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**CROSS-AGENCY REGULATION OF SERVICE CONTRACTS
IN TEXAS****Speakers:**

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CROSS-AGENCY REGULATION OF SERVICE CONTRACTS IN TEXAS

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I. Introduction

Under Texas law, a business that sells a contract to provide for windshield repair must be licensed by the Texas Department of Licensing and Regulation (“TDLR”) and comply with service contract regulations. However, a business that sells a contract to provide for windshield *replacement* is engaged in the business of insurance and must be licensed by the Texas Department of Insurance (“TDI”) and comply with insurance regulations. A business that offers contracts to repair or replace windshields must be licensed by both agencies. Yet, the windshield manufacturer that provides a warranty to repair and replace a defective windshield is not subject to the jurisdiction of either agency.

Also, under Texas law, a consumer with a complaint about a manufacturer or retailer who promised to repair or replace a television if it malfunctions may need to talk to the Texas Attorney General’s office regarding a breach of a warranty. But if the consumer separately paid for that promise, the complaint may need to go TDLR regarding a service contract. The same complaint about the consumer’s oven, on the other hand, should be sent to the Texas Real Estate Commission (“TREC”) regarding a residential service contract.

These examples demonstrate the current cross-agency regulatory approach regarding a category of contracts of a similar nature—where a consumer’s risk associated with a product being defective, damaged, or lost is transferred to another party by agreement. A consumer’s risk regarding products can be transferred to a manufacturer through a warranty to repair or replace the product if it is defective. Insurance companies accept risk for loss and damage to products by agreeing to indemnify consumers for covered losses. Texas also has service contract providers that sell service contracts (sometimes called “extended warranties,” “service agreements,” or “services plans”) that combine features of warranties and insurance. Moreover, Texas has real estate agents who are authorized to sell residential service contracts (sometimes called “home warranties”) to cover fixtures and appliances in an established home, which are different from a service contract that may cover other items in the home. Small variations in the terms of a particular “risk transfer” contract may trigger large changes in the regulatory consequences.

The purpose of this paper is to outline the various regulatory schemes that govern risk transfer contracts, noting the gaps and overlaps created by the cross-agency regulatory approach. The first section will provide an overview of the historical development of the various kinds of risk transfer contracts and the subsequent regulatory response to those changes. The second

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section of this paper outlines the current regulatory schemes that govern the various risk transfer contracts, including regulatory enforcement of manufacturers' warranties, TDLR regulation of service contracts, TREC regulation of residential service contracts, and TDI regulation of insurance.

II. Overview of Risk Transfer Contract Regulation in Texas

A. Insurance

Insurance companies have been subject to government restrictions in various forms at all times during the history of the United States. *See* Howell E. Jackson and Edward L. Symons, Jr., *Regulation of Financial Institutions*, 432-33 (1999). During the pre-civil war period, the predominant regulatory tool applied to insurance industry was the required publication of periodic financial reports. *See id.* Some states additionally limited the total risk of liability to a percentage of the company's capital, restricted the lines of business a company could write, and required financial reserves. *See id.* In recognition of the need for state regulatory coordination, a group of insurance commissioners began meeting in 1871, which subsequently developed into the National Association of Insurance Commissioners ("NAIC"). *See id.* at 435.

Texas began to regulate insurance in the 1870s, although certain Texas insurance corporations were created by special act of the Legislature prior to that time. *See* Texas Department of Insurance, History, available at <http://www.tdi.texas.gov/general/history.html>. The Legislature enacted the first general insurance statute in 1874, regulating life and health insurance company formation, activities and coverage. *See id.* In 1876, based on the new authority granted in the State Constitution, the Legislature established the first Texas Office of Insurance Commissioner. *See id.* In 1927, the Legislature replaced the Office of Insurance Commissioner with the Board of Insurance Commissioners, composed of a Life Insurance Commissioner, a Fire Insurance Commissioner, and a Casualty Insurance Commissioner. *See id.* The State Board of Insurance was created in 1957, which had the authority to hire a Commissioner of Insurance to serve as chief administrative officer. *See id.* In 1993, the Board's authority was transferred to a Commissioner appointed by the Governor for a two-year term and confirmed by the Texas Senate. *See id.*

Generally, insurance is regulated because the value of the promise sold to the consumer by the insurer rests in future performance. *See* Keyvan Samini, Comment, *Third Party Extended Warranties and Service Contracts: Drawing the Line Between Insurance and Warranty Agreements*, 54 OHIO ST. L. J. 537, 538-39 (1993). Insurance regulators have utilized a variety of tools designed to measure, monitor, and protect the financial solvency of an insurance company. The regulations provide standards for insurance forms and transaction details to avoid consumer confusion and enforcement mechanisms to address unapproved insurance company conduct. Insurance companies and their agents also have to meet a variety of standards regarding competence and financial security to be licensed to sell or provide insurance. Moreover, states typically have detailed procedures for addressing failing insurance companies and guarantee funds to protect against consumer harm.

B. Consumer Product Warranties

A product warranty in the general sense is a promise, either express or implied, regarding the quality or condition of the product being sold. Warranties under Texas law are commonly created by agreement as part of a consumer contract, but may also be established by statute and under common law. Product manufactures have offered standardized express warranties that provide specific remedies for a defect in material or workmanship since the early 1900s. *See* George L. Priest, *A Theory of the Consumer Product Warranty*, 90 YALE L. J. 1297, 1297 (1981); *see also* *Caples v. Port Huron Engine & Thresher Co.*, 131 S.W. 303, 305 (Tex. Civ. App. 1910) (discussing a replacement warranty for wagons). Over time, however, the remedies provided by product warranties generally became more restricted and often expressly negated broader implied warranties of merchantability and fitness for a particular purpose. *See* Christopher Smith, *The Magnuson-Moss Warranty Act: Turning the Tables on Caveat Emptor*, 13 CAL. W. L. REV. 391, 392 (1977).

During the 1960s and 1970s, federal and state governments took a variety of actions in response to growing consumer dissatisfaction fueled by complaints regarding manufactures and retailers not honoring their limited warranties and a perceived decline in product quality and durability. For example, in 1968, President Lyndon Johnson established a Task Force on Appliance Warranties and Service, which studied over 200 warranties for major appliances. *See id.* Additionally, in 1970, the Federal Trade Commission conducted a study of automobile warranties, concluding that the quality of automobiles was generally unsatisfactory and the warranty coverage was inadequate and confusing to consumers. *See id.*

The Texas response to these and other consumer issues was the 1973 enactment of the Texas Deceptive Trade Practices Act (“DTPA”). *See* Philip K. Maxwell, *Public and Private Rights and Remedies Under the Deceptive Trade Practices—Consumer Protection Act*, 8 ST. MARY’S L. J. 617, 620-21 (1977). As described in Section III.A below, the DTPA created new standards for enforcing claims for breach of warranty and deceptive conduct. Moreover, the DTPA granted the Attorney General powerful new tools to enforce the DTPA, including the power to seek temporary and permanent injunctions, significant civil penalties, and restitution for consumers. Nevertheless, the Attorney General’s ability to enforce standards regarding product warranties is limited to taking action based on past bad conduct. The Attorney General has no power to proactively compel warranty providers to disclose clear warranty terms and honor those terms.

C. Service Contracts

Generally, service contracts are agreements between consumers and either manufacturers, retailers, or independent service contract providers to repair or replace a defective or malfunctioning product or to indemnify the consumer for the cost of repair or replacement. Unlike warranties, a consumer generally purchases a service contract separately from the product that is covered by the contract. Unlike insurance, a service contract generally covers defects and failures in the product, not losses caused by external influences or events.

Declines in the quality of standard manufacturer’s warranty coverage in the 1960s and 1970s contributed to the increased demand for service contracts. *See* Sue E. Myerscough, Comment, *Service Contracts: A Subject for State Insurance or Federal Regulation—Do*

Consumers Need Protection from the Service Contract Industry?, 4 S. ILL. U. L.J. 587, 591 (1979). Yet, concerns regarding service contracts quickly arose, including complaints regarding exorbitant prices, failure to disclose coverage terms, unfounded denial of coverage, and poor repair of the product. *See id.* at 588.

Many states reacted by scrutinizing service contracts and service contract providers. Some states concluded that selling and administering service contracts constituted the business of insurance and applied insurance regulations to control misconduct. In the 1970s, the NAIC promulgated various model service contract statutes designed to exclude service contracts from insurance regulations but nevertheless assure that service contract sellers and obligors were financially responsible, capable of future performance, and not engaging in deceptive or unfair business tactics. *Id.* at 615.

D. Texas Residential Service Contracts

In 1979, Texas created a regulatory scheme under the Texas Real Estate Commission to oversee “residential service contracts” for the maintenance, repair, or replacement of residential structural components, appliances, and electrical, plumbing, heating, cooling, and air-conditioning systems.² The House Committee on Insurance noted that residential service contracts were relatively new in Texas at that time. *See* House Comm. on Ins., Bill Analysis, Tex. H.B. 962, 66th Leg., R.S. (1979). The contracts were offered mostly to protect buyers and sellers of residential property from defects and breakdowns in appliances and heating and cooling systems. *See id.* The Committee reported its understanding that other states had considered construing the contracts as the business of insurance, although that issue had not been raised in Texas. *See id.*

Representative Browder introduced H.B. 962 in the House Committee on Insurance. Browder noted that home warranty companies had been offering residential service contracts for approximately five years in Texas. *See* Hearing on Tex H.B 962 Before the House Comm. on Ins., 66th Leg., R.S. (March 6, 1979) (statement of Representative Browder). He explained that it was his understanding that California had recently determined that similar service contract programs constituted the business of insurance and could only be provided by insurance companies. *Id.* H.B. 962 was intended to protect consumers while allowing home warranty companies already operating in Texas to continue in business without the administrative burden and expense of reorganizing as insurance companies. *Id.*

Notably, H.B. 962, as filed, amended the Texas Insurance Code and delegated the regulation of residential service companies to the State Board of Insurance. *See* H.B. 962, 66th Leg., R.S. (1979) (as filed on February 8, 1979). The Property and Casualty subcommittee of the House Committee on Insurance, however, adopted a substitute to H.B. 962, which delegated the regulatory authority to the Texas Real Estate Commission instead. *See* C.S.H.B. 962, 66th Leg., R.S. (1979) (as adopted on May 3, 1979). The House Committee on Insurance explains the change in the Bill Analysis for C.S.S.B. 962, which states: “It is felt that the companies should not be regulated by the State Board of Insurance, but that jurisdiction properly lies with the

² The Residential Service Company Act became effective on August 8, 1979. It was originally enacted as Article 6537b of Title 113A of the Revised Civil Statutes of Texas then codified in 2001 as Chapter 1303 to the Texas Occupations Code.

Texas Real Estate Commission.” House Comm. on Ins., Bill Analysis, Tex. H.B. 962, 66th Leg., R.S. (1979).

