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PREVENTING SUCCESSOR LIABILITY FOR DEFECTIVE PRODUCTS: SAFEGUARDS FOR ACQUIRING CORPORATIONS

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In recent years, many courts have determined longstanding limitations on successor liability to be insufficiently sensitive to the compensation needs of products liability claimants. In response, courts in several jurisdictions have eroded traditional corporate law immunities to successor liability for defective products. Although this liberalization of the principles of successor liability has expanded the range of potential defendants in many tort lawsuits, the expansion of liability has caused an increase in uncertainty in corporate transactions, and an increase in complex legal and logistical maneuvering to avoid the growing liability web. This Article seeks to outline the expansion of successor liability in the products area, note the negative implications of that expansion, and identify mechanisms to prevent the attachment of successor liability under both the traditional and expanded regimes. The Article also prescribes a statutory alternative to create much needed stability and certainty in this area through a straightforward allocation of liabilities between purchasers and sellers.¹

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The views expressed in this Article are solely those of the authors and do not represent the position of Hogan & Hartson or any of its clients.

1. This Article does not undertake to evaluate the success in accomplishing compensatory goals that changes in the common law of successor liability have achieved, a task that has been extensively undertaken by others. See Phillips, *Product Line Continuity and Successor Corporation Liability*, 58 N.Y.U. L. REV. 907 n.1 (1983).

I. BACKGROUND

Under longstanding principles of corporate law, a corporation purchasing the assets of another corporation is not responsible for the debts or liabilities of the acquired corporation.² This rule, strictly a creature of corporate law, evolved as a protection for the rights of commercial creditors and dissenting shareholders.³ Over the years it has provided corporate successors a measure of security from unknown or contingent liabilities engendered by predecessors.⁴ Application of the rule has also added stability to the corporate acquisition process by providing a clear guideline under which the parties to an acquisition could operate with predictability.

Most jurisdictions traditionally qualify the general rule of nonliability with four exceptions. Under these exceptions, liabilities will transfer in an asset acquisition when: (1) the purchaser expressly or implicitly agrees to assume the liabilities of the seller; (2) the transaction amounts to a consolidation or merger; (3) the purchasing corporation is merely a continuation of the transferor corporation; or (4) the transaction is entered into to defraud creditors, or otherwise escape liability.⁵

2. See 15 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 7122 at 188 (rev. perm. ed. 1980). The justification for this rule lies in that it "accords with the fundamental principle of justice and fairness, under which the law imposes responsibility for one's own acts and not for the totally independent acts of others." *Leannais v. Cincinnati, Inc.*, 565 F.2d 437, 439 (7th Cir. 1977). Additional justifications have been found in the bona fide purchaser doctrine. A corporation purchasing another corporation's assets is basically a purchaser of property and, under the bona fide purchaser doctrine, the purchaser who gives adequate consideration and who has no knowledge of any claims against an item purchased, takes that item free of those claims. Note, *Products Liability and Successor Corporations: Protecting the Product User and the Small Manufacturer Through Increased Availability of Products Liability Insurance*, 13 U.C. DAVIS L. REV. 1000, 1005-06 (1980) [hereinafter Note, *Products Liability*]. See also Note, *Products Liability of Successor Corporations: A Policy Analysis*, 58 IND. L.J. 677, 683-85 (1983-84) [hereinafter Note, *Successor Corporations*].

3. See *Ramirez v. Amsted Indus., Inc.*, 86 N.J. 332, 340-43, 431 A.2d 811, 815-16 (N.J. 1981).

4. See, e.g., *Kloberdanz v. Joy Mfg. Co.*, 288 F. Supp. 817 (D. Colo. 1968); *Ortiz v. South Bend Lathe*, 46 Cal. App. 3d 842, 120 Cal. Rptr. 556 (1975); *Schwarz v. McGraw Edison*, 14 Cal. App. 3d 767, 92 Cal. Rptr. 776 (1971).

5. See, e.g., *Polius v. Clark Equip. Co.*, 802 F.2d 75, 78 (3d Cir. 1986); *Santa Maria v. Owens-Illinois, Inc.*, 808 F.2d 848 (1st Cir. 1986); *Swayze v. A.O. Smith Corp.*, 694 F. Supp. 619, 621 (E.D. Ark. 1988); *In re Asbestos Litigation (Bell)*, 517 A.2d 697, 699 (Del. Super. Ct. 1986); *Hartford Accident & Indem. Co. v. Canron, Inc.*, 43 N.Y.2d 823, 373 N.E.2d 364, (1977); AMERICAN LAW OF PRODUCTS LIABILITY 3d § 7:1 n.4 (1988).

A fifth exception, occasionally cited by courts, allows for a transfer of liabilities when a transfer of assets is made without adequate consideration and provision is not made for creditors of the transferor. See *Daweiko v. Jorgensen Steel Co.*, 290 Pa. Super. 15, 18, 434 A.2d 106 (1981).

There is some division in the federal courts in Maryland as to the acceptance of the four primary

Application of the traditional corporate law rule to products liability plaintiffs has given rise to numerous instances of perceived inequity. For example, injured plaintiffs have been left without a remedy in situations where the manufacturer of a product causing injury has dissolved and the current holder of the manufacturing assets did not assume tort liabilities. As one court adhering to the principle of nonliability observed:

Plaintiff's counsel argues eloquently and, to me, convincingly that as a matter of social policy, the right of a person injured by a defective product to recover from the manufacturing company should not turn on the subsequent history of that company, especially when the company, though under new ownership, is still extant in the eyes of the public and is still enjoying the benefits of its name and its good will. This argument, however, is directed to the wrong forum. My function is to follow the rule which the Wisconsin Supreme Court would probably follow.⁶

Today, due to the longevity of products, the long latency period for many diseases, and the fast pace of corporate evolution, the chances are decreasing that an original manufacturer will be still in existence when a plaintiff is injured.⁷ With the advent of strict tort liability as a mechanism for assigning liability in the absence of fault,⁸ some jurisdictions now have expanded the scope of the successor liability doctrine, enlarging the circumstances under which purchasing corporations may be deemed "successors" for purposes of fixing liability.⁹ The first such ex-

common law exceptions. *Compare* *Giraldi v. Sears, Roebuck & Co.*, 687 F. Supp. 987, 991 (D. Md. 1988) (applying the four exceptions) *with* *Smith v. Navistar Intern. Transp. Corp.*, 687 F. Supp. 201, 204 (D. Md. 1988) (rejecting the four exceptions, noting that successor liability is imposed when "the equities are sufficiently strong").

In addition, numerous state statutes recognize the assumption of tort liability by a successor corporation after a statutory merger or consolidation. *See, e.g.*, ARIZ. REV. STAT. ANN. § 10-076(B)(5) (1977); ILL. ANN. STAT. ch. 32, ¶ 11.50(5) (Smith-Hurd 1985); N.M. STAT. ANN. § 53-14-6(E) (1983); TEX. BUS. CORP. ACT ANN. art. 5.06(A)(5) (Vernon Supp. 1988).

6. *Bazan v. Kux Machine Co.*, 358 F. Supp. 1250, 1251 (E.D. Wis. 1973). *See also* *Turner v. Bituminous Casualty Co.*, 397 Mich. 406, 419, 244 N.W.2d 873, 878 (1976) (from the perspective of the claimant, "distinctions between the types of corporate transfers are wholly unmeaningful"); *Ramirez v. Amsted Indus., Inc.*, 86 N.J. 332, 341-42, 431 A.2d 811, 816 (1981) (traditional rule "places unwarranted emphasis on the form rather than the practical effect of a particular corporate transaction" and is "inconsistent with the [rapidly] developing principles of strict liability [in tort] and unresponsive to the [legitimate] interests of persons injured by defective products in the stream of commerce").

