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Strict Liability Be Reconciled with Corporate Law
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Order to Respond Fairly to the Legitimate Interests
of the Products Liability Plaintiff? *Nissen Corp. v.
Miller*, 323 Md. 613, 594 A.2d 564 (1991) (4-2
decision)

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TORTS - SUCCESSOR CORPORATIONS - DEFECTIVE PRODUCTS - CAN THE LAW AND POLICIES OF STRICT LIABILITY BE RECONCILED WITH CORPORATE LAW POLICIES WHICH PROTECT SUCCESSOR CORPORATIONS IN ORDER TO RESPOND FAIRLY TO THE LEGITIMATE INTERESTS OF THE PRODUCTS LIABILITY PLAINTIFF? *Nissen Corp. v. Miller*, 323 Md. 613, 594 A.2d 564 (1991) (4-2 decision).

The issue of successor liability in a products liability case involves questions of both corporate law and strict liability. In this field, a corporation that acquires the assets of another corporation generally does not assume the debts and liabilities of the predecessor.¹ The recognized exceptions to the general rule of successor nonliability, however, were developed to protect creditors and shareholders without regard for the interests of products liability plaintiffs.² Because traditional corporate law principles do not adequately address the issues presented by tort victims, courts and commentators have considered new rules which expand the traditional exceptions.³ One such rule is the continuity of enterprise theory, under which liability is imposed based on a continuation of the business of the predecessor corporation, absent any continuation in ownership.⁴ In *Nissen Corp. v. Miller*,⁵ the Court of Appeals of Maryland considered whether it should adopt the general rule of successor nonliability with its four recognized exceptions⁶ or whether it should add a fifth exception for continuity of enterprise when determining successor liability in a strict products liability case.⁷

In July 1981, Nissen Corporation bought the trade name, patents, inventory and other assets of the American Tredex Corporation.⁸

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1. See *Liability of Successor for Injury Caused by Product of Predecessor*, AMERICAN LAW OF PRODUCTS LIABILITY 3D, Nov. 1990, § 7:1, at 10-12 [hereinafter *Liability of Successor*].
 2. See *Polius v. Clark Equip. Co.*, 802 F.2d 75, 78 (3d Cir. 1986). The general rule, with its four commonly recognized exceptions, "protects creditors and dissenting shareholders, and facilitates determination of tax responsibilities, while promoting free alienability of business assets." *Id.*
 3. See *Giraldi v. Sears, Roebuck & Co.*, 687 F. Supp. 987, 990-91 (D. Md. 1988) (discussing product line theory and continuing liability doctrine in the tort context).
 4. LOUIS FRUMER & MELVIN FRIEDMAN, PRODUCTS LIABILITY § 2.06[3] (1989); *Liability of Successor*, *supra* note 1, §§ 7:19 to 7:24.
 5. 323 Md. 613, 594 A.2d 564 (1991).
 6. See *infra* notes 15-17 and accompanying text.
 7. *Nissen*, 323 Md. at 617, 594 A.2d at 565.
 8. *Id.* at 615, 594 A.2d at 565.

American TredeX retained all accounts receivable arising from sales shipped prior to the purchase date.⁹ A written agreement indicated the intent on the part of Nissen to substantially continue the business of American TredeX, although American TredeX was to remain in business for five years after the transaction.¹⁰ The purchase contract expressly excluded assumption of liability for injuries arising from any product previously sold by American TredeX.¹¹ The contract called for a payment of \$600,000 on execution and a fee of four percent of net sales for the following five year period.¹² Nissen retained some American TredeX employees, although it was not contractually obligated to do so. Nissen moved the business from Indiana to Iowa, and continued to sell replacement parts for equipment sold by American TredeX before the transfer.¹³

In October 1986, more than five years after Nissen's asset purchase, a consumer was injured on a treadmill he had purchased from American TredeX in January 1981. Nearly two years later, in September 1988, the consumer sued both American TredeX and Nissen.¹⁴ At the time suit was filed, American TredeX was administratively dissolved.¹⁵

In reversing the judgment of the court of special appeals and affirming the award of summary judgment for Nissen, the Court of Appeals of Maryland adopted the general rule of successor nonliability, with its four traditional exceptions, and rejected the continuity of enterprise theory. This decision may leave some products liability plaintiffs without a remedy, but it also soundly confirms Maryland's strict liability policy which requires fault on the part of the seller or manufacturer in order to impose tort liability.¹⁶

The general rule of successor corporation liability is:

[A] corporation which acquires all or part of the assets of another corporation does not acquire the liabilities and debts

9. *Id.* at 615-16, 594 A.2d at 565.

10. *Id.* at 615, 594 A.2d at 565. During the five year period for which the seller was to remain in existence, it was to be known by a new name, AT Corporation.
Id.

11. *Id.*

12. *Id.*

13. *Id.* at 616, 594 A.2d at 565.

14. *Id.* The suit also named as defendants AT Corporation and Atlantic Fitness Products, the retailer from whom the consumer had purchased the treadmill.
Id.

15. *Id.*

16. See *Phipps v. General Motors Corp.*, 278 Md. 337, 351-52, 363 A.2d 955, 963 (1976).

of the predecessor unless: (1) there is an express or implied agreement to assume the liabilities; (2) the transaction amounts to a consolidation or merger; (3) the successor entity is a mere continuation or reincarnation of the predecessor entity; or (4) the transaction was fraudulent, not made in good faith, or made without sufficient consideration.¹⁷

Before *Nissen*, the first, second, and fourth exceptions delineated above had been codified in the Corporations and Associations Article of the Maryland Annotated Code.¹⁸ Although the "mere continua-

17. *Id.* at 617, 594 A.2d at 565-66 (quoting *Liability of Successor*, *supra* note 1, § 7:1 at 10-11). See also *Baltimore Luggage Co. v. Holtzman*, 80 Md. App. 282, 290, 562 A.2d 1286, 1289-90 (1989) (discussing the general rule of corporate liability when a corporation acquires the assets of another corporation); 15 WILLIAM M. FLETCHER, *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* §§ 7122, 7123.05 (perm. ed. rev. vol. 1990) (examining general rule of corporate liability, in the products liability context, when there is mere purchase or acquisition of another company's property); FRUMER & FRIEDMAN, *supra* note 4, § 2.06[2] (defining general rule of successor liability).

