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OF EQUITY, CONTINUATION AND THE DE FACTO MERGER DOCTRINE: REFLECTIONS ON MISSISSIPPI LAW AND SUCCESSOR LIABILITY

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Much has been written regarding the proper theories of successor liability.[1] Courts and scholars have searched the vagaries of the de facto merger doctrine, the mere continuation theory, and the many ways a successor might assume the liabilities of another corporate entity. Even after all this searching, little certainty exists about whether a corporation that purchases another company's business can or may prevent an unplanned assumption of the liabilities as well. The failure to address this problem in a uniform way creates uncertainty in the purchase and sale of any business and therefore increases the transaction costs associated with those arrangements.[2]

Courts use several different theories to deal with the questions surrounding the disposition of liabilities when the assets of a business are transferred from one owner to another, either by sale or by dissolution. The primary lines of analysis arise from the exceptions to the general rule that the purchaser of a business is not liable for the debts of its predecessor. Among the exceptions to the general rule of non-liability are the de facto merger doctrine and the mere continuation of the business test. These exceptions, while useful, create a great deal of confusion and often lead to an increase in the expenses associated with the purchase, sale, or dissolution of a business. The responses to this confusion are varied. Several noted scholars, including the reporters for the American Law Institute's Restatement (Third) of Torts, call for a legislative solution to alleviate the confusion arising in this area.[3] However, a uniform statutory approach has not materi-

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1. Albert Bates, Jr. *et al*, *Asset Purchases, Successor Liability and Insurance Coverage: Does the Tail Always Follow the Dog?*, 100 W. VA. L. REV. 631 (1998); Jeanette M. Bowers, *A Parent Corporation's Potential Liability for Acts of its Dissolved Missouri Subsidiary Corporation*, 53 J. MO. B. 145 (1997); Steven P. Caley & Theresa I. Yard, *Avoid Buying Trouble: Successor Liability For Products Manufactured Prior To Asset Acquisition*, 67-FEB N.Y. ST. B.J. 30 (1995); Richard L. Cupp Jr., *Redesigning Successor Liability*, 99 U. ILL. L. REV. 845 (1999); Michael D. Green, *Fairness and Successor Liability: The Limits of the Common Law Process*, 8 KAN. J. L. & PUB. POL'Y 119 (1998); Frank Fazio, *Product Line Successor Liability: Back Through the Looking-Glass?*, 191-JUN N.J. LAW. 24 (1998); Michael D. Green, *Successor Liability: The Superiority of Statutory Reform to Protect Products Liability Claimants*, 72 CORNELL L. REV. 17 (1986); G. William Joyner, III, *Beyond* Budd Tire: *Examining Corporate Successor Liability in North Carolina*, 30 WAKE FOREST L. REV. 889 (1995); Dorit F. Kressel, *Successor Liability In Products Liability Litigation: Modern Judicial Response To Traditional Corporate Rules*, 4 PROD. LIAB. L.J. 211 (1993); Gary A. Magnarini, *Successor Products Liability: Redefining The "De facto Merger" Exception*, 62-MAR WIS. LAW. 18 (1989); Frank William McIntyre, *De facto Merger in Texas: Reports of its Death Have Been Greatly Exaggerated*, 2 TEX. WESLEYAN L. REV. 593 (1996); Michael H. Reed, *Successor Liability and Bankruptcy Sales*, 51 BUS. LAW. 653 (1996); Anthony D. Shaffer, *Successor Liability For the Predecessor's Defective Product: Should Predecessors Have Their Cake and Eat It Too?*, 23 CAP. U. L. REV. 1003 (1994); H. Lawrence Tafe, *The De Facto Merger Doctrine Comes to Massachusetts Wherein the Exception to the Rule Becomes the Rule*, 42 DEC B. B.J. 12 (1998); J. Maxwell Tucker, *The Clash of Successor Liability Principles, Reorganization Law, and the Just Demand That Relief Be Afforded Unknown and Unknowable Claimants*, 12 BANKR. DEV. J. 1 (1995); Frederick Tung, *Taking Future Claims Seriously: Future Claims and Successor Liability in Bankruptcy*, 49 CASE W. RES. L. REV. 435 (1999).

2. Professor Michael Green, in his recent symposium comments, suggested that an expanded successor liability rule would have serious unintended consequences including increased costs due to the unwillingness of corporations to purchase other businesses. Green, *Fairness and Successor Liability*, *supra* note 1.

3. RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY §12 reporters' Note cmt. b (1998); Green, *Successor Liability*, *supra* note 1; Mark R. Sarlitto, Note, *Recognizing Products Liability Claims at Dissolution: The Compatibility of Corporate and Tort Law Principles*, 87 COLUM. L. REV. 1048 (1987).

alized, and courts around the country grapple with these theories and reach varied conclusions.[4]

The development of the law governing when a successor corporation is liable for the debts of the predecessor is significant because of its ability to demonstrate the tension between the need to protect innocent creditors (both in tort and contract), and the need of corporate managers and owners for certainty when businesses are purchased, sold, or dissolved. Under traditional corporate law rules, a corporation is not liable for the debts of its predecessor unless: (1) the predecessor expressly or impliedly agreed to assume the liabilities; (2) there was a de facto merger of the two firms; (3) the successor was a "mere continuation" of the seller, or; (4) the transaction was fraudulent.[5] This strict rule began eroding during the late 1970s and early 1980s.[6] Cases from several jurisdictions began to loosen the traditional exceptions and provide recovery for plaintiffs in different circumstances.[7] This article will argue that some very old cases from Mississippi contain the key to an appropriate resolution of these issues.