7. *See Green, Successor Liability: The Superiority of Statutory Reform to Protect Products Liability Claimants*, 72 CORNELL L. REV. 17, 17-18 (1986).

8. *See Greenman v. Yuba Power Products, Inc.*, 59 Cal. 2d 57, 63, 377 P.2d 897, 900-01, 27 Cal. Rptr. 697, 701, (1962); RESTATEMENT (SECOND) OF TORTS § 402A (1965).

9. Several jurisdictions have expanded the scope of successor liability by imposing liability based upon a successor's failure to warn customers of defects in the predecessor's products that were

pansion was marked by the Michigan Supreme Court in *Turner v. Bituminous Casualty Co.*, which established a "continuity of enterprise" exception to the traditional nonliability rule for successor corporations.¹⁰ Under the framework of this exception, the court deemed it appropriate to attach liability to a purchasing corporation when:

- (1) the acquiring corporation retains the predecessor's key personnel, production facilities, and general business operation;
- (2) the seller dissolves following the acquisition;
- (3) the purchaser assumes the seller's liabilities and obligations necessary to continue its normal operation; and
- (4) the purchaser holds itself out to the world as the continuation of the seller.¹¹

Thus, the "continuing enterprise" exception embraces transactions that, in outward appearance, yield an ongoing and identical business operation.

Another judicially created exception that has evolved is the "product line" exception. The leading case adopting this exception is *Ray v. Alad Corp.*,¹² in which the California Supreme Court held that "a party which acquires a manufacturing business and continues the output of its line of products assumes strict tort liability for defects in units of the same product line previously manufactured and distributed by the entity from which the business was acquired."¹³ In *Ray* the plaintiff fell from a defective ladder manufactured by a company that had sold its assets and dissolved six months prior to the accident. The successor that acquired all the manufacturing assets of the original company had continued to manufacture the same line of ladders, using the same name, equipment, designs, and personnel.¹⁴ The successor also solicited customers through the same sales force without any outward acknowledgement of the

discovered, or should have been discovered, by the successor. This duty is based on a purchaser's assumption of the predecessor's duty to repair or service its products. See, e.g., *Jacobs v. Lakewood Aircraft Serv., Inc.*, 512 F. Supp. 176 (E.D. Pa. 1981). Application of this duty turns on post-transaction behavior by the seller and is beyond the scope of an article addressing transaction-based concerns.

10. 397 Mich. 406, 244 N.W.2d 873 (1976). The continuity of enterprise approach was also followed in *Mozingo v. Correct Mfg. Co.*, 752 F.2d 168 (5th Cir. 1985) (applying Mississippi law), *Rivers v. Stihl, Inc.*, 434 So.2d 766, 771-72 (Ala. 1983), and *Radzuil v. Hooper, Inc.*, 125 Misc. 2d 362, 479 N.Y.S.2d 324 (N.Y. Sup. Ct. 1984).

11. *Turner v. Bituminous Casualty Co.*, 397 Mich. 406, 430, 244 N.W.2d 873, 883-84 (1976).

12. 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).

13. *Id.* at 34, 560 P.2d at 11, 136 Cal. Rptr. at 582.

14. *Id.* at 24-25, 560 P.2d at 5, 136 Cal. Rptr. at 576.

change in ownership.¹⁵

In a suit against the successor, the trial court found that the successor corporation was not liable for the torts of the original manufacturer under traditional corporate rules governing successor liability. The California Supreme Court reversed, however, holding the successor corporation liable for the plaintiff's injuries. Contemplating the social policies underlying strict products liability,¹⁶ the court decided that traditional corporate rules did not adequately protect the policy goals of strict products liability. Therefore, the court created a "product line" exception to the traditional doctrine of successor liability. The court justified its extension of liability to the purchasing entity by noting: (1) the virtual destruction of the plaintiff's remedies against the original manufacturer as a result of its acquisition by the successor; (2) the successor's ability to assume the original manufacturer's risk spreading role; and (3) the fairness of requiring the successor to assume its predecessor's liabilities given that the successor was enjoying the benefits of the original manufacturer's goodwill.¹⁷

15. *Id.*

16. The court concluded that the paramount policies to be promoted by strict tort liability are protecting otherwise defenseless victims of manufacturing defects and spreading through society compensatory costs for them. *Id.* at 31, 560 P.2d at 8, 136 Cal. Rptr. at 579.

17. *Id.* at 33-34, 560 P.2d at 9, 136 Cal. Rptr. at 580. Several jurisdictions have followed the product line exception. See *Hickman v. Thomas C. Thompson Co.*, 592 F. Supp. 1282 (D. Colo. 1984); *Amader v. Pittsburgh Corning Corp.*, 546 F. Supp. 1033 (E.D. Pa. 1982); *State of Maryland v. Keene Corp.*, Civ. Action No. 1108600 (Cir. Ct. Anne Arundel Cty., Aug. 10, 1988) (unpublished County Court opinion); *Ramirez v. Amsted Indus., Inc.*, 86 N.J. 332, 431 A.2d 811 (1981); *Martin v. Abbott Laboratories*, 102 Wash. 2d 581, 689 P.2d 368 (1984).

Other jurisdictions, however, have declined to adopt this new exception. See, e.g., *Dayton v. Peck, Stow & Wilcox Co.*, 739 F.2d 690 (1st Cir. 1988) (Massachusetts law); *Page v. Gulf Oil Co.*, 812 F.2d 249 (5th Cir. 1987) (Louisiana law); *Everest v. American Transp. Corp.*, 685 F. Supp. 203 (D. Minn. 1988); *Andrews v. John E. Smith's Sons Co.*, 369 So.2d 781 (Ala. 1979); *Bernard v. Kee Mfg. Co.*, 394 So.2d 552 (Fla. Dist. Ct. App. 1981); *Domine v. Fulton Iron Works*, 76 Ill. App. 3d 253, 395 N.E.2d 19 (1979); *Stratton v. Garvey Int'l, Inc.*, 676 P.2d 1290 (Kan. App. 1984); *Jones v. Johnson Mach. and Press Co.*, 320 N.W.2d 481 (Neb. 1982); *Simoneau v. South Bend Lathe, Inc.*, 543 A.2d 407 (N.H. 1988); *Downtowner, Inc. v. Acremental Prods., Inc.*, 347 N.W.2d 118 (N.D. 1984); *Hamaker v. Kenwell-Jackson Mach., Inc.*, 387 N.W.2d 515 (S.D. 1986); *Griggs v. Capitol Mach. Works, Inc.*, 690 S.W.2d 287 (Tex. Ct. App.), *aff'd*, 701 S.W.2d 238 (Tex. 1985); *Ostrowski v. Hydra-Tool Corp.*, 144 Vt. 305, 479 A.2d 126 (1984); *Fish v. Amsted Indus., Inc.*, 126 Wis. 2d 293, 376 N.W.2d 820 (1985).

