Successor Liability Law in Products Liability Actions

by Jeffrey Zager and David L. Johnson

The Traditional Approach
It is universally accepted that, upon a corporate merger, the surviving successor company is liable for injuries caused by defective products manufactured by the preexisting company. Conversely, however, when a company sells or transfers its assets to another company, the acquiring company generally is not liable for injuries caused by defective products manufactured by the predecessor. The rationale for this general rule is that the successor company did not produce, market or sell the specific product that is the subject of the claim and, therefore, should not be held liable. See Restatement (Third) of the Law of Torts, Products Liability §12 cmt. a.

There are, though, four widely recognized, “traditional exceptions” to this general rule of non-liability in the context of asset purchases. As set forth in the Restatement (Third) of the Law of Torts, Products Liability, a successor company may be liable for harm caused by the predecessor company’s defective products if the transaction:

(a) is accompanied by an agreement for the successor to assume such liability;
(b) results from a fraudulent conveyance to escape liability for the debts or liabilities of the predecessor;
(c) constitutes a consolidation or merger with the predecessor; or
(d) results in the successor becoming a continuation of the predecessor.


The first two exceptions, which rarely come into play, speak for themselves and require little discussion. The third “de facto merger” exception and fourth “mere continuation” exception, which arguably overlap, have spawned a fair amount of litigation. These exceptions are typically applicable in the event of “1) a continuity of shareholders; 2) a cessation of ordinary business and dissolution of the predecessor as soon as practically and legally possible; 3) an assumption by the successor of all liabilities and obligations of the predecessor necessary for the uninterrupted continuance of the normal business of the predecessor; and 4) a continuity of management, personnel, physical location, assets, and general business operation.” Jerry J. Phillips, Product Line Continuity & Successor

The Advent of Strict Liability in Tort
The general rule of successor non-liability and the “traditional exceptions” to the rule developed prior to the recognition of strict products liability. 1 L. Frumer & M. Friedman, Products Liability §5.06[2] (1982). With the advent of the notion of strict liability in tort, many courts have considered whether to adopt additional exceptions to the general rule.

Recognition of strict liability in tort is rooted in the policy decision to allocate the costs of harm to a manufacturer who places a defective product into the stream of commerce rather than to an injured consumer. States recognizing strict liability in tort have deemed it preferable to place less significance on determination of who is at fault and more significance on compensation of an injured plaintiff. The adoption of strict liability in tort has caused many courts also to consider whether the public policy principles supporting its recognition warrant adoption of broader exceptions to the general rule of successor non-liability in the context of products liability. Typically, these courts have considered two additional exceptions: the “product line exception” and the “continuity of enterprise exception.”

The Product Line Exception
Since the late 1970s, several states have taken a more liberal approach and have expanded the traditional exceptions to the general rule of successor non-liability. Perhaps not surprisingly, the Supreme Court of California was among the first courts to deviate from the traditional approach, adopting what has come to be known as the “product line exception.”

In Ray v. Alad Corp., 19 Cal.3d 22, 560 P.2d 3, 136 Cal.Rptr. 574 (1977), the plaintiff was
injured after falling from an allegedly defective ladder manufactured by Alad Corporation (Alad I). Prior to the injury, Lighting Maintenance Corporation (LMC) purchased virtually all of Alad I’s assets, including its equipment, inventory, trade name, and goodwill. The agreement did not specify that LMC would be responsible for any liabilities of Alad I. Thereafter, Alad I dissolved and LMC eventually changed its name to “Alad Corporation” (Alad II). The factory employees remained the same and Alad II continued to manufacture the same line of ladders under the “Alad” name. The plaintiff brought suit against Alad II, Alad II was awarded summary judgment, and the plaintiff appealed.

After analyzing the claims under the four traditional exceptions to the general rule of successor non-liability, the Supreme Court of California concluded that these exceptions did not apply. The court, however, considered whether to recognize a “special exception” under the circumstances presented in that case. The court noted that “the paramount policy to be promoted by the rule [of strict tort liability] is the protection of otherwise defenseless victims of manufacturing defects and the spreading throughout society of the cost of compensating them’ (Italics added).” Ray, 560 P.3d at 8–9 (citation omitted). The court determined that, under certain circumstances, this public policy mandated that a special exception be recognized.