18. In regard to the express agreement exception, Maryland's Corporations and Associations Code "provides that a successor corporation is liable for all the debts and obligations of the transferor to the extent provided in the articles of transfer." *Baltimore Luggage Co. v. Holtzman*, 80 Md. App. 282, 291, 562 A.2d 1286, 1290 (1989) (quoting MD. CODE ANN., CORPS. & ASS'NS § 3-115(c)(1) (1993)). When no articles of transfer are filed, the sales agreement is treated as "equivalent to the articles of transfer." *Id.* at 292, 562 A.2d at 1291. See also MD. CODE ANN., CORPS. & ASS'NS § 1-101(c) (1993) (defining articles of transfer as "articles of sales").

In determining implied assumption of liability by a successor corporation, consideration of the following factors is suggested:

(a) "[T]he effect of the transfer on the predecessor's creditors," *Ladjevardian v. Laidlaw-Coggeshall, Inc.*, 431 F. Supp. 834, 839 (S.D.N.Y. 1977);

(b) any "[a]dmission of liability by officers or spokespersons of the successor corporation," *id.* at 840;

(c) fact that successor voluntarily pays some debts of predecessor does not necessarily signify assumption of predecessor's debts, see *Metropolitan Life Ins. Co. v. Commercial Nat'l Bank*, 175 A. 295, 296 (Pa. Super. Ct. 1934); and

(d) by continuing to perform the predecessor's contracts, the successor demonstrates intent to assume liability under the contracts, *Automatic Retailers of America, Inc. v. Evans Cigarette Serv. Co.*, 269 Md. 101, 106-07, 304 A.2d 581, 584-85 (1973) (citing *R.E.C. Management Corp. v. Bakst Serv., Inc.*, 265 Md. 238, 289 A.2d 285 (1972)).

In regard to the consolidation or merger exception, Maryland's Corporations and Associations Code "provides . . . that '[t]he successor is liable for all the debts and obligations of each nonsurviving corporation.'" *Baltimore*

tion" exception is not codified, the policy behind this exception permeates the Corporations and Associations and Commercial Law Articles.¹⁹ The codified policy seeks to protect the rights of creditors whenever there is a transfer of assets.²⁰ As noted by the Court of Special Appeals of Maryland, "[t]he 'mere continuation' exception reinforces this policy by allowing a creditor to recover from the successor corporation whenever the successor is substantially the same as the predecessor."²¹

Underlying the four traditional exceptions is a policy to protect creditors and shareholders by preventing the predecessor from escaping liabilities and obligations by changing form but not substance.²² Like Maryland, the majority of states recognizes only the four traditional exceptions to the general rule of successor nonliability.²³ Many courts have refused to expand successor liability where there is no causal relationship between the successor corporation's acts and a consumer's injuries.²⁴ Because the successor corporation neither

Luggage, 80 Md. App. at 290, 562 A.2d at 1290 (quoting MD. CODE ANN., CORPS. & ASS'NS § 3-114(e)(1) (1993)).

In regard to the fraudulent transfer exception, Maryland's Uniform Fraudulent Conveyance Act, codified in MD. CODE ANN., COM. LAW II §§ 15-201 to 15-214, protects the creditors of a transferor by allowing them to levy on property conveyed to a transferee if the transfer was made with the intent to defraud or without fair consideration. *Baltimore Luggage*, 80 Md. App. at 290-91, 562 A.2d at 1290 (citing MD. CODE ANN., COM. LAW II §§ 15-201 to 15-214 (1990)). See also *Smith v. Navistar Int'l Transp. Corp.*, 737 F. Supp. 1446, 1449 (D. Md. 1988) (stating that "the Maryland Uniform Fraudulent Conveyance Act . . . protects the rights of creditors of a corporation which transfers its assets with an intent to defraud or without fair consideration in a manner similar to the [fraudulent conveyance] exception").

19. *Baltimore Luggage*, 80 Md. App. at 297, 562 A.2d at 1293. See, e.g., MD. CODE ANN., CORPS. & ASS'NS §§ 3-114 to 3-115 (1993); Maryland Uniform Fraudulent Conveyance Act, MD. CODE ANN., COM. LAW II, §§ 15-201 to 15-214 (1990); Maryland Bulk Transfers Act, MD. CODE ANN., COM. LAW I, §§ 6-101 to 6-111 (1993).
20. *Baltimore Luggage*, 80 Md. App. at 297, 562 A.2d at 1293.
21. *Id.* The indicia of mere continuation include: common officers, directors and stockholders between successor and predecessor; only one corporation exists after completion of the sale of assets; continuation by purchaser of seller's business practices and policies; sufficient consideration running to seller corporation in light of assets being sold. *Id.*
22. *Id.*
23. See *Nissen Corp. v. Miller*, 323 Md. 613, 632-33, 594 A.2d 564, 573-74 (1991) (citing *Florum v. Elliot Mfg.*, 867 F.2d 570 (10th Cir. 1989) (applying Colorado law); *Conn v. Fales Div. of Mathewson Corp.*, 835 F.2d 145 (6th Cir. 1987) (applying Kentucky law); *Tucker v. Paxson Mach. Co.*, 645 F.2d 620 (8th Cir. 1981) (applying Missouri law); *Swayze v. A.O. Smith Corp.*, 694 F. Supp. 1619 (E.D. Ark. 1988) (applying Arkansas law); *Bernard v. Kee Mfg. Co., Inc.*, 409 So. 2d 1047 (Fla. 1982) (applying Florida law)); FRUMER & FRIEDMAN, *supra* note 4, § 2.06[2]; *Liability of Successor*, *supra* note 1, § 7:1.
24. See *Polius v. Clark Equip. Co.*, 802 F.2d 75 (3d Cir. 1986); FLETCHER, *supra* note 17, § 7123.05; *Liability of Successor*, *supra* note 1, § 7:21.

