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Products Liability of Successor Corporations: A Corporate and Commercial Law Perspective

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INTRODUCTION

Traditionally, when one corporation purchased substantially all the operating assets, including goodwill, from another, the successor was not liable for the damages resulting from defective products manufactured by its predecessor. Exceptions to this doctrine were limited to situations where (1) the successor explicitly or implicitly agreed to assume the liabilities of the predecessor corporation, (2) the transaction constituted a merger between the predecessor and successor corporations, (3) a substantial continuity of ownership and/or management interests existed between the predecessor and successor.
successor corporations, or (4) the predecessor corporation's liquidation constituted a fraud on its creditors.

In several notable decisions, however, Ray v. Alad Corp., a California case, and Ramirez v. Amsted Industries, Inc., and Nieves v. Bruno Sherman Corp., New Jersey cases, courts have held that successor corporations can be sued for product liability claims arising out of the manufacture and sale of defective products by predecessor corporations, despite the absence of circumstances which would make one or more of the exceptions to the general rule applicable. Quite the contrary, the purchase and sale agreements in Ray, Ramirez and Nieves, evinced the parties' intent to exclude an


Of the various categories of exceptions to the traditional general rule that a successor corporation is not liable for the torts of its predecessor, the continuation exception has been subject to the most expansion in recent years. For example, although continuity of ownership between the predecessors and successors was lacking, the Supreme Court of Michigan, in Turner v. Bituminous Casualty Co., 397 Mich. 406, 244 N.W.2d 873 (1976), and the First Circuit Court of Appeals in Cyr v. B. Offen & Co., 501 F.2d 1145 (1st Cir. 1974), used the continuation of enterprise exception to hold that successors could be sued for tort claims arising from defective products manufactured by their predecessors.

The courts in Ray v. Alad Corp., 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977), Ramirez v. Amsted Indus., Inc., 86 N.J. 332, 431 A.2d 811 (1981), and Nieves v. Bruno Sherman Corp., 86 N.J. 361, 431 A.2d 826 (1981), might have decided those cases on continuation grounds, but that analysis—particularly, as applied to the Ramirez and Nieves fact patterns, where the successor corporations had not acquired the assets and goodwill directly from the manufacturing corporations, see supra note 1—would have been tenuous.


assumption of liabilities beyond those specifically enumerated.\textsuperscript{11} Even more significantly, none of the successor corporations manufactured the model of product alleged to have been defective, although they were engaged in manufacturing the same line of products bearing the predecessor's trade name or mark.\textsuperscript{12} Rather than treating the issue of successor liability as a matter of corporate or commercial law, the New Jersey and California courts focused upon tort law and justified the potential liability of successor corporations primarily on the basis of the desirability of spreading the risk of accidents among all product users and other considerations that led to the expansion of strict liability in tort.\textsuperscript{13}

The legal commentary that usually accompanies decisions that depart from long established precedent has already appeared. The commentators generally argue that these recent cases conflict with corporate and commercial law doctrine,\textsuperscript{14} but that, despite such inconsistency, the decisions are defensible, indeed desirable, on the basis of the products liability grounds enunciated by the courts.\textsuperscript{15} In this article, I take issue with both lines of reasoning. I first argue that the ratiocination tendered by the courts, particularly the desirability of spreading the cost of accidents, is insufficient, without fur-
ther elaboration, to hold the successor corporations liable on a principled basis. The plaintiffs' equities in the cases seem problematic, but the primary analytic flaw has been the courts' failure to establish a satisfactory nexus between the plaintiffs' claims and the defendants' responsibility for the harm. I then argue that such responsibility can be established on the basis of the defendant's participation in foreseeably increasing the recourse risk of tort victims. In this regard, corporate and commercial law can provide useful analogies and perspectives to establish the successor's legal responsibility.

ANALYSIS OF RECENT SUCCESSOR LIABILITY CASES

The plaintiffs in these recent cases may have trouble convincing some people of their own equities. Ray, Ramirez and Nieves were injured while using products manufactured and sold by predecessor corporations many years prior to their injuries. In Ramirez, the power press was manufactured at least twenty-six years prior to the plaintiff's injury; the power press that injured Nieves' arm was manufactured some thirty-five years before the injury. Nevertheless, the tort law perspective adopted by the California and New Jersey courts does not suffer primarily in the findings that the plaintiffs were deserving parties entitled to recover from someone. Unless one rejects recovery on the basis of strict liability in tort (the merits of which this article does not take a position on, one way or another) and initiation of the statutory limitations period only upon injury, these plaintiffs are as equally deserving as other plaintiffs in products liability cases where the seller-manufacturer has remained in business.

The primary analytic flaw in the decisions has been the courts' failure to articulate valid bases for finding that the particular defen-

16. See infra text accompanying notes 18-19.
17. For a definition of recourse risk, see infra text accompanying notes 26-27.
19. Nieves v. Bruno Sherman Corp., 86 N.J. at 365, 431 A.2d at 828. Injury from a product, long after the manufacture of the product, does not necessarily mean that the manufacturer produced a defective product. Rather, the product may merely have exceeded its normal useful life. With the exception of certain machinery and real property, few assets have depreciable periods that exceed thirty years. See generally Rev. Proc. 77-10, § 3, 1977-1 C.B. 548, 549-68 (1977). It should be possible to dismiss summarily some of these product liability cases where the injury occurs many years after sale, whether or not the original manufacturer exists at the time of suit. Arguably, a point of sale statute of limitation makes more sense than one that commences on the date of injury, but I leave discussion about the relative merits of the two approaches to my torts brethren.
20. See supra note 19.
SUCCESSOR CORPORATE LIABILITY

dants should be susceptible to suit. The problem of nexus inheres in all of substantive law, whether categorized as torts, corporations, commercial law or otherwise.\textsuperscript{2} For much of our legal history, this problem has been referred to as the duty question: Did the particular defendant owe the plaintiff a duty?\textsuperscript{22} Whatever the phraseology, this issue has always been considered distinct from whether the plaintiff has been harmed,\textsuperscript{28} and should continue to be so in the successor liability area.

