

NOTES

PARADOX OF PRESUMPTIONS: SELLER WARRANTIES AND RELIANCE WAIVERS IN COMMERCIAL CONTRACTS

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This Note examines the enforceability of seller warranties and reliance waivers in New York, focusing on commercial contracts between sophisticated parties. In recent years, enforcement of these clauses has changed dramatically, resulting in an asymmetry in the law: Seller warranties are presumptively enforceable, but reliance waivers are presumptively unenforceable. This change has shifted the burden of persuasion from the buyer to the seller, thereby altering the contracting costs for the parties. This Note seeks to explicitly delineate the contours of this incongruity, proposes an information asymmetry hypothesis as a means of explanation, and tests this hypothesis against recent developments in New York law. Finally, this Note examines a sample of fifty commercial contracts that may give a preliminary indication of whether private parties are contracting around these new default rules, and if so, in what ways. The data indicate commercial parties are generally not contracting around the new rules, but that some aspects of their enforcement might be inefficient.

INTRODUCTION

Contracts are ubiquitous in modern business, often governing almost every aspect of a commercial transaction. This is particularly true of large transactions involving the sale of land, a business, debt, equity, or any other property or obligation between sophisticated parties. As a standard part of these contracts, warranty clauses play a critical role in allocating risk and determining the final sale price.¹

A buyer² will often insist on the inclusion of certain seller warranties in the contract.³ These seller warranties can serve many functions, but

1. Risk allocation is central to the law and economics view of contract law, as well as the standard view of incomplete contracting (or contracting with imperfect information). See Robert E. Scott, *The Law and Economics of Incomplete Contracts*, 2 *Ann. Rev. L. & Soc. Sci.* 279, 280–83 (2006) [hereinafter Scott, *Incomplete Contracts*] (noting that “[t]he law and economics theory of incomplete contracts . . . has developed a set of analytic tools” for understanding how parties can create optimal contracts in face of uncertainty).

2. This Note refers to the parties to the contract as the buyer and the seller. Although it is often clear who is who, the distinction can get murky at times. For the purposes of this Note, the “buyer” is the party who is receiving a good or service, and the “seller” is the party who is parting with or providing the good or service.

3. These are often found under the heading “Warranties & Representations” or “Express Warranties” in the contracts. The term “Express Warranties” distinguishes these clauses from implied warranties, such as the warranty of merchantability, which courts will often read into contracts as a standard part of common law, and some of which have now been codified in the Uniform Commercial Code (UCC). For a good background on

their main purpose is usually to give assurances to the buyer about the object of the sale.⁴ On the other side of the transaction, the seller will typically ask for certain buyer warranties, which usually appear in the form of reliance waivers.⁵ These waivers assure sellers that they are not exposing themselves to liability for false or misleading representations.⁶ All of this is expected commercial behavior, and makes a good deal of sense. Unexpectedly, however, these clauses are enforced incongruently in many jurisdictions.

This incongruence is a relatively recent development: Before 1990, both seller warranties and reliance waivers were presumptively unenforceable.⁷ In fact, a reliance waiver was almost always unenforceable.⁸ Any buyer allegations of misrepresentation or fraud with respect to the transaction could be contested in court, despite the reliance waiver that disclaimed the buyer's right to bring such a claim.⁹ In *Danann Realty Corp. v. Harris*, the New York Court of Appeals changed this default rule, holding that a reliance waiver was enforceable if it was specific "as to the very matter as to which [the buyer] now claims it was defrauded."¹⁰ This deci-

implied warranties, see Franklin E. Crawford, *Fit for Its Ordinary Purpose? Tobacco, Fast Food, and the Implied Warranty of Merchantability*, 63 Ohio St. L.J. 1165, 1170–76 (2002).

4. For a more descriptive account of the various uses of seller warranties in commercial contracts and the law governing them, see Debra L. Goetz et al., *Article Two Warranties in Commercial Contracts: An Update*, 72 Cornell L. Rev. 1159 (1987); see also *infra* Part I.A.

5. Although the term "buyer warranty" presents a clear symmetry with the term "seller warranty," this Note follows the standard terminology in contracts scholarship and refers to these clauses as "reliance waiver clauses." In addition, sometimes they are mistakenly referred to as "merger clauses," but there is a distinction. See *infra* note 58.

6. Of course, sellers can have legitimate interests other than protecting themselves against claims of fraud. Since fraud claims are so easy to bring, a seller might seek this waiver clause to protect against hold-up problems from the buyer seeking to bargain for a better deal *ex post*. See *infra* notes 63–66 and accompanying text (discussing reasons why sellers would include reliance waiver clauses); see also Gregory Klass, *Contracting for Cooperation in Recovery*, 117 Yale L.J. 2, 53 (2007) ("[T]here may well be good arguments for a default rule of no liability for fraud in the performance.").

7. Reliance waivers were presumptively unenforceable in order to protect the buyer from an asymmetry of information favoring the seller, whereas seller warranties were presumptively unenforceable due to the tort law heritage of warranty law. See *infra* Part I.A. For a discussion of the evolution of seller warranties, from unenforceable to enforceable, see James Nathan Spolar, Note, *Much Ado Leads to Nothing: That "Basis of the Bargain" in Section 2-313 of the Uniform Commercial Code Should Be Eliminated Is Still Lost on Drafters*, 24 J. Corp. L. 453, 456–60 (1999).

8. See *Danann Realty Corp. v. Harris*, 157 N.E.2d 597, 602–05 (N.Y. 1959) (Fuld, J., dissenting) (noting that unenforceability was rule in most of United States and England). The only major exception to this rule was, and remains, that the buyer cannot claim fraud or misrepresentation if the deception is so obvious that the buyer should have been able to recognize it through the use of ordinary intelligence. For more on this exception, see *infra* notes 161–167 and accompanying text.

9. Hence the sweeping claim that "fraud vitiates every agreement," including even warranties protecting against fraud. *Danann Realty*, 157 N.E.2d at 602 (Fuld, J., dissenting).

10. *Id.* at 599 (majority opinion). This specificity requirement has undergone some changes in the half century since *Danann Realty* was decided, see *infra* Part III.B.2, but

sion thus overturned an established tenet of contract law.¹¹ Nevertheless, although reliance waivers can now be shown to be enforceable in New York, they remain presumptively unenforceable.

The New York Court of Appeals was not done yet. Traditionally, seller warranties were also presumptively unenforceable, much like reliance waivers.¹² To avoid this presumption, the buyer had to show reliance upon the substance of the warranty.¹³ In the 1990 decision *CBS Inc. v. Ziff-Davis Publishing Co.*, the court ruled that seller warranties are presumptively enforceable, and that the burden is on the seller to show that the buyer did not rely on the warranty as a part of the bargain.¹⁴ This newer, alternate view is beginning to gain traction in other jurisdictions.¹⁵

This change creates an asymmetry in New York law: Reliance waivers are presumptively unenforceable, while seller warranties are presumptively enforceable. What possible justifications are there for these divergent interpretations? This mystery is complicated by UCC section 2-313, which deals with the enforcement of express warranties. The court in *Ziff-Davis* relies on the UCC, including this section, in creating its new

remains largely intact, see *Grumman Allied Indus., Inc. v. Rohr Indus., Inc.*, 748 F.2d 729, 735 (2d Cir. 1984) (“The *Danann* rule operates where the substance of the disclaimer provisions tracks the substance of the alleged misrepresentations, notwithstanding semantical discrepancies.”).

11. The rule is practically only enforced in New York, and as such it is at the forefront of what might be an evolution in the law. The rule was cited favorably, for example, in 5 Samuel Williston, *A Treatise on the Law of Contracts* § 811, at 893 n.13 (Walter H.E. Jaeger ed., 3d ed. 1957). There are dicta from Delaware and Texas, among other places, that support a move in this direction, but few jurisdictions have shifted to the degree that New York law has. See, e.g., *ABRY Partners V, L.P. v. F&W Acquisition LLC*, 891 A.2d 1032, 1057 (Del. Ch. 2006) (stating in dicta that “a party cannot promise, in a clear integration clause of a negotiated agreement, that it will not rely on promises and representations outside of the agreement and then shirk its own bargain in favor of a ‘but we did rely on those other representations’ fraudulent inducement claim”). For an alternative view, see *Van Der Stok v. Van Voorhees*, 866 A.2d 972, 976 (N.H. 2005) (referring to holding in *Danann Realty* and “declin[ing] to adopt that reasoning here”).

12. For a good background on seller warranties, see Matthew J. Duchemin, *Whether Reliance on the Warranty Is Required in a Common Law Action for Breach of an Express Warranty?*, 82 Marq. L. Rev. 689 (1999); see also Spolar, *supra* note 7.

13. Duchemin, *supra* note 12, at 700. The demonstration of reliance had to relate to the substance of the guarantee, which is distinct from bargaining for the specific warranty terms. *Ziff-Davis* drew this line very clearly. See *CBS Inc. v. Ziff-Davis Publ'g Co.*, 553 N.E.2d 997, 1000 (N.Y. 1990). For a more in-depth discussion of the reliance requirement in seller warranties, see *infra* Part I.A.2.

14. 553 N.E.2d at 1000–01 (opining that buyer is relieved of its duty to ascertain truth of representation because critical issue is “whether [buyer] believed [it] was purchasing the [seller’s] promise”).

15. See *Pegasus Mgmt. Co. v. Lyssa, Inc.*, 995 F. Supp. 29, 38–39 (D. Mass. 1998), for a discussion of jurisdictions that have purported to adopt the “basis of the bargain” terminology referenced in *Ziff-Davis* and the UCC. These jurisdictions include Indiana, Montana, and Massachusetts. *Pegasus* also references those jurisdictions that retain the reliance requirement, most notably Kansas and Minnesota. *Id.* at 39.

interpretation of seller warranty enforcement.¹⁶ The extent to which UCC section 2-313 incorporates a reliance requirement into the enforcement of these warranties remains quite contentious among scholars and within the judiciary,¹⁷ and adds another layer of complexity to the puzzle.¹⁸ What, if any, role does reliance play?

This Note argues that the rules adopted by the New York Court of Appeals for reliance waivers and seller warranties are congruent when viewed as default rules designed to reduce the information asymmetry between buyers and sellers. Part I examines the history and development of both of these contract clauses in New York law, with a focus on the courts' enforcement mechanisms, and delineates the paradox of presumptions in the enforcement of these two contract clauses from several different perspectives. Part II then proposes an information asymmetry hypothesis to explain this divergence. Part III attempts to test this hypothesis by outlining a few predictions about the enforcement of these default rules, and then looking to recent case law to determine if these predictions are supported. Finally, Part IV examines the evolution of seller warranties more closely, using some empirical data in order to determine if the recent shift in presumptions was a move in the right direction.

16. 553 N.E.2d at 1002 n.4. The dissent notes that such UCC sections, including section 2-313, might point to an alternative conclusion. *Id.* at 1004–05 (Bellacosa, J., dissenting). Moreover, many courts invoke UCC section 2-313 when applying the ruling in *Ziff-Davis*. See, e.g., *Rogath v. Siebenmann*, 129 F.3d 261, 265 (2d Cir. 1997).

17. There is a large ongoing debate as to whether UCC section 2-313 incorporates some requirement of reliance in order for a warranty to be enforceable. The text, as adopted in 1950, does not mention reliance at all, but instead includes language referring to the “basis of the bargain.” Some courts have argued that the UCC incorporates a light sense of reliance, the buyer’s “reliance on the express warranty as being a part of the bargain between the parties.” *Rogath*, 129 F.3d at 264 (quoting *Ziff-Davis*, 553 N.E.2d at 1001 (majority opinion)). Other courts insist that a heavier substantive reliance on the warranty should be necessary for its enforcement. See, e.g., *Hendricks v. Callahan*, 972 F.2d 190, 195 (8th Cir. 1992) (finding that buyer’s knowledge of lien abrogates substantive reliance necessary for enforcement). Many scholars, on the other hand, believe that section 2-313 was drafted to specifically eliminate any use of reliance in the analysis of warranty clauses. For a good analysis of this claim, see Charles A. Heckman, “Reliance” or “Common Honesty of Speech”: The History and Interpretation of Section 2-313 of the Uniform Commercial Code, 38 Case W. Res. L. Rev. 1, 28 (1987) (“The concept of reliance is not dead under the U.C.C. in spite of the efforts of the draftspeople to kill it.”); see also Sidney Kwestel, *Freedom from Reliance: A Contract Approach to Express Warranty*, 26 Suffolk U. L. Rev. 959, 992–1000 (1992) (“Since neither mutual assent nor consideration requires reliance, reliance should not be necessary to create an express warranty under section 2-313”); Matthew A. Victor, *Express Warranties Under the UCC—Reliance Revisited*, 25 New Eng. L. Rev. 477, 481–91 (1990) (“The decisions of the last decade demonstrate the courts’ continuing struggle with the reliance requirement”).