The only witness to testify at the Committee hearing on H.B. 962 was Mark Hanna, representing the Texas Association of Realtors and American Home Shield. *See* Hearing on Tex H.B. 962 Before the House Comm. on Ins., 66th Leg., R.S. (March 6, 1979). Hanna explained how the contracts were traditionally marketed by licensed real estate salesmen. *See id.* Hanna indicated that he actively sought input from the Texas Insurance Board on H.B. 962. *See id.* Hanna testified that Insurance Board Chairman, Lyndon Olson, believed that residential service contracts were more like repair and maintenance contracts than insurance, and therefore regulatory authority over these types of service contracts more appropriately lies with TREC. *See id.* According to Hanna, a key purpose of the legislation was to avoid the California situation, where residential service companies were “essentially put out of business overnight” when the California Attorney General ruled that they were engaged in the business of insurance. *See id.* Hanna also noted that California and Florida passed legislation similar to Tex. H.B. 962 shortly after the California Attorney General ruling. *See id.*

E. Texas Service Contract Regulatory Act

In 1997, the Texas Legislature passed S.B. 1913 to exempt other service contracts from insurance regulations, which was subsequently vetoed by Governor George Bush. *See* Tex. S.B. 1913, 75th Leg., R.S. (1997); *see also* Tex. H.B. 3036, 75th Leg., R.S. (1997). The Senate Committee on Economic Development reported that Texas law was “silent regarding the sale of a service contract by the manufacturer or seller of the property covered,” and the bill was intended to clarify that those transactions are not subject to the Insurance Code. *See* Senate Comm. on Econ. Dev., Bill Analysis, Tex. S.B. 1913, 75th Leg., R.S. (1997). Representative Smithee described the companion bill in the House Insurance Committee as a response to the increasing prevalence of used car dealerships that sold service contracts. Hearing on Tex. H.B. 3036 Before the House Comm. on Ins., 75th Leg., R.S. (April 7, 1997). Tom Bond, representing a variety of businesses, was the only witness to testify in the Senate and House committee hearings. *See* House Comm. on Ins., Committee Meeting Witness List, Tex. H.B. 3036, 75th Leg., R.S. (April 7, 1997); Senate Comm. on Econ. Dev., Committee Meeting Witness List, Tex. S.B. 1913, 75th Leg., R.S. (April 8, 1997). Bond explained that he worked closely with TDI in drafting the legislation and that various industry associations supported the bill.

S.B. 1913 provided a blanket exemption from insurance regulations for manufactures and sellers without creating any additional regulatory oversight. Third-party service contract providers, on the other hand, were subject to certain conditions to qualify for exemption. First, a third-party service contract provider would have to act through the manufacturer or seller of the covered product. *See* Tex. S.B. 1913, 75th Leg., R.S. (1997). Second, the third-party provider must maintain insurance to cover its obligations from an insurer licensed to do business in Texas. *See id.* Third-party service contract providers who have no relationship with the manufacturer or seller were not addressed by the bill, leaving open the possibility that the sale and administration of service contracts by those providers may be considered the business of insurance.

S.B. 1913 was voted out of the Senate and House committees without objection. Prior to enrollment, the bill was amended to include “asset management contract” as another type of

contract that was not governed by the insurance regulations. *See* Tex. S.B. 1913, 75th Leg., R.S. (1997) (as engrossed, April 29, 1997). After final passage, Governor Bush vetoed the legislation. In his Veto Message, Governor Bush explained that, after conferring with the Commissioner of Insurance, the bill may allow the “unregulated sale of insurance, including fire, theft and other casualties normally covered by property and casualty insurance.” *See* Veto Message of Gov. Bush, Tex. S.B. 1913, 75th Leg., R.S. (1997).

In the subsequent session, the Legislature readdressed service contracts resulting in the enactment of the 1999 Service Contract Regulatory Act (“SCRA”), which is described in more detail in Section III.B below. Unlike the prior version of service contract legislation, the SCRA enables the Texas Department of Licensing and Regulation to oversee a new regulatory scheme based on the 1995 NAIC model “Service Contracts Act”. Moreover, unlike the prior legislation’s purported purpose of clarifying which transactions are subject to the Insurance Code, the SCRA was reportedly enacted to address “exposing consumers to unscrupulous contract providers and leaving them without reasonable remedies to receive the benefits of the contract.” *See* House Licensing & Admin. Procedures, Bill Analysis, Tex. H.B. 2845, 76th Leg., R.S. (1999).

The SCRA was enacted without public opposition. Representative Brimer explained the mechanics of the bill in the House Committee on Licensing and Administrative Procedures, using service contracts for computers and stereos as examples of the types of contracts that would be regulated under the new statute. *See* Hearing on Tex. H.B. 2845 Before the House Comm. on Licensing & Admin. Procedures, 76th Leg., R.S. (April 21, 1999). Representative Brimer noted his understanding that TDI did not view service contracts as within its regulatory scope and that TDLR would be the appropriate agency to license and oversee service contract providers. Tom Bond, again representing various businesses and associations, testified in favor of the legislation and noted the bill was similar to legislation adopted in sixteen other U.S. states. *See id*; Hearing on S.B. 1775 Before the Senate Comm. on Econ. Dev., 76th Leg., R.S. (March 30, 1999). The SCRA is the current statute that regulates service contracts in Texas.

III. Current Texas Laws Governing Risk Transfer Contracts

A. Warranties

This section focuses on manufacturer or retailer’s limited “repair or replacement” warranties for consumer products, which are not subject to specific regulation by any Texas state agency. Warranties generally are less regulated than the other risk transfer contracts described above, including service contracts, residential service contracts, and insurance contracts. Although the Texas Attorney General appears to have broad authority to enforce warranties under the DTPA, there are no specific regulatory requirements or restrictions imposed by the Attorney General that affect the sale and performance of warranties in Texas. Thus, the only available resource for determining the scope of potential warranty regulation in Texas is past Attorney General enforcement actions pertaining to warranties.

1. Definition of “Warranty” for Consumer Products

There is no uniform definition of a “warranty” under Texas law. Warranties are created either by statute or under common law, yet neither authority provides a specific definition of warranty. Although Texas Business & Commerce Code chapters 2 and 2A (the Texas UCC) is the primary authority on warranties for consumer goods, the Texas UCC does not define “warranty,” and there is no consistent common law interpretation of that term. Texas cases only generally describe warranties as “promises” regarding the quality or condition of the goods sold. *See, e.g., Church v. Ortho Diagnostic Sys., Inc.*, 694 S.W.2d 552, 555 (Tex. App.—Corpus Christi 1985, writ denied) (stating that the term “‘warranty’ contemplates that a sale or contract has been made and the seller, to induce the sale, undertakes to vouch for the condition, quality, quantity, or title of the thing sold”) (internal citations omitted). Further, while a warranty action based on the Texas UCC or common law can be brought under the DTPA, the DTPA does not itself define “warranty” or create any warranties. *La Sara Grain Co. v. First Nat. Bank of Mercedes*, 673 S.W.2d 558, 565 (Tex. 1984); *see also Parkway Co. v. Woodruff*, 901 S.W.2d 434, 438 (Tex. 1995) (warranties “actionable under the DTPA must be recognized by the common law or created by statute”).

Although there are various types of warranties, both express and implied, this section focuses on a category of express or contract-based warranties for consumer goods known as “limited warranties.”³ In particular, the analysis below focuses on the written, limited warranties contained in warranty booklets that consumers receive when they buy a mobile phone, home electronics, or other consumer products. In most circumstances, limited warranties are conspicuously labeled as such in the warranty booklet that is supplied at the time of sale. *Cf.* Magnusson-Moss Warranty—Federal Trade Commission Improvement Act (“Magnusson-Moss Act”) § 103, 15 U.S.C. § 2303 (describing the federal warranty statute’s requirement that written warranties to be labeled either as “full” or “limited”).

A “limited warranty” can best be defined as a manufacturer’s or retailer’s written agreement, made as part of a sale contract, that: (1) a consumer product will be free from defects in material or workmanship; (2) for a stated period of time; (3) under normal use; and (4) that the

³ Although the Texas UCC does not define a “limited warranty,” it generally describes “express warranties” for consumer goods in the following manner:

(a) Express warranties by the seller are created as follows:

- (1) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.
- (2) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.
- (3) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(b) It is not necessary to the creation of an express warranty that the seller use formal words such as “warrant” or “guarantee” or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller’s opinion in commendation of the goods does not create a warranty.

TEX. BUS. & COM. CODE § 2.313(a)-(b). Based on this description, most limited warranties incorporated into a sale contract are, by their nature, express rather than implied warranties. *Compare id.* at § 2.313(a) (describing warranties that are part of the basis of the bargain) *with id.* at §§ 2.314-.315 (describing warranties that are implied in contracts).

manufacturer or retailer will repair or replace any defective parts during the warranty period.⁴ Examples of limited warranties meeting this definition are found in various Texas cases:

Case	Limited Warranty Description
<i>Design Tech Homes, Ltd. v. Maywald</i> , No. 09–11–00589–CV, 2013 WL 2732068, at *1 (Tex. App.—Beaumont June 13, 2013).	“The ACES limited warranty was purchased by DTH for the Maywalds, and the cost of the warranty was included in the contracted cost of the house. The Maywalds were given the ACES ‘Builder Limited Warranty and Performance Standards’ which explains that the builder is the warrantor and ACES is the warranty administrator. The ACES warranty states that ‘[s]ubject to the provisions of this Limited Warranty, builder will repair or replace a Major Structural Failure occurring during the ten year warranty period.’”
<i>Basham v. Audiovox Corp.</i> , 198 S.W.3d 9, 12 (Tex. App.—El Paso 2006, pet. denied).	“Audiovox . . . provided a 90-day limited warranty: AUDIOVOX CORPORATION (the Company) warrants to the original retail purchaser of this product that should this product or any part thereof, under normal use and conditions, be proven defective in material or workmanship within 90 days from the date of original purchase, such defect(s) will be repaired or replaced with new or reconditioned product (at the Company’s option) without charge for parts and repair labor.”
<i>Harley-Davidson Motor Co., Inc. v. Young</i> , 720 S.W.2d 211, 214 (Tex. App.—Hous. [14 Dist.] 1986, no writ).	“Harley-Davidson warrants to the first purchaser only of our 1980 model motorcycles that our Selling Dealer will repair or replace without charge any parts (except tires and maintenance items) found under normal use in the U.S.A. or Canada to be defective in factory materials or workmanship, and upon the following terms and conditions: 1. The warranty period is six months or six thousand miles, whichever comes first, measured from the date of delivery”
<i>Lankford v. Rogers Ford Sales</i> , 478 S.W.2d 248, 250 (Tex. Civ. App.—El Paso 1972, writ ref’d n.r.e.).	“The wording of the warranty is as follows: ‘Basic Warranty ‘Ford Motor Company warrants to the owner each part of this

⁴ Although this section focuses on Texas warranty law, the authors’ “limited warranty” definition also incorporates the federal Magnusson-Moss Act’s two-part definition of a “written warranty”:

(A) any written affirmation of fact or written promise made in connection with the sale of a consumer product by a supplier to a buyer which relates to the nature of the material or workmanship and affirms or promises that such material or workmanship is defect free or will meet a specified level of performance over a specified period of time, or

(B) any undertaking in writing in connection with the sale by a supplier of a consumer product to refund, repair, replace, or take other remedial action with respect to such product in the event that such product fails to meet the specifications set forth in the undertaking, which written affirmation, promise, or undertaking becomes part of the basis of the bargain between a supplier and a buyer for purposes other than resale of such product.

