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Products Liability--Liability of Transferee for Defective Products Manufactured by Transferor

P. Anthony Lannie

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I. INTRODUCTION

In determining who may be subject to liability for injuries caused by defective or disappointing[1] products, a growing number of courts have shifted their emphasis from traditional negligence law to the policies and theories of strict liability in tort. The imposition of liability for negligence has been based traditionally on the idea that one should compensate for injuries caused by his misfeasance[2] or nonfeasance.[3] The risk of loss, with few exceptions,[4] has

1. Disappointing products are those that do not live up to the representations of their sellers. For a comprehensive examination of liability for product disappointment see Shapo, *A Representative Theory of Consumer Protection: Doctrine, Function and Legal Liability for Product Disappointment,* 60 VA. L. REV. 1109 (1974). This Recent Development focuses primarily on that subcategory of disappointing products that also prove to be defective.

2. Misfeasance is "the improper performance of some act which a man may lawfully do." BLACK'S LAW DICTIONARY 1151 (4th ed. 1951).

3. Nonfeasance is the "nonperformance of some act which ought to be performed, omission to perform a required duty at all, or total neglect of duty." BLACK'S LAW DICTIONARY 1208 (4th ed. 1951).

4. The exceptions fall under the label "imputed negligence": because of some relationship between two individuals, one of them will be held accountable for the negligence of the other. For a discussion of various examples of imputed negligence see W. PROSSER, LAW OF TORTS §§ 69-74 (4th ed. 1971) [hereinafter cited as PROSSER].

been placed on the party at fault,[5] and the element of fault has assisted courts in identifying the party against whom a suit for negligence would lie. Strict liability, on the other hand, removes the element of fault from the products liability suit.[6] The imposition of liability without proof of negligence or fault has required courts to find new indicia for identifying the parties against whom a claim may be asserted, and consequently, courts have permitted products liability suits to be brought against a wide array of defendants.[7] The common characteristic of the various defendants is that each has participated in the business of supplying the product causing the injury.[8]

In their search for indicia to determine what parties may be subject to strict liability, most courts have disallowed actions against one class of potential defendants by adopting a corporate law rule intended to limit a transferee's liability to creditors of the transferor.[9] The rule states simply that a transferee corporation that

5. *See Id.* § 75, at 492-93. "Fault" is an ambiguous term that can lead to confusion. The term will be used in this Recent Development, however, because it is the only common term that succinctly conveys the idea of a lack of both wrongful intent and negligence. *See generally id.* § 75.

6. Wade, *Strict Tort Liability of Manufacturers,* 19 Sw. L.J. 5 *passim* (1965), *reprinted in* 32 ALA. LAW. 455 *passim* (1971). The element of fault is removed in the sense that an injured plaintiff need not prove negligence or fault on the part of a defendant. Strict liability, however, is not fault-free liability. Since the plaintiff must show a defect in the product, fault on the part of someone in the chain of distribution may be inferred. Carmichael, *Strict Liability in Tort — An Explosion in Products Liability Law,* 20 DRAKE L. REV. 528, 539 n.72 (1971); Frauen, *Submission of a Strict Products Liability Case (A Defense Lawyer's View),* 20 FED'N INS. COUNSEL Q., Spring 1970, at 22, 24; *see* PROSSER, *supra* note 4, at § 75; Lascher, *Strict Liability in Tort for Defective Products: The Road To and Past Vandermark,* 38 S. CAL. L. REV. 30, 47-48 (1965); Wade, *The Continuing Development of Strict Liability in Tort,* 22 ARK. L. REV. 233, 242-43 (1968). The inference of fault that arises from the proof of a defect should not be confused with the inference that may arise from the presence of a defect under the doctrine of res ipsa loquitur. PROSSER, *supra,* § 103, at 672-73; *compare id.* at 494-96, *with id.* at 214-18. *But see* Wade, *supra,* at 25, 32 ALA. LAW. at 479. Unlike the strict liability plaintiff, a plaintiff who is able to prove negligence from tbe presence of a defect under the doctrine of res ipsa loquitur has the further job of identifying a particular party to whom that negligence is attributable. PROSSER, *supra,* § 39, at 218.

7. Among those who have been held liable are manufacturers, wholesalers, distributors, retailers, restaurant operators, lessors, hailors, trademark licensors, and manufacturers of component parts of defective products. For detailed lists of cases and authorities supporting the liability of such defendants see Prosser, *The Fall of the Citadel (Strict Liability to the Consumer),* 50 MINN. L. REV. 791, 814-15 (1966) [hereinfter cited as Prosser, *The Fall*]; 27 ME. L. REV. 305 & nn.2-6. For an excellent discussion of the bases for seller and nonseller defendant liability see Carmichael, *supra* note 6, at 556-62.

8. Prosser, *The Fall, supra* note 7, at 814.

9. For cases in which courts have adopted this majority rule see 15 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 7122, at 189-91 n.1 (rev. perm. ed. 1973) [hereinafter cited as FLETCHER]; Annot., 66 A.L.R.3d 824 (1975).

purchases the assets of a transferor corporation will not be accountable for the unassumed debts of the transferor.[10] A sale of assets, unlike a transfer of ownership by sale of stock or by merger or consolidation, conceptually is a transfer of property from one entity to another.[11] The transfer of a business by a sale of stock is considered a change in the ownership of the corporation, but not a change in ownership of the business assets. The business assets are owned by the corporation itself both before and after the sale of stock.[12] The corporate entity concept, when combined with the negligence theory that the party who is at fault should bear the risk of loss,[13] produces a willingness on the part of most courts to dismiss a products liability suit against a transferee corporation without ever reaching the strict liability policy of spreading the risk of loss by shifting it to the manufacturer and the chain of distribution so that the cost of defects will be reflected in an increased price of the product.[14] Thus, the corporate law rule creates a barrier to the consideration of strict liability policy goals in determining transferee liability to parties injured by the defective products of the transferor corporation.[15]

In the landmark decision, *Greenman v. Yuba Power Products, Inc.*,[16] the California Supreme Court eliminated a similar barrier to consideration of products liability goals—the breach of warranty theory designed to meet the needs of commercial transactions. Justice Traynor addressed the central question—"When should the manufacturer be responsible to those injured by his products?"[17]—and concluded that "rules . . . that were developed to meet the needs of commercial transactions cannot properly be invoked to govern the manufacturer's liability to those injured by their defective products unless those rules also serve the purposes for which such liability is imposed."[18] Confronted with another cen-

10. FLETCHER, *supra* note 9, at § 7122, at 188.

11. Note, *Assumption of Products Liability in Corporate Acquisitions*, 55 B.U.L. REV. 86, 92-93 (1975).

12. *See* Note, *supra* note 11, at 92-93.

