

# Vertical Privity and Damages For Breach of Implied Warranty Under the U.C.C.: It's Time for Indiana to Abandon the Citadel

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## I. INTRODUCTION

A woman is injured when her daughter accidentally drops a container of drain cleaner, the container breaks, and its contents splash and burn the woman's legs, allegedly because the goods had not been adequately packaged by the manufacturer.<sup>1</sup> A couple purchases a mobile home from a dealer, only to discover after they move in that it is riddled with what are allegedly manufacturing defects and that the dealer has gone out of business.<sup>2</sup> A farmer purchases a planting machine from an authorized dealer of the machine's well-known manufacturer. The machine does not plant properly, allegedly because of manufacturing defects, and the farmer loses much of the season's crop.<sup>3</sup> In each of these implied warranty cases, the plaintiffs who suffered personal or economic injury, allegedly caused by goods which were unmerchantable when they left the hands of the manufacturer, were precluded from pursuing the manufacturer because of the absence of privity of contract between the respective plaintiffs and the particular manufacturer. Under present Indiana law, this result is required no matter how meritorious the claim may otherwise be.

It is the hypothesis of this article that in cases based on breach of implied warranty under the Uniform Commercial Code, the concept known as "vertical" privity, the absence of which prevents an injured buyer from recovering from a remote manufacturer or other remote seller, is an outmoded, artificial barrier which should, at long last, be abandoned.<sup>4</sup> Elimination of the vertical privity requirement does not mean automatic victory for each of these or any other plaintiffs, nor would it cause manufacturers to be insurers or prevent them from limiting

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<sup>1</sup>Lane v. Barringer, 407 N.E.2d 1173 (Ind. Ct. App. 1980).

<sup>2</sup>Candlelight Homes, Inc. v. Zornes, 414 N.E.2d 980 (Ind. Ct. App. 1981).

<sup>3</sup>Dutton v. International Harvester Co., 504 N.E.2d 313 (Ind. Ct. App.), *transfer denied* (1987).

<sup>4</sup>The obsolescence of requiring privity in warranty cases also calls for abandoning the similar concept of "horizontal" privity, but that action is not the main focus here. See the discussion of horizontal privity *infra* note 30 and accompanying text.

their exposure pursuant to the Uniform Commercial Code. It would, however, allow injured plaintiffs to present their cases, to prove that warranties were made and breached, and to recover any appropriate damages caused by that breach from the party directly responsible for and best able to prevent that breach: the manufacturer, while at the same time promoting judicial efficiency.

## II. PRIVACY: AN OVERVIEW

### A. *The Meaning of Privity*

The term, "privity of contract," is a legal term which has been much used, purportedly understood by everyone, but not often defined clearly, if at all. By 1931, the requirement of privity between a plaintiff and a defendant in an action based on an alleged breach of warranty had become so firmly entrenched in the law that it earned the description of being a "citadel."<sup>5</sup> This citadel of privity has since been described as being under assault,<sup>6</sup> having fallen,<sup>7</sup> in hasty retreat,<sup>8</sup> crippled,<sup>9</sup> decaying,<sup>10</sup> "razed in many states,"<sup>11</sup> "still standing,"<sup>12</sup> and possibly "only a historic relic in the year 2000."<sup>13</sup>

In Indiana, as elsewhere, some parts of the citadel have fallen completely.<sup>14</sup> With respect to actions for breach of implied warranty

<sup>5</sup>*Ultramares Corp. v. Touche*, 255 N.Y. 170, 180, 174 N.E. 441, 445 (1931). Justice Cardozo is credited with coining this description in *Ultramares* (which involved the liability of accountants to non-clients with whom the accountants had not dealt but who had relied on financial documents negligently or fraudulently prepared by those accountants for clients). See H. PRATTER & R. TOWNSEND, *INDIANA UNIFORM COMMERCIAL CODE WITH COMMENTS* 47 (1963); PROSSER, *The Assault upon the Citadel (Strict Liability to the Consumer)*, 69 *YALE L.J.* 1099 (1960) [hereinafter *The Assault*].

<sup>6</sup>*Ultramares*, 255 N.Y. at 180, 174 N.E. at 445 ("The assault upon the citadel of privity is proceeding these days apace."); PROSSER, *The Assault*, *supra* note 5.

<sup>7</sup>PROSSER, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 *MINN. L. REV.* 791 (1966) [hereinafter *The Fall*].

<sup>8</sup>J. WHITE & J. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* § 11-7 (2d ed. 1980) [hereinafter WHITE & SUMMERS].

<sup>9</sup>Special Project, *Article Two Warranties in Commercial Transactions*, 64 *CORNELL L. REV.* 30, 255 (1978) [hereinafter Special Project].

<sup>10</sup>3 A. SQUILLANTE & J. FONSECA, *WILLISTON ON SALES* § 22-5, at 169 (4th ed. Supp. 1987) [hereinafter *WILLISTON ON SALES*].

<sup>11</sup>2 *Am. L. Prod. Liab.* 3d § 21:4 (1987).

<sup>12</sup>*Id.* § 21:5. See Edmeades, *The Citadel Stands: The Recovery of Economic Loss in American Products Liability*, 27 *CASE W. RES. L. REV.* 647 (1977).

<sup>13</sup>WHITE & SUMMERS, *supra* note 8.

<sup>14</sup>See *infra* notes 39-44 and accompanying text.

under Article 2 of the Uniform Commercial Code,<sup>15</sup> however, the citadel remains unaffected. Indiana courts continue to hold that a plaintiff cannot recover from a defendant for breach of implied warranty under Article 2 unless there is privity between them.<sup>16</sup>

What, then, is privity, how did it develop, and what does it require?

Privity, in the law of contracts, is merely the name for a legal relation arising from right and obligation. . . . [It] is but a descriptive term, designating effect rather than cause. In short, privity of contract is legal relationship to the contract or its parties. To affirm one's right under a contract is therefore to affirm his privity with the party liable to him.<sup>17</sup>

Stated somewhat differently, "Privity of contract is the relation that exists between two contracting parties, and in cases of defective products this privity of contract is usually between buyer and seller."<sup>18</sup>

Privity of contract is a court-created requirement which relates back to a leading British case of the last century, *Winterbottom v. Wright*.<sup>19</sup>

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<sup>15</sup>The Uniform Commercial Code [hereinafter the Code or the U.C.C.] appears in the 1982 Indiana Code at sections 26-1-1-101 through 26-1-10-106. Article 2, Sales, appears in the 1982 Indiana Code at sections 26-1-2-101 through 26-1-2-725. Unless the Indiana text of the Code differs from the 1978 Official Text as promulgated by the Conference of Commissioners on Uniform State Laws and the American Law Institute, further citations to the Code will use the official, generic section citation form rather than the Indiana citation form. In the event there is difference between the two texts, the Indiana Code citation will be used to note the text applicable in Indiana.

<sup>16</sup>The most recent pronouncements are *Dutton v. International Harvester Co.*, 504 N.E.2d 313 (Ind. Ct. App.), *transfer denied* (1987), and *Prairie Prod., Inc., v. Agchem Div.-Pennwalt Corp.*, 514 N.E.2d 1299 (Ind. Ct. App.), *reh'g denied* (1987). In *Dutton*, the court of appeals affirmed summary judgment in favor of a manufacturer with whom the buyer of a planting machine did not have privity for purposes of enforcing the implied warranty of merchantability granted under U.C.C. § 2-314 (1978). In *Prairie Production*, which involved a breach of express warranty, the court reiterated the rule stated in *Dutton*. 514 N.E.2d at 1301. See the discussion of *Prairie Production infra* in the text accompanying notes 45-49 and 76-83.

<sup>17</sup>*La Mourea v. Rhude*, 209 Minn. 53, 57, 295 N.W. 304, 307 (1940); see BLACK'S LAW DICTIONARY 1362 (4th ed. 1951). Dean Murray has characterized this language as "the best judicial statement relating to privity." MURRAY ON CONTRACTS § 278, n.25 (2d rev. ed. 1974). The *La Mourea* court continued, "That simple truth removes the difficulty arising from the complicated notions expressed by judges and text writers concerning privity of contract." 209 Minn. at 57, 295 N.W. at 307. The case involved the technical absence of privity between a third party beneficiary and a promisor from whom the beneficiary sought to recover.

<sup>18</sup>2 AM. L. PROD. LIAB. 3D § 21:1 (1987).

<sup>19</sup>152 Eng. Rep. 402 (1842); see also *Hiatt v. Brown*, 422 N.E.2d 736, 739 (Ind. Ct. App. 1981); 2 W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-318:01 (1984) [hereinafter 2 W. HAWKLAND]; Speidel, *Warranty Theory, Economic Loss and the Privity Requirement: Once More Into the Void*, 67 B.U.L. REV. 1, 24-25 n.54 (1987) [hereinafter *Warranty Theory*].

In that case, the defendant had contracted with the postmaster general to furnish and maintain mail coaches. Plaintiff, a mail-coach driver who was seriously injured when his coach overturned, brought a negligence action against the defendant based on defendant's failure to keep the coach in a fit and safe condition, as required by the contract. The court held that the coachman could not recover and declared:

There is no privity of contract between these parties; and if the plaintiff can sue, every passenger, or even any person passing along the road, who was injured by the upsetting of the coach, might bring a similar action. Unless we confine the operation of such contracts as this to the parties who entered into them, the most absurd and outrageous consequences, to which I can see no limit would ensue.<sup>20</sup>

The real issue in the case was: to whom did the defendant owe the duty created by the contract? The response: only to the party with whom the defendant had contracted.<sup>21</sup> Thus, the citadel of privity was constructed as an almost impregnable defense in actions for breach of contractual duties brought by anyone other than the immediate parties to the contract which created those duties.

Privity became a part of warranty law in a society where the manufacturer and the seller with whom the buyer dealt were most often one and the same; there was no remote manufacturer in most cases.<sup>22</sup> Today,

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<sup>20</sup>152 Eng. Rep. at 405.

<sup>21</sup>*Id.*

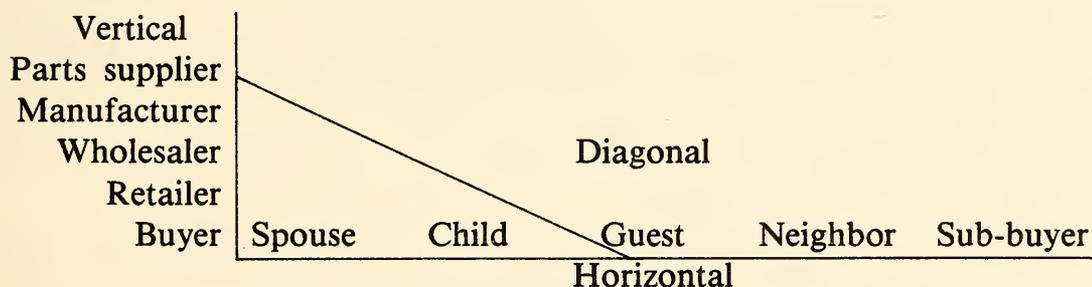
<sup>22</sup>See *Freeman v. Navarre*, 47 Wash. 2d 760, 765, 289 P.2d 1015, 1018 (1955); 2 L. FRUMER & M. FRIEDMAN, PRODUCTS LIABILITY § 3.02[3], at 3-145 to 3-146 [hereinafter FRUMER & FRIEDMAN]. As described in *Freeman*:

In the eighteenth century, [as the law of warranty first developed] . . . goods and chattels were manufactured or made largely on a custom basis involving a personal, over-the-counter relationship between the customer, on the one hand, and the artisan, or mechanic, who made the goods or chattels, on the other. Mass production, large scale or national promotion and distribution were unknown. Actually, there was little need for a legal remedy for a consumer against a manufacturer in a distant city who had sold products to a distributor, who, in turn, had sold them to a jobber, who had sold to retailers, who had then sold to consumers. At that time, in practically all lawsuits in the fields of contracts and torts, the factor of personal relationship was quite apparent and loomed quite large in the consciousness of the law courts. The idea of a lawsuit by a consumer against a manufacturer, where no orthodox, over-the-counter, personal relationship existed, was unusual and seemingly quite difficult for the courts to contemplate. There is some similarity, perhaps, between the philosophy or logic of the privity of contract doctrine and that inherent in the remnants of the concept of *caveat emptor*, the latter, certainly, inherited from a time when business morality was, perhaps, somewhat different from that prevailing today.