placed the defective product on the market nor represented that it was safe, most courts and commentators reason that it should not be held responsible for injuries caused by the predecessor's products.²⁵ Those courts further assert that extension of successor liability would frustrate the legitimate needs of certainty and predictability in business transactions because unforeseeable products liability claims complicate transfers, increase transaction costs and inhibit free alienability of corporate assets.²⁶ Finally, many courts conclude that post-transfer imposition of liability on the successor corporation defeats the benefit of the successor's bargain.²⁷

Nevertheless, courts in recent years have been confronted with the argument that the "traditional rule 'runs counter to the products liability policy of placing the burden on the party most able to bear the loss by spreading the risk.'"²⁸ In an attempt to balance the interests of creditors and shareholders with those of products liability plaintiffs, some courts have adopted other approaches which expand the scope of corporate successor liability. The most popular approaches include the "product line" theory, the "independent duty to warn" theory, the "bona fide purchaser" theory and the "continuity of enterprise" theory. This casenote focuses on the continuity of enterprise theory but includes first a brief description of the other three alternative approaches.

Under the product line theory, a successor is held liable for the defective products of the predecessor if the successor acquires substantially all of the predecessor's assets, continues to produce the same product line under a similar name, presents itself to the public as a continuation of the transferor and benefits from the goodwill of the transferor.²⁹ One justification for this theory is based on the elimination of the injured plaintiff's remedy against all but the successor, because in many instances the predecessor company dissolves shortly after the sale transaction. Additional justifications for the product line theory include the successor's ability to spread the risk and cost of product defects among future consumers and the equity of forcing the successor to assume the burdens associated with

25. FLETCHER, *supra* note 17, § 7123.06.

26. See *Polius*, 802 F.2d at 83; *Liability of Successor*, *supra* note 1, § 7:21.

27. See *Liability of Successor*, *supra* note 1, § 7:21.

28. *Giraldi v. Sears, Roebuck & Co.*, 687 F. Supp. 987, 990 (D. Md. 1988) (quoting FRUMER & FRIEDMAN, *supra* note 4, § 2.06[3] at 2-184).

29. See *Ray v. Alad Corp.*, 560 P.2d 3, 10-11 (Cal. 1977) (holding that a party which acquires a manufacturing business and continues the output of its line of products assumes strict tort liability for any defects in products previously manufactured by the predecessor business); FLETCHER, *supra* note 17, § 7123.07 (analyzing state court decisions regarding the product line theory); *Liability of Successor*, *supra* note 1, § 7:25 (defining the exception based on product line continuation).

the benefits of the transferor's goodwill.³⁰ The product line theory has been adopted in California,³¹ New Jersey,³² Pennsylvania³³ and Washington.³⁴ Most courts have rejected this theory, however, because of the absence of fault and causation on the part of the successor corporation and the additional constraint it places on business transfers. Unlike the established exceptions to the general rule of successor nonliability, the product line theory imposes liability absent any continuity in shareholders or an agreement to assume liability. Liability is premised on the fact that the successor holds itself out as a continuation of the predecessor and destroys or curtails consumer remedies by virtue of its acquisition.

The independent duty to warn theory imposes liability on a successor corporation for failure to warn prior customers of potential defects in the predecessor's product when a special relationship exists between the successor corporation and the predecessor's customers.³⁵ The requisite "special relationship" is said to exist when the successor takes over the predecessor's service contracts, repairs and services the predecessor's products and has knowledge of product defects and of the location of the product owner.³⁶

The bona fide purchaser doctrine, like the independent duty to warn doctrine, is an emerging theory of successor liability that holds a successor accountable if it knew or should have known of its predecessor's defective products.³⁷ While the established exceptions to the general rule of successor nonliability focus on the form of the transfer, the independent duty to warn and bona fide purchaser doctrines focus on the successor's knowledge of product defects. Both of these doctrines comport with the causation rationale underlying strict liability, and both protect successor corporations from the imposition of unknown liabilities. Although the successor is not responsible for placing the defective product on the market under either theory, the successor's knowledge of defects in the predecessor's products and its contribution to the dissolution of the predecessor indirectly cause the plaintiff's injuries and eliminate his or her

30. See Ray, 560 P.2d at 10-11 (1977); FLETCHER, *supra* note 17, § 7123.07; *Liability of Successor*, *supra* note 1, § 7:26.

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

32. See Ramirez v. Amsted Indus., Inc., 431 A.2d 811 (N.J. 1981).

33. See Dawejko v. Jorgensen Steel Co., 434 A.2d 106 (Pa. 1981).

34. See Martin v. Abbott Labs., 689 P.2d 368 (Wash. 1984).

35. *Liability of Successor*, *supra* note 1, § 7:32.

36. See FLETCHER, *supra* note 17, § 7123.08; FRUMER & FRIEDMAN, *supra* note 4, § 2.06[5]; *Liability of Successor*, *supra* note 1, § 7:33.

37. Timothy J. Murphy, Comment, *A Policy Analysis of a Successor Corporation's Liability for its Predecessor's Defective Products When the Successor Has Acquired the Predecessor's Assets for Cash*, 71 MARQ. L. REV. 815, 848-50 (1988).

recourse to the predecessor. Both theories prohibit business transfers that aim to destroy products liability claims by forcing either the predecessor or the successor to provide for potential claims.