13. *See* note 6 *supra*.

14. On the topic of risk spreading, see generally Escola v. Coca Cola Bottling Co., 24 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944); Carmichael, *supra* note 6, at 531-32; Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099, 1120 (1960); Shapo, *supra* note 1, at 1258-64; Note, *supra* note 11, at 89-90.

15. Note, *supra* note 11, at 91; *see* FLETCHER, *supra* note 9, at § 7123.

16. 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963); *see* notes 24-29 *infra* and accompanying text.

17. Traynor, *The Ways and Meanings of Defective Products and Strict Liability*, 32 TENN. L. REV. 363, 365 (1965). Although the decision made no attempt to define the central question, Justice Traynor, in hindsight, phrased the issue as quoted.

18. 59 Cal. 2d at 63, 377 P.2d at 901, 27 Cal. Rptr. at 701.

tral issue—Who may be held liable as a defendant to a products liability suit?—several federal courts and most recently two state courts have critically reexamined the corporate law rule that had been used to determine, within a limited context, who could be subject to liability and who could not.[19] Finding that the corporate law rule is not always consistent with the purposes for which strict liability is imposed,[20] several federal courts have found ways to avoid the undesirable result of the corporate law analysis by broadening existing exceptions to the majority rule of transferee nonliability.[21] Two recent state court cases, *Turner v. Bituminous Casualty Co.*[22] and *Ray v. Alad Corp.*,[23] have followed the federal courts by criticizing the corporate law creditor liability approach. These cases hold that a products liability suit for damages caused by the products of the transferor corporation may be maintained against a transferee corporation that purchased for cash all the assets of the transferor. This discussion will examine the *Turner* and *Ray* decisions, focusing on the different rationales used by each court to arrive at a common holding of transferee liability.

II. Background

A. *Policy and Strict Liability in Tort*

The California Supreme Court in *Greenman v. Yuba Power*

19. In articles on the topic of strict liability, discussion often is divided into sections dealing with particular issues that might arise in a given products liability suit. Among the divisions of such an article into its issue areas, one is likely to find sections entitled "What Products?" "What Plaintiffs?" and "What Defendants?" *See, e.g.*, Prosser, *The Fall*, *supra* note 7. The question of transferee liability for the defective products of the transferor properly falls within the framework of the broader issue "What Defendants?" The purpose for phrasing the central issue in the general terms—Who may be held liable as a defendant to a products liability suit?—is to impress upon the reader that transferee liability or nonliability should be viewed as one of many questions arising in a products strict liability suit rather than as a question of corporate law that intervenes to cause dismissal of the suit before the strict liability issues are addressed. *See* text accompanying note 31 *infra*.

20. *See* Knapp v. North American Rockwell Corp., 506 F.2d 361, 369 (3d Cir. 1974), *cert. denied* 421 U.S. 965 (1975) (resolution of the issue of transferee liability requires "an analysis of public policy considerations rather than . . . a mere procrustean application of formalities."), *noted in* 6 Seton Hall L. Rev. 477 (1975); Cyr v. B. Offen & Co., 501 F.2d 1145, 1153 (1st Cir. 1974) ("Thus where tort liability is concerned we should look to factors relevant to the specific claim and not be bound by the factors that control where other debts and liabilities are concerned."), *commented on in* 16 B.C. Ind. & Com. L. Rev. 676 (1975) *and* 27 Me. L. Rev. 305 (1975); Shannon v. Samuel Langston Co., 379 F. Supp. 797 (W.D. Mich. 1974); Fairfield v. Samuel Langston Co., No. K-18-71 CA (W.D. Mich. Mar. 12, 1974).

21. *See* Part II. B. *infra*.

22. 397 Mich. 406, 244 N.W.2d 873 (1976).

23. 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).

Products, Inc.,[24] adopted the doctrine of products liability in tort without negligence, and without regard to breach of warranty.[25] The plaintiff in that case had been injured by a defective power tool. The manufacturer of the power tool defended on the ground that the plaintiff had failed to notify him of the breach of warranty as required by the Uniform Sales Act.[26] Reasoning that rules designed to meet the needs of commercial transactions should not be used to govern the outcome of products liability cases unless those commercial rules also serve the purposes for which products liability is imposed,[27] the court concluded that it would no longer determine the liability of a manufacturer for his defective products by use of the breach of warranty theory. That theory and its notice requirements conflicted with the products liability goal of insuring that the costs of injuries from defective products are borne by the manufacturers that placed the products on the market rather than by the injured individuals who were powerless to protect themselves.[28] Thus, the court eliminated a substantial bar to recovery imposed by the commercial breach of warranty theory for deciding when a manufacturer would be liable for his defective products and replaced it with the doctrine of strict liability.[29]

B. *The Corporate Law Rule of Transferee Nonliability and the Broadening of Its Exceptions*

Until recently the courts considered the issue of transferee liability as a question of corporate law rather than as one of strict liability. In jurisdictions applying the corporate law rule, a transferee defendant to a products liability suit ordinarily moves for summary judgment on the ground that a transferee corporation is not liable for the unassumed obligations of the transferor just as an

24. 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963) (Traynor, C.J.), *noted in* 17 Sw. L.J. 669 (1963).