47 Wash. 2d at 765, 289 P.2d at 1018.

we speak of a chain of distribution in which "[t]he middleman is no more than a conduit, a mere mechanical device, through which the thing is to reach the ultimate user."<sup>23</sup>

In the context of a warranty of the quality or performance of goods, the relationship between the parties for purposes of a discussion of privity is best viewed as the sides of a right angle, as illustrated in the figure which follows. "Vertical" privity describes the chain of distribution, from the supplier of any component parts, through the manufacturer of the finished goods, the wholesale and retail dealers, and ultimately to the retail buyer of those goods. "Horizontal" privity describes the persons to whom any warranty extends beyond the retail buyer, such as members of the buyer's family, guests, neighbors, sub-purchasers, etc., who may be affected by a breach of the warranty.<sup>24</sup> It has also been suggested that there is a third type of privity, "diagonal" privity, which completes a right triangle, and describes the relationship between a party in the chain of distribution and a party in the horizontal line.<sup>25</sup>



If a court requires privity between a plaintiff and a defendant, vertical privity describes the person in the chain of distribution who is a proper defendant in a suit by the particular plaintiff, *i.e.*, who is responsible on the warranty which allegedly has been breached. Similarly, horizontal privity describes who along the horizontal line from the retail buyer of the goods to the person affected by the breach of warranty is a proper plaintiff, *i.e.*, who is a beneficiary of the warranty, or to whom does

<sup>23</sup>Prosser, *The Fall*, *supra* note 7, at 799; *accord* Santor v. A & M Karagheusian, Inc., 44 N.J. 52, 60, 207 A.2d 305, 309 (1965); Kassab v. Central Soya, 432 Pa. 217, 226, 246 A.2d 848, 853 (1968).

<sup>24</sup>See, *e.g.*, AM. L. PROD. LIAB. 3d § 21:4 (1987); 2 W. HAWKLAND, *supra* note 19, § 2-318:01; WHITE & SUMMERS, *supra* note 8, § 11-2; WILLISTON ON SALES, *supra* note 10, § 22-5.

<sup>25</sup>Ezer, *The Impact of the Uniform Commercial Code on the California Law of Sales Warranties*, 8 U.C.L.A. L. REV. 281, 324-26 (1961) (in which the term originated); see 2 W. HAWKLAND, *supra* note 19, § 2-318:01, n.4.

the warranty extend.<sup>26</sup> Diagonal privity links the two lines and describes who at each end of the diagonal line is a proper plaintiff and is a proper defendant in a particular situation.<sup>27</sup>

### B. Privity and the U.C.C.

The Uniform Commercial Code deals with privity only in section 2-318. When Indiana enacted the Code in 1963,<sup>28</sup> that section provided:

A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.<sup>29</sup>

This language is a limited legislative attack directed only to the wall of horizontal privity and has reached only its lower levels.<sup>30</sup> With respect

<sup>26</sup>See, e.g., *Williams v. West Penn Power Co.*, 502 Pa. 557, 467 A.2d 811 (1983); H. GREENBERG, *RIGHTS AND REMEDIES UNDER U.C.C. ARTICLE 2* § 14.30 (1987) [hereinafter H. GREENBERG].

<sup>27</sup>See Ezer, *supra* note 25, at 324-26.

<sup>28</sup>1963 Ind. Acts 317.

<sup>29</sup>IND. CODE § 26-1-2-318 (1982).

In 1966, because there continued to be a lack of uniformity among the states with respect to the privity requirement, the Permanent Editorial Board of the Code designated the language quoted above as Alternative A to § 2-318 and approved two additional alternatives as choices for states adopting the Code. See Permanent Editorial Board Note in 1966 Amendment to § 2-318; 2 W. HAWKLAND, *supra* note 19, § 2-318, at 407; Comment, *Enforcing the Rights of Remote Sellers under the UCC: Warranty Disclaimers, The Implied Warranty of Fitness for a Particular Purpose and the Notice Requirement in the Nonprivity Context*, 47 U. PITT. L. REV. 873, 884-85 (1986) [hereinafter *Rights of Remote Sellers*].

Alternative B provides:

A seller's warranty whether express or implied extends to any natural person who may reasonably be expected to use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

U.C.C. § 2-318.

Alternative C provides:

A seller's warranty whether express or implied extends to any person who may be reasonably expected to use, consume or be affected by the goods and who is injured by breach of the warranty. A seller may not exclude or limit the operation of this section with respect to injury to the person of an individual to whom the warranty extends.

*Id.*

<sup>30</sup>See H. PRATTER & R. TOWNSEND, *supra* note 5, at 47. Whether it restricts further judicial assault on that wall, e.g., by extending warranty protection to employees, passers-

to vertical privity, the drafters themselves said that this provision "is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the distributive chain."<sup>31</sup> The attack on or defense of the tower of vertical privity remains the assignment of the courts for further development in the common law tradition.<sup>32</sup>

### III. PRIVACY: INDIANA'S APPROACH

#### A. *The Assault on Privity in Indiana*

In Indiana, as elsewhere, the doctrine of privity traces back to *Winterbottom v. Wright*.<sup>33</sup> In the ensuing years, cracks began to appear in the privity barrier, and two leading cases caused the national collapse of major sections of the citadel of privity: *MacPherson v. Buick Motor Co.*<sup>34</sup> and *Henningsen v. Bloomfield Motors, Inc.*<sup>35</sup> *MacPherson* abolished the need for vertical privity in negligence actions by a buyer against a manufacturer if the goods involved (there, an automobile), if negligently made, are inherently dangerous and cause personal injury.<sup>36</sup> In *Henningsen*, the court imposed strict liability in tort, without regard to negligence and despite the absence of vertical or horizontal privity, upon both the manufacturer and the seller of a product (again, an automobile)

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by, bailees, or subsequent buyers from the first retail buyer, remains a matter for further development in many other jurisdictions, but not presently in Indiana where the provision is interpreted restrictively. Compare *Davidson v. John Deere & Co.*, 644 F. Supp. 707 (S.D. Ind. 1986); *Lane v. Barringer*, 407 N.E.2d 1173, 1176 (Ind. Ct. App. 1980) (Ratliff, J., concurring in part, dissenting in part) with *Morrow v. New Moon Homes, Inc.*, 548 P.2d 279 (Alaska 1976); *Milbank Mut. Ins. Co. v. Proksch*, 309 Minn. 106, 244 N.W.2d 105 (1976); *Salvador v. Atlantic Steel Boiler Co.*, 457 Pa. 24, 319 A.2d 903 (1974); *JKT Co. v. Hardwick*, 274 S.C. 413, 265 S.E.2d 510 (1980). Some other jurisdictions also read § 2-318 restrictively. See, e.g., *Bailey v. ITT Grinnell Corp.*, 536 F. Supp. 84 (N.D. Ohio 1982); *Miller v. Sears, Roebuck & Co.*, 148 Ill. App. 3d 1022, 500 N.E.2d 557 (1986) (no expansion in either case).

<sup>31</sup>U.C.C. § 2-318, Official Comment 3.

<sup>32</sup>See, e.g., H. PRATTER & R. TOWNSEND, *supra* note 5, at 47; WHITE & SUMMERS, *supra* note 8, § 11-3 at 403; Murray, *Products Liability v. Warranty Claims: Untangling the Web*, 3 J.L. & COM. 269, 275-78 (1983).

<sup>33</sup>152 Eng. Rep. 402 (1842); see *Hiatt v. Brown*, 422 N.E.2d 736, 739 (Ind. Ct. App. 1981). See the discussion of *Winterbottom* in the text accompanying notes 19-21, *supra*.

<sup>34</sup>217 N.Y. 382, 111 N.E. 1050 (1916).

<sup>35</sup>32 N.J. 358, 161 A.2d 69 (1960).

<sup>36</sup>See Prosser, *The Assault*, *supra* note 5, at 1100.

which, because of an apparent defect, caused serious personal injury.<sup>37</sup> During the four decades between the two cases, in something of a precursor to *Henningsen*, more courts nationally and in Indiana began to impose a similar form of strict liability on the manufacturers of foods or bottled goods sold for human consumption without requiring vertical or horizontal privity.<sup>38</sup>

Indiana followed the lead of these two landmark cases. When the first opportunity arose, the Indiana Supreme Court expressly applied the *MacPherson* rule and affirmed the recovery of damages from the negligent manufacturer of a defective farm combine by an injured farmer who had purchased the combine from another farmer and was not in either vertical or horizontal privity with the manufacturer.<sup>39</sup> The court thereby abolished the requirement of either vertical or horizontal privity in negligence cases involving inherently dangerous products with latent defects. In doing so, the court stated:

As so often happens in the development of the common law, eventually the exception becomes the rule, and that is what has happened during the last sixty years to the principle under consideration here. . . .

As stated by the leading authorities, public policy has compelled this gradual change in the common law because of the industrial age where there is no longer the usual privity of contract between the user and the maker of a manufactured machine. On the other hand, there must be reasonable freedom and protection for the manufacturer. He is not an insurer against accident and is not obligated to produce only accident-proof machines. The emphasis is on the duty to avoid hidden defects or concealed dangers. . . .<sup>40</sup>

Six years later, Indiana followed the lead of *Henningsen* when it expressly adopted the principle of strict products liability, without requiring proof of negligence or privity, as enunciated in the Restatement

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<sup>37</sup>See Prosser, *The Fall*, *supra* note 7, at 791-97. The injured party in *Henningsen* was the wife of the buyer of an automobile, thus raising the question of whether the warranty from the dealer to the husband-buyer extended horizontally to his wife. The issue of vertical privity was raised by the naming of the manufacturer of the automobile as a defendant.

<sup>38</sup>See *Coca Cola Bottling Works v. Williams*, 111 Ind. App. 402, 413, 37 N.E.2d 702, 706 (1941); Prosser, *The Fall*, *supra* note 7, at 794-798.

<sup>39</sup>*J.I. Case Co. v. Sandefur*, 245 Ind. 213, 197 N.E.2d 519 (1964); see *Elliott v. General Motors Corp.*, 296 F.2d 125 (7th Cir. 1961), *cert. denied*, 369 U.S. 860 (1961) (in which the federal court had earlier concluded that the *MacPherson* rule did apply in Indiana).

<sup>40</sup>*J.I. Case Co.*, 245 Ind. at 221-22, 197 N.E.2d at 522-23.

(Second) of Torts, § 402A,<sup>41</sup> which itself solidified the *Henningsen* rule.<sup>42</sup> The Indiana Legislature took a further step in this regard when it enacted the state's first Product Liability Act.<sup>43</sup>

Despite the continuing assault on and collapse of the citadel elsewhere,<sup>44</sup> the assault in Indiana has proceeded extremely slowly, and a major part of the structure remains unscarred. Until *Prairie Production, Inc. v. Agchem Div.-Pennwalt Corp.*,<sup>45</sup> the Indiana courts had not been confronted squarely with the privity issue in cases based on breach of an express warranty.<sup>46</sup> In this case, the defendant-manufacturer allegedly had made an express warranty that its product would control corn earworms, but there was no privity between the plaintiff-farmer and the defendant because the plaintiff had purchased the product as part of a crop-spraying service. Plaintiff lost part of its crop due to earworm infestation. The court of appeals relied on the leading case of *Randy Knitwear, Inc. v. American Cyanamid Co.*,<sup>47</sup> observing that "the authority in favor of discarding the privity requirement in express warranty cases is overwhelming."<sup>48</sup> In doing so, the court reversed summary judgment in favor of the defendant, and ruled that if the representations of the defendant-manufacturer amount to an express warranty, a question of fact, the buyer may recover economic losses for breach despite the absence of privity. However, the court restated the Indiana rule that in the absence of privity, a buyer cannot recover economic damages from a remote manufacturer if the claim is based on breach of implied warranties.<sup>49</sup>

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<sup>41</sup>*See* *Cornette v. Searjeant Metal Prods., Inc.*, 147 Ind. App. 46, 258 N.E.2d 652 (1970).

