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# WHETHER RELIANCE ON THE WARRANTY IS REQUIRED IN A COMMON LAW ACTION FOR BREACH OF AN EXPRESS WARRANTY?

## I. INTRODUCTION

The wide use of warranties today provides for an array of unsettled issues. One unsettled issue is “whether reliance is required to support a claim of breach of an express warranty”<sup>1</sup> at common law.<sup>2</sup> Reliance in this sense refers to a buyer’s reliance on the truthfulness of a seller’s warranty, not the reliance on a promise necessary for the formation of a warranty.<sup>3</sup> The uncertainty over whether reliance on the warranty is required is evidenced by the split in opinion that has arisen in jurisdictions that have addressed the issue.<sup>4</sup> This Comment examines the reliance requirement in an action for breach of an express warranty at common law by focusing on that split in opinion.

The importance of an answer to this dilemma is readily apparent to both purchasers and sellers of businesses, who on a daily basis are faced with express warranties which “extend over a wide range of subjects and cover virtually every aspect of purchaser-seller agreements.”<sup>5</sup> “In transactions involving the sale of a business, sellers may make express warranties concerning such matters as the business’s profitability or the accuracy of records provided to the purchaser for evaluation.”<sup>6</sup> Addi-

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1. Sidney Kwestel, *Freedom From Reliance: A Contract Approach to Express Warranty*, 26 SUFFOLK U. L. REV. 959, 960 (1992). Kwestel argues that regardless of the transaction, reliance should never play a role in an action for breach of an express warranty. See *id.* at 969. Rather, all actions involving breach of express warranty should be governed by contract principles. See *id.* at 970.

2. This debate also exists under the Uniform Commercial Code, but that is beyond the scope of this Comment. See Robert S. Adler, *The Last Best Argument for Eliminating Reliance from Express Warranties: “Real-World” Consumers Don’t Read Warranties*, 45 S.C. L. REV. 429 (1994). The debate centers on the words “basis of the bargain” in Section 2-313 of the U.C.C., and whether these words require a buyer to rely on the seller’s representations to maintain an action for breach of an express warranty. See *id.* at 430.

3. See *CBS Inc. v. Ziff-Davis Publ’g. Co.*, 553 N.E.2d 997, 1000 (N.Y. 1990).

4. Compare *CBS Inc. v. Ziff-Davis Publ’g. Co.*, 553 N.E.2d 997 (N.Y. 1990), with *Land v. Roper Corp.*, 531 F.2d 445 (10th Cir. 1976). See also *Hendricks v. Callahan*, 972 F.2d 190, 192 (8th Cir. 1992); *Shambaugh v. Lindsay*, 445 N.E.2d 124, 126-27 (Ind. Ct. App. 1983).

5. 8 SAMUEL WILLISTON & WALTER H. E. JAEGER, A TREATISE ON THE LAW OF CONTRACTS § 954, at 358 (3d ed. 1964 & Supp. 1997).

6. Frank J. Wozniak, Annotation, *Purchaser’s Disbelief in, or Nonreliance Upon, Ex-*

tionally, due to the size of these transactions, the lengthy preparation, the potential liability, and the likelihood they will not fall under the Uniform Commercial Code (U.C.C.), the development of the common law in this area is very important.

This Comment develops and then answers the question of whether reliance on a warranty should be required in a breach of warranty action brought by the buyer of a corporation or of stock. This Comment (1) outlines the split in authority by focusing on case law from jurisdictions both for and against requiring reliance on the warranty, (2) analyzes the two conflicting positions, and (3) based on that analysis comes to a conclusion as to which position represents the most logical, fair, and economically efficient approach.

## II. BACKGROUND

According to Professor Samuel Williston,<sup>7</sup> "[t]he law of warranty is one century older than special assumpsit,<sup>8</sup> and the action upon the case on a warranty was one of the bases upon which the law of assumpsit seems to have been built."<sup>9</sup> Early on, the law of warranty recognized that an "action on a warranty was regarded as an action in deceit."<sup>10</sup> The basis of the action in deceit was in tort,<sup>11</sup> however; "[t]he fact that the cause of action was grounded in tort did not remove the fact that it was contractual in nature and was based upon the breach of warranty as to the truth or nontruth of the statement which the maker warranted."<sup>12</sup> "Eventually, . . . the law concerning warranty became the domain of the

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*press Warranties Made by Seller in Contract for Sale of Business as Precluding Action for Breach of Express Warranties*, 7 A.L.R.5th 841, 841 (1993).

7. Professor Samuel Williston has written extensively on many areas of law that involve the use of warranties. He has published law review articles, *see, e.g.*, Samuel Williston, *What Constitutes an Express Warranty in the Law of Sales*, 21 HARV. L. REV. 555 (1908), treatises, *see, e.g.*, SAMUEL WILLISTON ET AL., WILLISTON ON SALES (5th ed. 1994) [hereinafter WILLISTON ON SALES], and he wrote the Uniform Sales Act (U.S.A.) (predecessor to the Uniform Commercial Code (U.C.C.)), promulgated in 1906, by the National Conference on Uniform Laws, 3 *Id.* at 6.

8. "Special assumpsit" is defined as "an action of assumpsit brought upon an express contract or promise." BLACK'S LAW DICTIONARY 122 (6th ed. 1990). "Assumpsit" is defined as "a common law form of action which lies for the recovery of damages for the non-performance of a parol or simple contract; . . . The action of *assumpsit* differs from *trespass* and *trover*, which are founded on a tort, not upon a contract. . . ." *Id.*

9. 2 WILLISTON ON SALES, *supra* note 7, at 350.

10. 2 *Id.* at 353.

11. *See* 2 *Id.* at 354.

12. 2 *Id.* at 355.

law of contract."<sup>13</sup> As early as 1778, courts recognized "an action in warranty brought in assumpsit."<sup>14</sup>

The development of the law of warranty has created "a curious hybrid, born of the illicit intercourse of tort and contract, unique in the law."<sup>15</sup> Professor Prosser notes that "the warranty gradually came to be regarded as a term of the contract of sale, . . . for which the normal remedy is a contract action;" however, "[u]nlike other elements of a contract, warranty never has lost entirely its original tort character."<sup>16</sup>

This tort-contract blend is an important distinction in the law of warranty, and courts today still recognize the "blur" between the two.<sup>17</sup> This Comment emphasizes the effect of this tort-contract "blur" on the element of reliance.

Citing his own law review article, Williston notes:

The nature of the action explains several features in the law of warranty that would have no proper explanation if the action sounded wholly in contract. The rule in regard to obvious defects is of this sort. There seems no reason why the seller should not promise to be answerable in damages for obvious defects, but this liability in tort is another matter. Just as in deceit, it is essential that the statements must be such as to induce the plaintiff naturally to rely upon them, so in warranty this natural reliance on the seller's assertions was early regarded as essential. . . . It is obvious however that a buyer might rely on the seller's statement and be deceived even though he could have found out the truth by careful inspection, and this was recognized before long.<sup>18</sup>

Later in his article, Williston mentions reliance as "another requirement of the law of warranty."<sup>19</sup> However, he warns that "[t]here is danger . . . of giving greater effect to the requirement of reliance than it is entitled to. . . . [A]s a general rule, no positive evidence of reliance by the buyer is necessary other than that the seller's statements were of a

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13. 2 *Id.*

14. 2 *Id.* at 355-56.