25. *See* Prosser, *The Fall, supra* note 7, at 803; Wade, *supra* note 6, at 9-10, 32 ALA. LAW. at 461; Note, *Expanding the Products Liability of Successor Corporations,* 27 HASTINGS L.J. 1305 (1976).

26. At the time of the decision in *Greenman,* the Uniform Sales Act in California provided that notice of breach of warranty be given to the maker of the warranty within a prescribed time after the alleged breach. If notice were not given, the cause of action for breach of warranty expired. Uniform Sales Act, ch. 1070, § 1, 1931 Cal. Stats. 2238 (repealed 1963); *see* Prosser, *The Fall, supra* note 7, at 803.

27. 59 Cal. 2d at 63, 377 P.2d at 901, 27 Cal. Rptr. at 701; *see* Traynor, *supra* note 16, at 365-66 ("One cannot look to warranty . . ., for it was designed to ensure commercial satisfaction rather than compensation for physical injury.").

28. 59 Cal. 2d at 63, 377 P.2d at 901, 27 Cal. Rptr. at 701.

29. Prosser, *The Fall, supra* note 7, at 805.

individual is not responsible for the debts of a stranger. Thus, the corporate law rule designed to define a transferee's liability to a transferor's creditors intervenes to prevent suit against a transferee for the defective products of the transferor. Because a products liability plaintiff is in the same position as any other creditor,[30] most courts would dismiss the action against a transferee corporation without reaching the policy reasons for imposing strict liability on a defendant to a products liability suit.[31] To avoid having his suit dismissed, a plaintiff must allege the existence of facts sufficient to require the application of one of the four well-established exceptions to the general rule. According to these exceptions the transferee may be held liable for the obligations of the transferor (1) when there is an express or implied agreement to assume those obligations, (2) when the transaction amounts to a de facto merger or consolidation of the transferor with the transferee, (3) when the transaction is a fraudulent attempt to escape liability, or (4) when the transferee corporation is a mere continuation of the transferor.[32] Several federal courts have criticized the general rule as being incompatible with the polcies behind strict products liability.[33] Nevertheless, by disguising their break with the corporate law rule through references to one or more of its exceptions, the courts have left the impression

30. Although the plaintiff in a products liability case receives the same treatment under the corporate law analysis as creditors, the contract of sale between the transferor and the transferee usually contains an express provision for the assumption of all noncontingent debts and liabilities. Thus, as a practical matter, a plaintiff in a products liability suit is in a worse position than creditors to whom obligations had arisen prior to the date of sale because those creditors will he able to recover against the transferee on contract grounds.

31. *See* note 15 *supra* and accompanying text.

32. Shane v. Hoban, Inc., 332 F. Supp. 526, 527-28 (E.D. Pa. 1971); Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817, 820 (D. Colo. 1968); *see* FLETCHER, *supra* note 9, at § 7122 & at 192-96 nn.6-11; Annot., 66 A.L.R.3d 824, 834-53 (1975); Note, *supra* note 25, at 1311 & nn.37-41; *see also* Annot., 49 A.L.R.3d 881, 883-90 (1973) (discussion of the fraud exception). For cases construing statutes relevant to exceptions to the general rule see Annot., 66 A.L.R.3d 824, 854-55. For breach of duty to warn as giving rise to transferee liability, wholly apart from the exceptions to the general rule of nonliability see *id.* at 853-54; Wallach, *Products Liability: A Remedy in Search of a Defendant—The Effect of a Sale of Assets and Subsequent Dissolution on Product Dissatisfaction Claims,* 41 Mo. L. REV. 321, 342-44 (1976). For breach of duty to warn, generally, see Kidwell, *The Duty to Warn: A Description of the Model Decision,* 53 TEX. L. REV. 1375 (1975).

33. *See* note 20 *supra* and accompanying text; Juenger & Schulman, *Assets Sales and Products Liability,* 22 WAYNE L. REV. 39, 54-55 (1975). Concern for the plight of a plaintiff who has been injured by the products of a dissolved corporation has been responsible, in part, for the increased interest in finding a solvent defendant for the plaintiff. The search for defendants may he the moving force behind the re-evaluation of the general rule. For discussions of the difficulties connected with finding a defendant in such situations see Henn & Alexander, *Effect of Corporate Dissolution on Products Liability Claims,* 56 CORNELL L. REV. 865 (1971); Wallach, *supra* note 32.

that their real intent is simply to broaden the existing exceptions rather than to abandon the general rule.[34]

Foremost among the federal court cases criticizing the general rule is *Cyr v. B. Offen & Co.*,[35] until recently the only case holding a purchaser of assets for cash liable for the transferor's defective products.[36] Following the death of the sole proprietor of the B. Offen Company, key employees of the company formed a corporation and purchased the proprietor's assets from the executor of his estate. The new corporation, B. Offen & Co., agreed to assume the obligation to service the transferor's products but expressly refused to assume the transferor's tort liabilities. To justify its imposition of transferee liability, the First Circuit Court of Appeals emphasized that the policy reasons for imposing strict liability on the transferor were equally applicable for holding the transferee strictly liable.[37] Ultimately, however, the court phrased its holding not in terms of strict liability, but rather in terms that suggested a reliance on the continuity exception to the general rule of transferee nonliability.[38] Because of the particular facts present, the continuity exception was the only state law ground upon which the decision to impose liability on the transferee could be made. To impose liability on a theory

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34. When federal jurisdiction is based on diversity of citizenship, a federal court must apply the law of the state in wbich the case arose, as though the federal court were a court of the state in which it sits. Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938); *see* 36 C.J.S. *Federal Courts* § 165(2) (1960). Because the law of the states is the corporate law rule of transferee nonliability, the federal courts are bound by the *Erie* doctrine to determine transferee liability in accordance with the corporate law rule. Therefore, despite strong criticism of the general rule followed by the states, federal courts have phrased their holdings of transferee liability to fit within the framework of one of the exceptions to the corporate law rule of transferee nonliability. Juenger & Schulman, *supra* note 33, at 54-55; *see, e.g.*, Note, *supra* note 25, at 1321.