<sup>42</sup>*See* Prosser, *The Fall*, *supra* note 7. Dean Prosser is the author of § 402A. *See* Edmeades, *supra* note 12, at 650, 663; Murray, *supra* note 32, at 275. But the concept of strict products liability was apparently first espoused some 20 years earlier by Karl Llewellyn, the principal drafter of the U.C.C., in a provision which was not included in the final official text. *See* Murray, *supra* note 32, at 275.

<sup>43</sup>1978 Ind. Acts, Pub. L. 141, § 28.

<sup>44</sup>*See, e.g.*, *Morrow v. New Moon Homes, Inc.*, 548 P.2d 279 (Alaska 1976); *Groppel Co. v. United States Gypsum Co.*, 616 S.W.2d 49 (Mo. Ct. App. 1981); *Spring Motors Distrib., Inc. v. Ford Motor Co.*, 98 N.J. 555, 489 A.2d 660 (1985); *Kassab v. Central Soya*, 432 Pa. 217, 246 A.2d 848 (1968); Comment, *Rights of Remote Sellers*, *supra* note 29, at 881.

<sup>45</sup>514 N.E.2d 1299 (Ind. Ct. App.), *reh'g denied* (1987).

<sup>46</sup>*See id.* at 1301. Language in earlier cases suggested that lack of privity would not be a defense in express warranty cases. *See* *Candlelight Homes, Inc. v. Zornes*, 414 N.E.2d 980 (Ind. Ct. App. 1981); *Richards v. Goerg Boat & Motors, Inc.*, 179 Ind. App. 102, 384 N.E.2d 1084, *transfer denied* (1979); Bepko, *Commercial Law, Survey of Recent Developments in Indiana Law*, 15 Ind. L. Rev. 109, 118 (1982).

<sup>47</sup>11 N.Y.2d 5, 181 N.E.2d 399 (1962).

<sup>48</sup>514 N.E.2d at 1302.

<sup>49</sup>*Id.* at 1301, citing *Richards, Candlelight Homes, Dutton, and Ridge Co., Inc. v. NCR Corp.*, 597 F. Supp. 1239 (N.D. Ind. 1984).

Thus, in implied warranty cases under the U.C.C., the absence of privity is a barrier behind which the defendant is totally protected regardless of the cause or nature of the damage or the justice of the plaintiff's claim. The two cases which furnish the strongest support for the barrier are *Lane v. Barringer*<sup>50</sup> and *Candlelight Homes, Inc. v. Zornes*.<sup>51</sup>

*Lane*, which involved the woman whose legs were splashed with caustic drain cleaner when the container broke,<sup>52</sup> contained issues of both vertical and horizontal privity, although the thrust of the court's opinion addressed only the vertical. Plaintiff named as defendants in her suit for breach of the implied warranty of merchantability<sup>53</sup> the entire vertical chain of distribution: the supplier of the container, the manufacturer of the drain cleaner, the distributor, the supermarket where the injury occurred, and the market operators. In affirming summary judgment in favor of all remaining defendants,<sup>54</sup> two members of the court held that the absence of privity between the plaintiff and the remaining defendants was an insurmountable barrier to her claim against them:

Clearly, privity of contract is no longer required if a personal injury action for a defective product sounds in tort; either on a negligence theory or on the theory of strict liability in tort. . . . However, the abrogation of the privity requirement in tort law has not eliminated the privity requirement when the cause of action sounds in contract for breach of warranty.<sup>55</sup>

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<sup>50</sup>407 N.E.2d 1173 (Ind. Ct. App. 1980).

<sup>51</sup>414 N.E.2d 980 (Ind. Ct. App. 1981).

<sup>52</sup>See discussion in the opening paragraph of this article *supra* note 1.

<sup>53</sup>U.C.C. § 2-314(2)(c) and (e) require that for goods to be merchantable, they must, *inter alia*, be fit for their ordinary purposes and be adequately packaged or contained. The container slipped out of the hands of the plaintiff's married daughter as she took it from a supermarket shelf to put in her shopping cart. The court assumed, for the purposes of argument, that there had been a sale. For reasons unknown, the plaintiff had allowed the statute of limitations for actions in negligence or strict liability—two years—to pass, and those actions were barred. Her only possible claim was for breach of warranty under the Code, the limitation on which is four years from the accrual of the cause of action pursuant to U.C.C. § 2-725.

<sup>54</sup>The market operators were dismissed by stipulation; the market itself, a corporation, was never properly served with process and, although named, was never a party. 407 N.E.2d at 1175.

<sup>55</sup>*Id.* A later, federal case characterized this distinction as "archaic" and declared that adoption of the U.C.C. had displaced common law actions for breach of implied warranty. *Corbin v. Coleco Indus., Inc.*, 748 F.2d 411 (7th Cir. 1984). The court held that because the buyer of an above-ground swimming pool from his neighbor was not in privity with the manufacturer, as required by Indiana law if the suit is for breach of

The third judge would have abolished the vertical privity requirement in all cases involving personal injury but agreed with the result because he found no horizontal privity under section 2-318 of the Code.<sup>56</sup>

In *Candlelight Homes*, the plaintiff-buyers who had purchased a defective mobile home from an authorized dealer of the defendant-manufacturer brought an action for breach of implied warranty against both the dealer and the manufacturer, but the dealer had gone out of business. The court reversed a judgment for the plaintiffs against the manufacturer and held that in a "suit for breach of implied warranty for loss of bargain, privity must be shown, or facts must be present" to prove an exception such as the seller's agency with the manufacturer or the manufacturer's participation in the sale.<sup>57</sup> Neither had been shown. Although these "exceptions," established in two earlier cases,<sup>58</sup> do not establish true privity in the sense that the manufacturer is a party to the sales contract with the buyer, they do establish a direct relationship between the manufacturer and the buyer.<sup>59</sup>

*Lane* and *Candlelight Homes* have been relied on repeatedly in subsequent cases to bar recovery by non-privity plaintiffs without regard to whether vertical or horizontal privity was at issue.<sup>60</sup> The most recent

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an implied warranty connected with the sale of goods, the manufacturer was entitled to summary judgment in its favor. 748 F.2d at 416.

In *Thiele v. Faygo Beverage, Inc.*, 489 N.E.2d 562 (Ind. Ct. App.), *transfer denied* (1986), the court concluded that actions for breach of warranty in tort and for strict products liability, first introduced by approval of RESTATEMENT (SECOND) OF TORTS, § 402A, and subsequently codified in the Indiana Product Liability Act, IND. CODE §§ 33-1-1.5-1 to -8 (1982), are indistinguishable. A complaint which states a count for strict products liability and for breach of warranty in tort will be considered duplicitous. *Thiele*, 489 N.E.2d at 584. See *Whittaker v. Federal Cartridge Corp.*, 466 N.E.2d 480, 481 n.2 (Ind. Ct. App. 1984).

<sup>56</sup>407 N.E.2d at 1177-78 (Ratliff, J., concurring in part, dissenting in part). See *supra* notes 28-32 and accompanying text.

<sup>57</sup>414 N.E.2d 980, 982 (Ind. Ct. App. 1981). The court stated that the amended complaint alleged breach of the implied warranty of fitness for particular purpose. As discussed *infra* in the text accompanying notes 161-172, such a warranty rarely, if ever, exists without privity or a direct relationship between the maker of the warranty and the beneficiary thereof. The case could have been decided against the plaintiffs on the basis that they failed to prove that such a warranty had been made by the manufacturer. Instead, the court treated the case as involving "breach of implied warranty," which should be taken to mean breach of the implied warranty of merchantability.

<sup>58</sup>*Richards v. Goerg Boat & Motors, Inc.*, 179 Ind. App. 102, 384 N.E.2d 1084, *transfer denied* (1979) (participation in the sale); *Thompson Farms, Inc. v. Corno Feed Prods.*, 173 Ind. App. 682, 366 N.E.2d 3 (1977) (agency).

<sup>59</sup>See *Richards*, 179 Ind. App. at 112, 384 N.E.2d at 1092.

<sup>60</sup>See, e.g., *Corbin v. Coleco Indus., Inc.*, 748 F.2d 411, 414 (7th Cir. 1984) (suit by sub-buyer against remote manufacturer); *Davidson v. John Deere & Co.*, 644 F. Supp. 707, 713 (N.D. Ind. 1986) (suit by employee against manufacturer who sold directly to

of these, *Dutton v. International Harvester Co.*,<sup>61</sup> cited *Lane* and stated, "An essential element for the recovery of incidental and consequential damages due to breach of warranty is privity of contract."<sup>62</sup> Quoting from an earlier case, the court declared that "[t]he rule in Indiana is[,] '[i]mplied warranties of merchantability and fitness for particular use, as they relate to economic loss from the bargain, cannot ordinarily be sustained between the buyer and a remote manufacturer.'"<sup>63</sup> Accordingly, the *Dutton* court affirmed summary judgment in favor of the manufacturer of a defective planting machine and against the farmer-buyer who had purchased the machine from an authorized distributor, claimed breach of implied warranty, and sought damages for his economic loss (there were no personal injuries).<sup>64</sup>

The rumblings of a further Indiana assault on the citadel had earlier been heard in *Barnes v. MacBrown & Co.*,<sup>65</sup> which involved a warranty parallel to those of the Code, the implied warranty of habitability. The Indiana Supreme Court held that the second purchaser of a dwelling, who had never dealt with the builder and was not in privity with him, could recover for breach of the warranty even though the claim involved only the economic loss of the cost of repairing a waterproof basement, not personal injury. In doing so, the court quoted from *J.I. Case Co. v. Sandefur*,<sup>66</sup> and stated:

The logic which compelled this change in the law of personal property is equally persuasive in the area of real property. Our society is an increasingly mobile one. Our technology is increasingly complex. The traditional requirement of privity between builder-vendor and a purchaser is an outmoded one.<sup>67</sup>

employer); *Ridge Co. v. NCR Corp.*, 597 F. Supp. 1239, 1242 (N.D. Ind. 1984) (suit by buyer against component part supplier); *Gonzales v. Kil Nam Chun*, 465 N.E.2d 727, 731 (Ind. Ct. App. 1984) (suit by employee of borrower of scaffolding against owner).

<sup>61</sup>504 N.E.2d 313 (Ind. Ct. App.), *transfer denied* (1987).

<sup>62</sup>*Id.* at 316.

<sup>63</sup>*Id.* (quoting *Richards v. Goerg Boat & Motors, Inc.*, 179 Ind. App. 102, 112, 384 N.E.2d 1084, 1092, *transfer denied* (1979)). The error in this statement with respect to the implied warranty of fitness for particular purpose under U.C.C. § 2-315 is discussed *infra* in the text accompanying notes 161-172.

<sup>64</sup>504 N.E.2d at 319. The statement of the court that after repair attempts by the seller, the manufacturer "extended its warranty for an additional year," indicates that the case also involved an express warranty. *Id.* at 315. However, the buyer-appellant apparently did not raise the issue of express warranty in his appeal. Had he done so, he might have avoided the privity issue. See *infra* text accompanying notes 45-49.

<sup>65</sup>264 Ind. 227, 342 N.E.2d 619 (1976).

<sup>66</sup>245 Ind. 213, 197 N.E.2d 519 (1964); see *supra* text accompanying notes 39-40.

<sup>67</sup>*Barnes*, 264 Ind. at 229, 342 N.E.2d at 620.

Although cited with approval in later cases involving real property,<sup>68</sup> subsequent cases involving sales of goods have failed to take up this lead either by ignoring the reasoning of *Barnes* altogether or by attempting to distinguish it despite the clearly stated position of the court that privity had already been eliminated as a requirement in cases involving the law of personal property.<sup>69</sup>

The current status of privity in Indiana, therefore, is that it remains a barrier against any lawsuit brought for breach of implied warranty under the U.C.C.

### B. *The Battle Plan for the New Assault in Indiana*

For the reasons developed in the remainder of this article, the assault on vertical privity in Indiana should resume until the citadel is demolished. There are two reasons why the assault should resume. First, permitting the damaged buyer to proceed against the manufacturer will impose liability for defective goods on the party most able to prevent the defect and to bear its cost, and who should, and probably will, ultimately bear the liability in any event. Second, permitting a direct suit against the manufacturer will result in judicial efficiency and will avoid substantial unfairness to the buyer and other parties in the chain of distribution between the buyer and the manufacturer. Because of the substantial protections available under the U.C.C., allowing suit against a remote manufacturer for breach of implied warranty will neither make him an insurer nor will it impose upon him any liability beyond his reasonable expectations.

