# SALE OF EXTENDED WARRANTIES REQUIRED FSA AUTHORISATION

*By William Hibbert*

*On 29 November 2011 the Court of Appeal held that a company carrying on the business of selling extended warranties was carrying on an unauthorized regulated activity under FSMA 2000, as, although the warranties only provided benefits-in-kind, they were regulated contracts of insurance. While the classes of insurance listed in the Regulated Activities Order 2001 may be wider than those in Directive 73/239/EC which it implements, Member States are entitled to regulate wider classes of insurance if so wished.* ***Digital Satellite Warranty Cover Ltd v FSA [2011] EWCA Civ 1413.***

## THE APPEAL

*Digital Satellite Warranty Cover Ltd v FSA* was an appeal from Warren J's decision[1] to wind up a company selling extended warranties, on the basis that this was a regulated activity within the meaning of s22(1) of FSMA 2000, the warranties fell within the definition of insurance, and the company, not being authorised, had acted unlawfully in breach of the general prohibition in s.19 FSMA.

## BENEFITS-IN-KIND INSURANCE IS INSURANCE AT COMMON LAW

The warranties had covered repair and replacement of equipment including in the event of accidental damage. Theft, intentional damage and fire were excluded; storm damage was not.

It had been argued that the warranties were merely contracts to repair and replace equipment, not to pay money, and therefore were not contracts of insurance in law at all. The submission had been rejected by the judge in the light of the definition of a contract of insurance in *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658 at 664:

"*A contract of insurance, then, must be a contract for the payment of a sum of money, or for some corresponding benefit such as the rebuilding of a house or the repairing of a ship, to become due on the happening of an event, which event must have some amount of uncertainty*

[1] [2011] EWHC 122 (Ch).

*about it, and must be of a character more or less adverse to the interest of the person effecting the insurance*."[2]

## THE CLASSES OF INSURANCE COVERED BY THE REGULATED ACTIVITIES ORDER AND DIRECTIVE 84/641/EEC

The essential question was whether they fell within Schedule 1 to the Regulated Activities Order 2001 ("the RAO"). This in turn involved a construction of Directive 73/239/EC (as amended by Directive 84/641/EEC), whose purpose was the coordination of the laws and regulations relating to the taking up and pursuit of the business of "direct insurance" (other than life assurance), and to which the RAO was intended to give effect.

"Direct insurance" refers to the 18 classes of insurance listed in the Annex to the Directive (as amended). Schedule 1 of the RAO also lists 18 classes of insurance, corresponding to those in the Directive. The relevant classes in this case were those listed in Schedule 1 at paragraphs 8 (damage or loss due to certain property by fire and natural forces), 9 (other damage to property); 16(b) and 16(c) (miscellaneous financial loss); and 18(b) (assistance in cash or in kind for people who get into difficulties).[3]

The CA considered extended warranties did not fall within paragraph 18, as this risk was not what was meant by "getting into difficulties". The judge had held the extended warranties came within 16(b), alternatively 16(c). Class 16 covers the:

> *"Extended warranties did not fall not within class 18, but did fall within class 16 (a) or (c)"*

*"Effecting and carrying out contracts of insurance against any of the following risks, namely-*
*(a) risks of loss to the persons insured attributable to interruptions of the carrying on of business carried on by them or to reduction of the scope of business so carried out;*
*(b) risks of loss to the persons insured attributable to their incurring unforeseen expense;*
*(c) risks neither falling within head (a) or (b) above nor being of a kind such that the carrying on of the business of effecting and carrying out contracts of insurance against them constitutes the carrying on of insurance business of some other class"*

## IS THE REGULATION OF BENEFITS-IN-KIND INSURANCE CONFINED TO ASSISTANCE FOR "PEOPLE WHO GET INTO DIFFICULTIES"?

It was argued that the Directive only covered insurance providing benefits-in-kind in so far as they fell within class 18 of the Annex (assistance in cash or in kind for people who get into

[2] The position is the same in EU law *Card Protection Plan v Customs and Excise Commissioners* (Case C-349/96: [1999] 2 AC 601, at 17-18.
[3] Article 15 of the amending Directive 84/641/EEC gave member states the option to extend this beyond people who get into difficulties while travelling or away from home, which is covered by paragraph 18(a).

difficulties), which had been added by the amending directive 84/641/EEC. Since the extended warranties did not fall within class 18, they were unregulated, and could not fall within Paragraphs 16(a) or (c).