In the New Jersey and California Supreme Courts' opinions, the courts emphasize, on one hand, the desirability of spreading the cost of accidents among all users or purchasers and, on the other, the acquisition and present enjoyment of the predecessor’s goodwill by the successor corporation.\textsuperscript{24} In addition, the California Supreme Court premised its holding on the liquidation of the predecessor corporation, and, hence, its nonavailability for suit.\textsuperscript{25}

In order to understand why these considerations require further elaboration before they can serve as the bases for holding the successor susceptible to suit, two product-related risks that the purchaser or user faces can be distinguished. The first is the risk of defective quality, the risk to which commercial doctrines of warranty\textsuperscript{26} and tort doctrines of negligence and strict liability\textsuperscript{27} respond. The second risk is that if the product proves to be defective, such that a cause of action arises against its manufacturer, the manufacturer may not be available to compensate the injured party. I refer to the first risk as the “quality risk” and the second as the “recourse risk.” The issue of successor liability concerns the recourse risk.

The cost-spreading rationale of Ramirez relates to both the


\textsuperscript{22.} See Palgraf v. Long Island R.R., 248 N.Y. 339, 342, 162 N.E. 99, 99 (1928) (“before negligence can be predicated of a given act, back of the act must be sought and found a duty to the individual complaining” (citations omitted)).


\textsuperscript{24.} See 19 Cal. 3d at 32, 560 P.2d at 8-9, 136 Cal. Rptr. at 579-80; 86 N.J. at 369-72, 431 A.2d at 830-32; 86 N.J. at 350-53, 431 A.2d at 820-22.

\textsuperscript{25.} See 19 Cal. 3d at 32, 560 P.2d at 8-9, 136 Cal. Rptr. at 579-80.

\textsuperscript{26.} See U.C.C. § 2-313 to -318 (1978).

quality and recourse risks, but hardly requires successor liability. Theoretically, the desirability of spreading the costs of accidents could lead to such alternative conclusions as the plaintiff being able to sue any manufacturer in the same line of business, the largest existing manufacturer at the time of injury or suit, or the government as a residual cost spreader for society.28

Lack of an original manufacturer to sue relates specifically to the recourse risk, but, again, without further elaboration, tells us nothing about the successor's responsibility for the risk. The non-availability of the manufacturer, by itself, could lead to a remediless plaintiff or the liability of almost anyone.

Of the considerations relied upon by the California and New Jersey courts, the defendant's enjoyment of the predecessor's goodwill comes the closest to providing the necessary nexus: It relates to the recourse risk and provides cause for the successor to bear that risk. But the courts' discussion of goodwill does not adequately address this point. Implicit in the courts' opinions is that the defendant benefits from the goodwill of the product manufactured by the defendant's predecessor.29 Accordingly, the impression we are left with is that the value of that goodwill would be enhanced undeservedly if the defendant was not held liable. This reasoning hardly withstands scrutiny.

Whether or not the successor corporation is held liable, the value of the goodwill it has purchased automatically decreases once an accident occurs through use of a product bearing the same trade name as the successor's products.30 The day before an accident, potential customers of the successor would have been evaluating products bearing the trade name as having a safety record which exceeds the valuation that they are willing to give after the accident. While information of this nature is not immediately dispersed into the marketplace, information dissemination with respect to product quality is probably much more efficient than one would first think.31 Cer-

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28. See generally Y. Aharoni, The No-Risk Society 76-98 (1981) (discussing role that federal government has already assumed as insurer against nearly everything from old age to natural disasters, loan defaults and bank failures).


31. As evidence of this, note the widespread popularity of Consumer Reports and Consumers' Research and the heavy emphasis on product evaluation in such trade and hobby journals as Stereo Review, Video Review, Cycle, and Popular Photography.
tainly, if suit is brought with wide press coverage, experience reveals that the value of the product name can drop substantially. Thus, the defendants, like the plaintiffs in these cases, are injured when the products prove to be defective. These suits, then, produce the spectre of one injured party suing another; both seem to have been injured by the same party, the seller-predecessor corporation. The goodwill perspective seemingly adopted by the courts hardly buttresses their decisions because permitting the plaintiffs to recover against the defendants may result in double injury to the latter.

In favor of the courts' reliance upon a successor's purchase of its predecessor's goodwill, it may be argued that the value which the successor paid the predecessor for goodwill reflected not only the probability of favorable sales from use of the trade name, but also the probability of loss of sales because the successor's products would be associated with products previously manufactured by the predecessor that would prove to be defective. If the probable benefit exceeded the risk of loss of goodwill from the predecessor's defective products, the goodwill still had a positive value to the successor. Even if this assumption is made, however, we can conclude only that, although the goodwill was worth less after the injury than before, it was not worth less after the accident than the defendant-successor bargained for. We cannot conclude that the goodwill was worth more than the defendant bargained for, which seems to be the leap of faith some courts would have us make.

CORPORATE AND COMMERCIAL LAW OBSTACLES TO SUCCESSOR LIABILITY

Is it correct that the courts' holdings in these recent products liability cases conflict with corporate and commercial law principles? One would think so, given the failure of the courts to recognize corporate doctrine as a point of departure.