In order to review the battle plan in a logical fashion, the points of the attack should be examined. Privity's greatest strength in Indiana is as a defense against claims of breach of the implied warranty of merchantability. That strength lessens significantly when the defense is raised against the Code's other implied warranty, fitness for a particular purpose. Because these warranties differ in their creation and characteristics, they must be dealt with separately. We attack first at the citadel's strongest point.

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<sup>68</sup>See, e.g., *Zimmerman v. Moore*, 441 N.E.2d 690, 694 (Ind. Ct. App. 1982); *Wagner Constr. Co. v. Noonan*, 403 N.E.2d 1144, 1148 (Ind. Ct. App. 1980).

<sup>69</sup>See, e.g., *Corbin v. Coleco Indus., Inc.*, 748 F.2d 411, 415 (7th Cir. 1984) (comment that *Barnes* is no authority for a U.C.C. case); *Ridge Co. v. NCR Corp.*, 597 F. Supp. 1239, 1243 (N.D. Ind. 1984) (no evidence in *Barnes* that the court intended to go beyond habitability). In stating that Indiana law requires privity in a warranty action based on contract, the court in *Neofes v. Robertshaw Controls Co.*, 409 F. Supp. 1376 (S.D. Ind. 1976), incorrectly forecast the possible future effect of *Barnes* on the privity requirement with a citation, "but cf." 409 F. Supp. 1379.

1. *The Implied Warranty of Merchantability.*—The U.C.C. states, “Unless excluded or modified (section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind.”<sup>70</sup> The basic definition of “merchantability” requires that the goods be “fit for the ordinary purposes for which such goods are used.”<sup>71</sup> Without some action by the seller to exclude or modify,<sup>72</sup> this warranty arises automatically in every sale in the chain of distribution.<sup>73</sup> The Code simply does not state to whom in the chain the warranty extends, nor does it limit the benefits of the warranty to the seller’s immediate buyer in the chain.<sup>74</sup> However, without some direct contact between the manufacturer and the retail buyer, there is neither traditional privity of contract nor an exception to it. Nevertheless, both the policy on which this warranty is based and modern business circumstances and practices support the conclusion that either (1) there really is a form of privity between the remote manufacturer and the buyer, although not direct or face to face,<sup>75</sup> or (2) the tower of vertical privity should be abandoned and demolished.

The nature of the implied warranty is that it arises automatically in every sale by a merchant unless it is specifically limited or disclaimed; it is an obligation imposed on the seller as a matter of law. Thus, it involves two basic situations: sales in which the seller also gives an express warranty and sales in which there is no express warranty whatever.

In sales involving an express warranty, in which privity is no longer a barrier to a buyer’s action against a remote manufacturer for breach of that warranty,<sup>76</sup> there is no reason for the barrier to stand against a similar suit for breach of the implied warranty of merchantability. In *Prairie Production, Inc. v. Agchem Div.-Pennwalt Corp.*,<sup>77</sup> the recent case which abolished the privity requirement with respect to express warranties only, the court first cited, described and relied on the two Indiana cases in which the barrier of privity was broken in implied warranty cases because of the manufacturer’s contacts with the buyer:

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<sup>70</sup>U.C.C. § 2-314(1).

<sup>71</sup>U.C.C. § 2-314(2)(c).

<sup>72</sup>See discussion of disclaimers of warranty and limitation of remedy under §§ 2-316 and 2-719 *infra* notes 176-181 and accompanying text.

<sup>73</sup>See U.C.C. § 2-314, Official Comment 2.

<sup>74</sup>See Speidel, *Warranty Theory*, *supra* note 19, at 42-43.

<sup>75</sup>Prof. Speidel suggests that, based on a relational perspective of contract law, there is indeed a connection between the remote manufacturer and the buyer which justifies the ability of the buyer to recover from the manufacturer. See Speidel, *Warranty Theory*, *supra* note 19.

<sup>76</sup>See *Prairie Prod., Inc. v. Agchem Div.-Pennwalt Corp.*, 514 N.E.2d 1299 (Ind. Ct. App.), *reh’g denied* (1987).

<sup>77</sup>*Id.*

*Richards v. Goerg Boat & Motors, Inc.*,<sup>78</sup> and *Thompson Farms, Inc. v. Corno Feed Products*.<sup>79</sup>

In *Richards*, the buyer had talked with the manufacturer's personnel at a boat show, had attended a demonstration at the manufacturer's plant, and, when problems arose after the sale, dealt directly with the manufacturer concerning problems with the boat. However, the buyer made his purchase from the intermediate dealer. In *Thompson Farms*, the court found that a special agency relationship existed between the dealer and the manufacturer involving arrangements for financing, and that the manufacturer had solicited the buyer directly as a customer for the hog houses involved and had inspected them after construction for conformity to blueprints.<sup>80</sup> In *Prairie Production*, however, the court found that there was no direct participation in the sale by the manufacturer who gave an express warranty.

By distinguishing *Richards* and *Thompson Farms* in this way, the court seems to be asserting that unless the contact between the manufacturer and the buyer is oral and face to face, the contact is insufficient to break through the barrier of privity; that advertising literature, no matter how descriptive or laudatory, does not even crack the barrier if it does not rise to the level of an express warranty. In describing *Randy Knitwear, Inc. v. American Cyanamid Co.*,<sup>81</sup> which the Indiana court found to exemplify the overwhelming weight of authority and virtually indistinguishable from the case before it,<sup>82</sup> the court of appeals stated:

It justified discarding the privity requirement under the circumstances of that case by observing that manufacturers commonly extoll the merits and quality of their products in newspapers, periodicals and other media directed to each purchaser in the chain of distribution. These affirmations, *which may or may not constitute an express warranty*, may effectively induce the purchase, and are even intended to have that effect.<sup>83</sup>

What, then, of the case in which the manufacturer engages in an extensive advertising campaign to induce sales but carefully avoids making any express warranties? Surely, the written contact through *Time* magazine or *The Wall Street Journal* is as effective as ten or fifteen minutes at a trade show to establish a form of direct contact between the manufacturer and the buyer to satisfy the privity requirement.

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<sup>78</sup>179 Ind. App. 102, 384 N.E.2d 1084, *transfer denied* (1979).

<sup>79</sup>173 Ind. App. 682, 366 N.E.2d 3 (1977).

<sup>80</sup>See *Prairie Prod.*, 514 N.E.2d at 1301.

<sup>81</sup>11 N.Y.2d 5, 226 N.Y.S.2d 363, 181 N.E.2d 399 (1962).

<sup>82</sup>*Prairie Prod.*, 514 N.E.2d at 1302.

<sup>83</sup>*Id.* at 1302-03 (emphasis added).

Moreover, the making of the express warranty itself should be sufficient to establish the required contact. The nature and quality of the express warranty itself may be the inducement, as in the automotive industry where the manufacturers are presently giving warranties of different coverages and durations. And in the *Richards* case, the court declared: "An express warranty is a contract between the buyer and the seller. . . ." <sup>84</sup> This being so, if a sale includes a manufacturer's express warranty, the existence of a contract between the manufacturer and the buyer establishes privity between them. This should be sufficient to support an action against the manufacturer for breach of the express warranty or the implied warranty of merchantability or both, <sup>85</sup> unless the manufacturer has taken affirmative steps to modify or disclaim warranties. <sup>86</sup> Furthermore, the privity requirement should be abolished in all cases involving the implied warranty of merchantability, whether or not the remote manufacturer has given an express warranty.

The concept of implied warranty is not and never has been purely contractual, but is in reality a blend of the principles underlying both contracts and torts. <sup>87</sup> As described by the court of appeals, in Indiana implied warranties "arise out of the *status relationship* between a buyer making a purchase from a seller; that is, they arise because the seller happens to be a merchant *or* has knowledge about the buyer's purpose and reliance." <sup>88</sup> A basic difference between warranty and negligence is

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<sup>84</sup>179 Ind. App. at 118, 384 N.E.2d at 1095.

<sup>85</sup>See *Szajna v. General Motors Corp.*, 115 Ill.2d 294, 503 N.E.2d 760, *reh'g denied* (1986), in which the court stated that if the manufacturer gives a written warranty pursuant to the Magnuson-Moss Federal Warranty Act (15 U.S.C. §§ 2301-2310 (1976)), as most manufacturers will, the manufacturer "establishes privity between the warrantor [manufacturer] and the consumer which, though limited in nature, is sufficient to support an implied warranty under sections 2-314 and 2-315 of the UCC." *Id.* at 305, 503 N.E.2d at 769. The Illinois Supreme Court therefore reversed the holding of the intermediate appellate court that although there was privity for purposes of the express warranty, there was no privity for purposes of the implied warranty of merchantability.

*But see* *Walsh v. Ford Motor Co.*, 588 F. Supp. 1513 (D.D.C. 1984). In *Walsh*, the court ruled that although an action under the Magnuson-Moss Act may include a claim for breach of implied warranties which arise under the U.C.C., the issue of privity is governed by state law without reference to the Magnuson-Moss Act. *Id.* at 1526-1527.

<sup>86</sup>See *infra* text accompanying notes 176-181.

<sup>87</sup>See, e.g., FRUMER & FRIEDMAN, *supra* note 22, § 3.02[3], at 3-143 to 3-144; Prosser, *The Assault*, *supra* note 5, at 1126-34; Rabin & Grossman, *Defective Products or Realty Causing Economic Loss: Toward a Unified Theory of Recovery*, 12 Sw. U.L. REV. 4, 49-50 (1981) [hereinafter Rabin & Grossman]. Dean Prosser called warranty "a freak hybrid born of the illicit intercourse of tort and contract." *The Assault*, *supra* note 5, at 1126.

<sup>88</sup>*Richards v. Goerg Boat & Motors, Inc.*, 179 Ind. App. 102, 110, 384 N.E.2d 1084, 1091, *transfer denied* (1979) (emphasis added). See discussion of Speidel, *Warranty Theory*, *supra* note 75.

that warranty is not based on fault but focuses on the condition of the product by imposing a form of strict liability on the seller.<sup>89</sup>

One major purpose of warranty law was to change the rule from *caveat emptor* to a rule which gives the buyer what he had reason to expect: goods fit for their ordinary uses.<sup>90</sup> In his article on the fall of the citadel, prompted by the explosion caused by *Henningsen v. Bloomfield Motors*,<sup>91</sup> Dean Prosser reflected that had another decade passed before a decision like *Henningsen* was announced, the law of warranties might itself have been changed to eliminate privity as a defense between remote manufacturers and injured consumers.<sup>92</sup> Since *Henningsen*, that change has occurred in most jurisdictions, at least with respect to personal injury and property damage,<sup>93</sup> but not in Indiana.

The Indiana courts speak of privity being required to protect the bargained for expectations of the parties.<sup>94</sup> This position is based on the false premise that the parties must deal with each other face to face in order to know those expectations, a premise which harks back to the 19th Century business climate and philosophy expressed in *Winterbottom*

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<sup>89</sup>See *Gregory v. White Truck & Equip. Co.*, 163 Ind. App. 240, 255-56, 323 N.E.2d 280, 289 (1975); FRUMER & FRIEDMAN, *supra* note 22, § 3.01[1], at 3-5; Prosser, *The Assault*, *supra* note 5, at 1126-34.

<sup>90</sup>See Prosser, *The Assault*, *supra* note 5, at 1145. It has been suggested that had Restatement (Second) of Torts, § 402A, been approved by the American Law Institute at the time Karl Llewellyn was chief reporter for the Code and the chief drafter of Article 2, he would not have included any provisions on warranty at all. Murray, *supra* note 32, at 276. This suggestion may go a bit too far. As strict liability in tort has developed, the general rule has been that recovery can only be for personal injury and property damage but not for economic loss. See, e.g., *Sanco v. Ford Motor Co.*, 771 F.2d 1081 (7th Cir. 1985); *Spring Motors Distribs., Inc. v. Ford Motor Co.*, 98 N.J. 555, 489 A.2d 660 (1985); Prosser, *The Assault*, *supra* note 5, at 1120-23 (whose position in this regard is discussed *infra* in note 131). This, too, may change, but the change will likely be long in coming.