35. 501 F.2d 1145 (1st Cir. 1974). For a criticism of the case see 16 B.C. IND. & COM. L. REV. 676 (1975). For a discussion praising the case, see 27 ME. L. REV. 305 (1975).

36. Note, *supra* note 25, at 1320.

37. According to the court,

> The manufacturer's successor, carrying over the experience and expertise of the manufacturer, is likewise in a better position than the consumer to gauge the risks and the costs of meeting them. The successor knows the product . . . and is the only entity capable of improving the quality of the product . . . . [I]t is true that the successor . . . was not tbe legal entity which launched the product on the stream of commerce or made an implied representation as to its safety. But in the most real sense it is profiting from [and] exploiting all of the accumulated good will which the products have earned, both in its outward representations of continuity and in its internal adherence to the same line of equipment.

501 F.2d at 1154.

38. Juenger & Schulman, *supra* note 33, at 51; Wallacb, *supra* note 32, at 338; 16 B.C. IND. & COM. L. REV. 676, 678 (1975); Note, *supra* note 25, at 1321; *see* 27 ME. L. REV. 305 *supra* note 35.

that the transferee impliedly assumed the transferor's tort liabilities would be extremely difficult, since the purchase agreement expressly excluded assumption of such liabilities. There could be no de facto merger since the assets were purchased not from another corporation but from a sole proprietor's estate.[39] The fraud exception to the general rule was unavailable since there was no evidence whatsoever that the transaction was undertaken to escape liability fraudulently. Therefore, the federal court could follow in form the law of the state in which this diversity action arose only by justifying its decision on the continuity exception to the general rule, which requires a continuity of business and a continuity of ownership.[40] In order to hold that the incorporated B. Offen & Co. was a mere continuation of the sole proprietorship B. Offen Company, however, the court had to eliminate the historically essential "substantial identity of ownership"[41] element of the continuity exception. As authority that continuity of ownership was not determinative of transferee responsibility, the court relied on a labor law test used to determine when a transferee will be bound by certain collective bargaining agreements signed by the transferor.[42] Although ignoring the absence of continuity of ownership, the court did emphasize the operational continuity.[43] The court's attempt to fit its holding within the framework of the continuity exception may have been an intentional effort to avoid being overturned for not following state

39. Juenger & Schulman, *supra* note 33, at 51.

40. The court proposed an alternative state law basis for the decision in the form of a makeweight *respondeat superior* argument:

> The negligence of employees in carrying out that business is the responsibility of the corporate body. If as a group the same employees continue, without pause to produce the same products in the same plant, with the same supervision, the ownership of the entity which maintains essentially the same name cannot be the sole controlling determinant of liability.

501 F.2d at 1154; *see* Juenger & Schulman, *supra* note 33, at 52, 54; Note, *supra* note 25, at 1321 n.91.

41. *See* note 38 *supra.* The elements of the continuity exception are characteristics that would lead a court to conclude that a transferee was essentially the same entity as the transferor with only a change of form or corporate name. Continuity of ownership, plant location, trade name, and other such elements are all traditionally necessary to a finding of sufficient continuity to justify holding the transferee liable for the defective products of its predecessor manufacturer.

42. The test from John Wiley & Sons v. Livingston, 376 U.S. 543 (1964), considered the following criteria to be indicative of continuity: "the composition and size of the work force, personnel policy, production lapses, product changes, change in plant location, and changes in internal operations, as well as manner of succession." 27 ME. L. REV., *supra* note 35, at 313.

43. Juenger & Schulman, *supra* note 33, at 53.

law as required by the *Erie* doctrine.[44] On the other hand, the court's need for a test to determine which transferees should be held liable may have led to the unintentional mingling of negligence law with strict liability.[45] The use of continuity terminology to phrase its holding suggests that the court was determining liability by attributing some degree of fault to the transferee corporation. Whatever the court's reason for using the continuity language, its decision had the effect of broadening the continuity exception so that a transferee might be more readily subjected to strict liability for a transferor's defective products.

In *Shannon v. Samuel Langston Co.*,[46] a diversity case litigated in Michigan but applying New Jersey law,[47] a federal court examined the leading New Jersey case, *McKee v. Harris-Seybold Co.*,[48] and educed a four-part test for determining when a sale and purchase of assets constitutes a de facto merger. Thus, under the de facto merger exception to the general rule of transferee nonliability, a transferee would be liable for injuries caused by the transferor's defective products when the following circumstances are present:

> (1) There is a continuation of the enterprise of the seller corporation, so that there is a continuity of management, personnel, physical location, assets, and general business operations.
>
> (2) There is a continuity of shareholders which results from the *purchasing corporation paying for the acquired assets with shares of its own stock,* this stock ultimately coming to be held by the shareholders of the seller corporation so that they become a constituent part of the purchasing corporation.
>
> (3) The seller corporation ceases its ordinary business operations, liquidates, and dissolves as soon as legally and practically possible.
>
> (4) The purchasing corporation assumes those liabilities and obligations of the seller ordinarily necessary for the uninterrupted continuation of normal business operations of the seller corporation.[49]

The court distinguished *McKee,* which reached a holding of no transferee liability on facts otherwise identical to those in *Shannon,*

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44. This potential explanation for the court's concern with the continuity exception is discussed in Juenger & Schulman, *supra* note 33, at 54. For a discussion of the *Erie* doctrine and its application in this context see note 34 *supra.*

45. *See* Note, *supra* note 25, at 1321 n.91. On the requirement of proof of fault see note 6 *supra.*

46. 379 F. Supp. 797 (W.D. Mich. 1974).

47. Although the accident occurred in Michigan, the defendant's transferor had manufactured the allegedly defective product in New Jersey and the defendant continued to operate the New Jersey manufacturing plant as a wholly-owned subsidiary.

48. 109 N.J. Super. 555, 264 A.2d 98 (1970), *aff'd,* 118 N.J. Super. 480, 288 A.2d 585 (1972).