18. *Ziff-Davis*, 553 N.E.2d at 1002 n.5 (“We do not hold that no reliance is required, but that the required reliance is established if, as here, the express warranties are bargained-for terms of the seller.”).

I. WARRANTIES IN COMMERCIAL CONTRACTS

Warranties are a standard part of most commercial transactional contracts, with both buyers and sellers choosing to make and demand these guarantees. This Part explores the evolution and current state of law for reliance waiver clauses and seller warranties. Part I.A examines seller warranties, providing an overview of the common law approach in New York and the effect of the ruling in *Ziff-Davis* on this approach. Part I.B addresses reliance waivers, providing an overview of their origins, evolution, and the current state of the law in New York, with a focus on the *Danann Realty* case.

A. Seller Warranties

1. *An Overview and History of Seller Warranties.* — Warranties, reduced to their most basic form, are simply guarantees to ease the mind of a contracting party and help close a deal. For example, suppose Sally is selling her car to Bob, and Bob is worried about a faint rattling sound he hears in the engine. In order to assure Bob the car is in proper working order, and to close the deal more quickly, she can promise Bob that he will not have any problems with the engine for the next six months. If Bob agrees to this deal, they can include this promise as part of the written contract for the sale of the car. The promise has now become a warranty binding upon both parties and enforceable under the law.¹⁹ It is called a seller warranty because the seller made the promise.

Seller warranties are a common feature of commercial contracts because they are often in the interests of both the buyer and the seller. One of the main ways they serve both interests is by solving an adverse selection problem, commonly referred to as the “lemons problem.”²⁰ For buyers, a seller warranty lends credibility to a product and reduces the risks related to a possible product defect. For sellers, a warranty can help distinguish the object of sale from others on the market that might look as good, but not function as well (so called “lemons”). As a result, sellers will often want to include these warranties in order to signal to the buyer that their product is not a “lemon,” thus reducing the effect of the adverse selection problem as well as helping sellers complete a deal that might be difficult to close otherwise.

19. For the purposes of this simple example, assume the warranty is enforceable under contract law notwithstanding such potentially relevant concepts as the doctrine of fraud, ideas of unconscionability, or duress.

20. See, e.g., Bruce Mann & Thomas J. Holdych, When Lemons Are Better than Lemonade: The Case Against Mandatory Used Car Warranties, 15 *Yale L. & Pol’y Rev.* 1, 8–11 (1996) (using used car industry to demonstrate how warranties in private marketplaces exist to combat lemons problem).

Seller warranties can also serve a risk-allocating function.²¹ In the simple example above, the parties reallocate risk to the seller by taking the risk of engine failure away from Bob and placing it on Sally. Along with a transfer of risk, this might also create a more efficient cost allocation.²² In this example the reallocation of risk can change the cost structure of the deal.²³ Sally may receive a higher price for her car by taking on this extra risk through the warranty, as long as Bob is willing to pay Sally to take this risk. This is most likely to occur when it is less expensive for sellers to assume the risk than for buyers.²⁴ For example, perhaps the seller has superior knowledge about the accuracy of the warranty, or perhaps the seller is better positioned to spread the costs related to defective products.²⁵

The cost- and risk-redistributive functions of warranties make them a useful tool in commercial transactions, and it is not surprising that warranties have been around for a long time. Basic seller warranties initially developed out of the law of tort and *assumpsit*.²⁶ Warranty law grew out of tort actions for deceit, but eventually was recognized as a distinct part of contract law.²⁷ Nevertheless, warranties represent an area of contract law that retains some vestiges of tort law, such as reliance.²⁸ The essence

21. See, e.g., *Saratoga Fishing Co. v. J.M. Martinac & Co.*, 520 U.S. 875, 880 (1997) (“If the buyer obtains a warranty, he will receive compensation for the product’s loss If the buyer does not obtain a warranty, he will likely receive a lower price in return.”).

22. A competing theory argues that a warranty helps close a deal because the buyer values the warranty more highly than it costs the seller to provide the warranty. See Thomas J. Holdych, *A Seller’s Responsibilities to Remote Purchasers for Breach of Warranty in the Sales of Goods Under Washington Law*, 28 *Seattle U. L. Rev.* 239, 245 (2005). This idea of costs is an important one, and receives more attention in Part IV of this Note.

23. See Joshua B. Konvisser, *Practicing Law Inst., The Price Is Right? When the “Right Price” Uses the Wrong Methodology*, in *Outsourcing and Offshoring 2007: Protecting Critical Business Functions* 397, 412 (2007) (discussing how legal terms, such as warranties, can affect price and cost structure in supplier contracts).

24. See Holdych, *supra* note 22, at 245–46.

25. Loss spreading is a standard concept in tort law that is also applicable in warranty law for these scenarios. See F. Patrick Hubbard, *The Nature and Impact of the “Tort Reform” Movement*, 35 *Hofstra L. Rev.* 437, 445–53 (2006). In fact, many breaches of warranty can also be brought as tort claims, although such claims are not as easily brought now that they can be governed by warranties. See *E. River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 874 (1986).

26. See Duchemin, *supra* note 12, at 690. These tort notions were eventually incorporated into contract law.

27. See 2 *Williston on Sales* § 15-1, at 353–55 (Deborah L. Nelson & Jennifer L. Howicz eds., 5th ed. 1994). As corporations became larger and standard contracts became more common, courts began to read implied warranties into standard contracts in order to protect the basic expectations of consumers. These were initially tort notions, but eventually developed into warranties built into contracts and governed by contract law. The classic case on the emergence of implied warranties from tort law is *Henningsen v. Bloomfield Motors, Inc.*, 161 A.2d 69 (N.J. 1960).

28. See William L. Prosser, *Handbook of the Law of Torts* § 95, at 651 (3d ed. 1964). For a more modern discussion, see Duchemin, *supra* note 12, at 691–92.

of reliance in tort law is that a party needs to have actually relied upon a false claim in order to have been injured by it. In contrast, contract law mandates recovery for breach of a contract, regardless of reliance.

2. *Reliance in Seller Warranties.* — Under warranty law in New York prior to 1990, the buyer had to show reliance in order to enforce a seller warranty.²⁹ This means the buyer had to affirmatively demonstrate that he relied on the substance of the promise made by the seller in the warranty.³⁰ Without reliance, courts found no harm to the buyer and therefore no tortious action. The standard for reliance in New York dates to the 1900 decision *Crocker-Wheeler Electric Co. v. Johns-Pratt Co.*, which stated “in order to entitle the plaintiff to maintain an action for breach of an express warranty, it must be established the warranty was relied on.”³¹ Subsequent New York court decisions affirmed this proposition numerous times.³²

In this fashion, New York courts, like all other U.S. jurisdictions at the time, adhered to the basic idea that substantive reliance is necessary in order to recover under a breach of warranty.³³ Although warranties were an accepted part of contract law by the turn of the century,³⁴ they retained some vestiges of their tort law roots.³⁵ For example, section 12 of the Uniform Sales Act recognized the concept of reliance as central to the ability of a buyer to recover on an express warranty,³⁶ although the Act removed certain other elements of tort law.³⁷

About forty years later, the American Law Institute and the National Conference of Commissioners on Uniform State Laws drafted the

29. Duchemin, *supra* note 12, at 692.

30. See Victor, *supra* note 17, at 485 (noting that courts will ask buyer to demonstrate reliance on warranty). Sometimes this showing was a tremendously difficult hurdle to surmount, as the courts applied a high standard. See Heckman, *supra* note 17, at 35 (arguing that at times courts were “using reliance as a club with which to bludgeon the plaintiff”).

31. 51 N.Y.S. 793, 794 (App. Div. 1898), *aff'd*, 58 N.E. 1086 (N.Y. 1900), and abrogated by *CBS Inc. v. Ziff-Davis Pub. Co.*, 553 N.E.2d 997 (N.Y. 1990).

32. See, e.g., *Holdridge v. Heyer-Schulte Corp.*, 440 F. Supp. 1088 (N.D.N.Y. 1977); *Scaringe v. Holstein*, 477 N.Y.S.2d 903 (App. Div. 1984).

33. See *supra* note 13 and accompanying text.

34. The acceptance of warranties is exemplified by their incorporation into the Uniform Sales Act, written by Professor Williston. See *Unif. Sales Act* § 12, 1 U.L.A. 7 (1908); see also Heckman, *supra* note 17, at 2.

35. For a good overview of the remaining elements of tort reliance in warranty interpretations, see generally James J. White, *Freeing the Tortious Soul of Express Warranty Law*, 72 *Tul. L. Rev.* 2089 (1998).

36. Professor Williston made this clear when explaining the Uniform Sales Act. See Samuel Williston, *The Law Governing Sales of Goods at Common Law and Under the Uniform Sales Act* 270–71 (1909). However, it is also important to note that reliance was of reduced importance as warranty law grew closer to contract law. Professor Williston cautioned that “[t]here is danger of giving greater effect to the requirement of reliance than it is entitled to.” *Id.*

37. See White, *supra* note 35, at 2090 (noting Act removed elements of tort from law of express warranty).

Uniform Commercial Code (UCC).³⁸ Section 2-313 of the UCC moved warranty law closer to pure contract law by eliminating any direct references to reliance, effectively displacing the notion of reliance embodied in the Uniform Sales Act.³⁹ However, the UCC still required that the warranty be a part of the “basis of the bargain” in order to be enforceable, and most scholars and courts have found that this incorporates a watered down version of reliance by implication.⁴⁰ The courts have therefore continued to promote the use of reliance, at least to some degree, when analyzing seller warranties.⁴¹ But some commentators have argued that the most recent developments in contract law, most notably a United Nations convention on international contracting, indicate the final step away from tort law and a complete removal of reliance in warranty law.⁴²

3. *Ziff-Davis and the Presumption Shift.* — In *CBS Inc. v. Ziff-Davis Publishing Co.*, the New York Court of Appeals reversed direction on seller warranties.⁴³ Expressly disavowing the language in *Crocker-*

38. The first definitive version was published in 1950, but before that the UCC went through many drafts. Professor Llewellyn was the primary author of UCC section 2-313, and completed a first draft in 1944. See Heckman, *supra* note 17, at 6–18 (detailing Llewellyn’s experience in drafting UCC).

39. *Id.* at 15–16.

40. Currently every jurisdiction in the United States requires some reliance element when enforcing express warranties. Since the majority of jurisdictions have adopted the UCC, this indicates the courts’ position that reliance of some sort is embodied in the UCC. However, some scholars argue that this was not the intent of the drafters. See, e.g., *id.* at 35 (noting that drafters of UCC section 2-313 did not intend to incorporate reliance, but that scholars and courts have done so anyway); see also Victor, *supra* note 17, at 485 (“Despite the seemingly unequivocal language of official comment 3, many courts still find reliance to constitute a required element in express warranty law.”); *supra* note 18.

41. The “full” form of reliance, which is what the term “reliance” originally denoted, requires that buyers rely on the substance of the warranty. See *supra* notes 29–31 and accompanying text. In contrast, the “weakened” form is the requirement that buyers rely on the warranty as part of the overall bargain of the contract. See *infra* notes 47–49 and accompanying text.

42. The United Nations Convention on Contracts for the International Sale of Goods (CISG), unlike the UCC, does not include any language that can be interpreted as implying a requirement of reliance for the enforcement of seller warranties. See United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, S. Treaty Doc. No. 98-9 (1986), 1489 U.N.T.S. 3; James C. Bruno & Jeffery M. Brinza, CISG’s New Year’s Day Triumph over U.C.C., 66 Mich. B.J. 1206, 1208 (1987) (noting differences between CISG and UCC, where CISG “prohibits unreasonable reliance on an implied warranty for a particular purpose”).

43. 553 N.E.2d 997 (N.Y. 1990). The facts of this case are intriguing. Ziff-Davis, acting through its investment bank Goldman Sachs, solicited bids for the sale of twenty-four publications and magazines, while offering a circular describing Ziff-Davis’s financial condition. CBS made an offer of \$362,500,000, which was accepted in November 1984. Under section 3.5 of the purchase agreement, Ziff-Davis warranted that its income statements and expense reports had been prepared according to the Generally Accepted Accounting Principles (GAAP). While conducting due diligence, CBS discovered in January 1985 that Ziff-Davis’s financial statements might not have been prepared in accordance with GAAP, and CBS accordingly sent a letter to Ziff-Davis to that effect. Ziff-Davis responded by insisting that the warranty was good, and warning that if CBS did not

Wheeler,⁴⁴ it held that the buyer no longer needed to show reliance on the warranty in order to succeed in an action for breach of warranty.⁴⁵ In doing so, the court significantly reduced the influence of the tort notion of reliance in this area of contract interpretation. However, the court carefully pointed out that it did not hold that “no reliance is required, but that the required reliance is established if, as here, the express warranties are bargained-for terms of the seller.”⁴⁶ In other words, the standard changed from a reliance on the substance of the warranty to a reliance on the more general bargain for the warranty.⁴⁷ This parallels the language in the UCC which mandates that a warranty is enforceable as long as it forms “part of the basis of the bargain.”⁴⁸ Indeed, the court looked to the UCC as “instructive” when making its decision.⁴⁹

In addition to this shift toward a more contract-based approach to warranty law, the court in *Ziff-Davis* also made a more subtle change: It effectively switched the presumption of enforceability. As held in *Ziff-Davis*, a seller warranty is still presumptively unenforceable until the buyer shows that the “express warranty [was] part of the bargain between the parties.”⁵⁰ However, the court also noted that warranties are now grounded “essentially in contract” law, which suggests that terms in a contract are presumptively valid, and the court appears to treat this burden on the buyer as a mere formality.⁵¹

go through with the closing of the deal in February that legal action could result. CBS, backed into a corner, agreed to the deal but stipulated that closing on the deal was not to be construed as a waiver of its rights if the warranty were to prove false. As it turned out, the warranty was false. CBS brought suit against Ziff-Davis. Ziff-Davis attempted to defend itself by arguing that CBS could not prove reliance on the substance of the warranty, since CBS had suspected the warranty of being false before the deal closed. Although this probably would have been a winning argument under prior law, the Court of Appeals decided to shift gears and enforce the seller warranty regardless of the lack of substantive reliance. *Id.* at 1001.