<sup>91</sup>32 N.J. 358, 161 A.2d 69 (1960); see *supra* discussion in text accompanying notes 35-37.

<sup>92</sup>Prosser, *The Fall*, *supra* note 7, at 801-02. Another scholar has commented that Karl Llewellyn, the principal drafter of Article 2, was hostile to privity as a defense. 2 W. HAWKLAND, *supra* note 19, at § 2-318:01. See also *supra* note 90.

<sup>93</sup>See FRUMER & FRIEDMAN, *supra* note 22, § 3.02[7][a] at 3-216 to 3-217; 2 R. HURSH & H. BAILEY, *AMERICAN LAW OF PRODUCTS LIABILITY* § 10.66 at 344 (2d ed. 1974) [hereinafter R. HURSH & H. BAILEY]; G. WALLACH, *THE LAW OF SALES UNDER THE UNIFORM COMMERCIAL CODE* ¶ 11.15[1][a] (1981) [hereinafter G. WALLACH].

<sup>94</sup>See *Richards v. Goerg Boat & Motors, Inc.*, 179 Ind. App. 102, 112, 384 N.E.2d 1084, 1092, *transfer denied* (1979). ("Generally privity extends to the parties to the contract of sale. It relates to the bargained for expectations of the buyer and seller.") *Accord Ridge Co. v. NCR Corp.*, 597 F. Supp. 1239, 1242 (N.D. Ind. 1984); see Bepko, *Contracts, Commercial Law & Consumer Law, 1979 Survey of Recent Developments in Indiana Law*, 13 IND. L. REV. 107, 109 (1980).

v. *Wright*.<sup>95</sup> A more realistic appraisal of the contemporary marketplace reveals that the expectations of all of the parties in the chain of distribution are that the manufacturer will produce merchantable goods and will ultimately be liable if the goods in the hands of the retail buyer prove to be unmerchantable.

When the manufacturer produces his goods and puts them into the chain of distribution, his expectation is that they will ultimately reach a user, not gather dust on the shelves of a distributor or retailer. Unless the manufacturer is acting fraudulently, he further expects that the goods are fit for the ordinary uses to which such goods are put by buyers.<sup>96</sup> Many manufacturers engage in massive and very expensive advertising campaigns aimed directly at the retail buyer with the specific intention of creating a demand for their products.<sup>97</sup> Although, as already noted, the advertising may be crafted carefully so as not to constitute an express warranty,<sup>98</sup> no manufacturer would spend money on advertising if he did not fully expect the buyer to react to it and buy the product. The manufacturer's expectation and intention with respect to the parties who are between him and the buyer is to encourage the interest of those parties so that they, too, will promote sales of his product. In the vast majority of transactions today, the intermediate parties do nothing more than facilitate the flow of the goods from the manufacturer to the buyer.<sup>99</sup> The fact that the manufacturer does not deal directly and individually with each buyer is irrelevant to these expectations.<sup>100</sup> At the

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<sup>95</sup>152 Eng. Rep. 402 (1842). See *supra* discussion of this case and the business climate in which it arose, at notes 19-22 and accompanying text.

<sup>96</sup>See Speidel, *Warranty Theory*, *supra* note 19, at 44-47.

<sup>97</sup>See *Lang v. General Motors Corp.*, 136 N.W.2d 805, 809-10 (N.D. 1965); R. NORDSTROM, *HANDBOOK OF THE LAW OF SALES* § 91 (1970).

<sup>98</sup>See U.C.C. § 2-313(2): "[A]n affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty."

<sup>99</sup>See *supra* notes 22-23 and accompanying text. In the few situations where the retail dealer is to perform some service on the goods, such as prepare an automobile for delivery or prepare and install industrial or consumer equipment, the manufacturer will have the opportunity to show that the damage was caused by improper service, rather than by a defect in the goods themselves. In most situations, however, the failure of goods to be merchantable, including those goods which require some preparatory service, occurs at the manufacturing level.

<sup>100</sup>See Speidel, *Warranty Theory*, *supra* note 19, in which Prof. Speidel states that the relationship between all of the parties in the chain of distribution is sufficient under modern contract theory to support the buyer's action against the remote manufacturer despite the absence of traditional privity. Cf. *Carlill v. Carbolic Smoke Ball Co.*, [1893] 1 Q.B. 256, the famous case in which a manufacturer was held liable on a promise in newspaper advertising to pay 100 pounds to anyone who contracted a cold or influenza after using the carbolic smoke ball. The offer was made to the general public and did not require notice of acceptance to the offeror.

same time, the wholesale distributor and the retailer expect that the manufacturer has sold them merchantable goods, and that no one will have cause to complain.

The buyer's expectations are that the goods will be fit for their ordinary purposes and that if they are not, the manufacturer whose advertising was seen or whose brand is on the goods will stand behind them. There is nothing inconsistent with the expectations of any of the parties if the responsibility for unmerchantable goods is placed precisely where it belongs, on the manufacturer. Moreover, the basic expectations of the parties are precisely the same in the absence of advertising or knowledge of the identity of the manufacturer at the time of the sale. All parties in the chain expect that the goods will be suitable for their ordinary purposes.

The policy which supports elimination of a privity requirement in implied warranty actions is quite straightforward. The party who can best assure that the goods are merchantable is the manufacturer, particularly when the distributor and retail dealer who stand between the manufacturer and the buyer in the chain of distribution do nothing more than pass the goods on to the buyer unchanged, frequently in a sealed package. If the goods are unmerchantable, the manufacturer is not only the party ordinarily responsible for the problem but is also the party most able to prevent or correct it.

Furthermore, under Code procedures, if the implied warranty of merchantability has been breached and the buyer sues her immediate seller, the likelihood is that responsibility will ultimately fall on the manufacturer, a fact also within its expectation. If the buyer sues the retail dealer for breach of warranty, the dealer may move up the vertical chain of distribution by using local third-party practice or by "vouching in" his immediate seller (the distributor) pursuant to the U.C.C., and so on up the line, until the manufacturer is vouched in.<sup>101</sup> Should vouched-in parties not come in and defend, and the court finds that the goods, as manufactured, were unmerchantable, that finding of fact will be binding in later litigation with the vouched-in parties who refused to appear.<sup>102</sup> Third-party practice or vouching-in, however, is "expensive,

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<sup>101</sup>See U.C.C. § 2-607(5):

Where the buyer [here, the retailer] is sued for breach of a warranty or other obligation for which his seller is answerable over

(a) he may give his seller [here, the distributor or manufacturer] written notice of the litigation. If the notice states that the seller may come in and defend and that if the seller does not do so he will be bound in any action against him by his buyer by any determination of fact common to the two litigations, then unless the seller after reasonable receipt of the notice does come in and defend he is so bound.

<sup>102</sup>*Id.*

time consuming, and wasteful."<sup>103</sup> It promotes multiplicity of actions and wastes valuable judicial resources.<sup>104</sup>

It may be argued that the availability of this vouching-in procedure prevents the privity requirement from causing any real harm to buyers who can always sue their immediate sellers, except in the few cases where the seller is judgment-proof or out of business.<sup>105</sup> Unfortunately for the buyers in *Candlelight Homes*,<sup>106</sup> theirs was one of the cases in which the dealer was out of business so they recovered nothing. The unavailability of the immediate seller is not all that rare.<sup>107</sup>

The result of barring a direct suit against the manufacturer is that the manufacturer of unmerchantable goods who is fortunate enough to have his goods sold by an economically shaky, irresponsible or judgment-proof entity somewhere in the chain of distribution between him and the retail buyer will enjoy the windfall of no liability if he hides behind the wall of privity.<sup>108</sup> A clearer case of unjust enrichment is difficult to imagine.<sup>109</sup> Also, if the manufacturer is not a party to the suit and cannot be joined involuntarily or vouched in because of the absence of

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<sup>103</sup>Prosser, *The Assault*, *supra* note 5, at 1131-33.

<sup>104</sup>*See, e.g.,* *Morrow v. New Moon Homes, Inc.*, 548 P.2d 279 (Alaska 1976); R. NORDSTROM, *supra* note 97, § 91.

<sup>105</sup>*See* Szajna v. General Motors Corp., 115 Ill. 2d 294, 301, 503 N.E.2d 760, 765 (1986) (in which the court observed that an automobile dealer is usually a responsible commercial entity and that the unavailability of the dealer occurs "infrequently"); R. NORDSTROM, *supra* note 97, § 91.

<sup>106</sup>414 N.E.2d 980 (Ind. Ct. App. 1981). *See supra* notes 2, 57-59 and accompanying text.

<sup>107</sup>*See, e.g.,* *Ford Motor Credit Co. v. Harper*, 671 F.2d 1117 (8th Cir. 1982) (tractor seller out of business); *Morrow v. New Moon Homes, Inc.*, 548 P.2d 279 (Alaska 1976) (mobile home seller out of business); *Durfee v. Rod Baxter Imports, Inc.*, 262 N.W.2d 349 (Minn. 1977) (auto dealer out of business). In 1984 and 1985, respectively, 13,787 and 13,418 (preliminary figure) retail businesses failed; 4,882 and 4,813 (preliminary figure) wholesale businesses failed. U.S. Bureau of the Census, *Statistical Abstract of the United States: 1987*, Table No. 866, p.510 (1986).

During the preparation of this article, one of the author's students came to him with the following problem which she was requested to research by the Indianapolis law firm for which she was working: the buyer of a truck seat was seriously injured in an accident, partly, he claimed, because the seat was defective. Because the statute of limitations for strict products liability or negligence had expired, he sued the retailer (represented by the student's law firm employer) for breach of implied warranty of merchantability. Unfortunately for the retailer, with whom the injured buyer was in privity, the wholesaler from whom the retailer purchased the seat is out of business. Under current Indiana law, because there is no privity between either the buyer or the retailer and the manufacturer, the retailer may be required to bear the personal injury damages which should be the responsibility of the manufacturer if the seat in fact was defective.

<sup>108</sup>*See* *Industrial Graphics, Inc. v. Asahi Corp.*, 485 F. Supp. 793 (D. Minn. 1980); Speidel, *Warranty Theory*, *supra* note 19, at 47.

<sup>109</sup>*See* Speidel, *Warranty Theory*, *supra* note 19, at 46.

privity with the retailer, it is unfair to impose on the retailer the cost of first litigating as a defendant with the buyer and then as a plaintiff with the distributor a claim which ultimately will be the responsibility of the manufacturer. If there is no break in the chain of distribution, the retailer may be able to recover most of his losses from the party immediately above the retailer in the chain, but the cost to him in terms of both time and money, particularly if he must pay an award for personal injuries or property damage, may be an unreasonable or impossible burden for the retailer to bear, even if only temporarily. And, if there is a break in the chain immediately above him, the retailer must bear the entire cost.<sup>110</sup>

In a case strikingly similar to *Candlelight Homes*, the Arizona Supreme Court imposed the privity barrier between the buyers of a woefully defective mobile home and its manufacturer, and stated rather cavalierly the philosophy underlying the vertical privity requirement in implied warranty cases: "In short, we believe that a buyer should *pick his seller with care* and recover any economic loss from that seller . . . ."<sup>111</sup> The court surely could not have meant that any buyer of a mobile home, an automobile, or other equipment of major cost should first obtain a favorable, current credit report on her seller before completing the purchase in order to be protected, or did it? It seems so. It requires little imagination to realize the impossibility of this task for the buyer of a family mobile home or of an office copying machine. The blunderbuss of *caveat emptor*, one of the weapons which the implied warranty of merchantability was designed to neutralize with respect to product quality, fires anew from the tower of vertical privity. In a business climate replete with the failure of retail businesses,<sup>112</sup> the burden of unmerchantability should be placed where it belongs, on the manufacturer, not on the buyer who unknowingly selected a failing retailer or on the retailer who dealt with an insolvent distributor. What buyer, for example, could have foreseen the demise of retailing giant W.T. Grant? Yet the courts requiring privity demand such foresight. The better policy was expressed in the context of a buyer's attempt to revoke acceptance<sup>113</sup> against a remote importer-distributor of a defective automobile: "A

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<sup>110</sup>See *supra* note 107.