This failure, as well as the related weakness of their arguments to support the defendant successors' responsibility for the plaintiffs' injuries, limits the acceptability of these holdings to courts that may confront the same issue in the future. Two conflicts would seem par-

32. For example, Ford Pinto's share of the subcompact market dropped sharply from the usual 11% or 12% to only 6.7% following widely publicized suits in 1978 involving potentially dangerous fuel tanks. The model has since been discontinued. Gray, Putting the Pinto Out to Pasture after a Decade, ADVERTISING AGE, Apr. 7, 1980, at 64.

33. The certainty of a defective product, by definition, results in a greater loss of goodwill than a probability of defect less than 100%.
amount: inconsistency between the courts’ holdings and the doctrine of corporate entity, and the courts’ disregard of the intent of the immediate parties—the predecessor and successor corporations—as the prime criterion for decisionmaking. Upon analysis, however, these conflicts turn out to be mere straw men.

The Doctrine of Corporate Entity

Aside from the concept of fiduciary obligations, no subject matter pervades corporate law more than the doctrine of corporate entity. It is the doctrinal underpinning of holdings that a corporation can assent to wrongs committed against it, that corporate attorneys represent the corporation distinct from its shareholders, and, most recently, that states may not tax corporations within their borders on account of their subsidiaries’ income. The Internal Revenue Code’s taxation of both corporate earnings and dividends received by shareholders reflects the same concept: A corporation is an entity distinct from its shareholders. But most importantly, the doctrine of corporate entity ordinarily precludes suits against shareholders on account of debts owed or wrongs committed by their corporations. Thus, as it is commonly stated, shareholders enjoy limited liability.

If the corporate veil cannot be pierced to allow a tort victim of

35. See supra note 11 and accompanying text.
36. See, e.g., Old Dominion Copper Mining & Smelting Co. v. Lewisohn, 210 U.S. 206, 215-16 (1908).
38. One consequence of the concept that the lawyer represents the corporation as distinct from its shareholders is that, in a shareholders’ derivative suit, the work product of the corporate attorneys or confidences between them and the corporate officers and directors are sometimes held not subject to shareholder discovery. See Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970), cert. denied, 401 U.S. 974 (1971).
41. Id. § 61(a)(7) (1976).
42. See, e.g., MODEL BUSINESS CORP. ACT § 25 (1982).
corporate conduct to sue its shareholders, how can liability be imposed on a successor corporation? Shareholders at least derived some benefit, indirectly if not directly, from the sale of the defective product. Moreover, they have some ability to control the actions of the corporate managers, through their ability to choose the board of directors. The latter, in turn, elect the officers, the corporation’s primary agents. The chain of control, which involves a multitude of steps, may be more theoretical than real. Nevertheless, it may be contended that the shareholders maintain ultimate control as well as receive benefits. In contrast, a successor corporation does not derive any benefit from the fact that its predecessor has manufactured a defective product, and certainly plays no role in controlling those employees who manufactured defective products. It would appear, therefore, that a successor corporation deserves more protection from liability than a shareholder.

Yet, it is crucial not to accept as reality the metaphysics of the entity doctrine and, on the basis of that “reality,” conclude that corporate entity theory stands as a bar to the liability of successor corporations. The doctrine of corporate entity is nothing more, nor less, than a legal fiction. This fiction may lead to sound results under most circumstances. But that is beside the point. Of importance is that the doctrine is a legal construct designed to serve certain interests. Only by analyzing, in a particular setting, whether the value of the interests served by treating the corporation as a legal entity exceeds the value of interests adversely affected by upholding the legal construct can we discover whether the doctrine has been soundly utilized. Phrased differently, courts generally utilize the corporate entity doctrine when the resulting benefits exceed the costs.

It is regrettable that courts do not disclose more openly that they simply are balancing interests when they use the corporate entity doctrine. If they did, more forthright debate might ensue about

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44. See id. § 36.
45. Id. § 50.
47. Doctrinal simplicity is itself a weighty interest that has to be considered. Thus, the textual remark is not intended to convey the impression that the determination will be simply based upon ad hoc considerations.
48. One interesting case where the court found the costs to exceed the benefits is Bangor Punta Operations, Inc. v. Bangor & Aroostook R.R., 417 U.S. 703 (1974). In the Bangor Punta case, the cost of recognizing the distinction between the corporation and its shareholders was, assertedly, a windfall to the corporation’s shareholders. See id. at 711-15.
which interests are preeminent in a particular setting, how much weight should be accorded to each interest, and how these interests are served or disserved by upholding or disregarding the fictional separation of a corporation from its shareholders.

Limited liability, for example, is defended on the ground that it attracts necessary capital. In a society with considerable specialization, the same parties who can supply capital do not necessarily have the expertise or time to manage the enterprise. Parties who do not control how their funds are utilized are not apt to transfer such funds if the risk in doing so extends well beyond their investment.

The interest against which attraction of capital must be balanced in situations where creditors seek to pierce the corporate veil and hold stockholders liable is “fairness” to such creditors. If a corporation’s assets are insufficient to compensate creditors for their claims, it would seem fair to allow them, in some situations, to pursue stockholders who stood to benefit most from the corporate venture. This fairness argument is not compelling, however, in the case of contract creditors. Most, if not all, contract creditors have the opportunity to assess the recourse risk and to adjust their credit terms accordingly. Financial institutional creditors, such as banks, are in the very business of assessing and profiting from risk; they even assert their superior expertise at doing so. Trade creditors, if not themselves able to adjudge the recourse risk, generally subscribe to credit rating firms that assess the risk equally as well as institutional creditors. Viewed in this light, contract creditors can be perceived as investors in the enterprise who prefer a different combination of risk and return than stockholder investors. Thus, fairness to contract creditors generally presents only a false conflict with the

51. See Posner, supra note 49, at 501-05 (discussing interplay between credit terms and risk).
52. Id. at 505.
53. Trade creditors include, most notably, merchants who do not insist on transacting business on a cash basis. Id.
54. Dun and Bradstreet, for example, is one such firm. Among other things, they assess risk for others. See DUN’S MARKETING SERVICES, MILLION DOLLAR DIRECTORY at iv-v (1982).
55. It generally makes little more sense to allow contract creditors to sue stockholders when a business fails, than it would to allow stockholders to sue contract creditors. In either case, an investor class is seeking, post-factum, to shift to another the risk it knowingly assumed.
goal of attracting capital. Accordingly, the latter goal dominates, and corporate entity theory is applied to bar stockholder liability.

