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The Demise of Vertical Privity: Economic Loss and the Uniform Commercial Code

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THE DEMISE OF VERTICAL PRIVITY: ECONOMIC LOSS UNDER THE UNIFORM COMMERCIAL CODE

The citadel of privity has undergone a massive assault in the field of products liability yet still remains a viable force in warranty law. In most cases, the privity requirement is held to be a function of the dangerousness of the product, the type of harm caused and the situs of the chose in action. As a prerequisite to recovery under a contract theory for breach of warranty, courts have required a finding of privity—a direct nexus between vendor and vendee. While the strict application of the doctrine created harsh results, courts made inroads to mitigate its effects and to satisfy judicial notions of justice where conduct was inexcusable and harm intolerable. The results in some instances were unpredictable and inconsistent until they were finally codified judicially into a category of exceptions that either supplied privity directly or obviated the need for its application, although in many instances the route taken was obfuscated. This article will explore the devices employed to evade the privity requirements and will discuss the necessity of extending judicial reasoning to its logical extreme—the elimination of the vertical privity barrier, regardless of the qualitative aspect of the harm caused.

The principle of stare decisis underlies the general reluctance of courts both to undermine previous judicial pronouncements and to implement, through their own power, rules of law consistent with modern views of social and economic justice. The task of legal reform is often left to the responsible judgment of the legislature whose function it is to create and modify law to meet the pressing demands of the times. While there is no doubt that courts share this power as well, history has revealed that courts are hesitant to usurp what they believe to be primarily a legislative function unless the need is imperative. This reluctance could well explain the viability of the nineteenth century rule of privity of contract. One might, however, note a strange inconsistency in that American courts have repeatedly refused to accept and fol-

low many common law doctrines that went unquestioned in England. American courts have attempted to explain away this inconsistency by stating that the common law doctrines did not suit our domestic conditions; that is, place makes a difference. What may work well under one set of conditions may be unsuitable under different conditions. Although privity, a simple rule easy of application probably worked well in days when consumers received their products directly by order, it appears in American jurisprudence as a vestige of a long since changed economic system. Nevertheless, it may be said that the privity requirement has flourished more than necessary during the twentieth century in the area of products liability. Many a plaintiff struck with an overwhelming harm has been nonsuited, forcing him to take action against insolvent defendants while insulating financially responsible manufacturers and distributors who not only could bear the loss, but who are in a better position to realize and allocate the risks flowing from their activities.

The assault upon the citadel of privity in the twentieth century has been waged primarily on a rule-plus or dialectical basis. Some commentators feel that this approach has produced a tolerably satisfactory synthesis, although, idealistically, it remains difficult to accept the notion that justice must await the machinations of time. An astute commentator observes that the courts can always and often do “... ‘save the rule’ by ‘construing’ the facts into a pattern that bears no relation to reality; and the facts brought out in dissenting opinions leave no doubt that this is often deliberately done in the interest of the court’s view of justice in the particular case.” When implementing a rule of law, a court can narrow or broaden its meaning and application to effect its underlying purpose. The question thus arises as to why courts

7. Id. The author does, however, note at p. 222 that such an approach does create superficial confusion compounded by presumably fixed rules, multitudinous exceptions, and a shifting line of decisions as the exceptions grow in response to changing needs. “In fact, the exceptions may become the rule, but ordinarily this is not formally acknowledged by reformation of the original rule until the process reaches full maturity and the obsolescence of the rule is obvious to all.”
9. Id. at 25.
have resorted either to constructing exceptions to the privity requirement or making unreasonable findings of fact in order to circumvent the privity requirement. While one underlying purpose, the imposition of liability upon a financially responsible defendant might seem manifest, further analysis must be undertaken to isolate other factors, such as culpability, upon which society may justify such liability. Therefore, a study of the relevant case law should prove useful.

I. DANGEROUS PRODUCTS

A cursory review of the application of the privity doctrine reveals that inroads were first made in the area of dangerous products intended for human consumption. Direct suits were allowed by the consumer against the manufacturer “where the thing causing the injury [was] of a noxious or dangerous kind.” Speaking of exceptions to the privity requirement, the court in Mazetti v. Armour noted that included in this class of exceptions were manufacturers of patent and proprietary medicines. Direct action would be allowed because manufacturers of these products are generally shrouded in mystery and the products may contain poisons which are injurious. The general public, thus, has “... a right to rely upon the implied obligation of the manufacturer that he will not use ingredients which if taken in prescribed doses will bring harmful results.” The court then noted that another, comparatively recent exception, applies to the modern method of preparing food for use by the consumer, and to the more general and ever increasing use of prepared food products. The court concluded:

Our holding is that, in the absence of an express warranty of quality, a manufacturer of food products under modern conditions impliedly warrants his goods when dispensed in original packages, and that such warranty is available to all who may be damaged by reason of their use in the legitimate channels of trade.

In Tomlinson v. Armour & Co. a New Jersey court stated:

11. Id. at 135 P. at 634.
12. Id.
13. Id.
14. Id.
15. Id. at 135 P. at 636.
16. 75 N.J.L. 748, 70 A. 314 (1908).
17. Id. at 70 A. at 317.
When the manufacturer puts the goods upon the market in this form for sale and consumption, he, in effect represents to each purchaser that the contents of the can are suited to the purpose for which it is sold, the same as if an express representation to that effect were imprinted upon a label.

Concerning the sale of food, a Missouri court reached this conclusion:18

If privity of contract is required, then, under the situation and circumstance of modern merchandise in such matters, privity of contract exists in the consciousness and understanding of all right-thinking persons.

