



WHITEPAPER

## THE “AS-IS, WHERE-IS” DISCLAIMER – HOW STRONG IS IT?

BY: ANDREW J. KALGREEN  
STEP TOE & JOHNSON PLLC

Ph: (614) 458-9827

[andrew.kalgreen@step toe-johnson.com](mailto:andrew.kalgreen@step toe-johnson.com)

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Steptoe & Johnson PLLC

A bank is planning to sell equipment collateral – either repossessed equipment taken after a borrower’s default or leased equipment that has been returned by a lessee at the end of the lease term. [In this article, the term “bank” is used as short-hand for any equipment finance company.] The proposed sale agreement includes the standard disclaimer that the bank is selling the equipment “as-is, where-is” and the bank feels confident that it does not have to worry about any mechanical or other problems with the condition of the equipment once the buyer pays the purchase price. However, two cases dealing with aircraft may give the seller reason to question its confidence.

In the case of *Luig v. North Bay Enterprises, Inc.*, the court considered a sale contract for a Bell helicopter which included both an “as-is, where-is” disclaimer and a requirement that the seller deliver an “airworthy” aircraft. After the buyer inspected the helicopter, the seller made repairs that the buyer requested and the buyer paid the sale price and accepted the helicopter. Sometime after delivery, the buyer learned that the helicopter did not comply with an FAA airworthiness directive and the helicopter’s original engine had been replaced with a non-compliant engine. The court ruled that: (a) the disclaimer terms of the sale contract disclaimed only **implied** warranties; (b) the terms of the sale contract regarding airworthiness constituted an **express** warranty that the helicopter was to be delivered in an airworthy condition; and (c) the condition of the helicopter breached the seller’s express warranties about its airworthiness.

The case of *McMahan Jets, LLC v. Roadlink Transportation, Inc.*, involved the sale of a Cessna Citation business jet. The sale contract included an “as-is, where-is” warranty disclaimer and a provision that the seller “shall deliver Aircraft ... with all systems functioning normally ... and in Airworthy Condition ...”. Almost two years after delivery, Cessna (the manufacturer) inspected the aircraft and discovered that holes had been drilled in a major structural component to accommodate a speaker system in the passenger cabin. Cessna concluded that, due to these holes, the aircraft was not airworthy. The court determined that the parties had allocated the risk associated with the condition of the aircraft to the buyer (a) by granting the buyer pre-purchase inspection rights (and if discrepancies were discovered, the right to have the discrepancies repaired at seller’s expense or to terminate the sale contract or to negotiate a reduction in the purchase price) and (b) by including explicit disclaimers of warranties. Essentially, the court ruled that the warranty disclaimers control.

Although these cases came to different conclusions about the sale of an aircraft– one upholding the “as-is, where-is” disclaimer, the other negating it – they expose the very real difficulties that a bank could encounter when it sells **any equipment** (not just aircraft) and the buyer discovers previously unknown problems. If this happens and the issues go to trial, the judge must reconcile the broad disclaimer of any product warranties with both any warranty-like provisions as well as the post-delivery discovery of one or more material defects in the equipment.

Most items of equipment today are complex machines (often including computerized components and related software) that are subject to significant on-going maintenance, service and

inspection requirements, not only from the manufacturer, but also from government agencies (such as OSHA for commercial equipment, the U.S. Department of Transportation for trucks and trailers, the FAA for aircraft, the U.S. Coast Guard for vessels, etc.). Also, maintenance records can be voluminous and incomplete depending on the age of the equipment, the number of prior owners and operators, and the diligence of the various repair and maintenance teams in keeping records intact.

In light of these practical issues, a bank's equipment sale contract is usually documented with an "as-is, where-is" warranty disclaimer and the buyer may be invited to complete a pre-purchase inspection by its own expert. If material condition discrepancies are found, the contract will typically give the buyer the right to have the bank correct the discrepancies at the bank's expense, to cancel the contract, or to reduce the purchase price to the satisfaction of the parties.

The purpose of this article is not to analyze the pros and cons of the decisions in the above cases or the quality of the legal drafting for the litigated sale contracts, but instead to recommend that banks review their equipment sale documents to include the following:

1. **STRONG WARRANTY DISCLAIMERS:** The sale documents (purchase/sale agreement and any related bill of sale) should include strong warranty disclaimers (more than just an "as-is, where-is" disclaimer).
2. **EXPRESS EQUIPMENT ACCEPTANCE TERMS:** The sales process should add a document that is signed by the buyer at the time it takes delivery that includes: (1) the buyer's unconditional and irrevocable acceptance of the equipment; (2) the buyer's confirmation that the equipment complies with the conditions stated in the sale contract; and (3) the buyer's release of any claims/warranties related to the condition of the equipment. These terms could be included as part of a final bill of sale.
3. **LIMIT THE EFFECT OF CONDITION PROVISIONS:** If the sale contract does include any reference to the expected condition of the equipment, make sure that any those provisions are identified as pre-conditions to the closing that are waived at the time of delivery instead of product warranties that survive after delivery.

By reviewing and updating your equipment sale process and documents now, banks are less likely to be embroiled in litigation due to the inherent tension between warranty disclaimers and delivery condition issues. Furthermore, if a bank finds itself in such a dispute and it has upgraded its sale documents as outlined above, then the allocation of risk regarding the condition of the equipment in the sale documents is much more likely to result in a decision in the bank's favor.