrow class of employees, or, in regard to consumers, from one specific type of purchase. Furthermore, [the law] may actually harm the public by making it inconvenient and difficult for people to comparison shop for motor vehicles at different dealerships.[15]

This case should stand as a warning concerning any challenge which might be brought against similar laws, because it represents a state supreme court striking down a dealer-specific Sunday closing law using the same basic facts, reasoning, and rationale as were reviewed by the courts of those other states in which such laws were upheld. Further, it shows a reviewing court refusing to speculate concerning possible legitimate purposes for such a law in order to uphold it, unlike the courts of other states in which such laws have been upheld.

B. Texas – *Motor Vehicle Board v. El Paso Independent Automobile Dealers Association, Inc.,* 37 S.W.3d 538 (Tex. App. 2001)

In this case the Texas Court of Appeals vacated a trial court's judgment finding that state's Sunday closing law for motor vehicles[16] to be unconstitutional because the lawsuit below had failed to include "necessary" parties – namely the state's Attorney General and the Motor Vehicle Board of the Texas Department of Transportation (which was responsible for enforcement of the Sunday closing law and for licensure and regulation of the state's motor vehicle dealers).

The trial court's judgment striking down the law was essentially a consent judgment, meaning that the parties to the action negotiated the terms of the judgment without actually conducting a trial on the legal issues. This is noteworthy because the defendants before the trial court, being El Paso County and local officials, agreed during negotiations that the state's Sunday closing law for dealers was unconstitutional, and thus agreed to the trial court's judgment striking down the law. However, the Attorney General and Motor Vehicle Board belatedly sought to become parties to this action, after the judgment was entered and despite the Attorney General being notified of the lawsuit before the judgment was entered and being offered an opportunity to participate, but declining at that time to do so. The appeal was brought to consider these parties' argument that the judgment was invalid without their participation.

Despite the Court of Appeals' strong disapproval of the Attorney General's belated efforts to become involved in the case, it found the Attorney General and the Texas Motor Vehicle Board to be "necessary" (*i.e.,* legally indispensable) parties to any case involving the Sunday closing law. The reasoning was the Motor Vehicle Board has primary enforcement authority over dealers concerning the Sunday closing law, and because the Attorney General is both the Board's attorney and was responsible for defending the constitutionality of the statute itself.

While the Court of Appeals' opinion does not disclose why the original defendants agreed that the state's law was unconstitutional, the opinion does provide guidance for any similar lawsuit brought elsewhere. The lesson here is that all "necessary party" defendants must be considered and included in any state court case brought to challenge the constitutionality of a Sunday closing law. It is also interesting to note that we could locate no further litigation in Texas courts concerning that state's Sunday closing law; apparently the plaintiffs in the *El Paso* case elected not to re-file their lawsuit naming the Attorney General and Motor Vehicle Board as necessary defendants. Thus, Texas' Sunday closing law for motor vehicle dealers

remains on the books, but only due to a legal error resulting from the Attorney General's initial decision not to participate in the lawsuit brought to challenge the law. Absent those circumstances, the Texas law would have been stricken as unconstitutional, although on what precise grounds we cannot say.

Conclusion

As the above cases indicate, Sunday closing laws for motor vehicle dealers have generally fared well when challenged on equal protection or due process grounds. These laws are reviewed using a rational basis standard, a standard that traditionally favors upholding the statutes in question. *Fair Cadillac-Oldsmobile Isuzu Partnership, supra,* remains the only major case striking down a Sunday Closing law as applied to vehicle dealerships. However, the Connecticut Supreme Court's analysis, citing the basis of "promoting a day of rest" as the only possible purpose of the legislation, was unusual and seems unlikely to be used by other courts. The strong majority of courts have taken the approach used in the cases discussed above upholding Sunday closing laws, considering any potential reasonable purpose, whether or not specifically expressed by the state legislature, as sufficient to uphold the law in question. ■

References

1 Our research has revealed that the following states continue to have Sunday closing laws on the books, directed specifically to motor vehicle dealers: Colorado; Illinois; Indiana; Iowa; Louisiana; Maine; Maryland; Michigan; Minnesota; Missouri; New Jersey; North Dakota; Oklahoma; Pennsylvania; Rhode Island; South Carolina; Texas; West Virginia. Several other states have statutes which allow each municipality within the state to decide for itself whether to enact a Sunday closing ordinance (Arkansas; Kentucky; Mississippi; Tennessee), while still others have general Sunday closing statutes which appear to apply to all "merchants" or "sales," presumably including motor vehicle dealers (Alabama; Massachusetts).

2 Such laws are sometimes referred to as "blue laws", whether applied to motor vehicle sales or sales of other types of products and services.

3 House Bills 1735, 1618 (Truly Agreed and Finally Passed), 97th General Ass'y (State of Missouri) (2014).

4 There are a large number of cases from other states involving challenges to other types of Sunday closing laws (*i.e.,* relating to businesses other than motor vehicle dealerships). However, there are separate facts and issues specific to the motor vehicle sales industry which leads to a different analysis by the courts, often making for weak precedent in considering Sunday closing laws for auto dealers.

