Note

PURCHASE OF ASSETS AND SUCCESSOR LIABILITY: A NECESSARILY ARBITRARY LIMIT

I. INTRODUCTION

Following a purchase of all or substantially all[1] a company's assets, can a successor corporation[2] be held liable for injuries caused by its predecessor's defectively manufactured product? The fact that this issue has commanded a great deal of attention is evident by the number of commentaries[3] in the past decade examining the question, analyzing the rationales, critiquing the decisions, posing unanswered questions, and suggesting untried solutions. Until recently the answer to this question had been governed exclusively by the law of corporations.[4] However, the inadequacy of corporation law in this area has been recognized and a corresponding application of traditional tort liability rules has resulted.[5]

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1. *See* Model Business Corporation Act § 12.01, Comment 1 (3d ed. 1985) [hereinafter cited as MBCA]. "The phrase 'substantially all' is synonymous with 'nearly all' and was added merely to make it clear that the statutory requirements could not be avoided by retention of some minimal or nominal residue of the original assets." *Id.*

2. "Successors," in the case of a corporation means another corporation which has become invested with rights and has assumed burdens of the first corporation by a process of amalgamation, consolidation, or duly authorized legal succession. *In re* New York, S. & W. Rail Co., 109 F.2d 988 (3d Cir. 1940); *In re* Stanley Hotel, Inc., 13 Bankr. 926 (Bankr. D. Colo. 1981).

3. The author of this note found no fewer than 40 relevant journal pieces, some 23 directed specifically to the issue of successor liability. An informal survey reveals that most took no definitive position, but of those which did, most seemed to favor a "hybrid" approach which preserves the necessary predictability of the law and, at the same time, serves our underlying sense of fairness to both innocent parties.

4. 15 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 7122 (rev. perm. ed. 1983) [hereinafter cited as W. FLETCHER]; N. LATTIN, LATTIN ON CORPORATIONS §§ 170-172 (1971).

5. *See* Yamin, *The Achilles Heel of the Takeover: Nature and Scope of Successor Corporations Product Liability in Asset Acquisitions*, 7 HARV. J. LAW & PUB. POL'Y 187, 187 n.4 (1984) [hereinafter cited as Yamin, *The Achilles Heel*]; and Corporations, *Successor Corporations and Their Liability in Personal Injury Cases*, 7 AM. J. TRIAL ADVOC. 411, 413 (1984). *See also* Turner v. Bituminous Casualty Co., 397 Mich. 406, 244 N.W.2d 873 (1976); Powers v. Baker-Perkins, Inc., 92 Mich. App. 645, 285 N.W.2d 402 (1979); Dawejko v. Jorgensen Steel Co., 434 A.2d 106 (Pa. Super. Ct. 1981).

This note examines the traditional rule,[6] its established exceptions,[7] and the departures from it.[8] The policies underlying both applicable bodies of law[9] are scrutinized and the degree to which each successfully addresses societal concerns[10] is analyzed. Also noted is how the courts have balanced these policies and the effects of their decisions on both corporations and consumers. Similarly, the extent to which the problems are solved by new judicial tests is addressed. Finally, the solution posed by The Model Business Corporation Act and proposals for further modifications in this area of the law are surveyed.

II. THE PROBLEM

Products liability has been a growing area of law since its inception in the mid-nineteenth century.[11] An expanding range of plaintiffs and defendants has been one factor in this evolution.[12] Over the course of time courts and legislatures have established the rights and responsibilities of each party in a variety of contexts. The issues associated with a plaintiff seeking recourse against a successor corporation were not present in the early history of products liability. Businesses tended to remain under the same ownership and, initially, a plaintiff's action was largely limited to liabilities expressly assumed by an acquiring corporation.[13] Therefore, a change of ownership had little impact on an acquiring entity's exposure.

The increasing occurrence of corporate mergers and acquisitions[14] has profoundly affected the availability of compensation for products liability plaintiffs. One writer observes: "[P]ersons injured by de-

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6. W. FLETCHER, *supra* note 4, § 7122.

7. *Id.*

8. *Id.*

9. *See infra* text accompanying notes 65-89 (discussion of the relevant corporate and tort law policies).

10. *See infra* text accompanying notes 141-72 (applicability of corporate law doctrines and the effectiveness of tort policies).

11. Winterbottom v. Wright, 10 M. & W. 109, 152 Eng. Rep. 402 (Ex. 1842) (referred to as the first products liability case).

12. *See generally* W. PROSSER, HANDBOOK OF THE LAW OF TORTS 662-65 (4th ed. 1971) (discussion of increase of potential plaintiffs) [hereinafter cited as W. PROSSER].

13. *See* Zimmerman v. Suissevale, 121 N.H. 1051, 438 A.2d 290 (1981). *See also* Hoffman, *Products Liability for Success or Corporations: A Break from Tradition*, 49 U. COLO. L. REV. 357 (1978).

14. Wall St. J., Apr. 3, 1986, at 29, col. 4 (more than 13,000 mergers and acquisitions since 1980).

fective products often discover that the original manufacturer is no longer in existence, and [therefore] the propriety and desirability of an action against the successor has acquired a previously unattained significance."[15]

When there is no recourse against the maker of a product, the court dealing with successor liability is faced with the difficult decision of whether to impose liability on a blameless, after-the-fact business owner or to deny recovery to an equally blameless, injured purchaser of a product. A purchase of assets provides a clear delineation between the old company and the new. Therefore, the usual consideration of the "kind and degree of continuity [which] must exist between a corporation and its successor in order to hold the successor liable for injuries caused by defective products manufactured and sold by the predecessor"[16] does not help. Thus, the courts are faced with the most difficult kind of balancing—deciding which of two innocent parties must bear the risk.

Another side of this issue is the need for predictability in the law of successor liability for corporations planning business expansion. Facing potentially unlimited and unpredictable exposure for future products liability claims which they had no part in creating forces companies interested in acquisitions to reconsider.[17] Corporations for sale face a correspondingly shrinking market. In purely economic terms, the free flow of assets to their most efficient uses is severely impaired if there is no way to know at the outset how much an acquisition will truly cost.[18] Neither buyer nor seller has any effective way of valuing a potential deal or of protecting themselves against such inherent uncertainties.[19]

In addressing these issues, three general approaches are available to the courts: (1) maintenance of the prior rule; (2) expansion of the exceptions to that rule; and (3) abandoning corporate law solutions

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15. *See* Comment, *A Restoration of Certainty: Strict Products Liability and Successor Corporations*, 43 OHIO ST. L.J. 441 (1982) [hereinafter cited as Comment, *A Restoration of Certainty*].

16. Phillips, *Product Line Continuity and Successor Corporation Liability*, 58 N.Y.U. L. REV. 906, 907 (1983) [hereinafter cited as Phillips, *Successor*].

17. *See* Roe, *Mergers, Acquisitions, and Tort: A Comment on the Problem of Successor Corporation Liability*, 70 VA. L. REV. 1559, 1561 (1984) [hereinafter cited as Roe, *Mergers*].

18. Fierman, *Assumption of Products Liability in Corporate Acquisitions*, 55 B.U. L. REV. 86, 142 (1975) [hereinafter cited as Fierman, *Acquisitions*].

19. *See* Note, *Products Liability of Successor Corporations: A Policy Analysis*, 58 IND. L.J. 677, 685-87 (1983) [hereinafter cited as Note, *Policy Analysis*].

and adopting entirely new "exceptions" based on the law of products liability. All have been tried with varying degrees of success, depending on the particular situation and the court's view of what the most important policy considerations are. There is a fundamental conflict at the social policy level and the very real practical effects on both consumers and corporations create a dilemma which is still in need of an adequate and sensible solution.

