

Part I

Handset Protection Programs – Overview of Insurance and Service Contract Regulation

Gerald “Gary” Mize
Chair, Handset Protection and
Insurance Practice
Gerald.Mize@alston.com
Direct: (404) 881-7579

Tejas Patel
Insurance Litigation and
Regulation
Tejas.Patel@alston.com
Direct: (404) 881-4987

- Handset Protection Webinar Series Topics
 - State Insurance and Service Contract Regulatory Part II
 - State Sales and Use Tax Part II
 - Captive Insurance Companies for Handset Programs
 - Mobile Payments
 - International Issues
 - Litigation Developments
 - Logistics and Supply Chain Issues
 - New Risks and Opportunities for Handset Programs
- Introduction
- Brief History of Handset Protection Program Regulation

Covered Perils

- The typical handset protection program covers the following perils:
 - Loss
 - Theft
 - Accidental Damage
 - Malfunction
 - Defect
- Loss, theft, and accidental damage are typically covered by an insurance policy.
- Malfunction and defect are typically covered by a service contract. However, service contracts may also cover incidental damage from handling.
- The insurance component and the service contract component are frequently bundled.

Portable Electronics Insurance Statutes

- The insurance component of handset protection programs is regulated by Portable Electronics Insurance (PEI) statutes.
- PEI statutes have either been passed or are pending in all 51 jurisdictions.
- The typical PEI statute regulates both the handset insurance product as well as the related sales activity.

Key Definitions

- Under the PEI statutes, Portable electronics insurance is defined as insurance providing coverage for the repair or replacement of portable electronics, which may be offered on a month-to-month or other periodic basis as a group or master commercial inland marine policy issued to a vendor by an insurer, and may cover portable electronics against loss, theft, inoperability due to mechanical failure, malfunction, damage, or other applicable perils.
- “Vendor” means a person in the business of engaging in portable electronics transactions directly or indirectly.

Key Definitions (cont.)

- “Portable electronics transaction” means:
 - (a) The sale or lease of portable electronics by a vendor to a customer; or
 - (b) The sale of a service related to the use of portable electronics by a vendor to a customer.

Licensing Requirement

- Under the PEI statutes, a vendor must hold a limited lines license to sell or offer coverage under a policy of portable electronics insurance.
- Employees or authorized representatives of a licensed vendor do not need separate licenses.

Vendor Compensation

- Under the PEI statutes, the charges for portable electronics insurance may be billed and collected by the vendor of portable electronics.
- The vendor may receive compensation for performing billing and collection services.
- If the charge to the customer for coverage is not included in the cost of the portable electronics, the charge for coverage must be separately itemized on the customer's bill.
- If the charge to the customer for coverage is included in the cost of the portable electronics, the vendor must disclose that the charge for portable electronics insurance coverage is included.

Disclosure Requirements

- At every location where portable electronics insurance is sold, brochures or other written materials must be made available which :
 - (a) Disclose that portable electronics insurance may provide a duplication of coverage already provided by a customer's homeowner's insurance policy....
 - (b) State that the enrollment by the customer in a portable electronics insurance program is not required
 - (c) Summarize the material terms of the insurance coverage.
 - (d) Provide a toll-free number and a summary of the process for filing a claim, including a description of how to return portable electronics and the maximum fee applicable in the event the customer fails to comply with any equipment return requirements.

Disclosure Requirements (cont.)

(e) State that an enrolled customer may cancel enrollment for coverage under a portable electronics insurance policy at any time and the person paying the premium shall receive a refund of any applicable unearned premium.

Training Requirements

- The insurer issuing the portable electronics insurance must either directly supervise or appoint a supervising entity to supervise the administration of the program, including development of a training program for employees and authorized representatives. The training must comply with the following:
 - (1) The training must be delivered to employees and authorized representatives of vendors who are directly engaged in the activity of selling.
 - (2) The training may be provided in electronic form. However, if conducted in an electronic form the supervising entity must implement a supplemental education program that is conducted and overseen by employees of the supervising entity.
 - (3) Each employee and authorized representative must receive basic instruction about the portable electronics insurance offered to customers and the disclosures required.