44. See *id.* at 1002 n.3 (“[T]o the extent *Crocker-Wheeler* can be broadly read to require the rule of ‘reliance’ urged by *Ziff-Davis* in this case it is not to be followed.”); see also *Crocker-Wheeler Elec. Co. v. Johns-Pratt Co.*, 51 N.Y.S. 793 (App. Div. 1898), *aff’d*, 58 N.E. 1086 (N.Y. 1900), and abrogated by *Ziff-Davis*, 553 N.E.2d 997.

45. *Ziff-Davis*, 553 N.E.2d at 1001.

46. *Id.* at 1002 n.5.

47. To use the previous hypothetical contract between Bob and Sally as a concrete example, relying on the actual engine performance as a result of the warranty would be substantive, but relying on the warranty simply because it was part of the overall contract would be reliance on the general bargain.

48. U.C.C. § 2-313(2) (1957).

49. *Ziff-Davis*, 553 N.E.2d at 1002 n.4. This approach was perhaps the closest the court could move toward the UCC, since the case before it did not involve the exchange of goods, and so was not governed by the UCC.

50. *Id.* at 1001.

51. *Id.* Although the court argues that a buyer must show that it was buying the seller’s promise as to the truth of the guarantee, it proceeds to note that a warranty is “as much a part of the contract as any other term.” *Id.*

Following the lead of *Ziff-Davis*, subsequent New York cases have treated this burden as met when the warranty is in the contract,⁵² which by definition is always the case for express warranties.⁵³ This has the practical effect of shifting the burden to the seller to show that the warranty was not a part of the bargain between the parties, making the warranty clause presumptively enforceable.⁵⁴ A similar shift in the presumptive validity of seller warranties has occurred in other jurisdictions that have adopted the “bargained-for” concept of reliance.⁵⁵ This moves the law of warranties closer to standard contract law, which treats all contract terms as presumptively valid.⁵⁶ However, it also shifts both risks and costs of the enforcement of these warranties to the seller from the buyer.⁵⁷ This shift in presumptions is explored in more detail in Parts II and III, and its effect on costs is examined in Part IV.

B. *Reliance Waivers*

1. *An Overview and History of Reliance Waivers.* — Reliance waivers are similar to seller warranties, except the buyer makes the promise. In the example above, suppose Sally and Bob went out for coffee after the test drive, and during conversation Sally told Bob about several wonderful aspects of the car she is selling. As the sale approaches completion, Sally worries that Bob might hold her to all of those fantastic claims she made earlier over coffee. Bob promises Sally that he is not buying the car based on any of her previous statements, and they include this promise in the written contract for the sale of the car. Bob’s promise has now become a buyer warranty, more commonly called a waiver of reliance or a “reliance waiver” clause.⁵⁸ Reliance waivers such as this one are common in

52. See, e.g., *Rogath v. Siebenmann*, 129 F.3d 261, 264 (2d Cir. 1997).

53. Indeed, the very term “express” is used to distinguish these clauses from “implied” warranties, which are not explicitly part of the contract.

54. Some commentators have argued that this burden on the seller is almost impossible to meet, since only the buyer really knows to what degree he relied on the warranty as part of the bargain. Therefore, the presumption of validity turns into an assumption of validity. See *infra* note 110 and accompanying text.

55. See, e.g., *C.R. Anthony Co. v. Loretto Mall Partners*, 817 P.2d 238, 246 (N.M. 1991) (assuming that express warranty is valid and not finding any nonreliance issues).

56. This discussion somewhat oversimplifies the legal issues, but the basic point is that contract law looks first to what is in the contract to determine liability, and only in certain instances looks outside the contract to bring in parol evidence.

57. See *supra* notes 21–25 and accompanying text (describing risk-allocating and cost-allocating functions of seller warranties).

58. These promises are also often called “merger clauses,” but there is a distinct difference. A merger clause states that the contract constitutes the entire agreement between the parties. The reliance waiver clauses go a step further because the buyer explicitly disclaims any reliance on any statements the seller has made that are not incorporated in the contract. See *Aniero Concrete Co. v. N.Y. City Constr. Auth.*, No. 94 Civ. 9111, 1997 WL 3268, at *7 (S.D.N.Y. Jan. 3, 1997), *aff’d per curiam sub nom. Aetna Cas. & Sur. Co. v. Aniero Concrete Co.*, 404 F.3d 566 (2d Cir. 2005) (acknowledging difference between the two, but using them interchangeably for purposes of facts at hand).

commercial transactions.⁵⁹

Just like seller warranties, reliance waivers developed out of tort law.⁶⁰ They were initially designed to provide protection against tort suits of fraud or misrepresentation in the formation of a contract. These warranties, however, proved to have limited value. If the buyer alleged the seller induced the contract through misleading oral assertions or representations, then a warranty disclaiming any reliance on those representations was held void and unenforceable.⁶¹ The reliance waiver provided the seller no defense, because the fraudulent activity undermined the validity of the entire contract.⁶²

Before moving on, it is important to distinguish two concepts: the reliance that the warranty is protecting, and the reliance that the warranty guards against. The reliance that the warranty is protecting is the seller's reliance on the buyer's promise that he will not claim fraud or misrepresentation based upon any statements not in the contract.⁶³ In contrast, the reliance that the warranty protects against is the buyer's reliance on any seller statements or promises not included in the contract.

There are several legitimate reasons why a seller might want to include a reliance waiver clause in the contract. First, consider the potential hold-up problem. A seller may fear that innocent representations made *ex ante* could be turned against her *ex post*.⁶⁴ Because claims of fraud often turn on questions of fact and thus often go to trial on the merits, the seller could face the costly enterprise of developing a factual and legal defense at trial.⁶⁵ This possibility gives the buyer an opportunity to use the claim of fraud as a bargaining chip *ex post*. In order to help protect against such opportunistic behavior, a seller may ask for

59. In fact, they are so common that they are often deemed unenforceable because they are too standardized or "boilerplate." For a guide to drafting these clauses, see John F. Baughman, Eric Alan Stone & Clifford D. Bloomfield, *Practicing Law Inst., Drafting Corporate Agreements: A Litigator's Perspective*, in *Drafting Corporate Agreements 2007*, at 601, 609 (2007).

60. See *supra* note 27 and accompanying text. Interestingly, although they developed out of the same tort notions of deceit as seller warranties, reliance waivers were effectively nullified by the competing tort notions of fraud and misrepresentation.

61. Cf. *Danann Realty Corp. v. Harris*, 157 N.E.2d 597, 602 (N.Y. 1959) (Fuld, J., dissenting) (asserting that history of merger clauses is that "it matters not" whether clause is general, specific, or even precise to fraudulent allegations).

62. See, e.g., *Bridger v. Goldsmith*, 38 N.E. 458, 459–60 (N.Y. 1894) ("This clause cannot be separated from the transaction in which it originated. It is tainted with the same vice, and must share the same condemnation.").

63. This is analogous to the buyer's reliance on the seller's promise in a seller warranty. See *supra* notes 40–41 and accompanying text.

64. This Note uses the terms "*ex ante*" and "*ex post*" as they are normally used in contract scholarship: to describe the state of the world before and after the implementation of the contract. See *infra* Part IV.A (discussing allocation of contracting costs due to information asymmetries before and after contract completion).

65. Fraud cases are often fact intensive and require a lot of background work to defend. See Michael R. Darby & Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J.L. & Econ. 67, 67–77 (1973) (exploring costs associated with fraud claims).

waivers of reliance in the contract. Thus, by potentially screening out litigious or manipulative buyers, these clauses address an adverse selection problem similar to the “lemons” problem addressed by seller warranties.⁶⁶

A second reason is the agency problem,⁶⁷ which complex commercial transactions may exacerbate. In these transactions, several groups of individuals often work on different parts of the deal.⁶⁸ The principal may ask for a reliance waiver clause to ensure that she will not be held accountable for a misrepresentation or misinterpretation by one of her agents during the course of negotiations.

Although buyers give up a bargaining opportunity in agreeing to reliance waivers, they often benefit proportionately. In exchange for the reliance waiver clause the seller may reduce the cost of the sale,⁶⁹ because the seller no longer has to expend the costs to carefully monitor its agents and their negotiations to avoid claims of fraud.⁷⁰ So the buyer, who may never have intended to sue at all, gains a lower price, while the seller gains some protection against the risk of a lawsuit. These reliance waivers are often boilerplate in nature,⁷¹ but before 1959 were rarely enforceable in New York.

2. *Danann Realty and the Specificity Requirement.* — In *Danann Realty Corp. v. Harris*,⁷² the New York Court of Appeals indicated that reliance

66. See supra note 20 and accompanying text.

67. Agency law governs the interactions between principals and agents, often in business settings. In this case the “agency problem” refers to the fact that a principal in a corporation could potentially be held responsible for statements and representations made by her agents during contract negotiations, even though some of those statements might be misleading or false and would not be approved by the principal. See Eric Rasmusen, *Agency Law and Contract Formation*, 6 *Am. L. & Econ. Rev.* 369, 369–71 (2004) (discussing issues arising from agency representation in contract negotiations).

68. Complex deals are often negotiated over a long period of time, during which several drafts of the contract are negotiated and renegotiated. A reliance waiver clause can serve to ensure that both parties are clear regarding the elements of the final deal. *Id.*

69. This harks back to the idea, found often in law and economics literature, that the party who has the greatest value for avoiding risk, or to whom avoiding risk is worth the most, will end up paying for it. See Scott, *Incomplete Contracts*, supra note 1, at 280 (explaining that contracting parties act rationally, seeking contracts that are value maximizing).

70. See supra note 68 and accompanying text.

71. Most guides to drafting commercial sale agreements include boilerplate language, which is usually used. See David S. Steuer, *Practicing Law Inst., A Litigator’s Perspective on the Drafting of Commercial Contracts*, in *Drafting Corporate Agreements 2007*, supra note 59, at 573, 578–89 (suggesting examples of boilerplate language).

72. 157 N.E.2d 597 (N.Y. 1959). The facts of *Danann Realty* are as follows: The plaintiff, an investor, purchased a lease on a building held by the defendants, largely based upon oral representations made by the defendants about the cost of maintaining the building, and the profits that could be derived from that investment. After profits did not pan out, the plaintiff sued the defendants for fraud. *Id.* at 598. The Court of Appeals noted that while these oral representations might have been misleading, and therefore normally an action of fraud would stand, the reliance warranty in the lease agreement was so particular as to the operating expenses of the building that it would not be fair to the

waivers were sometimes enforceable. The court held that a reliance waiver is enforceable if it is specific enough to show that the buyer disclaimed reliance on particular aspects of the deal or certain representations made by the seller.⁷³ The buyer is then precluded from bringing a tort action of fraud with regard to those particular aspects it disclaimed. The court noted that a general, boilerplate buyer warranty was still not enforceable—it must be specific to the allegations involved.⁷⁴

The doctrine governing buyer warranties has been elaborated since 1959,⁷⁵ but the basic rule remains: “The *Danann* rule operates where the substance of the disclaimer provisions tracks the substance of the alleged misrepresentations.”⁷⁶ By giving more value to the warranty as it stands in the contract, the court in *Danann Realty* (much like the court in *Ziff-Davis* thirty years later) moved warranty law further away from tort and further into the realm of contract. Despite this shift, the court remained concerned that unethical sellers could defraud unwary buyers.⁷⁷ This resulted in the *Danann* compromise: Courts will not enforce a general, boilerplate reliance waiver clause, but they will enforce one that is specific to the alleged fraudulent activity.⁷⁸ In implementing this rule the courts have presumed that a reliance waiver is boilerplate unless the seller demonstrates otherwise.⁷⁹ As a result, the default presumption remains the same—buyer warranties are presumptively unenforceable.

