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EXPANDING THE PRODUCTS LIABILITY OF SUCCESSOR CORPORATIONS

The final cause of law is the welfare of society. The rule that misses its aim cannot permanently justify its existence.¹

The growth of products liability law has demonstrated the truth in Justice Cardozo's observation. His main contribution to the field was *MacPherson v. Buick Motor Co.*,² in which he eliminated the requirement of privity of contract in negligence actions against manufacturers. In another landmark case, *Greenman v. Yuba Power Products, Inc.*,³ Justice Traynor, by creating the doctrine of products liability without negligence in tort, dispensed with the requirement of notice of breach of an implied warranty which had been an impediment to recovery from manufacturers and distributors of products. The basic postulate of products liability law is that consumers deserve special protection against the risk of personal injury inherent in the products they buy and use.⁴ Legal rules which contradict this policy have been discarded.

Nevertheless, sellers of products may escape liability for injury occurring as a result of the use of their defective products by virtue of the rule of corporate law that a purchaser of an existing business does not assume the liability of the former corporation unless such liability is expressly assumed in the contract of sale or the two corporate entities have blended.⁵ This corporate law rule is directly in conflict with the policy underlying products liability law and is being used to frustrate consumers' actions for injuries suffered from the use of products.

A recent California case, *Ortiz v. South Bend Lathe*,⁶ provides an illustration. In 1967, Refugio Ortiz was injured by a defective punch press which his employer had bought in 1955 from the Meyer Company, a distributor of sheet metal machinery. Ortiz could not sue the manufacturer of the press, the Johnson Machine and Press Company,

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2. 217 N.Y. 382, 111 N.E. 1050 (1916).
5. For a discussion of this rule see notes 35-78 & accompanying text infra; Annot., 66 A.L.R.3d 824 (1975).
because the company did not exist at the time of the injury. All of Johnson's assets had been acquired by the Bontrager Corporation in 1956. The Amsted Corporation, in turn, had purchased all of Bontrager's assets in 1962 and continued to manufacture the Johnson press line under that trade name through its subsidiary, South Bend Lathe. The California court of appeal denied the plaintiff recovery against Amsted, even though the company had succeeded to the business of manufacturing the same press that caused the injury.\(^7\) The court held that although Bontrager had assumed the liabilities of Johnson, Amsted had not assumed the liabilities of Bontrager.\(^8\) Under the court's interpretation, there was neither an express nor an implied assumption of liability in the assets sale contract.\(^9\) Furthermore, since Bontrager had received cash rather than Amsted stock in consideration for its assets, rights, trademarks, and business goodwill, and since Bontrager had remained in existence after the sale before eventually dissolving, the court saw no reason to find the nonstatutory merger necessary for an assumption of products liability by operation of law.\(^10\) In the words of the court, "[t]he two corporate entities were completely separate and distinct both before and after the sale."\(^11\) 

Ortiz is typical of current judicial treatment of the liability of corporate business successors for the defective products of their predecessors.\(^12\) The courts have continued to hold that the separateness of corporate entities is the determinative factor, refusing to recognize that the policy of products liability cannot be effectuated unless such cases turn instead on the existence of an ongoing relationship between the product line of a business and the consumer public.

In contrast to the acceptance by the majority in Ortiz that the rules of corporate assumption of liabilities should be the ratio decidendi in such cases is the view of Justice Fleming in dissent:

\(^7\) Id. at 849, 120 Cal. Rptr. at 560. At trial, the superior court entered judgment in favor of the plaintiff against Meyer, the distributor, and Amsted, the successor to the manufacturer, and in favor of Meyer against Amsted for indemnification. The court of appeal reversed both of the judgments against Amsted, leaving Meyer with full liability. Id. at 845, 850, 120 Cal. Rptr. at 557, 560.

\(^8\) Id. at 845-47, 120 Cal. Rptr. at 558-59.

\(^9\) Id. at 847, 120 Cal. Rptr. at 558.

\(^10\) Id. In both the statutory merger and the nonstatutory de facto merger, the liabilities of the dissolving corporation are transferred to the purchasing corporation whether it wants them or not. See notes 52-58 & accompanying text infra.

\(^11\) 46 Cal. App. 3d at 847, 120 Cal. Rptr. at 558.

Product liability today has become an integral part of a manufacturing business, and the liability attaches to the business like fleas to a dog, where it remains imbedded regardless of changes in ownership of the business. So long as the business retains its distinctive identity and character and continues to be operated as it has in the past, defective product liability adheres to the business and remains there until discharged by bankruptcy or comparable judicial act.\(^\text{13}\)

Justice Fleming was declaring more an ideal than an actuality. As the law now exists, if a corporation sheds its manufacturing business but retains its corporate form, even for a brief period, before dissolving, products liability will not survive to burden the transferee.\(^\text{14}\)

Although products liability plaintiffs can sue manufacturers, wholesalers, and retailers,\(^\text{15}\) they cannot recover from the corporation which has purchased the assets of the original offending corporation when the purchaser has had the presence of mind to conduct the transaction as a sale and not a merger.\(^\text{16}\) This note will discuss whether or not a plaintiff should have the right, irrespective of current corporate law limitations, to recover from a corporation that continues making the product of a dissolved manufacturer when the injury has occurred after the dissolution. Ortiz is one of many cases in which consumers have been denied recovery by reason of corporate law rules inapposite to the policies of consumer protection underlying products liability.\(^\text{17}\) The succeeding sections will examine the lack of a remedy for most products liability plaintiffs against the disappearing manufacturer, the various judge-made criteria for imposing successor products liability, and the public policies of consumer protection which have influenced the development of products liability law. Finally, a new rule will be proposed which would protect victims of defective products when the offending business has changed hands and the manufacturer of the specific product has vanished.

**Predecessor and Successor Nonliability: The Plight of the Products Liability Plaintiff**

*Banquo:* \[W\]hither are they vanish'd?

*Macbeth:* Into the air; and what seem'd corporal, melted
As breath into the wind.—Would they had stay'd!\(^\text{18}\)

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14. See note 71 & accompanying text infra.
17. See cases cited note 12 supra.
There are three ways\textsuperscript{19} for a corporation to acquire,\textsuperscript{20} absorb,\textsuperscript{21} or otherwise gain control of one or more other corporations: (1) statutory merger or consolidation;\textsuperscript{22} (2) sale of all stock of the acquired corporation to a purchaser in exchange for stock, cash, or other property;\textsuperscript{23} and (3) sale of substantially all the assets of the acquired corporation to a purchasing corporation in exchange for stock, cash, or other consideration.\textsuperscript{24} When a manufacturer decides to get out of a business, the

\textsuperscript{19} See generally B. Fox & E. Fox, CORPORATE ACQUISITIONS AND Mergers, in 13A BUSINESS ORGANIZATIONS §§ 23.01-23.04 (1975) [hereinafter cited as Fox]. These methods of acquisition correspond, in part, to the three forms of reorganization described in the revision of the California Corporations Code, to become effective January 1, 1977. See CAL. CORP. CODE § 181 (West Supp. 1976) (popularly known as A.B. 376). By defining the term “reorganization” as either a statutory merger, a stock acquisition, or a sale of assets for stock (as distinct from cash), the new California statute departs from the customary corporate law usage of the term to denote the creation of a new corporation to receive the property and continue the business of the old one, or the continuation of the old corporation under a different name or management. See 15 W. FLETCHER, PRIVATE CORPORATIONS § 7201, at 386-87 (rev. ed. 1973) [hereinafter cited as FLETCHER]. A familiar form of reorganization is that which is occasionally accomplished under chapter ten of the Federal Bankruptcy Act for the relief of corporations in financial distress. See generally 11 U.S.C. §§ 501-676 (1970).

\textsuperscript{20} A corporation can acquire either the assets or the stock of another corporation and still not be said to have absorbed the other corporation if the two remain separate corporate entities. When a corporation has simply purchased a majority of the shares of another corporation, it does not thereby become legally liable for the acquired corporation's obligations. The acquiring corporation's liability is limited to the extent of its interest. See Freling, Tax Consequences of Nontax Motivated Aspects and Factors in the Sale of a Corporate Business, N.Y.U. 21ST INST. ON FED. TAX. 1107, 1131 (1963).