A. The General Rule

1. Background

The outright purchase by one corporation of another corporation's assets is one of three methods of acquisition, and it is a well-settled rule of corporate law that this transaction insulates the acquirer from later claims.[20] This rule of non-liability may be likened to the property rule of the non-liability of bona fide purchasers.[21] The rule does not, however, apply to the other methods of acquiring a corporation. With a statutory merger or consolidation, the two other acquisition methods, the surviving corporation assumes both the assets and liabilities of the absorbed corporation.[22] Because common law holds that a corporation loses the capacity to sue or to be sued at the moment of its legal dissolution,[23] statutes have been enacted to govern the assumption of liabilities after mergers.[24] Assumption of liability also results where there has been sale of the stock of the acquired corporation.[25]

The doctrine of insulation was first developed with respect to creditors and contract claims[26] but has been generally interpreted to

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20. *See supra* note 4.

21. *See* C. SMITH & R. BOYER, SURVEY OF THE LAW OF PROPERTY 479-82 (2d ed. 1971) (general discussion of purchaser who gives adequate consideration and does not have notice of prior claims takes free of such claims).

22. *See* MBCA, *supra* note 1, §§ 10.08, 11.01-.06.

23. *See* W. FLETCHER, *supra* note 4, §§ 8127, 8142-43.

24. State statutes impose liabilities, known and contingent, on the transferee since the entity acquired in such manner ceases to exist. *See* DEL. CODE ANN. tit. 8, § 259(a) (1983); MBCA, *supra* note 1, § 11.06.

25. There is no liability imposed by law in the sale of support securities. Since the acquired entity remains intact, it remains liable for its pre-acquisition products. The parent's liability, however, is limited to the value of the subsidiary's stock which it owns. MBCA, *supra* note 1, § 11.06.

26. Gibson v. Stevens, 49 U.S. (8 How.) 384 (1850) (one of the earliest cases to use the rule).

apply to tort claims as well.[27] Its purpose was "to promote predictability in corporate transactions, free availability and transfer of capital and mobility in the business and economic world in general."[28] These goals form the basic policy considerations against the application of successor liability in other than statutory or express assumption contexts.

2. Application

The general rule was followed consistently for many years.[29] The advent of major products liability litigation has witnessed its corresponding erosion. However, some courts continue to uphold the traditional view; their comments indicate strong support for the rule's underlying strengths and give little comfort to those who advocate the insertion of tort principles into corporate law.

In *Kloberdanz v. Joy Manufacturing Co.*,[30] for example, the court construed the absence of an express agreement regarding assumption of tort liabilities as an indication of the parties' intent that the transferor retain such liabilities.[31] In this case, the traditional rule was applied even though the plaintiff was left without a remedy.[32] Similarly, a 1975 California court foreclosed a remedy for a minor injured by a consumer product in *Ortiz v. South Bend Lathe*.[33] In that case, the court could not justify imposing the predecessor's "preexisting liability" on the defendant[34] who was attributed with the characteristics of a bona fide purchaser for value.[35] One factor mentioned in the defendant's favor was its express disclaimer of tort liability.[36]

Six years later, the general rule was upheld again in *Bernard v. Kee Manufacturing Co.*[37] However, the court noted the viability of the consumer's position and suggested that adoption of a corrective rule

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27. *See* Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817 (D. Colo. 1968).
28. *See* Fierman, *Acquisitions, supra* note 18, at 91.
29. *See supra* note 4.
30. 288 F. Supp. 817 (D. Colo. 1968).
31. *Id.* at 821. The court was careful to eliminate each of the four recognized exceptions to the rule which are discussed *infra* at text accompanying notes 41-62.
32. *Kloberdanz*, 288 F. Supp. at 819-20 (defendant's predecessor dissolved following the sale of its assets).
33. 46 Cal. App. 3d 842, 120 Cal. Rptr. 556 (1975).
34. *Id.* at 849, 120 Cal. Rptr. at 560.
35. *See supra* note 21.
36. *Ortiz*, 46 Cal. App. 3d at 846, 120 Cal. Rptr. at 558.
37. 394 So. 2d 552 (Fla. App. 1981).

was properly the province of the legislature.[38] Most recently, the Supreme Court of Georgia in *Bullington v. Union Tool Corp.*[39] reined a previous expansion of successor liability by holding that, since the successor corporation did not have an opportunity to discover and correct the defect, liability would not be imposed.[40]

3. Exceptions

There are four established exceptions to the general rule of non-liability where there has been a purchase of assets.[41] Courts have not hesitated to find liability where these situations exist. In each instance the allocation of risk seems logically consistent with the concept of attaching liability where it "belongs."

The first of these exceptions is where the successor corporation has agreed to assume some or all of the existing or contingent liabilities. For example, a purchaser may assume debt obligations on plant and equipment or may agree to assume costs of product recalls for previously distributed products. Such negotiated terms are reflected in the parties' agreement and general contract principles govern any dispute over the scope of such assumptions.[42] Another

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38. *Id.* at 555. Other cases suggest that the legislature is the proper forum for addressing these changes. *See* Leannais v. Cincinnati, Inc., 565 F.2d 437, 441 (7th Cir. 1977) (rejects one of the newer judicially fashioned alternative theories as an improper exercise of judicial activism in an area where the legislature should be making policy); Hernandez v. Johnson Press Corp., 70 Ill. App. 3d 664, 388 N.E.2d 778 (1979); and Jones v. Johnson Machine & Press Co. of Elkhart, Inc., 211 Neb. 724, 320 N.W.2d 481 (1982).

39. 254 Ga. 283, 328 S.E.2d 726 (1985).

40. *Id.* at 285, 328 S.E.2d at 728.

41. *See* W. FLETCHER, *supra* note 4, § 7122. One case involving successor liability has stated that:

> [t]raditionally, when a company purchased the assets of another company, it was not obligated for the debts of the selling company unless one of the following circumstances existed:
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> (1) The purchaser expressly or impliedly agrees to assume the debts of the seller.
> (2) The transaction amounts to a consolidation or merger of the seller and purchaser.
> (3) The purchasing company is a mere continuation of the seller.
> (4) The transaction is consummated fraudulently in order for the purchaser to escape liability for the seller's debts.

Bernard v. Kee Mfg. Co., 394 So. 2d 552, 553 (Fla. App. 1981).

42. Pierce, *Products Liability: Successor Corporations: Liability for Defective Products*, 35 OKLA. L. REV. 846, 847 (1982) [hereinafter cited as Pierce, *Liability*]. Courts look especially to the wording of the agreement and to the circumstances surrounding the making of the agreement.

contractual assumption of liability problem which frequently results in litigation involves implied or express disclaimers, both of which the courts view with disfavor.[43] As a general rule, where the buying company agrees to assume its predecessor's liability as part of the arrangement, courts find no difficulty in holding them to their bargain.[44]

Second, courts will impose liability when the transaction was entered into for fraudulent purposes.[45] This generally means that the transaction was structured in such a way as to enable the purchaser to escape liability for the seller's obligations. This is often accomplished by a sale for inadequate consideration leaving insufficient funds to satisfy the seller's debts.[46] Instead of structuring the sale so that the selling corporation receives such consideration, an attempt to bypass creditors can be made by providing that the proceeds of the sale are to be distributed directly to the shareholders.[47] Not surprisingly, courts will not countenance prejudice to creditors—known and contingent[48]—in this manner.

The third exception involves the circumstance where the transaction is, in reality, a merger or consolidation, referred to as the *de facto* merger.[49] The court looks beyond the form and inquires into

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43. *See* Hoche Products, S.A. v. Jayark Films Corp., 256 F. Supp. 291, 295 (S.D.N.Y. 1966) (court stated that a typical situation in which it would find an implied assumption of liability existed is where buyer knew or should have known that the seller would be left unable to meet its obligations because of the inadequacy of the consideration given). *See also* Cyr v. B. Offen & Co., 501 F.2d 1145, 1151 (1st Cir. 1974) (liability imposed despite an express disclaimer of tort liability). *Cf. supra* notes 30, 36 and accompanying text.