This specificity requirement in *Danann Realty* can be viewed as a proxy for determining if the warranty clause was substantively discussed so as to make the buyer aware of the rights he forfeits.⁸⁰ In other words,

defendants to consider this clause unenforceable. *Id.* at 599. This went against established contract and tort law, and Judge Fuld strongly dissented.

73. *Id.* at 600.

74. *Id.* at 599 (“This specific disclaimer is one of the material distinctions between this case and [our precedents].”).

75. See *Aniero Concrete Co. v. N.Y. City Constr. Auth.*, No. 94 Civ. 9111, 1997 WL 3268, at *7 (S.D.N.Y. Jan. 3, 1997), *aff’d per curiam sub nom. Aetna Cas. & Sur. Co. v. Aniero Concrete Co.*, 404 F.3d 566 (2d Cir. 2005) (summarizing *Danann* rule and modern changes); see also *Grumman Allied Indus., Inc. v. Rohr Indus., Inc.*, 748 F.2d 729, 734–35 (2d Cir. 1984) (“[T]he rule of *Danann* has exhibited great resilience in the face of efforts to delimit its expanse.”).

76. *Grumman*, 748 F.2d at 735.

77. *Danann Realty*, 157 N.E.2d at 600. This concern is much more prevalent in consumer transactions than in transactions involving sophisticated commercial parties. For this among other reasons, the presumption of invalidity can often be relaxed in the latter type of disputes. See *infra* note 153 and accompanying text.

78. See *Aniero*, 1997 WL 3268, at *8 (noting that decision to recognize waiver clause is “buttressed” by fact that “it was tailored to the matter at issue, and was not merely a standard form agreement”).

79. See, e.g., *Grumman*, 748 F.2d at 736 (“[W]e believe, as a matter of law, that the disclaimer provisions in the Agreement relating to design and testing are sufficiently specific and unambiguous to invoke the *Danann* rule.”).

80. This interpretation is supported by the language in *Grumman*. See *id.* at 737 (“It would be unrealistic to ascribe the plaintiff’s officers such incompetence that they did not understand what they read and signed.” (internal quotation marks omitted) (quoting

it uncovers whether the clause was part of the bargain between the parties—the same concern that animated the court in *Ziff-Davis* thirty years later. This symmetry of analyses between reliance waivers and seller warranties makes sense, since both attempt to determine when a warranty can be enforced—and, as noted earlier, both attempt to solve an adverse selection problem. However, this symmetry does not extend to their enforcement. As Part I has shown, reliance waivers remain presumptively unenforceable, while seller warranties are presumptively enforceable. In Part I.C this Note looks more closely at this paradox.

C. Clarifying the Incongruity

1. *The Reliance View.* — As discussed in Part I.A, for seller warranties New York courts require the buyer to have relied upon the warranty as part of the “basis of the bargain.”⁸¹ Reliance waiver clauses have a similar reliance requirement: Under *Danann*, sellers must demonstrate a certain degree of specificity in the reliance waiver clause in order for it to be enforceable.⁸² The *Danann* court implied that the specificity requirement serves as a proxy for the court to determine if the buyer understood the rights he was waiving with this clause.⁸³ This is very similar to requiring the sellers to demonstrate that the warranty clause was part of the basis of the bargain.⁸⁴

Taking this perspective, one can see that reliance waivers require the seller to show reliance on the bargain, just as seller warranties require the buyer to show reliance on the bargain. This symmetry, however, does not resolve the incongruity—it only provides a different way of looking at it.⁸⁵ This is because the courts have interpreted the reliance burden in an incongruent fashion. When it comes to seller warranties, the courts presume that the buyer relied on the warranty clause, but in reliance waivers the courts presume the seller did *not* rely on the waiver clause. Thus, the asymmetry exists not in the clauses themselves, but in the presumptions of validity and reliance the courts use in analyzing them.

Danann, 157 N.E.2d at 599)). More recent cases also support this interpretation. See *Aniero*, 1997 WL 3268, at *7 (noting that specificity requirement can be relaxed when both parties are sophisticated businesses, because they have greater chance of recognizing rights they are surrendering).

81. See *supra* notes 47–48 and accompanying text.

82. See *supra* note 74 and accompanying text.

83. See *Danann*, 157 N.E.2d at 599 (“We can fairly conclude that plaintiff’s officers read and understood the contract, and that they were aware of the provision It is not alleged that this provision was not understood, or that the provision itself was procured by fraud.”). In fact, the specificity of the clause serves to warn the buyer about the specific rights he is giving up. *Id.*

84. See *supra* note 17.

85. Earlier this Note identified the incongruity in terms of the presumptions of enforceability. The discussion here examines the same incongruity, except now in terms of presumptions of reliance.

2. *Presumptive Enforceability*. — The *Ziff-Davis* line of cases and the UCC seem to place a presumption of validity upon seller warranties.⁸⁶ This presumption is strongly implied from the language and precedent set in *Ziff-Davis*,⁸⁷ but the intent of the UCC drafters in this regard is less clear. The UCC is important here not only because so many courts look to it for guidance, but also because the New York courts explicitly adopted the UCC language in later cases.⁸⁸ Yet perhaps New York courts have simply misinterpreted this code. The UCC mandates that an express warranty is created (and enforceable) as long as it is “part of the basis of the bargain.”⁸⁹ Although this standard implies that the burden is on the buyer to show that the warranty is part of the basis of the bargain, it does not outline what that might mean.

Turning to the official comments to UCC section 2-313 provides clarification.⁹⁰ Comment 5 says that affirmations and promises made by the seller are regarded as part of the bargain, and that “no particular reliance . . . need be shown in order to weave them into the . . . agreement.”⁹¹ This supports the stance taken by New York courts that seller warranties are presumptively valid.⁹² Comment 10 also addresses this issue and gives clearer support for this position. Answering a question regarding which of the seller’s statements become part of the basis of the bargain, the commentary says “all of the statements of the seller do so unless good reason is shown to the contrary.”⁹³ This indicates the drafters of the UCC intended to shift the burden to the seller from the buyer,

86. See *supra* Part I.A.

87. See *CBS Inc. v. Ziff-Davis Publ'g Co.*, 553 N.E.2d 997, 1001 (1990) (“The express warranty is as much a part of the contract as any other term.”).

88. Although New York has yet to adopt the new version of UCC Article 3, the older version has substantially similar language in this regard, and has been adopted. See, e.g., Samuel J.M. Donnelly & Mary Ann Donnelly, *Commercial Law 2000–2001 Survey of New York Law*, 52 *Syracuse L. Rev.* 247, 299–300 (2002).

89. U.C.C. § 2-313(2) (1957).

90. There is an ongoing scholarly debate about what degree of persuasiveness to give the official comments to the UCC. While most courts recognize these comments as indicative of the drafters’ intention and as strongly persuasive, some argue that they should not be given any weight as they have not been passed into law by the state legislatures. See Nigel Stark, Note, *Unofficial Official Comments*, 11 *Tex. Rev. L. & Pol.* 479, 488 (2007) (asserting that arguments against judicial use of legislative history also work against UCC Official Comments). Since here this Note looks not to the legislatures’ intent when passing the UCC, but instead at the intent of the drafters, the comments’ persuasiveness is subject to less debate.

91. U.C.C. § 2-313 cmt. 5. For a discussion of this comment, and a related argument that the UCC does not incorporate any standard of reliance into its language, see John E. Murray, Jr., *The Revision of Article 2: Romancing the Prism*, 35 *Wm. & Mary L. Rev.* 1447, 1486 (1994).

92. See *supra* note 54 and accompanying text.

93. U.C.C. § 2-313 cmt. 10. The exact question this answer refers to is: “What statements of the seller have in the circumstances and in objective judgment become part of the basis of the bargain?” The comment then clarifies that statements of the seller that amount to puffery typically should not be considered part of the bargain. *Id.*

and further supports the claim that although the theoretical burden is on the buyer, for all practical purposes it is on the seller.⁹⁴ These comments strongly indicate that the New York courts are not far off base in terms of the UCC; in both current New York law and in the Code, seller warranties are presumptively enforceable.

3. *Presumptive Unenforceability*. — The *Danann Realty* line of cases, and indeed the entire history of reliance waiver clause interpretation, places a presumption of invalidity on reliance waivers.⁹⁵ The continued existence of this presumption is clear in New York law,⁹⁶ but nevertheless the requirement of specificity, and thus the level of presumptive unenforceability, has been dramatically reduced in recent New York cases dealing with sophisticated parties.⁹⁷

In *Citibank, N.A. v. Plapinger*, the New York Court of Appeals found that a reliance waiver did not have to specifically match up with the subsequent claims of fraud in order to be enforceable, at least not when it involved sophisticated business parties and a multimillion dollar deal.⁹⁸ This flexibility when dealing with sophisticated parties was cited and used by the Southern District of New York a few years later in *Aniero Concrete Co. v. New York City Construction Authority*.⁹⁹ Although this recent shift in interpretation moves reliance waiver clauses closer to being presumptively enforceable, it falls far short of that line. Both *Citibank* and *Aniero* begin with a clear presumption of unenforceability when interpreting these clauses.¹⁰⁰ Note also that New York is moving into novel territory

94. See supra Part I.A (explaining how burden is shifted to seller).

95. See supra Part I.B. The presumption was a lot stronger before *Danann Realty*, but even afterward the presumption remains against the seller.

96. See infra note 156 (illustrating presumption of invalidity present even in cases finding valid waiver).

97. See, e.g., *Grumman Allied Indus., Inc. v. Rohr Indus., Inc.*, 748 F.2d 729, 734 (2d Cir. 1984) (“Particularly where the two sides are sophisticated, their allocation of risk and potential benefit is properly treated as supreme to any conflicting understanding we may have.”); *Citibank, N.A. v. Plapinger*, 485 N.E.2d 974, 977 (N.Y. 1985) (citing negotiations between sophisticated parties as factor in giving effect to reliance waiver clause that is not very specific to claims of fraud).

98. 485 N.E.2d at 976–77 (“[H]ere we do not have the generalized boilerplate exclusion Rather, following extended negotiations between sophisticated business people, what has been hammered out is a multimillion dollar personal guarantee proclaimed by defendants to be ‘absolute and unconditional.’”).

99. No. 94 Civ. 9111, 1997 WL 3268, at *7 (S.D.N.Y. Jan. 3, 1997), aff’d per curiam sub nom. *Aetna Cas. & Sur. Co. v. Aniero Concrete Co.*, 404 F.3d 566 (2d Cir. 2005).

100. *Citibank*, 485 N.E.2d at 975 (finding “language of disclaimer in the guarantee is sufficiently specific to foreclose as a matter of law the defenses and counterclaims based on fraud” (footnote omitted)); see also *Aniero*, 1997 WL 3268, at *8 (“Thus, a general disclaimer that a party has relied on any representations of the other signatory, coupled with the disclaiming party’s assertion of familiarity with a particular subject area, is specific enough to preclude a claim of reliance on statements falling within that topic.”).

with this shift of presumptions,¹⁰¹ and courts generally move cautiously when changing an established common law precedent.¹⁰²

In Part I this Note has established and explored an apparent incongruity in the enforcement presumptions for warranty law, but has not yet explored the underlying rationale. This is precisely what Part II attempts to do through an information asymmetry theory.

II. THE INFORMATION ASYMMETRY HYPOTHESIS

This Part develops the hypothesis that a perceived information disparity between buyers and sellers drove the change in enforcement presumptions in New York's warranty law. Part II.A.1 discusses the role of warranties in transferring information, and Part II.A.2 builds on this discussion to describe how the current default presumptions move information to the buyer. Finally, Part II.B assembles this framework to propose that seller warranties and reliance waivers are incongruently enforced in order to incentivize the parties to remedy an information asymmetry that favors sellers.

A. *Information to the Buyers*

1. *Allocation of Information.* — As outlined in Parts I.A and I.B, there are many reasons why sophisticated commercial parties might agree to include seller warranties and reliance waivers in their contracts. An important theme that runs through all of those reasons is the allocation of risk and cost, which is central to the concept of warranty clauses.¹⁰³ Seller warranties allocate the risk of product defects to the seller, and reliance waiver clauses allocate the risk of misunderstandings about the product to the buyer. Viewed from a broader perspective, the risk that is being traded is the risk of the unknown.¹⁰⁴ Buyers simply do not know what the risk of product failure is going to be, and as a result are willing to pay extra for a seller warranty that removes that risk. In an analogous fashion, sellers do not know what the risk of a buyer lawsuit is going to be,

101. See *supra* note 11 (explaining that New York is rare instance of such shift).

102. See, e.g., C. Christopher Brown, *A Search for Clarity and Consistency in Judicial Process: The Maryland Court of Appeals Decides Whether to Change Common-Law Rules*, 62 Md. L. Rev. 599, 602–04 (2003) (describing slow process through which state courts change common law rules).