THE MERE CONTINUATION EXCEPTION

The mere continuation exception was initially rather strictly construed. A corporation could not be considered a "mere continuation" of its predecessor unless only one corporation remained after the transfer of assets and the two corporations shared the same officers, directors and shareholders.[8] The two primary theories that arose to expand the mere continuation theory were the product line exception and the continuity of enterprise theory. The product line and continuity of enterprise theories were adopted by a number of courts in the 1980s and the 1990s.[9] These theories give courts and juries more discretion in allowing liabilities to follow assets. Cases decided by the Court of Appeals for the Fifth Circuit dealing with the mere continuation exception illustrate the variety of facts and theories applied in this context.[10] While the federal courts are simply apply-

4. Professor Richard L. Cupp, Jr., took great care counting the states that considered the question of successor liability when applying the "mere continuation" exception in a recent article. In this article, Professor Cupp counts eighteen states that follow the traditional approach to successor liability, and fourteen states that follow a less restrictive approach. Cupp, *supra* note 1, at 853-855. Fewer courts adopt the de facto merger doctrine originally applied to tort creditors in *Knapp v. North American Rockwell Corp.*, 506 F.2d 361, 367 (3d Cir. 1974).

5. Russell v. SunAmerica Sec., Inc., 962 F.2d 1169, 1175 (5th Cir. 1992); Mozingo v. Correct Mfg. Corp., 752 F.2d 168, 174 (5th Cir. 1985); RESTATEMENT (THIRD) OF TORTS § 12 (1998).

6. Cyr v. B. Offen & Co., 501 F.2d 1145, 1153 (1st Cir. 1974); Ray v. Alad Corp., 560 P.2d 3, 10 (Cal. 1977); Turner v. Bituminous Cas. Co., 244 N.W.2d 873, 881-82 (Mich. 1976).

7. *Cyr*, 501 F.2d at 1153; *Ray*, 560 P.2d at 10; *Turner*, 244 N.W.2d at 881-82.

8. Weaver v. Nash Int'l, 730 F.2d 547 (8th Cir. 1984); Travis v. Harris Corp., 565 F.2d 443 (7th Cir. 1977) (citing Lopata v. Bemis Co., 383 F. Supp. 342, 345 (E.D. Pa. 1974)).

9. Ray v. Alad, 560 P.2d 3, 10; Ramirez v. Armstead Indus., Inc., 431 A.2d 811, 818-19 (N.J. 1981); Garcia v. Coe Mfg. Co., 933 P.2d 243, 248-50 (N.M. 1997); Dawejko v. Jorgensen Steel Co., 434 A.2d 106, 110 (Pa. Super. Ct. 1981); Martin v. Abbott Lab., 689 P.2d 368, 388 (Wash. 1984); Asher v. KCS Int'l, 659 So. 2d 598, 600 (Ala. 1995); Turner v. Bituminous Cas. Co., 244 N.W.2d 873, 881-82 (Mich. 1976); Mozingo v. Correct Mfg. Corp., 752 F.2d 168, 174 (5th Cir. 1985); Cyr v. B. Offen & Co., 501 F.2d 1145, 1153-54 (1st Cir. 1974); Flaugher v. Cone Automatic Mach. Co., 507 N.E.2d 331, 334 (Ohio 1987); Holloway v. John E. Smith's Sons Co., 432 F. Supp. 454, 455 (D.S.C. 1977).

10. *Russell*, 962 F.2d at 1175; *Mozingo*, 752 F.2d at 174.

ing state law, their interpretation has great weight because so few state cases exist within the jurisdiction of the Fifth Circuit.[11]

The problem is well illustrated in the case *Mozingo v. Correct Manufacturing Corp.*[12] This case involved an alleged defect in a "Skyworker" brand "cherry-picker" manufactured by the predecessor of Correct Manufacturing Corporation.[13] Mr. Mozingo was injured while testing the device.[14] The Skyworker was manufactured by a company named Transairco sometime between 1969 and 1972.[15] In 1972, Transairco spun off most of its manufacturing assets including those which manufactured the Skyworker.[16] The plaintiff, Mr. Mozingo was injured in 1977.[17] Mr. Mozingo filed suit against Correct Manufacturing Corporation for damages caused when the boom on the device failed.[18] He admitted that Correct Manufacturing Corporation did not manufacture the defective product.[19] Mr. Mozingo alleged, however, that Correct Manufacturing Corporation was liable as the successor to Transairco.[20]

The District Judge permitted the question of successor liability to go to the jury, and the jury found for Mr. Mozingo.[21] The Fifth Circuit stated the general rule that a corporation was not liable for the debts of its predecessor unless one of the four exceptions was present.[22] The four exceptions are as follows: "(1) when the successor expressly or impliedly agrees to assume the liabilities of the predecessor; (2) when the transaction may be considered a de facto merger; (3) when the successor is a 'mere continuation' of the predecessor; or (4) the transaction was fraudulent."[23]

The court, noting that only the "mere continuation" exception could apply in this case, examined the three interpretations of the mere continuation exception.[24] The court recognized that the traditional rule provides that a corporation will not be considered a mere continuation of its predecessor, unless only one corporation remains after the transfer of assets and the two corporations share the same officers, directors and shareholders.[25] The court then noted that two groups of cases