44. *See* Bouton v. Litton Indus., Inc., 424 F.2d 643 (3d Cir. 1970) (purchase agreement expressly assumed various liabilities arising in the ordinary course of business, including the assumption of the risk of product's liability claims). *Cf.* Bonee v. L&M Constr. Chem., 518 F. Supp. 375, 378 (M.D. Tenn. 1981) (buyer assumed trade liabilities but not future tort liability); Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817 (D. Colo. 1968) (buyer, in the purchase agreement, expressly assumed responsibility for outstanding accounts payable, payroll taxes and wages, but was not held to have assumed liability for products since no express assumption was contained in the agreement).

45. *See, e.g.*, Ingram v. Prairie Block Coal Co., 319 Mo. 644, 5 S.W.2d 413 (1928) (consideration recited but never paid).

46. *See* Comment, *The Extension of Products Liability to Corporate Asset Transferees—An Assault on Another Citadel*, 10 LOY. L.A.L. REV. 584, 597 (1977) [hereinafter cited as Comment, *Corporate Asset*].

47. *See* Lamb v. Leroy Corp., 85 Nev. 276, 280, 454 P.2d 24, 27 (1969).

48. *See* Wolff v. Shreveport Gas, Elec. Light & Power Co., 138 La. 743, 70 So. 789 (1916) (transfer of assets following an explosion in an attempt to avoid liability found to be fraudulent).

49. *De facto* mergers are business combinations deemed to be mergers as if

the substance of the transaction, viewing it as a whole rather than analyzing each transactional element.[50] Several factors are important in this determination. One factor, the kind of consideration paid, may even be dispositive.[51] Other considerations are the extent to which key personnel from the selling company are involved in the new entity[52] and the relative status of each corporation. If the seller still exists and has sufficient assets, the court may decide that liability should be placed there rather than on the purchasing corporation.[53] When the purchase of assets looks more like a consolidation or merger but, in actuality, there is a true commonality of ownership,[54] liability will attach to a successor corporation.[55]

The final recognized exception to the general rule is that of "mere continuation" of the business.[56] While there is no general

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they had done it "by the statute." The factors below, taken from Shannon v. Samuel Langston Co., 379 F. Supp. 797 (W.D. Mich. 1974), are indicative of a *de facto* merger:

> (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.
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> (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 selling corporation so that they become a constituent part of the purchasing corporation.
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> (3) The seller corporation ceases its ordinary business operations, liquidates, and dissolves as soon as legally and practically possible.
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> (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.

Id. at 801.

50. Pierce, *Liability, supra* note 42, at 848-49.

51. *See* Jones v. Eppler, 266 P.2d 451, 457 (Okla. 1953) (same in the context of personal injuries); Spring Creek Oil Co. v. Dillman, 90 Okla. 129, 215 P. 1053 (1923) (corporation liable for debts of seller when consideration was stock).

52. *See* Note, Schumacher v. Richards Schear Co.: *A Warning to Successor Corporations*, 4 PACE L. REV. 457, 459 n.13 (1984) [hereinafter cited as Note, *A Warning*]. This is more critical if management and/or directors are retained than if the stockholders are the same. Also, the commonalities are sometimes viewed in the aggregate. *See, e.g.*, Skirvin Operating Co. v. Southwestern Elec. Co., 71 Okla. 25, 30, 174 P. 1069, 1073 (1918) (part of the court's finding of liability was premised on the fact that the officers of both corporations were the same).

53. *See* Utley v. Standard Magnesium & Chem. Co., 478 P.2d 953, 955 (Okla. 1970).

54. *See* Note, *A Warning, supra* note 52, at 461 n.26 ("[W]ith a stock payment there is a commonality of ownership and with a cash payment there is not.").

55. *See Shannon*, 379 F. Supp. at 801; Comment, *Corporate Asset, supra* note 46, at 586, 598.

56. *See* McKee v. Harris-Seybold Co., 109 N.J. Super. 555, 561, 264 A.2d

judicial agreement as to which factors are indicative of this exception,[57] several have proved to be decisive. The primary consideration is whether the business carried on by the buyer is the same as that of his predecessor, especially if it is being carried on in the same location.[58] Also significant is the passage of time;[59] this is particularly important where there have been intermediate successors.[60] Generally, the court takes into account "the existence or nonexistence of substantial changes in the business enterprise between the time of the product's manufacture and the accident."[61] Even where the seller continues to exist, a successor corporation continuing the business of its predecessor may be held liable under this exception.[62]

The traditional rule, modified by these exceptions, has comprised the core of the corporate law response to the issue of successor liability for purchasing corporations.[63] Throughout the past fifteen years, however, courts have increasingly adopted solutions based more on social need than on corporate law. The reason is simple: while the claims of creditors are protected, the general rule actually works to deny contingent claims.[64] The underpinnings of products liability law and the principles of strict liability provide a framework within which to examine "new" solutions and the problems they generate.

98, 102 (N.J. Super. Ct. Law Div. 1970), *aff'd per curiam*, 118 N.J. Super. 480, 288 A.2d 585 (N.J. Super. Ct. App. Div. 1972), *overruled* Wilson v. Fare-Well Corp., 140 N.J. Super. 476, 493, 356 A.2d 458, 468 (N.J. Super. Ct. Law Div. 1976) (recitation of this exception).

57. *See* Comment, *A Restoration of Certainty*, *supra* note 15, at 449.

58. *See Skirvin Operating Co.*, 71 Okla. at 30, 174 P. at 1073.

59. *See* Jones v. Johnson Machine & Press Co., 211 Neb. 724, 730, 320 N.W.2d 481, 484 (1982).

60. *See id. See also* W. FLETCHER, *supra* note 4, § 7123.5, at 22 (Supp. 1985).

61. W. FLETCHER, *supra* note 4, § 7123.5. Courts originally applied this doctrine fairly strictly, requiring that practically everything except the ownership, and perhaps the name, had to remain the same. As the exception was expansively applied by some courts, the factors mentioned here, alone and in combination, have been cited by various courts to support their application of this exception to the traditional rule. *See* Comment, *A Restoration of Certainty*, *supra* note 15, at 450.

62. *See* Pulis v. U.S. Elec. Tool Co., 561 P.2d 68 (Okla. 1977) (existence of seller in name only does not prevent application of the continuation exception); Tift v. Forage King Indus., 108 Wis. 2d 72, 322 N.W.2d 14 (1982) (same).

63. *See* McKee v. Harris-Seybold Co., 109 N.J. Super. 555, 561, 264 A.2d 98, 102 (N.J. Super. Ct. Law Div. 1970), *aff'd per curiam*, 118 N.J. Super. 480, 288 A.2d 585 (App. Div. 1972), *overruled* Wilson v. Fare-Well Corp., 140 N.J. Super. 476, 484-85, 356 A.2d 458, 463 (Law Div. 1976). Court recited the "fifth exception" centering on inadequacy of consideration of this exception. This element is often factored in during consideration of the standard exceptions.

64. Comment, *A Restoration of Certainty*, *supra* note 15, at 454.

B. *The Underlying Policies*

There has developed "a profound judicial sensitivity to the predicament of the injured consumer products liability plaintiff."[65] Correspondingly, the focus of the inquiry falls upon the extent to which plaintiffs are prejudiced by assets sales.[66]

The development of products liability law has been marked by the falling of barriers to recovery.[67] Commercial rules which do not comport with the purposes of products liability are viewed as inappropriate to govern the composition and extent of such liability.[68] As one writer commented, "Seen in this light, the expansion of successor products liability can be characterized as merely part of the long line of judicial extensions of the doctrine of products liability itself."[69]

There are two basic goals in products liability: loss shifting and risk control.[70] The first shifts the loss away from innocent injured plaintiffs and on to the manufacturer who placed the product in the stream of commerce.[71] While noting that not only is the manufacturer in a better position to protect itself and more easily bear the costs associated with products liability,[72] courts have also pointed out that the manufacturer is in the unique position of being able to pass the cost of the risk on to the consuming public as part of the product's cost.[73] The second goal, that of risk control, is to deter the introduction

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65. Yamin, *Achilles Heel, supra* note 5, at 203.