103. See, e.g., *E. River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 872–73 (1986) (“Contract law, and the law of warranty in particular, is well suited to commercial controversies . . . because the parties may set the terms of their own agreements. The [seller] can restrict its liability, within limits, by disclaiming warranties or limiting remedies. In exchange, the purchaser pays less for the product.” (citation omitted)).

104. The concept of contracting parties negotiating with imperfect information is the backbone of the “incomplete contracts” theory of contracting. For a good overview of this theory, see generally Robert E. Scott & George G. Triantis, *Incomplete Contracts and the Theory of Contract Design*, 56 Case W. Res. L. Rev. 187 (2005) [hereinafter Scott & Triantis, *Contract Design*].

and are often willing to pay extra to minimize that risk through a reliance waiver clause.¹⁰⁵

Allocating an unknown risk is one way of transferring information between the parties, and warranties provide a vehicle for this transfer. Sellers have a much better idea of the risk of product failure than the buyers have, since it is their product. As a result, the seller is often in a better position to evaluate and price this risk,¹⁰⁶ and the buyers are willing to pay for sellers to do so as long as the price does not exceed the cost of determining the risks themselves.¹⁰⁷

A similar transfer of information occurs through reliance waivers. Buyers know how likely they are to bring a lawsuit for fraud or misrepresentation, and so they are in a better position to price that risk. Sellers will pay for these waivers as long as they do not exceed the costs of the eventual lawsuits.¹⁰⁸ Thus, as this Note has earlier discussed, warranties can help solve an adverse selection (or “lemons”) problem by allocating risk more efficiently.¹⁰⁹ By placing these clauses in the contracts, buyers and sellers trade information and create a mutually beneficial and efficient transaction.

2. *Buyer Favoritism.* — How does this fit into the incongruent presumptions between seller warranties and reliance waivers? The next step is to notice that both current presumptions benefit the buyer, even though seller warranties and reliance waivers transfer information in opposite directions. In seller warranties, in effect, the buyer has the benefit unless the seller can prove nonreliance on the bargain.¹¹⁰ Since nonreli-

105. See Scott, *Incomplete Contracts*, supra note 1, at 280. The mitigation of risk and allocation of costs are not mutually exclusive and can overlap to a significant degree. In fact, often one of the best ways to mitigate risk for one party is to allocate the costs of the risk to the other party. *Id.*

106. In complex commercial transactions, this disparity of information regarding the product is not as one-sided as it can be with normal consumer contracts. In complex business deals, the buyers often do a great deal of their own due diligence research and have more information as a result. However, the existence of proprietary or confidential information, as well as the increased complexity of what is being sold, generally combine to result in a disparity of information favoring the seller even in these commercial transactions. See, e.g., *CBS Inc. v. Ziff-Davis Publ'g Co.*, 553 N.E.2d 997, 998–99 (N.Y. 1990) (noting CBS could not access Ziff-Davis’s financial information to ensure GAAP compliance but CBS’s extensive due diligence alerted it to possible problems with that warranty).

107. Buyers, just like sellers and any other party to the contract, will usually try to minimize the overall contracting costs. If the cost of the warranty is so high that the buyer can find out the information on his own for less, or if risking a lawsuit later on would be less costly, then the buyer will probably forgo the warranty to minimize costs. See Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 *Yale L.J.* 814, 823 (2006) [hereinafter Scott & Triantis, *Anticipating Litigation*] (describing ex ante marginal cost problem faced by contracting parties).

108. *Id.*

109. See supra notes 20–25 and accompanying text.

110. As some commentators have noted, this is a very tough position. See, e.g., Heckman, supra note 17, at 35 (“[S]hifting the burden of proof to the defendant will often

ance of the other party is such a difficult threshold to surmount, the presumption in favor of the buyer in these cases is very strong.¹¹¹ Indeed, the court in *Ziff-Davis* appeared to have the interests of the buyer at the forefront of its mind when it changed the common law in New York for seller warranties.¹¹² Before *Ziff-Davis*, the buyer had to prove reliance in order to enforce the warranty, and courts often required a strong substantive showing of reliance.¹¹³ Now the presumption has changed, and sellers often have difficulty proving the unenforceability of a warranty.¹¹⁴

Reliance waivers, although designed to transfer information to the seller, have also been interpreted to benefit the buyer. The seller has the burden of proving that the waiver clause is specific to the buyer's allegations in order to defeat the claim and enforce the warranty.¹¹⁵ If the seller cannot meet this burden then the clause is unenforceable and the buyer can bring, or threaten to bring, an action for fraud or misrepresentation.

The degree of information shift that is required differs with the clause. Seller warranties already exist to transfer information from the seller to the buyer for a price, and so all a court has to do in order to promote its information disparity reduction goal is to enforce these contract clauses as written, which is what the New York court did in *Ziff-Davis*.¹¹⁶ In contrast, reliance waiver clauses are designed to transfer information from the buyer to the seller for a price. In order to reverse this flow a court has to create an information-forcing rule for sellers: the requirement of specificity.¹¹⁷

put that party in the impossible position of disproving reliance. . . . [T]he seller is in no better position, if the burden is on him to prove nonreliance, than he would be if reliance were abolished entirely.”).

111. The buyer, not the seller, has all of the evidence in this regard. Moreover, this burden introduces a dangerous incentive for the buyer to perjure. *Id.* at 34.

112. The court clearly sympathized with CBS's predicament and was trying to find a way to enforce the warranty. *CBS Inc. v. Ziff-Davis Publ'g Co.*, 553 N.E.2d 997, 1002 (N.Y. 1990) (“[I]f Ziff-Davis's position were adopted, it would have succeeded in pressing CBS to close despite CBS's misgivings and, at the same time, would have succeeded in defeating CBS's breach of warranties action because CBS harbored these *identical misgivings*.”).

113. Some argue that the courts went too far, “using reliance as a club with which to bludgeon the plaintiff.” Heckman, *supra* note 17, at 35.

114. *Id.*

115. See *Aniero Concrete Co. v. N.Y. City Constr. Auth.*, No. 94 Civ. 9111, 1997 WL 3268, at *7 (S.D.N.Y. Jan. 3, 1997), *aff'd per curiam sub nom. Aetna Cas. & Sur. Co. v. Aniero Concrete Co.*, 404 F.3d 566 (2d Cir. 2005) (explaining that courts will not enforce general boilerplate reliance waiver clauses, but will enforce ones specific to alleged fraudulent activity).

116. *Ziff-Davis*, 553 N.E.2d at 1002.

117. Information-forcing rules are rules that impose a penalty when one of the parties does not include certain information in the contract. An example of a very basic information-forcing rule is the four corners rule, which does not allow the enforcement of terms agreed upon outside the contract. This forces the parties to include all their information up front in the contract. See Joshua A.T. Fairfield, *The Search Interest in Contract*, 92 *Iowa L. Rev.* 1237, 1267 (2007). In just such a fashion, the requirement of

In sum, these two clauses, as enforced in New York, represent information transfer vehicles that are enforced via presumptions that benefit the buyer. The purpose of the warranties is to deal with information asymmetries that create adverse selection problems, whereas the purpose of the presumptions is to deal with the embedded information asymmetries in those warranties. This analysis indicates that courts perceive an information disparity between buyers and sellers, with the seller having the informational advantage.¹¹⁸

Indeed, in the majority of transactions that occur in the business world the seller knows more about the object of the sale than the buyer does.¹¹⁹ Harking back to the example used in Parts I.A and I.B, Sally knew more about the car than Bob did. While Bob could inspect the car himself, and perhaps even have a mechanic look it over, he is still going to have less information about the potential upsides and downsides to buying the car than Sally does. The more complex the transaction and the object of the sale, the greater the disparity in information is likely to be.¹²⁰

B. *Hypothesis: Information Asymmetry*

This Note argues that seller warranties and reliance waivers are incongruently enforced in order to incentivize the parties to remedy an information asymmetry that favors the seller. Since the seller is more likely to have the relevant information about the value of a seller warranty, it is more efficient to place the burden of the presumption on the seller rather than the buyer.¹²¹ By making seller warranties more enforceable, the new presumptions force sellers to make a decision: either keep a warranty that might precipitate a lawsuit, or remove the warranty

specificity for reliance waiver clauses means that these clauses will not be enforced unless the sellers include very specific information in them.

118. This aspect of warranty law is governed both by common law and statutes, most states having adopted the UCC in some form or another.

119. While sellers often have more information than buyers do, debates often arise over what the seller actually knows at the time of sale, because seller knowledge is required for torts of deceit and fraud. As a result, paragraphs that define “knowledge” of the seller are commonplace in warranty clauses of commercial contracts. See Richard A. Goldberg & Justine F. Jones, *Practicing Law Inst., Negotiating the Purchase Agreement, in A Guide to Mergers and Acquisitions 2002*, at 361, 379 (2002).

120. See *supra* note 106.

121. The overall better decisionmaker is clearly the seller in consumer situations. In dealings between sophisticated parties, there is likely to be a greater degree of parity in terms of understanding the business implications, and the identity of the best decisionmaker may be less clear. Nevertheless, the overall purpose of contract warranty law (determining what the seller is actually selling) creates a reasonable presumption that the seller is better positioned to make critical determinations. See Heckman, *supra* note 17, at 36–38 (arguing seller should be held strictly liable).

and lower the price of the sale.¹²² The seller can make the most efficient decision because she is in the best position to know the value of the warranty. The result of this process presents valuable information to the buyer: either the warranty is no good and is removed, or the warranty remains and is more likely to be valid.¹²³ Seller warranties are already designed to transfer information from the seller to the buyer,¹²⁴ and so in order to promote this information transfer all the courts need to do is enforce these warranties. This is precisely what the court accomplished in *Ziff-Davis*.¹²⁵

In contrast, reliance waivers present a somewhat more complicated picture. As mentioned earlier in this Note, buyers are better positioned to know how likely they are to bring a lawsuit for fraud or misrepresentation, and so they are in the best position to sell insurance against these claims to sellers in the form of reliance waiver clauses.¹²⁶ Why should reliance waivers be interpreted to transfer information from the seller to the buyer if buyers already have the relevant information? The previous discussion, however, was incomplete—in fact, a buyer may have no idea at the time of the sale how likely he is to bring a lawsuit, because he does not yet know if any of the claims made by the seller are false or misleading.¹²⁷ From this perspective it appears that it is actually the seller who has the informational advantage. Once again assuming that the seller knows her product better than the buyer, the seller will also have a better idea as to the veracity of the claims she or her agents have made during the negotiations.¹²⁸ This analysis explains how the shift of presumptions in *Danann Realty* promotes information transfer to the buyer, and also provides a glimpse into why the common law has always treated these clauses as presumptively unenforceable.¹²⁹

122. This discussion assumes that the warranty was a bargained-for portion of the sale and has a monetary value, which is probably a reasonable assumption in serious contract disputes.

123. See *infra* notes 188–189 and accompanying text.

124. See *supra* note 22 and accompanying text.

125. *CBS Inc. v. Ziff-Davis Publ'g Co.*, 553 N.E.2d 997, 999 (N.Y. 1990).

126. See *supra* note 108 and accompanying text.

127. This ignores the scenario in which a buyer intends to threaten a fraud lawsuit *ex post* simply to gain a bargaining advantage and perhaps renegotiate the contract. Although this sort of disreputable dealing undoubtedly occurs, this Note focuses on legitimate claims for fraud or misrepresentation.

128. In sophisticated transactions, this informational advantage of the seller may not be as great as in consumer situations, but the differences of degree do not go so far as to have a significant effect on the argument. See *supra* note 121 and accompanying text.

129. See *supra* notes 61–62 and accompanying text. The above discussion implies that reliance waivers have always been presumptively unenforceable because they serve to protect the seller, when it is the buyer that needs protection. Such a clause only serves to reinforce the seller's informational advantage, and as such enforcing it would create inefficiencies and a significant moral hazard for the seller. Of course, between sophisticated parties, one would assume that this clause only exists because it is a bargained-for clause in the contract, and so nonenforcement also contradicts common ideas of contract efficiency. The solution that the New York courts have arrived at is to not

A possible counterargument for this hypothesis involves seller warranties. Although the seller has more information, it is not clear that the presumption of warranty validity addresses the information asymmetry in non-gray area cases,¹³⁰ such as when a warranty is clearly applicable. If sellers know they will be liable for their warranties, they may simply not include them in the contract at all. This could remove information from the buyer and increase the informational disparity.¹³¹ A good response to this counterargument is that sellers have an incentive to include these warranties in their contracts in order to distinguish their products and solve the adverse selection problem.¹³² Moreover, if the warranties that sellers might now remove from the contracts were not enforceable under pre-*Ziff-Davis* law, then such warranties did not provide any valuable information since sellers were not expecting them to be enforced.¹³³ It is even possible that they were spreading *misinformation*, and so removing them would actually decrease the information disparity. Regardless, it seems that the warranties that would drop out of contracts as a result of this rule do not result in an information loss for buyers, and thus the argument does not detract from the information asymmetry hypothesis.

