

# WARRANTY SERVICING LEGISLATION

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Over the past several years, a number of state legislatures have considered bills that would establish by legislation the compensation that manufacturers must pay to independent servicers for repair work performed under a manufacturer's warranty.<sup>1</sup> Such provisions usually form part of a larger scheme of warranty regulation which has its roots in the recent trend for consumer protection laws.

For example, on the federal level, the Magnuson-Moss Warranty Act<sup>2</sup> enumerates federal minimum standards for consumer product warranties and for their disclosure to consumers. The Act broadly defines "consumer product" to mean "any tangible personal property which is distributed in commerce and which is normally used for personal, family or household purposes"<sup>3</sup> in order to provide the widest protection. In the state arena, the California Song-Beverly Consumer Warranty Act<sup>4</sup> is probably the progenitor of some features of both the federal law and of consumer warranty legislation in other states. The California Act creates for retail sales of consumer goods special implied warranties of merchantability and fitness for a particular purpose,<sup>5</sup> as well as stating strict requirements as to the contents of express warranties and the manufacturer's duty to service nonconforming goods.

Legislation setting required levels of payment by manufacturers to servicers for warranty repair work, however, is not in the same category as consumer protectionism. It is based on the erroneous presumption that manufacturers in general have underpaid independent servicers for doing warranty service work. In fact, such legislation regulating reimbursement for in-warranty servicing represents an intrusion into what has usually been an area regulated by privately negotiated agreements between two types of businesses, manufacturers and

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1. *E.g.*, Cal. Civil Code § 1793 (West Supp. 1978); Minn. Stat. Ann. § 325.953 Subd. 3 (West Supp. 1978); R.I. Gen. Laws § 6A-2-329 (1977). *See also* N.J. Stat. Ann. § 56.10-13 to -15 (West Supp. 1978-79); 1977 Conn. Pub. Acts No. 77-493; Va. Code § 46.1-547.1 (Supp. 1978).
2. 15 U.S.C. §§ 2301-2312 (1976).
3. *Id.* § 3201 (1).
4. Cal. Civil Code §§ 1790-1795.7 (West 1973 & Supp. 1978).
5. These implied warranties are quite similar to the implied warranties of the California Commercial Code, *compare* Cal. Civil Code §§ 1792, 1792.1, 1792.2 with Cal. Comm. Code §§ 2314 & 2315, except that a maximum period of duration is set for the consumer warranties and the consumer warranties may only be waived in the manner expressly provided. Cal. Civil Code §§ 1792.3 & 1792.4. Where the provisions of the Commercial Code conflict with the rights guaranteed to buyers of consumer goods, the latter shall prevail. Cal. Civil Code § 1790.3. This type of modification of the so-called Uniform Commercial Code as exemplified by the California and Rhode Island legislation discussed here seems to work contrary to the intent of a Uniform Code and make compliance by businesses that are national in scope especially difficult.

servicers, and it may actually work to the detriment of consumers by creating higher in-warranty repair costs which will eventually be reflected in product prices. It is the purpose of this article to examine this legislation with a view to explaining how and why it is neither in the best interests of such servicers as support it nor of the consumers.

### CURRENT WARRANTY SERVICING

As most consumers are aware, contracts for the sale of appliances and other household products ordinarily contain an express written warranty provision.<sup>6</sup> On items such as household products, both parts and labor are generally covered by the warranty, although not necessarily for the same period of time.<sup>7</sup> Under all federal and state warranty laws, it is the manufacturer, as express warrantor of the product, who is responsible to the consumer for warranty service.<sup>8</sup> In order to provide an effective means for the consumer to take advantage of the contract's warranty provisions, and as sometimes required by state law,<sup>9</sup> the manufacturer will either provide his own service personnel or will designate specified independent servicers as his service representatives. No independent servicer is under compulsion to provide warranty service unless he has entered into a bona fide contract with the manufacturer to do so. Consequently, no servicer is compelled to provide warranty service at prices he finds unsatisfactory. In a bargained-for contract, the manufacturer and the servicer will agree upon terms for reimbursement, parts distribution, training and other necessary elements. The Magnuson-Moss Warranty Act § 107<sup>10</sup> specifically recognized this normal warranty pattern between manufacturers and servicers for in-warranty servicing:

Nothing in this chapter shall be construed to prevent any warrantor from designating representatives to perform duties under the written or implied warranty: *Provided*, That such warrantor shall make arrangements for compensation of such designated representatives, but no such designation shall relieve the warrantor of his direct responsibilities to the consumer or make the representative a cowarrantor.