As is the case with many other judicially improvised solutions to perceived social ills, the product line expansion of successor liability proceeds on faulty premises. Particularly troublesome is the assumption that the successor enjoys the predecessor's good will without bearing any correlative burdens of liability. It is noted that if the predecessor indeed enjoyed good will, it was included in the purchase price and that any resulting windfall accrues to the seller. See *Aylward & Aylward, Successor Liability for Defective Products—Misplaced Responsibility*, 13 STETSON L. REV. 555, 580-

Prior to the establishment of these new approaches to successor liability, a products liability plaintiff generally was limited to suit against the manufacturer, the stockholders and/or other parties in the chain of product distribution. Application of the continuing enterprise and product line exceptions has successfully broadened the cast of potential defendants in many products liability cases. Indeed, one commentator has characterized the altered doctrine as providing an injured party "with an unwarranted windfall of additional defendants," engendering costly litigation.¹⁸ With the additional defendants have come some intriguing outcomes. Several cases have found successor liability on the part of "intermediate successor" corporations that acquired a predecessor manufacturer's assets subsequent to the production of the injury causing product, but sold the assets to yet another entity prior to suit.¹⁹ Another court has attached responsibility for the same injury, in separate lawsuits, to both an intermediate and an ultimate successor corporation,²⁰ In addition, a successor has been assigned liability even though the predecessor remained extant.²¹ The product line net has also snared a manufacturer that did not even produce the specific product once produced by its predecessor.²² Finally, it appears that a purchaser of assets at a bankruptcy sale may be deemed to be a successor for purposes of products liability claims.²³

81 (1984). In addition, the argument that the successor corporation is best situated to spread the risk has been criticized as equating liability with ability to pay. See *Manh Hung Nguyen v. Johnson Mach. & Press Corp.*, 104 Ill. App. 3d 1141, 433 N.E.2d 1145, 1108 (1982).

18. Kadens, *Practitioner's Guide to Seller's Products Liability in Asset Acquisitions*, 10 U. Tol. L. Rev. 1, 18 (1978).

19. *Trimper v. Harris Corp.*, 441 F. Supp. 346 (E.D. Mich. 1977); *Nieves v. Bruno Sherman Corp.*, 86 N.J. 361, 431 A.2d 826 (1981).

20. *Trimper v. Harris Corp.*, 441 F. Supp. 346 (E.D. Mich. 1977); *Trimper v. Bruno-Sherman*, 436 F. Supp. 349 (E.D. Mich. 1977).

21. *Amader v. Pittsburgh Corning Corp.*, 546 F. Supp. 1033 (E.D. Pa. 1982); *Tift v. Forage King Indus.*, 108 Wis. 2d 72, 77, 322 N.W.2d 14, 16 (1982) ("logic does not lead to the conclusion that, because [the predecessor] is a proper defendant, his successor business organizations cannot be also"). The *Tift* decision has been cited as containing an "egregious lapse of logic." Green, *supra* note 7, at 46 n.129 (1986).

The Michigan courts do not require dissolution of the predecessor as a precondition to suit against the successor. *Trimper*, 436 F. Supp. at 351.

22. *Rawlings v. D.M. Oliver, Inc.*, 97 Cal. App. 3d 890, 159 Cal. Rptr. 119 (1979) (successor held liable even though injuring product—kelp drier—was made by predecessor to fill special order and no evidence existed that similar product ever made for others).

23. *In re Matter of Mooney Aircraft, Inc.*, 730 F.2d 367 (5th Cir. 1984) (where bankruptcy court order mandated asset sale free and clear of all claims and liabilities, injunction to protect this order could not bar products liability claims arising after sale).

II. DETRIMENTAL ASPECTS OF EXPANDED SUCCESSOR LIABILITY

The broadening of successor liability to embrace those purchasers of corporate assets that, in some sense, "continue" a preceding enterprise or product line poses financial problems for potential corporate defendants and doctrinal problems for those seeking to advance the goals of corporate and products liability law.

As a matter of intellectual purity and doctrinal consistency, the extension of liability to successor corporations (other than those resulting from mergers or consolidations) runs afoul of the central tort law requirement of causation-in-fact as a prerequisite to liability. Normally, tort liability is imposed only upon an individual or entity whose conduct has caused injury to others.²⁴ Yet, under expanded theories of successor liability, the corporation whose conduct has caused injury—the original manufacturer that placed a defective product into the stream of commerce—can escape liability through dissolution, leaving an otherwise blameless successor corporation to assume its liabilities.²⁵ Liability may be assessed against a successor corporation for the entirely independent acts of another.²⁶

Many courts and commentators have noted that it is improper to impose liability on an innocent successor corporation merely as a means of providing injured claimants with some form of compensation.²⁷ As one

24. Under notions of strict liability, a defendant may be held liable for a plaintiff's injury, although without fault, for having placed a defective injury-causing product in the stream of commerce. RESTATEMENT (SECOND) OF TORTS § 402A(1) (1965). The nexus between the parties provides a foundation for application of the adage that "between two innocents, the one who caused the harm should be liable."

25. Some argue that the ultimate burden of expanded successor liability is shifted back to the predecessor corporation and its shareholders when the successor corporation adjusts for potential liability by negotiating a lower price for the predecessor's assets. See *Turner v. Bituminous Casualty Corp.*, 397 Mich. 406, 428, 244 N.W.2d 873, 883 (1976); *Ramirez v. Amsted Indus., Inc.*, 86 N.J. 332, 354, 431 A.2d 811, 813 (1981). This is known as the "conduit argument." See *Green*, *supra* note 7, at 39. This argument is unrealistic because the successor often will be unable to gauge the size of the products liability costs associated with the seller's products. The nature of products liability creates difficulties for the successor in calculating the amount of actual expense that it is likely to incur. See *Green*, *supra* note 7, at 34 (acquisitions take place before the risks of a particular product are fully appreciated); Note, *The Post-Dissolution Products Liability Claim Problem: A Statutory Versus a Judicial Solution*, 38 SYRACUSE L. REV. 1279, 1296-297, 1307-08 (1987) (forecasting value of future liability claims at time of acquisition not easily factored into purchase price).

26. This foils the deterrence goals of tort law, in that the manufacturer of the defective product is not forced to bear the costs of the injuries caused by his product. See Note, *Successor Corporations*, *supra* note 2, at 701; *Aylward & Aylward*, *supra* note 17, at 579-80.

27. See *Leannais v. Cincinnati, Inc.*, 565 F.2d 437, 441 (7th Cir. 1977); *Travis v. Harris Corp.*, 565 F.2d 443, 448-49 (7th Cir. 1977); *Martin v. Abbott Laboratories*, 102 Wash. 2d 581, 619-21, 689

court stated, "the corporate stranger which purchases some or all of the assets of a corporation bears no closer relationship to a defective product produced by that predecessor than does any other company in the industry which is producing the same product."²⁸ Although a successor corporation is generally superior in risk-bearing or risk-spreading capacity to an individual plaintiff, the same is also true of any other organization of comparable size, or even the federal government.²⁹ Adoption of liability principles divorced from causation requirements can lead only to further expansion of the realm of potential liabilities generally, and to a compensation-maximizing tort system.³⁰

Expanded successor liability rules also hinder the alienability of assets by injecting a great deal of uncertainty into potential transactions.³¹ Prior to the *Turner*³² and *Ray*³³ decisions, the rules relating to successor liability were clearly developed and uniformly applied, providing a measure of stability and predictability for purchasing and selling corporations. Corporate acquisition planners knew when liabilities would transfer, and this certainty facilitated the transferability of assets, thereby promoting business in general.³⁴ Today, however, while some jurisdictions have expanded the scope of successor liability, others have refused

P.2d 368, 390 (Wash. 1984) (Pearson, J., dissenting); Aylward & Aylward, *supra* note 17, at 582; Burns & Kohane, *Liability of Successor Corporations: Altering the Suit to Add a Deep Pocket*, 27 FOR THE DEFENSE, April, 1985, at 24, 30 ("The lack of a 'deep pocket' is scarcely a principled reason to force an innocent manufacturer to pay for another's misdeeds."); Green, *supra* note 7, at 21.