Termination of PEI Insurance

- Insurer may terminate or change terms only upon providing the policyholder and enrolled customers with at least 30 days notice.
- An insurer may immediately terminate a customer's enrollment if an enrolled customer exhausts the aggregate limit of liability and the insurer sends notice of termination to the enrolled customer within 30 calendar days after exhaustion of the limit. However, if notice is not timely sent, enrollment shall continue notwithstanding the aggregate limit of liability until the insurer sends notice of termination to the enrolled customer.

Service Contract Regulation

- A service contract is another name for an extended warranty for which there is a separate fee beyond the cost of the product.
- Most states have enacted statutes regulating the sale of service contracts.
- A service contract is typically defined as a contract or agreement, for a separate or additional consideration, for a specific duration to perform the repair or replacement due to a defect in materials or workmanship. Service contracts may also provide for the repair, replacement or maintenance of property for damage resulting accidental damage from handling.
- Service contracts may not cover loss or theft.

Registration Requirement

- Third-party service contract providers (the entity contractually obligated to the service contract holder) must be registered and pay an annual registration fee.

Financial Requirements

- Typically, third-party service contract providers must comply with one of the following:
 1. Insure the performance of all its obligations under all service contracts pursuant to a service contract reimbursement insurance policy issued by an insurer; or
 2. (A) maintain a funded reserve account for its obligations under its service contracts issued consisting of at least 40% of the gross consideration received upon the sale of, less claims paid under, all its service contracts then in force.
(B) place in trust a financial security deposit, of at least 5% of the gross consideration received upon the sale of, less claims paid under, all service contracts issued and then in force, but not less than fifty thousand dollars, consisting of one or more of the following:
 - (i) a surety bond;
 - (ii) securities of the type eligible for deposit by authorized insurers in this state;
 - (iii) cash; or
 - (iv) a letter of credit issued by a qualified United States financial institution; or
 - (3) maintain a net worth or stockholders' equity of at least one hundred million dollars.

Exemptions from Registration

- There are two exemptions that may apply to service contract registration, depending on the state:
 1. A service contract provider may not be required to register if it is the manufacturer or seller of the product.
 2. A provider may not be required to register if the value of the product is less than a certain dollar threshold (e.g., \$250)

Sampling of Issues with PEI Statutes

- Must unearned premium be refunded upon termination for exhaustion of aggregate limit of liability?
- In a situation involving multiple vendors, must all vendors be licensed?
 - Which entity must be the policyholder?
 - Can non-licensed vendors share in the licensed vendor's compensation?
 - Does the group requirement still apply?
- How do installment sales laws (Consumer Credit Code) interface with PEI statutes?

Sales and Use Tax, Generally

- Imposed by 45 states plus D.C., in addition to thousands of local jurisdictions
- Transaction tax typically imposed on the purchaser and required to be collected by the seller
- Generally applies to the retail sale of tangible personal property, as well as specified services
- Bundled transactions (i.e., sale of both service and product) may be taxable
 - Usually depends on whether sale of TPP is incidental to sale of service
 - If not incidental, may be able to separately state charges

Taxability of Mobile Phones

- A mobile phone will be considered TPP subject to sales or use tax in every state that imposes such a tax
- Seller of such phone – i.e., the carrier or the retail store – will be obligated to collect tax from customer and remit such tax to state in which the sale is made
- Out-of-state sale: seller must collect and remit use tax to the customer's state, if it has nexus with that state

Taxability of Mobile Phones (cont'd)

- Tricky/contentious issue is the base for the tax
 - Context of subsidized or free phones when customer signs up for calling plan
 - States treat it differently
- California is an example of a state that requires the tax to be computed based on the unsubsidized price
 - Has been litigated and upheld in the state – class actions against carriers/retailers
- Massachusetts: the “sales price” is the greater of the price paid by the customer or the wholesale cost of the phone

