

# CONSUMER & PERSONAL RIGHTS Litigation

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## **Unveiling the Modern Transaction of Simultaneously Entering into Service Contracts and Disclaiming Implied Warranties in Violation of the Magnuson-Moss Warranty Act**

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Congress enacted the Magnuson-Moss Warranty Act (“Magnuson-Moss”) to protect consumer rights. This article focuses on Section 2308(a), which prohibits a dealer from disclaiming implied warranties while simultaneously entering into a service contract or providing a written warranty.<sup>1</sup> A succession of cases developed concerning this provision as dealers seek methods to reap the profitability of providing service contracts but at the same time enjoy protection from implied warranty disclaimers. Courts have consistently seen through these schemes developed by dealers to skirt Magnuson-Moss obligations.

### **I. Overview of Section 2308(a)**

Section 2308(a) does not create new causes of action for consumers.<sup>2</sup> It permits consumers, in certain situations, to proceed with claims for breach of implied warranties under state law.<sup>3</sup> Consumers can bring these claims even though the good was sold “as is” and the consumer acknowledged written disclaimers of such warranties.<sup>4</sup> When all is said and done, these claims are breach of warranty claims. The complexity comes in procedural posturing to permit the consumer to bring these claims.

Section 2308(a) is a straightforward provision limiting the dealer’s ability to disclaim implied warranties:

No supplier may disclaim or modify (except as provided in subsection (b) of this section) any implied warranty to the consumer with respect to such consumer product, or (2) at the time of sale, or within 90 days thereafter, such supplier enters into a service contract with the consumer which applies to such consumer product.<sup>5</sup>

Section 2308(a)(1) is clear: the dealer cannot make a written warranty and disclaim implied warranties.<sup>6</sup> The difficulty arises in the language of Section 2308(2) because Congress chose to use the phrase “enter into” rather than “sell” or “provide.” Under the language of the statute, it appears a dealer could sell or provide a service contract without entering into the service contract.<sup>7</sup> A dearth of authority exists expounding upon the “enter into” language of Section 2308(a)(2).<sup>8</sup>

The FTC promulgated one regulation regarding Section 2308(a).<sup>9</sup> This regulation provides a dealer may provide a third-party warranty without incurring liability under the warranty.<sup>10</sup> However, the dealer may become obligated under Magnuson-Moss by making written representations, oral representations, or through other actions connected with the sale.<sup>11</sup> Through such representations or actions, the dealer may adopt the provided warranty.<sup>12</sup> This regulation was issued at a time when service contracts were less prevalent. It only discusses warranties without specific reference that the regulation applies to service contracts.<sup>13</sup> Because Section 2308 affords consumers the same protections whether a written warranty or a service contract is involved, this FTC ruling applies with equal force to service contracts.

Section 2308(a)(2) is a significant provision affecting consumer rights, and the incorporated language has fostered the modern transaction used by dealers, discussed in Section IV, *infra*. Before evaluating the scope of Section 2308(a)(2), it is imperative to analyze the history of Magnuson-Moss.

## **II. Legislative History and Case Law Interpretation of Section 2308(a)**

The Federal Trade Commission (“FTC”) conducted an investigation on dealer warranties.<sup>14</sup> The FTC found dealers failed to perform their warranty obligations and were not living up to their promises.<sup>15</sup>

Congress was also concerned with dealers selling service contracts.<sup>16</sup> Congress noted that service contracts are often “overpriced and designed solely to increase the margin of profit on the sale.”<sup>17</sup> Moreover, these service contracts are “devised simply as a means for increasing sales and contain illusory promises which will not provide the consumer with any real protection.”<sup>18</sup> In light of these problems, Congress enacted Magnuson-Moss to provide “safeguards against the disclaimer or modification of the implied warranties of merchantability and fitness on consumer products where a written warranty is given with respect thereto.”<sup>19</sup>

In explaining the purpose behind Section 2308(a), Congress was particularly concerned because dealers used this practice to mislead consumers and restrict consumer rights:

This subsection is designed to eliminate the practice of giving an express warranty while at the same time disclaiming implied warranties. This practice often has the effect of limiting the rights of the consumer rather than expanding them as he might otherwise be led to believe.<sup>20</sup>

Congress also recognized consumers did not have practical means of forcing dealers to live up to their commitments.<sup>21</sup> To alleviate this problem, Magnuson-Moss provides for a successful plaintiff to recover an aggregate amount of costs and expenses, including attorney’s fees.<sup>22</sup>

Litigation involving Section 2308(a) has resulted in a line of cases that illustrates both the dealers’ increasingly creative attempts to skirt Magnuson-Moss and the courts’ unwillingness to permit the dealers to dodge their responsibilities. Each case has an underlying commonality: they all involve a dealer employing an artful transaction to skirt obligations under Magnuson-Moss. This section of the article traces the evolution of the case law.

### **i. Dealers Provided Consumers with Manufacturer Warranties, but the Dealer was Obligated to Perform Under the Warranty**

In four early cases, dealers disclaimed implied warranties. But they simultaneously gave the consumer a manufacturer warranty<sup>23</sup> or an “owner service policy”<sup>24</sup> that obligated the dealer to perform service. This scheme was unfair because the dealers were providing warranties even though the warranties officially belonged to the manufacturers. The courts recognized this and held the implied warranty disclaimers were invalid.