66. *Id.*

67. Comment, *A Restoration of Certainty, supra* note 15, at 441. *See generally* W. PROSSER, *supra* note 12, at 641-58 (discussion of negligence, warranty, and strict liability as theories of recovery in product liability cases).

68. Greenman v. Yuba Power Products, Inc., 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1962).

69. Yamin, *Achilles Heel, supra* note 5, at 220.

70. See Comment, *A Search for the Outer Limits to Successor Corporation Liability for Defective Products of Predecessors*, 5 U. CIN. L. REV. 117 (1982) (breaks the analysis into five components: loss shifting, risk control, risk spreading, deterrence, and improvement of defective products) [hereinafter cited as Comment, *Outer Limits*].

71. *Id. See also Cyr*, 501 F.2d at 1154 (lists reasons for imposition of strict liability on manufacturers); *Greenman*, 59 Cal. 2d at 63, 377 P.2d at 901, 27 Cal. Rptr. at 701 (discusses strict liability imposed on manufacturers).

72. *See generally* Ray v. Alad Corp., 19 Cal. 3d 22, 30, 560 P.2d 3, 8, 136 Cal. Rptr. 574, 579 (1977) (quoting Greenman v. Yuba Power Products, Inc., 59 Cal. 2d 57, 63, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1963) (cost of injury should be borne by manufacturers rather than injured party who is unable to protect himself)).

73. *See Ray*, 19 Cal. 3d at 30, 560 P.2d at 8, 136 Cal. Rptr. at 579 (quoting Escola v. Coca Cola Bottling Co., 24 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944)

of defective and dangerous products into the market.[74] A corollary to this is the goal of improvement of defective products already manufactured.[75] Imposition of liability thus serves to encourage the development of safe products, both new and already distributed. These checks help to maintain the marketability of the business by reassuring potential buyers[76] that continued attention is being paid to product safety.[77]

Similarly, evidencing concern with the marketability of the business, the rationales behind the traditional corporate rule of non-liability encourage economically efficient commercial transactions by reducing the buyer's risk of loss.[78] One important goal underlying this rule is the protection of creditors; without extensions of capital by creditors, business would be severely restricted. These creditors cannot be expected to extend credit without adequate assurance of return.[79] Additionally, concern for "efficiency" mandates internalizing all costs, including, to the extent possible, those for injuries caused by products. In contrast to products liability principles, however, corporate law principles tend to set out definitive parameters for liability.

The corporate law doctrine as applied to the sale of assets embraces aspects of contract and tort and property law. Contract law lends the maxim that no one (e.g., purchasers of assets) should be bound to an agreement (e.g., between manufacturer and its customer) to which he was not a party nor should a person be bound beyond the terms of the agreement.[80] Tort law contributes both the concepts of proximate cause[81] and that of strict liability, whereby

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(Traynor, J., concurring) (" '[T]he risk of injury can be insured by the manufacturer and distributed among the public as a cost of doing business.' ")).

74. *See* Note, *Policy Analysis, supra* note 19, at 689.

75. *See id.*

76. *See* Calabresi, *Commentary*, 58 N.Y.U. L. REV. 939, 941 (1983) (suggested that since entrepreneurs can be assumed to be less risk-adverse it may be appropriate to place more risk with them and their businesses).

77. *See id. See also* Pierce, *Liability, supra* note 42, at 853.

78. *See* Note, *Policy Analysis, supra* note 19, at 685 .

79. *See* C. SMITH & R. BOYER, SURVEY OF THE LAW OF PROPERTY 479-82 (1971).

80. *See* Note, *Policy Analysis, supra* note 19, at 683-84.

81. *See id.* at 684 n.54. The author stated that:

> [t]he tort law rationale for the traditional rule applies to strict liability claims is of this rationale is understood to be based on the lack of a causal connection between the successor and the plaintiff's injury, rather than simply on the fact that the successor was not at fault in that he was not negligent.

Id.

liability is not premised on fault but on responsibility for harm caused.[82] Therefore, absent a causal connection successors should not be liable. The concept of the bona fide purchaser for value, as applied in the contexts of real property[83] and commercial law[84] is taken from property law. Generally, one who takes in good faith, for value and without notice of existing claims should be protected from later liability.[85]

The difficulty in simultaneously satisfying all of the above goals is obvious.[86] Since the corporate rule and its exceptions were designed before the adoption of strict liability,[87] the eventual conflict between these policies was inevitable. As has been pointed out, until very recently the courts have consistently protected corporate interests[88] and products liability plaintiffs have had limited access to recovery from corporate assets after a sale. One writer notes that the "disappearance of optional [reachable] defendants causes the courts to lapse into a state of split consciousness, torn between the seemingly conflicting policies of two bodies of law . . . ."[89]

C. *The Traditional Defendants*

Prior to the new judicial solutions, plaintiffs had essentially three options: sue the seller,[90] sue the stockholders,[91] or sue other parties

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82. *See id.* at 692-93.

83. *See* J. CRIBBET, PRINCIPLES OF THE LAW OF PROPERTY 179 (1962); Note, *Liability of a Successor Corporation for Products Defectively Manufactured by a Predecessor*, 62 NEB. L. REV. 408, 411 (1983) [hereinafter cited as Note, *Products Defectively Manufactured*].

84. *See* Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057 (1954).

85. *See* Note, *Products Defectively Manufactured*, *supra* note 83, at 411.

86. See Roe, *Mergers*, *supra* note 17, at 1561-62, where the author states, "Satisfaction of both policy goals is not easy. At best we can clearly define the contours of the problem. Unless we forgo in some measure one of our two policy goals, deductive solutions elude our grasp."

87. Comment, *Corporate Asset*, *supra* note 46, at 584.

88. *Id.*

89. Yamin, *Achilles Heel*, *supra* note 5, at 215.

90. This is possible where the seller continues to exist after the sale of assets. Also, if the seller reinvests, the plaintiff may be able to recover directly from the maker of the defective product. *See* Yamin, *Achilles Heel*, *supra* note 5, at 197. *Cf.* Tift v. Forage King Indus., 108 Wis. 2d 72, 322 N.W.2d 14 (1982).

Another possible source of recovery is from the seller's products liability insurance which usually covers product related losses even after the duration of the policy providing that the offending product was sold while the policy was in effect. The terms of such policies, however, may provide otherwise and there is no protection if the product manufactured by the selling corporation is not sold until after policy ceases (usually on the sale of assets or formal dissolution). Comment, *A Restoration of Certainty*, *supra* note 15, at 459.

in the chain of distribution.[92] Abatement statutes, which extend filing deadlines, have provided a measure of access.[93]

Suits against these typical defendants have distinct disadvantages which often have resulted in foreclosing a remedy. For example, if the seller no longer exists, there is no entity to sue.[94] The sale proceeds distributed to the stockholders can be reached only to the extent of each shareholder's ratable share, but only after tracing and locating each such shareholder's portion.[95] State law may limit access to some of these potential defendants and, as to others, it may be difficult to identify and/or to establish a causal link.[96] Abatement statutes provide only a grace period for filing claims for injuries which occurred *before* the dissolution.[97]

The bars to recovery which are presented by these factors prompted courts to expand access for plaintiffs in previously unsanctioned ways. Setting aside the question of propriety, judicial activism in this area has been extensive, causing impact on both consumers and corporations. An examination of the "new exceptions" to the traditional rule of non-liability and an assessment of how these exceptions address policy concerns, leads to a subsequent review of the new problems created by their application.