III. PREDICTIONS AND MODERN DEVELOPMENTS

The information asymmetry hypothesis follows from a close reading of the law and the cases, but is this really the underlying rationale for these default rules? One way to test a hypothesis is to make predictions, and then see if those predictions match the real world results. Part III.A reviews predictions that follow from the information asymmetry hypothesis, and Part III.B looks to the case law to see if those predictions are supported.

A. Predictions

1. *Information Asymmetry Predictions.* — The information asymmetry hypothesis proposed by this Note, which argues that the incongruent enforcement of seller warranties and reliance waivers promotes information

enforce the clause with respect to consumer contracts, but relax this presumption significantly in cases involving sophisticated parties. See, e.g., *Grumman Allied Indus., Inc. v. Rohr Indus., Inc.*, 748 F.2d 729, 736–38 (2d Cir. 1984).

130. The gray area cases are ones where the buyer suspects that the warranty is no good, and whether the warranty is actually good or not is legitimately debatable, but the buyer completes the deal regardless and the court later finds the warranty was no good.

131. A seller would probably not include seller warranties if he believed that the ex post costs of litigating the warranty or a breach of warranty would be greater than the ex ante costs of including it, which would almost certainly be the case since the change in presumptions increases the ex post costs on the seller dramatically. See *infra* note 186 and accompanying text.

132. See *supra* notes 20–22 and accompanying text.

133. They might have provided some information, but since it would be difficult for the buyer to tell if it were correct, such information would not be reliable, which means it was not valuable in terms of the contract to the buyer.

transfer from sellers to buyers, can be tested by attempting to predict the basic contours of the evolution of common law in New York. The central prediction is simple: Actions or circumstances that reduce the informational disparity between sellers and buyers should mitigate the force of the pro-buyer presumptions.¹³⁴ If these presumptions exist primarily to facilitate an information transfer from sellers to buyers, they become moot when that information transfer has already occurred.

This prediction affects seller warranties and reliance waivers in slightly different ways. As applied to seller warranties, this prediction means that if sellers give information to buyers about the value of the warranty, then the pro-buyer presumption should be relaxed.¹³⁵ In this case, the pro-buyer presumption is a presumption of warranty validity,¹³⁶ so it should be relaxed into an assumption that the warranty is of questionable validity, or perhaps invalidity. As applied to reliance waivers, this prediction means that if sellers give information to the buyers regarding the value of their representations and other statements made outside the contract, then the pro-buyer presumption would be relaxed. In fact, this is the case with the current *Danann Realty* rule, because it is an information-forcing rule.¹³⁷ In this case the pro-buyer presumption is one of in-

134. Thus, the prediction is that the presumption operates in a manner similar to information-forcing rules, which are common in the world of contracts. See *supra* note 117. The textbook example of information-forcing is the rule espoused in *Hadley v. Baxendale*, (1854) 156 Eng. Rep. 145 (Ex.), which limits damages for breach of contract by imposing a foreseeability requirement. For a brief synopsis, see Russell Korobkin, “No Compensation” or “Pro Compensation”: *Moore v. Regents* and Default Rules for Human Tissue Donations, 40 J. Health L. 1, 16–18 (2007) [hereinafter Korobkin, No Compensation] (explaining that information-forcing rules are created “by making the default rule one that is unattractive to better-informed parties, thus encouraging them to explicitly opt for an alternative contract term”); see also *supra* note 117 and accompanying text.

135. Actually, to reduce the informational disparity between the parties it is not necessary for the information to come from the seller. As long as the buyer has the same information about the value of the warranty as the seller, the information asymmetry disappears. The law, however, is designed to promote an information transfer from the seller to the buyer. In addition, the buyer should only act on information if he has reason to believe the information is valid, and the true value of the seller’s warranty can only come from the seller. See *Rogath v. Siebenmann*, 129 F.3d 261, 265 (2d Cir. 1997) (discussing importance of whether buyer had information regarding value of seller’s warranty).

136. See *supra* note 87 and accompanying text.

137. It is information-forcing because it imposes a penalty. See Korobkin, No Compensation, *supra* note 134, at 16–17. There are many forums in which this information transfer can occur. The most obvious would be a direct transfer whereby the seller lists all of the representations that she made during the negotiations, and lets the buyer know the value of each one. This is unlikely to occur in sophisticated transactions because of its sheer impracticability and high costs. On a slightly more general level, this information transfer could occur by the seller’s outlining the specific areas where she feels she needs to be protected by the reliance waiver clause, thereby signaling to the buyer which areas are of higher value. This is precisely what happened in *Danann Realty*. See *supra* notes 73–74 and accompanying text. More evidence that this penalty default rule is promoting information transfer is that practical guides for lawyers encourage specificity to

validity, and so it would be relaxed toward validity. Both of these doctrines have had time to develop, and these predictions can be tested against the law.

B. *Testing the Predictions: The Evolution of New York Law*

1. *Testing the Seller Warranty Predictions.* — Although seller warranties are enforced in New York along the lines laid out in *Ziff-Davis*, the doctrine has evolved to encompass certain exceptions and clarifications that can help test the information asymmetry hypothesis. Two of the most significant clarifications have come from the Second Circuit.¹³⁸

In *Galli v. Metz*, the Second Circuit distinguished the holding of *Ziff-Davis* with regard to the time the buyer learns the seller warranty is no good. This case involved the sale of a company.¹³⁹ The sellers (Galli and Yeager) included a standard warranty clause in the sale contract stating that they were not “aware of any facts which might result in any . . . claim . . . which might adversely affect the business.”¹⁴⁰ The buyer (Metz) sued the sellers because the business was named as a third-party defendant in an environmental lawsuit. The buyer claimed that the sellers had knowledge of this post-sale liability at the time of the sale, and as a result had breached the contract warranty.¹⁴¹ The court found that, although the sellers knew about this litigation at the time of the sale, they did not breach the warranty because they disclosed the information to the buyer before the deal closed. The court distinguished *Ziff-Davis* as a case of ongoing dispute as to the accuracy of the warranty, whereas in this case there was no such dispute.¹⁴² As a result, the court basically held that a warranty is not a bargained-for term if the buyer learns of its falsity before the deal closes.

The holding of *Galli v. Metz* supports this Note’s predictions about information asymmetry.¹⁴³ By letting Metz know that the warranty had no value, Galli and Yeager eliminated the informational disparity and

comply with these new rules. See, e.g., Glenn D. West & Emmanuel U. Obi, Corporations, 60 SMU L. Rev. 885, 907 (2007) (“The importance of carefully crafting your ‘nonreliance’ and ‘merger’ clauses to remove any possible ambiguity concerning the non-applicability of other purported terms or promises outside of the final negotiated written agreement cannot be overemphasized.”).

138. Although the New York Court of Appeals has not yet had a chance to rule on the holdings of these two Second Circuit cases, the holdings are consistent with the language and direction of *Ziff-Davis*.

139. More accurately it involved the sale of three related companies: Betuna Corporation and its two subsidiaries (Peterson Petroleum Corp. and Pulver-Simmons-Mulhern, Inc.). 973 F.2d 145, 149 (2d Cir. 1992).

140. *Id.* at 150.

141. *Id.*

142. “*Ziff-Davis* has far less force where the parties agree at closing that certain warranties are not accurate.” *Id.* at 151.

143. See *supra* Part III.A.

hence eliminated the need for the presumptive validity of the seller warranty.¹⁴⁴

Another way to look at this case, which also fits with this Note's hypothesis, is that the rationale for protecting the buyer is greatly reduced as a result of this information transfer, and so it makes sense for the courts to determine that the seller has met her burden of showing buyer nonreliance.¹⁴⁵ Of course, this raises the thorny question of how certain the buyer must be of the falsity in order to have "waived" the warranty.¹⁴⁶

The Second Circuit again tackled this question five years later in *Rogath v. Siebenmann*, where it held that the buyer waives the breach of warranty only when he learns of the falsity of the warranty directly from the seller.¹⁴⁷ If the buyer simply suspects the warranty might be false, based upon his own investigation or information from some third party, then it is still conceivable that he is relying on the warranty as insurance against these suspicions.¹⁴⁸ This claim, however, is no longer reasonable if the buyer learns of the falsity of the warranty directly from the seller.

144. While this result is directly in line with the earlier hypothesis, it does not address the issue of why the courts would not follow the four-corner rule and enforce the seller warranty regardless of the buyer's knowledge. This issue is discussed in Part IV.

145. See *supra* note 110. Since the burden of showing nonreliance can be so difficult to meet, it might be that the courts have carved out this standard as a demonstration of how it might be applied in practice.

146. *Galli*, 973 F.2d at 151. The court argues that the right to bring a claim is "waived" implicitly by the buyer once he learns from the seller about the false warranty. Technically speaking the right has not been waived, but rather the seller has a positive defense to the claim. This tangle of terminology is explained in Sidney Kwesiel, *Express Warranty as Contractual—The Need for a Clear Approach*, 53 *Mercer L. Rev.* 557, 576 (2002) ("[B]y speaking in terms of waiver such as 'waived the breach,' the Second Circuit masked the real issue . . ." (footnote omitted)). The buyer can retain the right to bring a claim by explicitly setting it down in writing, as CBS did in the *Ziff-Davis* case. *Galli*, 973 F.2d at 151.

147. 129 F.3d 261, 266–67 (2d Cir. 1997). In this case, the defendant Siebenmann sold a painting to the plaintiff Rogath for \$570,000. *Id.* at 262–63. Rogath later sold the painting to Acquavella Contemporary Art, Inc. for \$950,000. However, Acquavella later learned that the painting might be fraudulent and requested a refund from Rogath. Rogath refunded Acquavella the \$950,000 and immediately sued Siebenmann for breach of contract and fraud. *Id.* The sale contract between the two parties included a warranty in which Siebenmann attested that he was not aware of any authenticity problems with the painting. Siebenmann argued that, even if this were true, Rogath knew about the authenticity debate surrounding the painting and so the warranty was not enforceable. *Id.* Although this was a motion for summary judgment, and as such did not get into the facts, the court clearly stated that the buyer must learn about the value of the warranty from the seller, and not a third party, in order to invalidate the warranty. *Id.* at 266.

148. *Id.* at 265. The characterization of a warranty as a form of insurance against suspicions that something might be wrong with the product can also be found in *Ziff-Davis*. *CBS Inc. v. Ziff-Davis Publ'g Co.*, 553 N.E.2d 997, 1002 (N.Y. 1990). This characterization is unfortunate because it leads to the inevitable question of why the buyer cannot plausibly buy insurance against suspicions of the seller, instead of having those suspicions void the warranty.

As a result, “what the buyer knew and, most importantly, whether he got that knowledge from the seller are the critical questions.”¹⁴⁹

This important distinction also fits neatly with this Note’s hypothesis. Although the information disparity has been reduced, remember that the information of concern is not information about the product, but about the value of the warranty.¹⁵⁰ If the buyer learns that the product is defective, he would still have questions or doubts about the applicability of the particular defect to the mechanics of the sale. This relates to the value of the seller warranty. In addition, it would impair the incentives created by the default rule.¹⁵¹ In other words, the information that is transferred through the warranty is the information from the seller—and if that particular brand of information is not transferred, the law is not serving its purpose. If the seller does not transfer the relevant information to the buyer and still is allowed to escape liability, then this possible rationale of the law would be circumvented.

2. *Testing the Reliance Waiver Prediction.* — Along with the *Danann* rule, one development and one exception form the backbone of reliance warranty jurisprudence in New York. Both of these aspects of reliance warranty law match the predictions of the information asymmetry hypothesis.

First is the *Danann* rule’s most significant development over the past fifty years, which occurred with respect to sophisticated parties.¹⁵² Under the new doctrine, when more sophisticated parties are involved in deals, the requirements of specificity in the merger clause are reduced.¹⁵³ In addition to the *Citibank* example discussed earlier, the case of *Grumman Allied Industries, Inc. v. Rohr Industries, Inc.* also highlights this point.¹⁵⁴ The exception makes sense because sophisticated parties, which have access to teams of lawyers and which spend months or years completing a business sale or merger, tend not to have as large of a disparity of information as exists between parties in a normal consumer transaction.¹⁵⁵ Of course, as the deal grows bigger and more complex it is also increasingly

149. *Siebenmann*, 129 F.3d at 265.

150. See *supra* note 135 and accompanying text.

151. The default rule in this case is a presumption of warranty enforceability, which places the burden on the seller.

152. See *supra* notes 97–102 and accompanying text.

153. See *Aniero Concrete Co. v. N.Y. City Constr. Auth.*, No. 94 Civ. 9111, 1997 WL 3268, at *7 (S.D.N.Y. Jan. 3, 1997), *aff’d per curiam sub nom. Aetna Cas. & Sur. Co. v. Aniero Concrete Co.*, 404 F.3d 566 (2d Cir. 2005) (“The specificity requirement is further relaxed when the contracting parties are ‘sophisticated business people,’ and the disclaimer clause is the result of negotiations between them.” (quoting *Citibank, N.A. v. Plapinger*, 485 N.E.2d 974, 977 (N.Y. 1985))).