In contrast, fairness to the tort claimant does present a real conflict. Tort claimants rarely have the opportunity to assess recourse risk. Moreover, even if they had the opportunity to assess the recourse risk prior to the tort, in practice they generally do not have the experience to do so. Despite the reality of the conflict of interests, however, stockholders are generally immune from personal liability if corporate assets are insufficient to compensate the tort victim. The law simply considers attraction of capital an interest greater than the resulting unfairness to the tort claimant.

Limited liability does not mean an absence of liability, however. The stockholders' equity, at least, must be at risk. Otherwise, stockholders would hardly have internalized the risk of their investment decision. Absence of all liability would result in free speculation, not investment, on the part of stockholders. Creditors would then find themselves in the ironic and unexpected position of having assumed both a higher level of risk and a lower rate of return when transacting with the corporation. In this context, any presumed conflict between attraction of capital and fairness to the creditors is also a false one; only the latter consideration is at stake.

Such a false conflict occurs when, having manufactured and put products into the mainstream of commerce by means of the corporation, stockholders sell its assets and liquidate without providing for tort claims that can be expected to arise in the ordinary course of events. Based on past experience, a manufacturer knows that some number of claims of uncertain amount will arise in the future. While the identity of the claimants is unknown and perhaps unknowable, the fact that there will be claimants is ascertainable. Given the existence of a body of jurisprudence that would potentially make the

56. See infra text accompanying notes 102-04.
57. See Model Business Corp. Act § 25.
59. This forms the basis of a manufacturer's regularly procuring insurance on account of such potential claims.

A useful analogy to planning for future product claims is found in the accounting treatment of product warranty liability. See U.C.C. § 2-313 to -316 (1978). Although amounts owed as a result of products liability claims are not reported until after a claim has been filed, product warranty liability is accrued by the seller as of the date of sale. W. Meigs, A. Mosich & C. Johnson, Intermediate Accounting 411-12 (4th ed. 1978). Liability incurred under product warranties can often be estimated quite accurately based on past experience. See Financial Accounting Standards—Original Pronouncements, Statement No. 5, Accounting for Contingencies § 3 (1978).
manufacturer liable for the product liability claims of parties injured by its products, liquidation, without provision for tort claims, amounts to a failure on the stockholders' part to internalize all the costs of doing business. They have absconded with the fruits without paying all costs associated with the planting and harvest.

In short, where the stockholders participate in increasing the recourse risk of third parties by failing to provide for tort claims arising after liquidation, corporate entity theory should not offer shareholders immunity from suit. Although this analysis in no way establishes the liability of successor corporations, it does demonstrate that such liability does not necessarily conflict with corporate entity theory on the notion that even stockholders could not be held liable.

**Intention of the Parties**

If conflict with the doctrine of corporate entity does not stand as a bar to successor liability, neither should the intent of the immediate parties. Successor liability in these products liability cases does contradict the intent of the parties; in each case the predecessor and successor corporations agreed that the successor would not assume liabilities other than those itemized on schedules appended to the purchase and sale agreement. It is also true that corporate and commercial law doctrines heavily rely upon the intent of the parties. In particular, adherence to intent explains one of the recognized exceptions to the earlier rule that successor corporations would not be held liable: the express or implicit assumption of liability by a successor corporation. Although the successor should be held liable where it has agreed to assume liabilities, however, it does not follow that it should escape liability where the announced intent is otherwise. Whole areas of the intersection of commercial and corporate law doctrines concern protection of creditors who are not parties to particular agreements; such protection often results in disregard of the parties' intentions. Courts even have been willing to hold stockholders liable to third party creditors who dealt with the corporate entity subsequent to agreement between the corporation and its

60. See supra note 11.
61. See supra note 3 and accompanying text.
shareholders as to the extent of their contribution.63

CORPORATE AND COMMERCIAL LAW DOCTRINE AS A SOURCE OF NEXUS

Corporate entity doctrine and transactional intent, as understood in corporate and commercial law, may not conflict with the possibility of successor liability, but demonstrating a lack of conflict is not equivalent to establishing a connection between injured user and successor corporation sufficient to hold the successor liable for its predecessor’s torts. The problem of nexus remains. At least three doctrines or perspectives common to corporate and commercial law can help to provide grounds for suit against successor corporations: fraudulent conveyance law, bulk sales law (related to fraudulent conveyance law), and risk allocation analysis.

Fraudulent Conveyances

A fraudulent conveyance occurs when property is sold under circumstances in which creditors of the seller are defrauded.64 The seller may continue to retain possession of the property65 (thereby misleading those creditors into thinking that the seller still owns the property), may abscond with the proceeds of the sale,66 or may sell the property for an inadequate amount to a relative or friend.67 The law of some jurisdictions, including those that have adopted the Uniform Fraudulent Conveyance Act,68 requires proof of actual intent to defraud creditors;69 other jurisdictions presume such an intent as a

63. See, e.g., Hospes v. Northwestern Mfg. & Car Co., 48 Minn. 174, 50 N.W. 1117 (1892) (where corporation issued bonus stock to shareholders, thereby inflating capital account, creditors who relied on this figure had action in fraud against shareholders, even though payment to corporation of such stock not required).