III. THE ALTERNATIVE APPROACHES

Courts have fashioned three new avenues of recovery for the products liability plaintiff: continuity of enterprise, a product line exception, and a new duty to warn.[98]

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91. If the seller is dissolved and the insurance not available, the next line of attack is the shareholders to whom the distributions were made following termination of the business. This is done on the basis of the "trust fund" theory which holds that the stockholders hold such distributions in trust for certain creditors of the business. For a discussion of the application of this theory, see Roe, *Mergers, supra* note 17, at 1564; and Comment, *A Restoration of Certainty, supra* note 15, at 454 n.100.

92. Yamin, *Achilles Heel, supra* note 5, at 204-06. Directors and officers of the selling corporation, sometimes limited by state law, are among those named as defendants.

93. *Id.* (approximately half of the states have such a statute). *See also* MCBA, *supra* note 1, § 12.01.

94. This is true unless there are undistributed assets under some state corporate provisions. *See, e.g.*, N.J. STAT. ANN. § 14A: 12-13 (West Supp. 1983).

95. Roe, *Mergers, supra* note 17, at 1592-95.

96. Yamin, *Achilles Heel, supra* note 5, at 204-06.

97. Note, *A Warning, supra* note 52, at 460.

98. Yamin, *Achilles Heel, supra* note 5, at 199 (even where the "discovery rule" tolls the Statute of Limitations in products liability actions, the limitation provisions of abatement statutes will foreclose this remedy in jurisdictions which have both).

The first theory is that of continuity of enterprise and it essentially liberalizes the requirements for satisfying a combination of the *de facto* merger and mere continuation tests under the traditional exceptions.[99] The seminal case in this area is *Cyr v. B. Offen Co.*[100] which held a success or corporation liable for injury caused by a predecessor's product despite the absence of continuity of ownership.[101] The *Cyr* court, applying the traditional rule and its exceptions, found the corporate approach wanting.[102] Disregarding the form of the transaction,[103] the express disclaimer,[104] and relying on both the company's outward representations to its customers and the policy behind strict liability, the court held the successor liable.[105] At almost the same time, a Michigan district court applying New Jersey law in *Shannon v. Samuel Langston Co.*, wrestled with a like question and resolved it in the same way.[106] Finally, the court in *Turner v. Bituminous Casualty Co.*[107] stated that the law of products liability and not that of corporations determined the existence of a cause of action against a successor corporation where there is continuity of the enterprise, regardless of how the transfer of assets is structured.[108] Thus, without meeting the technical requirements of an exception, the plaintiff, upon any showing of continuity of enterprise, might be granted access to a successor corporation. Moreover, the courts have freely

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99. With both of these traditional exceptions there is a commonality of shareholders of seller and buyer, making the imposition of liability more likely where assets have been purchased for stock. The extension of liability in the continuity of enterprise theory, however, eliminates the distinction between the kinds of consideration paid. *See* Pierce, *Liability, supra* note 42, at 856.

100. 501 F.2d 1145 (1st Cir. 1974).

101. *Id.* at 1154.

102. *Id.* at 1153.

103. *Id.* at 1153-54.

104. *Id.*

105. *Id.* Responding to counsel's argument that extensions of liability of the sort proposed (and, ultimately, mandated) would result in prejudice to the successor corporation, the court broadened the liability exposure of the successor corporation by bounding its decision to "[w]hatever may be the outer limit of liability on a successor . . . ." *Id.* at 1154.

106. The court in Shannon v. Samuel Langston Co., 379 F. Supp. 797 (W.D. Mich. 1974), framed the issue in the context of the general rule and its exceptions, but after analyzing several cases close to the issue, finally relied on "elemental justice" dictating a finding for the plaintiff. Commenting that such an extension would not tend to restrain alienation and thereby hinder the maintenance of a "favorable corporate climate," the court warned that "shuffling papers and manipulating corporate entities" would not shield companies from liability. *Id.* at 803.

107. 397 Mich. 406, 244 N.W.2d 873 (1976).

108. *Id.* at 416-18, 429-31, 244 N.W.2d at 833-34, 877-78.

borrowed from two distinct areas of law, corporate and products liability, to define the criteria for this result.

The second of the new judicial doctrines also involved the concept of continuity. The product line exception[109] refers to situations where the predecessor's product line is carried on by his successor. This approach differs from the continuity of enterprise theory in that it is not merely an expansion of traditional exceptions, but "a major departure from them."[110] The case first utilizing this approach was *Ray v. Alad Corp.* [111] Although factually similar to other cases which had sought to hold a successor liable for injuries caused by a product defectively manufactured and distributed by a predecessor, *Alad* is distinguishable because the acquiring company continued to manufacture the same product under the predecessor's trade name and used the same plant and equipment.[112] On the basis of the traditional rule, the case had been initially dismissed pursuant to a motion for summary judgment; however, the court of appeals subsequently imposed liability on the basis of the continuity theory.[113] The California Supreme Court, rejecting the reasoning of the court of appeals, declined to expand the traditional rule's exceptions and instead, created a new products liability exception to the corporate rule.[114]

Not all courts have accepted this new exception without qualification.[115] In a case procedurally identical to *Alad*, the New Jersey Supreme Court in *Ramirez v. Amsted Industries*[116] adopted the product line exception and differentiated it from the *Turner* reasoning.[117]

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109. *See generally* Fegan, *Successor Corporations and Strict Liability in Tort—A Convergence of Two Opposing Doctrines*, 69 ILL. B.J. 142 (1980) (discussion of the inception of the product line exception in *Alad Corp.* and its subsequent application) [hereinafter cited as Fegan, *Opposing Doctrines*].

110. Note, *A Warning*, *supra* note 52, at 463.

111. 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).

112. *Id.* at 25-26, 560 P.2d at 5, 136 Cal. Rptr. at 576.

113. Ray v. Alad Corp., 55 Cal. App. 3d 855, 560 P.2d 3, 127 Cal. Rptr. 817 (Cal. Ct. App. 1976).

114. *Ray*, 19 Cal. 3d at 34, 560 P.2d at 11, 136 Cal. Rptr. at 582. The court offered three justifications for doing so: (1) the plaintiff's remedies against the previous corporation had been virtually destroyed by the acquisition, (2) a traditional cost-spreading rationale (*see supra* text accompanying notes 69-76), and (3) the benefit the successor corporation had received from the goodwill of the predecessor made it "fair" to place the burden with the successor. *Id.* at 32-34, 560 P.2d at 10, 136 Cal. Rptr. at 581.

115. *See generally* Fegan, *Opposing Doctrines*, *supra* note 109 (provides an examination of the reservation of Ohio, New Jersey, and Illinois courts).

116. 86 N.J. 332, 431 A.2d. 811 (1981). *See also* Note, *Policy Analysis*, *supra* note 19, at 680.

117. *Ramirez*, 86 N.J. at 348, 431 A.2d at 819. Additionally, in June 1981,

Similarly, in *Rawlings v. D. M. Oliver, Inc.* [118] the new exception was extended by imposing liability on a successor even though it did not continue to make the same type of product.[119] In addition to this geographical expansion of the exception, *Alad* was clarified doctrinally by the Ninth Circuit in *Gee v. Tenneco, Inc.*[120] where the court expressly limited the *Alad* exception to situations in which the successor had received some "goodwill" benefit from the selling corporation.[121]

Another new avenue was opened when the courts imposed a new duty to warn upon successor corporations. The duty to warn is a negligence concept[122] applied to potential consumer hazards in a predecessor's product.[123] The new exception can be used affirmatively when a change in corporate identity occurs to avoid subsequent continuity theory liability.[124] It is distinguishable from the continuity

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the Supreme Court of New Jersey handed down a decision holding a remote successor (corporation that had acquired a product line from a prior successor to the manufacturer) and an intermediate successor (successor to predecessor whose assets it acquired and, simultaneously, predecessor to a later successor to whom it sells its previously acquired assets) jointly liable for injuries caused by their common predecessor. Nieves v. Bruno Sherman Corp., 86 N.J. 332, 361, 431 A.2d 811, 826 (1981). *But cf.* Comment, *Outer Limits, supra* note 70, at 118 (maintains that the New Jersey Supreme Court did not follow the analysis of the *Alad* case it purported to adopt and, therefore, its resolution as expressed in *Ramirez* and *Nieves* must be discarded).

