Products Liability: Developments in the Rule of Successor Liability for Product-Related Injuries

Mary Annette Horan
University of Michigan Law School

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PRODUCTS LIABILITY: DEVELOPMENTS IN THE RULE OF SUCCESSOR LIABILITY FOR PRODUCT-RELATED INJURIES

Products liability law is a fast-developing area. All the rules have not yet been formulated and products liability law, as it matures, has to shake off various impediments associated with traditional concepts, which, while relevant to other problems, are inappropriate for this new area.\(^1\)

The notion that a manufacturer or supplier of goods should be strictly liable for injuries resulting from the use of those goods did not exist at common law.\(^2\) It has arisen since the turn of the century\(^3\) as a judicial response to the increasingly sophisticated nature of manufactured goods and marketing techniques.\(^4\) Gradually, the harsh doctrine of *caveat emptor*\(^5\) has given way to the realization


\(^2\) Historically, a supplier’s responsibility for injury or damage caused by its goods was defined in terms of negligence or breach of warranty. In recent years, these doctrines have been widely supplanted by the concept of strict liability in tort. Wade, *On The Nature of Strict Tort Liability for Products*, 44 Miss. L.J. 825, 825-26 (1973).

Strict products liability has been distinguished from the classic principle of strict liability announced in the seminal case, Rylands v. Fletcher, L.R. 1 Ex. 265 (Exch. Ch. 1866), aff’d, L.R. 3 H.L. 330 (1868). Rylands-type liability is essentially absolute in situations where the activity which generated the injury or damage is abnormal or ultrahazardous, while strict products liability attaches only where the product is shown to have a “defect” that caused the injury. See Greenman v. Yuba Power Products, Inc., 59 Cal. 2d 57, 62, 27 Cal. Rptr. 697, 700, 377 P.2d 897, 900 (1963). However, at least one court has stated that the term “strict products liability” is not particularly helpful as it may easily be confused with the absolute Rylands-type liability. Cova v. Harley Davidson Motor Co., 26 Mich. App. 602, 611-12, 182 N.W.2d 800, 807 (1970). That court concluded that “it might be helpful if we abandoned the continued use in this context of our present and misleading terminology of warranty and representation, express and implied, and strict liability in tort, and simply refer to the manufacturer’s liability by the neutral term ‘product liability.’” Id. at 614, 182 N.W.2d at 807. See also Wade, *supra* at 835-36.


As handicrafts have been replaced by mass production with its great markets and transportation facilities, the close relationship between the producer and consumer of a product has been altered. 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 confidence by advertising and marketing devices such as trade-marks.

that today's layman has neither the capacity nor the opportunity to acquire the expertise necessary to determine the fitness of the goods he uses. Thus, a growing number of courts and commentators agree that the consumer needs special protection in the market place. This special protection is provided by the evolving doctrine of strict products liability under which the seller's responsibility for injuries resulting from the use of its products is continually expanding.

In one area of the law, however, traditional doctrine has, until recently, blocked this expansion. Under traditional principles of corporate law, when a manufacturer sells its business and dissolves before the product-related injury occurs, there may be no viable defendant for the injured plaintiff to pursue. Special rules protect


8 Strict products liability was initially limited to cases involving adulterated food and other products for intimate bodily use, but the trend in recent decisions has been to expand the scope of the special rule of liability to all products that may cause harm to the consumer or his property. Assault, supra note 3, at 1139-40. The barriers to recovery have also been lowered by alterations in the plaintiff's burden of proof. Under the theories of negligence or breach of warranty, the injured person must show a contractual relationship with the seller, or must show his injury was a foreseeable result of the seller's negligence. Strict liability may be imposed on any member of the distribution chain without regard to privity, proof of reliance upon express or implied representations, or negligence. W. Prosser, Law of Torts § 98 (4th ed. 1971). Additionally, courts have manifested their willingness to favor the interest of the injured consumer over the manufacturer in the adoption in a majority of jurisdictions of the negligence statute of limitations for claims brought on the theory of strict products liability. Under a breach of warranty theory, the statute of limitations begins to run at the time the product is sold or delivered. Thus, in some cases, the statute might bar a claim before the injury actually occurs. Under a negligence theory, the statute does not begin to run until the injury occurs. By choosing to allow the injured plaintiff to pursue his claim under the more liberal rule at the expense of the manufacturer's interest in repose, the courts have clearly indicated their willingness to abandon existing doctrines which are inconsistent with the underlying societal policy favoring full recovery to the widest possible number of injured consumers. Juenger & Schulman, Assets Sales and Products Liability, 22 Wayne L. Rev. 39, 39 n.2 (1975). See also Comment, Assumption of Products Liability in Corporate Acquisitions, 55 B.U.L. Rev. 86, 88 (1975).

9 In some cases, the injured plaintiff may have a number of potential defendants besides the original manufacturer or its successor to pursue. Other members in the chain of distribution of the defective product such as wholesalers or retailers may be held responsible for the plaintiff's injuries. Negligence may be evident, but even if there is no negligence, all dealers in goods are liable to their customers for the implied warranties of fitness and merchantable quality as a function of the doctrine of strict products liability. Restatement (Second) of Torts § 402A, comment f (1965). However, many products such as industrial machinery are sold by the manufacturer without the benefit of a chain of distribution. In those cases, the original manufacturer or its successor may be the only plausible defendants for a products liability suit. Comment, supra note 8, at 86. Even there, the injured plaintiff may not be totally barred from recompense. Accidents in work-related settings are typically initially compensated by worker's compensation benefits. See generally Horovitz, Workmen's Compensation: Half Century of Judicial Developments, 41 Neb. L. Rev. 1 (1961).

Although the concept of strict products liability developed largely in the context of consumer goods, see, e.g., Greenman v. Yuba Power Products Co., 59 Cal. 2d 57, 27 Cal. Rptr.
the interests of known creditors and minority shareholders in the event of a corporate dissolution, but these rules make no provision for the potential future claim of a products liability plaintiff. Moreover, traditional corporate law shelters the purchasers of an ongoing business from liabilities not expressly assumed when the


Although employers are frequently responsible for injuries resulting from the use of machinery in their plants because they fail to maintain machinery or because they remove safety features to improve production speed, worker's compensation schemes preclude employee suits against their employers. I.A. LARSON, WORKMEN'S COMPENSATION LAW §1.10 (1978). However, the manufacturer of the machinery is not similarly protected. Id. As a result, there has been a dramatic increase in the number of third party suits against manufacturers of capital goods over the past twenty years. This flood of litigation has stimulated a concurrent escalation in the cost of products liability insurance. Consequently, some small manufacturers have no coverage while others are liquidating rather than risk the chance of a debilitating lawsuit. See O'Connell Bargaining for Waivers of Third-Party Tort Claims: An Answer to Products Liability Woes for Employers and Their Employees and Suppliers, 1976 U. ILL. L.F. 435. See also note 42 infra.

Where there are other members of the distributive chain, the injured plaintiff may successfully pursue his remedy against them, but the same problem then arises as to their rights against the manufacturer. The law recognizes that any losses incurred by members of the distributive chain who function merely as conduits between the manufacturer and the injured consumer should be recouped from the manufacturer. Escola v. Coca Cola Bottling Co., 24 Cal. 2d 453, 464, 150 P.2d 436, 442 (1944) (Traynor, J. concurring). If the original manufacturer has since sold the business and dissolved, the wholesaler or retailer may be forced to absorb the loss alone.

Manufacturing entities may be organized as partnerships, limited partnerships, or sole proprietorships as well as corporations. For the sake of clarity, this discussion will focus on the problems created by corporate dissolution, although it is evident that the competing interests are similar notwithstanding the organizational format of the parties to the transfer of the business.

The personal responsibility of a sole proprietor for injuries resulting from the use of products manufactured by his business would not terminate upon its sale, but would effectively end upon the proprietor's death and the settling of his estate. Compensation for a product-related injury after that time could only come from the purchaser of the business. See Cyr v. B. Offen & Co., 560 F.2d 1145 (1st Cir. 1974) (applying New Hampshire law). The liability of the members of a partnership for torts committed in the course of business is joint and several. UNIFORM PARTNERSHIP ACT §§ 13, 15(a); Annot., 175 A.L.R. 1310, 1316 (1948). Dissolution of the partnership does not, of itself, change the nature of this responsibility. See UNIFORM PARTNERSHIP ACT § 36; 60 AM. JUR. 2d Partnership §208 (1972). Even where the business continues under the old firm's name, a new organization comprised of different persons will not be accountable for the old firm's debts, absent conduct demonstrating an agreement to assume such obligations or proof of fraud. 60 AM. JUR. 2d Partnership §213 (1972). Consequently, the problems presented by a post-dissolution product-related injury are similar whether the original manufacturer was organized as a partnership or a corporation.

10 Juenger & Schulman, supra note 8, at 41. See text accompanying notes 18-24, 64-92 infra.
acquisition takes the form of a purchase of assets for adequate consideration, even though the purchaser continues the business operation without interruption. 11

These principles by which an ongoing business may be severed from its existing and contingent liabilities encourage the free alienability of business capital. Specifically, they allow a prospective purchaser of a business to control the risk of unknown liabilities associated with the operation and to determine accurately the appropriate purchase price. 12 Although the control of contingent liabilities assumed as a result of an acquisition is clearly an important part of responsible business planning, the concurrent ability to cut off future products liability claims through the technical form of the acquisition is contrary to the basic assumptions embodied in the doctrine of strict products liability. 13 Manifestly, the existing principles of corporate law should be modified to take account of the special needs of the products liability plaintiff. That evolutionary process has already begun, 14 but it is evident that the judiciary has experienced some difficulty in striking a workable balance between the interests of the injured consumer and the business community.

This article will briefly review the traditional principles of corporate law governing the assumption of liabilities in the acquisition of an ongoing business, and the doctrinal premises of strict products liability. Attention will then be critically directed to recent developments in case law in which the traditional rules have been modified to reflect the policy considerations of strict products liability. Finally, this article will discuss the possibility of legislative intervention in the development of new principles governing successor responsibility for products liability claims and propose that this problem is an appropriate subject for legislative rather than judicial action.


12 Comment, supra note 8, at 91.

13 See text accompanying notes 105-13 infra.

14 See Parts III and IV infra.
I. THE TRADITIONAL APPROACH TO POST-DISSOLUTION LIABILITY

A. Post-Dissolution Liability of a Corporation and Its Stockholders

Although a corporation is physically composed of a number of individuals (officers, shareholders, and employees) in almost all its dealings, it is characterized by the law as having an identity of its own, completely separate from that of its various members.\footnote{15} Thus, contractual obligations are created in the name of the corporation, and claims arising as a result of corporate activities are generally pursued in the name of the corporation.\footnote{16} Given this conceptual separation between the corporation and its members, it is not surprising that, at common law, corporate dissolution was analogized to the death of an individual and, just as death ended all suits against that individual, dissolution was said to abate all claims against the corporation.\footnote{17}

1. Trust Fund — Whatever the merit of the reasoning underlying this analogy, the practical effect was to allow a corporation to avoid its creditors by selling its assets, voluntarily dissolving, and distributing the sale proceeds to its stockholders. To prevent this abuse, the courts of the time devised an equitable remedy under which a defunct corporation's creditors could pursue the assets of the entity into the hands of its stockholders.\footnote{18} In effect, the stockholders were said to hold the assets as a "trust fund" for the benefit of the corporation's unpaid creditors.\footnote{19}

This equitable theory provided substantial relief for unsatisfied creditors prejudiced by corporate dissolution, but it was not the optimal solution to the problem. The relatively long statute of limitations associated with equitable claims\footnote{20} meant that the sharehol-

\footnotesize{\textsuperscript{15}} W. FLETCHER, PRIVATE CORPORATIONS § 25 (rev. ed. 1974) For an extensive introduction to the philosophic concept of the corporate form of organization, see id. §§ 24-48
\footnotesize{\textsuperscript{16}} Id. at 99.
\footnotesize{\textsuperscript{17}} Henn & Alexander, Effect of Corporate Dissolution on Products Liability Claims, 56 CORNELL L. REV. 865, 879-80 (1971).
\footnotesize{\textsuperscript{18}} N. LATTIN, THE LAW OF CORPORATIONS § 175 (2d ed. 1971).
\footnotesize{\textsuperscript{19}} The parameters of the "trust fund" doctrine are described in detail in Updike v. United States, 8 F.2d 913, 917-18 (8th Cir. 1925).
\footnotesize{\textsuperscript{20}} Typically the statute of limitations on equitable claims is 10 years. Wallach, supra note 18, at 330 n.34.
ders of a dissolving corporation would be subjected to a prolonged period of uncertainty as to potential claims. Moreover, creditors who sought recompense were forced to pursue each stockholder individually for his proportionate share of the debt. 21

2. Abatement Statutes — Today, virtually every state has statutory provisions controlling the institution of claims against a dissolved corporation. 22 These provisions delay for a specified period of time the abatement of claims that otherwise occurs upon dissolution. 23 In essence, the corporation continues to exist for a time solely for the purpose of litigation. To assure that sufficient funds will exist to satisfy the claims made during this period, state corporation statutes impose a duty on the corporate officers to withhold sufficient funds from the distribution following dissolution to satisfy known corporate obligations which are subject to dispute or which are not yet mature. 24

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21 See Updike v. United States, 8 F.2d 913, 918 (8th Cir. 1925).
22 16 W. FLETCHER, supra note 15, at § 8143.
23 The postponement of abatement statutes are designed to operate in lieu of the applicable statute of limitations. They require the commencement of the suit within the specific period whether the statute of limitations for the claim has begun to run or not. The length of time following dissolution within which claims must be brought by or against the dissolved corporation varies from state to state. Most schemes provide a two or three year period. Wallich, supra note 18, at 325.
24 See, e.g., ABA-ALI MODEL BUS. CORP. ACT § 87 (rev. ed. 1976): § 87 Procedure After Filing of Statement of Intent to Dissolve.—After the filing
   (a) The corporation shall immediately cause notice thereof to be mailed to each known creditor of the corporation.
   (b) The corporation shall proceed to collect its assets, convey and dispose of such of its properties as are not to be distributed in kind to its shareholders, pay, satisfy and discharge its liabilities and obligations and do all other acts required to liquidate its business and affairs, and after paying or adequately providing for the payment of all its obligations, distribute the remainder of its assets . . . among its shareholders according to these respective rights and interests.

Citations to individual state statutes are collected in MODEL BUS. CORP. ACT ANN. 2D § 106, ¶ 6 A.B.A. (1971) [hereinafter cited as M.B.C.A. ANN.].

48 See, e.g., ABA-ALI MODEL BUS. CORP. ACT § 87 (rev. ed. 1976):
§ 87 Procedure After Filing of Statement of Intent to Dissolve.—After the filing
   (a) The corporation shall immediately cause notice thereof to be mailed to each known creditor of the corporation.
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Individual state statutes are cited in M.B.C.A. ANN. §§ 85-87, ¶ 6.

If the corporate officer fails to so provide for outstanding obligations, Section 48 of the Model Act specifies that a dissatisfied creditor may seek his remedy against the officers and directors individually.

§ 48 Liability of Directors in Certain Cases.

(c) A director who votes or assents to any distribution of assets of a corporation to its shareholders during the liquidation of the corporation without the payment and discharge of, or making adequate provision for, all known debts, obligations, and liabilities of the corporation shall be liable to the corporation, jointly and sev-
For both creditors and stockholders, this statutory pattern represents a significant improvement over the previous equitable remedy. It permits the creditor to file against one entity rather than a number of widely dispersed stockholders and it provides corporate officers and stockholders with a measure of repose, for claims made against the corporation must be filed within the statutory period or they are waived.\(^\text{25}\) Even so, it is unlikely that the postponement of abatement statutes would provide a viable remedy for an injured consumer whose claim arises after dissolution is complete. In general, the statutes focus on the preservation of claims for corporate liabilities incurred prior to dissolution.\(^\text{26}\)

Arguably, even though the postponement of abatement statutes and the "trust fund" theory serve the same general function, the postponement of abatement statutes were not designed to provide a remedy for claims arising after dissolution and therefore the "trust fund" theory should be retained to insure a remedy for such claims. Legislative intent is generally unclear. The comments to

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25\ Under ABA-ALI MODEL BUS. CORP. ACT §§ 100, 105 (rev. ed. 1976), claims which accrue prior to the decree of dissolution must be filed during the specified post-dissolution grace period or be barred. However, claims arising from the failure of an officer or director to comply with statutory dissolution procedures do not normally abate upon corporate dissolution and therefore are not barred by the expiration of the post-dissolution grace period. Henn & Alexander, supra note 16, at 885 n.110.

26\ The language of the particular statute may suggest that post-dissolution claims arising within the grace period may also be pursued. Under statutes patterned after ABA-ALI MODEL BUS. CORP. ACT § 105 (rev. ed. 1976), only those claims that are known as of the date of dissolution will survive to be pursued during the statutory grace period. See Chadwick v. Air Reduction Co., 239 F. Supp. 247, 250-51 (N.D. Ohio 1965) (refers to § 98, which was renumbered as § 105 in 1969).

A products liability claim may be said to arise at different times depending upon the theory under which it is pursued. Products liability claims may be brought on the theories of negligence, breach of warranty, or strict liability. In many jurisdictions all three theories are available, but at least two are available in most states. Wade, supra note 2, at 849. Under the theories of negligence or strict liability, the claim will not arise until the injury is, or should have been, discovered. Comment, Statutes of Limitations: Their Selection and Application in Products Liability Cases, 23 Vand. L. Rev. 775, 781, 787 (1970).