154. *Grumman Allied Indus., Inc. v. Rohr Indus., Inc.*, 748 F.2d 729, 734 (2d Cir. 1984) (“Particularly where the two sides are sophisticated, their allocation of risk and potential benefit is properly treated as supreme to any conflicting understanding we may have.”).

155. See, e.g., *Citibank*, 485 N.E.2d at 977 (noting “extended negotiations” that occurred between parties as reason for giving effect to the waiver).

hard for the buyer to know everything about the transaction, which might tend to cancel out that effect. Nevertheless, the language in opinions that use a more relaxed pro-buyer presumption supports the idea that information asymmetry is a driving force behind the reliance waiver default rules.¹⁵⁶ This supports this Note's predictions about reliance waivers: As the buyer gains more information about the company, he is better able to independently evaluate the veracity of the seller's claims. His increased knowledge reduces the information disparity, and so reduces the amount of information that needs to be transferred in the reliance waiver.

In addition to this modern development, the preservation of an old exception to the presumptive invalidity of reliance waivers also supports this Note's hypothesis. The only significant exception to the *Danann* rule is that the buyer cannot bring a claim if "the facts represented are not matters peculiarly within the [seller's] knowledge, and the . . . [buyer] has the means available to him of knowing . . . the truth . . . of the subject of the representation."¹⁵⁷ This is true even if the clause is specific to the fraudulent allegations of the buyer, as the *Danann* rule requires.¹⁵⁸ In other words, the buyer cannot claim to have been misled by the seller if the buyer could have easily discovered he was being misled, and if he did not trust in any sort of specialized or particular knowledge of the seller.¹⁵⁹ If the facts are not peculiarly within the seller's knowledge, then the buyer has the obligation to use "ordinary intelligence"¹⁶⁰ in discovering the truth, or else he will not be able to bring an action in court.¹⁶¹ This exception was reaffirmed in *Danann Realty*.¹⁶²

This exception does not exactly fit this Note's prediction. The potential moral hazard problem, however, can reconcile the existing doc-

156. See *Aniero*, 1997 WL 3268, at *8 (referring to buyer claim that it unknowingly waived its rights and noting holding is "further buttressed . . . by the fact that the plaintiff is a business sufficiently large and sophisticated to take on a project whose cost it estimated at close to \$19 million"); *Citibank*, 485 N.E.2d at 976-77 ("But here we do not have the generalized boilerplate exclusion referred to [in *Danann*]. Rather, following extended negotiations between sophisticated business people, what has been hammered out is a multimillion dollar personal guarantee proclaimed by defendants to be 'absolute and unconditional.'").

157. *Schumaker v. Mather*, 30 N.E. 755, 757 (N.Y. 1892).

158. *Id.*

159. The seller's knowledge need not be specialized. The term generally used is "'peculiarly' within the seller's knowledge," which encompasses proprietary information as well. See, e.g., *id.*

160. *Id.*

161. This exception has been around for a long time. It existed as far back as 1871, when the U.S. Supreme Court said: "If, having eyes, [the buyer] will not see matters directly before them, where no concealment is made or attempted, he will not be entitled to favorable consideration when he complains that he has suffered from his own voluntary blindness, and been misled by overconfidence in the statements of another." *Slaughter's Adm'r v. Gerson*, 80 U.S. (13 Wall.) 379, 383 (1871). It was affirmed as a part of New York law in *Sylvester v. Bernstein*, 127 N.Y.S.2d 746, 748-49 (App. Div. 1954).

162. *Danann Realty Corp. v. Harris*, 157 N.E.2d 597, 600 (N.Y. 1959).

trine with this Note's model.¹⁶³ This Note predicts that any information transfer from sellers to buyers that reduces the information disparity will relax the pro-buyer presumption of invalidity.¹⁶⁴ Here courts relax the pro-buyer presumptions, but there is no information transfer. If this Note's hypothesis is correct, the courts might be reasoning that there is no point in creating incentives for the seller to transfer information to the buyer if the buyer already has the means to ascertain information through the use of "ordinary intelligence."¹⁶⁵

The moral hazard emerges from the information-forcing aspect of the legal presumption. When dealing with seller warranties, the default rule simply enforces the contract clause as written. However, the potential imposition of a penalty on the seller in the seller warranty context could easily incentivize inefficient behavior on the part of the buyer, thereby creating a moral hazard.¹⁶⁶ In other words, the buyer has no incentive to act reasonably in evaluating the claims of the seller, because the rules are in the buyer's favor. By enforcing the second exception discussed above, the courts have created an incentive for buyers to exercise a minimal level of "ordinary intelligence" in their dealings.¹⁶⁷ This incentive mitigates the moral hazard of the reliance waiver clause, and reconciles the exception with this Note's information asymmetry hypothesis.

The predictions of the information asymmetry hypothesis appear to be supported by the developments and exceptions to both seller warranty law and reliance waiver law, as enforced by New York state courts and the Second Circuit. In situations where sellers transfer information about the

163. Generally, a moral hazard is the prospect that a party insulated from risk may behave differently from the way it would behave if it were fully exposed to the risk. This is because the protected party can act in bad faith without any negative consequences, and might do so if in his best interest. See Mark Geistfeld, *Manufacturer Moral Hazard and the Tort-Contract Issue in Products Liability*, 15 *Int'l Rev. L. & Econ.* 241, 252-53 (1995) (describing moral hazard problem in context of tort and contract law).

164. See *supra* Part III.A.

165. *Danann*, 157 N.E.2d at 600 (quoting *Schumaker*, 30 N.E. at 757). Of course, this raises the tangential question of why courts will hold that a warranty that is peculiarly within the seller's knowledge has no effect. As seen in the original cases, this exception has less to do with contract default rules and information-forcing and more to do with tort notions of deceit. If the misrepresentation is specifically within the seller's knowledge then it is much more likely that it was a deliberate misrepresentation, on which the buyer trusted the seller based on the latter's expertise in the area. This comes close to ideas of fraud. See *Slaughter*, 80 U.S. (13 Wall.) at 383 (stating that when misrepresentation "relate[s] to a matter respecting which the complaining party did not possess . . . means of knowledge," such a "misrepresentation . . . will vitiate a contract of sale . . ."). Tort notions take over in this case, and so this portion of the exception to the *Danann* rule does not affect this Note's information asymmetry analysis.

166. See *supra* note 163.

167. Since these clauses have always been presumptively unenforceable, it makes sense that this exception has been around for a long time. The unenforceability of this clause allows the buyers to create hold-up problems by acting opportunistically *ex post*. See *supra* note 6 and accompanying text.

value of the warranty to buyers, either through the warranty or outside the warranty, the pro-buyer presumptions are significantly relaxed.

IV. COSTS AND RISKS IN SELLER WARRANTIES

While information asymmetry might provide a reasonable way of understanding this paradox of presumptions, it leaves unanswered an important issue: Are these rules efficient? Much of the above analysis has drawn on ideas from law and economics,¹⁶⁸ and a central concept in this field is that parties contract around default rules that are not optimal or mutually beneficial.¹⁶⁹ Part IV.A examines the cost-shifting effect of the holding in *Ziff-Davis*, and poses the question of whether this shift in costs is efficient for private contracting parties. Part IV.B contains the empirical data from fifty commercial contracts. Finally, Part IV.C analyzes this data to clarify the question in Part IV.A, and outlines some possible explanations.

A. *Costs and Risks*

1. *Allocating Costs in Contracts.* — Two of the most important goals for commercial contracts are to mitigate risk and allocate costs, and through these mechanisms to arrive at a mutually beneficial agreement.¹⁷⁰ The theory of incomplete contracts provides a useful tool for analyzing the cost distribution in contracting.¹⁷¹ This theory defines a complete contract as one that specifies the legal consequences of every possible state of the world after the contract.¹⁷² The incentives and inabilities of parties to write complete contracts is the subject of much scholarship,¹⁷³ but for purposes of this Note only the implications for cost allocation are relevant.

Planning for every different state of the world, negotiating what the legal consequences should be, and incorporating these permutations into

168. These concepts include incomplete contracts, the creation of default rules, and, crucially, efficiency in contracting. See Scott, *Incomplete Contracts*, supra note 1, at 283; see also Robert E. Scott, *Rethinking the Default Rule Project*, 6 Va. J. 84, 85 (2003) [hereinafter Scott, *Default Rules*] (detailing interaction between default rules and parties' preferences).

169. See Scott, *Default Rules*, supra note 168, at 90 ("To be sure, the parties can, in theory, reject the state rules and select their own alternatives.").

170. There are many competing claims as to the end goal of contract law. The view discussed here is favored by those in law and economics. See Scott, *Incomplete Contracts*, supra note 1, at 280 (discussing law and economics approach for analyzing "tension between the need for commitment and the need for flexibility").

171. For a good overview of incomplete contracts theory, see *id.*; see also Scott & Triantis, *Contract Design*, supra note 104, at 188–95.

172. See Scott, *Incomplete Contracts*, supra note 1, at 280–81.

173. For several examples, see supra sources cited in notes 170–171; see also Eric A. Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 Yale L.J. 829 (2003) (analyzing from broader perspective).

a contract would be an impossibly time consuming and costly process.¹⁷⁴ Instead of trying to create a complete contract, parties can choose to forgo such an effort and simply deal with issues as they arise during the course of performance. In this case, since the contract does not spell out the legal consequences, it is often necessary for the parties to engage in negotiations, settlements, or even trials in order to settle their differences.¹⁷⁵ These processes can also be quite costly, especially litigation.¹⁷⁶

As sophisticated parties begin negotiating any transactional contract, each party must weigh the *ex ante* and *ex post* costs in order to determine how complete the contract will be.¹⁷⁷ Commercial parties will attempt to keep contracting costs as low as possible through an appropriate balance of these pre- and post-contracting expenses.¹⁷⁸ This implicates many areas of contract law, and would apply differently to long-term contracts vs. one-off contracts.¹⁷⁹ Putting these variations aside, this economic approach to contract theory postulates that the relative *ex ante* and *ex post* costs will determine to a large degree what information is included in the contract and the proxies by which that information is to be measured.¹⁸⁰

Importantly for this Note, this theory implies that the *ex post* costs are largely determined by the structure of the legal presumptions, and by who bears the burden of persuasion.¹⁸¹ For example, suppose the default rule for the sale of a used car is that the buyer is entitled to a car with a

174. See Scott, *Incomplete Contracts*, *supra* note 1, at 291 (“[I]n reality, contracting parties confront a vexing problem: The future is unknown and unknowable.”). These are called “*ex ante*” costs, because they occur before the signing of the contract. They are also sometimes called “front end” or “transaction” costs. See Scott & Triantis, *Anticipating Litigation*, *supra* note 107, at 823. These costs are incurred by parties attempting to resolve the uncertainty about future states of the world by anticipating such states and allocating the risks in the contract.

175. See Scott & Triantis, *Anticipating Litigation*, *supra* note 107, at 825–34 (discussing costs associated with incomplete contracts).

176. These are called “*ex post*” costs. *Id.* Also called “back end” or “enforcement” costs, these are largely affected by the probability of a dispute arising and various institutional forces such as the structure of the court system.

177. The tradeoff between these costs can be important in reducing the overall costs of the contracts. See Scott & Triantis, *Anticipating Litigation*, *supra* note 107, at 835–36. Scott and Triantis characterize the result of *ex ante* costs as “rules” and the result of *ex post* costs as “standards.” *Id.* at 820. Of course, many decisions to allocate costs *ex post* do not involve any vague standards in the contract. Instead, they simply rely on the default rules that govern contract law. Scott, *Default Rules*, *supra* note 168, at 85.

178. See Scott, *Default Rules*, *supra* note 168, at 85 (referring to “cost/benefit calculus” performed by contracting parties). This discussion assumes that contracting parties are rational actors, which is a standard economic assumption but might not always be the case.

179. See Scott & Triantis, *Anticipating Litigation*, *supra* note 107, at 837–39.

180. See *id.* at 838–39 (“[P]recise and vague contract terms (or rules or standards) may be distinguished by the manner in which proxies for a particular contingency or obligation are chosen.”).