11. Texas apparently follows the traditional rule, but only two appellate court cases discuss the rule. Both appellate cases note that Texas has abrogated implied successor liability by statute. McKee v. American Transfer & Storage, 946 F.Supp. 485, 487 (N.D. Tex. 1996); Mudget v. Paxson Mach. Co. 709 S.W.2d 755, 758 (Tex. Ct. App. 1986). Louisiana has no state cases dealing expressly with the issue. In one case, the Louisiana Court of Appeals discussed the issue, but held the traditional rule inapplicable in *Bourque v. Lehmann Lathe, Inc.*, because the case involved an involuntary sale of assets in bankruptcy. 476 So. 2d 1125,1128 (La. Ct. App. 1985). Mississippi has only a few cases that deal with successor liability. They are discussed in the text at notes 66-123 in section III.

12. *Mozingo*, 752 F.2d at 168.

13. *Id.* at 171.

14. *Id.*

15. *Id.* at 173.

16. *Id.*

17. *Id.* at 171.

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.* at 174.

23. *Id.*

24. *Id.* at 174-75.

25. *Id.* The court cited *Weaver v. Nash International*, 730 F.2d 547,548 (8th Cir. 1984) and *Travis v. Harris Corp.*, 565 F.2d 443, 447 (7th Cir. 1977) as examples of the traditional rule.

departed from the general rule.[26] These two groups of cases adopt either the "product line theory"[27] or the "continuity of enterprise theory."[28]

The *Mozingo* court characterized the product line theory as a "completely new exception to the rule of non-liability."[29] The court cited *Ray v. Alad Corp.*,[30] which held that a successor corporation which continues to manufacture the same product under the same name as the predecessor may be held liable for products liability claims based upon products manufactured by the predecessor.[31] The court said that the product line theory is based on two primary premises.[32] First, the successor corporation, like the predecessor corporation, is in a better position to spread the risk of loss than the injured plaintiff.[33] Second, fairness demands that one who takes the benefits of established goodwill related to a product should also bear that product's burdens.[34] The court noted that other jurisdictions had adopted this theory, but raised *Erie*[35] doctrine concerns about adopting a relatively new theory without authority from the state court.[36]

The court next turned to a discussion of the continuity of enterprise theory.[37] The court cited *Cyr v. B. Offen & Co.*[38] and *Turner v. Bituminous Casualty Co.*[39] for holdings adopting the theory.[40] The court said that the continuity of enter-

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26. *Mozingo*, 752 F.2d at 175.

27. *Id.* Professor Cupp states that the following six states currently follow the product line theory: (1) California, *Ray v. Alad*, 560 P.2d 3, 10 (Ca. 1977); (2) New Jersey, *Ramirez v. Amsted Industries, Inc.*, 431 A.2d 811, 817 (N.J. 1981); (3) New Mexico, *Garcia v. Coe Manufacturing Co.*, 933 P.2d 243, 248-50 (N.M. 1997); (4) Pennsylvania, *Dawejko v. Jorgensen Steel Co.*, 434 A.2d 106, 110 (Pa. Super. Ct. 1981); and (5) Washington, *Martin v. Abbott Laboratories*, 689 P.2d 368, 388 (Wash. 1984). Cupp, *supra* note 1, at 854 n. 45. Professor Cupp notes that the Connecticut Supreme Court has not spoken on the issue, but that three lower courts have applied the product line exception. *See*, Sullivan v. A.W. Flint Co., No. CV 920339263, 1996 WL 469716, at *7-*8 (Conn. Super. Ct. Aug. 5, 1996); Kennedy v. Oshkosh Truck Corp., No. CV92 0510394S, 1995 WL 27400, at *2, *4 (Conn. Super. Ct. Jan. 18, 1995); Copperthite v. Pytlik, No. 59053, 1992 WL 209660, at *4 (Conn. Super. Ct. Aug. 25, 1992). Also, Professor Cupp notes that New York holds the successor liable if it is selling the same product line sold by the predecessor or if it falls within the continuity of enterprise approach. Cupp, *supra* note 1, at 854 n. 46. *See, e.g.*, McCaffrey v. Weaver Jack Corp., No. CV 89- 3910, 1992 WL 266923, at *2 (E.D.N.Y. Sept. 29, 1992) (continuity of enterprise); Rothstein v. Tennessee Gas Pipeline Co., 664 N.Y.S.2d 213, 220-21 (N.Y. Sup. Ct. 1997) (product line exception); Salvati v. Blaw-Knox Food & Chem. Equip., Inc., 497 N.Y.S.2d 242, 247 (N.Y. Sup. Ct. 1985) (continuity of enterprise).

28. *Mozingo*, 752 F.2d at 175. Professor Cupp also states that there are six states which follow the continuity of enterprise approach. Cupp, *supra* note 1, at 854 n.44. The six states are (1) Alabama, Asher v. KCS International, 659 So. 2d 598, 600 (Ala. 1995); (2) Michigan, Turner v. Bituminous Casualty Co., 244 N.W.2d 873, 881-82 (Mich. 1976); (3) Mississippi, *Mozingo*, 752 F.2d at 174-76; (4) New Hampshire, Cyr v. B. Offen & Co., 501 F.2d 1145, 1152-54 (1st Cir. 1974); Ohio, Flaugher v. Cone Automatic Machine Co., 507 N.E.2d 331, 334 (Ohio 1987); and (6) South Carolina, Holloway v. John E. Smith's Sons Co., 432 F. Supp. 454, 455 (D.S.C. 1977). Professor Cupp also notes that New York holds the successor liable if it is selling the same product line sold by the predecessor, or if it falls within the continuity of enterprise approach. *See, e.g.*, *McCaffrey*, 1992 WL 266923, at *2 (continuity of enterprise); *Rothstein*, 664 N.Y.S.2d at 220-21 (product line exception); *Salvati*, 497 N.Y.S.2d at 247 (continuity of enterprise).