In his dissent, Judge Bland pointed out the fallacy of the court's reasoning. Since the court had never allowed recovery for injuries or death caused by a latent defect in a machine, which can be as dangerous to humans as glass in a soda bottle, it would appear that the court had taken a position inconsistent with well-settled rules of law.19 Thus, many courts perplexed by the same problem extended the categories of exception to dangerous products other than for human consumption and to dangerous instrumentalities.20

It is probably true, as Judge Bland noted, that the exception to the privity requirement in poisonous and deleterious food cases is based on the thought of dreadfulness and shock of one eating poisonous or harmful foods.21 The practical effect is to make the manufacturer an insurer of the product he furnishes to the dealer who sells it to the public in the original package for immediate consumption. It should be understood that the liability imposed by the courts in such cases is based on a warranty-contract action to which the manufacturer is not a party. The court thus presents

19. Id.
the anomaly of allowing a chose in action against one not privy to the contract by using the artifice of a limited exception doctrine whose boundaries seem arbitrarily drawn. Nevertheless, judicial inroads on the privity requirement are the result of this persistent whittling away of the original rule by expanding exceptions based on fictions concerning the dangerous character of the goods. Referring to these court-made exceptions produced through the use of fictions, one commentator suggests:

[Legal fictions] make it possible to change a rule while seeming to reaffirm it, to move in the direction of progress without alienating conservative interests, and to produce a workable and acceptable solution of a given conflict without tempting either side to rebellion and without completely destroying the apparent superficial consistency of “The Law,” which everyone needs to think of as being, in some degree at least, eternal, immutable, omniscient, and paternal.

Turning to the rationale of the court in the dangerous product cases, one may accurately conclude that the imposition of liability is a function of:

1. the existence of a warranty
2. the dangerousness of the product
3. the intent of the manufacturer—that is, whether in his marketing process he intends his product to reach the consumer in the same condition in which it leaves the factory and sells his product to a middle-man with full knowledge of its future status.

A court holding that such a product falls within an exception recognized in its jurisdiction will, as a result, feel no qualms in imposing liability on the manufacturer by circumventing the privity requirement.

II. Third Party Beneficiary

Another device used by courts to enable a direct suit against the manufacturer is the doctrine of third party beneficiary. Using this method obviates the requirement of privity. The third party sues on a contract which the law will aver that, based upon the circumstances involved, was made for his benefit. The courts, however, have been indefinite as to their tests for ascertaining what beneficiaries fall within the theory’s protection.\(^{23}\) “It is com-

\(^{22}\) Legal Fictions, supra note 6 at 220-21.

\(^{23}\) 2 S. Williston, Contracts §356A (2d ed. 1936).
monly said that such a beneficiary must be a third person whom the contracting parties ‘intend’ shall receive a ‘direct benefit’ from the promise.”

As a result, the third party may sue on the contract, for it is just and practical to permit the person for whose benefit the contract is made to enforce it against one whose duty it is to pay.

Thus, in isolated cases, courts have concluded that the contract between the manufacturer and the retailer was made for the benefit of the consumer, who is the third party beneficiary of the contract. In *Ward Baking Co. v. Trizzino*, a consumer was injured by a foreign substance embedded in a piece of cake. In rendering its decision the court stated:

The groceryman, who is in effect merely a distributing medium for the articles of food furnished by the Baking Company, and the Baking Company, having full knowledge of that fact, dealt with each other and entered into a contractual relationship for the benefit of the public, which is the ultimate consumer. In other words, this contract between the groceryman and the Ward Baking Company to all intents and purposes was a contract entered into for the benefit of a third party, to wit, the ultimate consumer. Whatever implied warranty arises in favor of the groceryman, who established the contractual relationship with the Baking Company, is for the benefit of this third party, namely, the ultimate consumer.

The result reached by the above court was to impose liability on the manufacturer. This result is, of course, the product of a fiction. While the consumer may benefit incidentally from the product, the primary benefit accrues to the manufacturer in selling his product to the retailer and to the retailer in selling his product to the consumer. Accordingly, their intent was to benefit themselves and confer no right or benefit in a third person. While the means employed is thus questionable, the result achieved is satisfying in that it permits a direct suit against the manufacturer.

III. ASSIGNMENTS

“It is a general rule that one who has a right in contract or quasi-contract may assign that right in effect at common law by

24. Id.
27. Id. at , 161 N.E. at 559.
giving the assignee the power to enforce the right in the name and
stead of the assignor, and generally by statute in his own name.\textsuperscript{28} Assignments, like other agreements, may sometimes be implied
without express words from the transaction.\textsuperscript{29}

Various courts have used this contract principle to subject a
manufacturer to direct suit by a consumer, the theory being that
any existing warranty (implied or expressed) is impliedly as-
signed to the vendee and to subpurchasers. The assignment prin-
ciples does not depend on a finding of privity, for under well-
settled contract law, no privity is necessary in the area of assign-
able contracts. The use of this device is, in fact, a fiction since
the prevailing rule in almost every jurisdiction concerning chattel
is that the mere resale of a warranted article does not give the
subpurchaser a right to sue the original seller for damages caused
by defects either in title or the quality of the goods.\textsuperscript{30} Although
Professor Williston points out that there seems no reason why a
warranty should be an exception to the rules governing assign-
ments,\textsuperscript{31} the fact remains that only under civil law jurisdictions
can it be said that a warranty in chattel can be assigned, in effect
having the warranty run with the goods.\textsuperscript{32}

In the notorious case of \textit{Coca-Cola Bottling Works v. Lyons}\textsuperscript{33}
(more often cited by erudite scholars than by Mississippi courts),
the plaintiff, Lyons, was injured by glass that apparently was
mixed in with her drink. In solving the problem of privity and
thereby allowing direct suit against the manufacturer, the court
stated:\textsuperscript{34}

\begin{quote}
We have carefully considered the question, and it appears
to be a new proposition in this state, so far as we are able to
discover, and we are of the opinion that the position of appellant
is not maintainable, because as we see it, the bottle of Coca-
Cola which Mrs. Lyons drank was at least a gift to her by her
friend, Mrs. Jackson, and since the gift carried with it the title,
and the implied warranty runs with the title, Mrs. Lyons was
the owner, and rightfully in possession thereof as one of the
public when she drank the Coca-Cola, and that the manufac-
\end{quote}

\begin{thebibliography}{9}
\bibitem{28} 1 S. \textit{Williston, Sales \S 244} (3d ed. 1948).
\bibitem{29} 2 S. \textit{Williston, Contracts \S 424} (2d ed. 1936).
\bibitem{30} 1 S. \textit{Williston, Sales \S 244} (3d ed. 1948). \textit{But see Bordwall v. Collie, 45 N.Y. 494}
\textsuperscript{(1871)}, where assignment involved warranty of title.
\bibitem{31} 1 S. \textit{Williston, Sales \S 244} (3d ed. 1948).
\bibitem{32} Morrow, \textit{Warranty of Quality: A Comparative Study}, 14 \textit{Tulane L. Rev. 529}
\textsuperscript{(1940)}.
\bibitem{33} 145 Miss. 976, 111 So. 305 (1927).
\bibitem{34} \textit{Id. at } 979, 111 So. at 307.
\end{thebibliography}
turer impliedly warranted the purity of the drink to such of the public as became the rightful possessor and owner of the Coca-Cola. Therefore, if the drink was injurious by reason of having glass in it, the bottling company was liable to the consumer.