This line of cases showed that Section 2308 receives an expansive interpretation. Dealers are deemed to have provided a written warranty if the dealer is obligated under the manufacturer warranty. The courts showed a willingness to examine the true substance of the transaction rather than the form. After these attempts at providing manufacturer warranties failed, dealers employed a new scheme: incorporate the warranty into the underlying sales transaction. This attempt was also unsuccessful.









**ENDNOTES**

<sup>1</sup> 15 U.S.C. § 2308(a).

<sup>2</sup> 15 U.S.C. § 2308(c).

<sup>3</sup> 15 U.S.C. § 2308.

<sup>4</sup> *See id.*

<sup>5</sup> *See* 15 U.S.C. § 2308(a).

<sup>6</sup> *See* 15 U.S.C. § 2308(a)(1).

<sup>7</sup> Christopher Smith, *Service Contracts Under the Magnuson-Moss Warranty Act*, 346 PLI/Comm 185, 194 (1985).

<sup>8</sup> Roger D. Billings, Jr., *HAND. AUTO. WARR. & REPOSS.* § 7: 36.50 (2d ed. West 2005).

<sup>9</sup> 16 C.F.R. § 700.4.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> H.R. No. 93-1107 (1974), *reprinted in* 1974 U.S.C.C.A.N. 7702, 7708.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* at 7710.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* at 7711.

<sup>19</sup> *Id.*

<sup>20</sup> 1974 U.S.C.C.A.N. at 7722.

<sup>21</sup> *Id.* at 7710.

<sup>22</sup> 15 U.S.C. § 2310(d)(2).

<sup>23</sup> *Henderson v. Benson-Hartman Motors, Inc.*, 33 Pa. D & C 3d 6 (C.P. Allegheny Cty. 1983); *Freeman v. Hubco Leasing, Inc.*, 324 S.E.2d 462, 465-66 (Ga. 1985).

<sup>24</sup> *Ventura v. Ford Motor Corp.*, 433 A.2d 801, 809 (N.J. Sup. 1981); *Rothe v. Maloney Cadillac, Inc.*, 492 N.E.2d 497, 503 (Ill.App. 1<sup>st</sup> Dist. 1986), *aff'd in part and rev'd in part on other grounds*, 518 N.E.2d 1028 (Ill. 1988).

<sup>25</sup> *Felde v. Chrysler Credit Corp.*, 580 N.E.2d 191, 197 (Ill.App. 2<sup>nd</sup> Dist. 1991).

<sup>26</sup> *Id.* at 197; *see also* 16 C.F.R. § 700.4.

<sup>27</sup> *Patton v. McHone*, 822 S.W.2d 608, 612 (Tenn.App. 1991); *Ismael v. Goodman Toyota*, 417 S.E.2d 290, 291-92 (N.C.App. 1992).

<sup>28</sup> *Patton*, 822 S.W.2d at n. 16.

<sup>29</sup> *Johnson v. Earnhardt's Gilbert Dodge, Inc.*, 111 P.3d 417, 423 (Ariz.App. 1<sup>st</sup> Div. 2005).

<sup>30</sup> *Id.* at 418.

<sup>31</sup> *Id.* at 419.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 420.

<sup>34</sup> *Id.* at 423.

<sup>35</sup> *See Johnson*, 111 P.3d at 423.

<sup>36</sup> *Lemons v. Showcase Motors, Inc.*, 88 P.3d 1149 (Ariz.App. 1<sup>st</sup> Div. 2004).

<sup>37</sup> *Id.* at 1150.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* at 1151.

<sup>41</sup> *Id.* at 1153.

<sup>42</sup> *See Lemons*, 88 P.3d at 1152.

<sup>43</sup> *Id.* at 1152.

<sup>44</sup> *Id.* at 1152-53.

<sup>45</sup> The modern transaction has been illustrated to a degree in *Lemons* and treatises cited in this section. A substantial amount of information regarding the modern transaction stems from the authors' experience in Section 2308 litigation.

<sup>46</sup> Jonathan Sheldon and Carolyn L. Carter, CONSUMER WARRANTY LAW, § 2.3.2.2 (2d ed. NCLC 2001).

<sup>47</sup> *See id.* (describing dealers as having a "huge profit margin" on service contracts).

<sup>48</sup> *Lemons*, 88 P.3d at 1152-53.

<sup>49</sup> 15 U.S.C. § 2308(a).

<sup>50</sup> *See* H.R. No. 93-1107 (1974), *reprinted in* 1974 U.S.C.C.A.N. 7702.

<sup>51</sup> *See* discussion, Section II, *supra*.

<sup>52</sup> 16 C.F.R. 700.4.

<sup>53</sup> *See id.*

<sup>54</sup> *See, e.g., Patton*, 822 S.W.2d 608; *Ismael*, 417 S.E.2d 290; *Johnson*, 111 P.3d 417.