6. The contents of the express warranty may be regulated by applicable federal and state laws, as briefly indicated above.
7. For example, the manufacturer may pay for labor charges for repairs necessary within 90 days of purchase but replace defective parts for one year. After the 90-day labor warranty period expires, labor charges for installing replacement parts are the consumer's responsibility.
8. The retailer or distributor may also be liable for any express warranties he makes as part of a consumer sale. *E.g.*, Minn. Stat. Ann. § 325.953 Subd. 2.
9. The Song-Beverly Consumer Warranty Act provides that every manufacturer of consumer goods sold in the state for which the manufacturer has made an express warranty shall maintain or cause to be maintained, in the state, sufficient service and repair facilities to carry out the terms of such warranties or be subject to provisions making him liable to a retailer who performs service or incurs obligations in giving effect to such warranties. A manufacturer making express warranties is also permitted to designate an independent repair or service facility as an authorized service and repair facility reasonably close to all areas where the manufacturer's consumer goods are sold. Cal. Civil Code § 1793.2(a) (1) (West Supp. 1978). Other less restrictive provisions, such as that in the Rhode Island law, require that "[e]very manufacturer, whether domestic or foreign, who makes an express warranty pursuant to a consumer sale shall designate a representative *within the state* to provide services or repairs under the terms of the express warranty." R.I. Gen. Laws § 6A-2-329.3(c) (1977) (emphasis added). It is particularly difficult for small manufacturing companies to comply with these requirements for maintaining a large number of service facilities or representatives in numerous locations, especially if they attempt to carry on a nationwide business and must comply with similar, but probably somewhat different, legislative requirements in other states.
10. 15 U.S.C. § 2307.

In the absence of state legislation, reimbursement rates for warranty work on items such as household appliances are freely negotiated between manufacturers and independent servicers. Currently, the majority of the dollar volume of warranty work is done at such negotiated warranty reimbursement rates. Such contracts are expected to include a reasonable profit to the servicer. It is good business practice from the manufacturer's point of view to pay an equitable reimbursement rate to his authorized independent servicers because, first, the manufacturer needs the servicer to stay in business, and second, the manufacturer wants his service work to get priority so that the customers are satisfied. It is neither logical nor reasonable for manufacturers, legislators, or the public to expect that servicers will agree to contracts which are economically disadvantageous to them. Servicers, in fact, compete for warranty repair work contracts because they are valuable to the servicer for a variety of reasons.

### BENEFITS ACCOMPANYING WARRANTY SERVICE WORK

Let us examine the practical realities of the warranty repair contract situation. Although the agreed upon price for servicer reimbursement may be less than the going rate charged for comparable out-of-warranty work, this may be a result of the fact that there are benefits other than mere payment for service work that accrue to the servicer from a warranty service agreement with a manufacturer. These benefits are quite properly taken into account in setting the rate of compensation for the servicer. Such benefits can be substantial. For example, the servicer need not seek out warranty customers or spend money on advertising to secure their business. In fact, in many cases the manufacturer directs the warranty customer, through toll-free numbers, listings in the *Yellow Pages*, or other means, to a particular servicer. Moreover, warranty customers are highly likely to continue to patronize the servicer after expiration of the warranty. Along these same lines, it must be noted that listing as an "authorized servicer" of a nationally recognized manufacturer is a prestige-plus and influences nonwarranty customers to patronize a servicer.

There is no credit risk to the servicer for in-warranty work; he will be paid by the manufacturer for service performed that is covered by the warranty.<sup>11</sup>

Also, manufacturers frequently provide, at little or no cost, technical assistance, literature, and training to service contractors. Furthermore, the