5 *See Courtesy Motor Sales v. Ward,* 179 N.E.2d 692 (Ill. 1962). The Illinois Supreme Court struck down the Sunday closing law for dealers, because the statute was not "rationally related" to the stated purpose of the law, which was to promote a "common day of rest" for the state's citizens. The Court found this to be irrational when only dealership employees were afforded this "day of rest."

6 *Fireside Chrysler-Plymouth-Mazda, Inc. v. Edgar*, 464 N.E.2d at 278.

7 For example, if a plaintiff challenges a statute because it makes a classification based on race, national origin, etc., the court must employ a "strict scrutiny" standard in which the state is held to a very high burden of proof concerning the necessity for the classification based on such factors.

8 *McDonald Pontiac-Cadillac-GMC, Inc. v. Prosecuting Attorney of Saginaw*, 388 N.W.2d 301, 303 (Mich. Ct. App. 1996).

9 *Id.*at 304 (emphasis added).

10 *Lakeside Imports, Inc. v. State*, 639 So.2d 253, 256 (La. 1994).

11 The state presented the testimony of four other dealerships, in defense of the Sunday closing law, concerning the "finite" number of sales which could reasonably be expected to occur on Sundays, and concerning the additional overhead cost and competitive factors which would come into play if dealerships were to be allowed to open on Sundays.

12 The Constitution of Missouri, for example, also prohibits the passage of "special" or "local" laws (i.e. those which benefit or restrict only a particular group of persons or a particular location), albeit only if passed without the required notice to affected persons. Mo. Const. Art. III, §42.

13 *Kittery Motorcycle, Inc. v Rowe*, 320 F.3d 42, 45 (1st Cir. 2003).

14 *Id.* at n.6.

15 *Fair Cadillac-Oldsmobile Isuzu Partnership v. Bailey,* 640 A.2d 101, 107 (Conn. 1999).

16 The Texas Sunday closing law prohibits dealers from selling or offering to sell motor vehicles on "consecutive days of Saturday and Sunday", and thus would apparently allow dealers to remain open on Sunday if they opted to close the preceding Saturday. The law is penal in nature. *See* §§728.002 and 728.003, Tex. Transp. Code (2004). The Texas law dates only from 1995.

Executive Director's Message

Erin H. Murphy
NADC Executive Director

The NADC 10th Annual Member Conference, held April 27-29, in Palm Beach, Florida was a success. The warm, inviting weather and the cool ocean breezes did not hurt either! We had a record breaking 180 members in attendance. Many folks came early to enjoy the sunny Florida weather and the resort's offerings.

Of course, the educational sessions were not to be missed! Topics on the first day included a legal and regulatory update from our friends at the NADA, electronic vehicle titling and odometer disclosures, top ten estate planning issues facing auto dealers, a primer on key challenges facing dealers with regards to factory relations, and understanding the statistics behind dealership lending and disparate impacts. On the second day, topics covered F&I and reinsurance strategies, 2014's top legal issues for dealers, protecting your dealership against fraud, and employment law.

The NADC would like to offer additional continuing legal education programs throughout the year through webinars. Webinars are a great way to continue information sharing when we are not together, in person, at our biannual Conferences. Webinars also offer a great medium to present topics that might appeal to a smaller, more niche audience.

We are currently looking for presenters and webinar suggestions. Please let me know if you have a topic or session that you would like to offer to the membership through a webinar. Furthermore, if you have a topic that you would like to see covered, please let me know. I will do my best to seek the right presenter on the topic.

It is important to develop and share our knowledge and expertise with members and the auto dealer community. Please contact me at emurphy@dealercounsel.com if you are interested in a webinar opportunity.

Our 2014 NADC Fall Conference will be held October 26th – 28th at the Trump International Hotel & Tower in Chicago, Illinois. Please watch your email for more details. We look forward to welcoming you to Chicago in the fall!! ■

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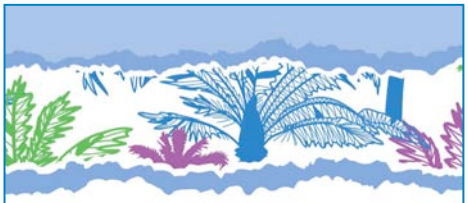

2014 10th Annual NADC Member Conference

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Are you interested in presenting at the NADC 2014 Fall Conference? If you have an interesting and informative program idea, please submit the following to Erin Murphy at emurphy@dealercounsel.com by **Wednesday, June 25, 2014**:

- Session Topic
- Outline and/or short description of session
- Names and bios of presenters
- Requested length of time

The Program Planning Committee will review all proposals. Proposals not chosen for the Conference will be considered for future webinars and/or the 2015 Annual Member Conference.


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

Andrew J. Weill, *Benjamin, Weill & Mazer*
Kellen Furlin, *Benjamin, 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).

NADC Member Announcements

Do you have an announcement or an accomplishment that you would like to share with the NADC community? We are starting a new section where we will highlight member's achievements. Please send any news you would like to share to emurphy@dealercounsel.com.

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