



RESIDENTIAL WARRANTY SERVICES, INC.

[via E-mail]

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RE: Preliminary Research into Warranty Management, LLC business plan effects on Home Inspection Companies

Mr. Thornberry,

Upon my review of the Warranty Management, LLC (“WM”) business documents, which appear to have been distributed to potential home inspector companies to educate them with regards to WM’s business plan, it appears that the plan greatly protects WM legally, perhaps to the detriment of the home inspection companies involved. Firstly, it is vital to remember that there is a great distinction between the roles WM and the home inspection companies play in this relationship; WM is simply the manager/administrator of the warranties while the home inspection companies own, underwrite, provide, pay for, and guarantee the warranties themselves. This is incredibly important because it lays the foundation for the relationship between the parties as well as how each will be treated by outside entities. That being said, here are a few of my preliminary thoughts on the matter, based on the documents I was given to review:

I. WM’s Attorney admits to doing no legal research as to whether the warranties provided to the home inspection companies are legal and WM refuses to guarantee the provided warranties’ legality.

Among the business documents was a Memorandum by the WM attorney, Joseph Denneler. This Memo contains preliminary legal advice with regards to WM, the results of which were publically distributed to home inspectors, which is strange because the attorney is only looking after WM’s legal interests, not the home inspection companies’, which WM makes very clear by stating, “the documents or other information or services supplied by [WM] are not legal advice and should not be relied upon as such.”¹ The WM Attorney, in his memo, states “I did not assess each state’s laws pertaining to regulations on the type of service the new company will perform”² followed by “I do not anticipate any issues given the limited scope of the warranty/guarantee being offered”³. Generally, when an attorney, in his/her professional capacity, states (s)he does not anticipate any issues with a business offering to administer multi-state services to companies in various states, it is usually not preceded by an admission that (s)he did no actual research into the matter, especially when you take into account Section V herein. Nonetheless, the admission that no research was completed on state laws means that this business may be illegal or non-compliant in an individual home inspection company’s state.

Furthermore, the agreement between WM and the home inspectors clearly states that WM (including its employees, attorneys, owners, etc.) “cannot and does not intend to guarantee any specific results or legal interpretations regarding the

¹ Warranty Management and Administrative Services Agreement, Section 13.10

² Memorandum by Joseph Denneler Esquire to Kevin O’Malley, 13 February 2015

³ Ibid.



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Warranty Program”⁴. Similar language is repeated throughout the documents I was provided, with examples such as: “Warranty Management LLC does not intend to provide legal advice regarding the enforceability of your Warranty Document”⁵ and “[WM] cannot and does not intend to imply, directly or indirectly, that the Warranty Program will be upheld in a court or other legal proceeding”⁶. The agreement goes a step further by having the home inspection company take full legal responsibility:

“the [home inspection] company hereby acknowledges that the provisions of the particular warranty documents, including, but not limited to, the scope of the Warranty Program and any exclusions, limitations, terms contained therein, are solely owned by the Company, the responsibility of the Company and all such determinations were made by the Company at its sole and exclusive discretion.”⁷

This language immediately caught my attention because few businesses, in my experience, offer contracts that tell their potential clients that their involvement in the proposed business plan may not be legal. Most companies have completed the research and can offer their customers a plan backed by the company itself; here WM is consciously distancing itself from any responsibility if any part of the plan is determined to be illegal and its disclaimers place responsibility and accompanying liability on the home inspection company utilizing it. Therefore, WM, by not guaranteeing the legality of the warranties it is helping the home inspection companies write, has potentially caused another legal risk for the home inspection companies, namely:

II. Home Inspection Companies may be acting as illegal providers of insurance/warranties and therefore subject to State and Federal sanctions.

It must be noted that warranties are handled differently in each state across the United States. Some regulate them as independent contracts, some have their own home warranty departments, and others consider them insurance. Failing to register the warranties correctly with their individual state regulators could result in the home inspection company being seen as providing insurance which they are not legally licensed to do.