In addition to the four traditional exceptions,³⁸ Alabama, Michigan, Mississippi and Ohio recognize the continuity of enterprise exception;³⁹ the status of this fifth exception remains uncertain in New York, New Hampshire and South Carolina.⁴⁰ Under the continuity of enterprise theory, a successor corporation is liable for damages caused by the defective products of its predecessor if there is a "substantial continuity of pretransaction and posttransaction business activities resulting from the use of the acquired assets."⁴¹ Substantial continuity is found based on the retention of management, personnel, physical location and assets or the manufacture of the same product for the same market under the same trade name, or both.⁴² Although the traditional mere continuation exception focuses on continuation of the corporate entity, the continuity of enterprise exception concentrates on continuation of the business operation or enterprise.⁴³ Under this expanded exception, a successor corporation may be held liable despite a lack of continuity of shareholders or an agreement to the contrary between the predecessor and successor.⁴⁴

In *Turner v. Bituminous Casualty Co.*,⁴⁵ a plaintiff who sustained injuries while using a power press brought a products liability suit against the corporate successor that acquired the assets of the original manufacturer through a cash purchase.⁴⁶ The successor corporation retained the seller's key personnel, assets, general business operations and name.⁴⁷ Additionally, the successor assumed those liabilities ordinarily necessary for the continuation of the enterprise and the seller liquidated and dissolved four days after the sale.⁴⁸ The purchase agreement required the successor to assume those liabilities reflected on the seller's balance sheet as of the closing date; no mention was made in the agreement regarding liabilities which might accrue in the

38. See *supra* note 17 and accompanying text.

39. *Liability of Successor*, *supra* note 1, § 7:19 (citing cases).

40. *Liability of Successor*, *supra* note 1, § 7:22 (citing cases). The continuity of enterprise exception has been rejected in Arkansas, Colorado, Iowa, Minnesota, North Dakota, Vermont and Wisconsin. *Id.* (citing cases).

41. *Id.* § 7:20.

42. FLETCHER, *supra* note 17, § 7123.06 at 275.

43. FRUMER & FRIEDMAN, *supra* note 4, § 2.06[3]; *Liability of Successor*, *supra* note 1, § 7:20.

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

45. 244 N.W.2d 873 (Mich. 1976).

46. *Id.* at 874-75.

47. *Id.* at 874.

48. *Id.* at 875-76.

future.⁴⁹ Espousing the continuity of enterprise doctrine, the Supreme Court of Michigan reversed the lower court's summary judgment for the defendant successor corporation.⁵⁰

The decision of the Supreme Court of Michigan was predicated on its treatment of the case "first and foremost" as a products liability case.⁵¹ Although the traditional exceptions to successor non-liability were developed to address creditor, shareholder and tax issues, Michigan's courts and legislature had not yet addressed the problems of products liability plaintiffs in this context.⁵² Owing to the new and evolving nature of products liability law, and the unsuitability of existing rules to the problems of tort victims, the court found it inappropriate for the traditional rules of successor liability to hinder the development of products liability law in this area.⁵³ The court elected to emphasize an approach to successor liability based on the rationale that a manufacturer is in a better position than a consumer to bear the cost of injury, to predict and insure against the risk of defective products and to improve product quality.⁵⁴

The court determined that the traditional rules of corporate successor liability were inadequate to address the needs of products liability plaintiffs because, regardless of the form of the corporate transfer,⁵⁵ once the predecessor corporation becomes defunct, an injured person is forced to look to the successor corporation for restitution.⁵⁶ In a transaction involving a sale of corporate assets for cash, the *Turner* court set forth four principles necessary to establish a prima facie case of continuity of enterprise:

- 1) There was 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.

49. *Id.*

50. *Id.* at 884.

51. *Id.* at 877.

52. *Id.* at 878.

53. *Id.* at 877-78.

54. *Id.* at 881.

55. *Id.* at 883. The court reasoned that

it does not make sense or promote justice to require a merger and a defacto merger to respond to products liability suits, and then to leave a transfer of assets for cash free from suit, when the needs and objectives of both the injured party and the corporation are the same in all three instances.

Id.

56. *Id.* at 878.

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.⁵⁷

Where a company holds itself out as the effective continuation of its predecessor and benefits from its goodwill, the court indicated that it is unfair not to impose the burdens affiliated with the business on the successor.⁵⁸ Finally, the court reasoned that imposition of liability under the continuity of enterprise theory would not significantly inhibit or interfere with corporate acquisitions because successor corporations are able to anticipate and accommodate products liability claims through "insurance, indemnification agreements or escrow accounts, or even a deduction from the purchase price"⁵⁹

In *Cyr v. B. Offen & Co.*,⁶⁰ after the death of the owner of a sole proprietorship, the employees of the company purchased the assets of the business for cash and held it out as an ongoing enterprise. The successor assumed existing service and contract obligations, purchased the goodwill of the business and provided no notice that a new business had been created. Finally, the purchase agreement specifically excluded assumption of tort liability by the successor. In holding the successor corporation liable for injuries sustained by two employees of the corporation while they were cleaning a printing press, the United States Court of Appeals for the First Circuit, applying New Hampshire law, focused on the continuity

57. *Id.* at 883-84.

58. *Id.* at 881. In *Bonee v. L & M Constr. Chemicals*, 518 F. Supp. 375 (M.D. Tenn. 1981), the district court, applying Ohio law, ruled that the successor could be held liable under the continuity of enterprise theory. *Id.* at 382. The court's recognition of the continuity of enterprise theory was primarily based on Ohio's strict liability policy of "spreading the risk of loss to all consumers of a product so that the product will bear the social and individual costs of its own defects." *Id.* at 381. Because the successor made a "measured business choice" in acquiring all assets and the benefits of good will and because it was better able to bear the burdens and protect itself by obtaining liability insurance, the court concluded that it would be unfair to permit a successor to avoid its predecessor's tort liabilities. *Id.* at 382.

Similarly, in *Andrews v. John E. Smith's Sons Co.*, 369 So. 2d 781 (Ala. 1979), the Supreme Court of Alabama held that where a successor "purposefully established an appearance of continuity to promote sales," it should be estopped from denying products liability, even though it may have an agreement with the predecessor to the contrary. *Id.* at 785. The court indicated that the continuity of enterprise theory was applicable to the facts in *Andrews* because under the successor, the same products were manufactured by the same people, in the same place and the successor attempted to benefit from the reputation of the seller by holding itself out as a continuation of the seller. *Id.*

59. *Turner*, 244 N.W.2d at 883.