64. See generally G. Glenn, FRAUDULENT CONVEYANCES & PREFERENCES § 1 (2d ed. 1940).


Irrespective of such doctrinal variations, fraudulent conveyance law teaches that remedy may be had not only against the seller, but also against the purchaser. Remedy is granted because the purchaser can legitimately be considered a participant in an act—a conveyance—that operated to defraud the seller's creditors. Although the purchaser did not participate in increasing the quality or performance risks to the sellers' creditors which gave rise to their tort and/or contract claims, the purchaser of the assets has foreseeably increased the creditors' recourse risk.

Comparable nexus exists in the prototypical fact pattern of successor corporation liability cases. As we have seen, the sale of assets by the predecessor corporation, followed by payment of all known creditor claims and the distribution of the net sale proceeds to stockholders, amounts to a failure on the part of stockholders to internalize all of the risks of their enterprise. They have shifted some of the risks of their enterprise onto third party consumers and users who, according to tort law, were expected to bear neither the quality nor recourse risks.

There are several ways in which the predecessor corporation could provide for such claims, even though they are unknown. First, the corporation could set aside a fund sufficient to procure insurance for the foreseeable length of time that product liability claims might arise. The second alternative is to contract for someone, other than an insurance company, to assume the liabilities when they arise. The logical party to such a contract is the successor corporation. The predecessor corporation can easily compensate the successor corporation for assuming these expected liabilities by agreeing to a lower purchase price. Presumably, the difference between the two possible purchase prices would approximately equal the net present value of present and future insurance premiums that would protect the successor against claims arising from defects in the products.


71. See UNIFORM FRAUDULENT CONVEYANCE ACT § 9, 7A U.L.A. 304 (1978). Some cases have held that the purchaser is an indispensable party to an action brought by creditors. See, e.g., Assurance Co. of Am. v. Southeastern Brick Co., 222 Ga. 638, 151 S.E.2d 708 (1966); Murray v. Murray, 358 So.2d 723 (Miss. 1978).

72. See supra text accompanying notes 58-59.


74. See supra note 59 and accompanying text.
sold by its predecessor, on top of those premiums paid to insure the successor against claims on account of defects in the products it will manufacture itself.

Besides its possible status as a direct or indirect insurer, the successor corporation cannot be considered an innocent party to the failure of the predecessor's stockholders to have internalized their investment risk. The successor is an active participant in the plan by which the cost of internalizing future liabilities is avoided. Moreover, it is a knowing active participant because, most frequently, the very terms of the purchase and sale agreement provide for the predecessor to liquidate after the sale. Finally, it is probably the negotiating party who will insist on any clause in the purchase and sale agreement requiring liquidation, because the value of the assets it has purchased would likely be less if the predecessor were to continue to use the same trade name.

One should depart from present fraudulent conveyance law sufficiently to recognize that probability analysis should be applied to liabilities. If one takes account of potential liabilities, the participation of the successor does not materially differ from the participation of purchasers in fraudulent conveyance cases that hold against such purchasers in favor of the sellers' creditors.

It is important to recognize that present law, with the exception of recent case law such as Ray v. Alad Corp. and its progeny, has not been neutral with respect to whether the predecessor pro-

75. See Ramirez v. Amsted Indus., Inc., 86 N.J. at 354, 431 A.2d at 822.


The suggestion that such insurance is unavailable, however, seems untrue. When one corporation assumes the risk of products liability claims of another, the products liability insurer of the assuming corporation typically will increase the premiums to reflect the additional risk. Nonetheless, it is possible to obtain such coverage. From the standpoint of the insurer, the situation is not unlike a merger, where the surviving corporation assumes all of the liabilities of the dissolving corporation; the insurer is in a position to insure against injury claims arising out of the defective products manufactured by the dissolving corporation.

76. See, e.g., Ray v. Alad Corp., 19 Cal. 3d at 26, 560 P.2d at 6, 136 Cal. Rptr. at 577.

77. See supra text accompanying notes 3-6.

vides recourse for future tort claimants. Quite the contrary—present law creates an incentive against the assumption of liabilities. If the successor does not assume liabilities, the predecessor remains liable, but only as a matter of theory. The predecessor corporation will liquidate, after providing for known creditors.79 If, on the other hand, the successor agrees to assume all liabilities, the contingent as well as the known, the successor obviously must bargain to deduct from the purchase price the present value of future expected liabilities (or the present value of insuring against such liabilities); the predecessor would receive less for its business. The predecessor is, therefore, better off under present law if the successor declines to assume unknown liabilities.

On its part, the successor is certainly not inclined to insist that it assume unknown, as well as known, liabilities, even if it can bargain to reduce the purchase price. There is apt to be some uncertainty about the present value of expected future claims arising from the sale of past products. This uncertainty may be reduced, but it is by no means eliminated, by insuring against the risk. The cost of insurance is bound to increase at a rate that cannot be calculated with certainty. On balance, the successor probably would prefer not to gamble that the present value of future liabilities has been calculated too high rather than too low.

The aggregate wealth of both the predecessor and successor corporations and their respective stockholders, consequently, are enhanced by agreeing that the successor will not assume unknown liabilities. Thus, while it theoretically may be possible for them to agree for the successor to assume the predecessor's unknown liabilities, one would expect it to occur rarely. The reported cases confirm this supposition: There are few instances where successors have expressly assumed unknown liabilities.80

80. For one such case, see Gee v. Tenneco, 615 F.2d 857, 863 (9th Cir. 1980). In most cases, however, the successor expressly declines to assume any unknown liabilities, particularly for contingent product claims. See, e.g., Nieves v. Bruno Sherman Corp., 86 N.J. at 371-72, 431 A.2d at 832; Ramirez v. Amsted Indus., Inc., 86 N.J. at 338-39, 431 A.2d at 814.