15. 2 *Id.* at 363 (citing WILLIAM L. PROSSER, HANDBOOK OF THE LAW OF TORTS § 95, at 651 (3rd ed. 1964)).

16. PROSSER, *supra* note 15, at 651.

17. See *Ainger v. Michigan Gen. Corp.*, 476 F. Supp. 1209, 1225 (S.D.N.Y. 1979).

18. 2 WILLISTON ON SALES, *supra* note 7, at 370 (citing Samuel Williston, *What Constitutes An Express Warranty in the Law of Sales*, 21 HARV. L. REV. 555, 557 (1908)).

19. Williston, *supra* note 7, at 570.

kind which naturally would induce the buyer to purchase the goods and that he did purchase the goods."<sup>20</sup>

From the background as set forth above came the definition of express warranty under section 12 of the Uniform Sales Act (U.S.A.):

Any affirmation of fact or a promise by the seller relating to the goods is an express warranty if the natural tendency of such affirmation or promise is to induce the buyer to purchase the goods, and if the buyer purchases the goods relying thereon. No affirmation of the value of the goods, nor any statement purporting to be a statement of the seller's opinion shall be construed as a warranty.<sup>21</sup>

Williston carried the reliance requirement into the U.S.A. definition of express warranty. This requirement was also recognized in the common law. Under the common law, express warranty arises "when the seller makes an affirmation with respect to the article to be sold, pending the treaty of sale, upon which it is intended that the buyer shall rely in making the purchase."<sup>22</sup> Professor Williston has been cited in the common law for the proposition that "[g]enerally reliance by the buyer is necessary in an action for breach of the seller's warranty."<sup>23</sup> Even in New York, a jurisdiction which has chosen to eliminate the common law reliance requirement, the requirement did once exist.<sup>24</sup>

Throughout the development of the law of warranty, reliance has been a requirement in an action for breach of an express warranty. Furthermore, "[n]o one disputes that [the Uniform Sales Act] required reliance on the part of the buyer to maintain a breach of express warranty claim."<sup>25</sup> However, since the promulgation of the U.C.C., there has been a debate as to whether the requirement of reliance contained in the U.S.A. carried over to the U.C.C.<sup>26</sup> Resolution of that debate is beyond the scope of this Comment. However, this Comment shows that the same debate exists at common law and concludes that the best approach is the contract approach taken by the Court of Appeals of New

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20. Williston, *supra* note 7, at 570.

21. 3 WILLISTON ON SALES, *supra* note 7, at 4.

22. Topeka Mill & Elevator Co. v. Triplett, 213 P.2d 964, 968-69 (Kan. 1950).

23. Land v. Roper Corp., 531 F.2d 445, 448 (10th Cir. 1976).

24. *See* Crocker Wheeler Elec. Co. v. Johns-Pratt Co., 51 N.Y.S. 793, 794 (N.Y. App. Div. 1898).

25. Adler, *supra* note 2, at 433.

26. *See id.* at 430-33.

York.

### III. BREACH OF AN EXPRESS WARRANTY IN A PURCHASE AGREEMENT

A seller commonly makes certain warranties in the purchase agreement when negotiating and contracting for the sale of a business or stock. Examples include profitability, value, adherence to accounting principles, or that a certain return will be realized. If after the closing of the sale it is discovered that any of the warranties were untrue, the buyer may bring an action for breach of warranty. The scenario becomes complicated when, before the closing of the sale, the purchaser obtains information that leads to a belief that the warranty is untrue.

This and similar types of scenarios have been contemplated by several commentators.<sup>27</sup> According to one author, whether the purchaser is entitled to bring a claim for breach of warranty "depends for the most part on whether reliance by the buyer on the seller's promise or affirmation of fact in entering into a sales contract is necessary to create or recover on an express warranty."<sup>28</sup> Thus, the question as posed in the introduction remains: Under common law, must the buyer of a corporation or of corporate stock show reliance to succeed on a claim for breach of an express warranty?

Today, courts remain divided on this issue.<sup>29</sup> The next two sections of this Comment outline the arguments of courts on both sides.

#### A. Reliance Required

The strongest support for the argument that reliance is a required element in a cause of action for breach of an express warranty exists in a series of Tenth Circuit cases interpreting Kansas law.<sup>30</sup> The Tenth Circuit also points to the Eighth Circuit as a jurisdiction that has taken the same approach in interpreting Minnesota law.<sup>31</sup> An examination of both of these jurisdictions will outline the position requiring reliance in an action for breach of an express warranty.

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27. See Kwestel, *supra* note 1, at 960; Wozniak, *supra* note 6, at 841.

28. Kwestel, *supra* note 1, at 961.

29. See *Pegasus Management Co. v. Lyssa, Inc.*, 995 F.Supp. 29, 37 (D. Mass. 1998); see also cases cited *supra* note 4.

30. See *Land v. Roper Corp.*, 531 F.2d 445 (D. Kan. 1976); *Koch v. Koch Indus., Inc.*, 969 F. Supp. 1460 (D. Kan. 1997); *Professional Serv. Indus., Inc. v. Kimbrell*, 834 F. Supp. 1305 (D. Kan. 1993); *Comeau v. Rupp*, 810 F. Supp. 1127 (D. Kan. 1992).

31. See *Kimbrell*, 834 F. Supp. at 1311 (citing *Hendricks v. Callahan*, 972 F.2d 190 (8th Cir. 1992)).

## 1. Kansas

The central case interpreting Kansas law is *Land v. Roper*.<sup>32</sup> Roper was a large corporation seeking to diversify its business by acquiring a small local manufacturing company, Land Manufacturing, Inc.<sup>33</sup> Through the course of negotiations, financial statements of the Land Company were furnished to Roper by E. H. Land.<sup>34</sup> After negotiations were completed, but before the closing, the value of the stock dropped from \$4.5 million to \$3.8 million.<sup>35</sup> The merger went through, but Roper tried to rescind the merger seven months later, believing that Land had misrepresented the condition of the business.<sup>36</sup> Land brought a declaratory judgment action, and Roper counterclaimed, seeking damages or rescission for Land's breach of warranties.<sup>37</sup>

Roper claimed that the following warranties were breached:

First, the representation by Land that the financial statement mentioned above had been prepared in accordance with generally accepted accounting principles . . . and presented fairly the financial position of the Land Company as of the dates thereof and the results of operations and changes in the financial positions for the period indicated. . . .