49. 379 F. Supp. at 801 (citing McKee v. Harris-Seybold Co., 109 N.J. Super. at 563-67, 264 A.2d at 103-05) (emphasis added).

on the basis of the second criterion above. Whereas the purchaser in *McKee* paid mainly cash, the transferee in *Shannon* paid for the transferor's assets with shares of the transferee's own stock.[50] To the extent that the transferor's shareholders retained their stock in the transferee after the transferor's dissolution, there was continuity of ownership. Although the court referred to the test in terms of the de facto merger exception, the first two components are the traditional elements of the continuity exception. The fourth part of the test is more relevant to the implied assumption of tort liabilities exception than to the de facto merger exception. Apparently, there is considerable overlap of the traditional exceptions to the general rule. Indeed for most factual situations[51] the de facto merger exception and the continuity exception are alternative rationales for achieving the same result.[52]

Through the use of what it referred to as the de facto merger exception, the court in *Shannon* found the transferee corporation liable for the defective products of the transferor. Yet, the de facto merger doctrine as applied in *Shannon* resembled the de facto merger doctrine as applied in *McKee* little more than the *Cyr* continuity exception resembled traditional notions of continuity. Neither of the federal courts addressed the issue of transferee liability as though it were simply a matter of corporate law and creditors' rights. Instead the courts in both *Cyr* and *Shannon* went beyond traditional state court analysis and considered the impact of the general rule of transferee nonliability on strict liability policy goals. The courts thus took a major step toward viewing the issue of transferee liability not as a question to be decided solely on corporate law principles but rather as one of several questions to be answered in a products liability context.[53] Concluding that transferee nonliability in *Cyr* and *Shannon* was inconsistent with the reasons for imposing strict liability in such cases, the two federal courts defined the exceptions to the general rule in such a way that they were broad enough to justify the imposition of transferee liability on state law grounds.

50. 379 F. Supp. at 801-02.

51. The facts of *Cyr* presented a situation in which the continuity exception produced a holding of transferee liability even though the de facto merger exception would not have been available to circumvent the corporate law rule. *See* note 39 *supra* and accompanying text.

52. Wallach, *supra* note 32, at 340.

53. *See generally* note 19 and text accompanying note 31 *supra*.

III. Two Recent State Court Cases

A. *Turner v. Bituminous Casualty Co.*

In *Turner*[54] the plaintiff brought a products liability suit against the defendant transferee corporation for injuries caused by a defective power press manufactured by the transferor. Defendant moved for summary judgment on the ground that it was a corporate stranger to the transferor who had manufactured and sold the power press. The trial court granted the defendant's motion for summary judgment and the appellate court denied leave to appeal. Reversing the trial court, the Supreme Court of Michigan held that a transferee corporation that purchased for cash all the assets of the transferor corporation could be subject to liability for the defective products manufactured by the transferor as long as three conditions were satisfied. The three conditions are the first, third, and fourth parts of the *Shannon* test,[55] which the *Turner* court concluded were the tests for continuity of interest,[56] the true controlling factor. Thus, the court in *Turner* decided to eliminate the requirement of continuity of ownership, the second component of the *Shannon* test, as a determinative factor in the test for transferee liability,[57] just as the First Circuit Court of Appeals in *Cyr v. B. Offen & Co.*, had abolished continuity of ownership from its version of the continuity exception to the general rule. In *Cyr* the necessity of conforming with state law produced the terminology indicating that transferee liability was based on the continuity exception to the general rule.[58] The Supreme Court of Michigan had no obligation to conform its decision to the majority rule of transferee nonliability. Although the court strongly criticized the corporate law approach to determining transferee liability,[59] the retention of the three steps of the *Shannon*

54. 397 Mich. 406, 244 N.W.2d 873 (1976).

55. 397 Mich. at ___, 244 N.W.2d at 883; *see* text accompanying note 49 *supra*.

56. 397 Mich. at ___, 244 N.W.2d at 883. Although the *Turner* continuity of interest test requires liquidation of the transferor and assumption of the business debts by the transferee, the primary emphasis is on continuity of the manufacturing enterprise in essentially the same form it had at the time the defective product was produced and sold. For a discussion of continuity of enterprise see text accompanying notes 84-87 *infra*.

57. The *Turner* court's reliance on *Shannon* is somewhat mystifying since the only element of the *Shannon* test that *Turner* rejected, continuity of ownership, was the very element used by the *Shannon* court to distinguish *McKee*. *See* text accompanying notes 48-50 *supra*. The result is that *Turner*, purporting to follow a test educed by the *Shannon* court from *McKee*, has arrived at a holding exactly the opposite of the holding in *McKee* despite substantially identical facts.

58. *See* note 44 *supra* and accompanying test. *But cf.* Note, *supra* note 25, at 1321 n.91 (possible alternative reason for use of the continuity language by the court).

59. The *Turner* court quotes the most potent language of the California Court of Ap-

test implies either that the *Turner* court was satisfied with the test developed from an exception to the corporate law rule or that the court was unable to devise a new standard for identifying who may be liable as a defendant in a products liability action.[60]

B. *Ray v. Alad Corp.*

In *Ray*[61] the plaintiff brought a products liability action against the defendant transferee corporation for injuries caused by a defective ladder that was manufactured and sold by the transferor before the defendant purchased the transferor's assets, name, and product line. The defendant moved for summary judgment on the ground that it was a corporate stranger to the manufacturer of the allegedly defective product. The plaintiff contended that the defendant transferee should be held liable because it had impliedly assumed the unspecified liabilities of the transferor and because it was a mere continuation of the transferor corporation. Concluding that the plaintiff had failed to allege facts sufficient to fit the case into one of the exceptions to the general rule of transferee nonliability, the trial court granted the defendant's motion. In overturning the trial court's dismissal of the action, the California Court of Appeals for the Second District held that a products liability suit could be

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peals decision in *Ray* on this very point:

> These observations focus on the wrong problem. This case has nothing to do with the interpretation of the contract between Alad I and Alad II; nor does it hinge on the technical differences between a sale of assets . . . ., merger, [and] consolidation . . . .
>
> The issue is, rather, one of tort law: does a manufacturer's responsibility for its defective products survive a change in ownership, where the manufacturing business, as such, maintains its identity and continues to operate as before "at the same old stand."