Another case focusing upon the assignment of a warranty, Hunter-Wilson Distilling Co. v. Foust Distilling Co.,\(^3\) involved a warranty of excess outage, the owner of a whisky supply having contracted for storage in the defendant's warehouse. The whisky and all rights were sold to the plaintiff who then sued the warehouseman on the warranty of excess outage. In rendering its decision in favor of the plaintiff, the court reasoned that since enforcement of the warranty in favor of the appellant did not materially vary the warehouseman's duty\(^3\) or materially increase the burden of risk imposed by the sale of the contract\(^3\) and that since the whisky was under the control and custody of the defendant who knew or should have known that the contract was not personal because the warehouse receipt contained language showing it was salable,\(^3\) then on that basis liability should be imposed on the assignment theory.

While in both cases the courts' reasoning is persuasive and may provide socially desirable results, such reasoning undermines accepted principles of law. As a result those cases are rarely cited for the propositions set forth and other cases with analogous circumstances have not extended the scope of the rationale employed. The determining factors leading to the imposition of liability and obviating the need for privity include:

(1) The existence of a warranty, express or implied.
(2) The product's being under the control of the manufacturer (or warehouseman).
(3) Knowledge that the product would be resold.
(4) Intent by the manufacturer that his product reach the consuming public.

IV. Agency

Another route by which courts have satisfied the requirement of privity is to find an agency or quasi-agency relationship be-

\(^35\). 181 F.2d 543 (3d Cir. 1950).
\(^36\). Id. at 545.
\(^37\). Id.
\(^38\). Id.
tween manufacturer and retailer or between retailer and consumer. The result is identical in either case, the law of agency operating to view the agent as extending or accepting the warranty for his principal (either manufacturer or consumer as the case may be). It should be understood that in using the agency concept the privity requirement is not circumvented but actually satisfied, the agent supplying the required nexus to the contracting parties. While the theory is sound, the determination by the courts based upon the application of the facts to the law has often been stretched in that where no legal agency exists, one is made to appear. As is true of the other devices employed, the purpose is to achieve substantial justice while at the same time preserving the rule of privity for future cases in which its implementation might prove a practical necessity.

“Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.”39 “To constitute the relation there must be an agreement, but not necessarily a contract between the parties; if the agreement results in the factual relation between them to which are attached the legal consequences of agency, an agency exists although the parties did not . . . intend the legal consequences of the relation to follow.”40

The use of the agency doctrine, has found some comfort in the courts of Washington, which have readily applied the doctrine in warranty actions to supply the privity necessary to sustain a chose in action. In Wisdom v. Morris Hardware Co.,4 the plaintiff had ordered an insecticide through a produce company under an agreement whereby credit was extended. Faced with the problem that a warranty on the sale of personalty does not run with the property, the court concluded that the produce company simply acted as the consumer's agent in obtaining the article requested.42

40. Id., comment b.

The analysis of agency includes concepts of apparent authority and agency by estoppel. Thus, in Gizzi v. Texaco, Inc., 437 F.2d 308 (3d Cir. 1971), the court (vacating a lower court decision) concluded that the evidence produced a question for the jury whether the station operator who repaired the brakes of an automobile and sold it to the plaintiff, who was injured when the brakes failed, had apparent authority to act as agent of the oil company. The facts of the case disclose that the oil company sold gasoline and automotive products through the station, owned pieces of equipment and urged in its advertising reliance on men wearing the oil company's insignia.

4. 151 Wash. 86, 274 P. 1050 (1929).
42. Id. at , 274 P. at 1052.
In *Freeman v. Navarre* an analogous situation arose. The plaintiff, Freeman, hired engineers to plan a heating system. The engineers recommended and planned a central heating system, specifying prefabricated pipe units designed and manufactured by the Ric-Wil Company. Navarre Plumbing and Heating Company was awarded the contract and accordingly ordered the pipes. Later, the pipe units proved defective, causing an inoperative heating system. In allowing recovery against Ric-Wil, the court concluded that Navarre was in fact an agent of Freeman, noting that Navarre was subject to Freeman’s complete control in its choice of pipe and did not exercise any independent judgment. Thus any existing warranties were given, in effect, to Freeman.

In the above cases, the agency analysis was superficial, the courts having created a fiction for imposing liability. The more difficult question is presented in analyzing franchises and dealerships in which the manufacturer or franchisor can exercise almost unbridled control. “Whenever a dealer is given what is tantamount to an exclusive distributorship, his license to operate can often be taken away without great difficulty, so that a court holding that such a dealer is independent is really inaccurate.” Nevertheless, under current law, an exclusive distributor is held to be an independent contractor. It rather seems that the dealer is the manufacturer’s alter ego. This notion may be admitted practically, but not legally. The manufacturer arranges his economic entities to avoid the legal determination of an agency relationship. From the manufacturer’s viewpoint, control without agency liability is the essence of the arrangement.