28. *Woody v. Combustion Eng'g, Inc.*, 463 F. Supp. 817, 821 (E.D. Tenn. 1978) (declining to adopt product line rule).

29. *Woody*, 463 F. Supp. at 820-21 ("[M]ost of the policies advanced . . . in support of the rule of expanded liability would be more efficiently advanced by placing liability on the entire industry rather than on the good faith purchaser alone [The] charitable instinct is insufficient, however, to justify holding liable a successor corporation, more or less at random, in order simply that a wealthier party be burdened.").

30. The reader should note that courts have also imposed liability without individual findings of causation in the so-called industry or enterprise liability cases. See *Sindell v. Abbott Laboratories*, 26 Cal. 3d 588, 607 P.2d 924, 163 Cal. Rptr. 132, *cert. denied*, 449 U.S. 912 (1980). A vigorous dissent in *Sindell* focused on, *inter alia*, the departure from causation principles. *Id.* at 614-15, 607 P.2d at 938-39, 163 Cal. Rptr. at 146-47 (Richardson, J., dissenting).

31. See generally Note, *supra* note 25, at 1307-311.

32. *Turner v. Bituminous Casualty Co.*, 307 Mich. 406, 244 N.W.2d 873 (1976). See *supra* notes 10-11 and accompanying text.

33. *Ray v. Alad Corp.*, 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977). See *supra* notes 11-16 and accompanying text.

34. Asset transfers are important to the health of the economy because they foster economic efficiency and productivity. Note, *supra* note 25, at 1294.

to budge from the traditional rule of nonassumption of liability.³⁵ This division among the courts creates difficulties for corporations engaging in asset transfers. Purchasers of corporate assets are no longer certain when they will be held responsible for the torts of their predecessors, and thus when they should account for such liabilities in assessing an appropriate purchase price.³⁶ By unmanageably complicating the bargaining process between the parties to an acquisition, expanded successor liability hinders the alienability of assets. Even if a purchasing corporation assumes that it will be held liable, accurate prediction of the magnitude of unknown claims arising from previously manufactured products, and thus an appropriate purchase price, poses a nearly insurmountable challenge.³⁷ To the extent that some calculation of contingent tort liabilities is possible, any estimation by both the buyer and seller is unlikely to yield the same figure.³⁸ If the parties cannot quantify contingent liabilities, an attempted acquisition likely will fail.

Even if from this day forward products liability costs could be foreseen and appropriately estimated by prospective buyers, no solace is forthcoming to those corporations which purchased assets prior to the advent of the expanded liability doctrines. Such buyers may face expenditures in sums greater than those for which they bargained. Further, the financial

35. Green, *supra* note 7, at 18; Note, *Recognizing Products Liability Claims At Dissolution: the Compatibility of Corporate and Tort Law Principles*, 87 COLUM. L. REV. 1048, 1054-55 n.39 (1987).

36. With the variation in law that exists from jurisdiction to jurisdiction, the liability of a successor corporation may depend upon the choice of law rules of the forum in which a plaintiff brings suit. See, e.g., *Standal v. Armstrong Cork Co.*, 356 N.W.2d 380 (Minn. Ct. App. 1984). See generally Comment, *Choice-of Law in Minnesota Corporate Successor Products Liability: Which Rule Is the "Better Rule?"*, 8 HAMLINE L. REV. 373, 388-409 (1985).

37. Green, *supra* note 7, at 34 (assumption that successors have adequate information to make an informed assessment of a predecessor's potential product liability is probably unjustified); Note, *Ray v. Alad Corporation: Imposing Liability on the Successor Corporation for the Defective Products of the Predecessor Corporation*, 15 CAL. W.L. REV. 338, 357-58 (1979) (the unlimited time during which successor is liable for predecessor's products makes estimation of reduction in purchase price for those liabilities unmanageable); Note, *supra* note 23, at 1308 (successor liability for contingent products liability claims not easily factored into the price of purchased assets). Other commentators argue that predicting and guarding against future liability is part of the regular conduct of business. Cantu & Goldberg, *Products Liability: An Argument for Product Line Liability in Texas*, 19 ST. MARY'S L.J. 621, 651 (1988). This would be true if the purchasing corporation has access to and comprehension of information about sales history and product design comparable to that for the purchaser's own business. This process, however, can be exceedingly complex. Green, *supra* note 7, at 47; Note, *supra* note 25, at 1308.

38. While the seller's valuation of the costs of expected liability is necessarily limited to the value of the seller's firm, the buyer may have more capital at risk than the seller, and thus will view the amount of potential liability as greater. See Note, *supra* note 35, at 1055.

burdens from these unanticipated liabilities likely will injure small businesses disproportionately.³⁹

The economic harm attributable to the expansion of successor liability is of particular significance in the mass tort context due to the magnitude and number of the potential liabilities. For example, numerous defendants have faced, under various theories, possible successor liability from products containing asbestos.⁴⁰ Although the need to identify responsible defendants is great in order to address widespread societal problems such as asbestos-related disease, the associated economic costs are equivalently large.

Although the goal of the expansion of successor liability is to provide compensation to the victims of defective products, such expansion, in practice, does not always fulfill compensation goals. Corporations attempt to, and often do, structure transactions to avoid successor liability.⁴¹

III. PREVENTIVE MEASURES UNDER TRADITIONAL RULES

It is incumbent on business planners and counselors to consider the implications of expanded concepts of successor liability for any contemplated asset acquisition. The question of whether one can acquire corporate assets without successor liability "is of crucial importance and should be the *first*, not the last item, considered by a company before it

39. See *Bernard v. Kee Mfg. Co.*, 409 So.2d 1047, 1049 (Fla. 1982) (rejecting product line approach, citing "threat of economic annihilation" of small businesses); *Flaughner v. Cone Automatic Mach. Co.*, 30 Ohio St. 3d 60, 507 N.E.2d 331, 337 (1987) ("potentially devastating burden on business transfers"). See also Sell, *Successor Corporation's Liability for Defective Products of Its Transferor—The Product Line Exception*, 4 J. L. & COMM. 65, 80 (1984) ("Where the [product line] exception had not been adopted previously, its adoption initially could produce disastrous results, particularly if the successor is a small manufacturer"); Note, *Products Liability*, *supra* note 2, at 1002 ("Small corporations have limited assets and thus face possible financial destruction should the predecessor's products give rise to multiple personal injury suits.").

40. See, e.g., *Wall v. Owens-Corning Fiberglass Corp.*, 602 F. Supp. 252 (N.D. Tex. 1985); *In re Related Asbestos Cases*, 578 F. Supp. 91 (N.D. Cal. 1983); *Amader v. Pittsburgh Corning Corp.*, 546 F. Supp. 1033 (E.D. Pa. 1982); *Tretter v. Rapid Am. Corp.*, 514 F. Supp. 1344 (E.D. Mo. 1981); *State of Maryland v. Keene Corp.*, Civ. Action No. 1108600 (Cir. Ct. Anne Arundel Cty., Aug. 10, 1988). By recent count, over 25,000 asbestos-related cases are pending in state and federal courts. Arness & Eliason, *Insurance Coverage for "Property Damage" in Asbestos and Other Toxic Tort Cases*, 72 VA. L. REV. 943 (1986).