In adopting this “special exception,” the Supreme Court of California enumerated three criteria as “[j]ustification” for imposing strict liability upon a purchasing company: (1) the virtual destruction of the plain-

### Table A. States Following Traditional Rule

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<td>West Virginia</td>
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1 It should be noted that several of these states have not considered whether to expand the traditional exceptions. Cases specifically declining to adopt an expansive approach are noted herein.
15 Nissen Corp. v. Miller, 594 A.2d 564 (Md. 1991) (rejecting “continuity of enterprise” exception); Giraldi v. Sears, Roebuck & Co., 687 F.Supp. 987, 991 (D. Md. 1998) (“In this Court’s view… the Maryland courts would neither adopt the product line theory nor otherwise take a liberal approach to the exceptions to the general rule.”).
17 Niccum v. Hydra Tool Corp., 438 N.W.2d 96 (Minn. 1989) (rejecting expansive approach).
25 Western Helicopter Services, Inc. v. Rossorner Aircraft Corp., 728 F.Supp. 1506, 1511 (D. Ore. 1990) (finding that “the Oregon Supreme Court is unlikely to adopt a product line exception, and would most probably hold to the traditional rule regarding successor liability”).
28 In fact, Texas, by statute, has been held to have rejected both the traditional de facto merger and the mere continuation exceptions. See Tex. Bus. Corp. Act Ann. art. 5.10(B) (2002); Shapolsky v. Brewton, 56 S.W.3d 120 (Tex. Ct. App. 2001).
33 Fish v. Amsted Indus., Inc., 376 N.W.2d 820 (Wis. 1985) (rejecting expansive approach).
tiffs’ remedies against the original manufacturer caused by the successor’s acquisition of the business;

(2) the successor’s ability to assume the original manufacturer’s risk-spreading role; and,

(3) the fairness of requiring the successor to assume a responsibility for defective products that was a burden necessarily attached to the original manufacturer’s good will being enjoyed by the successor in the continued operation of business.

Id. Finding that all of these criteria were satisfied, the court concluded that Alad II could be held liable to the plaintiff.

Since the Supreme Court of California’s landmark decision in Ray v. Alad, many other courts have considered whether to follow suit and adopt this “product line exception.” While courts in several other states have suggested that they would recognize the product line exception (see Table D), courts in Mississippi, New Jersey, New Mexico, Pennsylvania and Washington have explicitly joined California in adopting the exception. (See Table B).

In 1981, the New Jersey Supreme Court followed suit in recognizing the product line exception in instances in which an injured plaintiff’s potential remedy is destroyed by a transaction in which the successor company continues to engage in the business of the predecessor and enjoy its trade name and goodwill. See Ramirez v. Amsted Indus., Inc., 431 A.2d 811 (N.J. 1981); Nieves v. Bruno Sherman Corp., 431 A.2d 826, 830 (N.J. 1981) (“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.”). The court noted that the general rule of successor non-liability was not developed to address products liability actions but, instead, to protect commercial creditors and dissenting shareholders following acquisitions and for purposes of tax consequences and contractual obligations. Ramirez, 431 A.2d at 815–16. The court further reasoned that the original manufacturer has transferred to the successor the resources that it had previously used to compensate injured consumers. The successor company is in a position to estimate the possible exposure to liability caused by the predecessor’s actions and to thereby protect itself by insuring for those risks. Id. at 821–22. The court also reasoned that the predecessor could achieve a windfall if it enjoys the benefit of an inflated purchase price—that does not take into account potential product liability actions—and then dissolves. Id. at 822. With the understanding that the product line exception will be applicable, a predecessor company would receive less money for its assets, as the successor would be forced to take into account exposure to liability.

Other states adopting the product line exception have done so for reasons similar to those mentioned by the California and New Jersey courts. See, e.g., Garcia v. Coe Mfg. Co., 933 P.2d 243, 250 (N.M. 1997) (recognizing the exception because the successor, which benefits from the predecessor’s goodwill, can adjust the purchase price to reflect the increased risk); Dawejko v. Jorgenson Steel Co., 434 A.2d 106 (Pa. Super. Ct. 1981) (adopting the reasoning of the New Jersey Supreme Court); Hall v. Armstrong, 692 P.2d 787, 791 (Wash. 1984) (recognizing the exception for the simple reason that the successor’s actions in acquiring the predecessor’s business causes a plaintiff to otherwise be left without a remedy).