60. 501 F.2d 1145 (1st Cir. 1974).

of the business enterprise.⁶¹ The traditional exceptions to successor liability were developed to deal with tax assessment and to promote fairness to creditors and freedom in business transactions.⁶² Therefore, the court explained that "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."⁶³ The court discussed the policies underlying imposition of strict liability on manufacturers, and noted that the same policies were likewise applicable to those manufacturers' successors which continued to manufacture and service the predecessors' products and which acquired the experience and expertise of the predecessor.⁶⁴ Because the successor knows the product, it is better able to gauge and manage the risk and cost of product defects and to improve the quality of products.⁶⁵ Also, because the successor profits from the seller's goodwill, it should assume the burdens associated with that goodwill, regardless of whether or not it placed the product on the market.⁶⁶ The court highlighted the fact that the same employees who were involved in the manufacture of the defective product continued to produce the same product in the same plant for the successor, in order to de-emphasize the significance of the change in ownership of the entity, so that it no longer served as a dispositive factor rendering the successor immune from liability.⁶⁷

61. *Id.* at 1153-54.

62. *Id.* at 1152-53.

63. *Id.*

64. *Id.* at 1153-54.

65. *Id.* at 1154.

66. *Id.*

67. *Id.*; see also *Holloway v. John E. Smith's Sons Co.*, 432 F. Supp. 454 (D.S.C. 1977) (relying on the reasoning of *Cyr v. B. Offen & Co., Inc.*, 501 F.2d 1145 (1st Cir. 1974), to establish that the plaintiff's claim could properly be considered under the continuity of enterprise exception); cf. *Mozingo v. Correct Mfg. Corp.*, 752 F.2d 168 (5th Cir. 1985). In *Mozingo*, the successor continued to manufacture the predecessor's product, maintain service contracts and sell parts related to the product and promote the long history of production of the product. *Id.* at 173. The same management and employees continued to work for the successor in the same location. *Id.* The new corporation was represented in the management of the predecessor and "there was a substantial degree of identity of stockholders . . . in the sense that the [predecessor's] stock was simply converted to [successor] stock." *Id.* at 176. The United States Court of Appeals for the Fifth Circuit affirmed the district court's instructions regarding successor liability under the continuity of enterprise exception (applying Mississippi law) and held that because the same management and stockholders were represented in both the predecessor and successor corporations, liability was not imposed without responsibility. *Id.* at 175-76. The fact that the successor corporation was represented in the stockholders and management of the predecessor made it aware of the potential for products liability claims, so both predecessor and successor were in the same position to assume

Finally, the court stated that the "protective language in the purchase agreement, specifically excluding the assumption of any tort liability . . . cannot determine the rights of third parties, when no effort to give notice of the change was made."⁶⁸

In *Flaughner v. Cone Automatic Machine Co.*,⁶⁹ the Supreme Court of Ohio refused to adopt the product line theory because it represented a serious departure from the traditional exceptions to successor nonliability that the court considered best addressed by the legislature.⁷⁰ Although the court also considered the expanded continuity view espoused by *Turner*, it found that view inapplicable under the facts at issue.⁷¹ As a result, the court embraced only the four traditional exceptions, in contradiction with the *Bonee* court.⁷² The court's declaration that the mere continuation exception has been narrowly construed in order to protect corporations from unassumed liabilities, and its fear that adoption of the product line theory "would cast a potentially devastating burden on business transfers and would convert sales of corporate assets into traps for the unwary,"⁷³ strongly suggest that Ohio is not willing to find liability beyond the established exceptions.

The state of the law in New York with respect to the continuity of enterprise theory is somewhat unclear due to a split in lower court decisions. In *Schumacher v. Richards Shear Co.*,⁷⁴ the Court of Appeals of New York discussed the continuity of enterprise doctrine and applied the test set forth in *Turner*.⁷⁵ The court found, however, that the facts before it did not warrant application of either the continuity of enterprise or product line exceptions, and consequently adopted neither theory.⁷⁶

In *Radziul v. Hooper, Inc.*,⁷⁷ the Monroe County Supreme Court interpreted *Schumacher* as rejecting both the product line and continuity of enterprise theories, in accord with the majority of other jurisdictions.⁷⁸ Based on that interpretation and the facts before it,

the risk spreading role that underlies strict liability. *Id.* at 176. Lastly, consistent with strict liability policies, the court found that because the product did not leave the company until after the successor had assumed control, there was sufficient evidence for a jury to conclude that the successor actually placed the product on the market. *Id.* at 177.

68. *Cyr*, 501 F.2d at 1153.

69. 507 N.E.2d 331 (Ohio 1987).

70. *Id.* at 337.

71. *Id.* at 336.

72. *See supra* note 58.

73. *Flaughner*, 507 N.E.2d at 337.

74. 451 N.E.2d 195 (N.Y. 1983).

75. *Id.* at 198.

76. *Id.* at 197-98.

77. 479 N.Y.S.2d 324 (N.Y. App. Div. 1984).

78. *Id.* at 326. *See also* *Santa Maria v. Owens-Illinois, Inc.*, 808 F.2d 848, 858

the court's decision focused on a discussion of successor liability in the duty to warn context.⁷⁹

On the other hand, the Queens County Supreme Court in *Salvati v. Blaw - Lenox Food & Chemical Equipment, Inc.*⁸⁰ accepted the continuity of enterprise theory based on *Turner's* compelling logic.⁸¹ The court reasoned that because the continuity of enterprise doctrine was inapplicable to the facts in *Schumacher*, the court of appeals was unable to properly consider the theory.⁸² Consequently, the court of appeals' failure to adopt the theory was not interpreted as a rejection of the theory, but rather as a decision to leave the issue open for consideration and possible adoption in a proper case.⁸³ The Queens County court decided to adopt the continuity of enterprise theory based on its view that the holding in *Turner* was consistent with traditional tort principals; i.e., that liability was imposed on a successor based on its act of holding itself out as a continuation of the original enterprise.⁸⁴ Secondary reasons that influenced the court's decision include the unavailability of a remedy against the original manufacturer, the availability of the successor as a "deep pocket" to provide a remedy and to spread risk, and the fairness of forcing the successor to bear the burdens affiliated with the benefits of its asset and goodwill purchase.⁸⁵

Finally, in *Diaz v. South Bend Lathe, Inc.*,⁸⁶ the United States District Court for the Eastern District of New York, relying on *Cyr*, held a successor corporation liable because it had continued the predecessor's general business operations in all material respects.⁸⁷ The court agreed with *Cyr's* reasoning that it is unfair to allow a successor corporation to avoid liability solely because no stock is transferred, when the essence of the transaction is an ongoing business with no change in employees, product, supervision and plant.⁸⁸ Be-

(1st Cir. 1986) (applying New York law, court concluded that the Court of Appeals of New York in *Schumacher* rejected the product line and continuity of enterprise theories espoused in *Turner* and *Alad*).