Under the theory of breach of warranty as codified in the Uniform Commercial Code, the cause of action accrues when "tender of delivery is made." U.C.C. 2-725(2). Therefore, in states that have adopted postponement of abatement statutes similar to the ABA-ALI Model Act, a claim arising from a post-dissolution injury brought on the theories of negligence or strict liability might be barred, while the same claim brought on the theory of breach of warranty might not. Wallach, supra note 18, at 326-27. Even so, unless the injury predates dissolution, the officers of the corporation will not have notice of the potential claim, and they are not expected to withhold funds from distribution unless the claim is known. See, e.g., ABA-ALI MODEL BUS. CORP. ACT § 87 (rev. ed. 1976) and note 21 supra. As a practical matter, therefore, the claim may be pursued but there will be no assets withheld from distribution to satisfy it.
section 105 of the Model Business Corporations Act suggest that the "trust fund" theory is unnecessary where a postponement of abatement provision has been adopted, and the Wisconsin legislature modified its postponement of abatement provision to make it clear that the statutory remedy is exclusive. Logically, if the "trust fund" theory remains a viable remedy, the comparatively long statute of limitations which accompanies such equitable remedies would frustrate the policy of repose inherent in the statutory scheme. As a general proposition, equitable remedies are thought to operate where no legal remedy exists or where it is shown to be inadequate. The "trust fund" theory arose to provide unsatisfied creditors with a remedy despite the operation of the common law rule of abatement. The statutes now arguably provide an adequate legal remedy for those creditors. However, suggests the retention of the equitable remedy where an injured consumer is concerned, since he may have no other defendant to pursue.

Evidently, the most that can be said is that the law is uncertain. While the postponement of abatement statutes provide a reliable pattern for the disposition of claims against the dissolved corporation, the potential existence of the equitable "trust fund" remedy against the former shareholders of the corporation may provide the injured consumer with his only opportunity to recover. Even so, in pragmatic terms the remedy afforded by the "trust fund" theory is less than ideal. Each shareholder must be located and joined in the suit and each may be held responsible only for his proportionate share of the judgment. The technical problems inherent in the pursuit of such a claim may therefore render this remedy impractical in the context of a products liability claim.
B. Claims Against the Successor to the Original Manufacturer

I. Methods of Transfer and Successor Liability — When a corporation dissolves, the assets may be distributed directly to the shareholders. However, it is more common for the assets to be sold to a third party and the consideration then distributed to the shareholders. The assets may be sold piecemeal, but it is generally acknowledged that, in the vast majority of cases, a going business is more valuable than the sum of its parts. Thus, it is not surprising that businesses commonly change hands without substantial interruption in business operations or outward appearance. Despite this semblance of continuity, each corporation is a distinct legal personality and the law does not generally compel the purchaser of a business to assume the liabilities incurred by the former owner of that business.

In fact, the assumption of liabilities in corporate acquisitions depends upon the method of acquisition and the terms of the specified agreement between the contracting parties. There are several well-established techniques by which control of an ongoing enterprise may be transferred: (1) statutory merger or consolidation; (2) purchase of the stock of the target corporation; and

See generally I A. DEWING, THE FINANCIAL POLICY OF CORPORATIONS 281-95 (5th ed. 1953). A going concern may be said to be comprised of three distinguishable elements: permanent property, current capital, and the intangible elements that distinguish the ongoing enterprise from the dead business—"organization". Id. at 282. Pragmatically, the value of a business as a going concern must be measured in terms of its ability to generate income, for the "actual value of any commodity . . . is bottomed on what a property will produce in earnings to the owner." Temmer v. Denver Tramway Co., 18 F.2d 226, 229 (8th Cir. 1927), quoted in I A. DEWING, supra at 287 note n.

This assessment, commonly known as "capitalization of net earnings," consists of two steps: (1) a determination of the fundamental earning capacity of the ongoing business; and (2) an assessment of the relative probability that this rate of earning will continue. The greater the risks associated with the operation, the greater the doubt of continued earnings and therefore, the lower the value of the enterprise to a prospective purchaser. Id. at 288.

The rationale underlying this phenomenon was convincingly presented in the defendant—appellee's brief quoted at length by the court in Turner v. Bituminous Casualty Co., 397 Mich. 406, 244 N.W.2d 873 (1976).

Obviously, Harris is a well-known corporation on the New York Stock Exchange and has been a well-known corporation for years. It would make no business sense for Harris to change its name. Obviously the only prudent business decision was for Harris to form a new corporation which could inherit the name of the selling corporation, and thus, hopefully, continue on with the goodwill which the selling corporation had established with the public over a period of approximately sixty years. There is nothing unusual or fraudulent in Harris setting up a corporation to inherit the name of a corporation which Harris paid a huge sum of cash to, where part of the assets purchased were the goodwill and name of the selling corporation . . . . If goodwill is to be indeed acquired, it certainly will not occur if the purchaser operates its business under a new name, foreign to the public. Obviously, there must be continuity in the eyes of the public.

Id. at 416, 244 N.W.2d at 877. See also Note, Rights of Creditors Against a Successor Corporation, 44 HARV. L. REV. 260, 260 (1930).

15 W. FLETCHER, supra note 15, at § 7122. See discussion of this principle in the text accompanying notes 59-79 infra.

Comment, supra note 8, at 91.
(3) purchase of the assets of the target corporation.\textsuperscript{39} There are a number of factors which must be considered in the choice of an acquisition technique,\textsuperscript{40} but it is clear that the ability to sever a business from its existing and contingent obligations may well be a controlling factor in some acquisition negotiations.\textsuperscript{41}

Merger and consolidation are effected by compliance with the applicable state corporation statutes.\textsuperscript{42} Generally, compliance with

\textsuperscript{39} D. HERWITZ, BUSINESS PLANNING 679-80 (1966).

\textsuperscript{40} A number of the tax and nontax considerations which may affect the choice of acquisition mode are discussed in Darrell, \textit{The Use of Reorganization Techniques in Corporate Acquisitions}, 70 HARV. L. REV. 1183 (1957). The influence of federal securities laws in the area of corporate acquisitions is a topic of vast complexity, beyond the scope of this discussion. For an introduction to this question, the reader is referred to Lockwood, \textit{Corporate Acquisitions and Actions Under Sections 10(b) and 14 of the Securities Exchange Act of 1934}, 23 BUS. LAW. 365 (1968).

\textsuperscript{41} Darrell, supra note 41, at 1201-02; Wallach, supra note 18, at 336 n.55; Comment, supra note 8, at 91.

It is probable that fear of unknown contingent products liability claims was not a major factor in selection of the mode of corporate acquisition in years past. More recently, thousands of manufacturing companies have been significantly affected by the dramatic increase in products liability claims and concurrent escalation in products liability insurance premiums. \textit{See generally Legal Affairs: The Devils in the Product Liability Laws}, BUS. WEEK, FEB., 12, 1979, at 72. For example, products liability insurance premiums for one small machine manufacturer increased from $2,000 in 1970 to $200,000 in 1976. Another small manufacturer of product-handling equipment reported that its products liability insurance premium went from $4,000 to $100,000 in one twelve month period. These cases are extreme examples, but it is certain that the increasing cost of products liability litigation is having a serious detrimental effect on the profitability of manufacturing drugs, aircraft, tools, industrial safety devices and all forms of capital goods. Some companies have opted to continue production without any insurance; some have terminated particular product lines; a few have decided to liquidate. Wysock, \textit{Litigation Load Manufacturers Are Hit With More Lawsuits, Rising Insurance Costs}, Wall St. J., June 3, 1976, at 1, col. — \textit{See also Product Liability Insurance: Hearings Before the Subcomm. for Consumers of the Comm. on Commerce, Science, and Transportation on § 403, 95th Cong., 1st Sess. 49-53 (1977) (statement of Victor E. Schwartz).

If this trend of soaring insurance costs continues, many more small manufacturers will likely be forced to sell out. Furthermore, as corporate transfers stimulated by products liability costs increase, the existing principles of law concerning the continuing liability of successors and original manufacturers will be a growing source of difficulty for products liability plaintiffs.

\textsuperscript{42} Every state provides a formal procedure by which a statutory merger or consolidation may be effected. \textit{E.g.}, ABA-ALI MODEL BUS. CORP. ACT §§ 71-81 (rev. ed. 1976). Citations to individual state statutes are collected in M.B.C.A. ANN. § 71-72 ¶ 6.

The term "merger" is commonly used to describe all sorts of corporate combinations. Technically, however, corporate combinations may take three distinct forms. 15 W. FLETCHER, supra note 15, at § 7075. A merger occurs when one corporation absorbs another. The shareholders of the disappearing corporation receive shares in the surviving entity in exchange for their outstanding shares. \textit{See, e.g.}, ABA-ALI MODEL BUS. CORP. ACT § 71 (rev. ed. 1976). A consolidation is effected when the component corporations dissolve and an entirely new corporation is specially organized to receive their assets. The shareholders of the dissolving corporations trade their shares for shares in the new corporation. \textit{See, e.g.}, id. § 72. In the third form of corporate combination, the corporations coalesce, but retain their separate corporate identities, \textit{e.g.}, where one corporation purchases or leases the property of another, or obtains a controlling block of its stock. 15 W. FLETCHER, supra note 15, at § 7075.

For the purposes of this discussion, it is unnecessary to distinguish between acquisitions that take the form of a merger and those that are categorized as consolidations: in both transactions, only one corporate entity survives. Therefore, for simplicity, further references will be to mergers only although it may be assumed that the discussion would apply as well to acquisitions labeled "consolidations."
the statutory provisions has the advantage of being a tax-free reorganization for federal tax purposes. State statutes, however, customarily require formal approval of the plan by the shareholders of all constituent companies. Usually, a two-thirds majority vote of the shares is required for approval and many statutes also require a class vote of shares whose rights will be affected by the structural change. Dissenting shareholders are generally given the right to demand that their shares be redeemed for their appraised cash value. Since, by law, the completion of the statutory procedure for merger or consolidation results in the termination of the separate legal existences of the constituent corporations except the surviving or new corporation, that entity is forced to succeed to all the liabilities, including product liabilities, of its predecessors.

Control of an ongoing enterprise may, however, be acquired just as effectively without forcing the dissolution of either corporate entity. The acquiring corporation may gain control by purchasing all, or a controlling percentage, of the stock of the target corporation. The purchase may be made from a few controlling shareholders or the public at large; it may be an offer to exchange securities for se-

43 I.R.C. § 368(a)(1)(A). The specific problems associated with qualifying for tax-free treatment are beyond the scope of this article. The reader is referred to B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS & SHAREHOLDERS C. 14 § 14.12 (3d. ed. 1971), for a discussion of the "Type-A" tax-free reorganization.

44 Darrell, supra note 41, at 1192-93. Formal approval can entail considerable expense if proxy-solicitation materials must be filed to comply with applicable rules issued by the SEC, the state, and any stock exchange on which the stock is listed. Id. at 1188-92. Moreover, shareholders may attack the plan under Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b)(1976), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1975). 14 W. FLETCHER, supra note 15, at § 7162.1; 89 HARV. L. REV. 1917 (1976).

45 E.g., ABA-ALI MODEL BUS. CORP. ACT § 73 (rev. ed. 1976), requires the approval of a majority of the shareholders entitled to vote, and provides that any class of shares will be entitled to vote on the proposal if the plan affects the rights associated with those shares. Individual state statute citations are collected in M.B.C.A. ANN. § 73 ¶ 6.

46 E.g., ABA-ALI MODEL BUS. CORP. ACT §§ 80-81 (rev. ed. 1976). State statutory provisions are collected in M.B.C.A. ANN § 73 ¶ 6. Obviously, the appraisal right of dissenting shareholders can be used as a powerful weapon to prevent an otherwise legitimate merger. The corporations must be prepared to struggle with the problem of valuation, and must be certain that sufficient liquid assets exist to satisfy any dissident claim. This seems particularly burdensome in some situations where the stock of the corporations is publicly marketed, for a dissenter could reach the same result simply by selling his shares. The rule is equally difficult for the dissenting shareholder. The statutory procedure for obtaining appraisal is complex and could be expensive to the shareholder if he decides to litigate the issue of the fair value of his shares. An elaboration on these issues including several views as to the future utility of the shareholder's appraisal right is presented in A. CONARD, R. KNAUSS, & S. SIEGEL, ENTERPRISE ORGANIZATION 1139-49 (2d ed. 1977) [hereinafter cited as A. CONARD].


48 E.g., ABA-ALI MODEL BUS. CORP. ACT § 76(c) (rev. ed. 1976). Individual state statutes are cited in M.B.C.A. ANN. § 76 ¶ 6. All jurisdictions impose the obligations of the component corporations upon the surviving or new corporation and expressly provide that creditors rights shall not be impaired by the mutation in organizational form. Id. § 3.03(6). The liabilities assumed by the surviving entity in a merger include responsibility for the torts of the dissolved constituents. 15 W. FLETCHER, supra note 15, at § 7121.
securities, or an offer to buy for cash. Whatever the configuration, both corporate entities will exist after the acquisition is complete. A stock-for-stock purchase may have the advantage of characterization as a tax-free reorganization for federal tax purposes. It can be simpler and less costly than statutory merger because it does not generally require formal shareholder approval, or provide for disserter's appraisal rights. The technique is disadvantaged by the expensive and time-consuming disclosure procedure which may be required by federal securities law when the offer is made to the public at large. However, since the corporate identity of the target entity continues after the transfer of control is complete, it remains primarily responsible for its existing and contingent liabilities.

Finally, transfer of control may be achieved through a purchase of substantially all of the target business' assets. Compensation may be stock in the acquisitor corporation or cash. The transfer can be structured to gain tax-free status for federal tax purposes. The procedure may, additionally, be much simpler than a statutory merger or stock purchase since the procedural formalities are avoided. Under most state corporation statutes, only a majority of the shareholders of the target company need approve, and only dissenting shareholders of the target company are provided with appraisal rights. Moreover, the purchaser may choose, as a mat-

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51 Acquisitor shareholder approval may be necessary if additional shares must be issued in the exchange. Darrell, supra note 41, at 1194.

52 See note 49 supra.

53 As a stockholder in the target corporation, the acquiring entity assumes the danger of future liability to the extent of the value of interest it has acquired, but the target corporation retains initial legal responsibility for its existing and future liabilities. Note, supra note 7, at 1308 n.20.


55 E.g., ABA-ALI MODEL BUS. CORP. ACT § 74 (rev. ed. 1976), provides that the details of the plan for merger as embodied in the articles of merger approved by a majority of the shareholders, must be delivered to and approved by the state before the plan can become effective. Individual variations of this provision in state corporation laws are collected in M.B.C.A. ANN. § 74 11 6. The sale of assets technique also may avoid some of the complexities associated with the federal securities laws which plague the merger and stock acquisition techniques. See Lockwood, supra note 41, at 372-75.

ter of expediency, to assume only those obligations and liabilities integral to the continuation of business operations. Because a sale of assets does not, of itself, necessitate the dissolution of the transferor entity, it is presumed to survive the transfer of control and remains primarily responsible for liabilities not expressly assumed by the purchaser in the agreement.\textsuperscript{57} Thus, under the accepted rule, a bona fide purchaser of corporate assets for adequate consideration may not be held accountable for liabilities associated with those assets not expressly or impliedly assumed.\textsuperscript{58}

2. Judicially Created Exceptions to the General Rule of Nonassumption — Although this general rule of nonassumption allows an ongoing business to be separated from its existing and contingent liabilities, it provides ample protection for the claims of the transferor's creditors. If the transferor is not dissolved as a function of the sale, and if adequate consideration is paid to the corporation for its assets, existing creditors should not be prejudiced.\textsuperscript{59} In certain instances, however, the rights of the target company's creditors could be severely compromised by the operation of the general rule of nonassumption. For example, in transfers where the consideration consists of stock in the acquiror which has no recognized market, the value of the consideration may well be "adequate," but the transferor will have no liquid assets with which to satisfy its obligations.\textsuperscript{60} Or, if the purchaser pays stock consideration directly to the target corporation's shareholders instead of to the corporate entity, the value paid may be "adequate," but the transferor will be unable to pay its debts.\textsuperscript{61} Accordingly, the scope of the general


\textsuperscript{59} Even if the transferor dissolves soon after the transfer, creditors rights are protected by the postponement of abatement statute. See text accompanying notes 23-26 \textit{supra}.

\textsuperscript{60} Some courts have held that a purchase of corporate assets for stock consideration would not provide the purchaser with the protection of the general rule of nonassumption. \textit{See}, e.g., Peter v. American Ry. Express Co., 256 S.W. 100 (Kan. City Ct. App. 1923); American Ry. Express Co. v. Commonwealth, 190 Ky. 636, 228 S.W. 433 (1920), \textit{aff'd}, 275 U.S. 269 (1927); Comment, \textit{Transferee Liability and the C Reorganization}, 40 U. Colo. L. Rev. 380, 395 (1968). But there is also authority for the proposition that securities are "adequate" consideration if they are readily marketable. \textit{See}, e.g., Ozan Lumber Co. v. Davis Sewing Mach. Co., 284 F. 161, 172-73 (D. Del. 1922), \textit{aff'd}, 292 F. 135 (3d Cir. 1932); Juenger & Schulman, \textit{supra} note 8, at 45-46 n.28.

\textsuperscript{61} \textit{See}, e.g., Luedecke v. Des Moines Cabinet Co., 140 Iowa 223, 118 N.W. 456 (1908).
rule is limited by four judicially-created exceptions. The acquiror of an ongoing enterprise may be held responsible by law for liabilities associated with that enterprise, even though the transfer of control took the form of a purchase of assets where: (1) the purchase agreement is interpreted to expressly or impliedly assume those liabilities; (2) the transaction amounts to a fraudulent attempt to escape liability; (3) the purchase amounts to a de facto merger; (4) the purchaser is essentially a continuation of the seller.