\textsuperscript{21} Absorption can be defined as a type of acquisition. When one corporation absorbs another, the former becomes liable for the latter's obligations because the two corporations become one. Absorption describes mergers and sales of assets which can be labeled de facto mergers. See notes 52-58 & accompanying text infra.

\textsuperscript{22} For a discussion of merger and consolidation see notes 53-56 & accompanying text infra.

\textsuperscript{23} In a stock acquisition, the purchaser becomes a stockholder in the acquired corporation, which retains its separate corporate existence. C. SCHARF, ACQUISITIONS, MERGERS, SALES AND TAKEOVERS 117, 251-52 (1971); Freling, Tax Consequences of Nontax Motivated Aspects and Factors in the Sale of a Corporate Business, N.Y.U. 21ST INST. ON FED. TAX. 1107, 1131 (1963). As a stockholder, the acquiring corporation assumes the economic risk of the seller's products liability to the extent of its interest in the seller. Id.

A stock acquisition can be accomplished without the formal approval of the stockholders or in direct opposition to the management of the acquired corporation through a tender offer of cash to its stockholders at an attractive price. In contrast, acquisitions by merger or purchase of assets require the approval of the management and up to two-thirds of the shareholders of the acquired corporation under most state statutes. Fleischer & Mundheim, Corporate Acquisition by Tender Offer, 115 U. Pa. L. REV. 317, 318 (1967).

\textsuperscript{24} The term “assets” refers to the aggregate of property, stock in trade, and cash belonging to a company. BLACK'S LAW DICTIONARY 151 (rev. 4th ed. 1968).

State statutes require, in sales of assets not “in the usual and regular course of . . .
ability of a products liability plaintiff to recover at a future date depends on how the manufacturer transfers the business to the acquiring corporation. In some transfers, the acquiring corporation automatically assumes responsibility for claims any person might have against the manufacturer. In this category are mergers and consolidations, and sales of assets when either the contract expressly provides for assumption of liability or the elements of a de facto merger are found. In other transfers, however, no liability is assumed, and the products liability plaintiff can bring his action only against the original manufacturer. In this category are sales of assets for cash and sales of assets for stock when there is no de facto merger. The problem posed to the products liability plaintiff when faced with a transaction in the latter category is that by the terms of most asset acquisition contracts, the manufacturer-seller promises to end its existence by voluntary dissolution pursuant to the applicable state statute. Under such statutes, the dissolving corporation continues to exist for no other purpose than to be sued. As a

business," the approval of the shareholders of the selling corporation. W. PAINTER, BUSINESS PLANNING 622 (1975) [hereinafter cited as PAINTER]. No approval is required by and no dissenters' rights are given to the shareholders of the purchasing corporation unless the transaction can be construed as a de facto merger. See text accompanying notes 52-58 infra.


Dissolution is distinct from liquidation. Dissolution is the end of a corporation's legal existence, while liquidation is the winding up process of gathering assets, satisfying creditors' claims, and distributing the remainder to shareholders, giving liquidation preferences to preferred shareholders. H. HENN, CORPORATIONS 814 (2d ed. 1970) [hereinafter cited as HENN]. According to the particular statute, liquidation either precedes or follows dissolution. See id.

The contract for the sale of all corporate assets normally requires voluntary or nonjudicial dissolution of the seller, approved by the shareholders of the dissolving corporation. See id. at 720. Involuntary dissolution, such as that accomplished in a proceeding brought by a minority shareholder to dissolve a deadlocked corporation, requires judicial supervision. PAINTER, supra note 24, at 279 (1975). For a thorough treatment of dissolution and its effects on products liability claims against the disappearing manufacturer see Henn & Alexander, Effect of Corporate Dissolution on Products Liability Claims, 56 CORNELL L. REV. 865 (1971) [hereinafter cited as Henn & Alexander].

28. For a discussion of the variations among the statutes see Henn & Alexander, supra note 27, at 879-97. Some statutes specify a period of two or three years during which the acquired corporation can be sued. See, e.g., ABA-ALI MODEL BUS. CORP. ACT § 105 (rev. ed. 1974) (two year survival of claims period). Some other statutes impose no time limitation. See, e.g., CAL. CORP. CODE § 5400 (West 1955). The revision of the California Corporations Code has a similar section, which provides: "A
practical matter, however, the disappearing manufacturer, even if in this limbo-like state, will not have any assets against which a products liability judgment could be executed. The directors of the dissolving corporation are required by statute to make adequate provision for known debts and liabilities before they distribute what is left to the shareholders, but they have no duty to provide funds for the payment of products liability and other claims of which they have no knowledge at the time of dissolution. If an ample amount of funds has been reserved to pay the known claims of creditors, not even the directors or shareholders can be held liable, and the plaintiff whose products liability claim arises after dissolution may thus have no effective remedy against the original manufacturer of the product.

With regard to the three forms of corporate acquisition, it is only after a sale of assets, subject to exceptions, that the products liability plaintiff will be denied relief from the successor. The accepted rule is that a bona fide purchaser for value of another company’s assets is not liable for the obligations of the seller. This rule applies to tort as well as to contracts.

corporation which is dissolved nevertheless continues to exist for the purpose of winding up its affairs, prosecuting actions by or against it and enabling it to collect and discharge obligations, dispose of and convey its property and collect and divide its assets, but not for the purpose of continuing business except so far as necessary for the winding up thereof.” *Id.* § 2010(a) (West Supp. 1976).

29. As a legal rather than practical matter in half of the states, by virtue of the adoption of the Model Business Corporations Act, post-dissolution claims, which include many for products liability, are not even allowed. The Model Act provides for survival of claims during a two-year period following dissolution. *ABA-ALI MODEL BUS. CORP. ACT* § 105 (rev. ed. 1974). Products liability claims which arise upon injury after an asset sale do not survive and cannot be asserted because they were not in existence at the time of dissolution.

30. See, e.g., id. § 87; *CAL. CORP. CODE* § 2004 (West Supp. 1976).


32. Known claims, in the revision of the California Corporations Code, include those of creditors whose names are unknown to the directors of the dissolving corporation. *Id.* § 2008.

33. See *Henn & Alexander, supra* note 27, at 908.

34. There are three types of products liability claims—warranty, negligence, and strict liability. *See generally PROSSER, supra* note 15, at 641-82 (4th ed. 1971). Under the Uniform Commercial Code the cause of action for breach of warranty accrues when “tender of delivery is made.” *UNIFORM COMMERCIAL CODE* § 2-725. Tort claims for negligence, and, in most jurisdictions which have addressed the question, for strict liability, do not accrue until the physical injury occurs. *Henn & Alexander, supra* note 27, at 871-77. That a claim for breach of warranty arises before dissolution of the manufacturer even though the injury occurs after dissolution does not alter the result stated in the text. Irrespective of the products liability theory, the claimant will not sue until the injury occurs, at which time the dissolved corporation will, more often than not, be judgment proof.

as contractual liability. The courts have, however, formulated four exceptions to the rule, finding the purchaser liable: (1) when the purchasing corporation expressly or impliedly agrees to assume the seller’s obligations; (2) when the transaction amounts to a merger or consolidation of the seller with the purchaser; (3) when the purchasing corporation is merely a continuation of the selling corporation; and (4) when the transaction was entered into fraudulently in order to escape liability.