397 Mich. at ___, 244 N.W.2d at 880-81, quoting Ray v. Alad Corp., 55 Cal. App. 3d at ___, 127 Cal. Rptr. at 819-20 (1976), *vacated,* 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).

60. That the court was searching for various rationales to justify its decision is apparent from the following makeweight argument: "Justice would be offended if a corporation which holds itself out as a particular company for the purpose of sales, would not be estopped from denying that it is that company for the purpose of determining products liability." 397 Mich. at ___, 244 N.W.2d at 882. The makeweight argument appears in the decision again as though it were, along with the three elements of the *Shannon* test, the basis for a fourth requirement for establishing "a prima facie case of continuation of corporate responsibility for products liability." *Id.* at ___, 244 N.W.2d at 884. This makeweight "estoppel" argument falls short of its mark, because justice is only offended when a corporation escapes liability to someone who relied on the corporation's representation that it was the manufacturer of the defective product. In other words, the consumer must have believed the defendant was the manufacturer at the time of purchase. *Cf.* RESTATEMENT (SECOND) OF TORTS § 400, Comment d (1965). Although the court in *Turner* cited this source as support by analogy, this provision is only applicable when, due to the representations of the defendant, the consumer purchased the product with the mistaken belief that the defendant manufactured or exercised control over the manufacture of the product.

61. 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).

maintained against the transferee because liability for defective products attaches to the manufacturing business itself regardless of changes in ownership.[62] The California Supreme Court vacated the opinion of the Court of Appeals and held that a transferee that continues the output of a product line is subject to strict tort liability for defective units of the same product line that were manufactured and sold by the transferor.[63]

The Supreme Court of California arrived at its holding of transferee liability by completely repudiating the corporate law rule in the products liability context. Finding none of the four traditional exceptions to the general rule of transferee nonliability to be available, the court concluded that it would have to affirm the trial court's summary judgment if it adhered to the corporate law analysis. Furthermore, the court rejected the plaintiff's contention that the continuity exception to the corporate law rule should be broadened as it was in *Cyr v. B. Offen & Co.*,[64] since it felt that such a holding would set an undesirable precedent for courts assessing liability to creditors in general as opposed to products liability plaintiffs. Therefore, in order to effectuate the paramount strict liability policy of spreading to society the risk of loss from defective products[65] and at the same time avoid an undue broadening of the continuity exception, the court decided to find transferee liability by a special departure from the traditional corporate law analysis.[66]

According to the court, three reasons justify the imposition of liability on the transferee. First, the liquidation of the transferor, which is a usual consequence of the transferee's acquisition of all the

62. Ray v. Alad Corp., 55 Cal. App. 3d 855, 127 Cal. Rptr. 817 (1976), *vacated*, 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977). The Court of Appeals sought to devise a test for transferee liability from the policy considerations that justify the imposition of strict liability in tort. The test arrived at by the court would impose liability not on the particular entity that owned the manufacturing enterprise but rather on the manufacturing enterprise itself. The court determined transferee liability by examining evidence relevant to a decision that the manufacturing business at the date of suit is the same manufacturing business that was in existence on the day the defective product was manufactured. That evidence—continuity of management, key personnel, physical location, assets, and business operations—is the same evidence that would lead the *Turner* court to find that there was a continuity of enterprise sufficient to hold the transferee liable for the defective products of the transferor. *See* text accompanying notes 71-72 *infra*.

63. Ray v. Alad Corp., 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).

64. 501 F.2d 1145 (1st Cir. 1974); *see* text accompanying notes 35-45 *supra*.

65. *See* note 14 *supra*.

66. 19 Cal. 3d at ___, 560 P.2d at ___, 136 Cal. Rptr. at 579. *Ray* weighed the commercial need for insulating the transferee from liability against the need for continued protection of those injured by defective products and concluded that the corporate law rule should be suspended in the narrow area defined by the facts of the case at hand. *Id.* at ___, 560 P.2d at ___, 136 Cal. Rptr. at 576.

assets of the transferor, deprives the injured plaintiff of a formerly solvent defendant. The liquidation of the transferor, when combined with the practical difficulties of satisfying a judgment against the transferor corporation from the distributed assets held by former stockholders and directors, usually precludes recovery by a plaintiff from any source other than the transferee.[67] Secondly, the transferee is in the best position to insure that the costs of injuries from defective products are spread to the current customers of the product line. The transferee ordinarily has information necessary to gauge the risks of injury from previously manufactured items and can increase the price of products to meet those risks or, in the alternative, obtain insurance to cover such risks.[68] Finally, the transferee purchased the transferor's business and continued to market the transferor's product line under the same trade name, holding itself out as the transferor, in order to obtain the benefit of the transferor's goodwill. Since the transferor manufacturer could not have enjoyed its goodwill without the burden of liability for defective products, to allow the transferee to benefit from the transferor's goodwill without shouldering the attendant responsibilities would be unfair to the consuming public. In addition, the possibility of contingent liabilities should be reflected in the price paid by the transferee for the transferor's goodwill in order to prevent a windfall to the stockholders of the transferor; otherwise, shareholders might have the transferor sell its goodwill at an enhanced price, liquidate the transferor, and thus shield themselves in most cases from the liabilities that had formerly attached to the goodwill.

IV. Comparison and Analysis of the *Turner* and *Ray* Standards for Determining Transferee Liability

Reaching the same result, transferee liability, on substantially identical facts, both *Turner* and *Ray* recognize that the corporate law rule of transferee nonliability yields results that are inconsistent with the policies underlying strict liability for defective products. The decisions, however, establish different standards for determining who may be subject to a products liability suit. Under *Turner*, a transferee corporation is subject to liability for the defective products of the transferor if (1) the transferee continues the enterprise of the transferor, including a retention of key personnel, physical

67. Liquidation of the transferor, if not followed by a dissolution, will at least render the transferor insolvent. *See* Henn & Alexander, *supra* note 33; Wallach, *supra* note 32.