It is evident that the express or implied assumption of liabilities associated with an ongoing enterprise in the purchase agreement will negate the effect of the general rule of nonassumption. Typically, the acquisition of an operating business includes the acquisition of certain expressly assumed liabilities. But the law may imply a stipulation on the part of the acquiring firm to assume the obligations of its predecessor merely by virtue of its acquisition and continued operation.

Where the transfer of control may be characterized as somehow improper, the creditors of the transferor corporation may pursue the assets into the hands of the transferee under the exception for fraudulent transfer. Most frequently, transfers for inadequate consideration are set aside as fraudulent. A transfer may also be characterized as fraudulent where the consideration is paid directly to the target company’s shareholders rather than to the corporation, or where there is evidence that the transferee knew the transferor intended to default on its debts.

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62 Cases stating the general rule of nonassumption and its four exceptions are collected in 15 W. FLETCHER, supra note 15, § 7122 n.1.
63 Note, supra note 7, at 1311.
64 See, e.g., Bouton v. Litton Indus. Co., 423 F.2d 643 (3d Cir. 1970); Pearce v. Schneider, 242 Mich. 28, 217 N.W. 761 (1928). See also Note, supra note 37, at 261. An acquisitor may avoid this implied assumption of liabilities by expressly denying responsibility for all liabilities not specifically assumed in the purchase agreement.
65 The various improprieties that have been characterized by courts as fraudulent transfers are discussed in Annot., 49 A.L.R.3d 881, 884-899 (1973).

The transferor’s creditors may also be provided a remedy against the transferee by the applicable bulk sales law. See, e.g., U.C.C. art. 6. Bulk sales laws typically impose responsibility for the liabilities of the transferor associated with the assets on the transferee unless notice of the impending sale is provided to all known creditors in advance and unless information about the details of the sale is provided those creditors. See, e.g., U.C.C. §§ 6-104, -105, -107. The term “creditors” includes all known claimants against the transferor even though the amount or validity of the claim has not been determined as of the date of sale. See, e.g., U.C.C. § 6-104(2). Additionally, Article 6 imposes an affirmative duty on the transferee to oversee the payment of the transferor’s outstanding obligations but not every state has enacted such a provision U.C.C. § 6-106. For a thorough discussion of the theory and operation of bulk transfer laws, see J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE 640-66 (1972).
The equitable doctrine of de facto merger arose because control of an ongoing enterprise may be attained by a purchase of assets without the protection to dissenting shareholders and creditors afforded by law in a statutory merger.69 The ultimate objective of a transfer may be the merger of the enterprises into one surviving entity, but if the transfer takes the form of a purchase of assets, in most states only a majority of the shareholders of the target company need approve, no dissenting shareholder has appraisal rights, and the surviving entity need not assume any of the liabilities of the dissolving corporation although the business continues without interruption.70 Creditors and dissenting shareholders therefore persuaded courts to treat such transactions as tantamount to statutory mergers, forcing the parties to comply with the statutory formalities.71

To determine whether the transaction has the earmarks of a merger, courts have examined the nature of the transaction as a whole and its consequences.72 In statutory merger, the component entities blend into one surviving corporation and the shareholders of all become shareholders in the survivor.73 Therefore, in a sale of assets for stock of the purchaser, a de facto merger may be found where the buyer continues the seller's business operation, and the seller promptly dissolves, distributing the shares of the buyer to its shareholders.74

The final exception to the general rule of nonassumption is the "mere continuation" rule. In its most narrow sense, the exception applies to changes in the form of the corporate entity such as re-
capitalization, changes in the name of the entity, or changes in the state of incorporation.\textsuperscript{75} Some decisions have stated that a continuation may be found where the consideration paid for the seller's assets was inadequate to satisfy its outstanding obligations.\textsuperscript{76} Other courts have stated that a mere continuation of the seller may be found where there was continuity of business operation, management, directors, officers, and shareholders between the buyer and seller, and the seller corporation ceases to exist after the sale is consummated.\textsuperscript{77} To the extent that this definition includes the elements of continuity of operation and ownership coupled with the prompt dissolution of the seller it would seem to be merely a repetition of the exception for de facto merger.\textsuperscript{78}

3. \textit{Case Law} — The overlap in the judicial descriptions of the four exceptions to the general rule indicate that a particular transfer may be challenged under more than one exception simultaneously. Despite some confusion in the decisions as to the exact parameters of each exception, it seems clear that a sale of assets will not be characterized as a de facto merger or a mere continuation where the consideration paid is adequate cash rather than stock in the transferee, and the transferor continues to exist as a

\textsuperscript{75} See, e.g., Ozan Lumber Co. v. Davis Sewing Mach. Co., 284 F. 161, 165 (D. Del. 1922), where the court described the exception for mere continuation in the following terms:

[I]n order to recover from a corporation of one name the obligations of a corporation to another name, upon the theory that the former is a mere continuation of the latter, it must appear that the former is the same legal entity. . . . That is to say, it must be the same legal person, having a continued existence under a new name.


\textsuperscript{76} See, e.g., Knapp v. North Am. Rockwell Corp., 506 F.2d 361, 366 (3rd Cir. 1974), \textit{cert denied}, 421 U.S. 965 (1975); Ortiz v. South Bend Lathe, 46 Cal. App. 3d 842, 847, 120 Cal. Rptr. 556, 559 (1975). This concern with the adequacy of consideration paid for the assets overlaps the exception for mere continuation with that for fraudulent transfer. See text accompanying notes 66-69 \textit{supra}.


\textsuperscript{78} See text accompanying note 75 \textit{supra}. However, a recent decision by the First Circuit Court of Appeals significantly broadens the test for a mere continuation of the seller. In Cyr v. B. Offen & Co., 501 F.2d 1145 (1st Cir. 1974) (applying New Hampshire law), a corporate purchaser of a sale proprietorship for cash was held to be a mere continuation of the seller for the purposes of tort liability on the basis of continuity of personnel, management, and business operation even though the element of ownership continuity was missing. In so holding the court stated: "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 determinant of liability." \textit{Id.} at 1154. This formulation of the exception to the general rule for a mere continuation of the seller represents a radical departure from traditional corporate doctrine governing transferee liability by focusing on enterprise continuity rather than continuity of ownership. See Comment, \textit{supra} note 8, at 105-06. The \textit{Cyr} decision is discussed in the text accompanying notes 137-52.
separate legal entity for a time following the consummation of the sale. As classically formulated, both exceptions presume a continuity of ownership between the transferor and transferee which is not present if the component entities exist after the sale and if the consideration paid for the assets is cash. The analysis presented in three recent cases involving product liability claims against the successor to the original manufacturer illustrates how essential the concept of ownership continuity is to a finding of successor liability under the exceptions for de facto merger or mere continuation.

79 Note, supra note 7, at 1316. The products liability plaintiff may also argue that the sale contract contains an express or implied assumption of the target company’s contingent liabilities, or that the transaction amounts to a fraudulent attempt to escape liability, but these two theories have proven to be less useful in the context of a products liability claim than the exceptions for de facto merger or mere continuation. Id. at 1311-12.

The purchase agreement in a corporate acquisition may, and often does, include the assumption of selected liabilities associated with the continued operation of the business, such as outstanding debts to suppliers and contractual obligations. Darrell, supra note 41, 1202-03. Such specified assumptions, however, do not automatically include responsibility for contingent product liability claims. In fact, it is unusual for a purchase agreement to expressly include an assumption of responsibility for such claims. Note, supra note 7, at 1311. This general failure to make contractual provision for future products liability may be attributable to the difficulty of assessing such speculative future obligations accurately, but it is more probable that contingent products liability is not directly addressed in such contracts because the present legal structure allows both parties to the transfer to effectively avoid responsibility for such claims if the transferor dissolves after the sale. See text accompanying notes 55-59 supra.

It may be argued that a broad contractual assumption of the liabilities associated with acquired assets implies assumption of contingent products liability as well, and at least one court has so held. In Bouton v. Litton Indus. Co., 423 F.2d 643 (3d Cir. 1970), the court held that a broad assumption of liabilities clause in a sale contract coupled with the transferral of an existing products liability insurance policy to the purchasing corporation amounted to an implied assumption of responsibility for contingent products liability claims. Where the purchase agreement expressly provides for the assumption of certain existing liabilities and denies responsibility for all others, however, it is unlikely that a court would interpret the contract as providing for the assumption of contingent claims. Thus, as a practical matter, this exception provides the courts with little flexibility in developing a doctrine expressive of the needs of the products liability plaintiff.

The exception for fraudulent transfer is primarily intended to provide a remedy for known claimants of the transferor corporation against the assets in the hands of the transferee corporation where inadequate consideration renders the transferor unable to meet its obligations. See notes 66-69 supra. Where the consideration paid was adequate to satisfy known obligations, and there is no proof of actual intent to defraud existing or future claimants, the transferee may not be held accountable. 15 W. Fletcher, supra note 15, § 7330. In practice, therefore, even though the fear of contingent product liability claims may be a primary motive behind the transferor’s decision to sell, where adequate consideration is received for the assets it may be impossible for a subsequent products liability plaintiff to prove fraudulent intent. But see note 41 supra.

Under Section 7 of the Uniform Fraudulent Conveyances Act, a subsequent claimant, such as a products liability plaintiff, may recover against the transferee under the theory of fraudulent transfer if he can show intent “to hinder, delay, or defraud either present or future creditors,” even though the claimant cannot demonstrate an intent to defraud him personally. To date, no products liability plaintiff has recovered against a transferee of assets on this theory. Note, supra note 7, at 1312 n.49.

In Kloberdanz v. Joy Manufacturing Co.,\textsuperscript{81} the plaintiff was injured by oil drilling equipment manufactured by Web-Wilson several years after Web-Wilson had sold most of its tangible and intangible assets to Joy Manufacturing for an adequate cash consideration. The assets were purchased subject to certain liabilities, but Joy Manufacturing did not voluntarily assume responsibility for Web-Wilson's contingent products liability. Web-Wilson invested the proceeds of the sale during a ten month period following the transfer, but dissolved prior to plaintiff's injury. The plaintiff argued that the purchase of assets was essentially a de facto merger, or, alternatively, that Joy was a mere continuation of Web-Wilson because Joy continued to manufacture the same product line under the same trade name. The United States district court, applying California law, held that despite the continuity of business operations no de facto merger could be found where the transferor and transferee continued to exist separately after the transfer of assets was complete.\textsuperscript{82} The court held that there could be no finding of continuation where there was no common identity of stock, stockholders, officers, or directors between Joy and Web-Wilson.\textsuperscript{83}

On similar facts, a New Jersey superior court held in McKee v. Harris-Seybold Co.\textsuperscript{84} that a successor corporation could not be made responsible for a products liability claim arising from a machine produced by its predecessor.\textsuperscript{85} As in Kloberdanz, the plaintiff argued alternatively that the transferee of the assets, Harris-Seybold, was merely a continuation of the original manufacturer, Seybold, or that the transfer amounted to a de facto merger. Even though the contract required the prompt dissolution of Seybold upon consummation of the transfer and a portion of the consideration was stock in the purchase corporation, the court concluded that there was no de facto merger where two distinct corporate entities existed for a time following the transfer.\textsuperscript{86} The court also declared that the small amount of stock transferred as part of the consideration did not provide sufficient commonality of ownership for a finding of continuation.\textsuperscript{87} Thus, despite the fact

\textsuperscript{81} 288 F. Supp. 817 (D. Colo. 1968) (applying California law).
\textsuperscript{82} Id. at 822.
\textsuperscript{83} Id.
\textsuperscript{84} 109 N.J. Super. 555, 264 A.2d 98 (L. Div. 1970), aff'd per curiam, 118 N.J. Super. 480, 288 A.2d 585 (App. Div. 1972). The plaintiff in McKee was injured by a machine manufactured by Seybold in 1916. Seybold sold all its assets to Harris-Seybold Co. for cash and some stock before the plaintiff's injury occurred. As part of the contract, Seybold agreed to change its name at once and to dissolve as soon as possible, but the dissolution did not actually occur until a year after the sale was completed.
\textsuperscript{85} Id. at 570, 264 A.2d at 106.
\textsuperscript{86} Id. at 563-67, 264 A.2d at 103-04.
\textsuperscript{87} Id.
that Harris-Seybold continued to produce and market under the same trade name the products previously manufactured by Harris, it was not accountable for an injury caused by a machine produced by its predecessor.\(^8\)

In *Bazan v. Kux Machine Co.*,\(^8\) on facts almost identical to those presented by *McKee*, a United States district court sitting in Wisconsin cited the *McKee* analysis with approval.\(^9\) As in *McKee*, the court held that a sale of assets could not be termed a de facto merger or a mere continuance where the consideration paid was cash and both parties continued to exist after the transfer of control of the business operation was complete.\(^9\)

4. *Protection of Products Liability Plaintiffs* — It is clear that the general rule of nonassumption and its four exceptions adequately protect the interests of the parties for which they were designed.\(^9\) The acquiror can control potential future liability associated with the ongoing business operation, and so be assured of an accurate valuation of the enterprise's worth;\(^9\) existing creditors and claimants are assured that sufficient liquid assets will be paid to the seller corporation to satisfy their claims;\(^9\) and dissenting shareholders are provided with approval and appraisal rights in transfers that resemble a merger.\(^9\) However, the holdings of *Kloberdanz*, *McKee*, and *Bazan* demonstrate that the traditional corporate doctrine does not adequately protect the interest of an injured products liability plaintiff. In those cases, although the business operation continued without interruption, the plaintiffs' claims were barred because the ownership of the operation had changed and the original corporate entity had dissolved. The federal courts were forced to define the acquiror's responsibility to the injured plaintiffs by reference to traditional principles of corporate law. No doctrine existed in the state laws governing successor responsibility expres-

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\(^8\) The fact that the injury was caused by a fifty-two year old machine could have influenced the court in its result, but the age of the machine was not a factor in the court's discussion of the propriety of imposing successor liability.

\(^9\) 358 F. Supp. 1250 (E.D. Wis. 1973). The plaintiff was injured by a machine manufactured by the predecessor of the defendant corporation. Prior to the injury, old Kux Machine Co. sold almost all its assets to Wickes Corp. for adequate cash consideration. Wickes created new Kux Machine Co. to receive the assets. Old Kux changed its name immediately, but did not dissolve until approximately ten months after the sale was completed.

\(^9\) Id. at 1252.

\(^9\) Id.


\(^9\) The ability to selectively avoid liabilities associated with an ongoing business, by separating the assets from the corporate entity, facilitates the transfer of capital because purchasing corporations are able to precisely estimate the risk associated with the acquisition. *See* Comment, *supra* note 8, at 91.

\(^9\) *See* note 59 *supra*.

\(^9\) *See* text accompanying notes 69-71 *supra*. 
sive of the peculiar balance of interests presented by a products liability claim.

The problems faced by the products liability plaintiff are unique because his claim may not arise until years after the transfer of control of the business has been achieved. In that setting, the factors of adequacy of liquid consideration paid and the physical existence of the transferor for a time after the sale is completed, which are central to the traditional rules governing transferee liability, seem inapposite. Therefore, as a function of the continuing expansion of the rights of the users of products, it is reasonable to conclude that the existing corporate doctrine should be reexamined in light of the special interest of society in providing protection to the consumer, and modified to better reflect that interest in balance with the interest of the business community in the accurate estimation of future costs.

II. THE DEVELOPMENT OF PRODUCT LIABILITY LAW AND THE POLICY JUSTIFICATIONS FOR STRICT PRODUCTS LIABILITY

A. Development of the Law

Products liability is a rapidly developing branch of tort law under which a manufacturer of a defective product may be held responsible for harm to ultimate users of that product. The doctrine did not exist at common law, but arose in this century as a judicial response to the problems created by an increasingly industrialized and sophisticated system of production and distribution. Initially, the consumer's rights were characterized in terms of negligence or

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96 See generally Gillam, supra note 6; Prosser, The Fall of the Citadel, 50 MINN. L. REV. 791 (1966); Traynor, supra note 3.
97 This concept of manufacturer responsibility has found its most widely accepted form in Section 402A(1) of the RESTATEMENT (SECOND) OF TORTS (1965):

§ 402A Special Liability of Seller of Product for Physical Harm to User or Consumer. (1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if (a) the seller is engaged in the business of selling such a product, and (b) it is expected to reach the user or consumer without substantial change in the condition in which it is sold.

98 One commentator describes the historic shift in the law in this way:

The origin of caveat emptor is the medieval Christian belief that business is outside the law. The buyer has no legal protection and had to rely upon his own sharpness and skepticism; the simplicity of technology and the personal character of trade relations made it practical for him to do so.

Laissez faire and the Industrial Revolution modified the principle of caveat emptor as they destroyed the conditions under which it was tolerable. The ancient mercantile virtues could not cope with an impersonal market, characterized by
breach of warranty on the part of the retailer. Thus, the retailer could be held responsible for a consumer injury if he failed to use the degree of care which a reasonably prudent man would use. Typically, his duty was discharged by a reasonable inspection of his goods for defects. Similarly, the retailer could be found responsible for a consumer's loss or injury where the goods failed to conform to the implied warranty of quality and fitness for the use anticipated. Gradually, these concepts were extended to reach the manufacturer of the defective product, and more recently the traditional legal doctrines of negligence and breach of warranty have been widely supplanted by the doctrine of strict products liability.

Under the theory of strict products liability, a manufacturer or any other member of the chain of distribution may be held responsible for an injury to a person resulting from contact with its product if the product is shown to have left that entity's control in a defective or dangerous condition and if that defect or danger actually caused the injury. Fault on the part of the manufacturer or seller need not be shown, and no contractual relationship need exist between the manufacturer and the injured person. One

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specialization, division of labor, systematic exchange, sophisticated finance, corporate organization, and technological complexity.