41. See *infra*, Part III, IV. See also Green, *supra* note 7, at 42 n.110 (the incentive of parties to an acquisition to exploit the inadequacies of expanded successor liability law exacerbates its lack of comprehensiveness).

buys or sells assets.”⁴² The purpose of such an inquiry is not so that “the assets of a debtor might be laundered,”⁴³ but to ensure that the true economic intentions of a transaction are realized.

Under the traditional corporate law principle of nonliability of successor corporations, avoidance of successor liability for products claims is relatively easy. As discussed above, under the traditional corporate law rule liability does not pass to a purchaser of corporate assets unless: (1) the successor assumes liabilities through an express or implied agreement; (2) the transaction amounts to a consolidation or merger; (3) the purchasing corporation is merely a continuation of the transferor corporation; or (4) the transaction is fraudulently entered into to escape liability.⁴⁴ To avoid successor liability, a purchaser of corporate assets need only structure transactions to fall outside the scope of these four exceptions.

A. Avoiding Express or Implied Agreement

In order to avoid successor liability, a purchasing corporation should draft a purchase agreement that neither expressly nor implicitly provides for an assumption of products liability on the part of the purchaser. This requires careful drafting to avoid any implication of successor liability for products claims, especially when the purchaser assumes other tort liabilities. To ensure that courts do not interpret a purchase agreement as including an assumption of liability, the agreement should specifically state that product liabilities do not transfer. An express disclaimer or exclusion of product liabilities generally will be enforced by courts.⁴⁵ Conversely, an express assumption of product-related tort liabilities included in a purchase agreement will most certainly be viewed as grounds

42. Shecter, *Acquiring Corporate Assets Without Successor Liability: Is it a Myth?*, 1986 COLUM. BUS. L. REV. 137 (emphasis in original).

43. Carlson, *Successor Liability in Bankruptcy: Some Unifying Themes of Intertemporal Creditor Priorities Created By Running Covenants, Products Liability and Toxic-Waste Cleanup*, 50 LAW & CONTEMP. PROBS. 119, 127 (1987).

44. See *supra* note 5 and accompanying text.

45. See *Swayze v. A.O. Smith Corp.*, 694 F. Supp. 619, 622 (E.D. Ark. 1988) (enforcing express exclusion of liability); *Leannais v. Cincinnati, Inc.*, 565 F.2d 437, 438-40 (7th Cir. 1977) (enforcing five-year limitation of liability). The existence of a disclaimer or exclusion of liability can be trumped by a finding of continuity of product line or enterprise in jurisdictions adopting these exceptions. See *Cyr v. B. Offen & Co.*, 501 F.2d 1145, 1153 (1st Cir. 1974) (finding successor liability on “continuity of enterprise” theory despite presence of disclaimer).

for imposing successor liability.⁴⁶

The typical dispute arises in the context of arguably implied agreements to assume liability. The existence of implied agreements arises in a variety of circumstances. For instance, inclusion in a purchase agreement of a broadly worded clause assuming certain liabilities, such as those associated with an ongoing business, may well result in a judicial inference that the purchaser intended to assume other related liabilities. That is, courts may treat a transfer of several general liabilities as an indication that the parties were impliedly including a transfer of product liabilities as well.⁴⁷ Likewise, other actions taken to suggest an assumption of product liabilities, such as a purchaser's undertaking to repair or service all products manufactured by the seller, may justify the finding of an implied agreement.⁴⁸ If, on the other hand, a purchase agreement enumerates a list of specific debts and obligations to be assumed, a more likely conclusion is that unenumerated liabilities were not intended to be transferred to the purchaser.⁴⁹ For instance, one court deemed an assumption of "all of the obligations of the seller which exist at the closing date" sufficient to bar assumption of future products liability claims asserted after the closing date.⁵⁰

Because contracts may be interpreted to include an implied assumption of products liability, purchasers should fortify their immunity from successor liability by including an express disclaimer of product liabilities in any purchase agreement.

46. *Wall v. Owens-Corning Fiberglas Corp.*, 602 F. Supp. 252 (N.D. Tex. 1985); *Bippus v. Norton Co.*, 437 F. Supp. 104, 106 (E.D. Pa. 1976).

47. *See Bouton v. Litton Industries, Inc.*, 423 F.2d 643, 652 (3d Cir. 1970) (finding assumption of "all liabilities and obligations . . . in respect of . . . all other contracts and commitments entered into in the regular and ordinary course of [the seller's] business" to include products liability claims for future accidents). One commentator attributes this outcome "to the negligence of sloppy contract draftsmanship." Hyman, *The Liability of Successor Corporations for Defective Products of a Predecessor Corporation—A Switch from Corporate to Tort Law*, 10 S.U.L. REV. 165, 179 (1984).

48. *See also supra*, note 9.

49. *Shane v. Hobam, Inc.*, 332 F. Supp. 526 (E.D. Pa. 1971) (interpreting New York law); *Kloberdanz v. Joy Mfg. Co.*, 288 F. Supp. 817 (D. Colo. 1968) (interpreting California law) (agreement for assumption of wage, tax and accounts payable liabilities and absence of express agreement concerning assumption of tort liabilities indicated intent that seller retain liabilities).

50. *Grant-Howard Assocs. v. General Housewares Corp.*, 63 N.Y.2d 291, 296-97, 472 N.E.2d 1, 3, 482 N.Y.S.2d 225, 227 (1984). *See Elmer v. Tenneco Resins, Inc.*, 698 F. Supp. 535 (D. Del. 1988) (question of fact as to which liabilities were assumed).

B. *Avoiding De Facto Merger*

Where a purchase of assets amounts in practical terms and appearance to a merger, the purchaser may be deemed to have assumed the seller's product liabilities.⁵¹ A merger contemplates the absorption of the seller's operations by the purchaser and the near contemporaneous dissolution of the seller.⁵² Under this view, the selling entity ceases to have an independent existence and becomes a constituent part of the acquiring corporation.

A purchase of assets will be deemed to be a de facto merger when four elements are present. First, there must be a continuity of the business enterprise, with the operation utilizing essentially the same location, assets, employees and management. Second, there must be a continuity of ownership, with all or part of the purchase price being stock in the purchasing corporation, such that the seller's shareholders become shareholders in the acquiring corporation.⁵³ Third, the seller must dissolve after the sale. Fourth, the purchaser must assume those liabilities and obligations needed for the normal ongoing operations of the business.⁵⁴

Avoidance of these factors should prevent a court conclusion of a de facto merger. Thus, a business planner contemplating a purchase of assets should seek to change the management and the workforce of the acquired enterprise, the physical location of the plant, and should keep the portion of payment in stock as low as possible.⁵⁵ In addition, the

51. See, e.g., *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361 (3d Cir. 1974), *cert. denied*, 421 U.S. 965 (1975); *Shannon v. Samuel Langston Co.*, 379 F. Supp. 797, 800 (W.D. Mich. 1974) (transaction was something "other than an ordinary purchase of assets").