68. *See* note 75 *infra* and accompanying text.

location, assets, and general business operations, (2) the transferor corporation liquidates and dissolves as soon as possible following the acquisition, and (3) the transferee assumes the liabilities of the transferor necessary to the uninterrupted continuation of the business enterprise.[69] Under *Ray,* a transferee is subject to liability for the defective products of the transferor if the transferee continues to place the transferor's former product line on the market. Additionally, because of the reasons that the court used to justify imposition of transferee liability, liquidation of the transferor and exploitation of the transferor's goodwill may be second and third requirements for determining transferee liability. A comparison of the *Turner* and *Ray* standards reveals divergent theories of liability that led in *Turner* to the development of continuity of enterprise[70] and in *Ray* to continuity of product line as the primary indicators of transferee liability. Further insight may be gained by an examination of the requirement that the transferor liquidate, which is common to both cases, and an analysis of the third requirement of the *Turner* test and what may be a third requirement of *Ray.*

A. *Continuity of Enterprise/Continuity of Product Line*

A comparison of the first component of the *Turner* standard, continuity of the transferor's enterprise, to the *Ray* standard emphasizing continuity of the transferor's product line indicates that the two standards have their origins in different theories of liability. *Turner,* searching for a test to determine what transferees would be liable for the defective products of their transferors, adopted the continuity of enterprise requirement devised by the federal court in *Shannon.*[71] Under *Turner,* a plaintiff would introduce evidence that the management, personnel, physical location, assets, and general business operations of the transferee were the same as those of the transferor in order to prove continuity of enterprise. This evidence tends to equate the transferee and the transferor. Like the de facto merger, fraud, and continuity exceptions to the corporate law rule, the continuity of enterprise concept provides a rationale by which the court can ignore the separate identities of the transferee and the transferor and thus justify holding the former responsible for the obligations of the latter. The fiction that the transferee is a mere

69. 397 Mich. 406, 244 N.W.2d 873 (1976).

70. The *Turner* court admits that the first requirement of its test—basic continuity of the transferor's enterprise—is the most significant of the three requirements. 397 Mich. at ____, 244 N.W.2d at 883.

71. *See* text accompanying notes 46-53 *supra.*

continuation of the transferor is necessary in the overwhelming majority of courts that consider damages for injury from a defective product to be an obligation of the entity that produced and sold the particular item.[72] Were manufacturer liability based on fault—negligence or willful misconduct—this means of indentifying the potential defendants would be commendable. Strict liability, however, requires no proof of fault on the part of any identifiable party.[73] Therefore, it would seem futile to assess transferee liability by devising a fictitious scheme for imputing fault that need not even exist. Because the *Ray* standard was educed directly from a strict liability policy, the court avoided the necessity of a fiction for treating two entities as one and was able to hold that products liability attaches to the product line itself. The continuity of product line standard, which is explicitly established by the *Ray* holding, has its origin in the second justification for departing from the corporate law analysis: the transferee is in the best position to spread the risk of loss. Using the continuity of product line standard, the *Ray* court determined transferee liability not by examining evidence tending to equate the transferee enterprise with the transferor enterprise but rather by examining evidence, such as product utility and trade name, that tends to show uniformity of the transferor's defective product and the transferee's product line.

Continuity of product line is the only standard that can be justified on strict liability policy grounds as a method for identifying and limiting the class of potential products liability defendants. The fundamental purpose of strict liability is to insure that the individual and social costs of product defects are included in the costs of production[74] so that the product will pay for its own defects. If the transferee manufacturer or seller of the product carries liability insurance, the risk of loss will be spread to the general public and the actual cost of defects in the product will be determined by the actuarial risk involved. The cost of the defects or potential defects will be reflected as the cost of insurance premiums, and that cost will be passed on through increased prices to all consumers of the product. The availability or nonavailability of insurance should not be determinative,[75] however; the ultimate rationale for the test

72. "Although the purpose of imposing strict liability is to create a broader and more widely available basis of recovery, the basis has always been linked to a seller or manufacturer." 16 B.C. IND. & COM. L. REV. 676, 687 (1975). *See generally* RESTATEMENT (SECOND) OF TORTS § 402A (1965).

73. *See* note 6 *supra.*

74. *See* note 14 *supra;* RESTATEMENT (SECOND) OF TORTS § 402A, Comment c (1965).

75. For an example of the unavailability of liability insurance for transferee corpora-

should be that all consumers of the product should share the costs of risks involved in the use of that product to the greatest extent possible.

B. Liquidation of the Transferor

There are indications in both *Turner* and *Ray* that liquidation of the transferor corporation is a necessary prerequisite to recovery from the transferee. Immediate liquidation and dissolution of the transferor is the second component of the three part *Turner* test for transferee liability. *Ray* does not mention a transferor liquidation requirement in stating its holding, but the court does rely on the nonavailability of a remedy against parties other than the transferee, which results from the liquidation of the transferor, as one of the reasons justifying a departure from the corporate law rule of transferee nonliability. Reliance upon the liquidation of the transferor implies that there would be no cause of action against the transferee were the transferor still in existence and solvent. *Ray,* in fact, used the availability of a solvent transferor to distinguish an earlier California case that had refused to hold a transferee liable even though the transferee continued to manufacture and sell the product line formerly marketed by the transferor.[76] Thus, under both *Turner* and *Ray* a transferee defendant should be able to obtain summary judgment by proving the existence of a solvent transferor against whom the plaintiff could have brought suit.

Liquidation of the transferor is a requirement that has no relation to the purpose for which strict products liability is imposed. Requiring dismissal of suit against a transferee whenever a solvent transferor is available implies that the transferee's liability is secondary. The strict liability purpose of spreading the risk of loss through an increased price of the product is inconsistent with a rule imposing liability on a transferor that no longer has any connection with the product line. If the transferor that has ceased to manufacture and sell the product line is held to be liable in preference to the transferee that continues to place the product line on the market, then the only reason for such a preference must be the desire to penalize the transferor for his fault—negligence or willful misconduct. Although there is no need for a products liability plaintiff to prove fault on the part of any particular defendant in order for the

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tions and the practical problems that the unavailability can cause see 16 B.C. IND. & COM. L. REV. 676, 687 (1975).