<sup>111</sup>*Flory v. Silvercrest Indus., Inc.*, 129 Ariz. 574, 580, 633 P.2d 383, 389 (1981) (emphasis added); *accord* *Hole v. General Motors Corp.*, 83 A.D.2d 715, 716, 442 N.Y.S.2d 638, 640 (1981); *State ex rel. Western Seed Prod. Corp. v. Campbell*, 250 Or. 262, 267, 442 P.2d 215, 217 (1968), *cert. denied*, 393 U.S. 1093 (1969); *WHITE & SUMMERS, supra* note 8, § 11-6, at 410; *see* *James Sausage Co. v. Novalco, Inc.*, 17 U.C.C. Rep. Serv. (Callaghan) 1027, 1034 (Okla. Ct. App. 1975).

<sup>112</sup>See statistics cited *supra* note 107.

<sup>113</sup>See U.C.C. § 2-608.

consumer cannot be expected to foresee the demise of local dealerships; instead he is entitled to rely on the distributor who induced him to buy the automobile."<sup>114</sup>

In many jurisdictions, the success of the assault on privity depends to a large extent on the type of injury for which particular damages are being sought: personal injury, direct property damage caused by the unmerchantable goods, loss of bargain from the failure of the goods themselves, or consequential economic loss, such as loss of profits.<sup>115</sup> As a matter of fairness and practicality, the type of damages sought should be no impediment to the success of the assault.

Today, most actions involving personal injury or property damage in Indiana are based on the Product Liability Act,<sup>116</sup> which imposes strict liability upon all sellers of defective products that cause personal injury or property damage regardless of a lack of vertical or horizontal privity.<sup>117</sup> The Product Liability Act does not supersede the Code, however, so actions for personal injuries resulting from a breach of any Code warranty are still available.<sup>118</sup>

As one Indiana judge has observed: "The modern trend is to reject the privity requirement" in all cases involving personal injury because privity is of " 'no consequence' " in such cases.<sup>119</sup> It appears that the

<sup>114</sup>Durfee v. Rod Baxter Imports, Inc., 262 N.W.2d 349, 358 (Minn. 1977).

<sup>115</sup>See WHITE & SUMMERS, *supra* note 8, § 11-2.

<sup>116</sup>IND. CODE § 33-1-1.5 (1982 and Supp. 1987); see WHITE & SUMMERS, *supra* note 8, § 11-3.

<sup>117</sup>See IND. CODE § 33-1-1.5-3 (Supp. 1987):

(a) One who sells, leases or otherwise puts into the stream of commerce any product in a defective condition unreasonably dangerous to any user or consumer or to his property is subject to liability for physical harm caused by that product to the user or consumer or to his property if that user or consumer is in the class of persons that the seller should reasonably foresee as being subject to the harm caused by the defective condition, and, if:

- (1) the seller is engaged in the business of selling such a product; and
- (2) the product is expected to and does reach the user or consumer without substantial alteration in the condition in which it is sold by the person sought to be held liable under this chapter.

(b) The rule stated in subsection (a) applies although:

- (1) the seller has exercised all reasonable care in the preparation, packaging, labeling, instructing for use, and sale of this product; and
- (2) *the user or consumer has not bought the product from or entered into any contractual relation with the seller.*

(Emphasis added.)

See Citizens Gas & Coke Utility v. American Economy Ins. Co., 486 N.E.2d 998 (Ind. 1985); Whittaker v. Federal Cartridge Corp., 466 N.E.2d 480 (Ind. Ct. App. 1984).

<sup>118</sup>See IND. CODE § 33-1-1.5-1 (Supp. 1987); Thiele v. Faygo Beverage, Inc., 489 N.E.2d 562 (Ind. Ct. App. 1986).

<sup>119</sup>Lane v. Barringer, 407 N.E.2d 1173, 1178 (Ind. Ct. App. 1980) (Ratliff, J.,

“modern trend” has in fact become the majority position. In most jurisdictions vertical privity between an injured party and a remote manufacturer need not be shown in a suit for personal injuries or property damage caused by a breach of the implied warranty of merchantability.<sup>120</sup>

That a plaintiff, such as Mrs. Lane in *Lane v. Barringer*,<sup>121</sup> has four years to bring a U.C.C. warranty action<sup>122</sup> rather than two years for a products liability or negligence action<sup>123</sup> does nothing to upset the expectations of the manufacturer. In implied warranty cases, the time begins to run on delivery of the goods to the buyer, whether the defect is or is not discoverable.<sup>124</sup> In negligence or products liability cases, the limitation period begins to run from the time of the injury.<sup>125</sup> And under the Product Liability Act, suit may be brought against a manufacturer up to ten years after delivery of his product to the initial user, usually the retail buyer.<sup>126</sup> Thus, it is possible for the four year statute of limitations under the Code to expire before the occurrence of any personal injury or property damage, in which case an action to recover for that injury or damage will be barred. Yet there may still be an action for negligence or under the Product Liability Act for an additional six years. A manufacturer knows that under Indiana law, he is exposed to the possibility of liability for approximately ten years after he produces and

concurring in part, dissenting in part) (quoting *Berry v. G.D. Searle & Co.*, 56 Ill. 2d 548, 558, 309 N.E.2d 550, 556 (1974)). Judge Ratliff concurred in the judgment against the plaintiff only because she was not within the protection of U.C.C. § 2-318 in the horizontal line. See *supra* notes 50-56 and accompanying text. *Lane* is an unusual case because the plaintiff had allowed the two year statute of limitations for tort actions, including strict products liability, to expire. The only remedy still available for the personal injury she suffered was under the U.C.C. for breach of implied warranty of merchantability which, according to two judges of the court of appeals, required vertical privity.

<sup>120</sup>See, e.g., *Berry v. G.D. Searle & Co.*, 56 Ill. 2d 548, 309 N.E.2d 550 (1974); 2 FRUMER & FRIEDMAN, *supra* note 22, §§ 3.02[6] at 3-194, 3.02[7][a] at 3-216 to 3-217; 2 R. HURSH & H. BAILEY, *supra* note 93, § 10.6, at 344; G. WALLACH, *supra* note 93, ¶ 11.15[1][a].

<sup>121</sup>407 N.E.2d 1173 (Ind. Ct. App. 1980).

<sup>122</sup>See U.C.C. § 2-725(1).

<sup>123</sup>The limitation on a products liability action is two years from the date of the injury, but no action may be brought more than ten years “after the delivery of the product to the initial user or consumer.” Product Liability Act, IND. CODE § 33-1-1.5-5 (Supp. 1987). The limitation on ordinary negligence actions involving personal injury or property damage is two years. IND. CODE § 34-1-2-2(1) (1982).

<sup>124</sup>See U.C.C. § 2-725(2); *Stumler v. Ferry-Morse Seed Co.*, 644 F.2d 667 (7th Cir. 1981). An exception is if the warranty expressly extends to future performance, § 2-725(2), but that involves express, not implied, warranties. See H. GREENBERG, *supra* note 26, § 14.34.

<sup>125</sup>See *Dague v. Piper Aircraft Corp.*, 275 Ind. 520, 418 N.E.2d 207 (1981); *Wojcik v. Almase*, 451 N.E.2d 336 (Ind. Ct. App. 1983).

<sup>126</sup>See IND. CODE § 33-1-1.5-5 (Supp. 1987); see also *supra* note 123.

distributes his goods. Allowing recovery from a remote manufacturer for breach of a Code warranty therefore does nothing whatever to change that expectation of possible exposure.

The cases are more evenly divided when the damages sought are economic in nature.<sup>127</sup> Such damages may be of two distinct types. The first type, direct damages or loss of bargain damages, results from the effect of the unmerchantability of the goods on the value of the goods themselves. The buyer simply did not get what he bargained for. The second, consequential damages such as loss of profits, results from the buyer's inability to use the goods as expected.<sup>128</sup> Although the majority of courts apparently do not yet permit buyers to recover either type of economic damages from remote manufacturers without privity,<sup>129</sup> the number of jurisdictions allowing such damages in non-privity situations is increasing,<sup>130</sup> and the majority of writers on the subject consider privity to be an illogical, antiquated requirement which should be eliminated as a requirement in all warranty cases regardless of the type of damages sought.<sup>131</sup>

If the goods are not worth what the buyer paid because of a nonconformity attributable to the manufacturer, there is no reason why, privity or no privity, that the manufacturer should be insulated from responsibility for that economic damage to the buyer. That responsibility

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<sup>127</sup>See G. WALLACH, *supra* note 93, ¶ 11.15[1][a].

<sup>128</sup>See *Morrow v. New Moon Homes, Inc.*, 548 P.2d 279 (Alaska 1976); WHITE & SUMMERS, *supra* note 8, § 11-5. One writer calls these "repair loss"—the cost of repair or replacement when the product self-destructs without harming anything else—and "expectation loss"—the loss of use of the product. Franklin, *When Worlds Collide: Liability Theories and Disclaimers in Defective-Product Cases*, 18 STAN. L. REV. 974, 981 (1966).

<sup>129</sup>See WHITE & SUMMERS, *supra* note 8, at §§ 11-5, 11-6.

<sup>130</sup>See, e.g., *Morrow v. New Moon Homes, Inc.*, 548 P.2d 279 (Alaska 1976); *Spring Motors Distribs., Inc. v. Ford Motor Co.*, 98 N.J. 555, 489 A.2d 660 (1985); Comment, *Rights of Remote Sellers*, *supra* note 29, at 881. In their first edition, White & Summers characterized the courts awarding economic damages as "a healthy minority." J. WHITE & J. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* § 11-5 (1972).

<sup>131</sup>See, e.g., WILLISTON ON SALES, *supra* note 10, § 22-5, at 167-68; Edmeades, *supra* note 12; Rabin & Grossman, *supra* note 87; Razook, *The Ultimate Purchaser's and Remote Seller's Guide through the Code Defenses in Product Economic Loss Cases*, 23 AM. BUS. L.J. 84 (1985); Schwartz, *Economic Loss in American Tort Law: The Examples of J'Aire and of Products Liability*, 23 SAN DIEGO L. REV. 37 (1986); Speidel, *Warranty Theory*, *supra* note 19 at 24-25; *but see*, e.g., WHITE & SUMMERS, *supra* note 8, at §§ 11-5, 11-6; Prosser, *The Assault*, *supra* note 5, at 1124-34. One writer has suggested that during Dean Prosser's service in the assault on the citadel of privity, he "was a secret agent serving its defenders," and "completed his undercover mission for the defenders of the citadel by openly advocating that there should be no liability to the out-of-privity plaintiff for products which only caused him economic loss." Edmeades, *supra*, at 648-49.

is certainly within his expectations.<sup>132</sup> The buyer expects merchantable goods; the manufacturer expects his goods to be merchantable. As stated by the Michigan Court of Appeals:

On principle the manufacturer should be required to stand behind his defectively-manufactured product and held to be accountable to the end user even though the product caused neither accident nor personal injury. The remote seller should not be insulated from direct liability where he has merely mulcted the consumer.<sup>133</sup>

Nor will the remote manufacturer be liable for more than he should be; the provisions of the Code protect him. For example, it has been suggested that the manufacturer should not be responsible to the buyer for the difference between the retail price paid by the buyer and the actual value of the unmerchantable goods,<sup>134</sup> apparently because the manufacturer received less than the retail price from the retailer or wholesaler who purchased the goods from him.<sup>135</sup> But that is exactly the amount for which the manufacturer ultimately should be and will be liable if there is no break in the chain of distribution.<sup>136</sup>

For example, assume that the wholesale price paid by Retailer to Manufacturer is \$50 and the retail price paid by Buyer is \$100. If the goods are completely worthless because of their nonconformity, Buyer's loss of bargain damage is \$100. If Buyer sues Retailer, Buyer will recover \$100. If Retailer impleads or vouches in Manufacturer<sup>137</sup> or brings a separate suit against Manufacturer, Retailer's damages are \$100, which consist of the \$50 he paid to Manufacturer for the worthless goods plus the consequential damage of \$50 in profit he lost because of that worthlessness.<sup>138</sup>

Similarly, if a remote seller sells used goods to the retailer who then sells them as new to the buyer for considerably more money than he would have charged for used goods,<sup>139</sup> the remote seller should not suffer

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<sup>132</sup>See *supra* text accompanying notes 94-100.