29. *Mozingo*, 752 F.2d at 175.

30. Ray v. Alad Corp., 560 P.2d 3 (Cal. 1977).

31. *Mozingo*, 753 F.2d at 175.

32. *Id.*

33. *Id.*

34. *Id.*

35. Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938).

36. *Mozingo*, 752 F.2d at 175.

37. *Id.*

38. Cyr v. B. Offen & Co., 501 F.2d 1145, 1153-54 (1st Cir. 1974).

39. Turner v. Bituminous Cas. Co., 244 N.W.2d 873, 881-82 (Mich. 1976).

40. *Mozingo*, 752 F.2d at 175.

prise theory is simply an expansion of the mere continuation exception to the general rule of non-liability.[41] Under this theory, the strict requirements of the traditional theory are broadened and the court will take into account the following additional factors:

> retention of the same employees; retention of the same supervisory personnel; retention of the same production facilities in the same physical location; production of the same product; retention of the same name; continuity of assets; continuity of general business operations; and whether the successor holds itself out as the continuation of the previous enterprise.[42]

The court indicated that these cases were close to the traditional exception and that the district court's instruction regarding continuity of enterprise was not erroneous.[43] Therefore, the court adopted the continuity of enterprise test for Mississippi cases in the Fifth Circuit.[44] *Mozingo* is rather typical of the successor liability cases and provided a basic discussion of the issues raised by such cases.

Another prominent case from the Fifth Circuit is *Russell v. SunAmerica Securities, Inc.*[45] The *Russell* case involves the use of successor liability theories to determine whether an action against a successor corporation was barred by a settlement agreement entered into between the plaintiff and the predecessor.[46] In *Russell*, the plaintiffs alleged that their injuries were caused by Southmark Financial Services, Inc.[47] In 1988, the plaintiffs brought suit under federal and state securities laws, the Racketeer Influenced and Corrupt Organizations Act ("RICO"), and for common law fraud and breach of contract.[48] In 1989, SunAmerica agreed to purchase the assets of Southmark but did not agree to assume its liabilities.[49] At some point, the plaintiffs entered into a settlement agreement with Southmark and executed a release that discharged Southmark from "any and all past, present or future claims."[50] On April 30, 1990, based on the previous agreement between Southmark and the plaintiffs, Southmark was dismissed as a defendant with prejudice.[51] The plaintiffs brought suit against SunAmerica as a successor to Southmark on July 10, 1990.[52] The court used the doctrine of successor liability to determine whether the identities of the two corporations were so closely linked that the dismissal of Southmark with prejudice

41. *Id.*
42. *Id.* (citing *Cyr*, 501 F.2d at 1153-54; Bonee v. L & M Constr. Chem., 518 F.Supp. 375, 381 (M.D. Tenn. 1981); Trimper v. Bruno-Sherman Corp., 436 F. Supp. 349, 350-51 (E.D. Mich. 1977); Holloway v. John E. Smith's Sons, 432 F. Supp. 454, 455-56 (D.S.C. 1977); Rivers v. Stihl, Inc., 434 So. 2d 766, 771-72 (Ala. 1983); *Turner*, 244 N.W.2d at 879).
43. *Mozingo*, 752 F.2d at 175-76.
44. *Id.* at 176.
45. Russell v. SunAmerica Sec., Inc., 962 F.2d 1169 (5th Cir. 1992).
46. *Id.* at 1174-75.
47. *Id.* at 1171.
48. *Id.*
49. *Id.*
50. *Id.*
51. *Id.* at 1171.
52. *Id.*

barred the action against SunAmerica.[53] Applying the continuity of enterprise theory, the court held that the relationship between Southmark and SunAmerica was sufficient to bar an action against SunAmerica on the basis of *res judicata*.[54]

Two other cases from the Fifth Circuit bear mention in this area. The first is *Rhynes v. Branick Manufacturing Corp.*,[55] in which the court, applying Texas law, declined to adopt the product line theory of liability in the absence of any indication that Texas would do so.[56] In 1979, the Texas legislature enacted a statutory provision that some courts have interpreted to permit a purchaser the right to buy only the assets of the seller.[57] This Texas rule was an issue in *United States v. Vernon Home Health Care Agency, Inc.*[58] The court held that the Texas rule did not apply to a case involving the liability of a purchasing corporation for Medicare overpayments to the predecessor.[59] The court stated that "federal law governs cases involving the rights of the United States arising under a nationwide federal program."[60] In that case, the United States had provided for successor liability by regulation.[61] Even in the face of the Texas statute, the court applied the federal rule.[62]