	<p>vehicle to be free under normal use and service from defects in material and workmanship for a period of 24 months from the date of original retail delivery or first use, or until it has been driven for 24,000 miles, whichever comes first. ***</p> <p>‘All the warranties shall be fulfilled by the Selling Dealer (or if the owner is traveling or has become a resident of a different locality, by any authorized Ford or Lincoln-Mercury dealer) replacing with a genuine new Ford or Ford Authorized Re-conditioned part, or repairing at his place of business, free of charge including related labor, any such defective part. * * *</p> <p>‘The warranties herein are expressly IN LIEU OF any other express or implied warranty, including any implied WARRANTY of MERCHANTABILITY or FITNESS, and of any other obligation on the part of the Company or the Selling Dealer.’”</p>
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As seen in the above examples, limited warranties often disclaim any other express or implied warranties, such as the implied warranty of merchantability, and typically provide repair or replacement as the exclusive remedy. *See generally* TEX. BUS. & COM. CODE § 2.316 (allowing for the exclusion and modification of warranties), *and* § 2.719 (allowing for the contractual modification or limitation of remedies). Because these exclusions and limitations are presumably “bargained for,” courts tend to construe express warranties according to basic contract principles. *See Chaurasia v. General Motors Corp.*, 126 P.3d 165 (Ariz. Ct. App. 2006) (“Express warranties are treated like any other contract and interpreted according to general contract principles.”); *see also Cooper Mach. Corp. v. CIT Corp.*, 577 S.W.2d 356, 361 (Tex. Civ. App.—Ft. Worth 1979, no writ) (“Written warranties must be construed and applied as written.”). Moreover, limited warranties are usually limited to repair or replacement of defective parts for a stated period—e.g., one year. These warranties ordinarily protect against defects discovered in the course of normal use, not those that are caused by unreasonable use, improper maintenance, or other damage.

In sum, the definition of “limited warranty” boils down to a written promise that (A) a consumer product will be free from certain defects for a stated period of time and, if not, (B) the consumer product will be repaired or replaced. This limited repair or replacement warranty is included as part of the actual sale contract (and therefore included in the original cost for a product), not as a separate “service contract” regulated by TDLR or as “insurance” regulated by the TDI. In fact, the SCRA specifically exempts warranties from regulation by TDLR if they are (1) made by the manufacturer or seller without payment of “additional consideration,” and (2) are not “negotiated or separated from the sale” or are “incidental to the sale.” TEX. OCC. CODE § 1304.004(a)(2), (b). Warranties are also distinguishable from insurance in that “a warranty is issued to provide protection against defects or failures in a product, whereas an insurance policy is issued to provide reimbursement or indemnity based on an accident or occurrence unrelated to any defect or failure in the product.” *Rayos v. Chrysler Credit Corp.*, 683 S.W.2d 546, 548 (Tex. App.—El Paso 1985, no writ). These distinctions, regarding the nature of the consideration paid and the protection provided, among others, affect the regulatory treatment of each risk transfer contract.

2. Regulation of Warranties in Texas

There is no Texas statute that expressly provides for state regulation of warranties for consumer products.⁵ Although some statutes like the Texas UCC set standards for warranties that may influence the manner in which they are drafted or sold, that type of “*de facto* regulation” is not the subject of this section. Instead, this paper discusses the extent to which risk transfer contracts, including warranties, are actively regulated by state agencies. In that respect, there is no Texas statute empowering any specific state agency to regulate warranties for consumer products.

a. Attorney General Enforcement Procedures

Although the Texas Attorney General is not expressly authorized to regulate the sale and performance of warranties—for example through licensure or the imposition of financial requirements for manufacturers who provide warranties—the Attorney General nevertheless appears authorized to enforce warranties under the DTPA. Notably, the Attorney General may file suit under the DTPA for a basic breach of warranty, irrespective of whether the warranty was deceptive or unconscionable.

The Attorney General, through its consumer protection division, may file suit under the DTPA on behalf of the State of Texas for breach of an express or implied warranty. *See* TEX. BUS. & COM. CODE § 17.47 (regarding Attorney General’s ability to bring suit for DTPA violations), § 17.50(a)(2) (listing breach of warranty as a cause of action under the DTPA). In any DTPA breach of warranty action, the warranty must be established by reference to other statutory provisions or the common law. *See, e.g., Parkway*, 901 S.W.2d at 438. For this reason, an Attorney General action for breach of warranty under the DTPA may foreseeably be based on breach of the following Texas UCC warranties: express warranty (§ 2.213), implied warranty of merchantability (§ 2.214), and/or implied warranty of fitness for a particular purpose (§ 2.215).

However, the Attorney General could also bring a DTPA action against a manufacturer or retailer not based on breach but rather on the deceptive or unconscionable nature of the warranties sold. *See* TEX. BUS. & COM. CODE § 17.50(a)(1) (prohibiting the use of false, misleading, or deceptive acts or practices), § 17.46 (enumerating a laundry list of deceptive trade practices), and § 17.50(a)(3) (prohibiting any unconscionable action or course of action). For a Section 17.50(a)(1) claim, the Attorney General would have to prove that the warranty was “deceptive” or that the manufacturer or seller made some misrepresentation to a consumer in connection with the warranty. For a Section 17.50(a)(3) claim, the Attorney General would have to prove that the manufacturer or seller took advantage of a consumer’s “lack of knowledge, ability, experience, or capacity.” *Id.* at § 17.45(5); *Bradford v. Vento*, 48 S.W.3d 749, 760 (Tex. 2001). A repair and replacement warranty, however, is not in and of itself unconscionable. *See Taliaferro v. Samsung Telecomm. Am., LLC*, No. 3:11–CV–1119–D, 2012 WL 169704, at *8 (N.D. Tex. Jan. 19, 2012) (finding that a warranty with a limited repair or replacement remedy is

⁵ However, there was a short period (approximately 2005 to 2009) during which residential construction warranties were regulated by the Texas Residential Construction Commission pursuant to the Texas Residential Construction Commission Act. *See* Jana S. Reist and R. Douglas Rees, “Texas Residential Construction Claims After the TRCC,” Seventh Annual Construction Symposium, *available at* <http://www.cooperscully.com/uploads/seminars/Death%20of%20the%20TRCC%20-%20JR.pdf>.

not unconscionable where the value of the consumer product is established by the product itself as is the case with television sets or computers).

Manufacturers or retailers who provide warranties should also be aware that the Attorney General has broad pre-suit investigatory powers. See TEX. BUS. & COM. CODE § 17.61; see also James E. Davis and Jon L. Gillum, *Government Pre-Suit Investigative Powers: A Survey of Common Issues Arising from Investigations by the Texas Attorney General and the Texas Department of Insurance*, 14 TEX. TECH. ADMIN. L.J. 301 (2013). The Attorney General may exercise these powers prior to actually filing suit to enforce a warranty. Although the Attorney General's pre-suit investigatory powers are not equivalent to direct agency regulation, the potential for Attorney General oversight may affect manufacturers and retailers' decision-making in terms of how to draft and sell consumer product warranties.

b. Attorney General Enforcement Remedies

Although the Attorney General does not have the express statutory power to regulate consumer product warranties in Texas, the Attorney General's enforcement mechanisms can nonetheless be quite severe. First, manufacturers and sellers that sell consumer products with warranties should be aware that the Attorney General has broad authority to bring suit whenever the Attorney General "has reason to believe that any person is engaging in, has engaged in, or is about to engage in any act or practice declared to be unlawful by this subchapter, and that proceedings would be in the public interest." TEX. BUS. & COM. CODE § 17.47. Proof of an actual violation is not required. Second, the remedies available to the Attorney General if a manufacturer or seller fails to honor a warranty are substantial. The Attorney General's remedies under the DTPA include temporary and permanent injunctive relief, civil penalties, restitution (and disgorgement), and assurances of voluntary compliance:⁶

- **Injunctive Relief.** The Attorney General can seek temporary restraining orders and temporary or permanent injunctions. *Id.* at § 17.47(a)-(b).
- **Civil Penalties.** The Attorney General may seek to recover up to \$20,000 in civil penalties per violation. *Id.* at § 17.47(c)(1). "Violation" is not defined by the statute, but the Attorney General typically treats each event or transaction as a separate violation. Furthermore, there is a maximum penalty of \$250,000 per violation when the consumer is over 65 years old.
- **Restitution (and Disgorgement).** The Attorney General may also seek other court orders or judgments that are "necessary to compensate identifiable persons for actual damages or to restore money or property, real or personal, which may have been acquired by means of any unlawful act or practice." *Id.* at § 17.47(c), (d). With respect to "actual damages", the Attorney General may not recover damages incurred "beyond a point two years prior to the institution of the action by the consumer protection division." *Id.* at § 17.47(d). However, when seeking restitution, the Attorney General is not barred by any limitations period. *Thomas v. State*, 226

⁶ One could argue that a company's continuing obligations under an injunction, final judgment, or assurance of voluntary compliance constitutes "regulation" by the Texas Attorney General.

S.W.3d 697, 710 (Tex. App.—Corpus Christi 2007, pet. dismiss'd) (holding that Section 17.47(d) did not limit the State's ability to seek restitution of monies acquired by the defendants through alleged unlawful means more than two years prior to the Attorney General's filing of suit).

- **Assurance of Voluntary Compliance (AVC).** In addition, the Attorney General may accept an assurance of voluntary compliance, which is a voluntary agreement between the Attorney General and the individual or business that allegedly “is engaging in, has engaged in, or is about to engage in” a DTPA violation. TEX. BUS. & COM. CODE § 17.58. An AVC is a court-approved settlement outside of litigation in which the defendant promises its future compliance with the terms of the AVC. Although an AVC is not an admission of any prior DTPA violation, a party's subsequent failure to comply with the terms of an AVC is prima facie evidence of a DTPA violation. *Id.* at §§ 17.58(b)-(c). Further, the terms of the AVC may require restitution and payments of civil penalties and attorneys' fees.

Although this paper does not directly address federal regulation of warranties, it should be noted that the Magnusson-Moss Act provides that the Federal Trade Commission (FTC) or the U.S. Attorney General may file suit to restrain a warrantor from making a deceptive warranty or from otherwise violating the Act. 15 U.S.C. § 2310(c). Further, a warranty violation may be treated as an unfair or deceptive trade practice under the Federal Trade Commission Act. 15 U.S.C. § 2310(b); *see also Compaq Computer Corp. v. Albanese*, 153 S.W.3d 254, 261 n.5 (Tex. App.—Beaumont 2004, no pet.) (“[C]ourts may look to state law in providing enforcement remedies under the MMWA [Magnusson-Moss Warranty Act] with respect to limited warranties.”).

c. Past Attorney General Enforcement Actions Related to Warranties

The Attorney General has enforced warranties for consumer products on at least three occasions in the past. An analysis of those enforcement actions provides helpful guidance in determining the potential scope of warranty regulation in Texas.