52. *Shannon*, 379 F. Supp. at 801 ("practically contemporaneous" dissolution of seller); *Applestein v. United Board & Carton Corp.*, 60 N.J. Super. 333 159 A.2d 146 (1960), *aff'd per curiam*, 33 N.J. 72, 161 A.2d 474 (1960); *Freeman v. Hiznay*, 349 Pa. 89, 36 A.2d 509 (1944). See also *W. FLETCHER*, *supra* note 2, § 7014; Note, *Products Liability*, *supra* note 2, at 1004 n.16.

53. Authority is split as to whether all of the consideration must be in stock. *Cantu & Goldberg, Products Liability*, *supra* note 37, at 637 n.85. Compare *Marks v. Minnesota Mining & Mfg. Co.*, 187 Cal. App. 3d 1429, 232 Cal. Rptr. 594 (1986) (all stock required) with *Wilson v. Fare Well Corp.*, 140 N.J. Super. 476, 490-91, 356 A.2d 458, 466 (1976) (half of purchase price paid with stock was sufficient).

54. Different courts accord primacy to different elements listed. For cases listing and applying these considerations, see *Shannon*, 379 F. Supp. 797; *Manh Hung Nguyen v. Johnson Mach. & Press Corp.*, 104 Ill. App. 3d 1141, 433 N.E.2d 1104 (1982).

55. That is, the business planner should ensure that the corporations "remain strangers after the sale." *McKee v. Harris Seybold Co.*, 109 N.J. Super. 555, 565-67, 264 A.2d 98, 104 (N.J. 1970), *aff'd*, 118 N.J. Super. 480, 288 A.2d 585 (N.J. Super. 1972). At least one court found the continuity of shareholders to be the "most important requirement in finding a de facto merger." *Wessinger v. Vetter Corp.*, 685 F. Supp. 769, 773 (D. Kan. 1987).

purchaser should not request or require the seller to dissolve shortly after the transaction, but rather should encourage the seller's continued existence.⁵⁶ Finally, a purchaser should place a strongly worded exclusion of product liabilities in the purchase agreement. Although some courts suggest that the absence of any one of the four elements creating a de facto merger may be sufficient to defeat a contention of successor liability,⁵⁷ the test used by many courts appears to be something approaching "totality of the circumstances."⁵⁸

C. Avoiding a "Mere Continuation"

To prevent a transfer of liabilities, a purchasing corporation must avoid being characterized by courts as a mere continuation of the acquired corporation.⁵⁹ Courts will find a mere continuation or "reincarnation" of an asset-selling corporation, sufficient to warrant imposition of successor liability, where there is such a continuity of ownership and control between the seller and purchaser as to demonstrate that the asset sale constitutes a device for the seller to continue existence with a "new hat."⁶⁰ The focus of this inquiry is on continuation *vel non* of the corporate entity.⁶¹ Where a corporation is essentially continuing its preexist-

56. "[A] clever businessman can limit the chance that a product liability plaintiff will recover against the successor corporation by making certain that the selling corporation does not dissolve quickly." Hyman, *Liability of Successor Corporations*, *supra* note 47, at 175-76. See also Note, *Products Liability*, *supra* note 2, at 1009.

57. See *Leannais v. Cincinnati, Inc.*, 565 F.2d at 439 (no finding of de facto merger where payment was not in stock). See also Phillips, *Product Line Continuity*, *supra* note 1, at 912 (requirement of stockholder continuity is consistently deemed an essential element of de facto merger in corporate law). The absence of payment in stock, however, is the cornerstone of the expansion of successor liability marked by the "continuation of enterprise" theory.

58. See, e.g., *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361 (3d Cir. 1974) (court seeks to avoid "a mere procrustean application of formalities"); *Menacho v. Adamson United Co.*, 420 F. Supp. 128, 133 (D.N.J. 1976) ("[N]ot all of these factors are needed to demonstrate a merger; rather, these factors are only indicators that tend to show a de facto merger").

59. See generally Note, *supra* note 2, at 1009-11.

60. *Armour-Dial, Inc. v. Alkar Eng'g Corp.*, 469 F. Supp. 1198, 1201-202 (E.D. Wis. 1979). See also 15 W. FLETCHER, *supra* note 2, § 7205 (such continuation may occur where there is but one corporation which merely changes its form and ceases to exist upon the creation of the new corporation which is its successor).

61. Recall that the "continuity of enterprise" exception, where adopted, focuses on continuity of the business operations, not necessarily on the ownership and control. Although the "mere continuation" exception overlaps substantially with the de facto merger exception, the former does not require the exchange of assets for stock and often refers to a reorganization of the original corporation under federal bankruptcy law or state equivalents. *Everest v. American Transp. Corp.*, 685 F. Supp. 203, 206 (D. Minn. 1988). One court found that a corporation can be the "mere continuation" of a noncorporate organization, in this case a sole proprietorship, while a de facto merger

ing business under a different name, the law considers it appropriate to charge the successor with the liabilities of the predecessor.⁶²

Like the de facto merger exception, the mere continuation approach seeks to elevate the substance of an asset transfer over its legal form. Salient factors demonstrating a mere continuation are: common identity of officers, directors and stockholders; use of the same or similar name, location and employees; the adequacy of the consideration for the sale; and the dissolution of the seller contemporaneous with the transaction.⁶³

The key to preventing the imposition of successor liability on a “mere continuation” theory is straightforward: the two entities involved need to appear as dissimilar in structure as possible. The conclusion that planners should seek to avoid is that the two business organizations are, in fact, the same one. The asset purchase should be at arms length, and preferably made with cash rather than stock. The officers, directors and shareholders of the seller should not become those of the purchaser.⁶⁴ To the extent practicable, the name of the products manufactured should be changed.

D. Avoiding a Fraudulent Transfer

Under the traditional rule of successor nonliability, liability may be imposed on a successor corporation when the transaction is made for the purpose of defrauding creditors or when some elements of a good faith purchase are lacking.⁶⁵ Standards for determining whether a particular transaction is fraudulent are contained in the Uniform Fraudulent Con-

presumably requires the participation of two corporations. *Tift v. Forage King Indus., Inc.*, 108 Wis. 2d 72, 322 N.W.2d 14 (1982).

62. See *Wallace v. Dorsey Trailers Southeast, Inc.*, 849 F.2d 341, 343 (8th Cir. 1988) (successor must be created for the purpose of acquiring the predecessor's product line to be liable under the “mere continuation” theory).

63. See *Santa Maria v. Owens-Illinois, Inc.*, 808 F.2d 848 (1st Cir. 1986); *Tucker v. Paxson Mach. Co.*, 645 F.2d 620, 625-26 (8th Cir. 1981); *Weaver v. Nash Int'l, Inc.*, 562 F. Supp. 860 (S.D. Iowa 1983); *Stratton v. Garvey Int'l, Inc.*, 9 Kan. App. 2d 254, 266-67, 676 P.2d 1290, 1299 (1984). See also *Cantu & Goldberg*, *supra* note 37, at 631-32.

64. This is perhaps the most significant factor under the “mere continuation” exception. See *Travis v. Harris Corp.*, 565 F.2d 443 (7th Cir. 1977); *Parson v. Roper Whitney, Inc.*, 586 F. Supp. 1447 (W.D. Wis. 1984); *Weaver v. Nash Int'l, Inc.*, 562 F. Supp. 860 (S.D. Iowa 1983). *But see* *Western Washington Laborers-Employers Health & Sec. Trust Fund v. Harold Jordan Co.*, 760 P.2d 382, 387 (Wash. App. 1988) (no successor liability under “mere continuation” exception, despite total identity of officers, directors and stockholders because consideration was adequate); *George v. Parke-Davis*, 684 F. Supp. 249, 254-55 (E.D. Wash. 1988) (the identity of two minority stockholders and the corporate treasurer insufficient to yield conclusion of “mere continuation”).