The Continuity of Enterprise Exception

Courts in a few other states have elected to expand the traditional exceptions to the rule of successor non-liability but have chosen to take a slightly less radical approach. In the seminal cases of Cyr v. B. Offen & Co., 501 F.2d 1145 (1st Cir. 1974), and Turner v. Bituminous Cas. Co., 244 N.W.2d 873 (Mich. 1976), the “continuity of enterprise” exception was spawned. In essence, this approach expands the traditional “mere continuation” exception, holding the successor company liable if the basic business operation continues (rather than merely the corporate entity). Reasoning that an injured plaintiff should not be treated differently based on whether a corporate transaction was a traditional merger or an asset purchase, the Michigan Supreme Court concluded that an additional exception should be recognized under the following circumstances:

(1) There was a basic continuity of the enterprise of the seller corporation, including, apparently, a retention of key personnel, assets, general business operations, and even the [predecessor’s] name.

(2) The seller corporation ceased ordinary business operations, liquidated, and dissolved soon after distribution of consideration received from the buying corporation.

(3) The purchasing corporation assumed those liabilities and obligations of the seller ordinarily necessary for the continuation of the normal business operations of the seller corporation.

(4) The purchasing corporation held itself out to the world as the effective continuation of the seller corporation.

Turner, 244 N.W.2d at 883–84.

Although courts in a handful of states have suggested that they may recognize this “continuity of enterprise exception” (see Table D), courts in only two other states—Alabama and Alaska—have affirmatively adopted this approach. See Andrews v. John E. Smith’s Sons Co., 369 So.2d 781 (Ala. 1979); Savage Arms, Inc. v. Western Auto Supply Co., 18 P.3d 49 (Alaska 2001). In Savage Arms, the Alaska Supreme Court offered a comprehensive analysis of the public debate concerning expansion of the traditional exception. The court found that “[t]he posited negative effects on the overall economy are too indefinite and speculative to outweigh the policy of compensating persons injured by product defects.” Id. at 57. According to the court: “To permit the successor, which presumably negotiated a discount for potential successor liabilities when dickering over the purchase price, to avoid liability based on lack of causation would give the successor an unwarranted windfall.” Id. at 58. The court also surmised that recognition of the continuity of enterprise exception would encourage existing companies to manufacture safer products. Id.

Rejection of Expansive Approaches

Since the genesis of the product line and continuity of enterprise theories in the late 1970s, numerous courts and commentators have debated the appropriateness of expanding the traditional exceptions to the rule of successor non-liability. See generally Richard L. Cup, Jr., Redesigning Successor Liability, 1999 Univ. Ill. L. Rev. 845 (1999). Although the number of jurisdictions recognizing an additional exception has gradually grown, many courts have declined to expand the
traditional exceptions. (See Table A). The primary criticism of an expansive approach is that it exposes a successor company to damages when it had no involvement in the design, manufacture, marketing or distribution of a defective product.

In 1982, the Florida Supreme Court became one of the first courts to explicitly reject an expansive approach. See Bernard v. Kee Mfg. Co., 409 So.2d 1047 (Fla. 1982). Finding that “[e]xtending liability to the corporate successor is not consistent with at least one major premise of strict liability, which is to place responsibility for a defective product on the manufacturer who placed that product into commerce,” the court noted that the successor company did not create the risk, could not eliminate the risk, and did not warrant the product’s safety or invite its usage. Id. at 1050. See also Jones v. Johnson Machine & Press Co., 320 N.W.2d 481, 484 (Neb. 1982) ("[T]he corporate asset purchaser, as a successor of the manufacturer of a defective product, cannot be said to have created the risk of a product manufactured by its predecessor, and, except in a very remote way, does not realize the profit for the sale of the predecessor’s product."); Fish v. Amsted, 376 N.W.2d 820, 828 (Wis. 1985) ("If the product line exception is utilized, liability will be imposed on a successor corporation not for something it has done, but rather because it may be able to afford liability.").