Secondly, it was represented that there had been no adverse changes in the business, property or general financial condition of the Land Company as reflected by said financial statements.<sup>38</sup>

The Court of Appeals of Kansas framed the issue in the following manner: "Whether in Kansas Reliance is a Necessary Element in an Action for a Breach of Expressed Warranty."<sup>39</sup> Recognizing that the law in the state of Kansas was unsettled as to this question,<sup>40</sup> the court of appeals turned to dicta in *Topeka Mill & Elevator Co. v. Triplett*,<sup>41</sup> a 1950 Supreme Court of Kansas case: "The court there said: 'We think appellants' evidence failed to establish an express warranty and that

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32. 531 F.2d 445 (10th Cir. 1976).

33. *See id.* at 446.

34. *See id.* at 446-47.

35. *See id.* at 446.

36. *See id.* at 447.

37. *See id.*

38. *Land v. Roper Corp.*, 531 F.2d 445, 447 (10th Cir. 1976).

39. *Id.*

40. *See id.* at 448.

41. 213 P.2d 964 (Kan. 1950).

such a warranty, if made, was relied on.”<sup>42</sup> After examining *Topeka Mill*, and with deference to the trial court’s opinion, the court of appeals stated that “[g]enerally reliance by the buyer is necessary in an action for breach of the seller’s warranty.”<sup>43</sup>

As further support for their decision, the court of appeals referred to the U.S.A. and the U.C.C. The court recognized that under the U.S.A., reliance was a necessary element and that this element has been carried over to the U.C.C.<sup>44</sup> Based on its conclusion that reliance is a requirement under both the U.S.A. and the U.C.C., the court concluded that “it is reasonable to infer that the reliance requirement applicable to sales of goods would be extended to the transfer or sale of securities.”<sup>45</sup>

The court of appeals also found support by looking at the “analogous Kansas rule recognizing a cause of action for innocent misrepresentation . . . .”<sup>46</sup> The court reasoned that “breach of express warranty is similar to the action for non-negligent or non-intentional misrepresentation since the warranty action emerged from the law of deceit.”<sup>47</sup>

Having decided that reliance is necessary in an action for breach of warranty, the court of appeals examined the facts and held that Roper did not show reliance. The court noted that “Roper had made an independent evaluation of the Land Company and did not rely on Land’s representations at all. Land showed that Roper personnel and consultants had free access to the Land Company financial records and that Roper was fully aware of a drop-off in sales shortly before the merger.”<sup>48</sup> Based on these facts, the court affirmed the trial court’s ruling that “reliance was an essential element and in effect holding that there was substantial evidence to establish that Roper made an independent investigation,”<sup>49</sup> thereby not relying on the warranties.

Following the court of appeals’ decision in *Land v. Roper*, the U.S. District Court for the District of Kansas began citing *Land* for the proposition that, under Kansas law, reliance is a necessary element of a claim for breach of express warranty.<sup>50</sup> It was not until the 1993 decision

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42. *Land*, 531 F.2d at 448 (quoting *Topeka Mill & Elevator Co. v. Triplett*, 213 P.2d 964, 971 (Kan. 1950)).

43. *Id.* (citation omitted).

44. *See id.*

45. *Id.*

46. *Id.*

47. *Id.* at 449.

48. *Id.*

49. *Id.*

50. *See Comeau v. Rupp*, 810 F. Supp. 1127, 1161 (D. Kan. 1992) (“Reliance is an essen-

of *Professional Service Industries, Inc. v. Kimbrell*<sup>51</sup> that the district court re-examined its decision in *Land*.

In *Kimbrell*, David and Janet Kimbrell were majority shareholders of an environmental engineering corporation, Hall-Kimbrell (H-K).<sup>52</sup> In December of 1989, the plaintiff, Professional Services Industries (PSI), approached the Kimbrells to negotiate the purchase of H-K.<sup>53</sup> After negotiations, the parties executed a stock purchase agreement in which all of the stock of H-K was sold to PSI.<sup>54</sup>

In March 1990, the Environmental Protection Agency (EPA) began filing complaints against H-K based on a failure to inspect certain wall-board for asbestos.<sup>55</sup> Shortly thereafter, PSI brought suit against the Kimbrells alleging, among other things, breach of warranty based upon the Kimbrell's failure to notify PSI of impending action by the EPA.<sup>56</sup> Like *Land*, the dispute in *Kimbrell* centered on "whether, under Kansas law, reliance was a necessary element in an action for a breach of express warranty."<sup>57</sup> After acknowledging the arguments set forth in *Land*,<sup>58</sup> the *Kimbrell* court examined *Young & Cooper, Inc. v. Vestring*,<sup>59</sup> a 1974 Supreme Court of Kansas case.<sup>60</sup>

The court noted that "in *Young & Cooper*, . . . the Kansas Supreme Court held that reliance was not an element for breach of express warranty under the Uniform Commercial Code."<sup>61</sup> The court further pointed out that in *Young & Cooper*, because the affirmations were "part of the description of those goods," no reliance was required.<sup>62</sup> Recognizing this conflict in reasoning, the court also pointed out that both *Land* and *Young & Cooper* cite *Topeka Mill* for their respective positions on the reliance issue.<sup>63</sup> However, because *Young & Cooper*

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tial element to a Kansas breach of warranty claim."); *Owens-Corning Fiberglass Corp. v. Sonic Dev. Corp.*, 546 F. Supp. 533, 541 (D. Kan. 1982) ("In Kansas, it is necessary to prove both that an express warranty was made, and that it was relied upon by the buyer.").

51. 834 F. Supp. 1305 (D. Kan. 1993).

52. *See id.* at 1307.

53. *See id.*

54. *See id.*

55. *See id.*

56. *See id.* at 1310, 1311.

57. *Id.* at 1310.

58. *See supra* notes 38-49 and accompanying text.

59. 521 P.2d 281 (Kan. 1974).

60. *Professional Serv. Indus., Inc. v. Kimbrell*, 834 F. Supp. 1305, 1310 (D. Kan. 1993).

61. *Id.*

62. *Id.*

63. *Id.* at 1310 n.2.

involved a sale of goods governed by the U.C.C., the court was able to distinguish it from the non-U.C.C. transaction in *Land*.<sup>64</sup> With this conflict resolved, the court in *Kimbrell* held that "PSI must prove the element of reliance to recover under a breach of express warranty."<sup>65</sup>

Finally, in support of its holding, the court in *Kimbrell* acknowledged the case of *Hendricks v. Callahan*,<sup>66</sup> which also distinguished its facts as not being governed by the U.C.C. "*Hendricks* supports the view that breach of express warranty claims involving transactions arising outside the sale of goods context require reliance."<sup>67</sup>

## 2. Minnesota

The Eight Circuit, interpreting Minnesota law, is another jurisdiction that supports requiring reliance on the warranty in a claim for breach of express warranty. *Hendricks v. Callahan* involved a purchase agreement for the sale of stock.<sup>68</sup> Under the purchase agreement, Callahan, who was selling all of his shares to Hendricks, made certain warranties involving financial statements, title, and pending litigation.<sup>69</sup> As a result of that pending litigation, Hendricks was unable to sell the property and suffered a substantial loss.<sup>70</sup> Hendricks brought suit alleging a breach of the warranties and the court framed the issue as "whether Minnesota law requires a purchaser to rely on the warranty to succeed in a breach of warranty claim."<sup>71</sup>

The resolution of this issue turned on the interpretation of a Supreme Court of Minnesota case, *Midland Loan Finance Co. v. Madsen*,<sup>72</sup> which held that "to enable a party relying upon a breach of express warranty to recover, it must be clear and definite that there was actual reliance upon the warranties involved."<sup>73</sup> The debate in *Hendricks* centered on Minnesota's adoption of the U.C.C. Hendricks argued that the adoption of the U.C.C., which substituted "basis of the bargain" for the reliance language, in effect overruled *Midland*.<sup>74</sup> Aware of the changes

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64. *See id.*

65. *Id.* at 1311.