79. *Radziul*, 479 N.Y.S.2d at 326.

80. 497 N.Y.S.2d 242 (N.Y. App. Div. 1985).

81. *Id.* at 247.

82. *Id.* at 245.

83. *Id.* at 245-46.

84. *Id.* at 247.

85. *Id.* at 244-45.

86. 707 F. Supp. 97 (E.D.N.Y. 1989).

87. 707 F. Supp. at 101. All of the predecessor's assets were purchased for cash. *Id.* Although the successor did not retain any of the upper-tier management or directors, it did hire 95% of the predecessor's employees, assumed manufacturing contracts and continued to use the same plant, designs, assets, patents and customer lists. *Id.* at 101-02.

88. *Id.* at 101.

cause the successor incorporated the predecessor's ongoing business into its own, the transaction was in effect a "de-facto merger."⁸⁹ In addressing the liability of a subsequent successor and co-defendant, however, the court found no liability based on *Turner's* continuity of enterprise doctrine because the original successor continued in existence after the sale transaction.⁹⁰

The principal case cited in opposition to the continuity of enterprise doctrine is *Polius v. Clark Equipment Co.*⁹¹ In *Polius*, the plaintiff brought suit against a successor for injuries resulting from an allegedly defective crane that was designed and manufactured by a predecessor corporation.⁹² Under the sales agreement, the successor purchased most of the seller's assets for cash, including customer lists, goodwill, tradenames, trademarks and patents.⁹³ The successor assumed liability for trade accounts, payroll and other contract obligations. On the other hand, the successor expressly rejected assumption of tort liabilities, and the seller agreed to indemnify the purchaser against all claims arising out of its operations.⁹⁴ Although the agreement did not require that the seller dissolve, it became a corporate shell within a year after the sale, and dissolved four years later.⁹⁵ The successor continued to manufacture cranes, provide replacement parts to its distributors, and service machines through distributors.⁹⁶ At the time of the plaintiff's accident, however, the successor was no longer manufacturing cranes.⁹⁷ No officers or directors of the seller were retained by the successor.⁹⁸

In *Polius*, the United States Court of Appeals for the Third Circuit, applying the law of the Virgin Islands, rejected the continuity of enterprise theory, primarily because it disregards the causation requirement that is fundamental to tort law.⁹⁹ Since a deterrence rationale underlies the causation requirement, the continuity theory

89. *Id.* at 102.

90. *Id.* at 102-03.

91. 802 F.2d 75 (3d Cir. 1986).

92. *Id.* at 76.

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.* at 83 n.9.

98. *Id.* at 76.

99. *Id.* at 81-82. The Restatement of Torts requires a causal relationship between the defendant's act and the plaintiff's injury. RESTATEMENT (SECOND) OF TORTS § 402A (1965). By imposing liability on the successor corporation, the continuity of enterprise theory imposes liability on an entity which has no connection with the acts causing the injury. *Polius*, 802 F.2d at 81. It is the predecessor which caused the harm by placing the dangerous product on the market. *Id.* at 82.

promotes further inconsistency by "imposing liability where deterrence would not be furthered."¹⁰⁰ Although the continuity theory is based on a need to compensate strict liability plaintiffs, the court saw "no principled distinction between victims of corporate negligence and those whose recovery rests on § 402A"¹⁰¹ The fact that strict liability enables plaintiffs to obtain judgment without proof of negligence does not mean that it was necessarily implemented to improve a plaintiff's ability to collect on that judgment.¹⁰² In opposition to the notion that successor corporations are best able to assume the cost of product defects, the court cited significant difficulties many manufacturers face in attempting to obtain products liability insurance, including problems with availability, affordability and adequacy of coverage.¹⁰³ Lastly, the court found that the continuity of enterprise doctrine concentrates exclusively on the needs of the products liability plaintiff while discarding the "equally valid arguments of the business world."¹⁰⁴

In 1988, two judges of the United States District Court for the District of Maryland, applying Maryland law, considered the continuity of enterprise doctrine in the context of two products liability cases. First, in *Smith v. Navistar International Transportation Corp.*,¹⁰⁵ Judge Niemeyer, relying on the reasoning in *Cyr* and the lower court's decision in *Polius*,¹⁰⁶ predicted that Maryland would accept

100. *Polius*, 802 F.2d at 82.

101. *Id.* at 80.

102. *Id.* Plaintiffs with judgments based on negligence claims have always had an equal right to priority as those with strict liability judgments; as such, these claimants are in the same situation when a company dissolves, leaving nothing behind to satisfy judgments. *Id.* The *Polius* court did note, however, that the time lag that may elapse between the time of manufacture and the resultant injury does present one significant distinction between strict products liability claims and negligence claims. *Id.* Since products liability claims are more likely than negligence claims to entail lengthy time lags between the harmful act and the resultant injury, product liability plaintiffs may have more difficulty collecting judgments due to intervening corporate dissolution. *Id.* at 80-81. The courts adopting the continuity of enterprise theory, however, have not advanced this consideration. *Id.* at 81.

103. *Id.* at 82. Additionally, the court noted that although a large corporation may be able to spread the cost of product liability claims over its broad customer base, smaller corporations are unable to do the same. *Id.* at 81.

104. *Id.* at 83. Reasonable predictability is important in business decisions. The imposition of unknown liabilities on corporate successors complicates transfers, increases transaction costs and defeats the legitimate expectations of the parties. *Id.*

105. 737 F. Supp. 1446 (D. Md. 1988).