That an express assumption of the seller’s liabilities constitutes an exception to the rule of nonassumption is only a restatement of the obvious. In one case an implied assumption of the risk of products liability claims which were unforeseen at the time of the asset sale was based upon a broad express assumption clause in the sale contract and upon the seller’s transferral of a products liability insurance policy to the purchaser. Liability for existing contracts of the acquired corporation is frequently assumed by the purchaser as part of the consideration; alternatively, the seller is ensured ample cash reserves to pay the claims of creditors. Unforeseen products liability, however, is not ordinarily expressly assumed as part of the exchange because the dissolving manufacturer is exposed to only a remote possibility of such liability.
The fraudulent transfer exception is also of little value to the person injured by the acquired corporation's product after an asset acquisition. As mentioned previously, known contract or tort claimants can sue the directors and shareholders of the disappearing corporation when sufficient cash reserves have not been set aside to satisfy their claims. They can also hold the purchasing corporation liable as the recipient of a fraudulent conveyance if the empty pockets of the disappearing corporation are due to inadequate consideration for the sale. The cases, however, have routinely denied relief against the purchaser when claims have arisen after the sale of assets and either the seller was left with sufficient consideration to pay the claims of predissolution claimants or there was no proof of actual fraud as to existing or subsequent claimants. In the context of products liability, it is the rare case that involves intent to defraud unforeseen tort claimants only. More often, presently known creditors are the target of fraudulent conveyances, either actually or, in the case of inadequate consideration, constructively. A curious doctrine in the Uniform Fraudulent Conveyance Act does permit unknown or future creditors to recover without a showing of fraudulent intent as to them personally if an intent to defraud some other known creditor is shown or if the sale of assets was for inadequate consideration. No case, however, has imposed successor products liability on the basis of this theory of fraud. Actual or constructive fraud, developed to protect commercial creditors, is not

45. Id.
49. Under the Uniform Fraudulent Conveyance Act fraud can be either actual or constructive, but in either case it is defined in relation to existing creditors. Thus, a conveyance directly fraudulent as to an existing creditor may be indirectly fraudulent as to a future creditor. The act provides: “Every conveyance made and every obligation incurred without fair consideration when the person making the conveyance or entering into the obligation intends or believes that he will incur debts beyond his ability to pay as they mature, is fraudulent as to both present and future creditors.” UNIFORM FRAUDULENT CONVEYANCE ACT § 6. Moreover, the act states: “Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors.” Id. § 7.
likely to prove a source of protection for the unforeseen products liability plaintiff whose injury may have occurred years after the manufacturer sold its assets. Therefore, the remaining exceptions to the rule of nonliability in asset sales should be discussed to determine whether such exceptions will provide sufficient protection for injured consumers.

**Continuations and De Facto Mergers**

Suppose A Corporation supplies a corner grocery with a shipment of bottled “Soda Pop.” A week later A sells its assets, its plant, and the Soda Pop trademark to B Corporation for cash. B continues bottling Soda Pop and A invests the cash in corn futures. B sends another shipment of Soda Pop to the grocery. Both shipments are equally defective and, as a result, highly explosive. Arnold and Beatrice shop at the corner grocery one fine day. Arnold takes from the shelf a bottle which happens to be from the A shipment. When it explodes and injures Arnold, he cannot hold B liable. Beatrice, however, selects a bottle which was right next to Arnold’s bottle but came from the B shipment. When it explodes and injures Beatrice, she can hold B liable.

If, on the other hand, the sale of A’s assets had been for shares of B stock which were distributed to A’s shareholders and A immediately dissolved instead of playing the corn futures, B could be held liable for the injuries of both Arnold and Beatrice. This is the law,51 absurd as it may seem to those uninitiated in the arcana of corporate law. The predication of liability upon whether a sale of assets is for cash or for stock and upon which of a seemingly identical group of products the consumers purchased deserves explanation, a task less difficult than its rationalization.

The de facto merger and continuation exceptions to the rule of nonassumption of liability in asset sales produce the result in the foregoing hypothetical. According to the cases, if a purchase of assets amounts to a merger or consolidation, or if it accomplishes a mere continuation of the seller, the purchaser will have assumed, by operation of law, the assets and liabilities of the seller.52 Although merger and the continuation doctrine describe theoretically discrete transactions, the factors relied upon by courts to establish their existence have been quite

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51. See note 71 & accompanying text infra.


Arguably, to call such an absorption of liabilities along with assets an assumption is a conceptual distortion. An assumption implies acquiring the obligations of another, ordinarily by contract. In a merger, however, two entities become one. The obligations of each entity become those of the whole. See Painter, supra note 24, at 618.
similar. Before identifying these factors, some attempt should be made to define the terms “merger or consolidation” and “continuation.”

The theoretical distinction between a merger and a consolidation is that in a merger, one corporation, which survives, absorbs the business of another, which ceases to exist, whereas in a consolidation, the two or more constituent corporations dissolve and a new corporation survives. Other than this distinction, there is no difference. Further references will therefore be only to mergers.

All state statutes authorize mergers upon the approval of the managements and the shareholders of the participating corporations. Under the statutes, once the transaction has been approved, the business assets and liabilities of the acquired corporation are transferred to the acquiring corporation, the stock of the acquiring corporation is issued to the shareholders of the merged corporation, whose stock in the old corporation is cancelled, and articles of merger are filed with the state. To put the matter more simply, a statutory merger is a filing of required papers and a sale of all assets for stock.

To be compared with statutory mergers are de facto mergers. The de facto merger exception to the rule of nonassumption of liability in asset sales produces the same automatic assumption of liabilities as a statutory merger even though the transaction purports only to be a sale and the formal requirements of the statute, such as the filing of papers and the approval of the prescribed fraction of shareholders, have not been met. This result occurs only if the transaction amounts to a

53. Henn, supra note 27, at 713.
54. Since in both transactions a combined business survives the dissolution of all other constituent corporations, the merger concept can probably embrace consolidation. Fox, supra note 19, § 24.01[1]. The currently effective California Corporations Code provides for both merger and consolidation. Cal. Corp. Code § 4100 (West 1955). In apparent recognition that the two concepts are coextensive, California's Corporations Code revision, however, drops the distinction between merger and consolidation, providing simply that “[a]ny two or more corporations may be merged into one of such corporations . . . .” Id. § 1100 (West Supp. 1976).
55. Henn, supra note 27, at 714; Fleischer & Mundheim, Corporate Acquisition by Tender Offer, 115 U. Pa. L. Rev. 317, 318 (1967). Most statutes also give dissenting shareholders the right to recover the appraised value of their shares. Henn, supra note 27, at 714.

Liabilities absorbed by merger include responsibility for the torts of the disappearing corporation. Fletcher, supra note 19, § 7121, at 185; Fox, supra note 19, § 23.02[3][a]. Such torts include injuries resulting from defective products. Cf. Moe v. Transamerica Title Ins. Co., 21 Cal. App. 3d 289, 304, 98 Cal. Rptr. 547, 556-57 (1971).
merger. The meaning of this characterization will be discussed presently.

A continuation differs from a merger, but the courts and commentators have not been uniform in their descriptions of the exact nature of the distinction. Opinions in some cases have required that for there to be a continuation, consideration left in the seller's bank account must be inadequate to satisfy its debts. Other authorities have defined continuation as a change in the form of a business through the creation of a new corporation to receive the assets, stockholders, and management of the old company. More recent decisions have analyzed continuation in terms of continuity of management, business operations, and stockholders, whether in a new corporation or in another existing one.


The de facto merger doctrine not only protects creditors of the selling corporation as an exception to the general rule of nonassumption, but also protects dissenting shareholders of the purchasing corporation, in some jurisdictions, by giving them the right to recover the appraised value of their shares. The leading case is Farris v. Glen Alden Corp., in which the Supreme Court of Pennsylvania found that Glen Alden's purchase for stock of the assets of List, although structured as a sale, amounted to a merger. Farris v. Glen Alden Corp., 393 Pa. 427, 143 A.2d 25 (1958). The court was influenced by the following factors: (1) the purchaser increased in size; (2) the purchaser expressly assumed the seller's liabilities; (3) the purchaser changed the nature of its business; (4) the board of directors of the seller took control; (5) the value of the purchaser's shares declined; and (6) the purchaser's shares were distributed to the shareholders of the seller. Id. at 438, 143 A.2d at 31. Delaware has expressly rejected the de facto merger doctrine as it has been used to protect shareholders of the purchaser. Hariton v. Arco Electronics, 40 Del. Ch. 326, 182 A.2d 22 (Ch. 1962), aff'd, 41 Del. Ch. 74, 188 A.2d 123 (Sup. Ct. 1963). For a thorough discussion of the shareholder protection aspect of the de facto merger concept, see Folk, De Facto Mergers in Delaware: Hariton v. Arco Electronics, Inc., 49 VA. L. REV. 1261 (1963). A simplified equivalent of a de facto merger approach for shareholders has been adopted in the revision of the California Corporations Code, whereby shareholders of the purchasing corporation in a stock-for-assets transaction may require the purchaser to pay them the fair market value of their shares. CAL. CORP. CODE §§ 1200(c), 1201(a), 1300 (West Supp. 1976).