66. 972 F.2d 190 (8th Cir. 1992).

67. *Professional Serv. Indus., Inc. v. Kimbrell*, 834 F. Supp. 1305, 1311 (D. Kan. 1993).

68. *See Hendricks*, 972 F.2d at 191.

69. *See id.*

70. *See id.* at 192.

71. *Id.*

72. 14 N.W.2d 475 (Minn. 1944).

73. *Id.* at 481.

74. *See Hendricks*, 972 F.2d at 193.

adopted in the U.C.C., the court noted: "The transaction in this case (as well as the transaction in *Midland*) was not a 'transaction[] in goods' and therefore is not covered by the provisions of the U.C.C."<sup>75</sup>

The court was not persuaded by the U.C.C. argument nor by other cases after *Midland* that dispensed with reliance, as those cases also dealt with transactions of goods.<sup>76</sup> Finally, the court did not accept the "modern view" argued by Hendricks and set forth in *CBS Inc. v. Ziff-Davis Publishing Co.*,<sup>77</sup> which "provides that the buyer's reliance on the warranty is 'wholly irrelevant.'"<sup>78</sup> Conversely, the court was "convinced [Minnesota] would require some sort of reliance,"<sup>79</sup> thereby upholding the rule in *Midland*.

The Tenth Circuit's interpretation of Kansas law and the Eight Circuit's interpretation of Minnesota law provide the strongest support for requiring reliance on the warranty in an action for breach of express warranty. As recently as July of 1997, the U.S. District Court for the District of Kansas has upheld the arguments of both *Land* and *Kimbrell*, by holding "[r]eliance is an essential element to a breach of express warranty claim not governed by the Uniform Commercial Code."<sup>80</sup> Additionally, the Eight Circuit considered and dismissed *CBS, Inc. v. Ziff-Davis Publishing Co.*,<sup>81</sup> the prevailing case supporting the alternative view of no reliance.<sup>82</sup>

### B. Reliance Not Required

The state courts of New York and Indiana provide the strongest argument against requiring reliance in a claim for breach of express warranty. The alternative that has been adopted by these jurisdictions treats the warranty as a bargained-for term of the contract. Therefore, regardless of whether reliance is present, if there is a breach of the warranty, it is actionable under principles of contract law.

#### 1. New York

In 1990, the Court of Appeals of New York had before it the same question answered by the Kansas and Minnesota courts above: whether

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75. See *Hendricks*, 972 F.2d at 193 (citation omitted).

76. See *id.* at 193-94.

77. 553 N.E.2d 997, 1000-01 (N.Y. 1990).

78. *Hendricks*, 972 F.2d at 194.

79. *Id.*

80. *Koch v. Koch Indus., Inc.*, 969 F. Supp. 1460, 1491 (D. Kan. 1997).

81. 553 N.E.2d 997 (N.Y. 1990).

82. See *Hendricks v. Callahan*, 972 F.2d 190, 194 (8th Cir. 1992).

reliance is an essential element in a claim for breach of express warranty.<sup>83</sup> In *CBS, Inc. v. Ziff-Davis Publishing Co.*,<sup>84</sup> Ziff-Davis solicited bids for the sale of certain assets and businesses.<sup>85</sup> Based on the offering circular (which contained Ziff-Davis's financial condition including operating expenses), CBS made the highest bid.<sup>86</sup> As a result, CBS and Ziff-Davis entered into a purchase agreement which contained certain warranties regarding the health of the businesses. First, "Ziff-Davis warranted that the audited income and expense report . . . which had been previously provided to CBS in the offering circular, had 'been prepared in accordance with generally accepted accounting principles' (GAAP) and that the report 'present[ed] fairly the items set forth.'"<sup>87</sup> Second, Ziff-Davis warranted that "from July 31, 1984 until the closing, there had 'not been any material adverse change in Seller's business . . . taken as a whole.'"<sup>88</sup> Third, Ziff-Davis represented that "all representations and warranties of Seller to Buyer shall be true and correct as of the time of the closing."<sup>89</sup> Finally, Ziff-Davis warranted that all "representations and warranties . . . shall survive the closing, notwithstanding any investigation made by or on behalf of the other party."<sup>90</sup> After entering into the purchase agreement, but before closing, CBS "discovered information causing it to believe that Ziff-Davis's certified financial statements and other financial reports were not prepared according to GAAP and did not fairly depict Ziff-Davis's financial condition."<sup>91</sup> As a result of this discovery, CBS wrote a letter to Ziff-Davis inquiring as to the misrepresentations.<sup>92</sup> Ziff-Davis responded, assuring CBS that there was nothing wrong and that they would be held to the closing date.<sup>93</sup> After Ziff-Davis acknowledged that there was a dispute, and that closing would not be a waiver of any rights, the parties closed.<sup>94</sup> CBS then sued for a breach of the warranties.

To answer the question of whether CBS was required to show reliance on the warranties, the Court of Appeals of New York adopted the

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83. See *CBS Inc. v. Ziff-Davis Publ'g. Co.*, 553 N.E.2d 997, 1000 (N.Y. 1990).

84. *Id.*

85. See *id.* at 998.

86. See *id.*

87. *Id.* (brackets in original).

88. *Id.* at 998-99.

89. *Id.* at 999.

90. *Id.*

91. *Id.*

92. See *id.*

93. See *id.*

94. See *id.*

reasoning of *Ainger v. Michigan General Corporation*.<sup>95</sup> Just as in *Ainger*, the “critical question is not whether the buyer believed in the truth of the warranted information, as Ziff-Davis would have it, but ‘whether [it] believed [it] was purchasing the [seller’s] promise [as to its truth].’”<sup>96</sup> The court recognized:

This view of “reliance”—*i.e.*, as requiring no more than reliance on the express warranty as being part of the bargain between the parties—reflects the prevailing perception of an action for breach of express warranty as one that is no longer grounded in tort, but essentially in contract.<sup>97</sup>

In *Ainger*, the court recognized the case of *Crocker Wheeler Electric Co. v. Johns-Pratt Co.*,<sup>98</sup> as stating that “[i]t is elementary that, in order to entitle the plaintiff to maintain an action for breach of an express warranty, it must be established that the warranty was relied on.”<sup>99</sup> However, the *Ainger* court dismissed that language as “[t]ransplanting tort principles into contract law,” which is “analytically unsound.”<sup>100</sup> The court of appeals in *Ziff-Davis* recognized that this language from *Crocker Wheeler* has been criticized.<sup>101</sup> Later, the court noted a “blur” that had arisen in New York decisions distinguishing between tort and contract.<sup>102</sup> “This may be a result ‘consonant with historical attitudes towards breaches of warranty, which until 1778 had to be sued in tort,’ or that in many cases, indeed, in this case, the breach of warranty is also a fraud.”<sup>103</sup>

Nevertheless, the court in *Ainger* explained that the use of the word “reliance” by New York courts “relates to the first element of proof, existence of the contract. . . . The question of whether the promisee ‘relied’ on the warranty, then, is whether he believed he was purchasing the promise.”<sup>104</sup>

95. 476 F. Supp. 1209 (S.D.N.Y. 1979).