Equally as interesting would be analyzing the consequences of a joint venture, which is “. . . an agreement between the parties under which they have a community of interest, that is, a joint interest, in a common business undertaking, an understanding as to the sharing of profits and losses and a right of joint

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43. 47 Wash. 2d 760, 289 P.2d 1015 (1955).
44. Id. at 761, 289 P.2d at 1019.
45. Id. at 763, 289 P.2d at 1024 (Schwellenbach, J., dissenting). See also Legal Fictions, supra note 6 at 227.
47. Id.
49. Id. at 17.
control. While, in most cases, the manufacturer may not share directly in the net or gross income of his distributor or dealer, there is no doubt that he does so indirectly. (The situation is different in most franchise operations where the franchisor receives a percentage of gross sales or profits.) Should the distributor, dealer, or franchisee be given the right to return the product, this would be equivalent to a sale on consignment. Any sale made would net both the distributor and manufacturer the profit sought with both sharing in the sale. If the product were bought outright by the distributorship, the manufacturer would still retain an interest in moving the goods from the distributor's shelves through advertising and promotional schemes, enabling the distributor to reorder, and thus giving rise to a mutual benefit on each sale of the product. Coincidentally, the exercise of moderate control on the part of the manufacturer would, technically, create a joint venture. Nevertheless, this has not been a viable theory although a large percentage of today's marketing and production, involves highly integrated joint ventures; the arrangements are structured to create independent entities.

Thus, from a legal standpoint it seems difficult to create either a joint venture or an agency relationship because of the sophistication of the contracting parties. In analyzing, however, cases involving agency fictions, as in *Freeman* and *Wisdom*, the courts consistently emphasize:

1. the existence of an implied or express warranty;
2. that the manufacturer had knowledge that the product would be consumed by one other than the middleman whose function it was to purchase the product from the manufacturer.

V. **Advertised Product Liability**

Advertised product liability has been another device for imposing liability without privity on the manufacturer where the manufacturer disseminates the advertisements. The requirement, however, is that an express warranty and not mere puffing be conveyed to the public and relied upon by the individual con-

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This device is more closely akin to the tortious aspect of warranty, having originated as "a freak hybrid born of the illicit intercourse of tort and contract." It thus reflects the deceit rather than the contractual aspect of warranty; there exists no privity between manufacturer and consumer. As a result, by circumventing the privity requirement, this concept joins the ever-expanding class of exceptions. The rationale behind the rule is clearly expressed in *Baxter v. Ford Motor Co.*, where the court declared:

> It would be unjust to recognize a rule that would permit manufacturers of goods to create a demand for their products by representing that they possess qualities which they, in fact, do not possess, and then, because there is no privity of contract existing between the consumer and the manufacturer, deny the consumer the right to recover if damages result from the absence of those qualities, when such absence is not readily noticeable.

It should be noted that an express warranty in advertising may take many forms: statements in newspapers, in catalogues, in manuals, in tags affixed to the product, in legends upon containers, in circulars, in radio commercials, and direct negotiation between the subpurchaser and the manufacturer may be considered as part of the contract of sale. Thus, in *Free v. Sluss*, the court held that the guarantee of quality printed upon each bar of soap established the manufacturer's knowledge

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57. *Id.* at ____, 12 P.2d at 412.
and intention that the goods should move through the usual channels of trade and was a representation addressed to those who would deal in the product. While the manufacturer was under no obligation to make the guarantee, having made it, he would in effect, be estopped from repudiating it when the condition of complete unsuitability for the market brought the guarantee into play. 57

Thus, the rationale is simple; as demonstrated by the Baxter case, the underlying basis for the application of the advertised products liability doctrine for allowing direct suit against the manufacturer consists of:

1. The express representation to the public inducing the purchase of the product.
2. Knowledge and intent on the part of the manufacturer that his product be consumed by the public.

What is, however, difficult to rationalize is the distinction made by courts between express and implied representations made to the consuming public. While an express warranty might expand the scope of liability (the manufacturer having represented qualities other than merchantability), the fact that a manufacturer places his product on the market is an implied representation that the product is at least merchantable. Moreover, by placing its name upon the product, the manufacturer hopes to induce reliance on the good quality of its product, thereby conditioning the public to correlate quality with name. In product marketing, many manufacturers believe that finding catchy names for their product, is essential to successful selling. Therefore, manufacturers often expend huge sums in research analysis in their quest for a catchy name. To allow a manufacturer to claim no privity under such circumstances would be inconsistent with the advertised product liability theory presented above. The extension of the doctrine, however, while both logical and simple, is too often frustrated by myopic courts, that may feel no hesitation in avoiding such a logical analysis. But as often appears true in the field of products liability, logic may come eventually as a function of time.

VI. HENNINGSSEN v. BLOOMFIELD MOTORS

Henningsen v. Bloomfield Motors, Inc. 68 was a remarkable
case in that the court, arming itself with every theory used to circumvent the privity requirement, waged a massive assault upon the privity citadel to impose liability upon the manufacturer based on a breach of both an implied and express warranty. Recognizing modern marketing conditions, the court adopted the underlying rationale of previous exceptions and seemingly formulated a conduit theory of liability. This theory obviates the need for privity for it recognizes that the manufacturer is dealing in reality with the consumer using middlemen as conduits in the marketing process. In reaching its conclusion, the court considered the following factors:

1. By establishing a system of independent dealers, manufacturers took steps to avoid warranty obligations by avoiding an agency relationship with the dealer. Through the use of independent dealers, manufacturers were able to transfer their legal burdens to them, thus obtaining for themselves a large measure of immunity.

2. With the advent of mass marketing, the manufacturer became remote from the consumer; sales were accomplished through intermediaries while demand for the product was created by advertisements through media. It, thus, became obvious that the consumer was the one being cultivated.

3. The interest in consumer protection calls for warranties by the maker that do run with the goods, to reach all who are likely to be hurt from the use of any commodity that is unfit for its expected purpose.

4. It would be unjust to recognize a rule that would permit the manufacturer to create a demand by representing that the goods possess qualities which they do not and then deny the consumer the right to recover damages because privity is lacking.

