NO ASSUMPTION BY BUYER ENTITY OF SELLER ENTITY'S IMPLIED WARRANTY OF MERCHANTABILITY LIABILITY—WHETHER AN ENTITY THAT PURCHASES A MANUFACTURER'S ASSETS ASSUMES OR AGREES TO ASSUME AN IMPLIED WARRANTY OF MERCHANTABILITY THAT ATTACHED AND WAS NOT DISCLAIMED WHEN THE MANUFACTURER SOLD THE GOOD.

By Gina Brown*

Northland Industries v. Kouba, 2020 Tex. LEXIS 970 (Tex. 2020).

Factual Summary

In *Northland Industries v. Kouba*, the appellant, Northland Industries, Inc. (the Seller) manufactured and sold treadmills.[1] The Seller sold a treadmill to a gym that Audrey Kouba visited and thereafter the Seller transferred its assets along with certain liabilities and obligations to JHTNA Manufacturing, L.L.C. (the Buyer).[2] The parties' asset-purchase agreement (Agreement) included the buyer's parent company, Johnson Health Tech North America, Inc., as guarantor.[3] Thereafter, the Seller dissolved.[4]

Appellee, Kouba, fell and sustained fatal injuries while using the treadmill that Seller sold to the gym.[5] Subsequently, Kouba's heirs (Koubas) filed suit against the Seller and the Buyer under the Texas Business and Commerce Code § 2.314 for breach of the implied warranty of merchantability, along with other theories.[6]

The Buyer moved for summary judgment on all claims, arguing that as an asset- purchaser, it only assumed liability under certain express, written warranties of the Seller and assumed no liability under implied warranties of the Seller as part of the transaction, that the only relevant written warranty was that the treadmill would be free from defects for certain time periods, coupled with repair-or-replacement remedies, and that the Agreement expressly disclaimed any liability for bodily injury.[7] The trial court granted summary judgment to the asset-purchaser/Buyer for all claims.[8]

On appeal to the First District Court of Appeals, the Koubas challenged summary judgement only with respect to the implied warranty of merchantability, and the First District Court of Appeals reversed as to that claim and affirmed summary judgment on the unchallenged claims.[9] The appellate court focused on the issue of whether, under the terms of the Agreement, the Buyer assumed any liability for the implied warranty of merchantability with respect to the treadmill

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[1] *Northland Industries v. Kouba*, 2020 Tex. LEXIS 970, *1 (Tex. 2020).
[2] *Id.*
[3] *Id.* at *2, note 1.
[4] *Northland Industries v. Kouba*, at *1.
[5] *Id.*
[6] *Id.* at *2.
[7] *Id.*
[8] *Id.*
[9] Id.

purchase.[10] The Court reasoned that the Buyer assumed liability for implied warranties under the Agreement's terms, and liability for bodily injury claims were only excluded under the Agreement when accompanied by claims for property damage.[11]

Analysis

On October 23, 2020, the Supreme Court of Texas overruled all of Kouba's arguments and affirmed the trial court's order granting summary judgment in favor of the Buyer.[12] The majority rule is that an asset purchaser does not assume any liabilities of the asset seller for harm caused by defective products the seller sold, unless there is an exception such as the Buyer agreeing to assume liability.[13] Whether the Buyer had assumed the Seller's implied warranty liability depended on the terms of the Agreement, and the Agreement was construed under Wisconsin law, because it selected that state's law as governing the Agreement's validity, interpretation and effect.[14] Both Texas and Wisconsin have adopted the majority rule on successor liability.[15]

An implied warranty is an obligation arising by operation of law because of the circumstances of a sale, not because of an express representation or promise.[16] Implied warranties arise with respect to the underlying transaction rather than with respect to written warranties.[17] Specifically, an implied warranty of merchantability arises in connection with the sale of goods.[18] Distinctive in form and formation, implied warranties may be modified or replaced by expressed written warranties or coexist with additional written warranties.[19]

The Supreme Court explained that when Audrey Kouba's gym purchased the treadmill from Seller, an implied warranty of merchantability attached to the treadmill's sale because the implied warranty was not disclaimed or modified consistent with the Uniform Commercial Code adopted by both Texas and Wisconsin.[20] But the relevant question was <u>not</u> whether an implied warranty of merchantability attached to the treadmill's sale; instead the correct inquiry was whether the Agreement demonstrates the Buyer's intent to assume the implied warranty of merchantability liability.[21]

The Court concluded that under the asset-purchase agreement's language, the Buyer assumed some of the Seller's liabilities, but only assumed implied product warranty liability to the

[10] *Id.*
[11] *Id.*
[12] *Id.* at *15.
[13] *Id.* at *7.
[14] *Id.*
[15] *Id.* at *8.
[16] *Id.* at *10.
[17] *Id.*
[18] *Id.*
[19] *Id.* at *10-11.
[20] *Id.* at *8-9.
[21] *Id.* at *13.

extent of repairing or replacing defective parts.[22] Buyer assumed liability for Seller's specifically identified written warranties, and the only relevant warranty was that the treadmill would be free from defects for certain time periods, and the exclusive remedy for that warranty was to repair or replace the defective part.[23]

The Court held that that the Buyer only assumed liabilities expressed in the Agreement.[24] The record reflects no evidence to support that the Buyer agreed to assume the Seller's implied warranty of merchantability.[25] Thus, the Buyer will not be liable for beach of the implied warranty of merchantability because the Agreement failed to show that the Buyer agreed to take on such liability.[26]

[22] *Id.* at *9-11.
[23] *Id.* at *11-12.
[24] *Id.* at *14-15.
[25] *Id.* at *14.
[26] *Id.* at *10-15.