96. *Ziff-Davis*, 553 N.E.2d at 1000-01 (brackets in original).

97. *Id.* at 1001.

98. 51 N.Y.S. 793 (N.Y. App. Div. 1898).

99. *Ainger v. Michigan Gen. Corp.*, 476 F. Supp. 1209, 1224 (S.D.N.Y. 1979) (quoting *Crocker Wheeler Elec. Corp. v. Johns-Pratt Co.*, 51 N.Y.S. 793, 794 (N.Y. App. Div. 1898)).

100. *Ainger*, 476 F. Supp. at 1224.

101. See *Ziff-Davis*, 553 N.E.2d at 1002 n.3 (citation omitted).

102. *Ainger*, 476 F. Supp. at 1225.

103. *Id.* (quoting *Strika v. Netherlands Ministry of Traffic*, 185 F.2d 555, 558 (2d Cir. 1950)).

104. *Id.*

Based on this reasoning, which one commentator has recognized as “clearly . . . a contract approach to express warranties,”<sup>105</sup> the court in *Ziff-Davis* stated:

The express warranty is as much a part of the contract as any other term. Once the express warranty is shown to have been relied on as part of the contract, the right to be indemnified in damages for its breach does not depend on proof that the buyer thereafter believed that the assurances of fact made in the warranty would be fulfilled. The right to indemnification depends only on establishing that the warranty was breached.<sup>106</sup>

The court also looked analogously to the U.C.C. for instructive support.<sup>107</sup>

For these reasons, the New York Court of Appeals reinstated the breach of warranty claim. Relying on the contract theory enunciated above, the court stated that a “holding that [*Ziff-Davis*] should [be absolved from its warranty obligations] would have the effect of depriving the express warranties of their only value to CBS—*i.e.*, as continuing promises by *Ziff-Davis* to indemnify CBS if the facts warranted proved to be untrue.”<sup>108</sup>

After *Ziff-Davis*, reported cases with similar facts are sparse. However, in August and December of 1992, two cases involving breach of warranty in a stock purchase agreement were decided by the United States Court of Appeals for the Second Circuit. Respectively, these cases are *Galli v. Metz*,<sup>109</sup> and *Metromedia Co. v. Fugazy*.<sup>110</sup>

In *Galli*, the court acknowledged that *Ziff-Davis* “does curtail the role of reliance in breach of warranty actions.”<sup>111</sup> However, *Galli* also

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105. Kwestel, *supra* note 1, at 989.

106. *Ziff-Davis*, 553 N.E.2d at 1001 (citing *Glacier Gen. Assurance Co. v. Casualty Indem. Exch.*, 435 F. Supp. 855, 860 (D. Mont. 1977)).

107. *See id.* at 1002 n.4.

108. *Id.* at 1002. The strong dissent in *Ziff-Davis* relied on the following: First, that the language of *Crocker Wheeler*, 51 N.Y.S. at 794, was clear and has been recognized by the court of appeals in numerous cases. *Ziff-Davis*, 553 N.E.2d at 1004. Second, that the majority does not point out the qualification on Williston’s criticism of *Crocker Wheeler*. *Id.* Third, that in place of the well recognized rule of *Crocker Wheeler*, the court is adopting the *Ainger* court’s “categorical discussion.” *Id.* Finally, an analogy to the U.C.C., would actually lead to an affirmation of the language in *Crocker Wheeler*. *Id.* at 1004-05.

109. 973 F.2d 145 (2d Cir. 1992).

110. 983 F.2d 350 (2d Cir. 1992).

111. *Galli*, 973 F.2d at 151.

recognized that the result in *Ziff-Davis* may be limited:

Where a buyer closes on a contract in the full knowledge and acceptance of facts disclosed by the seller which would constitute a breach of warranty under the terms of the contract, the buyer should be foreclosed from later asserting the breach. In that situation, unless the buyer expressly preserves his rights under the warranties (as CBS did in *Ziff-Davis*), we think the buyer has waived the breach.<sup>112</sup>

*Metromedia* also involved a stock purchase agreement. In *Metromedia*, the Second Circuit analyzed the breach of warranty claim through the framework of *Ziff-Davis*.<sup>113</sup> After noting the contract rationale of the New York Court of Appeals, the court in *Metromedia* held that “[s]ince as a matter of law, an express warranty is as much a part of the contract as any other term, the inclusion in the Agreement here of the [warranties] established that those representations and warranties were part of the bargain reached.”<sup>114</sup>

Recently, the United States District Court for the District of Massachusetts followed the rationale in *Ziff-Davis*. The court in *Pegasus Management Co. v. Lyssa*,<sup>115</sup> in approaching the reliance question, balanced the conflicting positions in the common law. For the position adopting the contract approach, the court looked to *Ziff-Davis*.<sup>116</sup> The *Pegasus* court balanced the rationale of *Ziff-Davis* against the required reliance position taken in *Land v. Roper* and *Hendricks v. Callahan*.<sup>117</sup> Not persuaded by the reasoning of the courts requiring reliance, the court found that, under Connecticut law, “the plaintiffs do not have to prove reliance on the express warranties.”<sup>118</sup>

## 2. Indiana

The Indiana Court of Appeals has also adopted the position of no-reliance in actions for breach of express warranty. The court based its reasoning on a line of older cases and the decision of the New York Court of Appeals in *Ziff-Davis*. This older line of cases is best repre-

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112. *Galli*, 973 F.2d at 151.

113. *See Metromedia*, 983 F.2d at 360.

114. *Id.*

115. 995 F. Supp. 29 (D. Mass. 1998).

116. *See id.* at 37-38.

117. *See id.* at 38-39.