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The modern tendency is to substitute minimal standards of quality and merchantability for the precise bargain the parties made. . . . Implied warranty is being treated as an overhead cost, to be paid by the financially and legally responsible element in the chain of distribution and shifted to consumers as a class.

Gillam, supra note 6, at 119-21.

99 The law originally couched these principles in terms of the "retailer" because he dealt directly with the consumer. This was satisfactory in times past when goods were produced to order by local craftsmen. Gillam, supra note 6, at 129.

100 Id. at 122-23.

101 Id. at 124-28.

102 W. PROSSER, supra note 8, at §§ 96, 97. A detailed discussion of the development of products liability law is beyond the scope of this article. The reader is referred to Gillam, supra note 6, which discusses the area in depth with extensive citation to other authorities, and to the more recent articles on the rise of the theory of strict products liability cited in note 3 supra.

103 According to Dean Prosser, as of 1971, two-thirds of the states had accepted the theory of strict products liability. W. PROSSER, supra note 8, at 657-58.


"A manufacturer is strictly liable in tort when an article he places on the market, knowing that it is to be used without inspection for defects, proves to have a defect that causes injury to a human being."

105 RESTATEMENT (SECOND) OF TORTS § 402A(2)(a) & (b)(1965):

(2) The rule stated in Subsection (1) [see note 97 supra] applies although (a) The seller has exercised all possible care in the preparation and sale of his product, and (b) The user or consumer has not bought the product from or entered into any contractual relation with the seller.
practical effect of the doctrine has been to ease the burden of proof on the injured plaintiff. The widespread adoption of strict products liability as the primary theory of recovery in products liability cases is therefore indicative of a trend toward expanding the liability of the manufacturer to permit recovery by the broadest possible class of injured persons.106

B. Policy Justifications

A number of policy considerations are commonly espoused by courts and commentators in support of this shift of responsibility from the injured person to the manufacturer. One argument for imposing responsibility on the manufacturer is that the public interest in improved health and safety demands that the law provide affirmative protection against dangerous or defective products.107 This recognizes that the manufacturer is best equipped to anticipate and guard against potential injuries through improved product design and manufacture. To induce continued research and product development to this end, the law must force the manufacturer to bear the risk posed by product defects.108 Another common justification is that the manufacturer benefits from placing its products in the stream of commerce and therefore should bear the burden of the


106 This expansion is documented in W. Prosser, supra note 8, at 662-63.


Dean Prosser notes that this argument had its origin in cases involving the sale of adulterated food. There, the public sentiment was so powerful that the strict liability of suppliers was deemed justified. Id. at 1122-23. Gradually, this notion of strict liability, expressed in the form of an implied warranty of safety, was extended to products for intimate bodily use (e.g., Rogers v. Toni Home Permanent Co., 167 Ohio St. 244, 147 N.E.2d 612 (1958)). And after the precedental case, Henning v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960), the warranty of safety was extended to a wide variety of products. W. Prosser, supra, note 8, at 654-55.

108 One commentator has questioned the validity of this proposition, asserting that the existing standards provide sufficient incentive to the manufacturer to produce the safest possible product. Plant, Strict Liability of Manufacturers for Injuries Caused by Defects in Products - An Opposing View, 24 TENN. L. REV. 938, 945 (1957). Professor Plant also notes that:

[A] more powerful incentive to make products as safe as possible lies in the desire of manufacturers to avoid the danger that their products will develop a reputation for being unsafe or defective and therefore be unacceptable to the purchasing public...the element which is most disturbing to manufacturers is not the potential judgment of legal liability but the injury which is done to the reputation of the product and its producer. While it may be conceivable that the imposition of strict liability could increase in some small measure the pressure upon a few backward manufacturers to make their products safe, it is doubtful that it will add very much to existing pressures.

Id.
losses associated with the use of those products. In this way it is
thought that the costs associated with the use of a particular prod-
uct will be more accurately reflected in its market price. Theoretically,
products that are dangerous will gradually become more
costly than safer, comparable products and will disappear from the
marketplace. In the same vein, manufacturers are presumed to
be better able to absorb the costs flowing from product-related
injuries than are individual consumers. They have access to in-
formation concerning the potential dangers associated with a par-
ticular product, can more efficiently assess the probable costs, and
can spread those costs throughout society through insurance and
price adjustments.

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106 See, e.g., Suvada v. White Motor Co., 32 Ill. 2d 612, 619, 210 N.E.2d 182, 186 (1965);
Restatement (Second) of Torts § 402A Comments c, f (1965); Wade, supra note 2, at
826. See also Calabresi, Some Thoughts on Risk Distribution and the Law of Torts, 70 Yale
L.J. 499 (1961). Professor Calabresi notes that "'Enterprise liability' [is] the notion that los-
ses should be borne by the doer, the enterprise, rather than distributed on the basis of fault."
Id. at 500.

110 Calabresi, supra note 109, at 502, describes the concept in his explanation of "alloca-
tion of resources":

One of these [basic postulates], perhaps the most important, is that by and large
people know what is best for themselves . . . . [I]n order for people to know
what they really want they must know the relative costs of producing different
goods. The function of prices is to reflect the actual costs of competing goods, and
thus to enable the buyer to cast an informed vote in making his purchase.

Logically, then, the market price of an item can only accurately reflect the actual cost of its
continued use if the manufacturer is held responsible for every injury associated with it. Un-
reasonably dangerous products will gradually increase in price and market demand will ac-
cordingly decline.

111 Traynor, supra note 3, at 366; Comment, supra note 8, at 89-90.

(Traynor, J. concurring), was the first judicial recognition of this concept.

The purely dispassionate economic assessment that the manufacturer is better equipped
than is the individual consumer to anticipate and insure against the risk of loss associated
with a particular product through insurance policies or market price adjustments may well
be the central impetus behind the broad acceptance of strict products liability as the primary
theory of recovery. In a recent decision, Ray v. Alad Corp., 19 Cal. 3d 22, 31, 560 P.2d 3,8,
136 Cal. Rptr. 574, 579 (1977), the California Supreme Court noted that the "paramount pol-
icy" served by strict liability is the shifting of loss from the defenseless victim to the manu-
facturer with its superior risk spreading ability.

The economic logic embodied in the concept of strict products liability has been a favorite
topic for commentators. In an excellent discussion tracing the mutations in the common law
of negligence and implied warranty which characterized the development of products liability
law, Professor Gillam argues persuasively that the fictions devised by the judiciary to
mold existing legal doctrine to the needs of the injured consumer are workable but that:

None of them squarely faces the real issue: as a matter of economic policy should the
manufacturer be liable without fault to the consumer? Any one of these ap-
proaches in effect imposes strict liability, but the best way to impose it is to impose
it frankly as the soundest economic policy, rather than as a device for avoiding the
policy issue . . . . [If absolute liability is found to be called for, it should be im-
posed directly, without fiction or analogy, upon simple grounds of policy . . . .

Gillam, supra note 6, at 155.

More recently, the debate has shifted from whether strict products liability should be
adopted, to how far the doctrine should extend. Some commentators have proposed that this
The expansive character of the doctrine of strict products liability and the policy considerations underlying its development suggest that the balance of interests represented in the existing corporate rule of nonassumption does not adequately reflect the interests of the products liability plaintiff. Clearly, it is inconsistent with those policies to determine the rights of an injured person as against a successor to the original manufacturer by reference to a rule that predicates ongoing responsibility on continuity of corporate ownership rather than on the continued marketing of the product that caused the injury. It is not surprising, therefore, that some courts sitting in jurisdictions which have embraced the theory of strict products liability have suggested that the existing corporate rules of transferee liability be modified to more accurately reflect the policies embodied in strict products liability. 113

III. JUDICIAL EXPANSION OF THE EXCEPTIONS TO THE GENERAL RULE OF NONASSUMPTION

Two courts faced with the inconsistency between the general rule of nonassumption and the doctrine of strict products liability responded to the gap in state law by expanding the scope of the de facto merger and mere continuation exceptions. 114 Two other courts confronted with similar factual settings applied the classic corporate rule, but discussed the conflicting policy considerations of strict products liability. 115
A. Shannon v. Samuel Langston Co.

In Shannon v. Samuel Langston Co., the plaintiff was injured by a machine produced by Samuel Langston Co. (SML). Before the injury occurred, SML had sold all its assets to a subsidiary of Harris Intertype in exchange for stock in Harris. Applying New Jersey law, the United States district court held that under the test for de facto merger announced in McKee the sale of assets was essentially equivalent to a de facto merger: the transfer was for stock rather than cash and the transferor dissolved immediately after the sale was consummated. In dicta, the court remarked that the defendant corporation should bear the cost of plaintiff's product-related injury because it had received the benefits associated with the acquisition of a going concern. Such losses, the court declared, are "regarded as an economically and socially necessary cost of doing business."  


In another case involving a sale of assets for stock, Knapp v. North American Rockwell Corp., 379 F. Supp. 797 (W.D. Mich. 1974). It is not completely clear that New Jersey law should have been applied. The accident occurred in Michigan and the purchase agreement was executed in Ohio, the location of the headquarters of the purchaser, Harris Intertype. The court selected New Jersey law on the premise that the ongoing enterprise, Samuel Langston Co., was incorporated and located in New Jersey. The court condensed a rambling discussion of the concept of de facto merger in McKee v. Harris-Seybold Co., 109 N.J. Super. 555, 563-67, 264 A.2d 98, 103-05 (1970), into four distinct elements:

1. There is a continuation of the enterprise of the seller corporation, so that there is a continuity of management, personnel, physical location, assets, and general business operations.
2. There is a continuity of shareholders which results from the purchasing corporation paying for the acquired assets with shares of its own stock, this stock ultimately coming to be held by the shareholders of the seller corporation so that they become a constituent part of the purchasing corporation.
3. The seller corporation ceases its ordinary business operations, liquidates, and dissolves as soon as legally and practically possible.
4. The purchasing corporation assumes those liabilities and obligations of the seller ordinarily necessary for the uninterrupted continuation of normal business operations of the seller corporation.


Id. at 803.

Id. at 802. The court noted that the price paid for the acquired business would be adjusted to take the ongoing responsibility of the new owner into account, and concluded that justice could not allow corporations to avoid liabilities that natural persons could not avoid. "The solvent natural person cannot avoid his liability for injuries caused by him simply by changing his name . . . . Similarly, solvent corporations, going concerns, should not be permitted to discharge their liabilities to injured persons simply by shuffling papers . . . ." Id. at 803.
North American Rockwell Corp.,\textsuperscript{121} the Court of Appeals for the Third Circuit, applying Pennsylvania law, held that an injured plaintiff could seek recovery from a transferee of corporate assets for stock even though the transferor continued to exist as a separate entity following the sale.\textsuperscript{122} The plaintiff in Knapp was injured by a machine produced by Textile Machine Works (TMW). But the injury occurred after TMW had sold all its assets to Rockwell in exchange for stock, and had dissolved. As part of the purchase agreement, the parties stipulated that TMW dissolve as soon as possible following the transfer. TMW, however, continued to exist as a corporate “shell” for a full eighteen months after the sale. The district court granted Rockwell’s motion for summary judgment on the ground that the transaction was a sale of assets.\textsuperscript{123}

On appeal to the Third Circuit, the court noted that there was no Pennsylvania authority on point,\textsuperscript{124} but that a review of cases from other jurisdictions suggested that the existence of TMW following the transfer coupled with the value of the Rockwell stock paid to TMW, made the transfer a sale of assets rather than a de facto merger or continuation.\textsuperscript{125} Even so, the court declared that the “better-reasoned result” would be to treat the transaction as a de facto merger.\textsuperscript{126} The court discussed two recent decisions by the Pennsylvania Supreme Court which it interpreted as demonstrating that court’s willingness to look to the substance of a transaction rather than its form,\textsuperscript{127} and to impose the burden of loss on the party better able to spread that loss.\textsuperscript{128} From those general policy statements, the court of appeals concluded that to deny Knapp his remedy because of the “barren continuation” of TMW after the exchange would be overly formalistic.\textsuperscript{129} The court held that although one essential element of a classic de facto merger, prompt dissolution of the seller, was not presented by the facts, it was consistent with the social policies adopted by the Pennsylvania Su-

\textsuperscript{121} 506 F.2d 361 (3d Cir. 1974), cert. denied, 421 U.S. 965 (1975).
\textsuperscript{122} Id. at 370.
\textsuperscript{123} Id. at 363.
\textsuperscript{124} Id. at 365.
\textsuperscript{125} Id. at 367. The court specifically discussed the holdings in McKee and Bazan which are described in the text accompanying notes 84-91 supra. Additionally, the court discussed a Nevada Supreme Court decision, Lamb v. Leroy Corp., 85 Nev. 276, 454 P.2d 24 (1969), in which the Nevada Court held a transfer of substantially all the assets of Nevada Land and Mortgage Co. to Leroy Corp. for stock to be a sale of assets.
\textsuperscript{127} Id. at 368, citing the seminal case on de facto merger, Farris v. Glen Alden Corp., 393 Pa. 427, 143 A.2d 25 (1958).
\textsuperscript{128} Id. at 369, citing Ayala v. Philadelphia Bd. of Pub. Educ., 453 Pa. 584, 305 A.2d 877 (1973), in which the Pennsylvania Supreme Court abolished the doctrine of immunity in suits involving local government because the governmental body was better able to prevent the injury, and better able to spread the loss throughout the community.
The decision in *Knapp* clearly demonstrates the belief of that federal court that, despite overwhelming precedent to the contrary, corporate law should provide a remedy for post-dissolution products-related injuries where the transferee continues the business operation. But federal courts are not free to modify or augment state law. They are constrained by the *Erie* doctrine to apply a state's law as declared by its highest court. Consequently, the *Knapp* court framed its analysis in terms of the exception for de facto merger, but modified the universally-accepted elements of the exception to reflect general policy statements made by the Pennsylvania Supreme Court in contexts totally unrelated to the question of transferee liability. Apparently, in pursuit of the "better-reasoned result" the court was only too willing to discount the importance of one time-honored factor distinguishing a sale of assets from a merger: the separateness of transferor and transferee after the transaction.

Concurring in the result, Judge Rosenn argued that Pennsylvania's corporation law was designed to protect tort claimants as well as dissenting shareholders prejudiced by the mode of acquisition, but that their unique relationship to the corporation suggested that a court must look for different attributes of merger for the purposes of imposing tort liability on the successor corporation. He proposed a test for successor tort liability based on two factors: (1) that the successor acquires control of an ongoing business, and (2) that the transferor corporation dissolves after distribution to its shareholders of the consideration received in the transaction.

Even though *Knapp* was framed in terms of the existing exception for de facto merger, the opinion represents a radical departure from previous cases. Rather than simply apply the existing corporate principles to the facts, the *Knapp* court reexamined the effectiveness of the general rule of nonassumption and its exceptions in light of the development of public policy favoring recovery for product-related injuries. Finding the existing rule unresponsive to the needs of that class of injured persons, the court modified exist-

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130 *Id.* at 370.
131 *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938). In *Erie* the Supreme Court per Justice Brandeis declared that "[t]here is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a State, whether they be local in their nature or 'general'. . . ." *Id.* at 78. Thus, federal courts sitting in diversity are compelled to apply the law of the appropriate jurisdiction as interpreted by the Supreme Court of that jurisdiction.
133 *Id.* at 370.
134 *Id.* at 370-71.
135 *Id.* at 371.
ing doctrine to balance the interests of the products liability plain-
tiff and the parties to a sale of an ongoing enterprise.

C. Cyr v. B. Offen & Co.

Since Knapp involved a sale of assets for stock, the court of ap­peals did not reach the question of successor liability for post­dissolution products-related claims in a sale of assets for cash. That problem was addressed by the First Circuit Court of Appeals in Cyr v. B. Offen & Co. In Cyr, the plaintiffs were severely burned by a drying oven on a printing press. The oven was manufactured by a sole proprietorship, B. Offen Co. Before the accident occurred, the owner had died and a group of employees had formed a corpora­tion, B. Offen & Co., Inc., which purchased the business from the estate for cash. Under the terms of the purchase agreement the corporation was obligated to continue the business without sub­stantial modification. It continued to service and renovate existing drying ovens and marketed ovens under the B. Offen trademark. Existing customers were not advised that a change in ownership had taken place. The plaintiffs argued on these facts that the corporation was essentially a continuation of the sole proprie­torship. The district court agreed and submitted the plaintiffs' claims of negligence and strict products liability to the jury.