Sales and Use Tax on the Purchase of Handset Protection Plans

- Threshold question: whether the plan is considered “insurance” or a “warranty,” “service,” or “maintenance” plan
- General rule is that states may impose a sales/use tax on a warranty or service/maintenance plan, but not on an insurance policy

Sales and Use Tax on the Purchase of Handset Protection Plans (cont'd)

- Key hallmarks of an insurance policy (from case law):
 - Covers accidental damage, theft, and loss
 - Often provided by a third party rather than the manufacturer, retailer, or carrier
- Key hallmarks of a warranty or service/maintenance plan:
 - Covers product defects
 - Often provided by the manufacturer, retailer, or carrier of the mobile phone
- If insurance, then sale of plan should be exempt from sales/use tax

Sales and Use Tax on the Purchase of Protection Plans – Warranties/Maintenance Plans

- CA: separate charges for optional warranties or optional maintenance contracts are not taxable
- FL: sales of service warranties are taxable
- IL: both maintenance agreements and extended warranties are not taxable
- MA: the sale of a service contract is not taxable
- NY: the purchase of a maintenance or service contract is taxable
- OH: taxes all transactions in which a warranty, maintenance or service contract, or similar agreement is provided
- TX: tax is due on the sale of an extended warranty, service contract or service policy for the repair or maintenance of tangible personal property
- VA: taxes maintenance contracts, the terms of which provide for both repair or replacement parts and repair labor

Sales and Use Tax on the Fulfillment of a Protection Plan

- Two primary considerations:
 - (1) whether the provider is subject to tax on the purchase of parts used to repair/replace a phone; and
 - (2) whether the customer is subject to tax upon receiving such repaired/replaced phone from the provider

Sales and Use Tax on the Fulfillment of a Protection Plan (cont'd)

- General rules:
 - If the state taxed the purchase of the plan, it will not tax the provider's subsequent purchase of replacement parts in fulfillment, and it will not tax the provision of the repairs or replacement phone to the customer
 - This rule can vary if the customer is obligated to pay a deductible
 - However, if state did not tax the purchase of the plan (e.g., the plan is insurance or otherwise exempt), it will usually tax the provider and/or the customer

Sales and Use Tax on the Fulfillment of a Protection Plan

– States that Do Not Tax Plans

- CA: provider/repairer liable for tax on parts or materials used to fulfill plan; customer is taxable on deductible
- IL: repairs made under a maintenance agreement or extended warranty result in tax liability”
- MA: repairer shall pay the sales tax upon its purchase of parts, may not collect from customer; must collect tax on deductible

Sales and Use Tax on the Fulfillment of a Protection Plan

– States that Tax Plans

- FL: purchase of repair parts/property not taxable; customer taxable on deductible
- NY: tangible personal property transferred to the customer in fulfillment of plan may be purchased for resale; customer taxable on deductible
- TX: provider may issue a resale certificate for parts to be used in fulfilling plan; customer taxable on deductible
- VA: providers may purchase repair/replacement parts under a resale certificate of exemption

Special Tax Issues

1. Whether there is a way to structure a handset-protection plan operation in order to take advantage of special state tax exemptions
2. Whether a state could assert a use tax liability based on the provider's *own* putative “use” of the phones upon shipping them to a customer in the destination state

Special Tax Issues – Structuring an Operation

- Initial sale of plan
 - Likely no way to take advantage of exemptions, other than structure as insurance
 - Tax based on state in which customer is located/transaction occurs
- Subsequent fulfillment
 - Can possibly locate fulfillment center in state with favorable exemption
 - E.g., in a state that exempts purchase of parts in fulfillment of taxable warranties/maintenance plans
 - E.g., in a state with an import-for-export exemption (Illinois, Tennessee, Texas, etc.)

Special Tax Issues – Putative Use of Replacement Phones Upon Shipment

- Conceivable that a state could assert a use tax liability based on the provider's *own* putative “use” of the phones in the destination state
- Argument would be that ownership of the phones while they are being shipped and delivered in the state (before the customers take possession) constitute taxable uses
- Such an assertion would likely be premised on the so-called “catalog cases” – addressed whether the distribution of catalogs into a state is a taxable use in that state