11. It should be noted that many servicers complain about not being reimbursed for "instructional" or "nuisance" service calls. These are service calls from consumers who believe their product is malfunctioning or defective, but who in reality have not been properly instructed by the dealer, have not bothered to read instructions for operation, or have expectations exceeding the service possible to obtain from the product. Because warranty service is "free" to the consumer, he calls the servicer. The servicer arrives and finds that nothing for which he will be reimbursed under the terms of the warranty service contract with the manufacturer need be done. Since, at the least, his time spent on the service call would be charged to a retail customer, the servicer believes he loses money on nuisance calls for which the manufacturer should compensate him. In part it is to ameliorate this situation that servicers have called for legislation setting warranty reimbursement rates at a rate equal to rates charged for like service to retail customers for nonwarranty service. The resolution to this problem, however, does not lie in warranty servicing legislation. Rather, the consumer should be better educated through sales information; the dealer, if responsible, should bear the burden of "instructional" calls; and the servicer should make adequate inquiry to ascertain that he is not answering a "nuisance" call and warn the customer that he may have to pay for service not covered by the warranty. In addition, the servicer must include in his costs of doing business, and thus build into his negotiated reimbursement rates, the loss caused him by such service calls.

servicer enjoys a close working relationship with the manufacturer in terms of parts procurement and other aspects of the servicer's business dependent upon the manufacturer which can result in a considerable savings of time and expense for the servicer. The manufacturer, who is ultimately liable for complaints arising under the product warranty, shares with the servicer the responsibility for customer complaints and must aid in resolving them.

Finally, training and experience gained by the servicer from warranty work on new products prepares the servicer to perform better out-of-warranty work at lower costs to the out-of-warranty consumer.

For these reasons, freely negotiated contracts for warranty repair work encourage competition among both servicers and manufacturers. The former may agree to lower reimbursement rates; the latter may compete for a lower dollar cost for in-warranty work by offering more in terms of support such as technical assistance and training.

Moreover, it is likely that the primary impetus for servicers to encourage legislation which would tie warranty reimbursement rates paid to them to out-of-warranty service charges is not underpayment but rather a generally decreased volume of repair work which has resulted in decreased income for servicers. Legislation seeking to regulate warranty repair rates is really an attempt to counteract free market forces which are now working against servicers. Increased prices are, after all, a classic means of attempting to compensate for decreased volume.

Over the past decade, technological advances in appliance industries have resulted in far more reliable products. At the same time, prices of many appliances have also decreased.<sup>12</sup> As a consequence, the number of repairs has been decreasing steadily with a corresponding decrease in overall volume of servicing business. A consumer may prefer to purchase a new, late-model automatic dishwasher, for example, rather than pay for any major, expensive repairs on an old product.

In addition, warranties for labor have been reduced in many cases from one year to ninety days, which also reduces in-warranty business. Servicers who have traditionally done a high ratio of in-warranty business, as compared to out-of-warranty business, now find themselves having business troubles. They can no longer rely exclusively on in-warranty work.

Another major area of concern to manufacturers is that as household products become more technologically advanced, servicers may no longer be qualified as technicians to repair them. The rapid changes in the state of the art, such as sophisticated microwave ovens or electronic touch controls for washing machines, make products more complex. While this may put certain unsophisticated independent servicers out of business, technological advances at the same time create a growing market for qualified technicians.

This problem, however, has not been caused by the prices paid by manufacturers for in-warranty repair work. It is a problem caused by the action of market forces and it is a problem that will be resolved by market forces and not by "corrective" legislation of the type discussed in this article.

12. A dramatic example is the television set, which has decreased on the Consumer Price Index from 159.7 in 1950 to 101.7 in 1977.

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Let us now examine some of the legislation with which a few states have attempted to deal with this servicer problem. The bills that have been enacted generally require that the manufacturer reimburse the servicer for in-warranty service work at the same rate as the servicer charges for out-of-warranty work that is comparable. For example, a recently enacted amendment to the Rhode Island Uniform Commercial Code provides in pertinent part:

Every manufacturer who makes an express warranty pursuant to a consumer sale, who designates a representative within this state to provide sale and service under the terms of the express warranty shall be liable to said representative in *the amount equal to that which is charged by said representative for like service and repairs rendered to retail consumers who are not entitled to warranty protection*. This equality of charges shall apply both to labor and parts used.<sup>13</sup>

Minnesota's Manufactures and Sales law regarding express warranties similarly provides:

Every manufacturer who makes an express warranty pursuant to a consumer sale, who authorizes a retail seller within this state to perform services or repairs under the terms of the express warranty shall be liable to the retail seller in *an amount equal to that which is charged by the retail seller for like service or repairs rendered to retail consumers who are not entitled to warranty protection*.<sup>14</sup>

California provides the following alternatives:

As a means of complying with [service and repair facilities requirements] of this subdivision, a manufacturer shall be permitted to enter into warranty service contracts with independent service and repair facilities. *The warranty service contracts may provide for a fixed schedule of rates to be charged for warranty service or warranty repair work, however, the rates fixed by such contracts shall be in conformity with the requirements of Section 1793.3(c)*. The rates established pursuant to Section 1793.3(c), between the manufacturer and the independent service and repair facility, *shall not preclude a good faith discount which is reasonably related to reduced credit and general overhead cost factors arising from the manufacturer's payment of warranty charges direct to the independent*. The warranty service contracts authorized by this paragraph shall not be executed to cover a period of time in excess of one year.<sup>15</sup>

Section 1793.3(c) provides in part:

It shall be a rebuttable presumption affecting the burden of producing evidence that *the reasonable cost of service or repair is an amount equal to that which is charged by the independent serviceman for like services or repairs rendered to service or repair customers who are not entitled to warranty protection*.

13. R.I. Gen. Laws § 6A-2-329.3(d) (1977) (emphasis added).

14. Minn. Stat. Ann. § 325.953 Subd. 3 (West Supp. 1978) (emphasis added).

15. Cal. Civil Code § 1793.2(a) (1) (West Supp. 1978) (emphasis added).

Some states have limited regulations of warranty work rates to services performed by a motor vehicle dealer for the manufacturer. Virginia has enacted strict compensation requirements as follows:

Each motor vehicle manufacturer, factory branch distributor or distributor branch, shall specify in writing to each of its motor vehicle dealers licensed in this State the dealer's obligations for preparation, delivery and warranty service on its products, shall compensate the dealer for warranty service required of the dealer by the manufacturer, and shall provide the dealer the schedule of compensation to be paid such dealers for parts, work and service in connection with warranty service, and the time allowances for the performance of such work and service. In no event shall such schedule of compensation fail to include reasonable compensation for diagnostic work as well as repair service and labor. Time allowances for the diagnosis and performance of warranty work and service shall be reasonable and adequate for the work to be performed. *In the determination of what constitutes reasonable compensation under this section, the principal factors to be given consideration shall be the prevailing wage rates being paid by the dealer, and the prevailing labor rate being charged by the dealer, in the community in which the dealer is doing business, and in no event shall such compensation of a dealer for warranty service be less than the rates charged by such dealer for like service to retail customers for non-warranty service and repairs.*<sup>16</sup>

In New Jersey, legislation with respect to services or parts provided in satisfaction of a warranty issued by the motor vehicle franchisor provides in pertinent part:

The motor vehicle franchisor shall reimburse each motor vehicle franchisee for such services as are rendered and for such parts as are supplied, *in an amount equal to the prevailing retail price charged by such motor vehicle franchisee for such services and parts in circumstances where such services are rendered or such parts supplied other than pursuant to warranty*; provided that such motor vehicle franchisee's prevailing retail price is not unreasonable when compared with that of the holders of motor vehicle franchises from the same motor vehicle franchisor for identical merchandise or services in the geographic area in which the motor vehicle franchisee is engaged in business.<sup>17</sup>

Connecticut has enacted similar legislation to regulate petroleum product franchisors:

Every franchisor shall reimburse its franchisee *at the prevailing retail price* for any services rendered or parts supplied by such franchisee in satisfaction of any warranty issued by such franchisor, and no franchisor shall restrict a franchisee from rendering services or providing parts in accordance with standards of good workmanship in satisfaction of any such warranty.<sup>18</sup>

The desired benefits of this type of legislation are twofold. First, legislators hope to protect servicers by providing them with an "adequate" profit on warranty servicing work. Second, legislators believe that these benefits will be passed on to the consumers of out-of-warranty repair work as cost savings

16. Va. Code § 46.1-547.1(a) (Supp. 1978) (emphasis added).

17. N.J. Stat. Ann. § 56.10-15a (West Supp. 1978-79) (emphasis added).

18. 1977 Conn. Pub. Acts No. 77-493 § 3(i) (emphasis added).

because servicers will not find it necessary to raise retail customer prices to compensate for so-called economically disadvantageous warranty contract work. There are, however, basic fallacies underlying the assumption that "servicing of warranties" legislation provides a means of reaching these goals. It is of vital public concern that legislation of this sort not be considered and passed by state legislators without their having a full understanding of the facts surrounding warranty repairs.