On appeal, the First Circuit noted that New Hampshire courts had not announced a rule of successor liability for product-related injuries. New Hampshire did have a statutory provision preserv­ing creditor’s claims after corporate dissolution, and the state judiciary had accepted the doctrine of strict products liability. The Cyr court therefore assumed that New Hampshire would favor a rule preserving post-dissolution product-related claims. Additionally, the court assumed that New Hampshire’s judiciary would adopt the universally-accepted exceptions to the general rule of nonassumption. The facts of the case did not demonstrate the continuity of ownership essential to a finding of de facto merger nor was there evidence of fraud. The Cyr court concluded that

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136 501 F.2d 1145 (1st Cir. 1974) (applying New Hampshire law).
137 Id. at 1151.
138 Id. at 1149.
139 Id. at 1150.
140 Id. at 1153. New Hampshire had adopted a postponement of abatement statute which provided a three year period following corporate dissolution in which the dissolved corporation could still be sued. For a discussion of postponement of abatement statutes see text accompanying notes 22-34 supra.
141 Id. at 1150.
142 Id. at 1152.
143 Id. at 1151.
imposing responsibility on B. Offen & Co. would be appropriate only if there was sufficient continuity to characterize it as the mere continuation of its predecessor. 144

Asserting that existing case law did not provide an appropriate test of continuation for the purposes of negligence or strict products liability claims, 145 the court reasoned that sufficient continuity would exist if the considerations justifying the liability of the original manufacturer were generally applicable to the successor. 146 Accordingly, the court reviewed the policy considerations underpinning the strict products liability of an original manufacturer and concluded that they applied with sufficient force to a successor that continued the manufacture and servicing of the same line of equipment. 147 Additionally, the court held that the principle of respondeat superior which imposes responsibility on an employer for the negligent acts of its employees would apply as well to a successor who continues to manufacture the same products in the same

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144 Id. at 1153.
145 Id. at 1152. Actually, authority did exist for the proposition that a transaction should not be characterized as a de facto merger or mere continuation, even in the context of product liability claims, where both entities existed after the transfer and where the consideration paid was cash. See text accompanying notes 81-91 supra. The Cyr court did discuss one of these cases, Kloberdanz v. Joy Mfg. Co. There, the court observed, no continuity was found because the seller and buyer both existed after the sale and the buyer did not assume the seller's name. 501 F.2d at 1152 n.13. Kloberdanz is discussed in the text accompanying notes 81-83 supra.
146 Id. at 1154. The court mentioned four policy justifications which support the imposition of strict products liability on the original manufacturer:

(1) the manufacturer is better able to protect itself and bear the costs while the consumer is helpless; (2) it is the manufacturer which has launched the product into the channels of trade; (3) it is the manufacturer which has violated the representation of safety implicit in putting the product into the stream of commerce; and (4) the manufacturer is the instrumentality to look to for improvement of the product's quality.

Id.

147 Applying these principles to the successor, the court reasoned:

The very existence of strict liability for manufacturers implies a basic judgment that the hazards of predicting and insuring for risks from defective products are better borne by the manufacturer than by 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 position to insure therefor and reflect such cost in sale negotiations, and is the only entity capable of improving the quality of the product.

* * *

[It is true that the successor, by definition, 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 an exploiting of 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.

Id. at 1154.
plant with the same workers.\textsuperscript{148} The First Circuit therefore upheld the lower court's ruling that B. Offen & Co. was a mere continuation of its predecessor and could be sued for the negligence or strict products liability of that enterprise.\textsuperscript{149} In so doing, the \textit{Cyr} court modified the classic configuration of the exception for mere continuation\textsuperscript{150} in the context of product-related claims by eliminating the element of continuity of ownership.

The \textit{Cyr} opinion represents a positive step toward a rule of successor liability tailored to meet the particular needs of the products liability plaintiff. By eliminating the factor of ownership continuity from the determination of continuation, the court devised a rule of transferee liability which is probably more in keeping with the expectations of consumers. Presumably, public opinion as to product reliability and manufacturer responsibility is influenced more by continuity in the outward appearance of a manufacturing enterprise than by continuity in its ownership. Even so, the \textit{Cyr} court did not specify which elements of continuity would be minimally necessary for a finding of mere continuation in product liability cases. Since B. Offen & Co. was essentially identical to its predecessor in every respect save one,\textsuperscript{151} the opinion provides little guidance for courts seeking to define the scope of the concept of mere continuation in future post-dissolution products liability cases where the successor differs from its predecessor in several respects, but the basic identity of the enterprise has survived the transfer of control.

Troublesome too, for future cases, is the organizational structure of the court's discussion of the various policies favoring the imposition of successor liability. Because the case was brought on the theory of negligence as well as strict products liability, the First Circuit discussed the rationales underlying the theories of \textit{respondeat superior} and strict products liability.\textsuperscript{152} But the concepts are intermingled. The \textit{Cyr} court failed to carefully distinguish which factors of continuity are essential to a finding of continuation in a negligence claim as opposed to strict products liability. The opin-

\textsuperscript{148} \textit{Id.} Presumably, the court emphasized the corporation's responsibility for the negligence of its employees because the case was argued and decided on the theory of negligence as well as strict products liability. Successor responsibility for the torts of its predecessor's employees may be justified when the successor represents itself as equivalent to the proprietorship. For a more detailed discussion of the use of this principle in imposing successor liability, see the text accompanying notes 186-90 infra.

\textsuperscript{149} \textit{Id.}

\textsuperscript{150} See text accompanying notes 75-79 supra.

\textsuperscript{151} The same employees and managers produced the same products in the same physical plant under the same trademark, before and after the sale of assets. The corporation purchased the goodwill and agreed to fulfill the contract obligations of its predecessor. It continued the service and renovation of existing units in the field and even represented itself to its customers and the public as a forty year old business. The only element of the proprietorship missing was the owner, Bernard Offen. 501 F.2d at 1151.

\textsuperscript{152} \textit{Id.} at 1154.
ion implies that the continued presence of the negligent employees of the proprietorship in the successor corporation is an essential factor in the finding of continuation, but the theory of strict products liability does not focus on the behavior of particular individuals such as supervisors or employees. Rather, it imposes responsibility for a person's injury on the manufacturer because that entity is in a better position than the individual to anticipate the loss, spread the cost throughout society, and minimize the risk of future losses through product improvement. 153 Therefore, though continuity of management and employees might be a relevant factor in the determination of continuation for a negligence claim, it should be immaterial in a decision to impose strict products liability. The casual juxtaposition of these two distinct legal doctrines in the Cyril opinion may prove to be a source of confusion in future cases brought solely on the theory of strict products liability. As written, the opinion could be misinterpreted as standing for the proposition that personnel continuity is an essential factor in determination of mere continuation for the purpose of any product-related claim. 154

D. Ortiz v. South Bend Lathe

A California decision, Ortiz v. South Bend Lathe, 155 was the first opinion in a state court to acknowledge the gap between the traditional rule of nonassumption and the policies underlying products liability law. Ortiz was injured by a press made by Johnson Machine & Press Co. Sometime prior to the injury, Johnson sold its assets to Bontrager Corp. Bontrager assumed responsibility for Johnson's existing and future liabilities under the de facto merger doctrine. 156 Later, Bontrager sold all its assets including the corporate "shell" of Johnson to South Bend Lathe for adequate cash consideration. As part of the agreement, Bontrager promptly dissolved and the Johnson "shell" was subsequently dissolved by South Bend Lathe.

On those facts the California Appellate Court held that, under the traditional principles governing successor responsibility, South Bend's liability was limited to the value of the assets it received in

153 See text accompanying notes 104-12 supra.
154 The Cyril opinion has been discussed by a number of commentators. See, e.g., Wallach, supra note 18, at 338; Juenger & Schulman, supra note 8, at 51-55; Note, Corporations-Successor's Tort Liability for Acts or Omissions of Predecessor, 16 B.C. INDUS. & COM. L. REV. 676 (1975); Comment, supra note 8, at 102-06; Note, supra note 7, at 1320-22; Note, Products Liability-Liability of Transferee for Defective Products Manufactured by Transferee; 30 VAND. L. REV. 238, 244-46 (1977); Long, Products Liability-Corporations, Asset Sales and Successor Liability, 44 TENN. L. REV. 905, 911-12 (1977).
155 46 Cal. App.3d 842; 120 Cal. Rptr. 556 (1975).
156 For a description of this doctrine see text accompanying notes 69-74 supra.
the voluntary dissolution of the Johnson "shell," which was zero.157 In a well-reasoned dissent, Associate Justice Fleming noted the uninterrupted operation of the manufacturing enterprise under the Johnson trademark despite the numerous mutations in corporate form. He insisted that the continuity of business operation alone should be sufficient support for a finding of successor liability in a product-related claim.158

The judicial commentary presented in Shannon, Knapp, Cyr, and the dissent in Ortiz is indicative of a developing awareness that the traditional corporate rules governing transferee liability cannot provide the degree of protection for the consumer mandated by the policy assumptions underlying products liability law. Federal courts exercising diversity jurisdiction, however, are powerless to change state law. They may only attempt to effectuate the policy favoring recovery for product-related injuries through a liberalized interpretation of the factors comprising the existing exceptions to the general rule of nonassumption. While this gradual mutation of traditional doctrine does provide relief to product liability plaintiffs where none was previously available, it does so in a piecemeal manner and at the expense of businessmen who will be unable to accurately predict the potential risk associated with the acquisition of particular assets. A better long-term solution would be the development of a rule of successor liability specifically for product-related claims. Such a rule should strike an equitable balance between the interest of the injured plaintiff in recovery and the interest of the business community in the accurate valuation of ongoing enterprises.

IV. THE FORMULATION OF A NEW TEST FOR DETERMINING TRANSFEREE LIABILITY

Two state supreme courts recently responded to the need for a special rule of transferee responsibility in products liability

157 Ortiz v. South Bend Lathe, 45 Cal. App.3d at 847, 120 Cal. Rptr. at 559.

158 In dissent, Associate Justice Fleming declared that:

[A] manufacturer of heavy machinery who undertakes to carry on an existing business must take the good with the bad, and the bad includes defective product[s] liability.

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So long as the business retains its distinctive identity and character and continues to be operated as it has in the past, defective product[s] liability adheres to the business and remains there until discharged by bankruptcy or comparable judicial act.

Id. at 850-51, 120 Cal. Rptr. at 560-61.
cases.\textsuperscript{159} After reviewing the purposes of the traditional rules governing transferee liability to general creditors, and the purposes of products liability law, both courts concluded that a new rule was essential to the equitable disposition of such cases. Each court developed, however, somewhat different criteria for imposing successor responsibility in products liability cases. Unfortunately, a convincing case may be made for the proposition that there should be one universally-accepted test for determining successor liability in these cases. The task of accurately valuing business assets is rendered more difficult if the responsibility for future products liability claims depends upon the jurisdiction in which the injury occurs. The consistency with which the general rule of nonassumption and its exceptions has been applied is strong evidence of the pervasive need in business negotiations for predictability in the law: without it, meaningful long-range planning is impossible. With this interest in mind, the relative merits of the two state tests for successor liability in product-related claims will be critically examined to determine what factors noted by the courts should be included in that one ideal test.

\textbf{A. The Michigan Test}

In \textit{Turner v. Bituminous Casualty Co.},\textsuperscript{160} the appellant was injured by a power press manufactured by the T.W.&C.B. Sheridan Co. (Old Sheridan). Years before the injury, Old Sheridan had sold all its assets to a subsidiary of Harris Intertype Corp. (New Sheridan) for adequate cash consideration. In compliance with their agreement, Old Sheridan dissolved after the sale. In 1968, New Sheridan merged with its parent company, Harris Intertype, and was renamed the Sheridan Division.\textsuperscript{161}

Relying principally on the policy discussion presented in \textit{Shannon v. Samuel Langston Co.},\textsuperscript{162} Turner, the injured party, argued that although Old Sheridan's assets had been transferred for cash consideration, New Sheridan should be held accountable for product-related claims arising from the use of products marketed by its predecessor since New Sheridan represented itself publicly


\textsuperscript{160} 397 Mich. 406, 244 N.W.2d 873 (1976).

\textsuperscript{161} \textit{Id.} at 408, 244 N.W.2d at 875-76. At the time this case came before the Michigan Supreme Court, Bituminous Casualty Co., the worker's compensation insurance carrier for the plaintiff's employer, Seaman Manufacturing Co., was no longer a party to the suit. \textit{Id.}

as Old Sheridan. Predictably, the respondent asserted that New Sheridan was immune from suit under the "general rule of non-liability." The court held that an action for damages could be maintained against the successor, New Sheridan, despite the fact that the acquisition was for cash consideration, under its newly-created exception to the general rule of nonassumption designed especially to define successor liability for products liability claims.

The court declared that responsibility for a product-related injury should not be fixed by reference to principles developed to protect business creditors and minority shareholders. Such principles are likely to be unresponsive to the "substantially different problems associated with products liability torts." The court observed that the legitimate concerns of the parties affected by a products liability claim against the successor to the original manufacturer are identical no matter which acquisition technique is selected. Therefore, though commonality of ownership between

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163 In *Shannon*, the use of stock as consideration provided sufficient continuity of ownership between the transferor and transferee entities to support a finding of transferee liability under the traditional test for de facto merger, but the court also declared that "the public policy behind the evolving common law of products liability is that the enterprise, the going concern, ought to bear the liability for the damages done by its defective products." *Id.* at 802. The Michigan Court noted that the same policy considerations were present in *Turner*. 397 Mich. at 414, 244 N.W.2d at 876.

164 *Turner v. Bituminous Cas. Co.*, 397 Mich. at 417, 244 N.W.2d at 878. The court acknowledged that the general rule of nonassumption and its exceptions were the law in Michigan. *Id.* at 417 n.3, 244 N.W.2d at 878 n.3.

165 *Id.* at 430-31, 244 N.W.2d at 883-84.

166 *Id.* at 418, 244 N.W.2d at 878.

167 The court declared that an injured person's interest in recovery is substantially the same whether the control of the ongoing business is transferred through a statutory merger, sale of assets for stock, or sale of assets for cash. Similarly, whatever form the acquisition takes, a primary concern of the business is the accurate assessment of the risk of future liabilities and, therefore, the appropriate sale price for the enterprise. *Id.* at 419, 244 N.W.2d at 878.

The court recognized that avoiding potential products liability claims could be a significant factor in the selection of the mode of transfer, but dismissed that purpose as illegitimate.

[It seems both unfair and unbelievable that a corporate combination or acquisition decision would be principally or exclusively made on the basis of cutting off the contingent right to sue of a products liability victim.]

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[If there are no real business reasons for choosing a cash acquisition of corporate assets and the only real reason is to avoid products liability suits, then it would seem that the machinery of corporate law is unreasonably geared up to accomplish a purpose not really intended for it or in the public interest.]

*Id.* at 422-23. Actually, a transfer motivated solely by the desire to avoid potential products liability claims could be challenged as fraudulent. The transferee could then be forced to assume liability even under the traditional corporate rules. See text accompanying notes 65-68 *supra*. However, there are a number of valid business considerations which affect the selection of a particular mode of transfer. Consequently, it could be difficult for an injured plaintiff to prove that the change in corporate structure was motivated by a desire to evade potential products liability claims. See note 79 *supra*, but see note 41 *supra*. 
a transferor and transferee in a transaction framed as a sale of assets should clearly provide a sufficient nexus to justify forcing successor assumption of existing liabilities, the absence of such com- monality should not, of itself, preclude the imposition of responsibility for products liability claims. The court concluded that a better rule of successor liability for product-related claims could be devised by reference to the principles underlying products liability law.

The Michigan court approved the conclusion reached in *Cyr*, that a mere continuation in the context of products liability claims should be determined by reference to two criteria: the extent to which the successor entity has assumed the ability of the original manufacturer to predict and insure for the risk of injury from its defective products, and the extent to which the successor profits from the goodwill developed by its predecessor through a deliberate public representation of business continuity. The court found that New Sheridan intended to maintain as much continuity of product line, personnel, and business practice with Old Sheridan as possible. Therefore, it concluded that "[j]ustice would be offended" if New Sheridan could represent itself as Old Sheridan for the purpose of sales and the law did not then stop it from denying that identity for the purpose of responsibility for product-related in-

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168 Turner v. Bituminous Cas. Co., 397 Mich. at 422, 244 N.W. 2d at 880. The court noted that commonality of ownership is logically a strong justification for imposing successor liability because it is equitable to impose the debts of the predecessor on the successor where the ownership remains the same. However, this logic breaks down in the context of products liability claims. In the time between the sale of assets and the injury the stock may have changed hands many times. Thus the court concluded that the distinction between a sale of assets for stock and one for cash should not be a crucial factor in determining successor responsibility for product-related injuries.

Certainly, the notion that the owners should continue to bear responsibility for the business' debts despite mutations in corporate form is a convincing abstract justification for the distinction in the traditional rules between a sale of assets for cash and one for stock. However, there is a purely pragmatic reason for the distinction as well. When assets are exchanged for cash consideration, the transferee will presumably have sufficient liquidity after the transfer to satisfy outstanding obligations. But if the exchange is made for stock in the transferee, liquidity may be substantially impaired. If the transferee's shares are publicly traded, the transferor should be able to sell them and acquire the liquidity necessary to meet its outstanding obligations. Shares that are not readily marketable may prove difficult to convert into cash. Thus, in designing a rule to protect the interests of creditors, it makes sense to draw a distinction between the two types of consideration. A product-related injury, however, may not occur until many years after the transferor has dissolved. Once the consideration paid for transferor's assets has been distributed to its shareholders, the injured plaintiff's problem of recovery is equally difficult whether the consideration was stock in the transferee or cash. Clearly, there are practical as well as theoretical arguments against applying the traditional rules of successor liability in the context of a products liability claim. See text accompanying notes 59-61 supra.

169 Turner v. Bituminous Cas. Co., 397 Mich. at 423, 244 N.W. 2d at 880.

170 Id. at 424-25, 244 N.W. 2d at 881, citing *Cyr*, 501 F.2d at 1153-54. *Cyr* is discussed in the text accompanying notes 136-54 supra.

juries. Additionally, the court announced a special test for determining continuity in products liability cases comprised of three elements: (1) continuity of the outward appearance of the enterprise, its management, personnel, physical plant, assets, and business operation; (2) dissolution of the seller corporation as soon after the transfer of assets as is legally and practically possible; and (3) assumption by the transferee of those liabilities and obligations necessary to the uninterrupted continuation of normal business operations. When these factors are present, according to the court, a prima facie case of corporate continuity for the purpose of product liability claims exists.