Most practice aids and articles on successor liability either assume that the successor will want to avoid liability for defective products of the predecessor, or flatly advise against assuming such liability. See, e.g., B. Fox & E. Fox, Business Organizations, Corporate Acquisitions & Mergers § 29.03[1] (1981); 1 J. Herz & C. Baller, Business Acquisitions § 5.202d (2d ed. 1981); Note, Products Liability and Successor Corporations: Protecting the Product User and the Small Manufacturer Through Increased Availability of Products Liability Insurance, supra note 75, at 1006-07.
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Bulk Sales Law

Another transaction that substantially increases the creditor’s recourse risk is a bulk sale or transfer. Section 6-102 of the Uniform Commercial Code defines a bulk transfer as “any transfer in bulk and not in the ordinary course of the transferor’s business of a major part of the materials, supplies, merchandise or other inventory . . . of an enterprise.” Most sales between predecessor and successor corporations constitute bulk transfers within the meaning of Article 6, but that is not my point here. Nor is it my point that successor corporations may have violated the provisions of Article 6 and that, consequently, they can be held liable. Rather, Article 6, like its older relative and antecedent, fraudulent conveyance doctrine, presents an apt analogy with respect to the nexus question.

Under certain circumstances, Article 6 provides that bulk transfers are “ineffective” against the transferor’s creditors “holding claims based on transactions or events occurring before the bulk transfer.” One effect of this voidability doctrine is to give the transferor’s known creditors a remedy against the transferee. Assets are subject to the claims of the transferor’s creditors unless the transferee complies with the requirements of sections 6-104, 6-105 and 6-106. Section 6-104 requires “[t]he transferee [to require] . . . the transferee to furnish a list of his existing creditors . . . . [the transferor and transferee to] prepare a schedule of the property transferred sufficient to identify it; and . . . the transferee [to preserve]

82. Section 6-102(2) states that “[a] transfer of a substantial part of the equipment . . . of such an enterprise is a bulk transfer if it is made in connection with a bulk transfer of inventory, but not otherwise.” U.C.C. § 6-102(2). Most sales between predecessor and successor corporations, because they involve a sale of the whole business, will include a sale of inventory and, thus, be subject to Article 6.
83. The obligations of successor corporations under Article 6 relate to known creditors. See infra text accompanying notes 84-90.
84. U.C.C. §§ 6-104(1), -105.
85. U.C.C. § 6-109(1).
86. Section 6-109(1) also states that “creditors who become such after notice to creditors is given . . . are not entitled to notice.” U.C.C. 6-109(1) (emphasis added).

The same concern for fairness to the transferee seems to underlie § 6-109(2), which states:

Against the aggregate obligation imposed by the provisions of this Article concerning the application of the proceeds . . . the transferee or auctioneer is entitled to credit for sums paid to particular creditors of the transferor, not exceeding the sums believed in good faith at the time of the payment to be properly payable to such creditors.

U.C.C. § 6-109(2).
... the list and schedule for six months ... following the transfer.\textsuperscript{87} Section 6-105 requires the transferee to give notice to such creditors "at least ten days before he takes possession of the goods or pays for them."\textsuperscript{88} Nineteen jurisdictions have also adopted section 6-106,\textsuperscript{89} which provides an additional "duty [on the transferee's part] ... to assure that such consideration [paid for the business] is applied so far as necessary to pay those debts of the transferor."\textsuperscript{90}

It is easy to understand why a bulk transferee should be subject to the duties that Article 6 imposes. Unlike a sale or sales in the ordinary course of business,\textsuperscript{91} a bulk transfer leaves the transferor in a much greater state of liquidity than before.\textsuperscript{92} In fact, a bulk transfer frequently precedes a liquidation and dissolution of the transferor's business.\textsuperscript{93}

To be sure, Article 6's provisions provide an analogy supportive of successor corporations in the products liability cases. Fairness to the transferee in a bulk transfer, as well as fairness to the transferor's creditors, was an obvious concern of Article 6's drafters. Thus, Article 6 limits the obligations of the transferee to the transferor's known creditors.\textsuperscript{94} Nevertheless, if probability analysis is applied, and the possibility of insuring against risk based upon such analysis is considered, the relative cost to the transferee of providing recourse for the transferor's unknown creditors is foreseeable and, therefore, almost as calculable as the sum necessary to provide for the transferor's known creditors. Thus, the role of the successor corporation in increasing the recourse risk of future tort claimants does not substantially differ from its role in increasing the recourse risk of known creditors at the time of the transaction between the predecessor and successor corporations.

\begin{center}
\textit{Risk Allocation Analysis}
\end{center}

Risk allocation analysis is not distinct from fraudulent conveyance and bulk transfer law. Indeed, although fraudulent conveyance

\begin{footnotes}
\footnotetext{87. U.C.C. § 6-104(1)(a)-(c).}
\footnotetext{88. U.C.C. § 6-105.}
\footnotetext{89. For a list of those jurisdictions which have adopted § 6-106, see 2A U.L.A. 314.}
\footnotetext{90. U.C.C. § 6-106(1).}
\footnotetext{91. See U.C.C. § 1-201(9) (definition of "Buyer in ordinary course of business").}
\footnotetext{92. 19 W. Fletcher, Cyclopaedia of the Law of Private Corporations § 9315 (rev. perm. ed. 1978).}
\footnotetext{93. Id. §§ 9313, 9315.}
\footnotetext{94. See supra notes 83, 86.}
\end{footnotes}
SUCCESSOR CORPORATE LIABILITY

Doctrine predates conscious recognition and usage of risk analysis,\textsuperscript{95} such doctrine quite obviously allocates risk among several commercial parties. Nor is risk analysis distinctly corporate and commercial; other substantive bodies of law, torts for example, are recognized as involving an allocation of risks.\textsuperscript{96} But ever since American legal scholarship turned its attention to risk analysis early in the twentieth century,\textsuperscript{97} risk allocation has been common especially to corporate\textsuperscript{98} and commercial law\textsuperscript{99} scholarship.