<sup>133</sup>*Cova v. Harley Davidson Motor Co.*, 26 Mich. App. 602, 609, 182 N.W.2d 800, 804 (1970); see Speidel, *Warranty Theory*, *supra* note 19, at 46.

<sup>134</sup>The Code's measure of damages for breach of warranty is "the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted." U.C.C. § 2-714(2). The buyer may also recover incidental and consequential damages. U.C.C. § 2-714(3). Presumably, the retail price will be the value of the goods if they had been as warranted, *i.e.*, merchantable.

<sup>135</sup>WHITE & SUMMERS, *supra* note 8, § 11-5, at 409.

<sup>136</sup>See Ribstein, *Guidelines for Deciding Product Economic Loss Cases*, 29 MERCER L. REV. 493, 521-22 (1978).

<sup>137</sup>See *supra* notes 101-102 and accompanying text.

<sup>138</sup>See U.C.C. §§ 2-714, 2-715(2)(a).

<sup>139</sup>See WHITE & SUMMERS, *supra* note 8, § 11-5, at 409, where they pose this problem as another justification for not awarding loss of bargain damages in the absence of privity.

because of the retailer's misrepresentation or fraud. For the purposes of calculating damages under section 2-714, the value of the goods as warranted should be based on whose implied warranty of merchantability is being enforced. If it is the implied warranty of the remote seller, the "as warranted" value used in the calculation should be of merchantable, *used* goods as impliedly warranted by the remote seller, not the value of new goods as either expressly or impliedly warranted by the misrepresentation of the retailer. The misrepresentation should not be imputed to the remote seller without more facts that connect him to the retailer, such as actual or apparent authority.

Furthermore, allowing buyers to recover loss of bargain damages will not subject the manufacturer to unreasonably large or unpredictable damages. The upper limit on the manufacturer's exposure for this type of damage is the retail value of the goods, a figure well within the manufacturer's contemplation. A manufacturer who markets a product which is not fit for its ordinary uses should be responsible to every buyer who purchased one. Anything less would be unfair to the buyers and a windfall to the manufacturer.

The argument against allowing recovery of consequential economic damages, such as lost profits, from a remote manufacturer is that "[r]emote buyers may use a seller's goods for unknown purposes from which enormous losses might ensue."<sup>140</sup> This sounds remarkably similar to the argument made in *Winterbottom*<sup>141</sup> where the privity barrier was first constructed more than a century ago. But section 2-715 of the Code allows only the recovery of consequential economic damages "resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise. . . ."<sup>142</sup> This gives the manufacturer or other remote seller two important protections that cannot be ignored. First, the buyer's damages must be foreseeable.<sup>143</sup> A buyer's unknown or unpredictable requirements or needs can result only in damages that are not foreseeable. The warranty of merchantability extends only to ordinary purposes which, by definition, are known to the manufacturer.<sup>144</sup>

Second, the requirement that the buyer attempt to mitigate her damages "by cover or otherwise" or be precluded from recovering

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<sup>140</sup>WHITE & SUMMERS, *supra* note 8, § 11-6, at 410.

<sup>141</sup>*Winterbottom v. Wright*, 152 Eng. Rep. 402 (1842); *see supra* text accompanying notes 19-21.

<sup>142</sup>U.C.C. § 2-715(2)(a) (emphasis added).

<sup>143</sup>*See* H. GREENBERG, *supra* note 26, § 24.15; WHITE & SUMMERS, *supra* note 8, § 10-4.

<sup>144</sup>*See* Speidel, *Warranty Theory*, *supra* note 19, at 50.

consequential damages<sup>145</sup> limits the ultimate liability of the remote manufacturer. For example, a manufacturer of a seed planting machine expects that it will plant seeds. If the machine does not plant properly,<sup>146</sup> the manufacturer should reasonably foresee that the farmer-buyer who uses the defective planter may lose part or all of his crop for that season. However, if, before the end of planting time, the farmer realizes that the planter is not operating properly, the farmer's failure to mitigate his damages by borrowing, renting, or buying another planting machine may preclude him from recovering his consequential damages from any defendant,<sup>147</sup> including the retailer with whom he is in privity.

The Indiana Supreme Court squarely addressed the issue of consequential economic damages in *Barnes v. Mac Brown & Co.*,<sup>148</sup> where it stated, in the context of the implied warranty of habitability:

The contention that a distinction should be drawn between mere "economic loss" and personal injury is without merit. Why there should be a difference between an economic loss resulting from injury to property and an economic loss resulting from personal injury has not been revealed to us. When one person is personally injured from a defect, he recovers mainly for his economic loss. Similarly, if a wife loses a husband because of injury resulting from a defect in construction, the measure of damages is totally economic loss. We fail to see any rational reason for such a distinction.<sup>149</sup>

Having made this observation, the court held that the second purchaser of a dwelling could recover for breach of the implied warranty of habitability the cost of repairing and waterproofing the cracked walls of a damp basement despite the lack of privity with the builder-defendant. The comment by the same court nine years later, "We see no reason to extend the exception to the privity rule any further in this case or others not involving personal injury,"<sup>150</sup> contradicted the reasoning in

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<sup>145</sup>See U.C.C. § 2-715(2)(a) and Official Comment 2.

<sup>146</sup>See *Dutton v. International Harvester Co.*, 504 N.E.2d 313 (Ind. Ct. App.), *transfer denied* (1987).

<sup>147</sup>See U.C.C. § 2-715(2)(a); WHITE & SUMMERS, *supra* note 8, § 10-4, at 395-96; *The Citadel Stands*, *supra* note 12, at 678-80. Professor Edmeades suggests that courts are often stingy in awarding consequential damages because of their inherently speculative nature. See *id.*

<sup>148</sup>264 Ind. 227, 342 N.E.2d 619 (1976). See *supra* notes 65-69 and accompanying text.

<sup>149</sup>*Id.* at 230, 342 N.E.2d at 621.

<sup>150</sup>*Citizens Gas & Coke Utility v. American Economy Ins. Co.*, 486 N.E.2d 998, 1001 (Ind. 1985).

*Barnes* and was both short-sighted and substantially broader than required in the case before the court.<sup>151</sup>

If the theoretical basis for continuing the privity requirement in all warranty cases is to protect remote manufacturers from unpredictable or catastrophic damage awards, as it purports to be, then no recovery whether for personal injury or economic loss, in warranty or strict liability, should be recoverable, and *Winterbottom*<sup>152</sup> should again reign supreme. Abolishing the privity requirement only in personal injury or property damage cases, as has occurred in most states,<sup>153</sup> also conflicts with this theoretical basis for the privity defense. The exposure of a manufacturer to liability for personal injury or direct property damage can be far more unpredictable and far more devastating than exposure to liability for economic loss.<sup>154</sup> If the defective seed planting machine,<sup>155</sup> instead of merely not planting the farmer's crop, had thrown and seriously injured or killed him, and then ran wildly through his barn, destroying it and the animals in it, the damages could far exceed what the manufacturer might be required to pay to replace a defective machine or a lost crop.

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<sup>151</sup>*Citizens Gas* involved horizontal, rather than vertical, privity. The plaintiffs were the purchasers of a residence from a prior homeowner who had a gas water heater installed by the gas company and had also executed a waiver of the applicable plumbing code requirements in order to have the heater installed as requested. As a consequence of the code violation, the heater later malfunctioned, flooded the plaintiffs' home, and caused approximately \$12,000 in property damage but no personal injury. The court based its ruling against plaintiffs on the absence of privity with the gas company, but could just as well have decided that the only warranty to which plaintiffs were entitled was the warranty which their predecessor on the horizontal line had received, as limited by the waiver.

See also *Essex v. Ryan*, 446 N.E.2d 368, 372 (Ind. Ct. App. 1983), in which the court grudgingly conceded that *Barnes* was not limited to personal injury but added that personal injury was a significant factor in *Barnes*. In *Sanco v. Ford Motor Co.*, 771 F.2d 1081 (7th Cir. 1985), the court ruled that although the majority in *Barnes* rejected the requirement of privity in warranty cases involving either personal injury or economic loss, Indiana courts would continue to deny recovery of purely economic losses in negligence actions.

<sup>152</sup>152 Eng. Rep. 402 (1842), discussed *supra* notes 19-21 and accompanying text.

<sup>153</sup>See *supra* note 120 and the accompanying text.

<sup>154</sup>See Schwartz, *Economic Loss in American Tort Law: The Examples of J'Aire and of Products Liability*, 23 SAN DIEGO L. REV. 37, 60-61 (1986), in which the writer suggests that in very large economic loss cases, the buyer will usually have dealt directly with the manufacturer rather than with someone lower in the chain of distribution, thereby establishing privity. With the purchase of more ordinary products by consumers, "and even businesses can be consumers in the sense that they buy and use products about which they cannot bargain and have little expertise", the ultimate economic loss will be small but the personal injury loss can be staggering.

<sup>155</sup>See *Dutton v. International Harvester Co.*, 504 N.E.2d 313 (Ind. Ct. App.), *transfer denied* (1987).

Furthermore, if the theoretical basis for eliminating privity as a requirement in personal injury or direct property damage cases is "humanitarian," as it seems to be,<sup>156</sup> the emphasis is misplaced. A farmer's loss of a season's crop,<sup>157</sup> or the inability of a small business to use a truck<sup>158</sup> or a computer system<sup>159</sup> can have far more disastrous consequences to the buyer than a broken arm or leg. Yet for such physical injuries, damages would be available from the manufacturer in a products liability action or in the majority of jurisdictions which permit recovery for personal injuries resulting from breach of a U.C.C. warranty in the absence of privity.<sup>160</sup>

2. *The Implied Warranty of Fitness for Particular Purpose.*—Like the express warranty, the implied warranty of fitness for particular purpose requires some affirmative conduct on the part of the person who makes the warranty: the buyer must have a particular purpose for the goods, usually something other than the ordinary purpose;<sup>161</sup> the seller must have reason to know the buyer's particular purpose; the seller must have reason to know that the buyer is relying on the seller's expertise to furnish goods suitable for that purpose; and the buyer must in fact rely on the seller.<sup>162</sup> If any of these elements is missing, the warranty does not exist. Unlike the implied warranty of merchantability which arises automatically if the seller is a merchant who deals in the kind of goods involved,<sup>163</sup> not every sale by a merchant creates the implied warranty of fitness, nor is it necessary that the warrantor of fitness for particular purpose be a merchant for the warranty to exist.<sup>164</sup>

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<sup>156</sup>See *Citizens Gas & Coke Utility v. American Economy Ins. Co.*, 486 N.E.2d 998, 1001 (Ind. 1985).

<sup>157</sup>See *Dutton*, 504 N.E.2d 313.

<sup>158</sup>See *Sanco v. Ford Motor Co.*, 771 F.2d 1081 (7th Cir. 1985).

<sup>159</sup>See *Ridge Co. v. NCR Corp.*, 597 F. Supp. 1239 (N.D. Ind. 1984).

<sup>160</sup>See *supra* text accompanying notes 119-120.

<sup>161</sup>Whether the particular purpose of the buyer must be different from the ordinary purpose for which the goods are used is a matter of debate. U.C.C. Section 2-315, Official Comment 2, suggests that the implied warranty of fitness for particular purpose relates to uses peculiar to the buyer and the implied warranty of merchantability relates to the ordinary uses of the goods. See, e.g., H. GREENBERG, *supra* note 26, § 14.21; WHITE & SUMMERS, *supra* note 8, § 9-9 n.21; Lord, *Some Thoughts about Warranty Law: Express and Implied Warranties*, 56 N.D.L. REV. 509, 608-15 (1980).

<sup>162</sup>See U.C.C. § 2-315:

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

<sup>163</sup>See U.C.C. § 2-314(1).

<sup>164</sup>See U.C.C. § 2-315, Official Comment 4.