1. Enterprise Continuity — Although the Turner court characterized these factors as demonstrating a “continuity of interest” between the transferor and transferee rather than enterprise continuity, the test is actually indistinguishable from the expanded definition of mere continuation adopted in Cyr. Just as in Cyr, the central factor of the Michigan test is continuity of the outward appearance of the business. By focusing on enterprise continuity rather than continuity of product line, the Michigan test injects an element of individual fault of the business entity into the analysis which is superfluous in light of the policy considerations espoused by the court. Those policies support the imposition of liability

172 Id. at 426, 244 N.W. 2d at 882. Evidently, the Michigan Court was unwilling to impose successor liability solely on the dispassionate economic determination that New Sheridan was the most logical and efficient entity to bear the loss. The court’s reliance on the equitable principle of estoppel suggests that it believes that successor liability should turn on a showing that the successor’s outward appearance of continuity with its predecessor operates as a fraud or misrepresentation on users of the predecessor’s products. Thus, the Michigan court’s conclusion of successor responsibility was based both on what it perceived as a wrongful act on the part of New Sheridan and on the economic considerations of risk spreading ability and efficient cost allocation.

173 Rather than list these elements in the opinion, the Turner court referred to the first, third, and fourth elements of the Shannon test for determining de facto merger. Id. at 429, 244 N.W. 2d at 883. The Shannon test for de facto merger is reproduced in its entirety in note 118 supra. The Shannon opinion is discussed in the text accompanying notes 116-20 supra.

174 Turner v. Bituminous Cas. Co., 397 Mich. at 429, 244 N.W. 2d at 883. The Cyr test for mere continuation is discussed in the text accompanying notes 146-50 supra. Even though the Turner court essentially reaffirmed the enterprise continuity approach of Cyr, the creation of a special exception for products liability cases is an improvement over merely modifying the existing test for mere continuation. In this way, the special interests of the products liability plaintiff can be served while the integrity of the classic formulation of the rule and its exceptions is preserved for all other cases.

The Michigan court did not acknowledge the danger inherent in the progressive modification of the existing exceptions, but the California Supreme Court in Ray v. Alad Corp., 19 Cal. 3d 22, 30, 560 P.2d 3, 8, 136 Cal. Rptr. 574, 579 (1977), refused to modify the existing rule to embrace the special requirements of the products liability plaintiff because the precedent could possibly have an unexpected effect on a transferee’s liability to the transferor’s general creditors. Note, Products Liability - Liability of Transferee for Defective Products Manufactured by Transferor, 30 Vand. L. Rev. 238, 249 (1977).

176 Turner v. Bituminous Cas. Co., 397 Mich. at 425, 244 N.W. 2d at 881.
on the party best equipped to assess the risks associated with the use of a product, reduce those risks through improved product safety, and spread the cost of those injuries resulting from the use of the product through market price adjustments. The physical characteristics of a business are totally immaterial to such a determination. The ability to spread risk of loss and improve product safety necessarily follows from the manufacture and distribution of the product regardless of the name or physical appearance of the manufacturer. It is commonly said, and the Turner court asserted, that public expectation is tied to the continuity of enterprise identity. As a practical matter, however, it may be postulated that the public is more often familiar with a particular product trademark than with its manufacturer. Thus, public expectations as to a product’s suitability and safety are probably related more to its trademark than to familiarity with the identity of the manufacturing entity. Liability should therefore be imposed on a successor to the original manufacturer if it continues to market the product that caused the injury and benefits from the public’s acceptance of that product’s trademark, whether the successor represents itself as the continuation of the original manufacturer or not.

Because the Michigan test of successor continuity is framed in broader terms than the underlying policies mandate, it may not always impose transferee liability in a manner consistent with those policies. In a situation where the transferee purchases the right to produce a particular product under an existing trademark without acquiring any other assets of the transferor, it is clear that the transferee will benefit from the accumulated goodwill associated with that trademark. Moreover, the transferee will be in the best position to anticipate and provide for the cost of injury through adjustments in the market price of that product. Yet under the test of successor responsibility devised by the Turner court, it is not certain that an injured plaintiff could maintain a claim against that transferee. The physical elements of enterprise continuity emphasized by the Michigan court might not be present. On the other hand, where a purchaser acquires all the assets of a manufacturing entity and assumes all the outward semblances of continuity, the Michigan rule would appear to hold that purchaser responsible for all subsequent product-related injuries even in cases where the particular product was discontinued long before the transfer of control.

177 See text accompanying notes 107-12 supra.
178 Turner v. Bituminous Cas. Co., 397 Mich. at 425, 244 N.W. 2d at 881.
179 In fact, the doctrine of strict products liability assumes that the consumer may not even know the identity of the manufacturer of the products he uses. RESTATEMENT (SECOND) OF TORTS § 402A, comment n. (1965).
180 See text accompanying note 110 supra.
occurred. While it is evident that the original manufacturer cannot avoid responsibility for product-related injuries merely by ceasing the production of a product line, it is more difficult to justify the imposition of liability on a transferee that never produced or marketed the particular product that caused the injury. Such imposition would not stimulate improved product safety if the product were no longer produced, and the transferee would be unable to accurately reflect the cost to society of that product’s use through adjustments in its market price. 181 Moreover, if the product is not marketed by the transferee, that entity has not made express or implied representations as to its safety. Nor has the transferee derived a benefit against which the cost of injury should be assessed. 182 Of course, generally speaking a business entity should be in a better position to absorb and spread the cost of injury than an individual, but superior risk-spreading ability alone should not provide sufficient justification for the imposition of successor liability. Notably, courts have limited imposition of liability based on the manufacturer’s superior risk-spreading ability to those situations where the shift of responsibility will encourage improved product safety and assure a market price that accurately reflects the full cost of the product to society. 183 In practical application, therefore, it is possible that the Michigan test will yield results inconsistent with the policies cited as justifying the shift of responsibility.

There are several possible explanations for the Michigan court’s decision to frame its test of transferee liability in terms of enterprise rather than product line continuity. Conceivably, the court simply did not realize that a test emphasizing enterprise continuity rather than product line continuity is inconsistent with the policies it had approved. Three earlier opinions 184 proposed tests of trans-

181 The transferee could spread the cost of injury through price adjustments in currently marketed products, but those prices would not then accurately reflect the true cost to society of the continued use of the allegedly defective product. The theory of efficient cost allocation requires that every cost generated by the use of a particular product be reflected in that product’s market price: that is, “the activity of making the particular product should pay its own way.” Wade, supra note 2, at 826.

182 The goodwill generated by the sale of discontinued products is an asset and its value would be reflected in the purchase price of the enterprise.

183 If superior risk-spreading ability alone provided sufficient justification for the imposition of strict products liability, the manufacturer would be virtually an insurer. Wade, supra note 2, at 828. The scope and extent of strict products liability has been limited such that the imposition is consistent with the recognized public policies which initially suggested the need for additional consumer protection. Assault, supra note 3, at 1134.

feree liability based on the policies of strict liability but framed in terms of enterprise continuity. Even so, the court had access to a discussion of a test based on product line continuity. A law review article cited in the opinion proposed a test of transferee liability based on the degree of product control acquired in the transfer. Therefore, it is more reasonable to assume that the Michigan court adopted a test of transferee liability framed in terms of enterprise continuity in full realization that such a test necessarily includes an element of entity accountability for fault inconsistent with the concept of strict products liability.

2. Estoppel — Although the Turner court approved the analysis of policy considerations presented in Cyr, its own holding was not based on them exclusively. Rather, the court declared that because a products liability claim was presented, the finding of transferee responsibility must be based partly on the principle of estoppel. That is, New Sheridan's affirmative representation that it was the continuation of Old Sheridan for the purpose of sales was held to estop it from denying it was the same as Old Sheridan for the purpose of products liability claims.

Estoppel in that context is an equitable notion that one's representations may preclude the assertion of rights inconsistent with such representations as against someone who has changed his position in reliance on the representations. The court's assertion that consumer reliance on the transferee's representations is an essential prerequisite to a finding of successor responsibility may have dictated that the court frame its test in terms of enterprise continuity. An enterprise may be said to make representations; a product cannot. If this is the explanation for the court's position, it may be argued that the use of the doctrine of estoppel against the successor of the original manufacturer for its representations of enterprise continuity is improper. In such cases, the injured plaintiff's reliance, if any, was probably induced by representations made by the original manufacturer rather than the transferee. Few plaintiffs would be able to demonstrate that their injury was related to their

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185 397 Mich. at 418, 244 N. W. 2d at 878, citing Comment, supra note 8. There, the author suggests that the affirmative acts of the transferee in assuming control of the manufacture and/or servicing of a particular product might be said to create a duty to persons injured by previously marketed units of that product line. The notion of a duty arising as a result of affirmative acts of the transferee is conceptually quite different from the dispassionate economic determination of the most efficient entity to bear the loss mandated by the doctrine of strict products liability. Id. at 109.

186 See note 147 supra.

187 397 Mich. at 426, 244 N. W. 2d at 886.

188 BLACK'S LAW DICTIONARY 898 (4th ed. 1968): "The doctrine is that a person may be precluded by his act or conduct or silence, when it is his duty to speak, from asserting a right which he otherwise would have had."
reliance on the representations of continuity made by the trans­
feree. Thus, they should not be able to argue that the transferee be
stopped. Even if the doctrine could be said to apply to a succes­
sor’s representations of continuity with its predecessor, in a more
general sense the Michigan court’s reliance upon the principle
appears to be superfluous since the policy considerations adopted by
the court amply support the imposition of successor liability with­
ut any proof of specific representations on the part of the succes­
sor entity or specific reliance thereon by the injured plaintiff. 189
Those policies presume that the public expectations of product
suitability and safety arise from the simple fact that the product is
offered in the marketplace. 190 At least arguably, then, the Michi­
gan court’s reliance on the principle of estoppel as a basis for im­
posing products liability on a transferee of assets is not only tech­
nically suspect, but unnecessary given the policy considerations
espoused by the court.

3. Manufacturer Fault — A more plausible explanation for the
Turner court’s adoption of a test of successor responsibility based
on enterprise continuity rather than product line continuity may be
that considerations of enterprise continuity are more consistent
with the concept of products liability adopted by the Michigan Su­
preme Court. Although the court has approved the economic pol.
icy justifications of risk spreading and efficient cost allocation un­
derpinning the doctrine of strict products liability, it has refused to
adopt the doctrine as a separate theory of recovery. 191 Instead, an
injured plaintiff may seek recompense from a manufacturer or sel­
lver in Michigan under the theories of negligence or breach of an im­
plied warrant of fitness. This strongly suggests that the Michigan
court is, as yet, unwilling to impose liability without some showing
of fault on the part of the party held responsible.

One Michigan court has asserted that in practice this gap in
Michigan’s products liability law has little impact because the
proof problems presented by a claim of breach of implied warranty
of fitness are similar to those presented by a claim of strict prod­
ucts liability. 192 Since the warranty is implied by law, it arises in­
dependently of any contractual representation, privity need not be
shown, and the plaintiff’s rights are not affected by contractual dis-
claimers or the failure to give timely notice. In fact, the Michigan court has defined the elements of the cause of action in terms essentially equivalent to the most commonly espoused definition of strict products liability. Although it may be true that the two theories operate similarly in some contexts, it does not follow that they are functionally equivalent, for they are conceptually distinct. The Michigan court has, itself, acknowledged the major distinction between the two doctrines: it has emphatically declared that the liability imposed as a result of a breach of the implied warranty is not liability without fault. The plaintiff’s right to recompense arises as a result of a tortious wrong on the part of the manufacturer in that the product was marketed in a defective condition. In contrast, under the doctrine of strict products liability the manufacturer’s responsibility arises whenever that is the most efficient allocation of the loss.

By conditioning the injured plaintiff’s right to recover on a finding that the manufacturer committed a tortious wrong, rather than on a determination that the manufacturer provides the most efficient economic allocation of the cost of the injury, the Michigan court focuses the inquiry on the behavior of the manufacturer. In this framework, successor responsibility for the tortious wrongs of its predecessor could not logically be justified by a finding of product line continuity alone. The question of successor responsibility should turn instead on a finding of substantial identity between the

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193 In Piercefield v. Remington Arms Co., 375 Mich. 85, 133 N.W. 2d 129 (1965), the Michigan Supreme Court adopted a common-law remedy for the tortious breach of a legally implied, rather than contractually created, warranty of fitness. In its inception, the action for breach of warranty sounded in tort. The breach was of an assumed duty and the wrong was characterized as a misrepresentation. Only more recently were warranties characterized as express or implied terms of a sales contract and the cause of action as a breach of contract. Ames, History of Assumpsit, 2 HARV. L. REV. 1, 8 (1888). In Michigan, the ancient common law tort warranty has been preserved as the functional equivalent of the theory of strict products liability. The term “strict liability” was not adopted because the court believed it might be confused with the classic concept of absolute liability. Cova v. Harley Davidson Motor Co., 26 Mich. App. 602, 612-14, 182 N.W. 2d 800, 805-07 (1970); see note 2 supra. For a general discussion of the historic roots of warranty, see Prosser, The Implied Warranty of Merchantable Quality, 27 MINN. L. REV. 117 (1943).

194 In Piercefield, the court defined the concept of implied warranty in these terms: Implied warranty recovery is based upon two factors: (a) the product or article in question has been transferred from the manufacturer’s possession while in a ‘defective’ state, more specifically, the product fails either to be ‘reasonably fit for the particular purpose intended’ or of ‘merchantable quality,’ as these two terms, separate but often overlapping, are defined by the law; and (b) as a result of being ‘defective,’ the product causes personal injury or property damages.

375 Mich. at 96-97, 133 N.W. 2d at 134. This statement by the court of the elements of implied warranty recovery is almost identical to the opening lines of the definition of strict products liability embodied in Restatement § 402A. See note 97 supra.


196 Id. at 95, 133 N.W. 2d at 133.

197 See text accompanying notes 107-12 supra.
transferor and transferee. Clearly the nature of the injured plaintiff's cause of action in Michigan provides one rational explanation for the adoption of a test of successor responsibility premised on enterprise continuity. At least one federal court has reached the same conclusion. It recently characterized successor responsibility under the Michigan rule as "classic vicarious liability." 199

Vicarious liability is an ancient doctrine under which an innocent person may be held responsible for the tortious wrongs of another due to the nature of the relationship which exists between the two. 200 Liability for the injury flowing from the wrong is imposed on the innocent party because the original wrongdoer is unavailable or insolvent, and the innocent party has voluntarily assumed a relationship with the wrongdoer such that it is just and equitable to hold him accountable. 201 A number of rationales have been proposed as justifying the impositions of responsibility on one for the acts of another. Early writers spoke of the master's control over the servant, the superior knowledge of the master compared to the injured plaintiff, the possibility that liability might encourage the master to supervise his servants more carefully, and finally, the notion that the master benefited from the risk-producing activities of his servants and therefore his "deep pocket" should absorb the losses generated by their activities. 202 Today, these justifications have synthesized into a general statement of social policy remarkably similar to the policies underpinning strict products liability. 203 Despite this similarity in rationale, vicarious liability differs from strict products liability because it is premised on a tortious wrong

199 Id. at 351.
200 For a general discussion of the origin and development of the doctrine of vicarious liability see W. Prosser, supra note 8, Ch. 12; James, Vicarious Liability, 28 Tul. L. Rev. 161 (1954).
201 The principle of vicarious liability, sometimes known as respondeat superior, may have originated in the context of master and servant, but has gradually been extended to a wide variety of situations where the one to be held responsible stands in some close relationship to the one at fault. W. Prosser, supra note 8, at 552-53.
202 Each of these rationales for imposing vicarious liability is discussed in James, supra note 200, at 165-71.
203 This development is summarized by Dean Prosser:

What has emerged as the modern justification for vicarious liability is a rule of policy, a deliberate allocation of a risk. The losses caused by the torts of an employer's enterprise are placed upon that enterprise itself, as a required cost of doing business. They are placed upon the employer because, having engaged in an enterprise which will, on the basis of all past experience, involve harm to others . . . , and sought to profit by it, it is just that he, rather than the innocent injured plaintiff, should bear them; and because he is better able to absorb them, and to distribute them, through prices, rates or liability insurance, to the public, and so to shift them to society, to the community at large.

W. Prosser, supra note 8, at 459 [footnotes omitted].
committed by someone. It cannot arise without proof of a negligent act. Thus, even though the one charged is himself without fault, the doctrine is not a novel system of liability: it merely provides a broader class of parties who may properly be held responsible for a tortious wrong.

Given the nature of the causes of action available in Michigan for product-related injuries, it is reasonable to conclude that the district court's characterization of the rule of successor liability is correct. In this context, the Michigan court's preference for a test of transferee liability based on substantial continuity of identity between the transferor and transferee is justifiable. The court could have held that continuity of product line alone would provide a sufficient nexus between the transferor and transferee to justify the imposition of liability on the transferee. But the element of individual responsibility, which is essential to a finding of wrongful conduct, strongly suggests that a broader test premised on the identification between the transferor and transferee would be more consistent with the underlying legal doctrine justifying the imposition of liability on the original manufacturer.

4. Application of the Michigan Test—Although a rationale for the nature of the Michigan test of successor responsibility is suggested by the causes of action available in the state for product-related claims, it is difficult to understand the court's deliberate adoption of the test of enterprise continuity in light of the practical problems of administration which such a test could create. In particular, difficulty may arise in cases where the product which caused the injury is no longer produced, and in cases where the enterprise identity has been purchased by one entity and the means of producing a particular product line by another. Two recent decisions in the Sixth Circuit are illustrative of the latter problem.