Furthermore, WM is unable or unwilling to offer assistance with regards to the home inspection company’s compliance with state law as one of the documents they provided states, “Warranty Management LLC is simply the [home inspection] Company’s warranty administration service and is not responsible for the final approval of the Company’s Warranty Document”⁸. This sentence is jarring because many states, in fact the majority of them, regulate home warranties / residential service contracts / home protection plans, (their names vary from state to state) etc., with great vigor. There are usually stringent requirements companies have to follow and provide the state proof of, before they are allowed to underwrite and provide warranties in that state. These requirements include not only adding specific wording, applying for the applicable licenses, and following all reporting requirements, but also meeting extensive financial requirements as well, most of which include a financial security of some sort, usually \$25,000-\$100,000 in the form of a bond or reserve account. Without following all of the applicable procedures and requirements, the home inspection company could be found guilty of illegally offering home warranties such as those companies in Missouri, where the applicable statute reads “it is unlawful for any person to issue, sell, or offer for sale, in this

⁴ Ibid., Section 13.10

⁵ Warranty Management LLC Approval Letter

⁶ Warranty Management and Administrative Services Contract, Section 13.19.

⁷ Ibid., Section 13.11

⁸ Warranty Management LLC Approval Letter



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state any service contract, unless each provider has registered with the director on a form prescribed by the director.”⁹ To further exhibit how strenuous these regulations are, attached as Exhibits A, B, and C are a few examples of the individual state regulations regarding residential service contracts (Illinois¹⁰), home warranties (Florida¹¹), and home protection plans (California¹²), respectively. These statutes are only part of the processes required in these chosen states but are good examples of what is required before being able to sell (or issue) warranties within each of those states. Although these regulations include even the act of issuing a warranty, some arguments are that the warranty cost is included in the home inspection fee and so ‘free’. Unfortunately, due to the home inspection company also holding the roles of the warranty underwriter and provider, the price will likely be viewed as built into the inspection cost and therefore, not free. This is dangerous because, where an established home warranty company could offer the same item with no consequences, it is only because of the independent status of the warranty company to the home inspection it is providing a warranty for – an independent status the home inspection company would no longer have.

Even if you see the warranty being offered as ‘free’, there are other issues that would need to be discussed with an expert, namely the conflict of interest the home inspectors would be creating for themselves. Basically, by offering the warranty themselves, home inspection companies are taking on the burdens of placing themselves in the middle of a conflict of interest against their home inspection duties. For example, if a customer feels that something was missed in the home inspection but also feels that the warranty should cover its repair – if the warranty company and home inspection company are separate, there’s only a 50% chance the home inspector will be expected to pay. However, if both are the same company, the conflict could lead to greater payouts and a heightened risk of a lawsuit against the home inspection company.

Furthermore, if the home inspection company (or their offered warranty) is not properly registered within their respective states, they may fall on the wrong side of the deceptive trade practices statutes of their states due to misleading their homeowner customers into believing that the warranty has been approved by the state (which guarantees added protections and certain oversights) when it has not. Even more potentially damaging to the home inspection companies is if their state regulates home warranties as insurance. As stated previously, in these states, without proper research and registrations beforehand, the home inspection companies could be seen as committing insurance fraud by using, selling, or underwriting the warranties. In addition to the huge compliance risks that accompany this deal, as it stands, home inspection companies, by writing the warranties themselves and offering the warranties themselves may unknowingly cross into a highly regulated area, in most states, which is vital when it’s realized that:

III. All legal liabilities and risks (and associated costs) are on the Home Inspection Companies’ responsibility.

At the end of the WM Attorney’s Memo, he states, “the documents will need to reflect that the warranty/guarantee is being provided by the inspector, not [Kevin O’Malley] or [WM]”.¹³ This statement is vitally important because it stresses the importance of ensuring all legal liability rests with the home inspection companies, rather than WM.