5. The manufacturer's interest is not terminated when he sells his goods to the wholesaler. He must remove them from the wholesaler's shelves so that a new supply will be ordered. It would be a weakness in the law to allow the manufacturer to create a

69. The court, however, left unclear whether such liability would be extended in a case of economic loss.
70. 32 N.J. 358, 373, 161 A.2d 69, 77 (1960).
71. Id. at 379, 161 A.2d at 80-81.
72. Id. at 379-80, 161 A.2d at 81, citing 2 Harper & James, Law of Torts, §28.16 at 1571-72 (1956).
73. Id. at 380, 161 A.2d 81, citing Baxter v. Ford Motor Co., 168 Wash. 466, 12 P.2d 409, 412 (1932).
demand for his product by inducing a belief that they are suitable for human consumption and then to avoid liability because privity is lacking.\footnote{74}{Id. at 380, 161 A.2d at 81, citing Jacob E. Decker & Sons, Inc. v. Capps, 139 Tex. 609, 164 S.W.2d 828, 833 (1942).}

\(6\) From the facts of the case, it appears that the warranty of Chrysler Corp. was extended by the dealer to Henningsen as Chrysler's agent.\footnote{75}{Id. at 373-74, 161 A.2d at 78.}

\(7\) There is no rational basis for differentiating between a fly in a beverage bottle and a defective automobile with its great potentiality for harm to the driver, occupants and others, thus demanding even less adherence to the narrow barrier of privity.\footnote{76}{Id. at 383, 161 A.2d at 83.}

\(8\) Under modern conditions the ordinary layman must rely on the manufacturer, who has control of the product's construction. In such a marketing milieu, the laymen's remedy should not be based solely on privity of contract. It should also rest on the demands of social justice. If privity of contract is required, then under the circumstances of modern marketing conditions, privity of contract should be considered to exist in the consciousness of all right thinking persons.\footnote{77}{Id. at 384, 161 A.2d at 83, citing Madouros v. Kansas City Coca-Cola Bottling Co., 230 Mo. App. 275, 89 S.W.2d 445, 450 (1936).}

As a result of the above factors the court decided:

Accordingly, we hold that under modern marketing conditions, when a manufacturer puts a new automobile in the stream of trade and promotes its purchase by the public, an implied warranty that it is reasonably suitable for use as such accompanies it into the hands of the ultimate purchaser. Absence of agency between the manufacturer and the dealer who makes the ultimate sale is immaterial.

As noted above, the \textit{Henningsen} decision was based on the cumulation of theories formulated by other courts. By isolating the crucial factors underlying these theories, one can readily determine that direct liability may be based upon:

\(1\) The existence of an expressed or implied warranty;

\(2\) The manufacturer's knowledge and intent that its product be sold to the consuming public, although the manufacturer is not involved directly; and

\(3\) (Questionably)—the physical nature of the harm caused.

\footnote{78}{Id. at 384, 161 A.2d at 84.}
VII. Economic Loss

The Henningsen opinion was important in the assault upon privity because it collected the theories necessary to undermine the privity requirement. The case received wide acclaim in various jurisdictions that were interested in obviating this formidable barrier with the aid of a viable precedent. But, because the court relied upon a multitude of theories for allowing direct suit, it left open whether privity would be required in cases involving economic loss, both direct and consequential. As was noted in a later case that dealt with Henningsen:

[I]t cannot be said that serious consideration was given to whether a distinction should be made between personal injury claims and loss of bargain claims, i.e., where the breach of the warranty produced total or partial destruction or diminution in value of the article sold.

Faced with this problem, the court in Santor v. A & M Karagheusian, Inc. announced outright, in concise and unequivocal terms, its application of the conduit theory of liability to destroy the barrier of privity. In rendering its opinion, the court noted that it could find no just cause for allowing recovery where breach of an implied warranty of merchantability, regardless of the existence of privity, causes physical harm and disallowing recovery simply because loss of value of the article sold is the only damage proximately resulting from the breach. In perhaps one of the most noteworthy decisions in the history of products liability, the court refined the Henningsen rationale and extended it to its ultimate and necessary end:

The manufacturer is the father of the transaction. He makes the article and puts it in the channels of trade for sale to the public.

79. See Note, Economic Loss in Products Liability Jurisprudence, 66 Colum. L. Rev. 917 (1966). For the purpose of this article, economic loss may be defined in terms of direct and consequential economic loss, as distinguished by the author. "Direct economic loss may be said to encompass damage based on insufficient product value; thus, direct economic loss may be 'out of pocket'—the difference in value between what is given and received—or 'loss of bargain'—the difference between the value of what is received and its value as represented. Direct economic loss also may be measured by costs of replacement and repair. Consequential economic loss includes all indirect loss, such as loss of profits resulting from inability to make use of the defective product." Id. at 918.
81. Id. at 59, 207 A.2d at 309.
82. Id. at 59, 207 A.2d at 309.
No one questions the justice of a rule which holds him liable for defects arising out of the design or manufacture, or other causes while the product is under his control. After completion the article may pass through a series of hands, such as distributor and wholesaler, before reaching the dealer at the point of ultimate intended sale. The dealer is simply a way station, a conduit on its trip from manufacturer to consumer. For these reasons in the recent past the courts of many jurisdictions, in an endeavor to achieve justice for the ultimate consumer, have imposed an implied warranty of reasonable fitness on the person responsible for the existence of the article and the origin of the marketing process. From the standpoint of principle, we perceive no sound reason why the implication of reasonable fitness should be attached to the transaction and be actionable against the manufacturer where the defectively-made product has caused personal injury and not actionable when inadequate manufacture has put a worthless article in the hands of an innocent purchaser who has paid the required price for it. In such situations considerations of justice require a court to interest itself in originating causes and to apply the principle of implied warranty on that basis, rather than to test its application by whether personal injury or simply loss of bargain resulted in the breach of the warranty. True, the rule of implied warranty had its gestative stirrings because of the greater appeal of the personal injury claim. But once in existence the field of operation of the remedy should not be fenced in by such a factor.

Consistent with the Santor approach, the court in Lang v. General Motors,84 also adopted the conduit theory for obviating the privity requirement. In considering modern marketing conditions, the court concluded that when a manufacturer places a new product into the stream of trade and promotes its sale to the public, an implied warranty that it is reasonably fit and suitable for use accompanies the product into the hands of the ultimate buyer. Absence of privity is immaterial.85 The court noted it would be unreasonable to hold that where a buyer purchases an automobile, no implied warranty of merchantable quality may be asserted by the consumer against the manufacturer despite the fact that the new automobile is in such bad condition and so defective in materials or construction as to render it useless or unsatisfactory for the ordinary purpose for which such automobile was designed to serve.86

84. 136 N.W.2d 805 (N.D. 1965).
85. Id. at 809-10.
86. Id. at 810.
In *Media Production Consultants, Inc. v. Mercedes-Benz of North America, Inc.*, the court implemented the conduit theory of liability, asserting that by placing an automobile on the market the supplier represents to the public that the vehicle is suitable for use. Moreover, the court stated: "Louisiana has aligned itself with the consumer-protection rule, by allowing a consumer without privity to recover, whether the suit be strictly in tort or upon implied warranty." The court could not find any reason why the rule should not apply to the pecuniary loss resulting from the purchase of a new automobile that proves unfit for use because of latent defects.