To the extent that tort law allows an injured party a right of recovery for a product defect, it is the predecessor corporation, and indirectly its shareholders, who should bear that risk. In other words, because the applicable torts rule makes the predecessor corporation liable,\textsuperscript{100} by definition it should bear the recourse risk. Even if the predecessor successfully contracted to shift the risk elsewhere, such as to an insurer, the predecessor corporation has been forced to internalize the risk through the payment of the insurance premiums. The predecessor corporation may no longer exist, however, and its stockholders may be scattered. Even if not scattered, its former stockholders may have distributed the sums they received upon liquidation to numerous other parties who have relied upon receipt of these sums.

In the absence of the predecessor, it must be determined whether the injured party or the successor corporation should bear the recourse risk. It is now commonly recognized that efficiency is enhanced when risk is allocated to that party who, with the least cost, can avoid it.\textsuperscript{101} With respect to the recourse risk, can the product user-tort victim or the successor corporation best decrease the

\begin{itemize}
  \item Fraudulent conveyance doctrine can be traced as far back as 1571. See An Acte agaynst fraudulent Deedes Gyftes Alienations, &c., 13 Eliz., ch. 5 (1571). In contrast, risk analysis became current in the twentieth century. See infra notes 97-99 and accompanying text.
  \item See generally G. White, Tort Law in America 96-102 (1980).
  \item See Llewellyn, Some Realism About Realism—Responding to Dean Pound, 44 Harv. L. Rev. 1222, 1248-49 (1931).
  \item See, e.g., Douglas, Vicarious Liability and Administration of Risk (pts. 1 & 2), 38 Yale L. J. 584, 720 (1929).
  \item See, e.g., Moore, Sussman & Brand, Legal and Institutional Methods Applied to Orders to Stop Payment of Checks (pts. 1 & 2), 42 Yale L. J. 817, 1198 (1933); Patterson, The Apportionment of Business Risks Through Legal Devices, 24 Colum. L. Rev. 335 (1924).
  \item See Restatement (Second) of Torts § 402A (1965).
\end{itemize}
recourse risk by insuring that the predecessor corporation has provided for tort claims?

The product user is unlikely to protect himself against the recourse risk. In most cases where successor corporations have been sued on products liability grounds, privity between injured party and manufacturer is lacking.\(^{102}\) Even if privity is present, however, most manufacturers do not go out of business and, thus, most product purchasers are not apt to think about and attempt to protect themselves against the recourse risk. Further, even if the consumer were to think of the possibility that the manufacturer would sell its operations and liquidate, the risk that the manufacturer will do so would appear so remote as not to warrant affirmative action on the consumer's part. Consider the case of Chrysler Corporation. Few consumers have declined to purchase its products out of fear that Chrysler might become insolvent and thus not be available to service products sold or provide compensation for injuries resulting from defectively manufactured products. At most, one occasionally hears of a consumer declining to purchase a Chrysler Corporation product out of fear that servicing for such cars will be difficult.\(^{103}\)

Furthermore, most consumers do not have access to the necessary information to make an accurate assessment of the recourse risk. The information, first of all, must include the financial status of the predecessor corporation. A corporation is likely to sell its assets when the present value of returns expected on the financial assets to be received as consideration for the sale of the manufacturing assets exceeds the present value of returns expected on the manufacturing assets. An accurate gauge of the recourse risk would have to take account of both the manufacturer's rate of return on its present and future assets, and possible rates of return on the investment of financial assets received in the sale of the manufacturing assets. Further, the consumer would have to predict the existence of another corporation whose calculation of the expected returns on the manufacturer's assets exceeds those on the investment of financial assets that the manufacturer would receive in a sale. To the consumer of a

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\(^{102}\) See, e.g., Ray v. Alad Corp., 19 Cal. 3d at 25, 560 P.2d at 5, 136 Cal. Rptr. at 576 (plaintiff fell from defective ladder owned by University of California while working for contracting company); Nieves v. Bruno Sherman Corp., 86 N.J. at 365, 431 A.2d at 828 (plaintiff's injuries caused by defective power press purchased secondhand by his employer ten years before accident occurred); Ramirez v. Amsted Indus., Inc., 86 N.J. at 335, 431 A.2d at 812 (plaintiff injured while operating defective power press presumably owned by his employer).

\(^{103}\) This fear has been labelled "the orphan-car syndrome." See Ross, Chrysler on the Brink, FORTUNE, Feb. 9, 1981, at 41.
product, the identity of such a potential buyer of the manufacturing corporation's assets in the future is unknown, as is the financial data necessary for such a computation. Need I go on to demonstrate that the consumer and/or product user would need both an astrology doctorate as well as an M.B.A. degree to undertake these calculations!

Finally, it is unclear exactly how the consumer could protect himself against the recourse risk. The consumer could, theoretically, decline to purchase a product. Yet, given the consumer's lack of expertise in assessing the possibility that a manufacturer will liquidate and, consequently, that its products pose a substantial recourse risk, the consumer has few means to determine accurately which manufacturer's products to avoid.

Another theoretical recourse for the consumer is to make certain arrangements with the manufacturer to safeguard against the risk. The arrangements might include a contractual pledge that the manufacturer not go out of business, agreement by the manufacturer to set up a specific fund sufficient to procure insurance against the risk of defective goods, and so on. None of these arrangements seem quite feasible. Among other difficulties, the risk of the manufacturer's nonperformance would inhere in almost all such protective devices, and each consumer or user would have to expend transaction costs in regard to these arrangements.