181. See *id.* at 857–58 (“Burdens of proof illustrate the important connection identified above between the rules governing litigation and the rule/standard choice.”).

problem-free engine, unless the seller can show the buyer already knew the engine was problematic. This rule greatly reduces the ex post costs upon the buyer since it places a heavy burden on the seller.¹⁸² In a jurisdiction with this rule, the buyer is much less likely to commit the ex ante costs of negotiating an engine warranty with the seller of a used car. In the rare instance that something goes wrong with the engine, his ex post costs of proving a breach of warranty are quite low. These default rules are exactly what the New York Court of Appeals changed in *Ziff-Davis* when it altered the presumption of unenforceability.¹⁸³

2. *Shifting the Costs of Seller Warranties.* — The New York Court of Appeals in *Ziff-Davis* shifted the burden from the buyer to the seller.¹⁸⁴ This change created a different system of costs for parties negotiating contracts. Under the legal presumptions before *Ziff-Davis*, the burden was on the buyer to show a reliance on the substance of the warranty in order for it to be enforceable.¹⁸⁵ This meant that the ex post costs for buyers were quite high. Instead of relying on the courts and incurring these high costs, an economically rational actor would often have expended a relatively large amount of ex ante costs to determine the truth of the warranty for itself before the contract was signed.¹⁸⁶ A high level of ex ante costs was acceptable because the ex post costs were even higher.¹⁸⁷ For the sellers the reverse was true. Because the ex post costs for sellers were low, they had little incentive to put in a lot of effort ex ante in making sure the warranties were accurate and reliable.¹⁸⁸

By shifting the presumption of enforceability and placing the burden on the sellers, the court altered this calculation. Now the sellers' ex post costs are high, and this creates an incentive to allocate more ex ante costs

182. In this case, the ex post costs on the buyer are the costs of litigating or settling a dispute. Since the default presumption is in the buyer's favor, he is more likely to come out ahead in any such dispute, and so his costs are lowered.

183. Notice the similarity between this hypothetical and the situation in *Ziff-Davis*. Now imagine the default rules in the hypothetical are switched. This change in cost structure is what happened in *Ziff-Davis*. See *CBS Inc. v. Ziff-Davis Publ'g Co.*, 553 N.E.2d 997, 1002 (N.Y. 1990) (holding that *Ziff-Davis* should not be absolved from its warranty obligations).

184. See *supra* notes 50–51 and accompanying text.

185. See *supra* note 36 and accompanying text.

186. For example, in *Ziff-Davis* the buyer (CBS) performed its own due diligence investigation of *Ziff-Davis's* financials even though a warranty was in place testifying to the financial soundness of the company. *Ziff-Davis*, 553 N.E.2d at 999.

187. The change in presumptions does not mean that this sort of due diligence does not continue on a regular basis. It is often standard for a company to perform a basic check to verify the substance of the warranties. But now there is less riding on these checks, and so one might expect them to be less thorough.

188. The seller's cost structure is different in sophisticated transactions because there are no costs to verify the warranty accuracy. Sellers generally already have that information. The question is more likely to be what increase the seller can get in the price by being misleading with warranties that might not be enforced.

to ensure that the seller warranties are accurate and reliable.¹⁸⁹ When those ex post costs were lower there was no such incentive. The reverse is also true for the buyers. Since the ex post costs for them have dramatically decreased, there is less incentive to take on the high ex ante costs of verifying the reliability of warranties. In this way, the reallocation of the burden from the buyer to the seller can have a dramatic impact on the contracting incentives of the parties.¹⁹⁰

Although the courts and the legislature dictate the default rules, these rules are only applicable when parties have not invested the ex ante costs of specifying their own rules. Parties can contract around the default rules.¹⁹¹ The parties will usually create the liability scheme that results in the lowest overall contracting cost, sometimes avoiding use of the default rules. As a result, by looking at how commercial contracts are structured and noticing whether parties are contracting around the default rules, one can make an educated guess as to the efficiency of these rules.¹⁹² By analyzing the seller warranty clauses in contracts between sophisticated parties, this Note attempts to provide a rough indicator as to whether the new default rule articulated in *Ziff-Davis* is efficient. This sample is not intended to be a scientific analysis of commercial contracts in New York, but rather only to provide a rough insight into how some contracting parties are dealing with the shift of contracting costs, and perhaps to provoke further scholarship on the subject.

B. *The Empirical Data Set*

The data set contains fifty commercial contracts from 2000 to 2004, collected from the CORI database through randomized searches.¹⁹³ Out

189. This incentive exists because the seller will want to minimize contracting costs as a whole. If the seller can offset much larger ex post costs with slightly larger ex ante costs, then it is likely to do so. See Scott & Triantis, *Anticipating Litigation*, supra note 107, at 842–44.

190. This discussion illustrates another way of looking at the shift in the presumption of enforceability for seller warranties explored in Part II.A.

191. See Scott, *Default Rules*, supra note 168, at 86.

192. Professor Scott has argued that default rules, including the information-forcing default rules such as those proposed in Part II of this Note, might be impossible to enforce where asymmetric information prevents the enforcing authority from verifying the relevant information, thus creating a moral hazard. He further postulates that private parties will contract out of such regimes on a regular basis in order to remove themselves from this inefficient default scheme. See *id.* at 87–88. This idea, as applied to seller warranties, is tested in Parts IV.B–C.

193. Contracting and Orgs. Research Inst., Univ. of Mo.-Columbia, at <http://cori.missouri.edu> (last visited Jan. 20, 2009). The search was limited to the “Business Transactions” contracts from the EDGAR collection of the Digital Contracts Library. A separate search was run for each year: 2000, 2001, 2002, 2003, and 2004. Ten contracts from each set of search results that involved a sale or merger of a business or product were chosen at random. Any contracts not governed by New York law were discarded and a new contract was found from the same search results. The search term was: “‘express warranty’ & ‘New York.’” This dataset begins ten years after the rule in *Ziff-Davis* was published, so

of these fifty, twenty-eight were default contracts, where no clauses attempted to contract around the default enforcement rule for seller warranties. Another fourteen attempted to contract around the default rules by specifying what constituted a material or immaterial portion of the warranty for purposes of enforcement.¹⁹⁴ Finally, twelve contracts explicitly attempted to contract around the seller reliance exception spelled out in *Galli v. Metz*.¹⁹⁵ The total is more than fifty contracts because the contracts that fell into both the Materiality and Reliance categories were double-counted to provide a more accurate breakdown of the opt-out clauses.¹⁹⁶

C. Data Analysis

The data analysis is intended to provide only a preliminary insight into the cost-shifting effects of the recent common law developments in this field. It depicts a contracting world where parties often contract around the default rules, but not in a consistent manner,¹⁹⁷ and it indicates that parties may prefer an alternative set of default rules to those adopted by the courts.¹⁹⁸

One implication of the data is that the common law in New York is moving in the right direction. As explained in the previous section, if the presumptive enforcement of seller warranties were inefficient and costly for the parties, they could have contracted around such warranties to reintroduce the concept of presumptive unenforceability of these contracts. In a sample of fifty contracts, none attempted to do this. This finding indicates that the new legal presumption satisfies the contracting parties, whether the courts are proceeding on efficiency or some alternative grounds.¹⁹⁹

by this point commercial parties should have incorporated the burden shifting into their standard contracts. The dataset is on file with the *Columbia Law Review*.

194. See, e.g., CORI Contract ID #87116 § 9.1 (setting criterion of “any such breach or inaccuracy [of this section] determined without regard to any qualification for ‘materiality’ or similar qualifications”). The parties are thus specifying the materiality threshold, instead of using the default rules.

195. See, e.g., CORI Contract ID #54080 § 10.11 (“Such representations and warranties have been or will be relied upon by the Administrative Agent or any Lender or on their behalf and notwithstanding that the Administrative Agent or any Lender may have had notice or knowledge of any Default at the time of any Borrowing . . .”).

196. Many contracts that opted out of one opted out of both. However, to analyze each opt-out rate individually it is necessary to look at each contract for each opt-out. Therefore, contracts that had more than one opt-out clause were double-counted.

197. Of the contracts examined, 52% used the default rules, 26% used materiality clauses, and 22% used reliance clauses.

198. Of course, there are several alternative explanations for the data presented, which are also discussed in this Part. See *infra* note 203 and accompanying text.

199. This finding should be reassuring to the New York courts because they are at the forefront of the change in the default rules. Many jurisdictions still cling to the older rules of substantive reliance for seller warranties. See *supra* note 15.

Another implication of the data is that the exception to this rule, adopted by the Second Circuit in *Galli v. Metz*, might not fit the needs of contracting parties and may be inefficient.²⁰⁰ Since approximately twenty percent of the sophisticated parties introduced clauses in their contracts to bargain around this default rule, such a rule may not be cost-efficient. As noted earlier,²⁰¹ by applying the exception outlined in *Galli* the courts are not enforcing a plain contract clause. Although the courts' behavior fits with the information asymmetry hypothesis, it does not fit with the idea in law and economics that parties bargain for each contract clause by assigning risk and cost.²⁰² In such a scenario, the seller warranty was worth something to the buyer, and by not enforcing that clause the courts could be creating an inefficient outcome.

There are several possible alternative explanations for this data—most significantly, the types of contracts included in the survey. It might be, for example, that stock sale contracts are governed by particular rules or SEC regulations, or are subject to different incentives.²⁰³ In addition, the data were gathered without controlling for various possible biases in the database search feature.²⁰⁴ This data analysis is intended to demonstrate how the economic implications of this Note's analysis affect commercial contracts, and provide a preliminary analysis as to why that might matter.

Nevertheless, the data present an important step toward understanding the nature of the seller warranty default rules outlined in *Ziff-Davis*. Contract law accepts that default rules are sticky, and that parties often experience difficulty in contracting around these rules.²⁰⁵ This can be

200. This concern is indicated by the fact that 22% of the contracts examined included clauses that specifically allowed for buyer recovery, even when the buyer learns of the seller warranty default directly from the seller or one of her agents. This Note's author has not been able to find any cases in which these clauses have been litigated, and so it is possible that these represent strong default rules that cannot be contracted around so easily. Nevertheless, the fact that parties are attempting to do so indicates that the exception to the enforceability of warranties that is carved out in *Galli v. Metz* is not meeting their needs.

201. See *supra* notes 143–146 and accompanying text.

202. See *supra* notes 170–173 and accompanying text.

203. For example, one alternative explanation is that many of the large commercial contracts that occur in New York are sales of debt or equity, which might be governed by particular rules that affect the enforcement of seller warranty clauses. In addition, another factor not considered in depth here is that the information asymmetry problem might be altered in mergers of large financial institutions. In these cases, buyers might have a large incentive to purchase insurance even against seller representations about the truth or falsity of a particular warranty, because the buyers might not trust the sellers to fully know how those warranties would affect their businesses.

204. The data were gathered in a randomized fashion from a span of five years. See *supra* note 193 and accompanying text.

205. See, e.g., Omri Ben-Shahar & John A.E. Pottow, On the Stickiness of Default Rules, 33 Fla. St. U. L. Rev. 651 (2006) (arguing use of default rules despite better alternatives is more pervasive than previously thought). For the empirical origins of this theory, see Russell Korobkin, Inertia and Preference in Contract Negotiation: The

especially true in the transactional context.²⁰⁶ The finding that twenty percent of parties in a sample contracted around these rules thus shifts the intellectual burden of proof. Further studies and analysis could explore whether particular types of contracts, for example mergers of companies as opposed to the issuance of equity, exhibit different patterns in terms of liabilities, and if these new contract terms represent a larger opt-out pattern by private parties in these contracts.

CONCLUSION

The enforcement of seller and buyer warranties has evolved dramatically over the past several decades in New York State. As they developed, these two warranty enforcement schemes grew further apart even as they both moved toward the realm of contract law. This Note has examined how the presumption of unenforceability for buyer warranties can be reconciled with the presumption of enforceability for seller warranties. It has presented a way of looking at this incongruity in a way that makes sense of both the incongruent default rules as well as the exceptions to these rules. An information asymmetry theory provides just such a framework.

Seller warranties have shifted more dramatically, and more recently, than buyer warranties. Part IV of this Note examined a sample of fifty commercial contracts to see if sophisticated commercial parties are accepting the new default presumptions, or if these contracts are avoiding the default rules. Although the results did not demonstrate a clear trend, the non-negligible presence of contracts that include clauses intended to bypass a certain aspect of the default rules suggests some inefficiencies exist. A further exploration is needed to determine if this is really so, and in what context. For now, this Note seeks only to provide a first step forward in the understanding of these contract clauses, their enforcement, and the real world effects of commercial contracting.

Psychological Power of Default Rules and Form Terms, 51 *Vand. L. Rev.* 1583 (1998) (offering two explanations for default rule stickiness); Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 *Cornell L. Rev.* 608 (1998) (describing bias toward default rules and implications). But see Jennifer Arlen, *Comment: The Future of Behavioral Economic Analysis of Law*, 51 *Vand. L. Rev.* 1765 (1998) (urging caution in generalizing from the results of laboratory experiments); Robert E. Scott, *The Limits of Behavioral Theories of Law and Social Norms*, 86 *Va. L. Rev.* 1603, 1639–46 (2000) (same).

206. See, e.g., David S. Scharfstein & Jeremy C. Stein, *Herd Behavior and Investment*, 80 *Am. Econ. Rev.* 465 (1990) (discussing how group psychology may affect investment decisions by fund managers); Jeffrey Zwiebel, *Corporate Conservatism and Relative Compensation*, 103 *J. Pol. Econ.* 1 (1995) (discussing herd impact on managerial decisions).