A case in which a manufacturer makes an implied warranty of fitness for particular purpose without there being some connection between the warranting manufacturer and the retail buyer is exceedingly rare.<sup>165</sup> In the usual situation which gives rise to the existence of this warranty, the manufacturer and the buyer will have communicated with each other with respect to the buyer's particular needs. This being so, the manufacturer will have "participated in the sale," thereby establishing privity or an exception to it.<sup>166</sup>

There arguably might not be a direct connection between the manufacturer and the buyer when the buyer states his needs to a dealer who, in turn, relates those needs to the manufacturer and relies on the manufacturer to furnish goods which will meet the buyer's particular needs. In such a situation, however, there is still likely to be an exception to the privity requirement on one of two bases: (1) in relating the particular needs to the manufacturer, and only for that purpose, whether the dealer discloses the identity of the buyer or not, the dealer is acting as the agent of the buyer;<sup>167</sup> (2) the promise of the manufacturer to furnish goods which meet the particular needs of a particular buyer, as related to him by the dealer, is a third-party beneficiary contract in which the buyer is the intended beneficiary.<sup>168</sup> In either case, the principles of agency law or third party beneficiary contract law should furnish the necessary privity or surmount its barrier.

As with the giving of an express warranty, unless the dealer has the actual or apparent authority to make warranties on behalf of the manufacturer, any implied warranty of fitness made by the dealer should

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<sup>165</sup>See Rabin & Grossman, *supra* note 87, at 37-38; Comment, *Rights of Remote Sellers*, *supra* note 29, at 897-898.

<sup>166</sup>See *Richards v. Goerg Boat & Motors, Inc.*, 179 Ind. App. 102, 384 N.E.2d 1084, *transfer denied* (1979), and the discussion, *supra*, at note 78 and accompanying text.

<sup>167</sup>See *Pawlec v. Digiticom, Inc.*, 192 N.J. Super. 474, 477 n.1, 471 A.2d 60, 62 n.1 (1984).

<sup>168</sup>*But see Hixon v. Sherwin-Williams Co.*, 671 F.2d 1005 (7th Cir. 1982). The court said that to hold that an insurance company which hired a contractor to replace an insured's damaged linoleum floor was the third-party beneficiary of a contract between the contractor and a subcontractor who failed to follow instructions on use of the glue was "a transparent effort to evade the privity requirement; if it prevailed, the requirement would be meaningless." *Id.* at 1010. *Cf. Davidson v. John Deere & Co.*, 644 F. Supp. 707 (N.D. Ind. 1986), which involved an express warranty claim by a personal representative whose decedent was killed while using equipment purchased by his employer. The court observed that because Indiana has adopted U.C.C. § 2-318, Alternative A, no one other than the persons enumerated therein can be a third party beneficiary of the contract between the seller and the buyer. Although this case dealt only with horizontal privity, a court could conceivably take the same position with respect to vertical privity despite the position of the drafters that the section is neutral on the issue. U.C.C. § 2-318, Official Comment 3. See *supra*, notes 30-32 and accompanying text.

not be attributable to or the responsibility of the manufacturer. The absence of the required element of the manufacturer's reason to know the buyer's particular purpose, whatever the basis for that lack of reason to know, is fatal to the existence of such a warranty from the manufacturer.

It follows, therefore, that if the buyer is able to show that there is an implied warranty of fitness for particular purpose and that the warranty was made by the manufacturer, it will be almost impossible for the manufacturer to show that there was no privity with the buyer or an exception thereto. And once the warranty and its breach have been established, the buyer-plaintiff is entitled to the full range of remedies granted by the Code.

One difficulty that may arise is that the Indiana courts, both federal and state, seem to lump the implied warranty of fitness with the implied warranty of merchantability under the label "implied warranties," without distinguishing between them or considering their specific elements. In *Richards v. Goerg Boat & Motors, Inc.*,<sup>169</sup> the court flatly stated, without considering how the two warranties differ, "[I]mplied warranties of merchantability and fitness for a particular use, as they relate to economic loss from the bargain, cannot ordinarily be sustained between the buyer and a remote manufacturer."<sup>170</sup> In another case, the court concluded that "the particular purpose of a passenger automobile is to drive on the public streets and highways safely without uncontrolled and unsafe behavior," and that the implied warranty of fitness had been breached.<sup>171</sup> And in *Candlelight Homes*, the court noted that the amended complaint referred only to the "implied warranty of fitness,"<sup>172</sup> but the court treated the case as if it involved the implied warranty of merchantability.<sup>173</sup>

The analysis of these courts is incorrect. As demonstrated above, if the facts show that there is an implied warranty of fitness attributable to the manufacturer, no matter how far up the chain of distribution, there is a connection between the manufacturer and the buyer that should

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<sup>169</sup>179 Ind. App. 102, 384 N.E.2d 1084 *transfer denied* (1979).

<sup>170</sup>179 Ind. App. at 112, 384 N.E.2d at 1092; *accord* Dutton v. International Harvester Co., 504 N.E.2d 313, 315 (Ind. Ct. App.) *transfer denied* (1987).

<sup>171</sup>*Karczewski v. Ford Motor Co.*, 382 F. Supp. 1346, 1351 (N.D. Ind. 1974), *aff'd mem.*, 515 F.2d 511 (7th Cir. 1975). The federal court incorrectly concluded, without *Lane v. Barringer* or *Candlelight Homes* yet decided, that Indiana state courts would not require privity in an action for personal injuries resulting from a breach of warranty under the Uniform Commercial Code.

<sup>172</sup>414 N.E.2d at 981.

<sup>173</sup>The facts stated in the opinion do not support the existence of the fitness warranty, much less its breach. Thus, the result reached by the Indiana Court of Appeals, judgment in favor of the manufacturer, was probably correct but the court's analysis was flawed.

support a finding of privity or an exception to the privity requirement.

If the Indiana courts distinguish between the implied warranties of merchantability and of fitness for particular purpose, as they should, then a careful analysis of the facts in future cases would eliminate privity as a barrier in actions for breach of the implied warranty of fitness for particular purpose. Thus, the principal task of a damaged buyer will be to prove the existence of the warranty and its breach.

3. *Protection for the Manufacturer or Other Remote Seller.*—Contrary to the arguments of the defenders of the privity citadel, permitting a buyer to recover from a remote manufacturer or other remote seller does not convert that seller into an insurer. As discussed earlier, even if the remote manufacturer does nothing more than market his goods, he will not be liable for any damages peculiar to a particular buyer unless the seller knows or has reason to know of the buyer's needs. To be recoverable, the damages must be reasonably foreseeable.<sup>174</sup> If the buyer misuses the goods or puts them to some extraordinary or unusual use, the seller should not be liable for any of the resulting damages.<sup>175</sup> Furthermore, if the buyer could have avoided the claimed consequential damages by mitigating her losses but failed to do so, the consequential damages will not be recoverable.<sup>176</sup>

The Code also furnishes other protections to the seller, some of which the seller must affirmatively invoke, others of which are built into any Code transaction. The most important of these from the viewpoint of a seller or manufacturer is the ability to modify or disclaim warranties and to limit liability for damages.<sup>177</sup> The manufacturer of new goods does not usually attempt to disclaim all warranties, although he may do so. A disclaimer of all warranties, express and implied, which must clearly be brought to the attention of the buyer in order to be effective,<sup>178</sup> will likely have a chilling effect on the buyer's desire to buy the product, a result that no manufacturer wants. More typically, the manufacturer will give the buyer an express warranty that the goods shall be free of defects for a specific period of time, will disclaim all other warranties, express and implied, will limit the buyer's remedies in case of defect to repair or replacement of defective parts exclusively, and will disclaim liability for any consequential damages, all of which the Code expressly permits.<sup>179</sup> By doing so, and if the manufacturer

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<sup>174</sup>See U.C.C. § 2-715(2). See also *supra* notes 140-154 and accompanying text.

<sup>175</sup>See H. GREENBERG, *supra* note 26, § 14.29.

<sup>176</sup>See U.C.C. § 2-715(2)(a). See also *supra* text accompanying notes 141-47.

<sup>177</sup>See U.C.C. § 2-316 (exclusion or modification of warranties); § 2-719 (contractual modification or limitation of remedy).

<sup>178</sup>See U.C.C. § 2-316 and the Official Comments thereto.

<sup>179</sup>See U.C.C. §§ 2-316(2), 2-316(3), 2-719.

fulfills his promises, the expectations of all parties in the chain of distribution are fulfilled: the manufacturer gets his price; the intermediaries in the chain make their profit; the buyer gets goods that are defect free or at least an adequate remedy for any defect in the goods.<sup>180</sup> Only if the limitation of remedy fails of its essential purpose, meaning that it deprives the buyer of the benefit of his bargain, or is unconscionable, will the manufacturer be exposed to liability for all of the buyer's damages, possibly including consequential damages.<sup>181</sup>

If the buyer inspects the goods before entering into the contract of sale or refuses to do so on the seller's demand, there is no implied warranty with respect to defects which her inspection should have revealed to her.<sup>182</sup> Should the buyer fail to give notice of breach within a reasonable time after learning of it, she will be barred from any remedy whatever.<sup>183</sup> This is different from the running of the statute of limitations, discussed earlier,<sup>184</sup> in that the expiration of a reasonable time following breach can be much shorter than the four-year limitation. Moreover, the buyer-plaintiff must always sustain the burden of proof imposed upon any party claiming a breach of warranty: she must prove that the warranty was given by the particular defendant, that it was breached, and that the breach caused the damages claimed. The buyer's inability to prove any one of these elements will absolve the remote seller of any liability.

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<sup>180</sup>See U.C.C. § 2-719.

<sup>181</sup>See U.C.C. § 2-719(2), (3). Whether failure of essential purpose under § 2-719(2), thereby entitling a buyer to the full panoply of remedies given by the Code, also negates an otherwise valid disclaimer of liability for consequential damages is an issue on which the courts and the commentators are divided. The better view appears to be that if the limitation fails of its essential purpose, *all* damages become available to the buyer, including consequential damages. *Compare, e.g.,* Matco Mach. & Tool Co. v. Cincinnati Milacron Co., 727 F.2d 777 (8th Cir. 1984); Fargo Mach. & Tool Co. v. Kearney & Trecker Corp., 428 F. Supp. 364 (E.D. Mich. S.D. 1977); Durfee v. Rod Baxter Imports, Inc., 262 N.W.2d 349 (Minn. 1977) (consequentials may be recovered) *with* Chatlos Sys., Inc. v. National Cash Register Corp., 635 F.2d 1081 (3d Cir. 1980), *cert. dismissed*, 457 U.S. 1112 (1981); S.M. Wilson & Co. v. Smith Int'l, Inc., 587 F.2d 1363 (9th Cir. 1978); Stutts v. Green Ford, Inc., 47 N.C. App. 503, 267 S.E.2d 919 (1980) (consequentials may not be recovered). See H. GREENBERG, *supra* note 26, § 15.23; WHITE & SUMMERS, *supra* note 8, § 12-10, at 469-70; Eddy, *On the "Essential" Purposes of Limited Remedies: The Metaphysics of UCC Section 2-719(2)*, 65 Cal. L. Rev. 28, 88-93 (1977); Special Project, *supra* note 9, at 239; Speidel, *Warranty Theory*, *supra* note 19, at 54-55 n.160.

<sup>182</sup>See U.C.C. § 2-316(3)(b). Whether a particular buyer should have discovered defects during an inspection will depend, to a great extent, on that buyer's expertise. An ordinary consumer will not be expected to discover defects which only an expert could detect. See *id.*, Official Comment 8.

<sup>183</sup>See U.C.C. § 2-607(3). What constitutes a reasonable time will be a factual issue dependent upon the identity and knowledge of the buyer as well as the circumstances surrounding the discovery of the breach. See *id.*, Official Comment 4.

<sup>184</sup>See *supra* notes 121-126 and accompanying text.

#### IV. CONCLUSION

Abandoning the court-created requirement of vertical privity in U.C.C. implied warranty cases will fix the responsibility for defective goods precisely where it belongs, on the party who is in fact responsible for that defect and who is best able to prevent it. Contrary to the arguments of those who hide behind privity's moss-encrusted walls, abandoning this archaic defense will neither leave remote parties defenseless nor will it expose them to any risk beyond those to which they are already exposed. Not to abandon privity, given the modern structure of sales transactions, is irrational, illogical, and can result in both hardship for a damaged buyer or intermediary and a windfall to a cowardly seller who insists on hiding in the citadel rather than taking responsibility for his goods. The time has come for Indiana to resume the assault and press on to ultimate demolition of the citadel.