THE DE FACTO MERGER EXCEPTION

While the Fifth Circuit has not grappled with the de facto merger exception, other jurisdictions have done so. The de facto merger doctrine originated in the context of shareholder rights[63] and was imported into the successor liability context by *Knapp v. North American Rockwell Corp.*[64] In *Knapp*, the plaintiff was injured by a machine manufactured and sold by Textile Machine Works.[65] After the sale of the machine, but before the injury, Textile Machine Works sold all of its assets to North American Rockwell Corp. in exchange for North American Rockwell stock.[66] The Third Circuit, acknowledging that Pennsylvania courts had not addressed the issue in this context, determined that Pennsylvania would apply the de facto merger doctrine to the case as a way to appropriately allocate the risk between the injured plaintiff and the successor corporation.[67] The de facto merger doctrine has spread to other jurisdictions and has acquired the following list of factors that courts should consider when applying the doctrine:

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53. *Id.* at 1176-77. The court specifically declined to rule on whether SunAmerica would have any liability to the plaintiffs under any successor liability doctrine.
54. *Id.* at 1177.
55. Rhynes v. Branik Mfg. Corp., 629 F.2d 409 (5th Cir. 1980).
56. *Id.* at 410.
57. TEX BUS. CORP. ACT ANN. art. 5.10(B) (West 1980).
58. United States v. Vernon Home Health Care Agency, 21 F.3d 693 (5th Cir. 1994).
59. *Id.* at 695.
60. *Id.*
61. *Id.*
62. *Id.*
63. *See* Rath v. Rath Packing Co., 136 N.W.2d 410 (Iowa 1965); Ferris v. Glen Alden Corp., 143 A.2d 25 (Pa. 1958). *But see*, Hariton v. Arco Elec., 188 A.2d 123 (Del. 1963) (Delaware rejects the de facto merger doctrine in corporate reorganizations affecting shareholder rights).
64. Knapp v. North American Rockwell Corp., 506 F.2d 361 (3d Cir. 1974).
65. *Id.* at 362.
66. *Id.* at 363.
67. *Id.* at 369.

> whether (1) there is a continuation of the enterprise of the seller corporation so that there is continuity of management, personnel, physical location, assets, and general business operations; whether (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; whether (3) the seller corporation ceases its ordinary business operations, liquidates, and dissolves as soon as legally and practically possible; and whether (4) the purchasing corporation assumes those obligations of the seller ordinarily necessary for the uninterrupted continuation of normal business operations of the seller corporation.[68]

These factors are helpful in determining whether a corporation has engaged in a de facto merger with another. The question is whether the jurisdiction recognizes the concept at all.

While the de facto merger issue is almost always included in the list of exceptions to the general rule of non-liability, the fate of the de facto merger doctrine is clouded in Mississippi and the Fifth Circuit for several reasons. One of the reasons that the doctrine is somewhat ambiguous in Mississippi is that Mississippi has adopted the Revised Model Business Corporation Act ("RMBCA").[69] This act provides several methods for combining businesses.[70] In the comments to the RMBCA, the reporter stated that the drafters intended that each of the methods used to accomplish corporate combination or sale should have independent legal significance.[71] In other words, each method provided by the act would be independent of the other. The fact that a sale of assets for stock followed by dissolution would have the same effect as a merger should not require compliance with the merger provisions. These comments were not attached to the provisions passed by the Mississippi Legislature, and it is unclear what inference a Mississippi court would draw from the comments. Further, even if a court were to consult the comments to the RMBCA, it is unclear whether the de facto merger doctrine would apply to questions of liability to creditors rather than shareholders. Neither the Mississippi Supreme Court nor the Fifth Circuit has addressed the issue.

The fate of de facto merger doctrine is also clouded in Texas where the legislature enacted a provision that was apparently intended to abrogate the de facto

68. Cargill, Inc. v. Beaver Coal & Oil Co., 676 N.E.2d 815, 818 (Mass. 1997) (citing In re Acushnet River, 712 F. Supp. 1010, 1015 (D. Mass. 1989)).
69. MISS. CODE ANN. § 79-4-1.01 (1999).
70. MISS. CODE ANN. §§ 79-4-11.01, -12.01 (1999).
71. MODEL BUS. CORP. ACT ANN. § 11.01 cmt. 2 (1993) (Supp. 1997).

merger doctrine for corporations incorporated under Texas law.[72] The Fifth Circuit is bound in *Erie*[73] cases by Texas' interpretation of its statute. As discussed above, it is not so bound where the federal question is presented, but in other cases the issue is still unsettled. This article will not attempt to examine Texas law, but will only note the concern. Certainly, the de facto merger doctrine is a valid, albeit undeveloped, legal theory in Mississippi.

THE MISSISSIPPI CASES

While Mississippi is not well known for its large body of corporate law, some of its most interesting equitable and legal language occurs in some very old cases involving corporate reorganizations. Usually these reorganizations had the effect of terminating the rights of creditors while preserving the assets in another corporation. Using law, equity and common sense, these thoughtful cases demonstrate the proper analysis for cases involving claims against corporations dissolved to avoid foreseeable debts.

On December 2, 1901, the Mississippi Supreme Court encountered its first questions regarding the liability of a successor corporation for the debts of its predecessor.[74] In *Morrison v. American Snuff Co.*[75] and *Vicksburg & Yazoo City Telephone Co. v. Citizens' Telephone Co.*,[76] the court found successor corporations liable for the debts of their predecessors.[77] *Morrison* involved the legislative consolidation of several corporations.[78] The court held that when corporations consolidate, the new corporation becomes liable for the debts of the old corporation—at least to the extent of the property of the old corporation held by the new.[79] While this case is not directly on point, the rationale regarding equity and fairness in the reorganization of corporations has some bearing on an appropriate approach to corporate reorganization.