1. *State of Texas v. Conn's and Conn Appliances, Inc. (June 8, 2010)*

- **Allegations:** The Attorney General alleged that Conn's trained its sales associates to use high pressure sales tactics and misrepresentations to sell extended warranties and subsequently compensated them with a 15-18% commission for each extended warranty sold. The petition also alleged that the actual terms and conditions of the extended warranty—most of which favored Conn's—were not made available to the consumer and not disclosed by Conn's prior to the sale. Further, the terms that were presented to the consumer prior to the sale did not match the actual terms of the extended warranty. The petition also outlined various consumer complaints which disputed Conn's representations of “award winning service.” The petition does not appear to allege that Conn's failed to honor the terms of any manufacturer's warranties.

- DTPA authority: TEX. BUS. & COM. CODE § 17.46 (laundry list of deceptive trade practices)
- Warranty discussion: The petition distinguishes “manufacturer’s warranties” that are provided to a customer “at no extra charge” from “extended service warranties and product replacement warranties (collectively, ‘extended warranties’)” which are sold for \$100 up to \$1,000 each.
- Form of Resolution: Agreed Final Judgment and Permanent Injunction
- Agreement related to warranties:
 - Enjoined Conn’s from:
 - failing to provide to consumers a copy of the Extended Warranty Agreement at the time of sale;
 - failing to provide a copy of the Extended Warranty Agreement Brochure at the time of the sale;
 - representing to consumers that any Extended Warranty Agreement confers rights, remedies or obligations that it does not have;
 - adding any charges for an Extended Warranty Agreement or other charges to the consumer’s invoice without the consumer’s express written consent.
 - Requires that Conn’s replace any product that fails within 72 hours of purchase or delivery to the consumer;
 - Requires the Conn’s delivery team to remove any product from a consumer’s home that fails at the time of delivery and exchange it for the same or like product;
 - Requires that Conn’s pay restitution to consumers in the amount of \$4,500,000;
 - Requires that Conn’s pay the State of Texas \$250,000 in attorneys’ fees; and
 - Requires that Conn’s pay \$100,000 to the University of Houston Law Foundation to be used for the University’s consumer education programs.

2. ***In the Matter of: State of Texas, and Dell Inc. and Dell Financial Services, LLC (January 9, 2009)***

- Allegations: N/A
- DTPA authority: N/A

- Warranty discussion: The AVC groups “warranty or on-site repair or technical support service” into one category.
- Form of Resolution: Assurance of Voluntary Compliance
- Agreement related to warranties:
 - Restricts Dell from representing at the point of sale and in advertising that it provides “service,” including “warranty or on-site repair or technical support service,” unless it clearly and conspicuously discloses whether “telephone-based troubleshooting” or “remote diagnosis” is required to prior to obtaining service.
 - Requires that Dell disclose what constitutes telephone-based troubleshooting or remote diagnosis prior to finalization of the sale (provided that Dell represents to the consumer that it provides service and also requires the consumer to engage in the troubleshooting and diagnosis before receiving such service);
 - Requires that Dell fulfill its warranty obligations within thirty days from the date that it receives notice of a warranty claim from a consumer, or in cases where the product must be sent to Dell, within thirty days of Dell’s receipt of the product;
 - In cases where a consumer has made a warranty claim within the warranty period, requires that Dell fulfill its warranty obligations regardless of whether the service is performed after the expiration of the warranty period;
 - Requires that Dell honor all implied warranties to the extent required by applicable state law;
 - Implements a process for Dell to handle consumer complaints;
 - Requires Dell to pay \$62,500 for the State of Texas’ attorneys’ fees; and
 - Requires Dell to pay \$162,500 in restitution to consumers.

3. ***State of Texas v. ASAP Motors & Parts Systems, Inc., et al. (October 28, 2007)***

- Allegations: The petition alleges that ASAP Motors, in its advertising, makes false representations regarding the quality of its automobile engines and transmissions, the testing of those products, and the company’s ability to ship any order within days or overnight. The petition also alleges that ASAP delivers incorrect, defective, and damaged units, and that there are significant delivery delays after the consumer is charged for shipping. ASAP Motors would allegedly use delay tactics for returns to avoid paying claims under the warranty. The petition further alleges that ASAP Motors would not honor the terms of its own warranty and instead use claims of

expired warranties to deny refunds or returns to customers. ASAP Motors would also find reasons to deny coverage under the extended warranty and blame the consumer for any defects or damage to the products.

- Warranty discussion: The petition refers to “warranties” generally as well as “extended warranties.” It is unclear exactly what types of warranties are at issue, although it is likely that the petition addresses limited warranties, particularly repair or replacement warranties.
- DTPA authority: TEX. BUS. & COM. CODE § 17.46(a) and (b) (laundry list of deceptive trade practices, specifically including misrepresentations regarding a “guarantee or warranty”)
- Form of Resolution: Agreed Final Judgment and Permanent Injunction
- Agreement related to warranties:
 - Enjoined ASAP Motors from:
 - engaging in various deceptive practices that are designed to avoid the company’s warranty obligations;
 - representing that a product is of a certain “quality” without an express disclosure to a consumer prior to purchase of factors that are used to measure or guarantee such quality;
 - using any warranty that requires a consumer to give up their right to dispute any problem with their credit card company or issuer;
 - using any warranty that requires a consumer to use any arbitration procedure without requiring the same of ASAP Motors and without informing the consumer in writing prior to the purchase that the consumer is giving up and waiving their right to file a court claim;
 - implementing any warranty that begins on any date other than the date on which the consumer receives the product;
 - failing to state in a separate section in the warranty whether any accessories or components that are attached to an engine, transmission or other product are covered by the warranty; and
 - failing to state in a separate section in the warranty whether or not internal parts are free of defects.
 - Requires ASAP Motors to pay \$100,000 in civil penalties;
 - Requires ASAP Motors to pay \$400,000 in restitution to consumers;

- Requires ASAP Motors to pay \$250,000 to the State of Texas for attorneys' fees; and
- Prevents ASAP Motors from selling, conveying, encumbering, transferring, reducing the value of or failing to fully insure certain property until the entire money judgment has been fully and timely paid.

Based on the above enforcement actions, the Attorney General seeks to protect against: (1) inadequate or deceptive disclosures regarding the terms of and charges related to extended warranties purchased by a consumer; (2) impediments to the timely service or repair of consumer products under warranty; and (3) the possibility that warrantors will not honor their warranties and even engage in deceptive practices specifically designed to circumvent warranty obligations.

To avoid future enforcement efforts by the Attorney General, warrantors should seek to draft warranties with clear and conspicuous disclosures, provide the consumer with the product that was promised, and if that product is defective, ensure that the product is repaired or replaced within a reasonable time after discovery of the defect. In addition, monitoring consumer complaints and resolving them as soon as possible may reduce the likelihood of Attorney General intervention.

B. Service Contracts Regulated by the Texas Department of Licensing and Regulation

TDLR regulates “service contracts” pursuant to the Service Contract Regulatory Act contained in Texas Occupations Code Chapter 1304 (“Chapter 1304”) and the corresponding regulations contained in Title 16, Chapter 77 of the Texas Administrative Code. *See* TEX. OCC. CODE §§ 1304; 16 TEX. ADMIN. CODE § 77.

1. Contracts Subject to Regulation by TDLR

The scope of TDLR’s power to regulate service contracts is dictated by the definition of “service contract” and the various exceptions and clarifications contained in Chapter 1304. *See* TEX. OCC. CODE § 1304.003-004. Chapter 1304 defines the term “service contract” as an agreement:

- (1) that is entered into for a separately stated consideration and for a specified term; and
- (2) under which a provider agrees to repair, replace, or maintain a product, or provide indemnification for the repair, replacement, or maintenance of a product, for operational or structural failure or damage caused by a defect in materials or workmanship or by normal wear.⁷

⁷ The Texas Legislature recently passed an amendment to Chapter 1304 as it relates to identity recovery services, which is effective September 1, 2013. As a result, the definition of “service contract” as it relates to identity recover services and the numerical references to that definition will be different in some respects as of September 1, 2013. *See* 2013 Tex. Sess. Law, Ch. 1207 (S.B. 1388). Identity recovery service contracts and legal services contracts, while similar in name, are in large part conceptually different than the other warranties and service contracts discussed above and are beyond the scope of this paper. *See* TEX. OCC. CODE §§ 953, 1306 (repealed as of September 1, 2013).

In addition to this definition, Chapter 1304 provides specific additional examples of permitted coverage as well exclusions of certain products. *See* TEX. OCC. CODE §§ 1304.003(b)-(d), 1304.004.

Based on this definition and Chapter 1304's additional provisions, the following conclusions can be drawn as to the types of contracts regulated by TDLR:

- Chapter 1304 does not apply to “free” warranties or risk transfer contracts that include a service plan in the original cost of the product because such products are not sold for “separately stated consideration”. *See* TEX. OCC. CODE § 1304.003(a)(1). However, because Chapter 1304 contains no definition of the phrase “separately stated consideration,” it is not clear how much flexibility a vendor has in the way it markets and documents a “free” warranty. *Compare* TEX. OCC. CODE § 1304.003(a)(1) *with* TEX. OCC. CODE § 1304.004(2)(B).
- Chapter 1304 does not apply to certain warranties if they are (i) made by the manufacturer, importer, or seller, (ii) made without payment of “additional consideration,” (iii) not “negotiated or separated from the sale,” and (iv) “incidental to the sale”. *See* TEX. OCC. CODE § 1304.004(a)(2), (b). Moreover, to be excluded from TDLR regulation, such warranties must also be limited to (a) indemnity for a defective part, mechanical or electrical breakdown, or labor cost or (a) repair, replacement, or service of a product. *See* TEX. OCC. CODE § 1304.004(2). Because none of these phrases and concepts are defined by Chapter 1304, companies wishing to sell products that fall within this exception are left with many unanswered questions. For example, what is “additional consideration” and how does that differ from the concept of “separately stated consideration” contained in the definition of “service contract”? *Compare* TEX. OCC. CODE § 1303.004(2)(B) *with* TEX. OCC. CODE § 1303.003(1). Similarly, what does it mean for a contract to be “separated from” and “incidental” to the sale? *See* TEX. OCC. CODE § 1303.004(2).
- Unlike “residential service contracts” regulated by TREC, it is arguably permissible for a “service contract” regulated by TDLR to provide for a cash payment to the consumer for certain covered events. *See* TEX. OCC. CODE § 1304.003(a)(2) (permitting “*indemnification for the repair, replacement, or maintenance of a product*” (emphasis added)); *see also* TEX. OCC. CODE § 1304.003(b)(1) (permitting “incidental payment or indemnity under limited circumstances” for such costs as towing, rental, and emergency road service. Moreover, by allowing indemnification, Chapter 1304 specifically allows service contract providers to provide a product that might otherwise be considered insurance regulated by the Texas Department of Insurance. *See* Section III.C *infra*. Still, such indemnification is not open-ended and must be “for the repair, replacement, or maintenance of a product”. *See* TEX. OCC. CODE § 1304.003(a)(2).
- TDLR “service contracts” generally may not provide coverage for more than operational or structural failure or damage caused by a (i) defect in the materials

or workmanship or (ii) normal wear. *See* TEX. OCC. CODE § 1304.003(a). As a result, contracts that attempt to cover theft, loss, or other damage may fall outside of the definition of “service contract” contained in Chapter 1304 and may be considered insurance. In addition, Chapter 1304 contains lengthy provisions that specify what is considered “normal wear” for motor vehicles—provisions which allow service contracts to cover items that are not a result of defects in materials or workmanship and that might otherwise be considered insurance. *See* TEX. OCC. CODE § 1304.003(c) (allowing coverage for “small dents” to vehicles and “road hazards” for tires). Moreover, Texas Occupations Code Section 1304.003(b) permits coverage for certain additional events such as power surge protection, emergency road service, and identity recovery.⁸ *See* TEX. OCC. CODE §§ 1304.003(b)(2)-(b)(3). As discussed in Section III.C below, these types of fringe coverage become considerably complex from a regulatory standpoint because they touch upon areas of coverage that might otherwise be considered insurance regulated by TDI. *See* Section III.C *infra*; *see also* <http://www.tdlr.texas.gov/scp/scpfaq.htm>.