58. See cases cited notes 35, 39 supra.

59. See, e.g., Atkinson v. Western Dev. Syndicate, 170 Cal. 503, 510, 150 P. 360, 363 (1915). To require inadequate consideration in order for there to be a continuation destroys the distinction between the fraudulent conveyance and the continuation exceptions, making the latter superfluous.


It is certain, however, that in arguing for findings of either de facto merger or continuation, products liability plaintiffs have generally been unsuccessful when the asset seller remained in existence—even a paper existence—for any purpose, or when the consideration for the sale of assets was cash. Two often-cited cases arising from similar facts illustrate the substantial influence of this notion of separateness of corporate entities upon judicial decisions to deny successor liability for lack of a de facto merger or continuation.

In *Kloberdanz v. Joy Manufacturing Co.*, the plaintiff was injured by a defective part of an oil drilling rig on which he was working in 1964. The part had been manufactured by Web-Wilson in 1953. In 1960, Joy purchased all of Web-Wilson's assets in exchange for cash, assuming some of the latter's liabilities but not its product liabilities. Thereafter, Joy used the name "Web-Wilson" as a trademark for a number of its tools. Before dissolving ten months after the sale, Web-Wilson functioned as a corporation by leasing some buildings and by investing the $1 million consideration it had received for its assets. In denying the existence of a de facto merger the court emphasized that the transaction had been for cash rather than stock and that the seller had remained in existence for ten months after the sale. Hence, "[t]he two corporate entities were completely separate and distinct before and after the sale." Furthermore, there was no continuation because, again, "Web-Wilson, Inc. continued to exist after the sale, and there was no common identity of stock, directors, officers or stockholders between Joy and Web-Wilson."

The plaintiff in *McKee v. Harris-Seybold Co.* was hurt in 1968 by a paper cutter which had been manufactured in 1916 by a company that had sold its assets, including the right to use its name, in 1926 to the defendant in exchange for $2 million in cash and some stock. The manufacturing operation was continued by the purchasing corporation. Although dissolution was required by the contract, the selling corporation was not dissolved until a little over a year after the asset acquisition. A New Jersey superior court held there was no de facto merger because the consideration had been primarily cash and the seller had not dissolved soon enough after the sale of assets. The court explained:

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**McKee v. Harris-Seybold Co.**


63. *Id.* at 821-22.
64. *Id.* at 821.
65. *Id.*
67. *Id.* at 563-67, 264 A.2d at 103-04. The court also mentioned, "[T]here is
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The corporation could no longer function as a manufacturer, yet it could and did operate and function as a corporation for some time after the sale. The vendor corporation, as a corporate entity, was not absorbed into the purchasing corporation. What was absorbed was the nature of the manufacturing operations previously engaged in by Seybold, not the Seybold corporate entity itself. The stockholders of Seybold continued to remain stockholders of the Washington Machine Company [the name adopted by Seybold pursuant to the contract].

That the product had not caused injury until fifty-two years after its manufacture was of no apparent significance to the court. In denying the existence of a continuation, the court relied upon the cash consideration, the continued existence of the seller, and the lack of continuity of management.

The fact that the manufacturing operations of the seller were continued by the purchaser was given little weight:

When one company purchases all the assets of another, it is to be expected that the purchasing corporation will continue the operation of the former, but this does not by itself render the purchaser liable for the obligations of the former. For liability to attach, the purchasing corporation must represent merely a "new hat" for the seller.

If, in order for there to be a continuation, there need only be a sale of assets for stock which is distributed to the shareholders of the seller and a prompt dissolution by the seller, then continuation is nothing more than a confusingly different term for de facto merger. If, however, a continuation also requires continuity of management or the creation of a new corporation for the purpose of receiving the assets of its predecessor, continuation can be differentiated from de facto merger. In any case, conceptual clarity does not demand that this distinction be made. When a new corporation is created for the purpose of purchasing the assets of its predecessor in exchange for stock, the transaction can logically be labelled a de facto merger. Whether the merger is into an old or into a new corporation is irrelevant to the analysis. Furthermore, continuity of management has little relation to the concept of separateness of corporate entities which is the focal point of inquiries concerning successor liability under corporate law.

here no broad assumption of liabilities such as is usually present in de facto merger situations . . . ." Id. at 567, 264 A.2d at 104. In context, this comment refers to the observation, by courts finding de facto mergers as a basis for granting the appraisal remedy to shareholders of the purchaser, that these shareholders' interests were jeopardized by an assumption of liabilities which the shareholders had not contemplated when they bought their shares. See, e.g., Farris v. Glen Alden Corp., 393 Pa. 427, 438, 143 A.2d 25, 41 (1958). If, however, a broad assumption of liabilities were a requirement, the de facto merger exception to the nonassumption rule would become an unnecessary restatement of the express or implied assumption exception.

68. 109 N.J. Super. at 566, 264 A.2d at 104.
69. Id. at 570, 264 A.2d at 106.
70. Id.
Setting aside the problem of distinguishing between the exceptions, two elements can be extracted which courts have held to be minimum requirements for either a de facto merger or a continuation: (1) that the seller quickly dissolve and (2) that the consideration for the sale of assets be shares of the purchaser which are distributed to the seller's shareholders.\(^{71}\)

Rigid adherence to the requirement that the seller quickly dissolve does not comport with the principle of equity which is fundamental to the de facto merger doctrine and other areas of commercial law—"that courts will look to the substance and not merely to the form of a transaction to determine its real character."\(^{72}\) Some of the cases dealing with the question of successor products liability in asset acquisitions have involved contracts that required the seller to dissolve in a matter of months, yet the courts have found this period long enough to establish corporate separateness and thereby defeat claims of de facto merger.\(^{73}\) To hinge liability on whether the parties were sufficiently clever to postpone the seller's dissolution for a strategic period elevates form over substance. If the de facto merger doctrine is to be retained, an asset acquisition for stock should not be less of a merger simply because its consummation is delayed. The requirement for successor liability that the seller promptly disappear should be modified to embrace assets-for-stock transactions when dissolution is contractually anticipated by the parties.\(^{74}\)

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74. In Knapp v. North American Rockwell Corp., the court relied upon the public policy underlying products liability law and upon the insubstantiality of the manufacturer's continued existence to impose liability upon a purchaser of assets for stock for the negligence of the seller, which had remained in existence for eighteen months but had been required by the contract to dissolve. Knapp v. North Am. Rockwell Corp., 506 F.2d 361 (3d Cir. 1974), cert. denied, 421 U.S. 965 (1975). See notes 79-85 and accompanying text infra.

Perhaps the focus should be not upon contractually required dissolution, but rather upon whether the circumstances surrounding the transaction indicate that dissolution was contemplated by the parties. In one case, the seller spent ten months investing the benefit of its bargain and then dissolved, although the sale of assets contract did not require dissolution. Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817 (D. Colo. 1968). In such situations, so long as the sale of assets was for stock, a court could reasonably find a de facto merger, delayed only by the make-work activities of the seller.
The requirement of stock rather than cash consideration is more troublesome. A sale of assets for stock transfers an ownership interest in the purchaser to the selling corporation. When the seller dissolves and distributes the purchaser's stock to the seller's shareholders, those shareholders are left as owners of the purchaser. For all practical purposes, a merger has occurred because the property of the dissolved corporation is held by another corporate entity which is, in part, owned by those who were once shareholders of the seller. When, on the other hand, the sale is for the purchaser's cash, only property is transferred to the purchaser, and the selling corporation's shareholders are left with no interest in the buyer. In this situation, neither a merger nor a continuation has occurred. Thus, the courts view the distribution of stock consideration to the shareholders of the seller as a major requirement for finding a de facto merger.