65. See, e.g., *Dominc v. Fulton Iron Works*, 37 Ill. App. 3d 253, 395 N.E.2d 19 (Ill. App.

veyance Act, enacted by a majority of states. Under the Act, a conveyance by an insolvent corporation for less than fair consideration is fraudulent, as is a conveyance with actual intent to defraud present or future creditors.⁶⁶

Cases addressing this exception are rare and, in the products liability context, generally unfavorable to plaintiffs.⁶⁷ Fraudulent transfers generally are of concern to existing commercial creditors. In addition, the evidentiary problems facing tort plaintiffs in demonstrating a fraudulent transfer are severe.

Avoidance of successor liability under this exception is not difficult. Liability for a fraudulent transfer will not attach inadvertently; the requisite intent to defraud creditors must accompany the transaction. Parties to a transaction can reasonably assume that, absent an intent to defraud the predecessor corporation, a court will not impose successor liability under this exception.

IV. PREVENTIVE MEASURES UNDER THE NEW EXCEPTIONS

Avoiding successor liability is more complex in those jurisdictions that have adopted or potentially may adopt the "product line" or "continuity of enterprise" exceptions to the traditional rule of nonliability. Unlike the four exceptions to the nonliability rule mentioned above which can be sidestepped with little damage to a proposed transaction, the new exceptions are difficult to evade without disturbing the motivations for an asset purchase. A purchaser seeking to acquire assets that have value as an operational, productive whole must recognize that the more of a "product" or "enterprise" it seeks to acquire, the more likely it is to acquire the associated product liabilities from the seller. A piecemeal asset purchase is far less likely to result in the attachment of liability, but such a transaction in most cases will have substantially diluted benefits.⁶⁸

1979); *Hernandez v. Johnson Press Corp.*, 70 Ill. App. 3d 664, 388 N.E.2d 778 (1979); *Pierce v. Riverside Mortgage Co.*, 25 Cal. App. 2d 248, 77 P.2d 226 (1938).

66. UNIFORM FRAUDULENT CONVEYANCE ACT §§ 4, 7, 7A U.L.A. 474, 509 (1988).

67. *See, e.g., Kloberdanz v. Joy Mfg. Co.*, 288 F. Supp. 817, 821 (D.D.C. 1968) (finding sufficient consideration and no fraud); *Schwartz v. McGraw-Edison Co.*, 14 Cal. App. 3d 767, 781, 92 Cal. Rptr. 776, 784 (1971) (no evidence of fraud); *Reina v. Gingerale Corp.*, 472 So.2d 530 (Fla. Dist. Ct. App. 1985) (fraud allegation insufficient on facts). *But see Economy Ref. & Serv. Co. v. Royal Nat'l Bank*, 20 Cal. App. 3d 434, 439, 97 Cal. Rptr. 706, 710 (1971) (admission that predecessor corporation received no consideration for transfer of assets to successor is sufficient to demonstrate requisite intent to defraud).

68. *See Turner v. Bituminous Casualty Co.*, 397 Mich. 406, 429, 244 N.W.2d 873, 883 (1976).

Express agreements excluding products liability may be effective to funnel any liabilities back to the seller, but will be insufficient to defeat claims by a plaintiff espousing a product line or continuity of enterprise theory.⁶⁹ Similarly, a successor corporation demonstrating lack of identity of ownership will leave a court nonplussed. What is a purchaser to do?

The court introducing the “continuity of enterprise” exception provided the following advice to purchasers:

It is clear that once corporations considering such transactions become aware of the possibility of successor products liability, they can make suitable preparations. Whether this takes the form of products liability insurance, indemnification agreements or of escrow accounts, or even a deduction from the purchase price is a matter to be considered between the parties. Negotiation may be complex, but, with familiarity, they should become a normal part of business transactions.⁷⁰

Use of deductions from the purchase price and escrow accounts to reflect anticipated future liabilities presents numerous practical problems.⁷¹ Leaving aside the problems associated with prediction, valuation and appropriate discounting of future claims, no allowance can be made for unknown, delayed manifestation, or “long-tail” product claims. Again, indemnification agreements are of limited utility after the dissolution of the seller.

Courts often refer to the availability of products liability insurance as a ground for their decisions imposing strict tort and successor liability on manufacturers.⁷² This insurance presumably forms the basis of judicial faith in the superior risk-spreading capacity of the responsible defendants.⁷³ Although the purchase of proper insurance may provide a limited

69. Nevertheless, an exclusion of product liabilities and an indemnification provision should be included in all purchase agreements. Obviously, the value of an indemnity agreement diminishes rapidly upon the seller's extinction. *See id.* at 419, 244 N.W.2d at 879 (“Once the deal is made and the transferor corporation is extinguished, the transferee has nowhere to go for relief.”).

70. *Id.* at 428, 244 N.W.2d at 883.

71. *See supra* text accompanying notes 36-39.

72. *See, e.g.,* *Cyr v. B. Offen & Co.*, 501 F.2d 1145, 1154 (1st Cir. 1974); *Ray v. Alad*, 19 Cal. 3d 22, 33, 560 P.2d 3, 10, 136 Cal Rptr. 574, 581 (1977). *See also* *Escola v. Coca Cola Bottling Co.*, 25 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944) (Traynor, J., concurring).

73. *See* *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361, 369 (3d Cir. 1974) (noting importance of insurance in performing loss spreading function), *cert denied*, 421 U.S. 965 (1975). *But see* *Tift v. Forage King Indus., Inc.*, 108 Wis. 2d 72, 94, 322 N.W.2d 14, 26 (1982) (Callow, J., dissenting) (insurance covering injuries caused by predecessor's product difficult to obtain and expensive); Note, *supra* note 25, at 1310 (many manufacturers unable to obtain liability insurance).

resource for future claimants,⁷⁴ courts have not undertaken to expound an analysis of the responsibilities for and consequences of purchasing or not purchasing adequate insurance.

V. NEED FOR STATUTORY REFORM

Regardless of the efficacy of any of the prescriptive measures identified above for warding off successor liability, the fact remains that the application of these measures has associated costs. For example, it is not always economically efficient for purchasing corporations to change the management, personnel, and business operations of companies they acquire. Such actions strategically avoid any continuity of enterprise between purchasers and sellers, but thereby eliminate the benefits that a successor corporation might gain from the structure and stability of a predecessor's business operations. With the advent of expanded successor liability, at least one observer has recommended that purchasers acquire corporate assets on a piecemeal basis in order to ensure the continued existence of the selling corporation.⁷⁵ This recommendation complicates the acquisition process by encouraging purchasers to shop in several places for the necessities of production, and by pressuring corporations to sell only a portion of their assets when it may not be in their best interest to do so.⁷⁶

Use of preventative measures also cannot impose order upon a system that is hallmarked by uncertainty. Regardless of the number of measures that a corporation may take to avoid successor liability, those measures do not make it any easier for the corporation to predict where and when it may be held liable for the torts of a predecessor. Different rules of successor liability are applied in different jurisdictions, creating an uncertainty and fear among corporations that, in turn, discourages corporate acquisitions, and causes the economy to suffer.