118. *Id.* at 39.

sented by the holding in *Shambaugh v. Lindsay*.<sup>119</sup> *Shambaugh* involved certain express warranties in a purchase agreement for the sale of stock.<sup>120</sup> The court began its reasoning by quoting a large portion of *Land v. Roper*,<sup>121</sup> representing that court's position that reliance is an essential element of a claim for breach of an express warranty.<sup>122</sup> The court in *Shambaugh* balanced this argument against the rationale of *Glacier General Assurance Co. v. Casualty Indemnity Exchange*,<sup>123</sup> and held that *Glacier* represented the better view.<sup>124</sup>

The court noted that *Glacier* held that "the warranty is as much a part of the contract as any other part, and the right to damages on the breach depends on nothing more than the breach of warranty."<sup>125</sup> The *Shambaugh* court found this reasoning consistent with the law of Indiana, which is represented by the old line of cases referred to above. The court quoted one of these cases as follows:

[W]hatever, under the circumstances the parties can be said to have intended by their contract, to that will the seller be held as to other lawful engagements, and it is not necessary to the buyer's recovery that he should have been deceived. . . . One party is induced by the reliance upon the engagements of the other contracting party, and in a pleading based upon a breach of such a warranty, if the warranty be sufficiently shown to have entered into the contract as an intended element thereof, and as a part of the consideration for the purchase price, it is not necessary, any more than in other suits on contracts, to allege reliance of the buyer upon the warranty.<sup>126</sup>

The influence of the New York Court of Appeals is seen in *Essex Group, Inc. v. Nill*.<sup>127</sup> In *Essex*, the court cited *Ziff-Davis* for the definition of warranty,<sup>128</sup> and for its holding "that reliance is not an element of

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119. 445 N.E.2d 124 (Ind. Ct. App. 1983).

120. *See id.* at 124.

121. 531 F.2d 445 (10th Cir. 1976).

122. *See Shambaugh*, 445 N.E.2d at 126.

123. 435 F. Supp. 855 (D. Mont. 1977).

124. *See Shambaugh*, 445 N.E.2d at 126.

125. *Id.* at 126-27.

126. *Id.* at 127 (quoting *McCarty v. Williams*, 108 N.E. 370, 372 (Ind. Ct. App. 1915)). This language and reasoning traces back to an 1882 Supreme Court of Indiana case, *Shordan v. Kyler*, 87 Ind. 38 (Ind. 1882).

127. 594 N.E.2d 503 (Ind. Ct. App. 1992).

128. *See id.* at 506.

a breach of warranty claim."<sup>129</sup>

The courts of New York and Indiana provide the strongest argument for the position that reliance is not an element in a claim for breach of express warranty. The contract approach of the court in *CBS Inc. v. Ziff-Davis Publishing Co.*,<sup>130</sup> and the long history of this reasoning in Indiana,<sup>131</sup> make this argument quite persuasive. Further, these are not the only two states that support the no-reliance position. This position is also followed by the Supreme Court of New Mexico<sup>132</sup> and the Appellate Court of Illinois.<sup>133</sup>

However, strong support exists on the other side. The extensive and consistent treatment of the issue by the United States District Court for the District of Kansas, even after the adoption of the U.C.C., lends strong support for requiring reliance. Also, the Minnesota Supreme Court's decision in *Midland Loan Finance Co. v. Madsen*,<sup>134</sup> supported by the interpretation of the Eighth Circuit Court of Appeals in *Hendricks v. Callahan*,<sup>135</sup> shows that this rationale has existed in Minnesota for over fifty years. Finally, also supporting the argument for reliance are cases such as *Crocker Wheeler Electric Co. v. Johns-Pratt Co.*,<sup>136</sup> which show that even in a state that has adopted a no-reliance position, reliance was required in the past.<sup>137</sup>

The cases above make it clear that a split in the common law of warranties exists as to whether reliance is required in an action for breach of such warranties. Although arguments on both sides are persuasive, weaknesses in each ultimately reveal that one argument is stronger.

#### IV. ANALYSIS

With public policy and economic efficiency in mind, an analysis of the cases shows that the contract approach followed by the court in *CBS Inc. v. Ziff-Davis, Inc.* represents the best position.

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129. *Essex*, 594 N.E.2d at 506-07.

130. 553 N.E.2d 997 (N.Y. 1990).

131. *See supra* notes 119-27 and accompanying text.

132. *See C.R. Anthony Co. v. Loretto Mall Partners*, 817 P.2d 238, 246 (N.M. 1991) (citing *Vitro Corp. v. Texas Vitrified Supply Co.*, 376 P.2d 41, 48 (N.M. 1962)).

133. *See Regopoulos v. Waukegan Partnership*, 608 N.E.2d 457, 461 (Ill. App. Ct. 1992) (citing *Coryell v. Lombard Lincoln-Mercury Merkur, Inc.*, 544 N.E.2d 1154, 1158 (Ill. App. Ct. 1989)); *Hrosik v. Keim Builders*, 345 N.E.2d 514, 515 (Ill. App. Ct. 1992)); *Vasco Trucking Inc. v. Parkhill Truck Co.*, 286 N.E.2d 383, 386 (Ill. App. Ct. 1972)).

134. 14 N.W.2d 475 (Minn. 1944).

135. 972 F.2d 190 (8th Cir. 1992).

136. 51 N.Y.S. 793 (N.Y. App. Div. 1898).

137. *See id.* at 794.

### A. The Tort/Contract "Blur"

As noted above, the development of the law of warranty has created a "curious hybrid, born of the illicit intercourse of tort and contract, unique in the law."<sup>138</sup> This hybrid likely grew out of "historical attitudes towards breaches of warranty, which until 1778 had to be sued in tort."<sup>139</sup>

This mixing of contract and tort results in one of the weaknesses in the Tenth Circuit's reasoning and interpretation of Kansas law. In *Land v. Roper*, the United States Court of Appeals argued that an action for non-negligent misrepresentation provides analogous support for answering the reliance question in a breach of warranty action.<sup>140</sup> The court stated: "The breach of express warranty is similar to the action for non-negligent or non-intentional misrepresentation since the warranty action emerged from the law of deceit."<sup>141</sup> What the court failed to note is that "the warranty gradually came to be regarded as a term of the contract of sale . . . for which the normal remedy is a contract action."<sup>142</sup> This developmental fact detracts from the *Land* court's analogous argument.

Further evidence of the weakness of this analogy is the failure of the United States District Court for the District of Kansas to engage in the same reasoning. In *Professional Service Industries, Inc. v. Kimbrell*,<sup>143</sup> the court did not look to any deceit-based claims for analogous reasoning. This is especially interesting because in addition to their claim for breach of warranty, the Kimbrells alleged deceit and negligent misrepresentation.<sup>144</sup> Evidence of the separation of the tort and contract-based claims is also seen in *Shambaugh v. Lindsay*<sup>145</sup> and *Pegasus Management Co. v. Lyssa*,<sup>146</sup> where the courts considered the arguments in *Land* but chose to follow the contract approach.

It should be noted that analogy to tort-based claims should not be wholly abandoned.<sup>147</sup> Rather, it should not be applied to breach of war-

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138. 2 WILLISTON ON SALES, *supra* note 7, at 363 (citation omitted).

139. *Ainger v. Michigan Gen. Corp.*, 476 F. Supp. 1209, 1225 (S.D.N.Y. 1979) (citation omitted).