From the consumer's point of view it is hardly sufficient to use corporate legal theory to explain the judicial practice of predicing the consumer's right to recovery on whether the errant manufacturer sold its assets for cash or for stock, especially when the purchaser continues the product line. If products liability indeed reflects important social policies, it is not justifiable to base its defeat on the fact that in a transfer of assets from one corporation to another, the consideration was cash and not shares of stock. The socially sensitive policies behind products liability law have been ignored in making this distinction. Two cases, however, provide notable exceptions to the failure of the judiciary to analyze successor liability in light of public policy.

Judicial Recognition of Public Policy

Rationales for Imposing Successor Products Liability

Knapp v. North American Rockwell Corp. was a diversity case in which the Court of Appeals for the Third Circuit applied Pennsylvania law to impose successor products liability upon a purchaser of assets for stock even though the acquired corporation continued functioning separately after the sale, thereby placing the existence of a de facto merger in doubt. Rockwell was held liable for the injury of a worker caused by a defective packaging machine manufactured by Textile Machine Works (TMW) despite the fact that after the purchase of TMW's assets for

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76. See Pinellas Ice Co. v. Commissioner, 287 U.S. 462, 470 (1933); Cortland Speciality Co. v. Commissioner, 60 F.2d 937, 939 (2d Cir. 1932).
77. See cases cited note 76 supra.
Rockwell stock, TMW remained in existence for eighteen months.\textsuperscript{80} Although the merger requirement that the seller dissolve immediately after the sale had not been met, the court treated the transaction as a merger.\textsuperscript{81}

It was suggested earlier that a de facto merger should be found, as a matter of corporate law, when the sale contract requires eventual dissolution of the transferor.\textsuperscript{82} The court in \textit{Knapp}, however, did not rely solely upon the logic of elevating substance over form. According to the court, the case called for “an analysis of public policy considerations rather than... a mere procrustean application of formalities.”\textsuperscript{83} In view of the public policy of shifting the losses caused by defective products away from the victim, the empty existence of TMW after the sale was not allowed to defeat recovery, especially since TMW’s dissolution was required by the asset sale contract “as soon as practicable.”\textsuperscript{84} As between plaintiff Knapp and Rockwell, the latter was deemed better able to spread the loss because it could easily have obtained an assignment of TMW’s prepaid products liability insurance policy.\textsuperscript{85}

Since the sale of assets was for stock, the opinion in \textit{Knapp} did not address the question whether the public policy of spreading losses could justify holding a purchaser of assets for cash liable for the acquired corporation’s product defects. The court in \textit{Knapp} did, however, evince a refreshing willingness to disregard the formalisms of corporate law when dealing with a products liability claim.

The only case to date holding a purchaser of assets for cash liable for the transferor’s defective products is \textit{Cyr v. B. Offen & Co.}\textsuperscript{86} After the death in 1962 of the sole proprietor of the B. Offen Company, which manufactured printing presses and dryers, key employees formed a new corporation named B. Offen & Co. to purchase the predecessor’s assets from the proprietor’s executor, agreeing to assume the obligation to service old ovens. The purchase agreement specifically excluded assumption of liability for the predecessor’s torts. The new corporation continued to manufacture the same kind of product in the manner of the old company. In 1969, two employees of a printing company were severely burned, one fatally, while cleaning the inside of an Öffen print dryer that had been sold to their employer in 1959. The dryer was defective because it lacked a fail safe device which could have prevented...

\textsuperscript{80} 506 F.2d at 363, 368-70.
\textsuperscript{81} Id. at 368-70.
\textsuperscript{82} See notes 72-74 & accompanying text \textit{supra}.
\textsuperscript{84} Id. at 369.
\textsuperscript{85} Id. at 370.
\textsuperscript{86} 501 F.2d 1145 (1st Cir. 1974), \textit{noted in} 16 B. C. IND. & COM. L. Rev. 676 (1975).
ignition while workers were inside.\textsuperscript{87} The Court of Appeals for the First Circuit held the successor, B. Offen & Co., liable even though it had no identity of ownership with its predecessor.\textsuperscript{88} The court, therefore, departed from the established analysis of the continuation exception to the rule of nonassumption in ruling that, in light of public policy considerations, continuity of manufacture and service of a product line by the same employees in the same plant is sufficient for a continuation.\textsuperscript{89} In imposing liability, the court relied upon the public policies underlying the products liability of an original manufacturer stating:

The very existence of strict liability for manufacturers implies a basic judgment that the hazards of predicting and insuring for risk from defective products are better borne by the manufacturer than the consumer. The manufacturer's successor, carrying over the experience and expertise of the manufacturer, is likewise in a better position than the consumer to gauge the risks and the costs of meeting them. The successor knows the product, is as able to calculate the risk of defects as the predecessor, is in [a] position to insure therefor and reflect such cost in sale negotiations, and is the only entity capable of improving the quality of the product. . . . [I]t is true that the successor . . . was not the legal entity which launched the product on the stream of commerce or made an implied representation as to its safety. But in the most real sense it is profiting from [and] exploiting all of the accumulated good will which the products have earned, both in its outward representations of continuity and in its internal adherence to the same line of equipment.\textsuperscript{90}

In its attempt to fit the case within the continuation exception, the court in \textit{Cyr} was eager to find as many earmarks of continuity as possible. Continuity of product line, employees, and location were stressed. Nevertheless, the public policies relied upon by the court to place responsibility upon the successor for products marketed before the change in entities are supportive of the predication of successor liability upon continuation of the product line. The public policies advanced by the court require no inquiry into whether the product is manufactured by the same employees at the same facility.\textsuperscript{91}

\textsuperscript{87} 501 F.2d at 1149.
\textsuperscript{88} \textit{Id.} at 1151-54.
\textsuperscript{89} \textit{Id.} at 1152-54.
\textsuperscript{90} \textit{Id.} at 1154.
\textsuperscript{91} The court in \textit{Cyr} said, "[A] corporation itself cannot act. It can conduct its business only through its officers and employees. The negligence of employees in carrying out that business is the responsibility of the corporate body. If as a group the same employees continue, without pause to produce the same products in the same plant, with the same supervision, the ownership of the entity which maintains essentially the same name cannot be the sole controlling determinant of liability." \textit{Id.} at 1154. By making continuity of employees a determinant of successor liability, the court seems to have blurred the distinction between the law of negligence, which requires fault of the defendant or its agents, and the law of strict products liability, which shifts the cost of
Four public policies justifying the strict liability of manufacturers were invoked by the court to impose liability upon the successor corporation. As applied to the successor these policies are: (1) that the successor is better able than the consumer to insure against, and to reflect in the price of the assets, the risk of product-related harm; (2) that the successor should take the burden of liability for previously sold products along with the benefit of an established product line; (3) that by its “outward representations of continuity” the successor adopts and should be bound by its predecessor’s implied representations of product safety; and (4) that the business capable of improving the quality of the product should bear responsibility for injuries caused by the product.93

The fourth policy mentioned by the court is an unpersuasive rationale for imposing successor liability, because improvement of a product line has no relevance to injuries caused by products marketed before the correction. Although liability for its predecessor’s defectively designed products may induce the successor to change its design to prevent future injuries, the inducement would be equally strong if the successor were simply alerted to such mishaps. Thus, the successor’s ability to improve its product does not, standing alone, demand that liability attach to the successor for preexisting defective products. Nonetheless, in *Cyr* the Court of Appeals for the First Circuit pointed the way toward making continuation of the product line rather than congruence of corporate entities the determinant of successor products liability. The first three public policy rationales mentioned by the court should be examined in some detail.

The Policies Underlying Products Liability Law

The legal protection afforded the users of products has steadily expanded since the days when liability required breach of an express warranty or negligence based upon privity of contract between the seller and the plaintiff.93 The apex of this development, whether couched in warranty language or described as strict liability in tort, is the liability without fault of sellers of chattels to third persons with whom they are not in privity of contract.94

injuries from vulnerable consumers to product sellers who are deemed better able to bear the loss. For a discussion of the policy reasons justifying strict products liability see notes 98-102 & accompanying text infra.