76. 19 Cal. 3d at ____, 560 P.2d at ____, 136 Cal. Rptr. at 581 n.6.

court to impose strict liability, proof of a defect in the product, which is required, implies that someone involved in the manufacture and distribution was at fault.[77] Considering the lack of even this minute attribute of fault on the part of a transferee corporation that was unrelated to the chain of distribution at the time the defect allegedly occurred, courts may be reluctant to impose liability for defective products on a transferee when the transferor is solvent. Strict manufacturer liability, however, is not based on the negligence or willful misconduct of the transferor. Indeed, the transferor may be as free from fault as the transferee. Because fault on the part of an identifiable defendant is irrelevant to his being held strictly liable, the equities of imposing liability on the transferor rather than the transferee are outweighed, even if they exist, by what the *Ray* court referred to as the paramount policy of strict liability—insuring that the risks of injury from defective products are distributed to the consumers of the product line as a cost of doing business.[78] Since the goal of spreading the risk of loss by an increased cost of the product is fulfilled by transferee rather than transferor liability,[79] the *Greenman v. Yuba Power Products, Inc.*[80] principle that rules and standards should not be used unless they serve the purposes for which products liability is imposed dictates that the transferor liquidation requirement be abrogated.

C. Assumption of Liabilities and Exploitation of Goodwill

The final component of the *Turner* standard is the requirement that the transferee corporation must have assumed the liabilities and obligations of the transferor necessary to continuation of the

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77. *See* Carmichael, *supra* note 6, at 539 n.72; 16 B.C. IND. & COM. L. REV. 676, 687 (1975); Comment, *Tort Defenses to Strict Liability,* 20 SYRACUSE L. REV. 924 (1969).

78. 19 Cal. 3d at ____, 560 P.2d at ____, 136 Cal. Rptr. at 579; *see* Escola v. Coca Cola Bottling Co., 24 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944) (Traynor, J., concurring).

79. The California Court of Appeals in *Ray* mentioned two frequently listed purposes for imposing strict liability other than the risk spreading purpose upon which this discussion has focused. 55 Cal. App. 3d at ____, 127 Cal. Rptr. at 820. Neither of those purposes supports transferor rather than transferee liability. First, imposing liability on either transferor or transferee will equally compensate the plaintiff who was helpless to insure or guard against injury from a defective product. Secondly, the strict liability goal of encouraging improvements in the product is not facilitated by a rule that would impose liability upon a transferor that no longer has any control over the manufacturing process. The argument that the transferor will be encouraged to make product improvements at the time of manufacture in order to prevent liability in the future is not weakened by imposing liability on the transferee since the transferor will have adequate incentive to improve products from the possibility of pre-transfer liability.

80. 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963); *see* text accompanying note 27 *supra.*

transferor's normal business operations. As with the other two components of the *Turner* test this requirement originated as part of the *Shannon* de facto merger exception to the corporate law rule. Imposing liability on only those transferees that assumed the necessary business liabilities of the transferor is a method of insuring that only those transferees with an intent to continue the business enterprises are held liable. The requirement adds nothing useful to the continuity of enterprise component of the *Turner* test; on the other hand, the requirement provides an easy means by which a transferee might evade liability despite continuity of enterprise. By not assuming the transferor's liabilities and obligations, the transferee may be able to escape liability to an injured plaintiff without any strict liability policy reason for allowing such an escape.

The *Ray* court also opens the door for future attempts to avoid liability by relying upon the goodwill requirement as one of the reasons for imposing transferee liability. The third justification given in *Ray* for departing from the traditional analysis of the corporate law rule and its exceptions is that the goodwill purchased by the transferee carries with it the burden of liability for defects in the products that gave rise to the goodwill.[81] The court does not identify failure to purchase the goodwill of the transferor as a characteristic that would distinguish a case that had refused to hold a transferee liable, but a court might refuse to depart from the traditional corporate law analysis on the ground that there had been no attempt by the transferee to exploit the goodwill of the transferor. Such a result would be inconsistent both with the holding as phrased by *Ray* and with the strict liability goal that led to that holding. Permitting a plaintiff to avoid strict liability by declining to exploit the goodwill of the transferor will defeat the purpose for which transferee liability is imposed—to spread the cost of product defects to the consumers of like products.

V. Conclusion

Both *Turner* and *Ray* rejected the corporate law approach and refused to fit their holdings within the framework of one of the exceptions to the general rule of transferee nonliability. Both decisions evidence a growing awareness of the inappropriateness of the corporate analysis for determining what defendants may be liable in a products liability suit. *Turner* borrowed its three-part test from a decision that had justified transferee liability by broadening an

81. 19 Cal. 3d at ____, 560 P.2d at ____, 136 Cal. Rptr. at 580.

existing exception to the corporate law rule. As a consequence, the three components of the *Turner* test, including the essential continuity of enterprise component, resemble those exceptions to the general rule that would tend to equate the transferor and the transferee. *Ray,* on the other hand, devised its continuity of product line test directly from the paramount strict liability policy of spreading the risk of loss to all the consumers of the product line so that the product will bear the social and individual costs of its own defects. In order to effectuate consistently this ultimate purpose of strict liability, a transferee should be liable regardless of the existence and solvency of the transferor and regardless of the assumption of the transferor's business liabilities or the exploitation of the transferor's goodwill. Continuity of product line is the only test based solely upon strict liability policy considerations, and it is the only test that will not lead to results inconsistent with the paramount goal of strict liability. Consequently, transferee liability should be determined solely by examining the resemblance of the transferor's defective product to the product line being placed on the market by the transferee.[82]

P. ANTHONY LANNIE

82. It has not been the purpose of this Recent Development to explore fully the merits and scope of a test basing transferee liability on continuity of product line. For a comprehensive discussion of the continuity of product line test see Note, *supra* note 25, at 1324-32.