In *Citizens'*, the court was faced with a situation in which one corporation purchased the assets of another and continued its business.[80] The purchasing corpo-

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72. The Texas legislature, apparently in response to *Western Resources Life Insurance Co. v. Gerhardt*, 553 S.W.2d 783 (Tex. Civ. App. 1977), a case imposing liability on a successor, adopted the following provision in its corporate law:

> A disposition of any, all, or substantially all, of the property and assets of a corporation, whether or not it requires the special authorization of the shareholders of the corporation, effected under Section A of this article or under Article 5.09 of this Act or otherwise (1) is not considered to be a merger or conversion pursuant to this Act or otherwise; and (2) except as otherwise expressly provided by another statute, does not make the acquiring corporation, foreign corporation, or other entity responsible or liable for any liability or obligation of the selling corporation that the acquiring corporation, foreign corporation, or other entity did not expressly assume.

TEX BUS. CORP. ACT, art. 5.10(B) (1999). *See also*, McIntyre, *supra* note 1 (arguing that the Texas legislature should repeal or amend this provision).

73. Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938).

74. Morrison v. American Snuff Co., 30 So. 723 (Miss. 1901); Vicksburg & Yazoo City Tel. Co. v. Citizens' Tel. Co., 30 So. 725 (Miss. 1901).

75. *Morrison*, 30 So. at 723.

76. *Citizens'*, 30 So. at 725.

77. *Morrison*, 30 So. at 725; *Citizens'*, 30 So. at 728.

78. *Morrison*, 30 So. at 723.

79. At the time of this case, consolidation was by legislative authority and not by statute. No mention of the debts of the corporation was made in the enactment. Today, the statute provides that the surviving corporation in a merger is liable for all the debts of the merging corporations. MISS. CODE ANN., § 79-4-11.06.

80. *Citizens'*, 30 So. at 726.

ration failed to honor a contract between the selling corporation and the plaintiff.[81] More specifically, Standard Telephone Construction Company ("Standard"), the predecessor of the Vicksburg & Yazoo City Telephone Company ("Vicksburg & Yazoo") entered into a contract with the Citizens' Telephone Company ("Citizens'") in 1897.[82] The purpose of the contract was to allow and encourage Standard to build long distance telephone lines throughout Mississippi and Louisiana and to connect those long distance lines to the local phone service in Vicksburg.[83] The contract provided that Standard could place its lines on any poles owned by Citizens', and that Citizens' would furnish a place on its telephone exchange for Standard's long distance service.[84] The contract also provided that Standard would not be required to pay any charge for the use of the poles or the exchange.[85] The contract was to last for ten years and was binding on successors.[86]

Standard built its long distance service in Vicksburg and placed its long distance equipment in Citizens' exchange in accordance with the contract.[87] The parties honored the contract for some time, and then Standard was acquired by Vicksburg & Yazoo.[88] Vicksburg & Yazoo honored the agreement as a successor and assignee of Standard, and the parties continued the arrangement in accordance with the contract.[89] At some time thereafter, Citizens' sold all of its assets and business to Cumberland Telephone & Telegraph Company ("Cumberland") who took over all of Citizens' telephone business.[90] Cumberland refused to honor the contract between Standard (now Vicksburg & Yazoo) and Citizens'.[91] Vicksburg & Yazoo brought this action to enforce the contract.[92] The court held that while the transaction at issue was not technically a merger or a consolidation, the effect was the same, and Vicksburg & Yazoo was entitled to damages for breach of contract against Cumberland.[93]

In 1911, the court considered a case involving an out-of-state corporation that had dissolved and reorganized without paying a debt to a creditor.[94] In *Mahaffey*

81. *Id.* at 725.
82. *Id.* at 726.
83. *Id.*
84. *Id.*
85. *Id.*
86. *Id.*
87. *Id.*
88. *Id.*
89. *Id.*
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.* at 728. The court stated:

> This bill, whilst charging no consolidation or merger when properly understood, nevertheless does charge that the dealing between these two corporations has resulted practically, to all intents and purposes, in exactly the same conditions, so far as creditors of the Citizens' Telephone Company and its property are concerned, as would have resulted had there been consolidation. We think the same principle which applies in favor of the simple contract creditor against a consolidated corporation, enabling him to subject, in the hands of that consolidated company, property of a constituent corporation received by the consolidated company (such constituent corporation being debtor of the simple contract creditor), will apply in cases like this.

94. Mahaffey Co. v. Russell & Butler, 54 So. 807 (Miss. 1911).

Co. v. Russell & Butler,[95] the court stated, "One corporation cannot, to the prejudice of its creditors, give away its assets to another corporation; nor can one corporation defeat the creditors of another by the purchase of its assets, even for value, unless such purchase is bona fide."[96] This case involved the Mahaffey Co., a Wisconsin corporation, which was dissolved in 1907.[97] Later that same year, a new corporation of the same name was formed in Illinois by the shareholder of the earlier dissolved corporation.[98] The new corporation engaged in the same business as the former corporation.[99] The court held that the purchasing corporation is liable for the debts of the selling corporation to the extent of the value of the assets received by it.[100] The legacy of this case serves us today as we attempt to balance the rights of creditors and the rights of business owners who wish to reorganize or discontinue their businesses without government interference.

