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JUST HOW SOLID IS YOUR DEALERSHIP SERVICE CONTRACT PROGRAM?



Whenever a service contract provider fails, the telephone calls and emails come immediately from dealers asking me what things they should consider when analyzing a service contract provider and its program. Their concern is certainly understandable. Whenever a service contract provider fails,

announces it can no longer pay claims and files for protection under bankruptcy laws, dealers across the country find themselves exposed to potential liability they never thought existed.

As with any other third party product or service, a dealer should do some due diligence with respect to both

the service contract provider and the product it is offering prior to offering it for sale. Most service contract providers offer a wide range of options within each of their programs. Be realistic when looking at a particular service contract program and remember, cheapest is not best. Since the dealership is the one

continued on page 36

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continued from page 34

selling the product to the consumer it can, in certain circumstances, be exposed to liability regardless of what the actual service contract or service contract provider's dealer agreement might say.

The first and foremost issue for a dealer to consider is whether the provider is offering a "dealer obligor" or "third party/administrator obligor" service contract program. While the actual mechanics of the program will be somewhat similar, the dealership bears the responsibility for all of the obligations to the consumer under a dealer obligor program, including financial responsibility for the payment of claims. A careful review of the service provider's dealer agreement and the service contract should enable you to ascertain the structure of the program. In conducting your review, focus on each party's contractual obligations and how

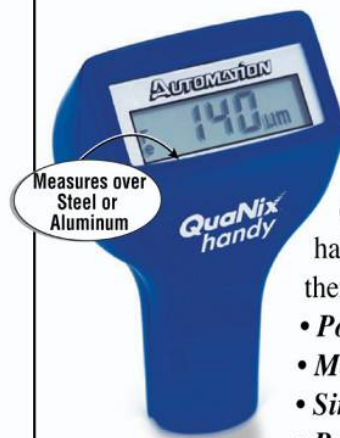
those obligations are fulfilled rather than document headings that may contain labels such as "administrator" or "provider".

Even when dealing with third party or administrator obligor service contract programs, if everyone else involved with the program becomes insolvent, the consumer's last resort is the dealership where the service contract was sold. A number of dealers have discovered this fact when dealing with a service contract provider's exit from the market place. When selecting a program, you should consider the service provider's current ability and past history with respect to the payment of claims. Ask for references and check the provider out with the appropriate State Regulator and the State Attorney General's Office. Dealers should also inquire about the type of insurance coverage the provider has obtained for the program and obtain

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copies of the current insurance policy. An important factor to consider when analyzing the insurance coverage is whether the policy provides "first dollar," "stop loss," or some other coverage. If you don't understand what all of this means, get someone who does to look over the documents for you.

Apart from the dealer's belief or any statements made by the service provider during its sales presentation indicating that the dealership will have no liability under a given program, the dealer agreement and/or service contract itself often contain other areas of potential liability for a dealership. For example, some service contract programs provide for a delay in coverage between the date of sale of a motor vehicle and the effective date of a service contract, thereby limiting coverage during one of the most crucial time periods when the consumer owns the vehicle. Other service providers require that an application for a service contract be received and accepted by the provider before the service contract becomes effective, once again limiting coverage and potentially exempting the service contract provider from responsibility for paying claims that arise during those first few days of ownership of a vehicle.

Many service contract providers' dealer agreements also make it the selling dealership's obligation to repair, or assume liability for the cost of repairing, any damage to vehicle components covered by the service contract that existed at the time of the sale of the vehicle to the retail customer. This can present a number of problems when a service contract is sold in conjunction with a used motor vehicle. Furthermore, many of the dealer agreements provide that the service provider can deny a prospective

continued on page 38



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continued from page 37

consumer's claim if the vehicle has been modified from the original manufacturer's specifications. Since it is virtually impossible for anyone dealing in used vehicles to be familiar with the original manufacturer's specifications and equipment for the motor vehicles with which they deal, this creates another potential area of exposure for the dealership.

Claims administration is also an important consideration. Effectively handling claims and getting them paid helps keep your customers satisfied, and thus loyal customers of


the dealership. Additionally, if your dealership will be performing any of the repair work pursuant to the service contract, you should inquire as to what the standard is for the payment of

cost of repair should have been according to the provider, and whether you are obligated to provide any additional warranty to the customer in connection with the repair.



A motor vehicle service contract program, structured properly, can be an important profit center for a dealership. The exercise of a little due diligence by the dealership prior to executing a dealer agreement with a service

labor rates (i.e. are they determined by national averages, flat rate manuals or actual time spent?), whether the provider will pay the entire cost of the repair or only what the "reasonable"

contract provider and engaging in the sale of its products will not only protect the dealership from unforeseen liability, but will help ensure the overall success of the program. 



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