The Florida Supreme Court also predicted that an expansion of the traditional exceptions could lead to the “economic annihilation [of] small businesses,” which would be forced to liquidate rather than transfer ownership. Bernard, 409 So.2d at 1049–50. The Illinois Court of Appeals, in rejecting an expansive approach, similarly opined that small manufacturers would have difficulty obtaining products liability insurance and that competitive forces would preclude them from attempting to insure the risk simply by raising prices. Nguyen v. Johnson Machine & Press Corp., 433 N.E.2d 1104, 1111 (Ill. Ct. App. 1982). Responding to the suggestion that an expansion is justified due to the successor’s enjoyment of its predecessor’s goodwill, the court noted that the successor pays value for the goodwill at the time of purchase and, therefore, it does not create an unfair windfall. Id. at 1112.

These and other courts have expressed apprehension that the expansive approaches are rooted in public policy notions that require cost-shifting and fundamental changes to well-established tort law. Therefore, many courts have declined to extend the traditional exceptions on the basis that it would be more prudent for the legislative branch to perform this equity-balancing exercise. See, e.g., Winsor v. Glasswerks PHX, LLC, 63 P.3d 1040, 1047–50 (Ariz. Ct. App. 1993); Nguyen, 433 N.E.2d at 1111; Downtownier Inc. v. Weather-Rite, Inc., 347 N.W.2d 118, 125 (N.D. 1984); Fish v. Amsted, 376 N.W.2d 820, 828 (Wis. 1985).

Several courts also have surmised that imposing liability on a successor company will not result in products being made safer. As noted by one court, a successor company that chooses to discontinue one product line that is too dangerous could, nevertheless, be found liable under the continuing enterprise theory. Polius v. Clark Equip. Co., 802 F.2d 75, 81 (3rd Cir. 1986). Accordingly, “[a] system that compensates for accidents perfectly once they have occurred but does nothing to prevent them in the first place is obviously not desirable.” Id. at 82 (quoting G. Calabresi, The Cost of Accidents, 64 (1975)).

In 1997, the American Law Institute (ALI) promulgated the Restatement (Third) of the Law of Tort, Products Liability. The ALI specifically considered whether to expand the traditional exceptions to the successor non-liability rule but declined to do so. Id. §12 cmt.b. The institute noted that a majority of courts that have considered the issue have determined that expanding the exceptions would be “unfair and socially wasteful.” Id. As of this date, a clear majority of states continue to follow the traditional approach. (See Table A).

**Tips for Defending a Successor Company**

When representing a successor company sued by a plaintiff injured by the predecessor’s product, counsel should be fully prepared to defeat the plaintiff’s claims. As a threshold matter, a successor company should scrutinize choice of law issues and be prepared to advocate the applicability of a favorable state’s law. Given the current extent of interstate commerce, this can create many challenges for courts. Suppose that a California plaintiff injured herself in Michigan from a product that she purchased in Illinois. The defective product was manufactured by a New Jersey corporation, whose assets were purchased by a New York corporation in an agreement that specified that Texas law would govern the transaction. Plainly, the state law applied by the forum court would be pivotal in determining whether the successor company faces exposure.

States that follow the Restatement (Second) of Conflicts “most significant relationship” rule typically have leaned toward applying the law of the state of the plaintiff’s residency and/or injury, because the dispute lies in tort. See, e.g., Ruiz v. Blentech Corp., 89 F.3d 320, 322 (7th Cir. 1996); Hoover v. Recreation Equip. Corp., 792 F.Supp. 1484 (N.D. Ohio 1991); Western Helicopter Services, Inc. v. Rogerson Aircraft Corp., 728 F.Supp. 1506, 1512 (D. Ore. 1990); Savage Arms, Inc. v. Western Auto Supply Co., 18 P.3d 49, 53–54 (Alaska 2001). Nevertheless, an argument may be made that the choice of law provision specified in the asset purchase agreement should...
be accorded significance. See, e.g., Standal v. Armstrong Cork Co.; 356 N.W.2d 380, 381–83 (Minn. Ct. App. 1984). (In that respect, it would be advisable for a transactional attorney representing a purchasing company to include a choice of law clause from a state with favorable successor liability laws. The successor should also consider purchasing product liability insurance that will cover products manufactured by the predecessor.)