118. 97 Cal. App. 3d 890, 159 Cal. Rptr. 119 (Cal. Dist. Ct. App. 1979).

119. *Id.* at 899-902, 159 Cal. Rptr. at 123-24. The *Rawlings* court strictly construed the goodwill element in *Alad* to require that the successor realize some benefit attributable directly to the seller's goodwill before liability could attach. The rationale was based on typical policy considerations for strict liability. *Id.* The general rule of strict liability is set out in the *Restatement (Second) of Torts* § 402A (1965). *See also supra* notes 70-77 and accompanying text.

120. 615 F.2d 857 (9th Cir. 1980) (general business continuity sufficient where there is a custom-made product making it difficult to maintain that the "same" product continued to be manufactured).

121. *Id.* at 864-65. One of the factors identified by the *Gee* court in this regard was that the successor had held itself out as the same enterprise. *Id.* This same factor has been mentioned in other cases. *See, e.g.*, Stratton v. Garvey Int'l, Inc. 9 Kan. App. 2d. 254, 676 P.2d 1290 (1984) (product line theory of successor liability was inapplicable against successor corporation for injuries arising from alleged defect in man-lift device installed by original corporation because injured grain inspector's remedy against the surviving partner had not been destroyed).

122. *See generally* W. PROSSER, *supra* note 12. Su ch a duty usually exists only when the party sought to be charged has a special relation to the plaintiff of "actual or potential economic advantage" to, in these cases, the successor. *Id.* at 339. Additionally, the relationship must be such as to begin to adversely "affect the interests of the plaintiff . . . as distinguished from merely failing to confer a benefit upon him." *Id.* at 340.

123. *See* Yamin, *Achilles Heel, supra* note 5, at 240-41.

124. *See id.*

of enterprise and product line theories because the duty to warn arises out of the successor's independent actions[125] rather than acts of its predecessor and does not directly conflict with corporate law principles.[126]

There are two generally accepted prerequisites to imposing liability under this theory: (1) the successor must have been in a position where it knew or should have known of the defect, and (2) there must be some relationship between the successor and the products' purchasers.[127] This relationship test is essentially satisfied when the successor continues the relationship that had existed between the predecessor and its customer.[128] Merely to be a successor is not a sufficient catalyst to create the duty to warn of recently discovered defects.[129]

With the application of these new doctrines the courts achieved the desired result, namely, effective recourse for the products liability plaintiff. The balance between corporate objectives and society's interest in innocent injured consumers tipped in favor of the consumers.

A. *The Unintended Consequences*

There has been much comment about the effects these judicial expansions of liability have had on corporate America. In application,

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125. *See* Note, *A Warning, supra* note 52, at 465-66; Phillips, *Successor, supra* note 16, at 926-27.

126. *See* Yamin, *Achilles Heel, supra* note 5, at 242-43.

127. See Leannais v. Cincinnati, Inc., 565 F.2d 437, 442 (7th Cir. 1977) (factors stated in dicta). *See also* Shane v. Hobam, Inc., 332 F. Supp. 526, 528-30 (E.D. Pa. 1971) (possible existence of duty to warn was noted in *dicta*); Wilson v. Fare-Well Corp., 140 N.J. Super 476, 491-93, 356 A.2d 458, 467-68 (1976).

An alternate theory would suggest that a successor corporation's duty to warn arises from control, not of the instrumentality or product, but of the business. *See* W. PROSSER, *supra* note 12, at 339-43; RESTATEMENT (SECOND) OF TORTS § 322, comment a (1965).

128. The relationship is a critical element, Gonzalez v. Rock Wool Eng'g & Equip. Co., 117 Ill. App. 3d. 435, 438, 453 N.E.2d 792, 795 (1983), although there is no judicial agreement as to what factors or combination of factors are determinative. The *Leannais* court suggested that where the successor takes over the service contracts and knows of the owners' location and identity such a duty arises. *Leannais*, 565 F.2d at 442. *See also* Tucker v. Paxson, 645 F.2d 620 (8th Cir. 1981) (bare assertion that successor knew of defective nature of 1918 rubber calendar machine and of its location at manufacturing plant did not show necessary relationship between successor and customers of predecessor to establish successor's duty to warn).

129. *See* Downtowner, Inc. v. Acrometal Products, Inc., 347 N.W.2d 118 (N.D. 1984). *See also* Schumacher v. Richards Shear Co., 59 N.Y.2d 239, 252-53,

some outcomes have been neutral, others adverse. However, beyond the social responsibility concerns, there appear to be no positive comments on the changes as they affect corportions.

The trend has not greatly affected corporate creditors, nor were the changes intended to do so.[130] Creditors' claims, by their very nature, arise before dissolution.[131] As a result, creditors always have a defendant, and abatement statutes adequately insure that they will be able to timely file their claims. Usually, the buyer and seller negotiate the responsibility for known liabilities at the time of sale.[132]

While creditors are protected by the traditional rule and consumers by the new exceptions, purchasers of corporate assets are on their own. Expanded liability may mean that such a buyer effectively pays more than it had bargained to pay;[133] the successor may incur unanticipated losses from its investment.[134] Thus, the real impact of the new "rules" goes to the heart of corporate mergers and acquisitions: valuation. To the extent that it is not possible to quantify contingent liabilities, the alienability of corporate assets decreases.[135] Buyers, if not flatly unwilling to assume unknown liabilities, are hesitant to offer more than a discounted price.[136]

More basic than marketability is survival. Smaller businesses are hit hardest because the impact of unforeseen liability is proportional to the size of a company. Not all companies have the financial resources to survive the unexpected expenses of defending against or settling lawsuits. Expansion of contingent liability to successor corporations may contribute to the demise of small corporations.[137]

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451 N.E.2d 195, 202, 464 N.Y.S.2d 437, 444 (1983) (Jasen, J., dissenting) (opposes extension of this duty to warn beyond economic relationships regardless of the policy or sentiment which might favor a further reach).

130. Yamin, *Achilles Heel, supra* note 5, at 219.

131. *Id.* at 258-59.

132. *See* Comment, *A Restoration of Certainty, supra* note 15, at 446.

133. *See id.* at 458.

134. Roe, *Mergers, supra* note 17, at 1567.

135. Note, *Policy Analysis, supra* note 19, at 685; Note, *Torts—Products Liability—Corporations—Florida Court Adopts Traditional Rule of Successor Liability*—Bernard v. Kee Manufacturing Co., 9 FLA. ST. U.L. REV. 525 (1981) (chilling effect on commercial transfer of assets) [hereinafter cited as Note, *Traditional Rule*].

136. *See* Roe, *Mergers, supra* note 17, at 1563-83 (discussion and an interesting mathematical analysis of the impact on corporations).

137. *See* Comment, *Torts—Products Liability—Successor Corporation Strictly Liable for Defective Products Manufactured by the Predecessor Corporation*, 27 VILL. L. REV. 411, 424-25 (1982) [hereinafter cited as *Torts—Products Liability*]. *See also* Bernard v. Kee Mfg. Co., 409 So. 2d 1047, 1049-50 (Fla. 1982) (problem of heavy financial burden on small successor corporations).