⁹ § 385.02.1 RSMo et al

¹⁰ 215 ILCS 152/1-99

¹¹ Fla. Ins. Stat. § 634.301-348; § 634.401-634.444

¹² Cal. Ins. Code § 12740-12764

¹³ Memorandum by Joseph Denneler Esquire to Kevin O’Malley, 13 February 2015



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The management agreement furthers this idea by clearly stating that WM is just providing “certain management and administrative support services to the Company”¹⁴ and that “The Company understands that [WM] does not sell warranties nor are they an insurance company. The Manager strictly manages warranty programs created by the Company”¹⁵. This limitation furthers the idea that the warranty is the Company’s, along with all legal repercussions surrounding it. The agreement also includes an indemnification clause that the home inspection companies will hold WM (including its employees, agents, officers, etc.) harmless for ANY damage due to WM’s duties or provisions of the entire WM program¹⁶. The only way a home inspector seems to be able to recoup their money is if WM commits fraud, gross negligence, or willful misconduct, all of which are, as you know, incredibly high standards to prove and so unlikely to be met, especially due to the home inspector already accepting that WM’s documents may not be legal, that WM is only the administrator, and that the home inspector is fully liable. Moreover, WM takes extra precautions to even further limit the damages a home inspection company could receive, even if due to WM’s fraud, negligence, misconduct, etc. by stating:

“Neither [WM] nor any of its affiliates shall be liable for indirect, incidental, or consequential damages suffered by the [home inspection] Company, or for punitive damages, with respect to any term or subject matter of this agreement, even if informed of the possibility thereof in advance. This limitation applies to all causes of action, including, without limitation, breach of contract, breach of warranty, negligence, strict liability, fraud, misrepresentation, and other torts.”¹⁷

Incredibly, the indemnity clause goes even further to state that:

“the indemnities provided by the [home inspection] Company hereunder shall cover all reasonable costs and expenses payable or incurred by [WM] in connection with any claims, including, but not limited to, attorney’s fees, costs of litigation, and indemnity for any claims or judgments entered against [WM] as a result of the provision of the Management Services.”¹⁸

What this provision says is that the home inspection company agrees to not only hold WM harmless if WM is sued, even if because of WM’s own actions, but that the home inspection company will reimburse (or repay) WM any money spent in legal defenses. Furthermore, even if a judgment is issued against WM as the result of a lawsuit related to the warranty program, the home inspection company is STILL responsible for indemnifying WM and paying off (or reimbursing WM for paying off) the judgment.

The agreement goes further, as stated earlier, by stating that the home inspector acknowledges that “provisions of the particular warranty documents including, but not limited to, the scope of the Warranty Program and any exclusions, limitations, terms contained therein, are solely owned by the Company, the responsibility of the Company, and all such determinations were made by the Company at its sole and exclusive discretion”¹⁹. This provision immediately makes everything surrounding the warranty the responsibility of the home inspection company. Therefore, as it appears as if the risk and liability related to this endeavor falls primarily on the home inspection companies, it is vitally important that:

¹⁴ Warranty Management and Administrative Services Contract, Preamble

¹⁵ Ibid., Section 3.3

¹⁶ Ibid., Section 6.1

¹⁷ Ibid., 7.1

¹⁸ Ibid., Section 6.2

¹⁹ Ibid., Section 13.11



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IV. Any interested Home Inspection Company should complete ample independent research and consult with local experts prior to offering warranties under this business plan.

Based on the documents I've been provided, WM has made it clear that they are simply managing and administering the home inspectors' warranties and it is the home inspection companies themselves who are the underwriters and providers of these warranties. Each of these responsibilities comes with a plethora of legal and financial obligations that must be complied with and the home inspection company must first ensure that it is protected legally and financially regarding this business deal as it is apparent, by WM's documents, that WM is unable or unwilling to do so itself.

Any interested home inspection company should, at minimum, speak with a local attorney who specializes in home warranties or compliance issues within their state to determine that the warranties they hope to offer are legal and contain all disclaimers and wordings that the applicable state has determined must be included therein. Then the home inspection company should contact their local state government (or have a compliance attorney do so) to find out what regulations / processes would apply to an underwriter/provider of home warranties (both of which the home inspection company would be, under this business plan). The home inspection company may then want to speak with a financial advisor to determine which financial security requirement is best for their business. Finally, it may be necessary for the home inspection company to retain an attorney or other individual to ensure they comply with all renewal requirements (some, like California²⁰ and Texas²¹, include annual financial audits, which may require the hiring/retention of a CPA).