In *Meridian Light & Railway Co. v. Catar*,[101] the court protected the rights of an injured passenger upon the reorganization of a streetcar company. In *Meridian Light*, the court eloquently stated, "[N]either law nor equity will permit one corporation to take all the property of another, deprive it of the means of paying its debts, enable it to dissolve its corporate existence, and place itself practically beyond the reach of creditors, without assuming its liabilities."[102]

In December of 1900, the Meridian Street Railway & Power Company owned an unprofitable street railway doing business in Meridian, Mississippi.[103] The plaintiff was injured at some time prior to December 1, 1900.[104] In December of 1900, the officers, directors, stockholders and bondholders—who were the same people—contracted to sell the assets and stock of the corporation to Stoutz, Ambrecht & McAlpine.[105] Although no transfer of the property was made, Stoutz, Ambrecht & McAlpine took possession of the business and proceeded to operate the street railway.[106] The new corporation, Meridian Light & Railway Company, was formed in February of 1901.[107] In March of 1901, Meridian Street Railway & Power Company conveyed its property to a trustee who conveyed it to the new corporation.[108] While the details of the ownership of the new corporation are not completely clear, the court indicated that the new corporation was owned and controlled by substantially the same persons who had controlled the old corporation.[109] The court noted that one of the largest shareholders of the old

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95. *Id.* at 807.
96. *Id.* at 808.
97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.* The court rejected the lower court's jury instruction that the new corporation will be liable for all the debts of the old. This court made it clear that under the theory of this case, the new corporation was liable for the debts of the old only to the extent the new corporation acquired assets of the old. *Id.*
101. Meridian Light & Ry. Co. v. Catar, 60 So. 657 (Miss. 1912).
102. *Id.* at 658 (citations omitted).
103. *Id.* at 657.
104. *Id.* at 658.
105. *Id.* at 657.
106. *Id.*
107. *Id.*
108. *Id.*
109. *Id.* at 658.

corporation, a Mr. Kamper, became the owner of ninety-five percent of the stock of the new corporation.[110]

The plaintiff in *Meridian Light* alleged that she was injured due to the negligence of the old corporation.[111] She instituted suit against the old and the new corporations, taking judgment against the old corporation and dismissing her suit against the new corporation without prejudice.[112] She then brought suit in equity to collect the judgment from the assets of the old corporation in the hands of the new corporation.[113] The plaintiff advanced three theories upon which the new corporation would be responsible for the debts of the old:[114]

> (a) That the transaction by which the assets of the old company were transferred to the new company was a merger; (b) that the new company took the property in trust for the payment of the debts of the old company; (c) that the pretended sale of the assets of the old company was a fraudulent scheme to hinder and delay creditors of the old company in the collection of their debts.[115]

The defendant's position was that Stoutz, Ambrecht & McAlpine purchased the property in good faith for fair value and without notice of the plaintiff's claim.[116]

The court looked past the form of the transactions to the substance of the process.[117] It found that the ultimate goal of the transactions in the case was to promote and organize a new company.[118] The new company was to be a reincarnation of the old company, clothed with the powers and franchises of the old company; the only change in identity being the name.[119] The court here reasoned that the transaction in this case was tantamount to a consolidation.[120] The court stated:

> The agreement and the whole scheme was to obtain the property of the old corporation by paying the stockholders the purchase price—not to be paid by the stockholders to the corporation, but to be kept by the stockholders as their own. While it may be conceded that the company is but another name for the stockholders, it is nevertheless patent in the present case that the stockholders were taken care of as individuals, and the corporation and its creditors were frankly ignored.[121]

The court held that the new corporation was liable for the debts of the old.[122] This court saw that the equities involved favored allowing the plaintiff to recover against the new corporation to the extent that it held assets belonging to the old

110. *Id.*
111. *Id.*
112. *Id.*
113. *Id.*
114. *Id.*
115. *Id.*
116. *Id.*
117. *Id.*
118. *Id.*
119. *Id.* at 659.
120. *Id.*
121. *Id.*
122. *Id.*

corporation.[123] Here, the court looked to the substance of the transaction and found that it would be inequitable to deny the plaintiff recovery against the assets of the old corporation in the hands of the new corporation.[124]

In 1931, the Mississippi Supreme Court considered another case involving successor liability.[125] In *Mississippi Cottonseed Products, Co. v. Planters Manufacturing Co.*,[126] the court considered the reorganization of several corporations into one and held that the assets of the old corporation that had moved into the hands of the new one were held in trust for the creditors of the old.[127] In *Cottonseed Products*, the plaintiff, Planter's Manufacturing Company, held a deed of trust on property, including crops, owned by the grantor.[128] The grantor of the deed of trust sold cotton and cotton seed to the Hollandale Cotton Oil Mill.[129] The proceeds of the sale were paid to the grantor rather than to the plaintiff.[130] Plaintiff filed suit against the Hollandale Cotton Oil Mill to recover the value of the cotton and seed purchased by the Hollandale Cotton Oil Mill.[131] After this suit was filed, but before trial and judgment, the owners of the Hollandale Cotton Oil Mill and the Mississippi Cottonseed Products Company decided to reorganize the corporations so that the businesses would all be a part of one entity instead of several.[132]