Additionally, increased liability exposure adds to the cost of products liability litigation as courts seek the outer limits of these new doctrines.[138] Obtaining insurance against such eventualities may become virtually impossible[139] and may encourage piecemeal sales between parties intent on disguising successors.[140]

B. Meeting Policy Concerns

The policies supporting the traditional corporate rule and products liability law conflict. Each body of law developed separately, and only recently have the precepts of both been forced to accommodate one another.[141] A re-examination of the scope of each area yields the components essential to achieve the best result from this compelled combination.

In regard to rationales for strict liability, not all are needed to ensure the desired results of loss shifting[142] and risk control[143] in successor cases.[144] Risk control, for example, does not apply across the board because there are situations where the manufacturer will not be liable even though it can afford the cost. These situations include those where there is no proof of defect, deliberate misuse, adequate warning, and, in some jurisdictions, assumption of the risk. The risk control rationale is equally inappropriate where the ability to spread the cost is literally nonexistent (e.g., a successor's inability to insure) or is unnecessary because of the injured person's access to medical insurance, disability payments or workman's compensation.[145] How desirable it is to make the ability to bear a risk the dispositive factor is questionable.[146] Risk spreading, however, remains viable because the manufacturing corporation can always pass the costs on to the consuming public.[147]

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138. *See generally* Note, *Traditional Rule, supra* note 13, at 458.

139. *Id.*

140. Roe, *Mergers, supra* note 17, at 1590.

141. *See supra* text accompanying notes 12-16.

142. *See supra* note 71 and accompanying text.

143. *See supra* note 74 and accompanying text.

144. *See* Note, *Policy Analysis, supra* note 19, at 690. *See also Cyr*, 501 F.2d at 1154 (risk spreading and deterrence alone were sufficient).

145. Note, *Policy Analysis, supra* note 19, at 691 n.84.

146. Pierce, *Liability, supra* note 42, at 853.

147. *See supra* notes 70-77. *See also* Note, *Policy Analysis, supra* note 19, at 695-96. It was suggested that cost spreading should never be viewed as sufficient rationale for future impositions of strict liability. This goal can better be accomplished by a system of social insurance; a maximization of spreading costs removes the deterrent effect leading to better products.

The deterrence rationale is similarly inapplicable to every case because the source of the product is not always best situated to effect safety measures.[148] Furthermore, the motivation presupposed by this rationale, that of making the product safe to avoid costly suits, does not work in the case of a successor: nothing the new owner does now can shield it from liability for products his predecessor has already distributed.[149]

Causation would seem to be essential to any analysis. Absent a causal link, liability should not attach.[150] However, the counter-argument pragmatically questions why causation should be retained since the cost is ultimately spread to noncausal parties. The rebuttal, as phrased by one writer, concerns our sense of fairness: "Spreading liability is more like paying a tax than paying a fine: everyone else has to do it also. On the other hand, liability placed directly on a noncausal party is more like a fine."[151] Even though inclusion of a causation factor is generally supported, the requisite degree is debatable. Another writer comments: "This [causal] link seems quite tenuous at times, and indeed the court's eagerness to find it sometimes appears to be directly proportional to the injured plaintiff's need to locate a viable defendant"[152]—enter the new exceptions.

The alternative approaches to successor liability were fashioned with the intent of more closely meeting plaintiffs' needs.[153] The extent

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148. *Id.* at 691 n.85. The deterrence rationale of successor liability might more properly be to discourage alteration of the corporate form to avoid the imposition of liability.

149. *See id.* at 701.

150. In this context causation consists of placing the product in the stream of commerce with a defect which existed at the time such product left the control of the manufacturer. W. PROSSER, *supra* note 12, at 671-72; RESTATEMENT (SECOND) OF TORTS § 402A(1) (1965). The court in Woody v. Combustion Eng'g, 463 F. Supp. 817 (E.D. Tenn. 1978), for example, held that it was unfair to hold a stranger responsible for the level of safety determined by someone else.

A notable exception to the above line of thought has occurred in several industry-wide cases holding manufacturers liable even though plaintiffs could not prove that the defendant companies in the particular suits manufactured the product that harmed them. This "enterprise liability" theory may or may not be viewed as an extension of strict liability. *See* Sindell v. Abbott Laboratories, 26 Cal. 3d 588, 614-15, 607 P.2d 924, 938-39, 163 Cal. Rptr. 132, 146-47, *cert. denied*, 449 U.S. 912 (1980). Therefore, if it is included, the only plausible causation argument would be that industry manufacturers acted together to some extent in developing and marketing the product. It may more properly be excluded on the basis of inability to establish any link in the chain of causation.

151. Note, *Policy Analysis, supra* note 19, at 698.

152. Yamin, *Achilles Heel, supra* note 5, at 217.

153. Comment, *Outer Limits, supra* note 70, at 119.

to which the rationales underlying products liability are furthered by these new exceptions varies. For example, the traditional mere continuation exception[154] is consistent with the causation rationale; but the continuity of enterprise exception, which dispenses with the requirement of commonality of ownership, severs the rationale from the imposition of liability.[155] Even supporters of this new exception dislike the fact that this approach "still allows the parties to the transaction to determine the rights of injured [third] persons."[156] Also, this alternative does not provide the certainty required by businesses because predicting the degree of similarity necessary to trigger the imposition of liability is difficult.[157] The product line exception is supported by the following reasoning:

> If the success of a given product line provided the incentive for a corporation to purchase the assets of another corporation and to continue manufacturing that product in a substantially similar manner, it does not seem unfair to force the successor to accept responsibility for the liabilities inherent in that manufacturing process.[158]

However, the exception has been attacked on the basis that there can never be enough goodwill passed from seller to buyer to justify the imposition of liability for a predecessor's products.[159] The Illinois courts, for example, have consistently rejected the exception,[160] citing lack of active participation in placing the product in the stream of commerce, an inability on the part of the successor to exert any pressure on the manufacturer to improve the product, lack of responsibility for creation of the risk, and the remoteness of any benefit

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154. *See supra* note 56.

155. Note, *Policy Analysis, supra* note 19, at 699.

156. Note, *Products Defectively Manufactured, supra* note 83, at 435.

157. *Id.*

158. *Id.* at 436. This rationale seems to presume that a seller is running, and has always run, his manufacturing process to the best of his ability. How would such a rationale work if an acquirer wants to buy precisely *because* of inefficiencies in the production process which he planned to correct, thereby making his profit?

159. Pierce, *Liability, supra* note 42, at 851.

160. Barron v. Kane & Roach, 79 Ill. App. 3d 44, 398 N.E.2d 244 (1979) (successor not liable to indemnify distributor of selling corporation for amount distributor had paid in settlement of seller's claim); Domine v. Fulton Iron Works, 76 Ill. App. 3d 253, 395 N.E.2d 19 (1979) (factors set out in *infra* text accompanying note 163); Hernandez v. Johnson Press Corp., 70 Ill. App. 3d 664, 388 N.E.2d 778 (1979) (intermediate transaction and time delay of 19 years); Johnson v. Marshall & Huschart Mach. Co., 66 Ill. App. 3d 766, 384 N.E.2d 141 (1978) (sale of business and injury separated by 36 years).

to the successor corporation from the sale of such products.[161] The court also indicated that it could not justify adoption of this exception on the basis that general public interest in human life and health would be furthered.[162]

From the standpoint of a business which desires predictability, the only thing worse than a distortion of an existing rule is the complete abandonment of it. The product line exception presents both a distortion and an abandonment of prior law.[163] The third new doctrine reflects a compromise. The court in *Travis v. Harris Corp.*,[164] for example, was uncomfortable enough with the extent of the expansion inherent in the product line exception to refuse to adopt it. It did, however, recognize the possibility of imposing liability on a duty to warn theory.[165]

In many ways the duty to warn as applied to successor corporations is the most plausible of the new alternatives.[166] It is consistent with a causation rationale since it is based on something within the control of the entity sought to be held responsible.[167] Similarly, deterrence is served inasmuch as a successor can act in such a way as to minimize his exposure.[168] Application of this duty to warn also distributes the risk more fairly on the basis of ability to prevent harm.[169]

There are, however, potential problems in application of such a rule. One writer suggested that complying with a "facially reasonable duty to warn could prove all but impossible to meet in practice. How does one effectively warn the public of the potential hazards posed by defective products manufactured by the predecessor and scattered across the nation, or beyond?"[170] One answer may be

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161. *See* Domine v. Fulton Iron Works, 76 Ill. App. 3d 253, 395 N.E.2d 19 (1979).