The use of the conduit theory of liability concerning the application of implied warranty again found favor in *Cova v. Harley Davidson Motors Co.*, where the court sanctioned a direct suit against the manufacturer for economic loss. In reaching its decision, the court reasoned: "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." The court continued that one who sues the manufacturer must, consistent with warranty liability, prove a defect attributable to the manufacturer and the causal connection between the defect and the injury or damage resulting.

In *Kassab v. Central Soya*, the court overruled *Miller v. Preitz* (a case requiring vertical privity), and allowed for direct suit against a remote manufacturer. In recognizing the practicalities of the situation, the court reasoned that continued adherence to the requirements of vertical privity resulted merely in perpetu-

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87. 262 La. 80, 262 So. 2d 377 (1972).
88. Id. at , 262 So. 2d at 381. The court added, "[t]he Legislature has declared that the distribution and sale of motor vehicles in Louisiana vitally affect the public interest. See LSA-R.S. 32:1251."
89. Id. at , 262 So. 2d at 381.
90. Id. at , 262 So. 2d at 381.
92. Id. at , 182 N.W.2d at 804.
93. Id. at , 182 N.W.2d at 804. See also Uniform Commercial Code §2-715 and comments on subsection (2).
94. 432 Pa. 217, 246 A.2d 848 (1968). The harm alleged in this case was damage to cattle—property damage. The court, however, seemed not to restrict its holding specifically to property damage. From its holding one may draw a fair inference that the vertical privity requirement was abolished in reference to all types of harm—physical, property, and economic.
ating a needless chain of actions whereby each buyer must seek redress from his immediate vendor until the manufacturer has liability thrust upon himself. 96 “Vertical privity can no longer commend itself to this court.” 97

Finally, the momentous decision in Randy Knitwear v. American Cyanamid Co. 98 cracked the citadel of privity, the court declaring: 99

In concluding that the old court-made rule should be modified to dispense with the requirement of privity, we are doing nothing more or less than carrying out an historic and necessary function of the court to bring the law into harmony “with modern-day needs and the concepts of justice and fair dealing”.

It thus appears that courts are finally recognizing that there is no longer any justification for vertical privity requirements in modern society, while continued adherence to the principle creates a gross disservice to the consuming public. When the purpose for a rule ceases, it is logical that the rule should be interred. 100 While many courts today will allow direct suit against the manufacturer where defective products cause physical or property damages, there lurks an underlying fear to extend it as well in cases of economic loss. Upon what might this fear be justified?

Some authorities suggest that when privity is lacking and no danger of physical harm results from the manufacturer’s actions, recovery for most consequential economic loss caused by a defective but not dangerous product cannot be justified on the grounds of deterrence of dangerous conduct or responsibility for induced reliance. 101 Further, it is also difficult to justify such economic recovery under a risk spreading theory since the risk to the manufacturer is less insurable than in the case of a personal injury. 102 The proponents of this position, therefore, must accept as basic

96. 432 Pa. 217, 246 A.2d 848, 856 (1968).
97. Id.
99. Id. at 15, 181 N.E.2d at 404, 226 N.Y.S.2d at 370. Although the language of the court may be interpreted broadly, the holding should be restricted to cases of express warranties made by the manufacturer and relied upon by those not in privity with it. Thus, the court allowed recovery despite the fact that the damage was only economic in nature.
102. Id. and see examples following in text of Note.
premises that circumvention of the privity requirement is to deter
the production of dangerous products only, and that there can be
no reliance by a consumer, absent an express representation, that
a product is what it purports to be. Concerning the allocation of
risk, the underlying premise is that the intention of the *Uniform
Commercial Code*, as evinced by various sections, is to allow
merchants to distribute risk among themselves by using disclaim-
ers and limitations on consequential damages. Moreover, the
merchant further down the chain of distribution is better able to
realize the risks involved and can more effectively insure against
them. He is also in a position of comparable bargaining power
with his vendor and they can thus contract to allocate the risks
between themselves to create the desired result while using price
as the tool.

These arguments seem superficially convincing, but the
basic premises involved are unacceptable. While the purpose of
strict tort liability may be to deter the production of dangerous
products that cause physical harm, the purpose of contract law
is to provide the parties with the benefit of their bargain. The
basis for obviating the privity requirement with respect to defec-
tive products stems from the rationale that the manufacturer has
placed a defective article in the hands of an innocent purchaser
who has paid the required price. Since the manufacturer in-
tends his product to reach the ultimate consumer in the same

103. *Id.* at 965-66. *See also Uniform Commercial Code*, §2-316 (Exclusion or Modi-
cation of Warranties) and comments, and §2-719 (Contractual Modification or Limitation
of Remedy) and comments thereafter.

104. *Id.*

105. *Id.*

106. *Restatement (Second) of Torts* §402A:

Special Liability of Seller of Product for Physical Harm to User or Consumer—

(1) one who sells any product in a defective condition unreasonably dan-
gerous to the user or consumer or to his property is subject to liability for

physical harm thereby caused to the ultimate user or consumer, or to his prop-

erty, if

(a) the seller is engaged in the business of selling such a product,

and

(b) it is expected to and does reach the user or consumer without

substantial change in the condition in which it is sold.

(2) the rule stated in subsection (1) applies although

(a) the seller has exercised all possible care in the preparation

and sale of his product, and

(b) the user or consumer has not bought the product from or

entered into any contractual relation with the seller.


108. *Id.*
condition, using middlemen as conduits, and since the law will imply a warranty, it seems only natural that a consumer may justifiably rely on his belief that the goods are fit for their intended purpose.