- Chapter 1304 arguably does not apply to warranties that have no end date because such warranties lack a “specified term”. *See* TEX. OCC. CODE § 1304.003(a)(1). As a result, an indefinite or “lifetime” warranty might not be considered a service contract.
- Chapter 1304 does not apply to a “maintenance agreement” which provides for “scheduled maintenance for a limited period”. *See* TEX. OCC. CODE § 1304.004(1).
- Chapter 1304 does not generally apply to products sold to businesses because Texas Occupations Code Section 1304.004(b)(3) excludes service contracts “sold or offered for sale to a person who is not a consumer”. *See* TEX. OCC. CODE § 1304 .004(b)(3). However, the application of this exclusion is not straightforward because of (i) the multipronged definition of “consumer” contained in Texas Occupations Code Section 1304.002(4) and (ii) the cumbersome way that Chapter 1304 relies on negative phrasing so as to exclude “contracts sold . . . to a person *who is not* a consumer” rather than affirmatively limiting service contracts to persons who are consumers.
- Chapter 1304 does not apply to certain service contracts sold by motor vehicle dealers who are licensed under Texas Occupations Code Chapter 2301. *See* TEX. OCC. CODE § 1303.004(a)(6).
- Chapter 1304 does not apply to certain industry-specific products including certain products sold by a local exchange telephone company or an automobile service club. *See* TEX. OCC. CODE §§ 1304.004(b)(5), 1304.004(b)(7).

⁸ As noted above, the Texas Legislature also recently amended the portions of Chapter 1304 that address identity recovery, effective September 1, 2013. *See* 2013 Tex. Sess. Law, Ch. 1207 (S.B. 1388).

- Chapter 1304 does not apply to a “residential service contract” sold by an entity licensed by TREC under Texas Occupations Code Chapter 1303. *See* TEX. OCC. CODE § 1304.004(b)(4); *see also* TEX. OCC. CODE § 1304.005(1).⁹

See TEX. OCC. CODE §§ 1303.003-1303.04.

2. *Persons Who Must Be Licensed by TDLR*

In general, any person or company who acts as a “provider” or “administrator” of a “service contract” in Texas must have a TDLR license. *See* TEX. OCC. CODE § 1304.101. The definitions of a service contract “administrator” and “provider” are set out in Texas Occupations Code Section 1304.002. A “provider” is the person or entity contractually obligated to a service contract holder, while an “administrator” is the person or entity responsible for the third-party administration of a service contract. *See* TEX. OCC. CODE §§ 1304.002(1), 1304.002(7); 16 TEX. ADMIN. CODE § 77.10(2)-(3). Because both of these definitions are limited to the person or entity legally responsible for administering or providing a service contract, it is generally not necessary for employees of providers or administrators to have an individual TDLR license. *See* TEX. OCC. CODE § 1304.002(1) and .002(7); *see also* TEX. OCC. CODE § 1304.101(b).

Unlike “residential service contracts” regulated by TREC, a person who merely sells or markets a “service contract” under Chapter 1304 does not need a TDLR license. *See* TEX. OCC. CODE §§ 1304.101(a-b); *see also* TEX. OCC. CODE § 1304.002(8-a). However, service contract “providers” are required to provide TDLR with information on the persons who sell the provider’s products and who serve as administrators. *See* TEX. OCC. CODE § 1304.102(c). Moreover, Texas Occupations Code Section 1304.1531 requires that sellers process service contract applications and payments in accordance with Chapter 1304, and the prohibited actions specified in Texas Occupations Code Section 1304.161 specifically apply to sellers. *See* TEX. OCC. CODE §§ 1304.1531(d), 1304.161. Furthermore, sellers of service contracts are subject to the investigatory powers of TDLR’s executive director. *See* TEX. OCC. CODE § 1304.051(a).

Texas Occupations Code Section 1304.101(c) generally prevents providers and administrators from outsourcing their respective duties to persons who are not licensed by TDLR. *See* TEX. OCC. CODE § 1304.101(c). However, because administrators must themselves be licensed by TDLR, providers are permitted to appoint licensed administrators to handle the administration and sale of their service contracts. *See* TEX. OCC. CODE § 1304.152. Similarly, because selling a service contract does not require a TDLR license, providers are permitted to engage unlicensed sellers for their products. *See* TEX. OCC. CODE § 1304.1531. Such sellers, however, cannot engage in activities that would require registration as a provider or administrator. *See* TEX. OCC. CODE § 1304.1531(c). And, a provider’s use of sellers or administrators does not eliminate the provider’s duty to comply with the provisions of Chapter 1304. *See* TEX. OCC. CODE § 1304.1531.

⁹ In 2001, Texas Attorney General John Cornyn issued an opinion letter discussing the jurisdictional landscape of service contracts regulated by TDLR and TREC under the applicable statutes that existed at that time. However, that opinion letter contains some conclusions about the jurisdiction of TDLR and TREC which are arguably not accurate under the current versions of Chapter 1303 and 1304. *See* Tex. Atty. Gen. Op. JC-0322, 2001 WL 20504 (2001).

Although ostensibly straightforward, TDLR’s licensing framework creates uncertainties. Most of these gray areas arise for three main reasons. First, companies may not know if they need a license due to the intricate and murky language used to define the term “service contract” and the applicable exceptions noted above. Second, companies may not fully appreciate that the features which determine whether a product is a “service contract”—such as the pricing and method of selling manufacturer’s warranties—may change as the product moves through the stream of commerce. Third, the fact that sellers are not licensed by TDLR means that individuals who are intimately involved in the business of service contracts may not fully appreciate the delicate regulatory framework in which they work and how their own actions could affect whether a product requires a TDLR license. *See* TEX. OCC. CODE §§ 1304.003, 1304.004, and 1304.101.

For example, what if a manufacturer initially includes a “free” warranty with its product but the merchant who subsequently sells that product adds an additional charge for that warranty without the knowledge of the manufacturer? Without that additional sum, the warranty is arguably not a service contract and the manufacturer is arguably not a service contract “provider.” However, by charging that additional sum, the merchant arguably has arguably received additional consideration, thereby potentially transforming the warranty into a “service contract.” By doing so, the merchant has also created the potential need for the manufacturer to have a TDLR “provider” license even though the merchant arguably does not need a license.

Similarly, the applicability of Chapter 1304 to motor vehicle dealers is not straightforward due to specific definitional exclusions and the fact that TDLR does not require service contract “sellers” to have a TDLR license. As a result, some motor vehicle dealers must have a TDLR “provider” license, others may act as unlicensed sellers provided that their contracts are issued by licensed providers, and still others may be entirely free of TDLR regulation. *See* TEX. OCC. CODE § 1304.004(b)(6), 1304.004(a), 1304.101(b); *see also* <http://www.tdlr.texas.gov/scp/scpfaq.htm>.

3. Requirements for Obtaining a License from TDLR

A person or company seeking a license from TDLR must submit an application and fee pursuant to the applicable provisions of Chapter 1304 and TDLR’s administrative rules. *See* TEX. OCC. CODE §§ 1304.102-103; 16 TEX. ADMIN. CODE § 77.80. Providers must submit proper forms, provide control person information, and demonstrate their ability to meet financial security requirements. *See* TEX. OCC. CODE § 1304.1025; 16 TEX. ADMIN. CODE §§ 77.20, 77.40; *see also* <http://www.tdlr.texas.gov/scp/scpforms.htm> (providing downloadable forms created by TDLR). Administrators must submit the materials required by TDLR’s administrative rules, including a completed registration form, information concerning the providers that the administrator will assist, and control person information. *See* 16 TEX. ADMIN. CODE § 77.22. Unlike “residential service contracts” regulated by TREC, providers and administrators of a TDLR “service contract” must (i) renew their licenses annually and (ii) may have to resubmit the same information provided during their initial application process during the renewal period. *See* TEX. OCC. CODE §§ 1304.103, 1304.105, 1304.1025; 16 TEX. ADMIN. CODE § 77.20-23. In addition, providers are required to submit additional information to TDLR concerning websites, administrators, and sellers within 30 days after obtaining a new license—information must be updated with each renewal of a TDLR license. *See* TEX. OCC. CODE

§§ 1304.1025(c-d); 16 TEX. ADMIN. CODE § 77.20(d). It may also be possible to obtain a temporary or emergency license pursuant to general provisions in Chapter 51 of the Texas Occupations Code. *See* TEX. OCC. CODE §§ 1304.407-.408.

4. Continuing Regulatory Duties Overseen by TDLR

A service contract provider company must continuously comply with the financial requirements imposed by Chapter 1304, which help ensure that the company is able to meet its obligations under the service contracts it issues. *See* TEX. OCC. CODE §§ 1304.151, 1304.152; *see also* 16 TEX. ADMIN. CODE §§ 77.40-.43. These provisions require service contract providers to have (i) a reimbursement insurance policy; (ii) a funded reserve account and security deposit; or (iii) a net worth of at least \$100 million. *See* TEX. OCC. CODE §§ 1304.151-.1521; 16 TEX. ADMIN. CODE § 77.40(b). And, each of those options is governed by extensive requirements imposed both by statute and TDLR's administrative rules. *See* TEX. OCC. CODE §§ 1304.151-.1521; 16 TEX. ADMIN. CODE §§ 77.40-.44; *see also* <http://www.tdlr.texas.gov/scp/scpfaq.htm>.