92. 501 F.2d at 1154.
According to the Restatement Second of Torts, the seller of an "unreasonably dangerous" product is liable for the harm it causes to the user if the seller is in the business of selling such products and the product was expected to and did reach the user without substantial change, even though the seller has exercised all possible care. Strict products liability in tort has been adopted in most jurisdictions.

Fault has been replaced by strict liability because of three public policy justifications for imposing tort liability on the product seller. These policies are: (1) that the public interest in human life and safety requires that the manufacturer, who by placing a product on the market represents that it is safe, take full responsibility for any harm resulting from an unsafe product; (2) that as between the seller of the product and the injured consumer, the public interest demands that the burden of the loss be borne by the party responsible for putting the product on the market, as that party is likely to be in a better position to obtain insurance or otherwise spread the risk; and (3) that one who obtains the commercial advantage of a product should bear the losses arising from the use of that product as a cost of doing business.

The first policy recognizes that manufacturers and other sellers have so effectively marketed their products that consumers do not guard against defects. As Justice Traynor of the California Supreme Court stated in his prescient concurring opinion in Escola v. Coca Cola Bottling Co.:

Manufacturing processes, frequently valuable secrets, are ordinarily either inaccessible to or beyond the ken of the general public. The consumer no longer has means or skill enough to investigate for himself the soundness of a product, even when it is not contained in a sealed package, and his erstwhile vigilance has been lulled by the steady efforts of manufacturers to build up


95. A comment after section 402A of the Second Restatement defines the phrase "unreasonably dangerous" as "dangerous to an extent beyond that which would be contemplated by the ordinary consumer." Restatement (Second) of Torts § 402A, comment i (1965). California and a few other states have rejected this requirement as a "regression" to a negligence theory of liability. See Cronin v. J.B.E. Olson Corp., 8 Cal. 3d 121, 501 P.2d 1153, 104 Cal. Rptr. 433 (1972); Glass v. Ford Motor Co., 123 N.J. Super. 599, 304 A.2d 562 (L. Div. 1973).

96. Restatement (Second) of Torts § 402A (1965).

97. Prosser, supra note 15, at 657-58 (stating that as of 1971, two-thirds of the states had accepted the theory).


confidence by advertising and marketing devices such as trademarks. Consumers no longer approach products warily but accept them on faith, relying on the reputation of the manufacturer or the trademark. Trademarks and advertising can be taken as representations that the products concerned will be safe. Product safety is a public expectation, as demonstrated by the willingness of consumers to use products in their daily routines. When a product causes injury, this public expectation becomes disappointment. The injured consumer looks to the manufacturer for redress.

The second policy shifts the burden of a personal injury away from the product's victim to the manufacturer or other seller who is in a better position to obtain insurance which spreads the risk. The manufacturer can decide whether to produce a safer product or to pass the cost of insurance for the dangerous product on to consumers in the price of the product. In theory, dangerous products will eventually be forced off the market owing to their high prices. If a manufacturer is not in a position to manipulate prices to recoup the cost of insurance, it will be impelled more directly to make a safer product or go out of business. Our legal system thus seems to place greater importance upon the protection of life and limb than upon the assurance of business success.

The third public policy upon which courts have relied to impose liability without negligence upon the sellers of chattels is that it is fairer to require the commercial beneficiaries of the market to bear the loss than to impose this burden on the injured plaintiff. These policy reasons for strict liability can be summarized. The manufacturer occupies a relationship with the marketplace whereby it represents, albeit impliedly, that its product is safe and benefits from the willingness of consumers to use the product without question. When the product injures someone, it is appropriate to hold the seller liable. Such liability promotes the goal of spreading the risk of product-related injuries through insurance which is available to the seller.

A New Rule for Successor Liability

The matrix of corporate and creditor protection rules, previously

100. Id. at 467, 150 P.2d at 443 (citations omitted).
discussed, which define the limits of the responsibility of corporate successors for the torts of their predecessors allow courts to ignore the social policies underlying products liability. It is for this reason and the reasons to be discussed subsequently that the following rule is proposed for judicial consideration:

A business that acquires and substantially continues to manufacture the product line of a predecessor manufacturing corporation shall be liable for injuries caused during its continuation of the product line by units of the product placed upon the market before the acquisition to the same extent that the original manufacturer of the product would have been liable but for the acquisition.

Justification

The proposed rule is based on the relation of the successor to the market that was once occupied by the manufacturer of the defective product and is consistent with the history of strict products liability in warranty. Warranty is no longer the sole ground for strict liability recovery in most states because of the difficulties plaintiffs encountered in overcoming disclaimers and notice of breach, and because the tort theory of strict liability was deemed a more forthright approach to the products liability problem. Nevertheless, the warranty concept of representation to the public and the resultant expectation of safety remains a cogent public policy underlying strict products liability. One rationale for the proposed rule is that when a successor steps into the shoes of a manufacturer, there is an implied assumption of that manufacturer's implied representations to the public. Perhaps, however, it is better to avoid couching the rationale for the proposed rule in warranty language and to explain the rule as a logical extension of the policies which have been used to impose strict liability upon the manufacturers and intermediate sellers of products. Those policies apply with equal force to successors.

103. See notes 35-78 & accompanying text supra.
105. In Greenman v. Yuba Power Products, Inc., Justice Traynor referred to the consumer's reliance on an implied representation, noting: "Implicit in the machine's presence on the market, however, was a representation that it would safely do the jobs for which it was built. Under these circumstances, it should not be controlling whether plaintiff selected the machine because of the statements in the brochure, or because of the machine's own appearance of excellence that belied the defect lurking beneath the surface, or because he merely assumed that it would safely do the jobs it was built to do." Greenman v. Yuba Power Prods., Inc., 59 Cal. 2d 57, 64, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1963). See also Prosser, Strict Liability to the Consumer in California, 18 Hastings L.J. 9, 19 (1966).
106. See text accompanying notes 98-102 supra.
A purchaser of the assets, plant, and trade names of a manufacturer enters into the same relationship with the market that was maintained by its predecessor. By continuing the business of manufacturing the product, the successor makes itself the object of the uninterrupted expectations of the public. As Justice Fleming pointed out in his dissent in *Ortiz v. South Bend Lathe*: 107

Amsted, having undertaken to operate the business, thereby assumed the risks growing out of the continuity of business operation. One of these risks was product liability for defective machinery put in circulation at an earlier time and never corrected. While users of an orphaned product no longer actively manufactured or marketed cannot look to an existing manufacturer for parts, repairs, service, information, and the like, users of a product that continues to be manufactured, marketed, and serviced under its original trade name can reasonably expect a degree of protection from the entity currently carrying on the business, even though that entity may not be the one that originally manufactured and marketed the particular item involved. 108

The policy of protecting consumers because of the public expectation of safety is frustrated when the law, as interpreted by the majority in *Ortiz*, allows no remedy against a successor who is the current beneficiary of the manufacturer-consumer relationship.

The policy of distributing the risks of defective products also applies to a company that succeeds to the business of manufacturing a product. The successor is better able than the consumer to obtain insurance to spread the risk. Like original manufacturers, successors should be made to provide for the dangers of their businesses. The proposed rule would induce the parties to a sale of a product line to consider and insure against, rather than to ignore as under the present system, the possibility of liability for defective products which have been placed on the market by the manufacturer. Adjustments could accordingly be made in the sale price of the assets.

Furthermore, the rule would establish the same protection for products liability plaintiffs as that currently enjoyed by contract creditors. Owing to the present limitations on liability, there is little incentive for the purchaser to agree during sale negotiations to assume unforeseen products liability because the seller cannot effectively be sued on a claim arising an appreciable time after its dissolution.109 In contrast, part of the consideration in many asset sales is the assumption by the purchaser of the known liabilities of the seller.110

107. 46 Cal. App. 3d 842, 850, 120 Cal. Rptr. 556, 560 (1975) (Fleming, J., dissenting); see text accompanying notes 6-13 *supra*.
108. 46 Cal. App. 3d at 850, 120 Cal. Rptr. at 561.
109. See notes 29-34 & accompanying text *supra*.
liability plaintiffs deserve as much protection as contract creditors, and this protection could be afforded by making the parties to an asset sale allocate the cost of products liability insurance premiums between themselves.