Concerning the allocation of risk argument, its proponents seem inextricably confused. They associate the concept of privity with limitation of damages and disclaimers. Should the manufacturer desire to allocate the risks thrust upon him, he need merely disclaim the implied warranty under §2-316 or limit consequential damages under §2-719 of the Code. Obviating the need for privity would also reverse the process, in effect, having the manufacturer's disclaimer or limitation of damages travel directly to the ultimate consumer. As a practical matter, however, the requirement of effective notice must still be met. The manufacturer could stamp such a notice on the face of the product. This the manufacturer would seem hesitant to do since to do so would tend to instill in the public a sense of distrust. The manufacturer would prefer to hide behind the cloak of privity and limit his exposure to liability while keeping the public unaware of his disclaimer or limitation on recovery.

Should, however, the manufacturer, choose to disclaim or limit consequential damages (according to the above procedure), he would, in effect, be transferring that risk to his vendee who would be free to do the same with his buyer. In this manner, the manufacturer and its subpurchaser could allocate the risks as between themselves with a "disclaimed" or "limitationed" product, realizing a lower price than one in which the liability is assumed. Moreover, if the limitation were ruled ineffective or unconscionable, the members in the chain of distribution could agree to indemnify one another using the price as leverage when

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109. As noted in subsection 3—"[c]onsequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not."

110. See Uniform Commercial Code §2-316 and comments therein and §2-719 and comment on subsection (1)(b) and (3).

Herein lies the greatest problem with the author's analysis. Disclaimers or limitations on the face of the product may not be able to provide adequate notice to the consumer. The size of the product, the nature of the product, the possibility of labels being torn, or being intentionally removed, and sundry other possibilities, including space limitations, present a practical difficulty in this area. Another problem to be considered is whether a consumer would understand the wording and the effect of the limitation or disclaimer.

111. In any sale made by the subpurchasing merchant, an implied warranty will arise by operation of law. Uniform Commercial Code §2-314.

112. The possibility of indemnification assumes no violation of public policy.
bargaining. This procedure, noted above and set forth in the Code, would seem to undermine the previous argument presented, distinguishing between privity on the one hand and disclaimers and limitations on the other. Privity in this context would seem the improper factor upon which to focus the analysis of the manufacturer's ability to exclude or limit damages.

Another possible motive for requiring privity in cases involving economic loss may be found in Seely v. White Motor Company. Chief Justice Traynor denied recovery against a remote manufacturer on the basis of strict liability in tort and implied warranty, although he permitted recovery on the theory of express warranty, even though the plaintiff Seely did not rely upon the express representation. Nor did the manufacturer's warranty constitute part of the basis of the bargain. In denying recovery under strict liability in tort Judge Traynor might have applied the same analysis to the theory of implied warranty, holding it, likewise, inapplicable. Note that in denying recovery in tort, the court stated that the manufacturer would be liable for damages of unknown and unlimited scope. In differentiating, then, between economic loss and physical injury, the court concluded that a consumer should not at the manufacturer's will be chargeable with bearing the risk of physical injury when a consumer buys a product on the market. The cost of the injury, the loss of time and health may be an overwhelming misfortune to the person injured, but not to the manufacturer since the risk of liability can be insured against and distributed among the public as a cost of doing business.

If the Seely rationale is to serve as the basis for refusing the application of implied warranty, a deeper analysis is required. As shown by Judge Peters, both economic loss and personal injury involve the element of economic loss and both proximately arise out of the purchase of a defective product. While personal injury may be slight and may include loss of earnings (realistically economic loss), a defective product could force suspension of

113. 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965).
114. Id. at 24, 403 P.2d at 152, 45 Cal. Rptr. at 24 (Peters, J., concurring and dissenting).
115. Id.
116. Id. at 22-23.
117. Id. at 23.
118. Id.
119. Id. at 27-28 (Peters, J., concurring and dissenting).
business activity and cause an intolerable loss of earnings; such a result could have a more widespread effect, than, for example, a sprained finger. Moreover, those who fear that such a procedure might expose the remote manufacturer to unlimited liability need only remember that warranty recovery is limited to the reasonable damages contemplated by the parties proximately resulting from the breach, and may be liquidated or limited, while recovery for physical injury is governed only by the scope of proximate cause and may not be limited or disclaimed. This point, however, realistically is merely academic since the manufacturer is ultimately liable, in any event, through indemnification, a process involving impleader or vouching in. One must note, however, that this circuitry of action is an expensive, time-consuming, and wasteful process and may be interrupted by insolvency, lack of jurisdiction, disclaimers, or the statute of limitations. It would, therefore, serve no purpose of the law to insulate a culpable manufacturer based upon fortuitous circumstances which would prevent the imposition of liability upon him. While destroying the privity barrier is one solution, some commentators call for a judicial change in the basic indemnity principle so that the plaintiff would be permitted to take his judgment against the retailer and pursue it directly against anyone from whom the retailer might recovery indemnity. Simply destroying the privity barrier, however, appears simpler and superior. Thus, while Judge Traynor may not have considered the application of implied warranty to economic loss where privity is lacking, it behooves all courts that deny recovery on that basis to understand the underlying rationale that they are adopting.

120. Uniform Commercial Code §2-715.
124. Id. at subsection (3). A fair inference can be drawn that if recovery for physical injury may not be limited in any manner, then the implied warranty may not be disclaimed where such injury arises. It would be folly to uphold a disclaimer while voiding a limitation. See Walsh v. Ford Motor Company, 59 Misc. 2d 241, 298 N.Y.S.2d 538 (Sup. Ct. Nassau Co. 1969); Hawkins Construction Co. v. Matthews Co., 190 Neb. 546, 209 N.W.2d 643, 653 (1973).
125. 1 S. Williston, Sales §244 (3d ed. 1948).
127. Uniform Commercial Code §2-607 subsections (5) and (6) and comments thereon.
CONCLUSION

The trend in warranty law concerning products liability is manifest. Courts are finally recognizing that the ancient law of privity has no application in today’s complex economic system. While the older cases reveal a struggling effort on the part of courts to create an exception or a fiction as the basis for circumventing the formidable barrier of privity, the underlying rationale is based upon the theory that the manufacturer knew and intended the product to be placed in the stream of commerce and to reach the ultimate consumer in the same condition as when it left its hands. Recent decisions reveal no hesitation on the part of courts to adopt outright the conduit theory of liability, placing the real costs of the product, on the party creating the defective product.