Even if the law of a state recognizing an additional exception is applied, a successor company may successfully argue that the expansive exception is inapplicable under the circumstances of the case. California courts, for instance, have narrowly construed and applied the product line exception and have required that all three of the Ray v. Alad criteria be satisfied. See Phillips v. Cooper Laboratories, Inc., 215 Cal. App. 3d 1648, 1657 (1989). Suppose that the predecessor company remains an extant and viable entity or ceases to exist several years after the acquisition. Under these circumstances, the first criterion in Ray is not satisfied because the successor's acquisition did not “cause” the destruction of the plaintiffs' remedy. See Leo v. Kerr-McGee Chem. Corp., 37 F.3d 96, 99–100 (3rd Cir. 1994); Conway v. White Trucks, 885 F.2d 90, 95–96 (3rd Cir. 1989); Nelson v. Tiffany Indus., Inc., 778 F.2d 533, 536 (9th Cir. 1985); Kline v. Johns-Manville, 745 F.2d 1217, 1219 (9th Cir. 1984).

Often a company is purchased as part of a decision to avoid liability. In these circumstances, the second criterion in Ray v. Wainwright, 501 S.E.2d 802 (Ga. 1998), and Bullington v. Union Tool Corp., 328 S.E.2d 726 (Ga.1972), the Georgia Supreme Court implicitly recognized both the product line and “continuity of enterprise” exceptions.

An argument may be made that in Farmex, Inc. v. Wainwright, 501 S.E.2d 802 (Ga. 1998), and Bullington v. Union Tool Corp., 328 S.E.2d 726 (Ga.1972), the Georgia Supreme Court implicitly recognized both the product line and “continuity of enterprise” exceptions.

Similarly, Alabama courts have required that all criteria supporting the continuing enterprise theory be satisfied by “substantial evidence” before the exception will be recognized. Asher v. KCS Int'l, Inc., 659 So.2d 598, 599 (Ala. 1995). Thus, even the courts that have chosen to recognize an expansive approach have expressed reluctance to apply the additional exception in a liberal fashion. An astute defense attorney should focus on elements that the plaintiffs will have difficulty establishing and argue that the exception, therefore, does not apply as a matter of law.

Finally, even in situations in which no exception to the non-liability rule applies, a successor company should be prepared to defend against a failure to warn claim. A few courts have found that a successor company that discovers defects in a predecessor's products owes an affirmative duty to warn the predecessor's customers. See, e.g., LaFountain v. Webb Indus. Corp., 951 F.2d 544 (3rd Cir. 1991); Gee v. Tenneco, Inc., 615 F.2d 857 (9th Cir. 1980).

### Conclusion

Expansion of the “traditional exceptions” to the general rule of successor non-liability will continue to be hotly debated among courts throughout the country. Counsel representing successor companies should be prepared to aggressively defend claims brought by plaintiffs injured by a product manufactured by the predecessor company.

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**Table D. States in Which it is Unclear as to Whether Expansive Approach Recognized**

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<th>Connecticut</th>
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**FO43** The authors were unable to locate any decisions in Wyoming addressing successor liability law.


**FO45** An argument may be made that in *Farmex, Inc.* v. *Wainwright*, 501 S.E.2d 802 (Ga. 1998), and *Bullington v. Union Tool Corp.*, 328 S.E.2d 726 (Ga.1972), the Georgia Supreme Court implicitly recognized both the product line and “continuity of enterprise” exceptions.

**FO46** *See Fagundes v. Soly Conversions, Ltd.*, 1990 WL 163533 (9th Cir. (Idaho) Oct. 25, 1990) (denying to apply the product line exception under the specific facts of the case).

**FO47** *See Guerrero v. Allison Engine Co.*, 725 N.E.2d 479, 487 (Ind. Ct. App. 2000) (finding that it “may” be appropriate to recognize the product line exception, but declining to do under the facts in that case).

**FO48** *See Roll v. Tracor, Inc.*, 140 F.Supp.2d 1073 (D. Nev. 2001) (noting that the Nevada Supreme Court has not considered the issue of successor liability and predicting that it would follow California courts).


**FO52** Although no South Carolina state court decisions have considered expanding the traditional exceptions, a South Carolina federal district court recognized the continuity of enterprise exception in *Holloway v. John E. Smith’s Sons Co.*, 432 F. Supp. 454 (D. S.C. 1977).

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