In light of the problems and inefficiencies created by the judicial expansion of successor liability and the resulting measures taken by persons to prevent such liability, a legislative solution is needed that will add predictability to the law of successor liability and protect purchasing corporations from unearned liabilities, while also advancing the compensa-

74. Among the issues affecting the adequacy or utility of insurance coverage are the nature of the insuring agreement ("occurrence" basis or "claims made" basis), the description of the named insured, the policy duration and the premium.

75. See Note, *Products Liability*, *supra* note 2, at 1008-09, 1017-018.

76. See *id.* at 1009.

tion needs of product liability claimants. Several statutory solutions have already been proposed that seek to protect the interests of postdissolution products liability claimants, while advancing the goals of corporate and products liability law.⁷⁷

The authors of this Article propose the enactment of a statute which would provide purchasing corporations with a predictable means of escaping successor liability. Under this statute, a purchaser may obtain immunity from successor liability merely by arranging to have future product liabilities allocated to the seller. That is, in advance of an acquisition, the seller must formally agree to assume responsibility for future claims arising from products that it manufactured prior to the acquisition, and it must make adequate financial provisions for those claims. If the seller refuses to purchase liability insurance or establish some other mechanism by which to pay for future products liability claims, then the purchaser may become subject to successor liability if it would otherwise have been exposed under the circumstances.

Such a statute might read as follows:

TRANSFER OF ASSETS AND SUCCESSOR LIABILITY

A. *Definitions*

- (1) "Product" means any object, substance, mixture, raw material, or mineral that:
 - (a) has intrinsic economic value;
 - (b) is capable of delivery itself or as a component part or ingredient; and
 - (c) is produced for distribution in trade or commerce.
- (2) "Manufacturing" means engaging in business to produce, make, create, construct, assemble, or fabricate any product or component part of a product. The term also includes the remanufacturing of any existing product or component part of an existing product.
- (3) "Future Products Liability Claim" means any claim for damages arising out of the manufacture, sale, or lease of a product by a corporation that is based at least in part on events occurring after the effective date of the asset transfer.

B. A corporation that acquires the assets of another corporation shall

77. See, e.g., Green, *supra* note 7 (proposing a statutory solution that would restrict a corporation's right to dissolve and distribute its assets to shareholders until the corporation has made adequate provision for future liabilities); Note, *Post-Dissolution*, *supra* note 25 (advocating lengthening the five-year "survival of remedy" period currently provided for in § 14.07 of the Revised Model Business Corporation Act which makes dissolved corporations amenable to suit for up to five years after publication of dissolution notice).

not be held liable for products liability claims relating to products manufactured or sold by the selling corporation prior to the acquisition, if the selling corporation has assumed responsibility for and made adequate provision for future products liability claims.

- (1) Provision for future products liability claims may be made by:
 - (a) obtaining liability insurance for future products liability claims;⁷⁸ or
 - (b) arranging for any other method that provides adequate protection for those asserting future products liability claims including, but not limited to, establishing an escrow account or trust fund for future claims.
- (2) Provision for future products liability claims shall be adequate if the amount of insurance coverage or other assets available to satisfy future products liability claims is not less than the selling corporation's net current value.⁷⁹

C. At the time of an acquisition of corporate assets, included among the records formally filed with the [Secretary of State/Officer of Corporations] shall be a document stating:

- (1) the name and address of any entity that, by insurance or otherwise, has agreed to assume any future products liability claims; and
- (2) a description of the manner in which the assuming entity has made adequate provision for future products liability claims.

Enactment of this proposed statute would encourage asset purchasers and sellers to allocate liabilities prior to the completion of an acquisition. The statute would thus serve to add stability and certainty to the acquisition process and would promote the transferability of assets. In addition, the statute would induce purchasing corporations seeking immunity

78. Once the selling corporation has dissolved, it is not clear how a products liability claimant could gain access to this insurance. State dissolution statutes might be amended to permit suit against corporations that have dissolved, enabling future claimants to recover insurance of this type. Alternatively, the purchasing corporation might obtain an assignment of the seller's rights under the insurance policy or be named an additional insured. See Note, *Purchase of Assets and Successor Liability: A Necessarily Arbitrary Limit*, 11 DEL. J. CORP. L. 791, 816 (1986).

79. Alternatively, the statute could require that the amount of insurance coverage or other assets made available be sufficient to cover reasonably expected future liabilities. Under this alternative, the selling corporation would have to purchase insurance with a policy limit based on the amount of future liability reasonably anticipated at the time of the transaction. An objective assessment could be assured by requiring independent appraisal by a qualified actuary.

Under either alternative, claimants still bear the risk that future liabilities will exceed the amount of money reserved or insurance purchased to satisfy future liability claims. One commentator has suggested that a public sector insurance institution could help redistribute consumer losses in excess of policy limits or reserves. See Note, *supra* note 31, at 1071-72.

from successor liability to find sellers willing to assume responsibility for future products liabilities. When liabilities are allocated to sellers under the statute, both purchasers and future claimants are better protected in that purchasers avoid successor liability for product claims which they had no part in creating, and claimants are ensured some form of compensation for their injuries. In this way, the statute also protects the rights of putative creditors of the selling corporation.⁸⁰

VI. CONCLUSION

The rapid emergence of products liability has created a class of products liability claimants seeking redress from successor corporations. Courts have responded differently to these claimants. Some have expanded the scope of the successor liability doctrine in order to provide an avenue of compensation for these claimants, while others have refused to budge from the traditional rule that successors generally are not responsible for the debts and liabilities of predecessor corporations. The ad hoc decisions of courts have been neither consistent nor satisfactory.

For potential purchasers, the current state of the law is very disturbing. Under expanded rules of successor liability, purchasing corporations may be held liable for injuries they did not cause. In addition, due to the division among the courts on this issue, there is no way for a purchaser to foresee when it should account for successor liability in assessing an appropriate purchase price. In light of this situation, it is particularly important for purchasers to take preventative measures to avoid successor liability when taking part in an acquisition.

Enactment of a statute such as that proposed in this Article would help to remove uncertainty from the corporate acquisition process, en-

80. Product liability claimants are long-tail creditors of the selling corporation who, because their claims often accrue after the seller's demise, have not been afforded the same protection that traditional corporate law has provided other creditors. See Green, *supra* note 7, at 20.

The idea of looking to a third-party purchaser or acquirer of assets to help protect the rights of creditors is not a novel one. Article 6 of the Uniform Commercial Code, for example, protects commercial creditors by requiring that prior to any bulk transfer of a merchant's inventory the purchaser of the inventory must give notice of the transfer to the merchant's creditors. U.C.C. §§ 6-101 to 6-111, 2A U.L.A. 281-331 (1988). This requirement of advance notice is meant to prevent a merchant who owes debts to his creditors from selling his stock in trade, pocketing the money, and disappearing. U.C.C. § 6-101 comments 2, 4, 2A U.L.A. 281-82 (1988). If a purchaser does not comply with these bulk transfer requirements, then the transfer of the inventory is deemed to be "ineffective" and creditors of the merchant have the right to either levy, attach or garnish the goods in the purchaser's possession. U.C.C. § 6-104 comment 2, 2A U.L.A. 304 (1988).

hance the alienability of assets, and, at the same time, preserve a viable remedy for injured product liability claimants.