A service contract provider must also maintain accurate accounts, books, and other records as specified in TEX. OCC. CODE § 1304.155. Moreover, providers and administrators must notify TDLR within 30 days of any change to the registration information they provided to TDLR under Texas Administrative Code, Title 16, Chapters 11.20-.23. *See* 16 TEX. ADMIN. CODE §§ 77.70(g)-(h). Considering that TDLR licenses must be renewed annually, it is not surprising that TDLR does not require annual or mid-year reports. However, any service contract provider that ceases operations may be subject to the wind-up provisions set out in Texas Administrative Code, Title 16, Chapter 77.71. *See* 16 TEX. ADMIN. CODE § 77.71.

5. TDLR Requirements and Restrictions Affecting the Sale and Performance of Service Contracts

Chapter 1304 and TDLR's related regulations contain numerous requirements and restrictions affecting the sale and performance of service contracts. These include the following:

- A provider must provide a service contract holder with a receipt or other written evidence of purchase of a service contract. *See* TEX. OCC. CODE § 1304.154(1); *see also* 16 TEX. ADMIN. CODE § 77.70(f). By administrative rule, this receipt must be provided within a timeframe to allow the service contract holder the opportunity to cancel the contract and receive a full refund. *See* 16 TEX. ADMIN. CODE § 77.70(f).
- A provider must provide a service contract holder with a copy of the service contract within a reasonable period after purchase. *See id.* § 1304.154(2); *see also* 16 TEX. ADMIN. CODE § 77.70(e). By administrative rule, this copy must be provided within a timeframe to allow the service contract holder the opportunity to cancel the contract and receive a full refund. *See* 16 TEX. ADMIN. CODE § 77.70(e).
- Service contracts must be in writing and contain numerous pieces of required information as set out in Texas Occupations Code Section 1304.156 and Texas

Administrative Code, Title 17, Chapter 77.70. *See* TEX. OCC. CODE § 1304.156; 16 TEX. ADMIN. CODE § 77.70. The required information includes but is not limited to the price of the contract, the terms and restrictions governing cancellation, the parties involved in the administration and sale of the contract, and the limitations and exclusions under the contract. *See* TEX. OCC. CODE § 1304.156; 16 TEX. ADMIN. CODE § 77.70. Service contract holders are also entitled to various additional disclosures specified in TDLR’s administrative rules. *See* 16 TEX. ADMIN. CODE §§ 77.70(c-d). However, TDLR does not review or approve service contracts. *See* <http://www.tdlr.texas.gov/scp/scpfaq.htm>.

- A service contract must permit the service contract holder to cancel the contract at any time. *See* TEX. OCC. CODE § 1304.1581(a). Any cancellation must be free of charge within the first 30 days of purchase (with a deduction for any claims paid during that period). *See* TEX. OCC. CODE § 1304.1581(b). However, cancellations after 30 days must include a pro-rated refund of the purchase price, but the provider may charge a reasonable cancellation fee up to \$50. *See* TEX. OCC. CODE § 1304.1581(c). A service contract provider that fails to provide a refund within 45 days of cancellation “is liable” for a penalty as well as the refund. *See* TEX. OCC. CODE § 1304.1581(e).¹⁰ *See generally* *Tex. Dep’t of Licensing and Regulation v. Chase America Warranty Company, Inc.*, SOAH Docket No. 452-04-1050.SCP, 2004 WL 4172862 (2004) (entering a default proposal for decision based partially on failure to provide a refund or credit before the 46th day after the refund was requested).
- A provider may cancel a service contract by mailing proper notice to the service contract holder and providing a prorated refund. *See* TEX. OCC. CODE § 1304.159(a). However, prior notice is not required if the service contract holder fails to pay for the contract, breaches the contract, or engages in fraud or a material misrepresentation. *See* TEX. OCC. CODE § 1304.159(b).
- A service contract provider generally cannot use a name that (i) includes “insurance,” “casualty,” “surety,” “mutual” or any other word indicative of insurance or (ii) is deceptively similar to the name of an insurance company. *See* TEX. OCC. CODE § 1304.160. But, a service contract may include the word “guaranty” in its name. Moreover, a service contract provider that existed before September 1, 1999 may use the aforementioned prohibited words in its name if it includes a disclaimer noting that the contract is not an insurance contract. *See* TEX. OCC. CODE § 1304.160(c).
- Providers, administrators, sellers, and other representatives of the provider cannot use contracts or literature or written communications that contain any false, deceptive, or misleading statements or omissions. *See* TEX. OCC. CODE § 1304.161(a).

¹⁰ The application of these cancellation provisions may vary based on the date the service contract was purchased. *See* <http://www.tdlr.texas.gov/scp/scpfaq.htm>.

- The purchase of a service contract cannot be used as a condition for a loan or sale of property. *See* TEX. OCC. CODE § 1304.161(b).
- Service contracts cannot generally be sold through telemarketing calls to consumers unless there is an established business relationship with the consumer. *See* TEX. OCC. CODE § 1304.161(c).

5. *TDLR Enforcement Procedures and Remedies*

Chapter 1304 provides TDLR with the power to impose sanctions, penalties, and other remedies upon a finding that a ground for disciplinary action exists. *See* TEX. OCC. CODE § 1304.201; *see also* TEX. OCC. CODE § 1304.102(c); 16 TEX. ADMIN. CODE § 77.90-91. The remedies available to TDLR may include those found in Chapter 1304 as well as those found in Chapter 51 of the Texas Occupations Code depending on the language of the applicable remedy. *See* TEX. OCC. CODE § 1304.201; 16 TEX. ADMIN. CODE § 77.91. Based on those authorities, the following conclusions can be drawn as to TDLR’s enforcement powers over service contracts:

- Texas Occupations Code Chapter 51 provides for a notice of violation and proposed penalty prior to the initiation of an administrative hearing. *See* TEX. OCC. CODE § 51.202-.304.
- Texas Occupations Code Chapter 51 provides that hearings are held before the State Office of Administrative Hearings, incorporates Chapter 2001 of the Texas Government Code, but also provides for additional procedures concerning administrative hearings and judicial review. *See* TEX. OCC. CODE §§ 51.305-307, 310; *see also* TEX. OCC. CODE § 51.354.
- TDLR’s executive director may institute an action for injunctive relief to restrain a violation or threatened violation of Chapter 1304, a rule adopted under Chapter 1304, or an order issued under Chapter 1304. *See* TEX. OCC. CODE § 1304.202. In addition, Chapter 51 provides TDLR’s executive director with the power to issue emergency orders, cease and desist orders, and seek injunctive relief. *See* TEX. OCC. CODE §§ 51.3511, 51.3513, 51.352. Chapter 51 also allows for license denial, revocation, probation, suspension, and non-renewal for violations of applicable laws, regulations, or orders. *See* TEX. OCC. CODE § 51.353
- TDLR’s executive director may seek civil penalties. *See* TEX. OCC. CODE §§ 51.352, 1304.202. Civil penalties are capped at \$2,500 for each violation and \$50,000 in the “aggregate for all violations of a similar nature.” *See* TEX. OCC. CODE § 1304.202. Violations are considered to be of a “similar nature” if they consist of “the same or a similar course of conduct, action, or practice, regardless of the number of times the conduct, act, or practice occurred”. *See* TEX. OCC. CODE § 1304.203. The Attorney General is also arguably permitted to seek civil penalties pursuant to TEX. OCC. CODE § 51.352.
- In addition to civil penalties, TDLR’s executive director arguably may seek administrative penalties of up to \$5,000 per day for each violation. *See* TEX. OCC.

CODE § 51.301-.02; *see also* 16 TEX. ADMIN. CODE § 77.90. TDLR’s website also includes a matrix for the penalties it typically seeks in enforcement cases. *See* <http://www.tdlr.texas.gov/enforcement/scpsanctions.htm>; *see also* TEX. OCC. CODE § 51.302(c).

- TDLR’s executive director has the power to investigate providers, administrators, sellers, and other persons “necessary to enforce” Chapter 1304 and to “protect service contract holders in this state.” *See* TEX. OCC. CODE § 1304.051(a). In addition, a service contract provider is required to make available to TDLR’s executive director the records that the provider is required to maintain under Texas Occupations Code Section 1304.155. *See* TEX. OCC. CODE § 1304.051(b); *see also* 16 TEX. ADMIN. CODE § 77.70(i). Chapter 51 of the Texas Occupations Code also gives TDLR (i) the power to issue subpoenas for production of documents and attendance of a witness and (ii) the power to “conduct inspections or investigations as necessary” to enforce the laws TDLR administers, including the power to make an on-site inspection during reasonable business hours. *See* TEX. OCC. CODE §§ 51.351, 51.3512. Like most government investigation statutes, the aforementioned provisions do not provide clear guidance as to issues of relevance, privilege, response time, and the interplay with open records laws. James E. Davis and Jon L. Gillum, *Government Pre-Suit Investigative Powers: A Survey of Common Issues Arising from Investigations by the Texas Attorney General and the Texas Department of Insurance*, 14 TEX. TECH. ADMIN. L.J. 301 (2013). However, Chapter 1304 does make it clear that information concerning the “number of service contracts sold or issued by a provider” is a trade secret. *See* TEX. OCC. CODE § 1304.104.¹¹
- TDLR and the Attorney General may initiate an action to collect an unpaid administrative penalty. *See* TEX. OCC. CODE § 51.308.

In addition to enforcement mechanisms available to TDLR, Chapter 1304 provides some remedies that arguably may be sought by service contract holders themselves. As noted above, a service contract provider “is liable to the service contract holder” for a penalty for failure to provide a timely refund upon cancellation of a service contract in certain situations. *See* TEX. OCC. CODE § 1304.1581. But, Chapter 1304 is silent as to how and by whom this liability can be established. *See* TEX. OCC. CODE § 1304.1581; *see also* *Davis v. Hendrick Autoguard, Inc.*, 294 S.W.3d 835, 840 (Tex. App.—Dallas 2009, no pet.) (discussing the limited availability of private rights of action under a prior version of Chapter 1304). In addition, service contract holders may be entitled to a cancellation and refund rights if the Texas Commission of Licensing and Regulation determines by an order that a person has operated without a proper TDLR service contract license. *See* TEX. OCC. CODE § 1304.205. Finally, the powers of the Attorney General to regulate warranties under the DTPA (as discussed in Section III.A above), are arguably applicable to residential service contracts. *See* Section III.A *supra*.

¹¹ This provision was recently amended, effective September 1, 2013, with respect to identity recovery services. *See* 2013 Tex. Sess. Law, Ch. 1207 (S.B. 1388).

C. Residential Service Contracts Regulated by the Texas Real Estate Commission

TREC regulates “residential service contracts” pursuant to the Residential Service Company Act found in Texas Occupations Code Chapter 1303 (“Chapter 1303”) and the corresponding regulations contained in Title 22, Chapter 539 of the Texas Administrative Code.

