

# The COMPUTER & INTERNET *Lawyer*

Volume 42 ▲ Number 8 ▲ September 2025

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## A Regulatory Assessment of AI Performance Guarantees

By Alex Selarnick and Greg Hoffnagle

In the United States, the warranty industry is evolving, with companies seeking to modernize conventional warranties by leveraging advanced technologies such as artificial intelligence (AI) to analyze risk and guarantee or warrant specific outcomes. As AI-powered products and services become more prevalent across industries – including software, automation, healthcare and finance – companies are increasingly exploring the use of warranties and guarantees to build customer confidence and mitigate risk. However, offering warranties on AI-powered products and services raises unique regulatory questions and risks, particularly given the evolving nature of this technology and because warranty laws do not always apply cleanly to many of the innovative offerings on the market today.

### KEY MOTIVATIONS

As with traditional warranties, companies offering technological solutions to analyze risk may benefit in various ways by guaranteeing certain performance thresholds, including:

- *Customer Trust.* AI can be complex and difficult for a customer to understand. Warranties provide customers assurance that AI-enabled products will perform as expected.
- *Competitive Differentiation.* A warranty can set a company apart from its competitors, especially in industries where AI adoption is still growing.
- *Risk Mitigation.* Clearly defined warranty terms help manage customer expectations and limit liability if AI does not perform as anticipated.

That said, before offering an AI performance guarantee, it is important for companies to understand the potential risks in doing so, as it is common for these types of programs to straddle the boundary between insurance and other regulated risk-sharing arrangements.

### KEY REGULATORY CONSIDERATIONS

Though insurance laws can vary from state to state, AI warranty programs may be permissible and may not be considered insurance if they are merely incidental to another legitimate business activity or purpose.

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# AI Performance Guarantees

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However, the laws governing when such an offering is “incidental” are not always defined or clear, particularly when applied to AI offerings.

When evaluating an AI performance guarantee, an initial question may arise as to whether such a guarantee falls within the technical definition of “insurance.” Even then, courts in several states have recognized that not every contract that meets the technical definition of insurance is an insurance contract for purposes of regulation. Instead, courts must consider the “principal object and purpose” of the contract as a means to delineate insurance from transactions that include only an incidental element of insurance.

Given the lack of legal precedent in the context of AI performance guarantees, the question of whether any particular program may constitute insurance is a highly fact-specific analysis and may vary between states, and there are various factors that courts or regulators would generally consider in order to distinguish insurance from non-insurance in this context. These include the nature of the agreement, scope of the obligations undertaken, offeror and its “relationship” to the risks, and degree of “control” over the risks. However, if a regulator were to conclude that an AI performance guarantee is not incidental to another legitimate business activity or covers risks outside of the offeror’s control, then the program may be considered an insurance product, and any company offering or selling such a product would need to be licensed.

Ultimately, the particular test for when something is “incidental” or under the offeror’s control may vary from state to state, and it can be difficult to determine how to apply these tests to a particular program. Companies offering AI performance guarantees are therefore arguably operating in somewhat of a legal gray area without clear rules.

## BEST PRACTICES

In order to reduce risk in offering an AI performance guarantee, companies should consider the following:

### Defining AI Performance and Warranty Scope

- Traditional warranties cover hardware defects or software bugs, but AI-based products involve probabilistic decision-making rather than fixed outcomes.
- Companies must carefully define the performance guarantee (e.g., uptime, accuracy thresholds), any limitations (e.g., AI recommendations are not always 100 percent accurate) and any exclusions (e.g., external factors such as regulatory changes).

## Avoiding Common Characteristics of Insurance Products

- When cast as non-insurance, AI warranty programs should not look like an insurance product. Further, because this is not an insurance product, fortuitous events outside of the offeror’s reasonable control should be excluded.
- Since state regulators focus more on products for which an “add-on” fee is charged, companies offering AI warranty programs should consider baking the cost of the warranty into the cost for the AI product or service itself, such that there is no separate consideration for the warranty protection.

## Other Best Practices

- AI warranties must comply with any applicable consumer protection laws, such as the Magnuson-Moss Warranty Act, which mandates transparency in warranty terms.
- Given that one of the primary factors a court or regulator would review is whether the warranty is “incidental” to the offeror’s core business, AI warranty programs should include lower coverage limits that are more closely aligned with the pricing of the underlying product/service, and companies offering AI warranty programs should avoid marketing them as a major new offering.
- AI models often improve over time through machine learning updates. Warranties should specify how updates impact coverage. For instance: Will updates be included in the warranty? Does retraining the AI reset warranty coverage?

## TAKEAWAYS

- With the warranty industry evolving in the United States, companies seeking to modernize conventional warranties by leveraging advanced technologies such as artificial intelligence are faced with unique regulatory questions and risks.
- Before offering an AI performance guarantee, it is important for companies to understand the potential risks in doing so, as it is common for these types of programs to straddle the boundary between insurance and other regulated risk-sharing arrangements,

and the laws governing these offerings are not always defined or clear.

- In order to reduce risk in offering an AI performance guarantee, companies should consider carefully defining AI performance and warranty scope, avoiding common characteristics of insurance products and employing other best practices.

## CONCLUSION

Warranties for AI-based products require a carefully structured approach that balances customer satisfaction with regulatory requirements. As AI regulations evolve, businesses must continuously refine their warranty terms, disclosures and risk management strategies to stay competitive and remain compliant.

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