The third public policy mentioned above\textsuperscript{111} should also apply to successors. Although the successor does not obtain the benefit of the profit from the original sale of the dangerous product, it does obtain the advantage of the reputation and trademarks of a going business. Along with obtaining the benefit of an established product, the successor should bear the losses arising from the use of that product.

To date, the courts have normally applied the public policies underlying products liability only to manufacturers or other sellers who helped place the product on the market. The requirement, in the absence of assumption of liabilities by contract or corporate law, that the defendant actually have been associated with the particular product that caused the injury is simply a rational technique for circumscribing the system of liability without fault. The boundaries of strict liability can be altered, without sacrificing rationality, to include the automatic assumption of predecessor products liability by the corporation acquiring an ongoing business.

Another obstacle to the implementation of the proposed rule of liability assumption is the rule that a bona fide purchaser of assets for value does not assume liability unless a de facto merger or other exception is found. The rule and the de facto merger and continuation exceptions conform to corporate legal theory and produce a logical result. A purchaser of assets for cash is deemed an entity separate from the seller, while a purchaser for stock is treated as a surviving corporation in a merger or continuation and therefore as a part of the same corporate entity as the disappearing corporation.\textsuperscript{112} Accordingly, the purchaser of assets for stock is, in part, the same corporation that was responsible for placing the defective product on the market, whereas the purchaser for cash is "separate and distinct before and after the sale."\textsuperscript{113} To impose liability for its predecessor's product defects upon a purchaser for cash would make it responsible for conduct not its own. Such a result is not, however, foreign to the law. For example, employers who have not themselves engaged in tortious conduct are held vicariously liable for the acts or omissions of employees.\textsuperscript{114} Public policy demands that the risk of employee torts be allocated to the enterprise which profits from the employment relation and is in a better position than tort

\textsuperscript{111} See note 102 & accompanying text supra.
\textsuperscript{112} See notes 75-78 & accompanying text supra.
\textsuperscript{114} See, e.g., Eule v. Eule Motor Sales, 34 N.J. 537, 544, 170 A.2d 241, 244-45 (L. Div. 1961); PROSSER, supra note 15, at 458-59.
victims to obtain insurance to absorb losses.\textsuperscript{115} As discussed previously, similar policies support holding the successor in an asset sale for cash liable for the defective products of its predecessor when it sustains the product line.\textsuperscript{116} Thus, although the corporate law rules delineating successor liability have a certain technical appeal, they should not simply be recited to dispose of products liability cases when important social policies are at stake. A balance must be struck between the policies supporting products liability and those supporting the limitations on liability defined by the bona fide purchaser rule and its exceptions in order to determine the propriety of imposing liability upon the purchaser for cash for the defective products of the manufacturer whose business is continued.

The bona fide purchaser rule and its technical exceptions offer an attractive prospect for those desiring to expand their commercial horizons. By purchasing assets for cash instead of purchasing them for stock or instead of buying the acquired corporation's stock so as to make it a subsidiary,\textsuperscript{117} the acquiring company can avoid unknown liabilities such as those stemming from products liability claims.\textsuperscript{118} Arguably, such avoidance of liability is supported by a public interest in commercial development through the rehabilitation of enterprises which may be floundering because of poor management.\textsuperscript{119} Business planners want to predict, with some precision, the costs of asset acquisitions and may shudder at the thought of unknown liabilities.\textsuperscript{120} A rule of assumption in asset sales for cash when continuation of a product line is contemplated could conceivably make such acquisitions less attractive.

Nevertheless, the interest in human life and safety, which supports the allocation of risk to those associated with a defective product, seems to outweigh the interest in marketability of the manufacturer's assets. The scales would be more evenly balanced if competing economic or property interests were at stake. In any case, the effect of the proposed rule on commercial development is minimized by the fact that the successor desires insurance protection against liability for defective goods sold \textit{after} the asset acquisition.\textsuperscript{121} Because products liability

\textsuperscript{115} PROSSER, \textit{supra} note 15, at 458-59.

\textsuperscript{116} See text \textit{supra} note 158-159.

\textsuperscript{117} See note 23 \textit{supra}.

\textsuperscript{118} See text accompanying notes 71-73 \textit{supra}.


\textsuperscript{120} \textit{See} Note, \textit{Assumption of Product Liability in Corporate Acquisitions}, 55 B.U.L. Rev. 86, 91 (1975).

\textsuperscript{121} In \textit{Shannon v. Samuel Langston Co.}, the court found a de facto merger and therefore held the successor liable. Shannon v. Samuel Langston Co., 379 F. Supp. 797, 801 (W.D. Mich. 1974). The court observed, in dicta, that "[i]n practice in nearly all cases, the acquiring corporation will merely arrange for the continuation of the products
insurance indemnifies the insured against legal liability to third persons, implementation of the proposed rule would require little alteration of existing insurance policies to cover the successor-defendant held liable for goods sold before the acquisition. Insurance eliminates any objection to the proposed rule on the grounds of unpredictability of the costs of an asset acquisition because the only added cost would be increased premiums commensurate with the augmented exposure of the carrier. Such added costs are not a persuasive argument against the proposed rule because such costs would simply require the successor to accept the burdens along with the benefits of a preexisting product line.

**Boundaries of the Rule**

Some observations should be made about the scope of the proposed rule. First, whereas the current law on successor products liability is phrased in terms of assumption of liabilities by contract, by fraudulent conveyance, or by alterations in corporate entities, the proposed rule focuses on continuation of the business of making the predecessor's product. Continuation of management and employees, in contrast, would not be a controlling factor in applying the rule because such continuation has little relevance to the public expectation of product safety. Furthermore, for its application, the suggested rule would not require a purchase of assets. In most situations other than a statutory merger, de facto merger, or stock acquisition, continuation of a product line has entailed a purchase of assets, plant, and trademarks or trade names of a manufacturer. Under the proposed rule, however, a company that buys the trademark but not the plant of a manufacturer in order to make the product at its own facilities could be held liable for injuries resulting from units of the product sold before acquisition of the trademark. Liability for a defective product would run with its identity.

liability insurance maintained by the seller, and the price of the acquired corporation will be adjusted to take the projected premium into account. The decision of the court simply means that the seller and purchaser corporations will not both be able to profit by cutting off liability for damages to battered and maimed people.” *Id.* at 802.

122. R. KEETON, INSURANCE LAW 232 (1971); PROSSER, supra note 15, at 541-42.
123. See notes 35-41 & accompanying text supra.
124. See notes 55-56 & accompanying text supra.
125. See notes 57, 62-78 & accompanying text supra.
126. See note 23 supra.
in the market. Since product identity is the focal point of the rule, it makes little difference whether the product is made at the plant of the original manufacturer or at that of the successor.

Second, it could be argued that successors who have discontinued manufacturing the product at the time of the injury should not be liable under the rule. The successor that has discontinued or sold to another corporation an acquired product line is unlike an original manufacturer, which can be held liable, as a corporate entity, even after dropping its product line. The successor is a separate corporate entity. The connection between the product which caused the harm and a successor that no longer identifies itself with the product line is more tenuous than that between a product and an original manufacturer that has discontinued the product line. If courts willing to apply the proposed rule deemed it proper to deny its application when the successor has discontinued the product before the plaintiff's injury, such a plaintiff would have to rely upon corporate assumption of liability rules in the absence of a further successor. A requirement that the successor be engaged in manufacturing the offending product line at the time of the plaintiff's injury might therefore construct the same kind of procrustean bed that the rule is designed to dismantle. Suppose A manufactures gismos and sells one to plaintiff in 1965. B purchases A's assets, plant, and name for cash in 1966 and continues manufacturing gismos until 1975, at which time B discovers a substantial design defect in the product line. B hastily enters a different line of business. Two weeks later plaintiff is injured by his gismo. Applying the public policies of products liability, a court might grant recovery. Perhaps a more difficult case would be posed if the successor continued the product for only a short time and the plaintiff were injured ten years after discontinuation. Rather than probe the problem of product line discontinuation with a rough sense of justice, this writer desires merely to point out that a problem exists. It is possible that the problem will never arise in an actual case because manufacturers normally take their chances with potential future liability in order to continue business in the present.