1. Contracts Subject to Regulation by TREC

Chapter 1303 defines the term “residential service contract” as “an agreement under which, in exchange for a fee, a person undertakes for a specified period to maintain, repair, or replace all or any part of a structural component, an appliance, or an electrical, plumbing, heating, cooling, or air-conditioning system of a residential property.” *See* TEX. OCC. CODE § 1303.002(5). This definition goes on to specifically exclude “a service or maintenance agreement sold, offered for sale, or issued by a manufacturer or merchant under which the manufacturer or merchant undertakes to maintain, repair, or replace a product or part of a product, including a structural component, an appliance, or an electrical, plumbing, heating, cooling, or air-conditioning system of a residential property, that is: (A) manufactured or sold by the manufacturer or merchant; or (B) installed by the merchant in a building or residence.” *See id.*

Based on this definition and other exclusions found in Chapter 1303, the following conclusions can be drawn as to the types of contracts regulated by TREC:

- Chapter 1303 does not apply to “free” warranties (i.e., those included in the original cost for a product) because those warranties are not provided in exchange for a fee. *See id.*
- Chapter 1303 does not generally apply to warranties for commercial establishments because such warranties do not involve “residential” property. *See id.*
- Chapter 1303 arguably does not apply to contracts that provide monetary compensation to a customer because such contracts arguably do more than “maintain, repair, or replace” the item in question. *See id.* Unlike TDLR service contracts under Chapter 1304, Chapter 1303 contains no express authorization allowing for indemnification to purchasers. *See* TEX. OCC. CODE § 1304.003(a)(2). In fact, TDLR has an administrative rule which specifically excludes indemnification contracts from the definition of “residential service contract”. *See* 22 TEX. ADMIN. CODE § 539.31.
- Chapter 1303 does not apply to service or maintenance agreements sold by a manufacturer for its own products. *See* TEX. OCC. CODE § 1303.002(5); *see also* TEX. OCC. CODE § 1303.004, 1303.005(4). Unlike service contracts regulated by TDLR, the exclusion for manufacturer contracts under TREC’s laws arguably

applies even if the manufacturer charges an additional fee for its service plan.¹² Compare TEX. OCC. CODE § 1303.002(5) with TEX. OCC. CODE § 1304.004(2).

- Chapter 1303 does not apply to service or maintenance agreements sold by a merchant that installs the product in question. See TEX. OCC. CODE § 1303.002(5). Unlike service contracts regulated by TDLR, the exclusion for merchant contracts under TREC’s laws arguably applies even if the merchant charges an additional fee for its service plan. Compare TEX. OCC. CODE § 1303.002(5) with TEX. OCC. CODE § 1304.004(2). Moreover, the merchant does not need to manufacture the product covered by the warranty. See TEX. OCC. CODE § 1303.002(5).
- Chapter 1303 does not apply to persons engaged in structural pest control who comply with Texas Occupations Code Section 1951. See TEX. OCC. CODE § 1303.004(c).
- Chapter 1303 does not apply to performance guarantees given by (i) residential builders or (ii) manufacturers or sellers of appliances, other systems, or components of residential property. See TEX. OCC. CODE § 1303.005(1).¹³
- Chapter 1303 does not apply to service contracts, guarantees, or warranties for the repair of an appliance, system, or component if (i) they are issued by a person that is not in the business of a residential service company and (ii) the issuer sells, services, repairs, or replaces the product at the time or before the contract, guarantee, or warranty is issued. See TEX. OCC. CODE § 1303.005(3).
- Chapter 1303 does not apply to home warranty insurance as defined by the Texas Insurance Code. See TEX. OCC. CODE § 1303.005(5).
- Chapter 1303 does not apply to residential service contracts executed before August 28, 1979. See TEX. OCC. CODE § 1303.005(2).

See TEX. OCC. CODE § 1303.002-005.

2. *Persons Who Must Be Licensed by TREC*

For the most part, any person or company who *issues* or *administers* a residential service contract in Texas must be licensed by TREC as a “residential service company”. See TEX. OCC. CODE § 1303.101(a). Moreover, Chapter 1303 expressly limits the category of persons that are

¹² Chapter 1303 excludes manufacturers and merchants in multiple statutory sections, many of which are arguably redundant in some respects.

¹³ TREC’s website states the following with respect to warranties offered by new home builders: “New construction builders usually utilize risk retention groups to warrant the workmanship, systems and appliances of new homes they have built. While risk retention groups are not regulated by any Texas state agency, the Texas Department of Insurance and the Office of the Attorney General will process consumer complaints that may be filed against a risk retention group.” See http://www.trec.texas.gov/licenses/RSC_info.asp.

permitted to *sell* a residential service contract. *See* TEX. OCC. CODE § 1303.101(b). However, Chapter 1303 contains certain provisions which allow the following individuals to avoid having a TREC license:

- The “authorized representative” of a licensed residential service company can *issue and administer* a residential service contract without having an individual TREC license. *See* TEX. OCC. CODE § 1303.101(a). However, an “authorized representative” arguably cannot *sell* a service contract unless the representative falls within another exception contained in Chapter 1303. *Compare* TEX. OCC. CODE § 1303.101(a) *with* TEX. OCC. CODE § 1303.101(b).
- An employee of a licensed residential service company can *sell* residential service contracts issued by his or her employer without holding an individual TREC license. *See* TEX. OCC. CODE § 1303.101(b)(1)(A). Moreover, because an employee is presumably also an “authorized individual,” the employee can also arguably *issue and administer* residential service contracts for his or her employer. *See* TEX. OCC. CODE § 1303.101(a). TREC’s rules further define what it means to be an employee of a residential service company, including a requirement that the company “have the right to direct and control the employee’s performance.” *See* 22 TEX. ADMIN. CODE § 539.51.
- A person licensed in Texas as real estate salesperson, real estate broker, mobile home dealer, or insurance agent may *sell* residential service contracts issued by licensed residential service companies. *See* TEX. OCC. CODE § 1303.101(b)(1)(B). However, such individuals arguably cannot *issue or administer* service contracts unless they are also “authorized representatives” of a licensed residential service company and/or themselves licensed as a “residential service company”. *Compare* TEX. OCC. CODE § 1303.101(b) *with* TEX. OCC. CODE § 1303.101(a).

In addition, the employees and agents of merchants and manufacturers do not require a TREC license if the merchant or manufacturer is itself excluded from TREC regulation. *See* TEX. OCC. CODE § 1303.004(b).

3. *Requirements for Obtaining a License from TREC*

A person or company seeking a license from TREC must submit a fee and an application containing the numerous documents specified in Texas Occupations Code Section 1303.103. *See* TEX. OCC. CODE §§ 1303.052, 1303.102, 1303.103. TREC must approve or disapprove the license application within the timeframes specified in Texas Occupations Code Section 1303.104. *See* TEX. OCC. CODE § 1303.104; *see also* 22 TEX. ADMIN. CODE § 539.63. An applicant who is denied a TREC license may appeal that decision pursuant to the provisions of Texas Occupations Code Section 1303.106. *See* TEX. OCC. CODE § 1303.106. Once TREC issues a license, the license remains in effect as long as the license holder complies with Chapter 1303 and the license is not otherwise suspended, revoked, or terminated. *See* TEX. OCC. CODE § 1303.107. Thus, unlike a service contract license with TDLR, it is not necessary for a TREC licensee to obtain an annual renewal.

4. Continuing Regulatory Duties Overseen by TREC

A residential service company must continuously comply with the financial requirements imposed by Chapter 1303, which help ensure that the company is able to meet its obligations under the contracts it issues. *See* TEX. OCC. CODE § 1303.151-54; *see also* 22 TEX. ADMIN. CODE § 539.81-82. In addition, a residential service company must do the following under Chapter 1303:

- Provide prior notice of modifications to certain documents and practices. *See* TEX. OCC. CODE § 1303.201; 22 TEX. ADMIN. CODE § 539.66; *see also* TEX. OCC. CODE § 1303.1303.103.
- Provide prior notice of changes to contract charges, including discounts and other price reductions. *See* 22 TEX. ADMIN. CODE § 539.62.
- Provide prior notice of changes in company information. *See* 22 TEX. ADMIN. CODE § 539.64-.65.
- Submit a mid-year report. *See* 22 TEX. ADMIN. CODE § 539.137.
- Submit an annual report pursuant. *See* TEX. OCC. CODE § 1303.202; 22 TEX. ADMIN. CODE § 539.91.

Some of these filings must be made on TREC approved forms as specified and may require payment of certain fees. *See* 22 TEX. ADMIN. CODE §§ 539.71, 539.91, 539.137, 539.231.

4. TREC Requirements and Restrictions Affecting the Sale and Performance of Residential Service Contracts

Chapter 1303 and TREC's related regulations contain numerous requirements and restrictions affecting the sale and performance of residential service contracts. These include the following:

- A residential service company cannot engage in deceptive sales practices, which include but are not limited to using the words “insurance,” “casualty,” “surety,” “mutual,” or other words indicative of an insurance company (unless the company is licensed as an insurer). *See* TEX. OCC. CODE § 1303.301 (a)-(b).
- A residential service company cannot use side-by-side comparisons in advertising that involve contracts with substantially different covered items and exclusions. *See* 22 TEX. ADMIN. CODE § 539.161
- The sale of residential property cannot be conditioned upon the buyer's purchase of a residential service contract, and certain disclosures must be made to that effect. *See* TEX. OCC. CODE § 1303.302.
- A residential service company cannot charge a customer for certain duplications of coverage without consent. *See* TEX. OCC. CODE § 1303.303.

- A residential service company cannot pay a commission or other consideration as an inducement or compensation for the issuance, purchase, or acquisition of a residential service contract to “an agent, representative, attorney, or employee *of an owner or prospective owner* of a residential property for which a residential service contract has been or will be issued.” *See* TEX. OCC. CODE § 1303.304(a) (emphasis added). However, the statute does not expressly prohibit payment of commissions or other consideration to other parties. Moreover, the statute expressly allows a residential service company to pay “a reasonable amount for the sale, advertising, inspection, or processing of a residential service contract.” *See* TEX. OCC. CODE § 1303.304(b).
- A residential service company must provide customers with evidence of coverage pursuant to Texas Occupations Code Section 1303.251. *See* TEX. OCC. CODE § 1303.251. This evidence of coverage must be approved by TREC and must contain the information specified in Texas Occupations Code Section 1303.252. *See* TEX. OCC. CODE §§ 1303.251-.252.
- A residential service company must provide customers with a complete copy of the residential service contract within 15 days after payment is made or the contract becomes effective, whichever is earlier. *See* 22 TEX. ADMIN. CODE § 539.160.
- A residential service company must have its schedule of charges approved by TREC. *See* TEX. OCC. CODE § 1303.253.
- A residential service contract must have disclosure language concerning the customer’s rights and remedies under the DTPA. *See* TEX. OCC. CODE § 1303.254(b).
- A residential service company must include a notice that complies with certain language and typeface requirements if the company pays persons not employed by the company for the sale, advertising, inspection, or processing of residential service contracts. *See* 22 TEX. ADMIN. CODE § 539.41.
- A residential service company cannot cancel a residential service contract unless it adheres to the limitations specified in Texas Occupations Code Section 1303.255. *See* TEX. OCC. CODE § 1303.255.