The position was complicated by the fact that the wording of Paragraph 16 of Schedule 1 was derived not from class 16 of the Annex to the Directive, but from section 83(1)(c)-(e) of Insurance Companies Act 1974. Was paragraph 16 of the RAO more extensive than the Directive?

The CA referred to the principle in *Marleasing SA v La Comercial Internacional de Alimentacion SA*: C-106/89; [1990] ECR I-4135 (national courts must construe the legislation of member states in a way which gives effect, so far as possible, to the purpose of the relevant directive; difficulties of language may (and often do) exist in relation to the directives themselves but the conventional use of extensive recitals often provides a useful guide to what the directive was intended to do).

While benefits-in-kind insurance had not been expressly referred to in the Directive, the wording of the recitals of the amending Directive suggested that benefits-in-kind insurance had been within the original Directive's scope. On the other hand, the substantive provisions in the amending Directive for the calculation of the insurer's solvency margin suggested that benefits-in-kind insurance was limited to the new class 18 insurance.

## MEMBER STATES CAN REGULATE WIDER CLASSES OF INSURANCE THAN THOSE IN THE DIRECTIVE

The Judge had thought the complex issue would have required a reference, but held that the Directive had not required the complete harmonization of non-life assurance, so that Paragraph 16 of RAO could be wider than the terms of the Annex to the Directive. The CA agreed with this approach: without expressing a concluded view on whether Annex 1 of the Directive included benefits-in-kind insurance, it held that national governments were not excluded from extending regulation to a wider class of benefits-in-kind insurance than merely that in class 18. The application of the *Marleasing* principles of interpretation went no further than requiring the RAO to be construed so

> *"reference to ECJ avoided by finding that Directive does not require full harmonization"*

as to import the degree of regulation required under the Annex and did not exclude anything which went beyond that.

## EQUATING REPAIR AND REPLACEMENT WITH FINANCIAL LOSS

It was further argued that it was wrong to equate repair and replacement of equipment with an indemnity for financial loss; the risk was not loss attributable to the customers incurring unforeseen expense, but the risk of breakdown or malfunction in the equipment. There was no agreement to indemnify in respect of financial loss. Classes 16(a) and (b) therefore did not apply.

This argument was rejected. The risk was essentially a financial one: without the cover the insured would be exposed to the cost of remedying the defect. Further (although this was obiter), class 16(c) is a catch-all provision which was intended to apply to all contracts of general insurance which do not fall within one of the other classes or classes 16(a) or (b).

## PRINCIPAL OBJECT TEST

In the further alternative, the judge had held that that the extended warranties also fell within paragraphs 8 and 9 of Schedule 1 to the RAO. In the course of his decision on this point it is interesting to note that to some extent he preferred the "principle object" test to the "discrete elements" test. However, the CA did not have to consider arguments on this in view of its finding on paragraph 16.

## UNRESOLVED TAX CONSEQUENCES OF THE DECISION

The CA also would not address late submissions, made after the judgment was circulated for corrections, that the Court should reconsider the judgments to take account of the consequences on the tax exemptions for insurance if there were categories of insurance within the RAO which were outside the provisions of the Annex of the Directive.

Permission to appeal to the Supreme Court was refused.

## THE POSITION OF A RETAILER SELLING EXTENDED WARRANTIES

This case involved a company selling independent extended warranties. What if the retailer sells extended warranties itself? It would appear from the FSA's Perimeter Guidance at PERG 6.7.8 to 6.7.17 that authorisation will not be required if the warranty, including an

extended warranty, provides an obligation that is "of the same nature as a seller's or supplier's usual obligations as regards the quality of the goods or services". The obligation will be of the same nature if it bears a "reasonable relationship" to the seller's statutory or common law obligations as regards the quality of goods or services of that kind, or is a "usual obligation relevant to quality or fitness" in commercial contracts for the sale of goods or supply of services of that kind.

On the other hand, if an extended warranty is provided by a person other than the seller or supplier, or is "significantly" more extensive in content, scope or duration than a seller's usual obligations as to the quality of goods or services of that kind, then it is likely to be considered insurance by the FSA.

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