The Uniform Commercial Code does not deal with the problem of vertical privity. In regard to vertical privity, the Code states that it “. . . 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.” Because the results differ greatly depending on the situs of the chose in action, it would seem that the Code has failed, in that respect, to make uniform the law with respect to sales. Accordingly, it is left to the various jurisdictions to formulate a rule of law, hopefully on a rational basis, to achieve the substantial ends of justice. It thus remains difficult to comprehend the fear both in courts and legislatures which impels them to plod blindly on, hoping that somehow a resolution of the problem will occur through some messianic process. The Code and the various jurisdictions have so far failed to squarely confront and resolve the problem in the spirit of a rational jurisprudence. Defining products in terms of degrees of dangerousness or segregating damages into personal injury or economic loss does little to produce a viable theory that satisfies the expectations of the consuming public in a modern setting. With respect to privity, differentiating between an express warranty and an implied warranty of merchantability is, perhaps, merely a useful exercise in the art of semantics. Courts must pursue with alacrity the ends of social and economic justice to protect a consuming body incap-
able of self-protection. Accordingly, the author recommends an alternative to the existing alternatives currently offered by §2-318 of the Code (as amended 1966):

**ALTERNATIVE D**

A seller's warranty whether express or implied extends to any subpurchasing merchant and to any consumer who suffers physical injury, property damage, or economic loss because of the breach of warranty. A consumer is defined as any person who may reasonably be expected to use, consume, or be affected by the goods. A seller is defined as any person or entity in the manufacturing or distributive chain of sale. A seller may not exclude or limit the operation of this section with respect to injury of the person or property of an individual to whom the warranty extends. Limitations on economic loss shall be governed by sections 2-719 (contractual modification or limitation of remedy) and 2-302 (unconscionable contract or clause). Any limitation on remedy shall be governed by the notice provisions of section 2-316 (exclusion or modification of warranties).

The practical effect of adopting the above alternative is significant. It would place all sellers, from manufacturer to retailer, in privity with the consumer and in privity with each other. The consumer could then proceed against any party unless that seller's limitation or disclaimer appeared on the face of the product, conspicuously marked. The seller, in turn, could seek indemnification from any seller above himself in the distributive chain of sale including the manufacturer who likewise did not disclaim nor limit liability. This procedure would result in shifting the burden of liability as close as possible to the party responsible for creating the risks. Since a "limitationed" or "disclaimed" product would be less desirable, the manufacturer would realize a lower price, thereby shifting that exposure to his vendee, who would assume the risk of economic loss only because, under the Code, personal injury and property damage may not be limited or disclaimed.\(^\text{132}\) The vendee would in turn bargain with his sub-

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\(^{132}\) See *Uniform Commercial Code* §2-719, subsection (3). The Code leaves a gap in this section by not covering injury to property. The Code states, "Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where loss is commercial is not." Property damages constitute neither injury to the person nor commercial loss. A premise of this author's analysis, however, is that personal and property damages should be treated alike. See *Seely v. White Motor Co.*, 63 Cal. 2d 9, 403 P.2d 145, 152 (1965), in which Chief Judge Traynor notes: "Physical injury to property is so akin to personal injury that there is no reason for distinguishing them." See also Prosser, *The Assault Upon The Citadel (Strict Liability To The Consumer)*, 69 Yale L.J. 1099, 1143 (1960). See also note 124, supra.
purchasers, consistent with the above procedure, to further allocate the risks. The result would be to provide all sellers as proper defendants for personal and property liability suits, thereby adequately protecting those interests of the consumer by allowing the direct suit by a consumer against any seller. Thus, in the case of personal injury or property damage, the manufacturer would be held ultimately liable while in cases of economic loss the seller highest up in the distributive chain of sale who neither disclaimed nor limited consequential damages would be liable with the sellers being allowed to allocate the risks as between themselves consistent with the intent of the Code. This alternative, in effect, would fairly protect the necessary interests of the consumer while allowing merchants to allocate between themselves the cost of insuring for economic loss, or else limiting consequential damages, whereby they would pass on the savings to the public, such product having a market price less than a fully warranted product in which no disclaimer or limitation on recovery appears. Since any attempt to disclaim or limit liability would have to be conspicuous, the consumer would have full knowledge and could intelligently decide for himself how to allocate the risks involved—whether to buy the more expensive product or to buy the less expensive one and assume the risk of economic loss. Accordingly, this alternative would achieve the optimum of fairness by protecting the inviolate interests of consumers while allowing for the conscious determination of risk distribution on the part of sellers and consumers alike. Although the advent of industry-wide disclaimers and limitations on economic loss might be the practical result of such a procedure, it must be noted that a manufacturer maintains an interest in preserving the quality of its name in a competitive market and in bolstering the demand for its product. Should the competitive forces fail, however, it would be the task of the courts to proceed on a case by case basis.

133. Uniform Commercial Code §2-316 and comments: It would seem, concerning consumers, that a disclaimer of the implied warranty would be similar to a limitation of consequential damages. Since it would appear that a seller may not disclaim his warranty in cases of personal injury or property damage, the disclaimer would be equivalent to a limitation, the only difference being the seller's liability for direct economic loss—diminution in the value of the product. Although the seller may exclude recovery for consequential damage, he may not do so in a case of direct economic loss. See Uniform Commercial Code §2-719, subsection (2). However the use of a disclaimer would result in no liability for direct economic loss. Since, however, limitations and disclaimers are so similar, it would be perfectly consistent to have the notice requirements under §2-316 be applicable to limitations and exclusions as well. See Gore v. George J. Ball, Inc., 279 N.C. 192, 182 S.E.2d 389, 394-95 (1971).
to refine the concept of unconscionability as set forth in §2-302 of the Code, and in that manner further protect the interests of the consuming public. The final result would be to achieve social and economic justice predicated on a rule of law which is both fair and rational.

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