5. TREC Enforcement Procedures and Remedies

Chapter 1303 specifies the situations in which TREC may institute disciplinary action against a residential service company. *See* TEX. OCC. CODE § 1303.352. These include but are not limited to failures to comply with the aforementioned requirements as well as (i) operating in conflict with the company’s organization documents filed with TREC and (ii) failure to operate in a financially responsible manner to the detriment of the company’s obligations to contract holders. *See* TEX. OCC. CODE § 1303.352. In addition, Chapter 1303 contains various provisions

governing enforcement proceedings against residential service companies, including the following:

- Disciplinary hearings are held before the State Office of Administrative Hearings and are subject to the Administrative Procedures Act. However, Chapter 1303 also includes its own language concerning judicial review of a TREC decision. *See* TEX. OCC. CODE § 1303.354.
- Administrative penalties may be imposed “as provided” by Texas Occupations Code Chapter 1101. Chapter 1303 caps administrative penalties in the amount of \$5,000 for each violation. *See* TEX. OCC. CODE § 1303.355(b). By statute, each day a violation continues or occurs can be considered a separate violation for penalty purposes. *See id.* Moreover, TREC’s regulations contain a schedule of penalties which range from \$100 per violation per day to \$5,000 per violation per day depending on the statute or regulation in question. *See* 22 TEX. ADMIN. CODE § 539.140. These penalties may be doubled if the residential service company has a history of previous violations. *See* 22 TEX. ADMIN. CODE § 539.140(d); *see also* TEX. OCC. CODE §§ 1303.355(c-d).
- In addition to administrative penalties, TREC has the power to collect civil penalties pursuant to Texas Occupations Code Section 1303.404 in an amount not to exceed \$2,500 or \$50,000 “in the aggregate for all violations of a similar nature.” *See* TEX. OCC. CODE § 1303.404.¹⁴
- A residential service company that continues to write new business while in violation of Chapter 1303 is potentially subject to an additional \$100 penalty per day. *See* TEX. OCC. CODE § 1303.407.
- TREC has the power to order temporary suspensions of a license and to seek injunctive relief in district court. *See* TEX. OCC. CODE §§ 1303.356, 1303.403.
- TREC has the power to take actions to remedy a company’s hazardous financial condition, including appointment of a receiver. *See* TEX. OCC. CODE § 1303.401-.402.
- TREC also has regulations which discuss (i) investigation of complaints and (ii) examination of the affairs of licensed residential companies. *See* 22 TEX. ADMIN. CODE §§ 539.121, 539.150. Like with many government investigatory powers, these regulations do provide clear guidance as to issues of relevance, privilege, response time, and the interplay with open records laws. *See* James E. Davis and Jon L. Gillum, *Government Pre-Suit Investigative Powers: A Survey of Common Issues Arising from Investigations by the Texas Attorney General and the Texas Department of Insurance*, 14 TEX. TECH. ADMIN. L.J. 301 (2013).

¹⁴ Under prior law, private parties—rather than just TREC—were arguably allowed to seek civil penalties. *See Am. Home Shield of Tex., Inc. v. Kortz*, 01-99-00380-CV, 2000 WL 1262617, at *5 (Tex. App.—Houston [1st Dist.] Sept. 7, 2000, pet dism’d).

See generally TEX. OCC. CODE § 1303.351-.407.

In addition to enforcement mechanisms available to TREC, Chapter 1303 provides for additional penalties and remedies that arguably may be sought by others. For example, Texas Occupations Code Section 1303.405 provides a tie-in to the Texas Deceptive Trade Practices Act, which allows consumers to seek relief for actionable violations of Chapter 1303. *See* TEX. OCC. CODE § 1303.405. In addition, Texas Occupations Code Section 1303.406 provides for criminal penalties for (i) willful violations of Chapter 1303 or TREC’s rules and (ii) knowingly making a false statement with respect to a report or statement required by Chapter 1303. *See* TEX. OCC. CODE § 1303.406. Finally, the powers of the Attorney General to regulate warranties under the DTPA (as discussed in Section III.A above) are arguably applicable to residential service contracts. *See* Section III.A *supra*.

D. Insurance Regulated by the Texas Department of Insurance

TDI has the power to regulate insurance products in Texas but lacks any express statutory authority to regulate warranties or service contracts.¹⁵ If fact, activities that are considered “service contracts” under Texas Occupations Code Chapter 1304 and “residential service contracts” under Texas Occupations Code Chapter 1303 are generally exempted from TDI’s oversight. *See* TEX. OCC. CODE § 1304.005 (“Marketing, selling, offering for sale, issuing, making, proposing to make, and administering a service contract are exempt from . . . the Insurance Code and other laws of this state regulating the business of insurance.”); TEX. OCC. CODE § 1304.003 (“Except as otherwise provided by this chapter, the insurance laws of this state do not apply to a residential service company This chapter does not exempt a warranty or service contract other than a residential service contract from the Insurance Code.”).¹⁶

Nevertheless, a warranty product that falls outside of TREC’s or TDLR’s domain is not automatically free of regulatory oversight and may very well be subject to TDI regulation. For that to happen, a product would generally have to meet the definition of “insurance” but not meet the definition of a “service contract” or “residential service contract”. In other words, if a product fell outside of the safe harbors established by Chapters 1303 and 1304 of the Texas Occupations Code *and* the product still met the definition of “insurance,” then TDI may have authority to regulate that product.

This type of analysis is obviously complex because it requires a careful parsing of the statutes and regulations of three regulatory bodies. To make matters worse, the Texas Insurance Code does not define “insurance” even though it contains lengthy provisions describing the “business of insurance”. *See, e.g.*, TEX. INS. CODE § 101.051. As a result, the concept of “insurance” has typically been defined in Texas by reference to the common law.

¹⁵ Although TDI does not regulate the issuance or licensure of service contracts under Chapter 1304, TDI may regulate insurance policies used by service contract providers as financial security under Chapter 1304. *See* TEX. OCC. CODE §§ 1304.151-152.

¹⁶ These exclusions make it all the more important for a provider to fully understand the statutory limits of the products it can offer under a particular regulatory framework. Although a company might avoid TDLR or TREC regulation by selling products which fall outside Chapters 1303 and 1304, the company may also deprive itself of the TDI “exemption” contained in those statutes. *See* TEX. OCC. CODE §§ 1304.005, 1304.003.

Most Texas cases define insurance as a contract requiring *indemnity* for a *specified loss*. See, e.g., *In re Miller*, 202 S.W.3d 922, 925 (Tex. App.—Tyler 2006, no pet.) (“Insurance is a contract by which one party, for consideration, assumes a particular risk on behalf of another party and promises to pay him a certain or ascertainable sum of money on the occurrence of a specified contingency.”); see also *Hanson Business Park, L.P. v. First Nat. Title Ins. Co.*, 209 S.W.3d 867, 869 (Tex. App.—Dallas 2006, pet. denied) (“A title insurance policy is a contract of indemnity, imposing a duty to indemnify the insured against losses caused by defects in title.”); *Employers Reinsurance Corp. v. Threlkeld & Co. Ins. Agency*, 152 S.W.3d 595, 597-98 (Tex. App.—Tyler 2003, no pet.) (“Insurance is a contract by which one party, for consideration, assumes particular risks on behalf of another party and promises to pay him a certain or ascertainable sum of money on the occurrence of a specified contingency.”); *In re Valetutto*, 976 S.W.2d 893, 896 (Tex. App.—Austin 1998, no pet.) (defining insurance as a “contract ‘to indemnify another against loss, damage, or liability arising from an unknown or contingent event’” based on Black’s Law Dictionary) (internal citations omitted).

This common-law definition arguably creates several possibilities for products to exist which are free from direct regulatory oversight in Texas—products which may resemble service contracts but which are arguably not regulated by TDLR, TREC, or TDI. For example, a manufacturer’s warranty that does not provide monetary payments to a consumer—and instead provides services or in-kind replacement—is arguably not an insurance product because it lacks an indemnification component. See, e.g., *In re Miller*, 202 S.W.3d at 925. Moreover, such a product is generally excluded from the definition of “residential service contract” under Chapter 1303 and “service contract” under Chapter 1304. See TEX. OCC. CODE §§ 1303.002(5), 1304.004(a)(2).

Similarly, a program that focuses on maintenance or other services regardless of loss would likely fall outside of TDI’s jurisdiction because such a program is not based on a specified peril. See, e.g., *In re Miller*, 202 S.W.3d at 925. Moreover, such a program could fall outside of the definition of “residential service contract” under Chapter 1303 and “service contract” under Chapter 1304. See TEX. OCC. CODE §§ 1303.005(4), 1304.004(a)(1).

Nevertheless, the broad common-law definition of insurance and the murky boundaries of Chapters 1303 and 1304 create several possibilities where a company selling what it thinks is a service contract may inadvertently be selling an insurance contract. For example, TDLR suggests that a contract which provides for the replacement of a windshield—rather than the repair of a windshield—is outside the scope of Chapter 1304 and within the regulatory purview of TDI. See <http://www.tdlr.texas.gov/scp/scpfaq.htm> (“The provisions of the contract that provide for windshield repair fall within the scope of the service contract statute, but the windshield replacement services do not A company offering windshield repair and replacement services would need to be registered as a service contract provider with TDLR for the repair services and would need to be licensed/authorized by TDI for the replacement services). Moreover, TDLR suggests that if a company provides a contract for both windshield replacement and repair, then the company may need to be licensed by both TDI and TDLR. See *id.* (“If the contract covers both types of windshield services, you must be registered with TDLR and licensed/authorized by TDI.”).

In the event a product is considered insurance, then the provider, seller, and administrator of that product would generally be required to submit to the licensing and other requirements established by the Texas Insurance Code—requirements that are much more thorough and much more onerous than those imposed by TDLR and TREC. *See, e.g.*, TEX. INS. CODE §§ 101, 253, 254, 4001, 4151. Moreover, a failure to adhere to those requirements could subject those parties to the potentially severe consequences of engaging in the unauthorized business of insurance. *See, e.g.*, TEX. INS. CODE §§ 82, 101.

In light of the above, companies licensed by TDLR and TREC should take great care to make sure that their products do not exceed the parameters established by the statutes of those agencies. By the same token, a company that wishes to offer a product that is not regulated by TDLR or TREC should diligently assess whether such a product might be considered an insurance product regulated by TDI.¹⁷

IV. Conclusion

The current cross-agency regulation of risk transfer contracts, including warranties, service contracts, residential service contracts, and insurance, creates gaps and overlaps in the law. Small changes to the terms of a risk transfer contract may have significant and unintentional regulatory consequences. The complicated regulatory scheme is not helpful for consumers' awareness of their rights and available remedies. Multi-agency authority creates uncertainty for businesses that seek to comply with Texas law and has the potential of limiting the development of beneficial risk transfer contracts that do not squarely fit in one regulatory space. Additionally, the cross-agency approach could create gaps in the law or inconsistent outcomes that may undermine the State's regulatory goals and interest in efficiency.

¹⁷ Moreover, the provider of such product must still consider the potential oversight of the Texas Attorney General's Office as discussed in Section III *supra*.