In the previous section, we have pointed out and discussed the factors to be used in deciding whether servicers are receiving an "equitable" rate of reimbursement on warranty repair work. It is clear that the determination cannot be made without considering all of the other benefits that may accrue to a servicer from a warranty repair contract. It is also true that servicers who are not making an "adequate" profit may be the victims of market forces for which this type of legislation is not a remedy. Legislation such as that set out above would in effect subsidize noncompetitive servicers and manufacturers at the expense of competitive servicers, manufacturers, and the general public.

Another cause of reimbursement rates which servicers may feel are not "fair" is the need for better business management techniques in much of the service industry. A servicer, in order to negotiate an adequate rate of compensation with a manufacturer, must know what his costs are. For example, reimbursement and handling of parts is part of the package negotiated between the manufacturer and the servicer. Parts distribution under a warranty is generally handled in one of the following two ways. One method involves two-step distribution. The manufacturer distributes parts to a local distributor. Parts are thus locally available and the distributor independently sets policy on matters such as credit or freight payment for delivery to the servicer. The second method involves direct parts distribution by the manufacturer. The manufacturer usually pays for shipment of warranty parts. In the first case, the servicer must usually maintain enough of a parts inventory to do normal in-warranty repairs; send in the defective part for reimbursement; and pay for freight himself. In the second case, the servicer gets a new part free but must usually order it and make a return service call to install it. There is no billing for parts and thus substantially less paper work for the servicer.

The independent servicer should take the total cost to him of the particular parts distribution system offered into account when calculating the cost of an in-warranty service call for purposes of negotiating a reimbursement rate with a particular manufacturer. By the same token, all of the servicer's other costs of doing business should be taken into consideration when he is negotiating with a manufacturer. Legislation setting reimbursement rates is not required if good management practices, such as better inventory control, will resolve the problem.

Aside from the fact that reimbursement rate requirements such as those in the above legislation fail to take into account the benefits that servicers receive from a contractual association with a manufacturer for warranty repair work, it is extremely doubtful whether the rates charged by servicers for "comparable" work for non-warranty customers are an adequate yardstick for "fair" in-warranty repair charges.

In many ways each problem and each repair is unique. Hence, there is often no real correlation between repairs done under warranty and those done out-of-warranty. Since the warranty repair is "free" to the consumer, the

customer requests service at the first sign of trouble. On the other hand, a consumer with an appliance no longer under warranty will often "live with" service problems until repair is absolutely necessary. This makes an out-of-warranty repair more difficult and expensive. As can be expected, repair work on out-of-warranty products is usually on older models and is dirtier and more time-consuming than in-warranty work. Comparisons are not practical, therefore, because products are dissimilar and repair jobs are distinct. Consumer organization studies<sup>19</sup> show that there is a wide range in charges by servicers even for remedying the same fault in the same product.

Out-of-warranty repair charges are also not a fair basis for pricing in-warranty work because retail customers are susceptible to overcharging. Unlike a manufacturer bargaining with a servicer for an equitable repair charge, an ordinary customer has no special knowledge of the nature or difficulty of the problems involved. In fact, even a knowledgeable consumer would find it almost impossible to challenge the hours and work claimed to be necessary by a servicer. Thus, the servicer is free to set out-of-warranty costs as high as possible and these sometimes excessive rates must be reflected, if legislation so requiring is in effect, by in-warranty reimbursement rates, to the detriment of all consumers. The manufacturer has much more experience than the typical consumer for making cost comparisons and evaluating servicer prices.

### CONCLUSION

Instead of legislating prices pegged to out-of-warranty repair work, legislation should permit freely negotiated contract rates. Under normal business practices a reasonable profit to the servicer will be included in the rates, when the value that the servicer receives from having a service contract with a manufacturer is taken into account.

Consumer protection legislation should recognize that the basic means for a manufacturer to provide for warranty service is either through its own service employees or through formal contracts with independent servicers. Without such a contract, an independent servicer would have no liability to the consumer under a manufacturer's warranty and, therefore, the servicer would be free to charge the consumer for any service he performs at his normal rates. Any "remedial" legislation should be directed toward those manufacturers who do not negotiate reimbursement rates with servicers and who will not provide them with adequate back-up services.

19. Federal Trade Commission Staff, *Regulation of the . . . Television Repair Industry in Louisiana and California: A Case Study* (1974).