140. *Land v. Roper Corp.*, 531 F.2d 445, 448-49 (10th Cir. 1976).

141. *Id.* at 449.

142. PROSSER, *supra* note 15, at 651.

143. 834 F. Supp. 1305 (D. Kan. 1993).

144. *See id.* at 1307.

145. 445 N.E.2d 124, 127 (Ind. Ct. App. 1983).

146. 995 F. Supp. 27, 39 (D. Mass. 1998).

147. "[I]n the area of products liability, the tort theory of breach of warranty has been

ranty claims arising out of contracts, such as purchase agreements. As the New York Court of Appeals has said:

The express warranty is as much a part of the contract as any other term. Once the express warranty is shown to have been relied on as part of the contract, the right to be indemnified in damages for its breach does not depend on proof that the buyer thereafter believed that the assurances of fact made in the warranty would be fulfilled. The right to indemnification depends only on establishing that the warranty was breached.<sup>148</sup>

### B. *The U.C.C. Analogy*

A weakness in both the Tenth and Eight Circuit Courts' reasoning relates to their analogous use of the Uniform Commercial Code. In *Land*, the Court of Appeals for the Tenth Circuit pointed to the U.S.A. as containing a reliance requirement.<sup>149</sup> According to the court, comment 3 to U.C.C. section 2-313 "has been held to express an intent that the reliance requirement be continued."<sup>150</sup> Therefore, "[i]t is reasonable to infer that the reliance requirement applicable to sales of goods would be extended to the transfer or sale of securities."<sup>151</sup>

This reasoning is flawed. As the court in *Professional Service Industries, Inc. v. Kimbrell*, pointed out:

The reasoning of *Roper* is difficult to reconcile with *Young & Cooper*. . . . [T]he law in effect at the time *Roper* was decided was the UCC, and the Kansas Supreme Court had interpreted the UCC's breach of express warranty provision to eliminate the element of reliance. Thus, the Tenth Circuit's reasoning appears to be at odds with the Kansas Supreme Court's conclusion in *Young & Cooper*.<sup>152</sup>

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utilized to avoid the consequences of contract law with regard to privity, statute of limitations, survival of actions, and damages." *Ainger v. Michigan Gen. Corp.*, 476 F. Supp. 1209, 1226 n.65 (quoting WILLIAM L. PROSSER, HANDBOOK OF THE LAW OF TORTS § 95, at 634-35 (4th ed. 1971)).

148. *CBS Inc. v. Ziff-Davis Publ'g. Co.*, 553 N.E.2d 997, 1001 (N.Y. 1990) (citing *Glacier Gen. Assurance Co. v. Casualty Indem. Exch.*, 435 F. Supp. 855, 860 (D. Mont. 1977)).

149. *See Land v. Roper Corp.*, 531 F.2d 445, 448 (10th Cir. 1976).

150. *Id.*

151. *Id.*

152. *Professional Serv. Indus., Inc. v. Kimbrell*, 834 F. Supp. 1305, 1311 (D. Kan. 1993).

The *Kimbrell* court justified this flawed reasoning with the *Land* court's additional rationale of comparing a breach of warranty claim to an innocent misrepresentation claim.<sup>153</sup> However, as shown above, that reasoning is also flawed, leaving no escape for the Tenth Circuit.

The Eighth Circuit's reasoning presents a different problem. An analysis of the comments to the Minnesota version of the U.C.C. and to the U.C.C. itself, leave ambiguous whether Minnesota would require reliance.<sup>154</sup> Despite this ambiguity, the *Hendricks* court refused to consider cases that lay out the elements of breach of warranty under the Minnesota U.C.C. The *Hendricks* court recognized that "to establish a warranty claim the plaintiff must prove three elements: [1] the existence of a warranty, [2] a breach, and [3] a causal link between the breach and the alleged harm."<sup>155</sup> The court further stated "[t]hat these are the elements of a breach of warranty claim under the U.C.C. in Minnesota is beyond dispute."<sup>156</sup> Nevertheless, the court refused to consider these cases because they involved transactions in goods, unlike the transaction in *Hendricks*. This reasoning is flawed because although the case may be distinguished, the court was reasoning by analogy. The cases would have aided in their comparison with the U.C.C., but because there is no element of reliance in *Peterson*, that reasoning would not have brought the court to the result it sought.

### C. Two Types of Reliance

An area of confusion that seems to plague courts advocating the reliance requirement relates to two potential meanings of the word "reliance." This is best illustrated by the language in *Hendricks*, which states that "[e]ssential to the court's rulings is its determination that Minnesota law requires a party alleging a breach of express warranty to have relied on that warranty *when making the contract*."<sup>157</sup> Is that "reliance" the same that is required to show a breach of warranty? Courts seem to confuse the "reliance" that is required to form the express warranty, and the "reliance" on the warranty arguably required in a claim

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153. *See id.*

154. *See Hendricks v. Callahan*, 972 F.2d 190, 194 (8th Cir. 1992). Compare MINN. STAT. ANN. § 336.2-313 Minn. com. subsec. 2-313(1)(a) (West 1966 & Supp. 1998), with MINN. STAT. ANN. § 336.2-313 U.C.C. com. 3 (West 1966 & Supp. 1998).

155. *Hendricks*, 972 F.2d at 193 (quoting *Peterson v. Bendix Home Sys.*, 318 N.W.2d 50, 52-53 (Minn. 1982)).

156. *Id.*

157. *Id.* 192 (emphasis added).

for breach. In *Topeka Mill & Elevator Co. v. Triplett*,<sup>158</sup> the Kansas Supreme Court stated that "whether an affirmation or representation constitutes a warranty is a question of the intention of the seller and the reliance placed thereon by the buyer."<sup>159</sup> This "reliance" is the type needed to form a warranty, not the type needed to recover for a breach. In its holding, the court stated that "appellant's evidence failed to establish an express warranty and that such a warranty, if made, was relied upon by Mrs. Triplett."<sup>160</sup> This is the reliance necessary to sustain a claim for breach of express warranty.<sup>161</sup>

This confusion was acknowledged by the *Ainger* court which stated: "In these contexts, however, the word relates to the first element of proof, existence of the contract, . . . [t]he question of whether the promisee 'relied' on the warranty, then, is whether he believed he was purchasing the promise."<sup>162</sup> As seen in the New York cases, it is not the reliance requirement that disappears, but the confusion. The *Ziff-Davis* court pointed this out by saying: "We do not hold that no reliance is required, but that the required reliance is established if, as here, the express warranties are bargained-for terms of the seller."<sup>163</sup> Adopting the no reliance approach would resolve the confusion in determining to what "reliance" refers.

#### D. What About Midland?

*Midland* is the only case that remains viable as support for the requirement of reliance. The Supreme Court of Minnesota stated that "[t]o enable a party relying upon breach of express or implied warranty to recover, it must be clear and definite that there was actual reliance upon the warranties involved."<sup>164</sup> However, *Midland* is distinguishable because it involved a transaction for the sale of goods; a contract for the sale of an automobile.<sup>165</sup> Additionally, *Midland* was decided prior to the adoption of the U.C.C. The U.S.A., which was in effect at that time, re-

158. 213 P.2d 964 (Kan. 1950).