Third, liability for defective products under the rule would run to successors of the manufacturer but not to successors of an intermediate seller of the product. Suppose A makes widgets and sells them to distributor B, and B's assets and name are purchased by C. C could not be held liable for A's defective widgets that B sold before the acquisition, even though A and B have gone out of business. Again, the rule would attach liability to the activity of making the product that caused the harm. It is reasonable to limit liability to the business that identifies itself to the public as the maker of a product. Retailers and other distributors of defective products are usually mere conduits who, when held liable for a defect in the product, have a right to indemnity against
the manufacturer because of the latter's immediate fault. The liability of the manufacturer is primary, whereas that of the distributor or retailer is secondary. As discussed previously, public policy justifies imputing the products liability of the dissolved manufacturer to the current maker of its product. A much stronger set of policies would seem necessary to impute the passive liability of an intermediate seller to its successor. Such liability is not here proposed.

Fourth, the suggested rule supplements rather than replaces the body of rules which currently determine the scope of successor liability. Thus, when a sale of assets constitutes a de facto merger, the acquiring corporation would be liable for its predecessor's tort even if its trade name were not acquired and the product line were not continued. Furthermore, contract creditors of the dissolved manufacturer would not be able to sue a mere purchaser of assets or trademarks for cash. The suggested rule is for the relief of products liability plaintiffs whose claims arise after the acquisition. Creditors whose claims are known at the time of a corporate acquisition are adequately protected under the existing law, since the dissolving corporation must provide for them, either by setting aside ample funds or by contracting with the acquiring corporation for express assumption of debts.

Fifth, the product successor should have a right to indemnity against its predecessor. The doctrine of implied indemnity "permits one of two tortfeasors to shift the entire loss to the other when, without active fault on the claimant's part, he has been compelled by reason of some legal obligation to pay damages occasioned by the immediate fault of the other." This doctrine could be applied in the odd case in which the manufacturer sheds the product line but retains its corporate entity for some other activity and the plaintiff sues the current maker of the product. In such a case the successor could sue or implead its predecessor for indemnity and the injured plaintiff would not be required to select a defendant at peril.

Sixth, states that have not accepted strict liability for product defects, under the implied warranty theory or the tort theory, would...
have difficulty applying the proposed rule because it is based on the policies underlying strict liability. For successor liability, such states would probably require proof of independent negligence on the part of the acquiring corporation. Negligence of the purchaser could consist of participation in the manufacture or distribution of a product which was negligently designed or assembled, breach of a duty arising from a service relationship with the predecessor's customers, or failure to warn prior customers after discovering a defect through testing.

On the other hand, in a jurisdiction recognizing strict liability, the proposed rule could be applied to successors even in cases in which the defective product was placed on the market owing to the carelessness of the original manufacturer. In such jurisdictions, courts are not deterred from imposing liability upon middlemen such as wholesalers and retailers when the only negligent party was the manufacturer. Such intermediaries are as free from negligence as successors to the business of manufacturing the product.

Conclusion

From the consumer's perspective, the consequences of a statutory merger, de facto merger, or continuation are identical to those of a purchase of assets or trade name when the continued manufacture of a product is the purpose of the transaction. The product continues to be advertised and to appear on the market, and prior purchasers of the product continue to use it. The consequence of products liability, however, varies with the type of corporate acquisition. Although a person who continues to use a product after its manufacturer has sold its business naturally expects protection from the company currently producing the item, the law now affords such protection erratically. In many cases in which the product user is injured after an asset acquisition, the manufacturer of the particular offending product has dissolved, lawfully distributing the proceeds of the transaction to contract creditors and to its shareholders. If such products liability plaintiffs are to have a remedy, therefore, it must be against the successor to the manufacturing

at 650-82. As of 1971, two-thirds of the states had adopted strict products liability in tort and only eight states had adopted neither the tort nor the warranty form of strict liability. Id. at 655, 657-58.

132. See notes 104-11 & accompanying text supra.


134. Id.


136. The seller need only place on the market a defective product which is expected to reach its user without substantial change. RESTATEMENT (SECOND) OF TORTS § 402A(1) (1965).
business. Under the corporate law, there can be no recovery against the successor unless it expressly or impliedly agreed to assume products liability, purchased for stock the assets of a manufacturer who promptly dissolved, or committed actual or constructive fraud as to known creditors of the predecessor. Thus, by careful planning, corporate successors are able to avoid responsibility for products marketed before the acquisition of a product line.

Social policies, which have been articulated to explain holding the manufacturer strictly liable for its defective products, can be invoked to justify holding the successor to a product line liable for injuries caused by products marketed before the acquisition. By continuing to market a product, the successor impliedly represents that it is safe. It is logical to conclude that the representation runs to consumers who continue to use the product after its manufacturer has dissolved. Furthermore, the corporation that steps into the manufacturer's shoes is better able than the plaintiff to obtain insurance to spread the risk. Finally, it is fair to require the successor to take the personal injury burdens of a product line along with the commercial advantages of acquiring an established name.

On the premise that the public policies underlying products liability should be reflected in all cases involving product-related injuries, this note has proposed that products liability be automatically assumed by companies that acquire the business of manufacturing a product line. The rule would protect the consumer fortuitously injured after the product line has changed hands.

As this note was in its final stages of preparation for publication, the California court of appeal took an approach very similar to the one proposed. In Ray v. Alad Corp., the court held a corporation liable for a defective ladder sold before the defendant had acquired the assets, name, and product line of its predecessor, even though no continuity of ownership existed between the two corporate entities. The only forms of continuity were those of product identity and business location. Unlike the Court of Appeals for the First Circuit in Cyr. v. B. Offen & Co., the California court made no attempt to squeeze its case into an ill-fitting corporate law analysis. According to the court, "The manufacturing entity's responsibility to the victims of defective products it has placed in circulation cannot be hostage to the niceties which distinguish a sale of assets from a merger." Instead, the court analyzed the case

137. 127 Cal. Rptr. 817 (1976), petition for hearing granted, No. L.A. 30613 (Sup. Ct., Apr. 28, 1976). Because the petition for hearing has been granted, the vacated opinion of the court of appeal may not, of course, be cited to the California Supreme Court.

138. 501 F.2d 1145 (1st Cir. 1974). See text accompanying note 91 supra.

solely in terms of tort law policies and emphasized that "it is the entity which continues to carry the business which can best distribute the individual and social costs of injuries to the public—principally, of course, by insurance."\textsuperscript{140} Perhaps the Ray case will mark the beginning of a trend toward viewing continuation of a product line as sufficient for the imposition of successor products liability. The court did not expressly so hold. In addition to continuity of the product line, the Ray court stressed the successor's continued operation "at the same old stand."\textsuperscript{141} It has been suggested in this note that the purchase of a product name in order to continue manufacturing the product at a plant other than that of the predecessor could warrant application of the proposed rule. From the perspective of consumers who have little awareness of changes in corporate entities, all that occurs in such a case is a change in the location of the manufacturer, leaving the product's identity intact. Part of the rationale for the proposed rule is that the law should uphold the public expectation of product safety. That expectation has little to do with the location of a manufacturing operation.

Application of a rule requiring liability assumption in the acquisition of product lines would probably not be free of difficulty. The determination of the minimum elements of continuation of a product line would demand especially careful analysis. Like other rules, the proposed rule has a core of certainty in application surrounded by potentially hard cases requiring judicial discretion.

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140. \textit{Id.} at 860, 127 Cal. Rptr. at 820.

141. \textit{Id.}

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