The successor corporation's position with respect to the product consumer or user's recourse risk differs significantly. First, by the time the successor transacts with the predecessor, the user's recourse risk has increased substantially. Whereas to the consumer the recourse risk, if recognized, might seem remote and improbable, to the successor corporation the risk approaches certainty. The successor corporation need not expend additional resources to determine whether the manufacturer wants to sell its assets; it knows such to be the case. The successor need not expend additional resources to determine if a potential buyer for those assets is available; it qualifies as that buyer. Moreover, if the law required the successor corporation to bear the recourse risk, the successor has the wherewithall when transacting with the predecessor corporation to insure that it is not left holding the ball.104

In short, on the basis of the information that the successor corporation has acquired for other reasons, it can construct a posterior probability with respect to the recourse risk, which is both far higher

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104. See supra text accompanying note 33.
and more accurate than the anterior probability that the consumer would be able to construct when purchasing the product. When negotiating with the predecessor corporation to purchase the assets, the successor can protect itself without an undue expenditure of transaction costs. The successor, in short, can protect against the recourse risk at a lower cost than can the consumer or product user.

**PRACTICAL DIFFERENCES BETWEEN APPROACHES**

In addition to possibly proving more persuasive to courts that have not confronted the issue of successor liability recently, the approach of this article might dictate a different result in several situations than would the torts oriented perspective articulated in recent decisions. Consider three possible variants of the successor paradigm wherein the successor purchases the assets and goodwill of the predecessor, the predecessor dissolves, and the successor continues to manufacture the predecessor’s product line.

In the first variation, after five years, the successor discontinues the manufacture of the predecessor’s products and the use of its goodwill.\(^{105}\) If the ability to spread costs among all users of the same product is integral to the tort analysis adopted by *Ray* and its progeny, it is not clear that the successor should be held liable.\(^{106}\) In contrast, recourse risk analysis would dictate that the successor should be held liable, whether or not it continues to manufacture the same line of products under the same trade name. A later calculation by the successor that the product line and trade name that it purchased from the predecessor is not worth what it paid is unfortunate from the successor’s perspective, but does not change the successor’s responsibility for substantially increasing the consumer’s recourse risk. At the time that the assets were purchased, the successor paid a positive value for the predecessor’s goodwill. Thus, the successor had the opportunity to bargain in such a manner as to force the predecessor to internalize the risks created by the manufacture and sale of its products. Actual manufacture and use of the predecessor’s goodwill, therefore, is irrelevant to the imposition of liability pre-

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106. Significantly, the court in *Seipp* did not apply the product line theory adopted in *Ray*, in part because defendants did not use the goodwill and did not produce the same product. The court also considered the passage of time since manufacture and the existence of numerous intermediary successors, a significant variation of the requisite product line elements. *Id.* at ___, 646 P.2d at 786.
Consider, next, a situation where the predecessor remains in business, but does not continue to produce the same product line. If the cost spreading rationale is applied, the successor should be susceptible to suit because, regardless of the predecessor’s continuation, it is still in the best position to spread the losses among the purchasers of the same line of products. Indeed, the New Jersey courts, unlike the California Supreme Court, have not insisted upon the nonavailability of the predecessor as a precondition to suit against the successor. The recourse risk analysis probably dictates a contrary result. The mere fact of the predecessor’s continuation means that the successor and predecessor did not bargain for the latter to dissolve and liquidate. Since the predecessor would remain in business to provide recourse to injured parties, the successor did not actively participate in increasing the consumers’ recourse risk.

Finally, suppose that the successor purchased all or some of the predecessor’s assets in a forced liquidation or similar proceeding. This is not a setting in which an accurate calculation of the extent of quality claims, actual or incipient, is readily accomplished. Such statistics are based upon such data as the length of time the products were manufactured, the number of products, and similar information. Nor is there bargaining between the predecessor and successor by which the predecessor can be forced to internalize the recourse risk. Rather, liquidation sales commonly occur when present creditors are fighting each other for a share of the pie. Discouraging the successor from making as high a bid as possible in that context would, on balance, probably work to the disadvantage of the predecessor’s creditors. In contrast, it is not quite so clear why courts, applying a cost spreading rationale, would deny recovery against a predecessor in this situation, although I hasten to add that no court has yet granted recovery against a successor corporation in this context.


109. Cost spreading, along with an emphasis upon whether the successor is enjoying the predecessor’s goodwill, would probably not lead a court to hold the successor susceptible to suit. Cost spreading, however, divorced from an emphasis upon the continuation of the good-
CONCLUSION

Except for those who are prepared to impose tort liability anytime and anywhere regardless of conflicting considerations, readers of the New Jersey and California courts’ opinions are apt to be unpersuaded that successor corporations should be susceptible to suit. The opinions do not persuade because they needlessly and fruitlessly plow the terrain of the defendant successor’s responsibility for the product defect. Nexus between the injured tort victim and the successor corporation exists, instead, in the terrain of recourse risk. And when addressing the recourse risk, rather than quality risk, courts would be advised to till, rather than neglect, the fertile ground of corporate and commercial law.

In addition to suggesting that successors can be held responsible for increasing the recourse risk of third parties, corporate and commercial law doctrines suggest the contours of advisable limitations on that responsibility. If the source of liability is the successor’s act of foreseeably increasing the consumer’s recourse risk, of knowing that consumers or users will be deprived of their right of recourse, and of having the opportunity to influence events otherwise, liability should not be imposed when the successor either cannot possibly foresee liability for particular defects or exercise an opportunity for the predecessor to provide for future claims.