159. *Id.* at 969-70.

160. *Id.* at 971.

161. It should be noted that the "reliance" argument is further complicated by the fact that both *Young & Cooper* and *Land* cite to *Topeka* for opposite positions on reliance. See *Professional Serv. Indus., Inc. v. Kimbrell*, 834 F. Supp. 1305, 1310 n.2 (D. Kan. 1993).

162. *Ainger v. Michigan Gen. Corp.*, 476 F. Supp. 1209, 1225 (S.D.N.Y. 1979).

163. *CBS Inc. v. Ziff-Davis Publ'g. Co.*, 553 N.E.2d 997, 1002 n.5 (N.Y. 1990).

164. *Midland Loan Fin. Co. v. Madsen*, 14 N.W.2d 475, 481 (Minn. 1944).

165. See *id.* at 268.

quired reliance in a claim for breach of express warranty.<sup>166</sup> Therefore, it is not surprising that *Midland* would require reliance as an element. That does not mean that reliance should be a requirement in a common law action for breach of warranty involving a transaction outside the U.C.C.

Similar to the *Hendricks* court's interpretation of *Midland*, the Court of Appeals of New York, in *Ziff-Davis*, was faced with the interpretation of a very old New York case relating to the sale of an insulating material; a sale of goods.<sup>167</sup> Unlike *Hendricks*, the court in *Ziff-Davis* was interpreting an intermediate appellate decision, and chose to dismiss its rule as dicta. As the highest court in the state, the *Ziff-Davis* court's opinion is more persuasive than the opinions of the District Courts of the Tenth and Eight Circuits. This is apparent in the case of *Pegasus Management Co. v. Lyssa, Inc.*, where the court was not persuaded because "the *Land* and *Hendricks* decisions were by federal Courts of Appeals that were trying to divine the state law in circumstances in which the highest court in the state had not been presented with the issue."<sup>168</sup>

For these reasons, and due to the long line of cases out of Indiana supporting the contract approach,<sup>169</sup> the position taken by *Ziff-Davis* is the most consistent with the law of warranty and the most persuasive.

### E. Economically Efficient

In addition to the contract theory being the most consistent with the law and the most persuasive, it is also economically efficient. The contract theory ensures that the buyer and seller will get what they bargained for in the contract.<sup>170</sup> It also ensures that the buyer will get the promises for which he or she paid.<sup>171</sup>

The contract theory also prevents the seller from forcing a closing when the buyer has knowledge that the warranties were false, thus foreclosing action by the buyer.<sup>172</sup> It may seem from the protections above

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166. See Adler, *supra* note 2, at 433.

167. See *Crocker Wheeler Elec. Co. v. Johns-Pratt Co.*, 51 N.Y.S. 793 (N.Y. App. Div. 1898).

168. *Pegasus*, 995 F. Supp. at 39.

169. See *supra* notes 119-27 and accompanying text.

170. See *Ziff-Davis*, 553 N.E.2d at 1002. "CBS was not merely buying identified consumer magazine businesses. [CBS] was buying businesses which it believed to be of a certain value based on information furnished by seller which the seller warranted to be true." *Id.*

171. See *id.*

172. See *id.*

that the buyer gets a better deal under the contract approach. This may be true, but not for the reasons above. First, these protections must be balanced against the possibility of waiver.<sup>173</sup> The Second Circuit in *Galli* recognized that “unless the buyer expressly preserves his rights under the warranties (as CBS did in *Ziff-Davis*), we think the buyer has waived the breach.”<sup>174</sup>

In *Associates of San Lazaro v. San Lazaro Park Properties*, a case involving the sale of a mobile home park, the Colorado Supreme Court recognized that “[o]ne who intentionally relinquishes a known right waives that right.”<sup>175</sup>

In the context of purchase and sale agreements, the determination of whether the buyer’s conduct constitutes an intentional relinquishment of a seller’s express warranty includes consideration of the source of information available to the buyer and a determination of whether the buyer clearly relied upon [the] information.<sup>176</sup>

The Colorado Supreme Court noted that this rule promotes efficiency because “sellers are encouraged to warrant only to that which they know they can fulfill.”<sup>177</sup> However, the court also recognized that the rule may give the buyer an advantage if the buyer does not actually rely on the warranty.<sup>178</sup> In that situation the buyer may wait and see how the transaction turns out before deciding whether to bring a claim.<sup>179</sup>

Although the waiver theory may give a slight advantage to the

173. One commentator argues that a “post-contract disclosure to the buyers” should not matter. Kwestel, *supra* note 1, at 991 n.106. “Why should the buyers’ choice seemingly be, according to *Galli*, either to refuse to close and sue for damages or to close and waive their right to damages?” *Id.*

The answer to that question lies in the contract theory which allows the parties to contract around situations such as these. In other words, the parties may expressly reserve their rights by contract as they did in *Ziff-Davis*. See *Galli v. Metz*, 973 F.2d 145, 151 (2d Cir. 1992).

174. *Galli*, 973 F.2d at 151.

175. *Associates of San Lazaro v. San Lazaro Park Properties*, 864 P.2d 111, 115 (Colo. 1993).

176. *Id.* “[E]ven though the buyer makes an inspection the warranty is not rendered inoperative unless the buyer is clearly relying upon his own investigation and waives the warranty.” *Id.* at 115 n.3 (quoting *Rudd v. Rogerson*, 297 P.2d 533, 538 (Colo. 1956)).

177. *Id.* at 115.

178. *See id.*

179. *See id.*

buyer, when balanced against the advantages above and because it represents a more accurate fit with the common law, it is the better approach. Furthermore, the contract and waiver theories reduce the burden on the courts by encouraging parties to contract more carefully. The parties' increased consciousness as to what they are warranting reduces the possibility of litigation and makes the contract more clear, aiding a court with interpretation.

## V. CONCLUSION

The long history of the law of warranty, combined with a mixture of analogous reasoning based on the different laws interpreting warranties, creates a confusing backdrop for analyzing the reliance issue. However, arising out of the mist of that backdrop are two distinct lines of reasoning:<sup>180</sup> the first requiring reliance on a warranty in a breach of warranty claim; the second applying a contract approach to a breach of warranty claim. Through an analysis of the two positions, it is clear that the contract approach is the most logical, fair, and economically efficient. The approach protects the buyer's promise as a bargained-for term of the contract,<sup>181</sup> protects the seller through the doctrine of waiver,<sup>182</sup> and promotes efficiency by encouraging clearer contracts that result in less litigation. Finally, this approach makes the most sense to these buyers and sellers of corporations who never enjoy having years of work compromised by last minute indecision.

MATTHEW J. DUCHEMIN\*

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180. See cases cited *supra* note 4.

181. See *Ziff-Davis*, 553 N.E.2d at 1000.

182. See *Associates of San Lazaro*, 864 P.2d 111.

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