Both these cases involved an injury to the plaintiff, Trimper, on a Sheridan die cutting press manufactured before 1964. In 1964, Sheridan sold all its assets to Harris Intertype for adequate cash consideration and dissolved. Harris continued to manufacture and market Sheridan's lines of presses as the Sheridan Division of

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204 Id. at 552-53.
205 Id.
206 See text accompanying notes 198-99 supra. But see Note, Postdissolution Product Claims and the Emerging Rule of Product Liability, 64 VA. L. REV. 861, 875 (1978), where the author comments that the Trimper court's characterization of the Turner test is "novel" since the plaintiffs asserted claims of strict liability.
207 See text accompanying notes 180-83 supra for a discussion of these potential situations and the effect of the Michigan test.
209 See text accompanying notes 160-61 supra for another description of this corporate acquisition.
Harris Intertype. In 1970, Harris sold the assets associated with the type of Sheridan press which later injured Trimper to Bruno-Sherman for adequate cash consideration. The sale included goodwill, historical data, patents, trademarks, and equipment associated with the die cutting press and provided that for a period of five years the presses manufactured by Bruno-Sherman could be marketed as the "Sheridan Die Cutting Press manufactured by Bruno-Sherman Corporation."\\(^2\) The Sheridan Division of Harris Intertype continued to market other types of Sheridan presses. Thus, when Trimper was injured in 1973, there were two viable corporate entities representing themselves to the public as the continuation of the original manufacturer. Accordingly, Trimper sought recompense from both Harris and Bruno-Sherman in separate actions.\\(^3\)

In the case of Trimper v. Bruno-Sherman Corp., the federal district court examined the nature of the sale of assets to Bruno-Sherman and concluded that the "totality of the transaction ... [demonstrated] a basic continuity of the die cutting press enterprise."\\(^4\) Therefore, the court held that the principle of estoppel which led the Michigan Supreme Court in Turner to impose vicarious liability on Harris supported the imposition of vicarious liability on Bruno-Sherman. However, this result is not truly consistent with the thrust of the Turner test. Bruno-Sherman actually purchased only one of several product lines associated with the Sheridan name. The Sheridan Division of Harris Intertype continued to possess all the elements of enterprise continuity stressed by the Michigan court in Turner after the sale of assets to Bruno-Sherman, except those elements directly related to the specific product which was the object of the transfer. The fact that Bruno-Sherman acquired the right to use the Sheridan name for only a few years after the purchase is compelling evidence that the Sheridan Division fully intended to maintain its public status as the successor to the original manufacturer despite the sale of selected assets to Bruno-Sherman.\\(^5\) Yet, the imposition of liability on Bruno-Sherman is fully compatible with the economic policy considera-

\(^{210}\) 436 F. Supp. at 350.  
\(^{213}\) Id. at 350.  
\(^{214}\) 397 Mich. at 430, 244 N.W. 2d at 883-84.  
\(^{215}\) 436 F. Supp. at 350. The federal district court noted that:  

[the contract of sale also included a ten-year non-competition clause; provided for training of the buyer's employees and for providing technical assistance; and anticipated that for a period of up to five (5) years presses manufactured by the buyer could contain the following name: Sheridan Die Cutting Press Manufactured by Bruno-Sherman Corporation.]

\textit{Id.}
tions relied upon in *Turner*. The entity that markets the product is obviously in the best position to assess and provide for the risk of injuries resulting from the use of that product. Clearly, the result reached by the district court is expressive of the policy considerations underpinning *Turner* even though it is not consistent with the literal requirements of the *Turner* test.

The full significance of the difficulties created by *Turner* becomes evident in the companion opinion. In *Trimper v. Harris Corp.*, the same federal district court concluded that the policies espoused in *Turner* required that both Harris and Bruno-Sherman be held vicariously liable for Trimper's injuries. The court based its determination on the fact that, by the terms of the sale, Harris "made it possible for Bruno-Sherman Corporation to continue the illusion of continuity between the original manufacturer and Bruno-Sherman Corporation." While the district court's reasoning appears to bear little relationship to the concerns voiced in *Turner*, it is clear that the imposition of liability on Harris satisfied the technical letter of the *Turner* test for finding successor responsibility. The Sheridan Division of Harris retained all the elements of enterprise continuity emphasized by the Michigan court in *Turner*. But at the time of Trimper's accident, Harris no longer controlled the manufacture of the product that caused Trimper's injury. Consequently, it could not lessen the chance of future injuries through improved product safety, or spread the cost of injury efficiently among users of the product through adjustments in its market price.

The *Trimper* opinions graphically illustrate the contradiction inherent in the *Turner* opinion. Bruno-Sherman should bear the loss logically since it controls production of the product that caused the injury. But Bruno-Sherman does not manifest the outward characteristics of enterprise continuity crucial to a finding of continuation under the *Turner* test. The Sheridan Division of Harris is clearly the successor to the enterprise identity of the original manufacturer, but it makes poor economic sense to impose the loss on an entity which did not produce the allegedly defective machine and which does not now control the production of that type of machine. On the authority of *Turner*, the district court could reasonably conclude that either successor to the original manufacturer was an ap-

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216 397 Mich. at 425, 244 N.W. 2d at 881.
217 Bruno-Sherman did not manifest the various indices of enterprise continuity which comprise the first and most significant factor in the Michigan test. Id. at 429, 244 N.W. 2d at 883. See note 171 supra.
219 Id. at 348.
220 Id.
propriate entity to bear the loss.

But it is less certain that Turner supports the Trimper court’s finding of joint and several liability. One possible explanation for this aspect of the Trimper opinions may be the Michigan court’s emphasis on the principle of estoppel in the formulation of the Turner test. Perhaps the federal district court was compelled by that part of the Turner analysis to conclude that if two or more transferees of a manufacturer’s assets concurrently represent themselves to the public as continuations of that manufacturer, they must be held jointly and severally liable for injuries arising from previously marketed products of that manufacturer.\textsuperscript{221} Although the result may therefore be in keeping with the concept of estoppel relied upon in Turner, arguably the imposition of joint and several liability is inconsistent with the economic policy considerations voiced by the Michigan court. Efficient cost allocation is best achieved by the imposition of liability on only one entity:\textsuperscript{222} the current distributor of the product that caused the injury. If the cost of injury is divided among two or more transferees of the original manufacturer’s assets simply because they have represented or are representing themselves as the continuation of that enterprise, the current producer of the product line will be unable to pass the cost on to consumers of that product through its market price. An accurate assessment of the cost of that product to society will therefore be impossible.\textsuperscript{223} Moreover, the principle of vicarious liability does not compel a finding of joint and several liability. The concept of vicarious liability merely expresses a value judgment that, as between two innocent parties, the injured plaintiff and the one held vicariously liable, the loss generated by a wrongful act should not be borne by the injured plaintiff, but by the party that has voluntarily placed itself in a close relationship to the wrongdoer.\textsuperscript{224} Logically, only one such substitute for the initial wrongdoer need be located to provide recompense to the injured plaintiff. Therefore, were it not for the reliance on the principle of estoppel in Turner,

\textsuperscript{221} Id. The district court reasoned as follows:

\begin{quote}
[u]nder the circumstances, it is consistent with the public policy of the State of Michigan defined in Turner to hold both Harris Corporation and Bruno-Sherman Corporation vicariously liable to the injured party. It is not the injured party’s concern as to how that liability, if he wins his suit, will be allocated or borne as between them.
\end{quote}

\textsuperscript{222} Logically, too, efficiency is better served by the institution of one legal action to obtain relief rather than multiple suits. This simple notion of judicial economy was one of the original rationales espoused in favor of the adoption of strict products liability. Escola v. Coca Cola Bottling Co., 24 Cal. 2d at 463, 150 P.2d at 441 (Traynor, J. concurring).

\textsuperscript{223} See note 110 supra.

\textsuperscript{224} See text accompanying notes 200-05 supra.
the federal court could have concluded that the policies expressed in *Turner* would be satisfied by the imposition of liability on Bruno-Sherman alone.

It is also possible that the federal court was persuaded on equitable grounds to hold Harris and Bruno-Sherman jointly and severally liable for Trimper's injuries. If either were forced to bear the loss alone, the other would benefit from a "windfall" profit, since the purchase price of the assets probably did not reflect the cost of contingent products liability claims. The argument that the imposition of successor responsibility by the judiciary involves unfair surprise for the parties to transfers completed years before and "windfall" profits for the entity escaping responsibility have strong appeal, but the Michigan Supreme Court rejected them in *Turner*. It is unlikely, therefore, that these equitable concerns alone influenced the federal district court to impose joint and several liability on Harris and Bruno-Sherman.

The *Trimper* court's interpretation of *Turner* may have serious detrimental effects on future sales of businesses as going concerns. The valuation problems created by the *Turner* court's focus on enterprise continuity are significant in themselves because a successor to the identity of an ongoing business must be prepared to assume responsibility for accidents involving every product ever produced by its predecessor. The *Trimper* interpretations of *Turner* create additional uncertainties. In holding Bruno-Sherman responsible for Trimper's loss, the district court ruled that continuity of product line was sufficient evidence of continuation to satisfy the *Turner* test. The language of *Turner* suggests, however, that the Michigan court would not have imposed responsibility based on this fact alone. In holding Harris equally responsible, *Trimper* implies that responsibility for product-related injuries may not be terminated, even by divestiture. These two aspects of the *Trimper* opinions make it much more difficult for the parties contemplating the purchase of an ongoing enterprise to predict the extent of their potential future liability. They may contract among themselves as to which party will bear the costs of future liabilities, but the injured plaintiff may, under the authority of *Trimper*, pursue any one or all of the present and former owners of the assets. Thus, it is impossible to predict which entity will be forced to initially bear the burden of litigation.

The degree of uncertainty created by the *Turner* and *Trimper*
opinions suggests that the Turner formulation for imposing successor responsibility does not represent a workable balance between the needs of injured plaintiffs and those of the business community. Certainly the interest of the injured person in recompense would be served as effectively by a rule of successor responsibility that designated one viable defendant as by a rule that allows the pursuit of multiple defendants. The compelling need of the business community for predictability can only be served by a rule that selects one "best" entity to bear the responsibility for product-related liabilities.

The rationale underlying the Turner test of successor responsibility may also have an unanticipated effect in cases where the injured person is a worker and his employer has negligently maintained or removed safety equipment from the machine that caused the injury. Typically, such injuries are compensated by the employer under the worker's compensation law. The amount of liability is determined in an administrative proceeding and the award is intended to be the exclusive remedy available to an employee against his employer.²²⁷ He may, however, seek additional recompense from third parties.²²⁸ Where there is evidence that the employer's negligence played a role in the employee's injury, third parties sued by the employee have sought to join the employer on the theories of contribution or indemnity.²²⁹

In Husted v. Consumers Power Co.,²³⁰ the Michigan Supreme Court considered the viability of such a claim for contribution given the clear intent of the legislature that an employer who pays compensation under the worker's compensation law should not be subjected "to any other liability whatsoever."²³¹ The court adopted the reasoning of the majority of jurisdictions that a third party cannot seek contribution from an employer whose concurring negligence contributed to the employee's injury because the employer is not jointly liable to the employee in tort: his liability is an absolute liability imposed by statute.²³² The court reserved the question of a third party's right against an employer for indemnity. In Dale v. Whiteman²³³ the court considered whether the exclusive

²²⁷ See note 9 supra.
²²⁸ Id.
²²⁹ Contribution is defined as the "[r]ight of one who has discharged a common liability to recover of another also liable, the aliquot portion which he ought to pay or bear." BLACK'S LAW DICTIONARY 399 (4th ed. 1968). Indemnity is an equitable right to restitution. It arises, for example, in favor of a person who is held liable for damages without any personal fault on his part for the tortious act of another. 42 C.J.S. Indemnity § 21 (1944).
²³¹ Id. at 53, 135 N.W. 2d at 375.
²³² Id. at 54-55, 135 N.W. 2d at 376.
remedy provision is also a bar to that claim. It concluded that it was not because the exclusive remedy provision was intended to block only those actions against an employer by its employee or one which is derivative from his claim.\textsuperscript{234} In \textit{Dale} the plaintiff was an employee at a carwash. He was drying an automobile on the carwash apron when he was struck by Whiteman's car as it was driven from the washline by a fellow employee. Under the car owner's liability statute\textsuperscript{235} Whiteman was liable to the plaintiff though he was without fault. He therefore filed a third-party complaint against Dale's employer for indemnification. The Michigan Supreme Court held that Whiteman's right to indemnification arose independently of the claim of the employee against his employer and that therefore it was not barred by the exclusive remedy provision.\textsuperscript{236}

If the \textit{Trimper} court was correct in characterizing the \textit{Turner} test for successor liability as "classic vicarious liability,"\textsuperscript{237} then it would seem that the principle adopted in \textit{Dale} would be applicable to successor entities charged with responsibility for product-related injuries in work settings. Since a large percentage of the products liability claims currently filed arise from work-related accidents,\textsuperscript{238} the \textit{Dale} holding could have a profound, unexpected impact on the practical operation of the \textit{Turner} rule of successor liability. In situations where the employer has modified a machine or neglected to maintain it properly, the burden of loss may fall on the employer rather than the manufacturing entity's successor.

It might be argued that this result is desirable. If the employer's acts contributed to the injury then it should bear the loss. The Michigan Supreme Court approved this policy in \textit{Dale}, holding that the "[l]iability should fall upon the party best situated to adopt preventative measures."\textsuperscript{239} This is arguably contrary, however, to the clear intent of the legislature that the statutory remedy be the sole liability of an employer for its employees' injuries.\textsuperscript{240}

\begin{footnotes}
\footnote{\textsuperscript{234} Id. 708, 202 N.W. 2d at 802.}
\footnote{\textsuperscript{235} M.C.L. § 257.401 (1970).}
\footnote{\textsuperscript{236} 388 Mich. at 708, 202 N.W. 2d at 802. The court noted that it was following the reasoning of the great majority of jurisdictions that had interpreted the meaning of their worker's compensation statutes on this particular question. \textit{Id.} at 706, 202 N.W. 2d at 801. The court justified Whiteman's right to indemnity on the principle that "[l]iability should fall upon the party best situated to adopt preventative measures and thereby to reduce the likelihood of injury." \textit{Id.} at 706, 202 N.W. 2d at 801, quoting \textit{Italia Societa per Azionidi Navigazione v. Oregon Stevedoring Co. Inc.}, 376 U.S. 315, 324 (1964).

\footnote{\textsuperscript{237} See note 199 supra.}
\footnote{\textsuperscript{238} See note 9 supra.}
\footnote{\textsuperscript{239} 388 Mich. at 706, 202 N.W. 2d at 801. See note 236 supra.

\footnote{\textsuperscript{240} In \textit{Husted} the Michigan Supreme Court noted that "the primordial intent of [the legislature] was that \textit{quo} to be received by the employer in return for his \textit{quid} would be outright and absolute immunity from liability (except as provided in the act) stemming from each compensable injury." 376 Mich. at 53, 135 N.W. 2d at 375.}
Moreover, it seems illogical to allow a successor to raise the defense of the employer's negligence while the original manufacturer may not.\textsuperscript{241} If public policy favors penalizing the employer for his negligence in a suit involving a successor to the original manufacturer of the machine, it should also favor penalizing the employer in suits involving the original manufacturer.

It is apparent that the Michigan test for successor liability provides only a marginally acceptable balance between the interests of the injured plaintiff and the business community. The test may also be difficult for courts to apply consistently in novel factual settings because the \textit{Turner} court premised the imposition of successor responsibility on the principle of vicarious liability. Finally, the test may have unexpected and undesirable effects on the operation of Michigan's worker's compensation law.

\textbf{B. The California Test}

Within six months of the \textit{Turner} opinion, the Supreme Court of California also devised a special rule for determining transferee liability for product-related injuries. In \textit{Ray v. Alad Corporation},\textsuperscript{242} the plaintiff/appellant was injured falling from a ladder manufacturer by Alad Corporation (Alad I). About one year prior to this accident, Alad I sold all its assets to Lighting Maintenance Co. for adequate cash consideration. Alad I subsequently dissolved and Lighting Maintenance transferred the Alad I assets to a newly-formed entity, Alad Corporation (Alad II). Ray brought his products liability claim against Alad II. Relying on the general rule of nonassumption, the trial court granted Alad's motion for summary judgment because the transfer was for adequate cash consideration and there was no continuity of ownership between Alad I and Alad II. At the intermediate appellate level,\textsuperscript{243} the California Court of Appeals asserted that Alad II's responsibility to Ray should be determined by reference to the principles of strict products liability described in \textit{Greenman v. Yuba Power Products, Inc.}\textsuperscript{244} rather than by reference to the contractual arrangement between Alad I and Alad II.\textsuperscript{245} Stressing the physical similarities between Alad I and Alad II, the appellate court adopted as its ruling the conclusion

\begin{footnotes}
\textsuperscript{241} The original manufacturer may not join the employer as a joint tortfeasor. See text accompanying notes 230-32 \textit{supra}.
\textsuperscript{242} 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).
\textsuperscript{244} 59 Cal. 2d 57, 63-64, 377 P.2d 897, 900-01, 27 Cal. Rptr. 697, 700-01 (1963). See note 104 \textit{supra}.
\textsuperscript{245} Ray v. Alad Corp., 127 Cal. Rptr. at 820.
\end{footnotes}
of the dissent in *Ortiz v. South Bend Lathe*,\textsuperscript{246} that strict products liability adheres to a business so long as it "retains its distinctive identity and character and continues to be operated as it has in the past."\textsuperscript{247}

On final appeal, the California Supreme Court vacated the opinion below.\textsuperscript{248} Observing that the existing corporate principles governing successor liability were not designed to address the special problems presented by a products liability claim, the court concluded that a new exception to the general rule of nonassumption was required.\textsuperscript{249} The court reviewed the policy considerations which justify the imposition of strict products liability on the original manufacturer and determined that those policies would also justify imposing strict products liability on a successor to the original manufacturer where: (1) the successor acquires the ongoing business operation and continues to market the original manufacturer's product line; (2) the successor benefits from the goodwill associated with the ongoing manufacturing concern, a benefit that the original manufacturer could not have enjoyed without also bearing the burdens of potential products liability; and (3) the injured plaintiff has no viable remedy against the original manufacturer of the defective product.\textsuperscript{250} Thus, under the California rule, a transferee of assets must assume primary responsibility for product-related claims arising from goods marketed by its predecessor where the transferee continues the business operation and continues to market the product that caused the injury.