106. In *Polius*, the district court granted the plaintiff's motion for partial summary judgment on the basis of the continuity of enterprise doctrine. *Polius*, 802 F.2d at 75. This grant was reversed by the decision of the third circuit court of appeals to reject the continuity of enterprise doctrine. *Id.* at 84.

the continuity of enterprise theory. The court was persuaded by the equitable concept that the substitution of one corporation for another manifested an intent by the successor to assume the predecessor's tort liability, despite an expressed intent to the contrary.¹⁰⁷ The court in *Smith*, however, did not hold the successor liable under the continuity of enterprise theory because the original manufacturer remained a viable entity.¹⁰⁸

Second, in *Giraldi v. Sears, Roebuck & Co.*,¹⁰⁹ Judge Smalkin predicted that Maryland would reject the continuity of enterprise theory. In support of his prediction, Judge Smalkin noted Maryland's "particularly conservative" stance in the field of products liability law, the general policy to construe the four established exceptions narrowly, and limited recognition of successor liability in corporate matters in Maryland case law.¹¹⁰

In *Miller v. Nissen Corp.*, the Court of Special Appeals of Maryland rejected the product line theory but adopted an expanded interpretation of the mere continuation exception where the "predecessor corporation is functionally extinct at the time [an] action is filed."¹¹¹ The court seemingly adopted the continuity of enterprise theory based on the need to protect consumers "who [have] no information relative to . . . internal corporate changes."¹¹² In reversing the decision of the court of special appeals, the Court of Appeals of Maryland adopted the four traditional exceptions to the general rule of successor nonliability, but refused to adopt the continuity of enterprise theory.¹¹³ To assess the applicability of the rules of corporate successor liability in the context of a products liability case, the court first examined the policies supporting Maryland's adoption of strict liability.

In *Phipps v. General Motors Corp.*,¹¹⁴ the Court of Appeals of Maryland adopted strict liability in tort as set forth in the Restatement (Second) of Torts § 402A (1965).¹¹⁵ The basic justifications for strict

107. *Smith*, 737 F. Supp. at 1447, 1449.

108. The court noted that one of the key elements of the continuity of enterprise doctrine was the unavailability of the predecessor to be sued for its tortious conduct. *Id.* at 1451.

109. 687 F. Supp. 987 (D. Md. 1988).

110. *Id.* at 991-92.

111. *Miller v. Nissen Corp.*, 83 Md. App. 448, 456, 575 A.2d 758, 762 (1990). The court referred to this expanded exception as the "substantial continuation" exception, i.e., the continuity of enterprise. *Id.* at 455, 575 A.2d at 762.

112. *Id.* at 457, 575 A.2d at 763 (quoting *Baltimore Luggage Co. v. Holtzman*, 80 Md. App. 282, 296 n.10, 562 A.2d 1286, 1293 n.10 (1989)).

113. *Nissen Corp. v. Miller*, 323 Md. 613, 632, 594 A.2d 564, 573-74 (1991).

114. 278 Md. 337, 363 A.2d 955 (1976).

115. RESTATEMENT (SECOND) OF TORTS § 402A (1965). This section provides:

(1) One who sells any product in a defective condition unreasonably

liability are that (1) a seller has a special responsibility toward the consumer and (2) the seller is in the best position of all possible parties to take precautions against product defects and to absorb and protect against the cost of injuries caused by products that it manufactures and markets.¹¹⁶ Although the *Phipps* court found these reasons persuasive, it did not view strict liability as a "radical departure from traditional tort concepts"¹¹⁷ that dispenses with the element of fault. Instead, the court found that a seller was impliedly at fault when it placed a defective product on the market.¹¹⁸ Additionally, because the seller was in a better position to guard against defects, it would be inequitable to force consumers to bear the costs of injuries as a result of their inability to meet the proof requirements of a negligence action.¹¹⁹ By holding a seller accountable for placing a defective and unreasonably dangerous product on the market which injures a user, the "Restatement reaffirms the notion of a causal relationship between the defendant's [seller's] acts and the plaintiff's [user's] injury—a concept that is fundamental to tort law."¹²⁰ Con-

dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if

(a) the seller is engaged in the business of selling such product, and

(b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.

(2) The rule stated in Subsection (1) applies although

(a) the seller has exercised all possible care in the preparation and sale of his product, and

(b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

Id.

116. *Miles Lab., Inc. v. Doe*, 315 Md. 704, 717, 556 A.2d 1107, 1114 (1989); RESTATEMENT (SECOND) OF TORTS § 402A cmt. c (1965).

117. *Phipps*, 278 Md. at 351-52, 363 A.2d at 963. See *Nissen*, 323 Md. at 622-23, 594 A.2d at 568-69; *Miles Lab., Inc.*, 315 Md. at 717, 556 A.2d at 1113; *Harig v. Johns-Manville Products Corp.*, 284 Md. 70, 83-84, 394 A.2d 299, 306-07 (1978).

118. *Phipps*, 278 Md. at 351, 363 A.2d at 955.

119. *Id.* at 352, 363 A.2d at 963. The court reasoned that

the seller is not an insurer, as absolute liability is not imposed on the seller for any injury resulting from the use of his product. Proof of a defect in the product at the time it leaves the control of the seller implies fault on the part of the seller sufficient to justify imposing liability for injuries caused by the product.

Id. (citations omitted). See also *Harig*, 284 Md. at 83-84, 394 A.2d at 307 ("[T]he major distinction between an action in strict liability in tort and one founded on traditional negligence theory relates to the proof which must be presented by the plaintiff.") (quoting *Phipps*, 278 Md. at 350-51, 363 A.2d at 962).

120. *Polius v. Clark Equip. Co.*, 802 F.2d 75, 81 (3d Cir. 1986).

sequently, the concepts of fault and causation are inherent in Maryland's strict products liability policy.

