

Extended warranty – High Court accepts FSA’s position that repair obligations on breakdown involved ‘contracts of insurance’ requiring FSA authorisation

Key points

- In a Judgment on 31 January 2011¹, the High Court has considered the question of what amounts to a ‘contract of insurance’.
- It found, as the FSA had contended, that the “extended” warranty contracts in question did amount to contracts of insurance. This was the case even though there was no obligation on the provider to pay money (the obligation was to repair or replace the equipment); the breakdown protection amounted to insurance, as well as the accidental damage coverage.
- Accordingly (subject to a possible appeal and to statutory exclusions, for example, for vehicle breakdown insurance), only UK (and EEA) authorised insurers can enter into contracts providing this sort of coverage.

Summary of facts

The FSA sought the winding-up of two companies and a partnership, alleging that they were providing extended warranty contracts in relation to satellite television dishes, digital boxes and associated equipment without the required authorisation under the Financial Services and Markets Act 2000 (“FSMA”). As such, the issue centred on whether these entities had been carrying out and effecting insurance business in breach of the general prohibition in section 19 FSMA.

The warranty cover was similar for each entity and the contract terms were evidenced from a variety of sources: mail-shots, scripts for salespersons, transcripts of phone calls and written conditions. The cover under the warranty provided for the repair or replacement of the relevant items of equipment in the event of (mainly) breakdown or accidental damage; there was no obligation to pay out any money for loss. One of the businesses involved had registered for Insurance Premium Tax and was no longer registered for VAT.

Legal basis

Under section 19 FSMA, no person may carry on a regulated activity in the UK or purport to do so unless he is an authorised person or an exempt person. Contravention of the general prohibition is a criminal offence (section 23 FSMA).

Article 10 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the “RAO”) provides that ‘effecting’ or ‘carrying out’ a contract of insurance as principal is a regulated activity. Schedule 1 of the RAO lists the various classes of insurance; these broadly reflect the classes contained in the Annex to the First Council Directive 73/239/EEC. Despite the extensive nature of EU and UK legislation regulating insurance, there is no statutory definition of a ‘contract of insurance’. Hence the need for FSA’s extensive (and sometimes contentious) guidance on this issue in its Perimeter Guidance (“PERG”). This is based on the limited case law, which, in the UK, goes back to the Prudential case in 1904.

¹ Digital Satellite Warranty Cover Limited [2011] EWHC 122 (Ch)

Analysis of extended warranty as an insurance contract

Following a consideration of this case law², the judge found that where a contract provides cover in the form of 'consideration other than money', particularly an obligation to provide services, such as to repair or replace, such a contract can be construed as an insurance contract at common law. These contracts fell within class 16 - "Miscellaneous financial loss".

The Judge wrestled with the notorious question, from earlier case law, of the relevance (and interpretation) of a 'principal object' test. In the end this was not relevant because all elements of the contract involved insurance. The judge did, however, find that if he was wrong and the breakdown coverage for repair and replacement was not insurance, the contracts still required authorisation because of the accidental coverage. The latter was not minor, nor incidental to the former. The Judgment steers a careful course – rejecting the idea that a contract can only have one purpose and that that purpose is determinative, whilst not endorsing in full the current FSA guidance in PERG, which only requires an insurance obligation somewhere in the contract. (Although, as the judge noted, it does exclude an ordinary manufacturer's warranty provided as part of a sale agreement).

The Judge considered the position under EU law and concluded that domestic law on this issue could differ; the decision was therefore a matter of domestic UK law.

Permission to appeal has been granted.

Click [here](#) to read the FSA's announcement in light of the ruling.

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² Prudential Insurance Co v Inland Revenue Commissioners [1904] 2 KB 658; Department of Trade & Industry v St Christopher Motorists Association Ltd [1974] 1 WLR 99; and Medical Defence Union Ltd v Department of Trade [1980] 1 Ch 82. In this latter case, Megarry V-C summarised the elements of a contract of insurance as:

- a. The contract must provide that the assured will become entitled to something on the happening of some event;
- b. The event must be one which involves some element of uncertainty; and
- c. The insured must have an insurable interest in the subject matter of the contract.