1. **Product Line Continuity**—This special rule of transferee continuity for products liability claims is more consistent with the policy considerations of strict products liability than is a rule premised on enterprise continuity alone. Presumably, the court in *Ray* meant

\textsuperscript{246} 46 Cal. App. 3d 842, 850, 120 Cal. Rptr. 556, 560 (1975) (Fleming, J., dissenting).

\textsuperscript{247} *Ray v. Alad Corp.*, 127 Cal. Rptr. at 822, quoting from *Ortiz*, 46 Cal. App. 3d at 851, 120 Cal. Rptr. at 561 (Fleming, J., dissenting). The *Ortiz* opinion is discussed more fully in the text accompanying notes 155-58 supra.


\textsuperscript{249} The court reviewed the various options available to a products liability plaintiff whose cause of action arises after the dissolution of the original manufacturer and concluded that the operation of the existing rules governing successor liability would work a particular hardship on the injured person as compared to the other types of claimants. *Ray v. Alad Corp.*, 19 Cal. 3d at 31-33, 560 P.2d at 9-11, 136 Cal. Rptr. at 580-82.

\textsuperscript{250} The court reasoned that:

\[\text{[j]ustifications for imposing strict liability upon a successor to a manufacturer under the circumstances here presented rests upon (1) the virtual destruction of the plaintiff's remedies against the original manufacturer caused by the successor's acquisition of the business, (2) the successor's ability to assume the original manufacturer's risk-spreading role, and (3) the fairness of requiring the successor to assume a responsibility for defective products that was a burden necessarily attached to the original manufacturer's good will being enjoyed by the successor in the continued operation of the business.}\]

*Id.* at 31, 560 P.2d at 8-9, 136 Cal. Rptr. at 579-80.
to impose liability on a successor to the original manufacturer only if the successor continues to market the product that caused the injury. If, at the time of acquisition, the transferee chooses to discontinue production of a particular product, the California test should prevent the transferee from assuming responsibility for injuries caused by previously marketed units of that line. Admittedly, this aspect of the rule's operation will block access to the most desirable defendant for persons injured by a discontinued product after that product's original manufacturer has dissolved. But even this effect is essentially consistent with the policies underlying strict products liability. Since the transferee derives little or no benefit from a discontinued product, it should not be forced to bear losses associated with that product. Moreover, the policy favoring improved public safety anticipates that marginally unsafe product designs will gradually disappear from the marketplace. 251

The product line element of the California test should also prevent the imposition of liability on a successor for injuries arising from products discontinued by its predecessor before the transfer of control. This, too, will clearly limit the number of viable defendants available to persons injured by those products, but it is otherwise consistent with the underlying policy considerations enumerated by the California Court. 252

Thus, the product line element of the California test for successor liability recognizes the need of the business community to control the effects of commercial transactions and predict future costs. Since the risk of contingent products liability is assumed only upon the decision to continue production of the particular product, a potential purchaser of an ongoing business operation can more easily estimate the value of, and control the transfer of, the assets associated with each product acquired. Therefore, the rule enunciated in Ray effectively balances the interests of products liability claimants, the policies of efficient cost allocation, risk spreading, and improved product safety, and the acknowledged interests of business in predictability and control of future costs.

2. Enterprise Continuity—Although product line continuity is clearly an essential element in the California test of successor continuity, it is not the only factor enumerated by the court. In Ray, the court made repeated references to numerous elements of en-

251 See text accompanying notes 107-12 supra. Even though the purchaser of assets may avoid future products liability by discontinuing the product after acquisition, the California rule does not preclude an injured plaintiff's pursuit of another members in the chain of distribution. Arguably, this effect of the California rule is contrary to the widely accepted notion that members of the distributive chain are merely conduits and their losses from products liability suits should be passed on to the manufacturer. See note 9 supra.

252 But see note 251 supra.
terprise continuity between Alad I and Alad II and concluded that the imposition on Alad II of responsibility for injuries arising from products sold by Alad I was "fair and equitable" because Alad II held itself out to potential customers as the same enterprise. Thus, it seems evident that enterprise continuity is an implied, if not express, element in the California rule. It is not clear from *Ray*, however, what elements of enterprise continuity other than continued production of a product line would provide a level of business continuity sufficient to justify the imposition of liability on a transeree. The circumstances presented in *Ray* surely comprise the most obvious case of enterprise and product line continuity, for Alad II apparently acquired and exploited every possible aspect of Alad I's corporate and product line identity. Therefore, the *Ray* opinion is more narrowly drawn than would appear from a reading of the rule of transferee liability adopted by the court. It remains to be seen whether the California Court will insist upon proof of enterprise continuity in future cases, or place increasing emphasis on the one factor which is central to an imposition of liability premised on the policy justifications of strict products liability: product line continuity.

3. Viability of The Original Manufacturer—One other aspect of the California rule could prove to be a source of confusion for business planners in the future. Under the rule as framed by *Ray*, so long as the original manufacturer remains a viable legal entity it will continue to be primarily responsible for product liability claims arising from products it marketed, even though the ongoing busi-

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253 For example, the court described the transfer of control as follows:

The tangible assets acquired by Lighting included Alad I's manufacturing plant, machinery, offices, office fixtures and equipment, and inventory of raw materials, semi-finished goods. These assets were used to continue the manufacturing operations without interruption except for the closing of the plant for about a week "for inventory." The factory personnel remained the same, and identical "extrusion plans" were used for producing the aluminum components of the ladders. The employee of Lighting designated as the enterprise's general manager as well as the other previous employees of Lighting were all without experience in the manufacture of ladders. The former general manager of Alad I, Mr. Hambly, remained with the business as a paid consultant for about six months after the takeover.

The "Alad" name was used for all ladders produced after the change of management. Besides the name, Lighting and Alad II acquired Alad I's lists of customers, whom they solicited, and continued to employ the salesman and manufacturer's representatives who had sold ladders for Alad I. Aside from a redesign of the logo, or corporate emblem, on the letterheads and labels, there was no indication on any of the printed materials to indicate that a new company was manufacturing Alad ladders, and the manufacturer's representatives were not instructed to notify customers of the change.


254 *Id.* at 34, 560 P.2d at 10, 136 Cal. Rptr. at 581.

255 See note 253 supra.
ness and product line have since been sold to a transferee. If, at some point, the transferor is no longer a viable defendant because of dissolution or distribution of its assets, primary responsibility for subsequent product liability claims automatically shifts to the transferee marketing the product line at that time. Of course, the rule does not prevent the parties to the transfer from negotiating on the issue of financial responsibility for such contingent claims; it only determines primary legal responsibility to the injured plaintiff.

To the extent that this rule separates ongoing legal and financial responsibility for product-related injuries from the entity that controls the manufacture of the product, it may not be the most effective way to stimulate continued improvement of product safety. It is almost certain, however, that the cost of such injuries will be accurately reflected in the product’s market price regardless of which corporate entity bears primary legal responsibility for contingent products liability. Once the parties to a transfer realize that such contingent claims will no longer be barred by the operation of the rule of nonassumption, the valuation of a transferor’s assets will surely reflect the contractual agreement between the parties as to which entity will bear final financial responsibility for such claims, and their estimated total cost. Thus, the economic rationale represented by the policies of superior risk-spreading ability and accurate cost allocation are adequately expressed whether primary legal responsibility is placed on the transferor or transferee.

Even though the California rule places primary legal responsibility on the transferor as long as it continues to exist as a viable entity, any sales agreement must take into account the possibility that the transferor could dissolve or become insolvent at some future point. The transferee would then become exposed to primary liability for subsequent claims. Therefore, as a practical matter, a transferee under this rule cannot be completely certain of freedom from future claims arising from the transferor’s products, and the price paid for the ongoing enterprise will accordingly be discounted to reflect these considerations. Given the fact that the policies underlying the imposition of strict products liability are indifferent to the location of primary legal responsibility on either the transferor or transferee, the California court’s inclusion of the element of transferor unavailability in the test for transferee liability would seem to be unnecessary.

It is possible that the inclusion of the requirement of transferor unavailability was motivated by considerations of individual responsibility. The court stated that the imposition of liability on a

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256 See text accompanying note 250 supra.
transferee is "fair and equitable" where that transferee has assumed the corporate identity of its transferor. This would seem to imply that when the transferor exists as a viable legal entity, it would not be "fair and equitable" to impose responsibility for injuries caused by its products on its successor. It is also possible that the court included the element of transferor unavailability in the rule because strict products liability has traditionally been imposed on members of the chain of distribution of the defective product. While a transferee might continue to market the products of its predecessor, it may not be a member of the chain of distribution of the particular unit that caused the injury. Therefore, if the original manufacturer exists as a viable legal entity, the classic formulation of strict products liability theory would select that entity as the logical party to bear primary responsibility. Since the economic policies of risk-spreading and efficient cost allocation are indifferent to the primary location of responsibility, the California court may have concluded that the element of transferor unavailability was essential to the symmetry of its developing scheme of strict products liability law. Whatever the court's motivation, requiring that the transferor be unavailable before liability is imposed upon the transferee may prove to be a trap for the unwary purchaser, and will surely further complicate the already formidable task of accurate asset valuation.

Although the California court was unwilling to frame its rule of transferee liability solely in terms of product line continuity, the rule adopted by the court in Ray represents a substantial step in the continuing evolution of the concepts of products liability law. However, to date no other state court has abrogated the traditional rule of nonassumption in favor of the Ray formulation. Moreover, on two occasions the Seventh Circuit Court of Appeals has expressly declined to adopt the California rule in anticipation of its adoption by the relevant state court.

In Travis v. Harris Corp., the Seventh Circuit was urged to adopt the California rule as the law of Indiana in a case where the plaintiff was injured by a die press manufactured by the predecessor of Harris, T.W. & C.B. Sheridan Co. The court refused to anticipate such a sweeping change in the existing law of Indiana

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257 Ray v. Alad Corp., 19 Cal. 3d at 34, 560 P.2d at 10, 136 Cal. Rptr. at 581.
258 W. Prosser, supra note 8, at 664-65.
259 Travis v. Harris Corp., 565 F.2d 443 (7th Cir. 1977); Leannais v. Cincinnati, Inc., 565 F.2d 437 (7th Cir. 1977).
260 565 F.2d 443 (7th Cir. 1977).
261 This suit is yet another in a series of claims brought against Harris Intertype and/or Bruno-Sherman Corporation for injuries resulting from the use of Sheridan die cutting presses. The details of the changes in corporate form are explained in the text accompanying notes 160-61, 208-10 supra.
and affirmed the lower court's dismissal of the claim against Harris and Bruno-Sherman. Similarly, in *Leannais v. Cincinnati-Forte Co.*, the court was asked to adopt the California rule as the law of Wisconsin. The plaintiff was injured by a machine manufactured by Forte Equipment Co. Forte had previously sold its assets to Cincinnati-Forte for adequate cash consideration. The court noted that strict products liability had been adopted in Wisconsin, but refused to predict on that basis alone that the Wisconsin Supreme Court would adopt a test of transferee liability similar to the California rule. Moreover, the court denounced the California rule as judicial usurpation of legislative powers and postulated that such sweeping changes in a major principle underlying the planning of commercial acquisitions should be left to the scrutiny of the legislature.

### C. The Role of Legislation

Although the bulk of products liability law has evolved through judicial modification of existing legal doctrines to meet particular problems presented by the impact of increased industrialization on consumers, the reservations expressed by the Seventh Circuit concerning the wisdom of judicial activism in this particular aspect of products liability law are, arguably, well taken. Manifestly, each state has an interest in defining the rights and obligations of its citizens and the corporations operating within its borders. It is true, however, that the traditional rules governing the rights and obliga-

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262 *Travis v. Harris Corp.*, 565 F.2d at 448.
263 565 F.2d 437 (7th Cir. 1977).
264 *Id.* at 441, citing *Dippel v. Sciano*, 37 Wis. 2d 443, 155 N.W.2d 55 (1967).
265 The court observed that:

> [t]here is an essential difference between the fixing of responsibility upon manufacturers or sellers for their own acts and transferring that responsibility to a purchasing corporation innocent of and having no control over those acts. The latter may be good policy or bad, but it is not the policy set forth in *Dippel*.

*Id.* at 471 n.8.
266 The court expressed doubt as to the ability of the judiciary to identify and balance all the interests affected by such a dramatic modification of the existing patterns:

> With deference, grave risks arise from court adoption of policy considerations to effect a change in a law so fundamental to the interdependent economic segments of a complex society. Whether the mounting costs of such change can be absorbed by insurance, whether product liability costs may grow so high in one state as to encourage business emigration, whether the relationship of workmen's compensation laws to product liability laws should be adjusted, and whether the many other economic and social effects of such an exception can be justified; are questions difficult to answer by analysis of the facts of a particular case and, it would appear, are more amenable to legislative investigation and determination.

*Id.* at 440-41 n.7.
267 *See Restatement (Second) of Torts* § 402A, comment b (1965).
tions of parties affected by the transfer of commercial property are essentially similar in every jurisdiction. Apparently, the courts and legislatures have recognized that long-range financial commitment requires a measure of predictability and consistency that is unattainable if every state subscribes to its own formula for determining these issues. It is now evident that the existing practices concerning commercial acquisitions will be significantly affected by the evolving law favoring recovery for product-related injuries. Moreover, a number of complex problems concerning the escalating cost of products liability litigation, the unavailability of insurance, the relationship of third party claims to the established pattern of worker's compensation law, and proposals for comprehensive social insurance cannot be adequately addressed by a court which has access only to the record made by the parties to the suit. The legislature is a more appropriate body to gather the information necessary to strike a balance among these competing interests. Additionally, the legislature may control the retroactive effect of the rule it adopts. A judicially-framed exception to the general rule favoring the products liability plaintiff will surely subject many unsuspecting successor manufacturers to burdensome litigation and potentially crushing liability. The extent to which business viability should be prejudiced by the spectre of unanticipated products liability claims is a question of policy best determined by the legislative branch. The foregoing discussion of the analytic and practical problems presented by the Michigan and California tests suggests that the California formulation provides a more equitable balance between the interests of the injured plaintiff and the business community. Absent legislative action, the judiciary should acknowledge in its determinations the vital need of the business community for predictability and control by adopting a consistent test of successor responsibility for products liability claims in every jurisdiction.

268 There are a few variations in the statutory rules governing corporate acquisitions. See text accompanying notes 42-58 supra. The judicially created exceptions to the general rule of nonassumption have been universally applied. See note 58 supra.


270 The products liability problem has recently been the subject of an intensive Congressional investigation. The scope and complexity of the problem attests to the need for an organized overview of the impact of products liability law on business, the economy, and the society in general as a preliminary step to any doctrinal modification. See U.S. FEDERAL INTERAGENCY TASK FORCE ON PRODUCT LIABILITY: FINAL REPORT OF THE INSURANCE STUDY (1977).
V. Conclusion

The respective obligations of the parties to a transfer of corporate assets have traditionally been determined by a group of well-defined principles of corporate law. Under these principles, the parties to the transfer may allocate or even eliminate responsibility for contingent liabilities associated with the assets through the mechanism of the transfer. By selecting a particular mode of transfer, a manufacturer could effectively cut off future products liability claims arising from the use of its predecessor’s products.

This body of corporate law has been the object of criticism in recent years because its operation frustrates the compelling social policies underlying the principle of strict products liability. Therefore, a number of courts have moved to modify the traditional corporate rule, and two state courts recently abrogated the corporate formulation completely in claims involving product-related injuries, in favor of an entirely new standard for determining when a transferee of assets must bear the contingent products liability of the original manufacturer by operation of law.

Both courts relied heavily on the economic rationales which stimulated the development of strict products liability for guidance in formulating the elements of continuity which would support the imposition of successor responsibility, but the tests adopted differ significantly. The Michigan test turns on a finding of substantial enterprise continuity. The California test emphasizes enterprise continuity but turns on the element of product line continuity. The existence of two distinct standards makes it more difficult for business planners to predict the probable future products liability associated with the purchase of a going concern's assets. Thus, while both tests amply protect the interest of the injured plaintiff in recovery, they do not balance that interest against the business community's need for a measure of predictability, or the public interest in efficient risk-spreading, improved product safety, and incorporation of full social costs in pricing.

The interests of the business community and the injured consumer would be most effectively balanced by the statutory adoption of one standard for determining transferee liability. That standard should be premised on the continuation of the production of the product line which allegedly caused the plaintiff's injury. By focusing on the product rather than the entity, the policy considerations of strict products liability are well served, for the entity which controls the future development and distribution of the product should be forced to bear the cost of the injuries resulting from the continued use of that product. In addition, by hinging
transferee liability on the continued exploitation of the particular product line, the transferee may avoid future liability by making the economic decision to discontinue a product because its potential costs outweigh its anticipated revenue.

Even though the bulk of products liability law has developed as a result of judicial willingness to modify existing legal principles, the complexity of the issues in this particular area, and the continuing economic interest in the free alienability of property, suggests that judicial activism in the development of the principles which control this question should be replaced by the careful deliberation of the legislature.

— Mary Annette Horan