In furtherance of this plan, the Hollandale Cotton Oil Mill transferred all of its assets to Mississippi Cottonseed Products Company on July 31, 1927.[133] The contract recited that the transactions were intended to change "the form of the operation and not its substance."[134] Later that year, the Hollandale Cotton Oil Mill was dissolved by action of its shareholders.[135] The plaintiff received judgment against the Hollandale Cotton Oil Mill and sought to enforce it against the assets then held by Mississippi Cottonseed Products Company.[136] Mississippi Cottonseed Products Company asserted that it was a purchaser in good faith for value and without notice and should not be responsible for the debts of Hollandale Cotton Oil Mill.[137] The court noted that the two corporations had common directors and that Mississippi Cottonseed Products Company knew of the litigation when it entered into the transaction.[138] Consequently, the court affirmed the chancellor's ruling that the assets of the Hollandale Cotton Oil Mill in the hands of Mississippi Cottonseed Products Company were subject to the

123. *Id.*
124. *Id.*
125. Mississippi Cottonseed Products, Co. v. Planters Mfg. Co., 132 So. 96 (Miss. 1931).
126. *Id.* at 96.
127. *Id.* at 100.
128. *Id.* at 97-98.
129. *Id.*
130. *Id.* at 98.
131. *Id.*
132. *Id.*
133. *Id.*
134. *Id.*
135. *Id.*
136. *Id.*
137. *Id.* at 99.
138. *Id.*

judgment of the plaintiff.[139] The court explained that the actions here, which were designed to unite several corporations under common control, did not constitute a bona fide purchase for value without notice.[140] The court held that the assets of the old corporation were held in trust for creditors by Mississippi Cottonseed Products Company.[141]

These venerable cases indicate a common sense approach to the problem of successor liability.[142] The corporation, as an entity, had just come into its own in American law, and the Mississippi court was adapting its law to a developing medium. In each of these very old cases, the judgment of the court is based upon notions of equity and good sense. The court looked to the substance of the transaction and not to its form. While issues of substance over form are inherently subjective, the court's reasoning incorporated several elements that could be used to determine when liabilities should pass from the predecessor to the successor.[143] These elements include (1) the transfer of the essential assets of a business from one owner to another; (2) the same or a group of the same owners participating in both entities; (3) the continuation of the same type of business; and (4) the equitable nature of the claim.[144]

Interestingly, these factors are very similar to developed factors that apply to the de facto merger exception and those described by courts which apply the continuity of enterprise definition of the mere continuation exception. Like the courts that adopt the continuity of enterprise theory, the Mississippi court, in these cases, adopted a flexible approach to the problem. This is a wise and sensible concept. While the justices who decided these cases might be surprised by the types of actions brought today, they would probably continue to look for ways to balance the rights of the injured creditor and the entrepreneurial business owner.

Mississippi is a state with a legal history steeped in the concept of equity. The privilege of corporate existence is one that should be available to encourage economic development and prosperity in the state. At the same time, the law should not permit this privilege to be abused at the expense of injured consumers and creditors who, in good faith and with or without knowledge, interact with the corporation.

In a recent case, Delaware's Chancellor Allen noted that "if the corporation law does not treat these possible contingencies [of compensation to persons

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139. *Id.*
140. *Id.* at 99-100.
141. *Id.* at 100.
142. Other, more modern Mississippi cases exist and do not contradict the above discussed cases; they simply reaffirm the analysis and logic. Morris v. Macione, 546 So. 2d 969 (Miss. 1989) (holding the new corporation formed by shareholders of old corporation to avoid contract was liable for contract to the same extent as the old); West Ctr. Apartments Ltd. v. Keyes, 371 So. 2d 854 (Miss. 1979) (holding that a limited partnership which purchased all the assets of an apartment complex liable for the debts of the corporation); Hood Ind. Inc. v. King, 255 So. 2d 912 (Miss. 1971) (holding a successor corporation liable for the entire contract of the predecessor where successor assumed part of the contract).
143. Morrison v. American Snuff Co., 30 So. 723 (Miss. 1901); Vicksburg & Yazoo City Tel. Co. v. Citizens' Tel. Co., 30 So. 725, 726 (Miss. 1901); Mahaffey Co. v. Russell & Butler, 54 So. 807, 808 (Miss. 1911); Meridian Light & Ry. Co. v. Catar, 60 So. 657, 658-59 (Miss. 1912); *Cottonseed Prod.*, 132 So. at 99.
144. *See Morrison*, 30 So. at 723; *Citizens'*, 30 So. at 726; *Mahaffey*, 54 So. at 808; *Meridian Light*, 60 So. at 658-59; *Cottonseed Prod.*, 132 So. at 99.

injured by defective products or by undiscovered and actionable environmental injury] responsibly, it can be expected that other legal doctrines, such as successor liability doctrines, will be stretched and shaped to address them."[145] This statement demonstrates the understanding that equity is a critical concept that should not be abandoned by the courts in attempting to articulate fixed rules to address constantly changing problems. The Mississippi court's analysis of this issue is still valid today.[146] The Mississippi court very eloquently stated the rule when it said, "[N]either law nor equity will permit one corporation to take all the property of another, deprive it of the means of paying its debts, enable it to dissolve its corporate existence, and place itself practically beyond the reach of creditors, without assuming its liabilities."[147]

145. *In re* RegO, Co. 623 A.2d 92, 96 (Del. Ch. 1992).
146. *Meridian Light*, 60 So. at 658.
147. *Id.*