Additionally, WM has declined all legal liability and offers no legal assistance with regards to claims against the home inspection company (whether due to the inspection itself, a claim denial, or simply because a homeowner feels they deserve more money than a warranty provides/a provider is willing to pay). Even their Claims Assist program only offers help before a lawsuit is filed: "The program does not provide claims assistance or risk management advice regarding any claims where a lawsuit or demand for arbitration has been filed. In those instances the member is specifically encouraged to report the claim to his or her insurance carrier or, in the case of no insurance, retain local counsel in the member's state or jurisdiction to provide legal assistance."²² Therefore, it is likely in the home inspection company's best interest to have a separate legal fund set up, along with having a local attorney retained to handle any lawsuits, as they are filed.

I would further suggest all interested home inspection companies request proof that WM is properly licensed because, due to the WM Attorney's statements that he conducted no state-wide legal research, WM may not be compliant with the various state laws that mandate:

V. WM must be licensed in each applicable state where it is operating as an administrator.

WM has stated that it is an administrator/manager of the home inspection company's warranty yet warranty administrators also must abide by stringent state-by-state regulations and application processes. WM may have to obtain licenses, along with proof of financial stability before administering any warranties. If WM meant to disclaim this as well, and administrator was simply meant to be interpreted in layman's terms (not legal terms), then they will likely have to edit their

²⁰ Cal. Ins. Code § 12750-12757

²¹ Tex. Occ. Code Ann. §1304.151-1521

²² Claims Assist brochure



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documents to reflect the same. This may have appeared confusing because, while an independent warranty company may act as its own underwriter, provider, and administrator, any business plan that splits up the tasks among various companies still must ensure that each is licensed/registered appropriately. Under the WM business plan, while home inspection companies must be properly licensed/registered as the warranty's underwriter and provider, WM is the administrator and so must ensure its compliance under certain state codes, as well. To name a few states as examples, Texas,²³ Utah,²⁴ and Maine²⁵ have regulations that all require third party administrators to register prior to administering any residential service contracts on behalf of the service contract provider.

VI. Conclusion

In conclusion, based on the documents provided, this business plan appears to have some serious, legal implications for any involved home inspection company. As a result, the home inspection companies must do everything they can to ensure that what they are offering is legal in each of their respective jurisdictions. Due to the way WM has set up its business with regards to home inspection companies, the home inspectors will be viewed as the warranty underwriters/providers which, added to the fact that WM has disavowed any ability to provide legal or compliance assistance or assurances, necessitates that each interested home inspection company complete their own research and speak with their own local experts before joining. Furthermore, the legal risk is seemingly completely on the home inspection companies, making it unlikely that any compliance attorney (acting in the interest of the home inspection companies) could justify this business arrangement without substantial changes being made, either to the business relationship with WM or to the home inspection company itself.

As a licensed attorney who, as you know, has researched and obtained licenses for RWS throughout the majority of the United States as well as personally handling all compliance issues in every state we've touched along the way, I feel the burden being placed on home inspection companies – having to navigate the various state laws, prepare the necessary financial securities/statements, and handle all compliance issues – would be near impossible without their bringing in (and retaining) local, third party experts, likely at great costs. For example, as you know, California's application alone took over two (2) years and hundreds of thousands of dollars spent before the process was completed and warranties could be issued. As a result, as it stands, this is not a program that I would promote (or would suggest you promote) due to the insurmountable efforts and resources each home inspection company will likely have to put into research and compliance, simply to ensure their liability and risk is somewhat contained.

Please contact me if you have any additional questions or concerns.

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²³ Tex. Occ. Code Ann. §1304.101(a)

²⁴ Utah Code § 31A-25-203

²⁵ Md. Code Ann., ins. Law, Title 24-A § 7103