The absence of a causal relationship between Nissen and the alleged harm was pivotal to the court's decision.¹²¹ Based on the facts, Nissen was not the seller and was not responsible for bringing the defective product and the plaintiff together.¹²² The court also concluded that extension of liability under the continuity of enterprise theory would frustrate the need for stability and predictability in business transactions because unforeseeable products liability claims discourage corporate transfers and acquisitions.¹²³ The court rejected the argument that a successor corporation should be held liable because it benefits from the goodwill of the predecessor, finding instead that when a predecessor's defective products cause injuries, the successor will "suffer a resultant loss in the value of the goodwill it purchased."¹²⁴ Because the successor loses some of the benefit of its original bargain, further imposition of liability for the predecessor's product defects would be inequitable.¹²⁵

Because it emphasized the causation requirement inherent in strict liability law, the court accepted much of the rationale advanced in *Polius*.¹²⁶ Like the *Polius* court, the Court of Appeals of Maryland dismissed the notion of the successor as a "deep pocket" that was best able to bear the burden of product defects by assuming the risk-spreading role and protecting itself with liability insurance.¹²⁷ Consistent with *Polius*, the court also concluded that well established corporate law policies deserve at least as much merit as the evolving strict products liability policies and concerns. This finding is evident in the court's attack on the *Turner* decision, where it stated "[w]e do not agree that traditional rules of successor liability should be 'shaken off' as 'impediments.'"¹²⁸ This tendency to discard corporate law principles and focus exclusively on strict liability concerns was a significant factor in the court's rejection of the rationale in *Cyr*, *Turner* and their progeny. The predominant reason for the court's

121. See *Nissen*, 323 Md. at 624, 633, 594 A.2d at 569, 574.

122. *Id.* at 625, 594 A.2d at 570.

123. *Id.* at 624 n.2, 594 A.2d at 569 n.2.

124. *Id.* at 629, 594 A.2d at 570.

125. Because the successor pays for the predecessor's goodwill in the asset transfer, subsequently discovered product defects diminish the benefit of the successor's bargain by damaging the company's reputation, the product's reputation, or both. Therefore, holding a successor liable for the defective products of its predecessor serves as a double penalty against the successor. See *Murphy*, *supra* note 37, at 835-36.

126. *Nissen*, 323 Md. at 627, 594 A.2d at 571.

127. *Id.* at 624-25, 594 A.2d at 569-70.

128. *Id.* at 629, 594 A.2d at 572 (quoting *Turner v. Bituminous Gas Co.*, 244 N.W.2d 873, 877 (Mich. 1976)).

rejection of such cases was, however, their disregard for the fundamental concept of fault inherent in tort law.¹²⁹

The court's holding is consistent with the majority position and with Maryland's strict liability policy, which requires some degree of fault, i.e., a causal relationship between a defendant's acts and a plaintiff's injuries.¹³⁰ The court's decision was well-reasoned because corporate law policies and strict liability policies each present equally valid concerns that must be balanced by the court. Just as it is unfair to destroy a plaintiff's remedy through a corporate transfer of assets, it is equally unfair to deny a purchasing corporation the benefit of its bargain through the imposition of unanticipated liabilities.

None of the alternative theories of successor liability directly apply to the factual circumstances at issue in the case. Inconsistent with the continuity of enterprise exception, the seller corporation did not cease ordinary business operations, liquidate and dissolve soon after the asset transfer. In fact, the transferor was required by agreement to remain in business for at least five years after the transfer in order to indemnify the successor from product liability. Also, the successor relocated the transferor's business, retained only a few of the transferor's employees, and notified its dealers of the acquisition.¹³¹ Contrary to the product line theory, the successor's acquisition of the transferor's assets did not destroy the injured plaintiff's recourse to the predecessor, and the injured plaintiff was notified of the acquisition.¹³² Lastly, neither the independent duty to warn nor the bona fide purchaser theories apply under the circumstances at issue because there was no evidence that the successor corporation had any knowledge of defects in the predecessor's products.¹³³

Although the court considered the societal value of allowing a consumer to recover for his injuries, it stressed the unfairness of requiring a successor to bear the cost of "unassumed and unanticipated products liability claims primarily because it is still in business and is perceived as a 'deep pocket.'" ¹³⁴ The court, however, failed to consider what remedies, if any, remain for an injured consumer when the successor's acquisition later eliminates the predecessor and destroys the ability of the injured party to seek redress from the party actually responsible for the defective product. In *Nissen*, one might reasonably expect that after the passage of the required five year indemnification period, the successor corporation should be

129. *Id.* at 633, 594 A.2d at 574.

130. *Id.* at 623, 633, 594 A.2d at 569, 574.

131. *Id.* at 616, 594 A.2d at 565.

132. *Id.* at 626, 594 A.2d at 570.

133. *Id.* at 626 n.3, 594 A.2d at 570 n. 3.

134. *Id.* at 624, 594 A.2d at 569.

subject to liability. Just as the four established exceptions protect creditors and shareholders by precluding a change in corporate structure that permits a corporation to escape debts and liabilities, the law should protect products liability plaintiffs by precluding any manipulation of corporate structure which circumvents future products liability claims.

The decision of the Court of Appeals of Maryland in *Nissen Corp. v. Miller* reaffirms Maryland's conservative stance with respect to products liability law¹³⁵ and reinforces Maryland's strict liability policy which requires fault in order to impose tort liability.¹³⁶ Recognition of only the traditional exceptions to the general rule of successor nonliability, on the other hand, fails to respond to the legitimate interests of products liability plaintiffs. To protect products liability plaintiffs from the elimination of remedies, and successor corporations from the imposition of unknown liabilities, Maryland should consider adoption of the independent duty to warn and bona fide purchaser theories. Both of these theories comport with the causation rationale of Maryland's strict liability policies and with its corporate law policies.

It is inappropriate to allow products liability law to develop in this context on a case-by-case basis in the courts, because such a policy promotes inconsistent results and forces the courts to give preferred consideration to one of two equally important areas of law. The issue would be best addressed by the legislature¹³⁷ through a statutory standard that requires business entities to accommodate future products liability claims and imposes liability by default if the parties fail to meet the standard.

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135. See *supra* notes 109-10 and accompanying text.

136. See *supra* notes 114-18 and accompanying text.

137. *Flaughner v. Cone Automatic Mach. Co.*, 507 N.E.2d 331, 337 (Ohio 1987).