162. *Id.*

163. *See generally* Fegan, *Opposing Doctrines, supra* note 109, at 153. It is a distortion because the mere continuation elements are not required and no new ones fixed which can be relied on to be definitive. Some jurisdictions have not yet addressed this issue. It is an abandonment in the sense that an entirely new rule is evolving based on a body of law other than corporate. This exception has been referred to as a products liability exception to corporate law. *Id.*

164. 565 F.2d 443 (7th Cir. 1977).

165. *Id.* at 448.

166. Yamin, *Achilles Heel, supra* note 5, at 242-43.

167. Note, *Policy Analysis, supra* note 19, at 706.

168. *Id.*

169. A manufacturer cannot control what a consumer does with a product but, given adequate warning, a consumer assumes responsibility for his own actions.

170. *See* Yamin, *Achilles Heel, supra* note 5, at 243.

to use the media.[171] Despite the difficulties in defining and discharging such a duty to warn, a successor corporation is not as burdened economically by a duty to warn where it has some control over its exposure.[172] This discussion reflects the application of the rationales derived from both bodies of relevant law to an emerging minority rule of successor liability.[173] While some goals are met, others are frustrated. Not all elements of both doctrines are needed to formulate a "right result." There remain areas of uncertainty for corporations in the context of planning acquisitions.

C. *Unanswered Concerns*

The distortion of applicable principles of law created by the new exceptions has probably raised more questions than it has answered. The factors outlined here are viable operating considerations for any company, but take on a special significance in the context of acquisition planning. Since a purchase of assets no longer necessarily signals a clear dividing line between two operations, a potential successor must carefully consider its likely exposure to liability for acts of a current owner.

One factor which is very difficult to assess, but almost certain to have an impact, is susceptibility in a geographical sense. In a large operation, expansive distribution is likely to cause problems in determining potential jurisdictions where claims could arise.[174] Not only does this raise a choice of law issue,[175] but also the prospect of having to defend in a distant location. Furthermore, even if possible jurisdictions could be identified and even if they currently followed the traditional rule of non-liability, it is not possible to predict with any certainty that the law in any given location will not change.[176] The factor which often determines whether a suit may be brought at all is the time that has elapsed between the sale of a product (or

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171. *See* Pierce, *Liability, supra* note 42, at 858.

172. *See id.* at 859.

173. *See* Fegan, *Opposing Doctrines, supra* note 109, at 142.

174. *See* Yamin, *Achilles Heel, supra* note 5, at 190.

175. *See* Heitland, *Survival of Products Liability Claims on Asset Acquisitions*, 34 BUS. LAW. 489, 490 (1979) (state law applies generally to products liability suits which sound in tort, but the question of which state law is to be applied and who will be applying it compound the uncertainty). *See also* Travis v. Harris Corp., 565 F.2d 443 (7th Cir. 1977) (generally, situs of injury and domicile of injured party determine jurisdiction).

176. *See* Yamin, *Achilles Heel, supra* note 5, at 191-92.

in some jurisdictions discovery of a defect) and injury.[177] From a manufacturer's view, there clearly needs to be repose at some point in time.[178] Equally clear is the plaintiff's position that the defect, and not time, should control ability to bring suit.[179] To the extent that the time in which to file could become a question in any jurisdiction, uncertainty prevails in planning.

A corollary to the number of possible suits is the extent of expected liability. This is affected by the law and climate in a given jurisdiction and, perhaps just as importantly, by the seller. Regardless of how well a business has been run, the seller will have better information as to potential problem areas *and* greater incentive to de-emphasize their importance.[180] In a selling transaction emphasis is placed on positive aspects of the sale and this focus may prove hazardous in the area of successor product liability because of the scope and size of potential exposure.[181]

Another unpredictable aspect of this exposure is retroactive application. The *Cyr* court eschewed sympathy for a company so burdened by remarking, "[T]his kind of surprise is endemic in a system where legal principles are applied case by case . . . ."[182] In another case, despite defense counsel's arguments that both the parties and their insurers had (justifiably, according to the court) relied on the existing state of the law in structuring their deal, the court extended its adoption of the new product line exception a full nineteen months back to accommodate a "handful" of "similarly situated plaintiffs" with suits in progress.[183] One writer labels the enthusiasm of a "court

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177. *Id.* at 191-92 & n.22. *See* Phillips, *Successor, supra* note 16, at 923-25. *But see* Comment, *Torts—Products Liability, supra* note 137, at 428-30 (length of time elapsed may be irrelevant; one court imposed strict liability on a successor corporation for defects in predecessor's product manufactured nearly 28 years before injury occurred).

178. *See* Phillips, *An Analysis of Proposed Reform of Products Liability Statutes of Limitations*, 56 N.C.L. REV. 663, 664 (1978). *See generally* Dworkin, *Product Liability of the 1980's: "Repose if Not the Destiny" of Manufacturers*, 61 N.C.L. REV. 33 (1982) (lobbying efforts of manufacturers concerned with "delayed accrual" of products liability claims have, in nearly half of the states, resulted in passage of statutes of repose providing for a 5 to 10 year cap on claims running from date of sale).

179. *See* Comment, *Torts—Products Liability, supra* note 137, at 429 n.97 (since this type of statute would bar some claims before they arise, some statutes have been declared unconstitutional).

180. Roe, *Mergers, supra* note 17, at 1573-74.

181. *Id.*

182. Cyr v. B. Offen & Co., 501 F.2d 1145, 1154 (1st Cir. 1974).

183. *See* Ramirez v. Amsted Indus., Inc., 86 N.J. 332, 355-57, 431 A.2d 811, 823-24 (1981) (court held as it did despite the passage of 28 years during which the corporation changed hands twice).

determined to adopt a liberalized rule of successor liability" as turning a blind eye to contrary reasoning and visiting the proverbial "sins of the father" on a successor.[184] The mass tort disaster graphically illustrates the possible cumulative effects of the above factors in combination. Areas of litigation such as asbestos[185] and DES, cause a multiplication of every disadvantageous element mentioned, often to the point of paralyzing a corporation facing such litigation.[186] A natural inquiry may be raised as to how well plaintiff's interests are served when the very source of recovery sought to be preserved by the courts is, by that very process, "hamstrung" out of existence.

This is but one of a number of questions still open. Which combinations of the rationales for strict liability should apply to successor situations?[187] Whether successor liability is foreclosed by the continued existence of a predecessor is also unsettled.[188] Much would be resolved if a test could be developed to distinguish between the purchase of an ongoing business and the purchase of assets.[189] Whether or not such a test can be eventually developed, other alternatives must be explored.

IV. PROPOSALS AND STRATEGIES

The traditional rule of non-liability for a successor corporation upon purchase of the assets of another company could still work *if*, as one writer noted, "[T]he highest plausible liability is small in relation to firm size, or as long as the range of uncertainty is small enough that the transferee can [insure]. Unfortunately, [these] simple conditions . . . are not always present when assets are transferred."[190] Preventive strategies abound,[191] even though the courts are often not sympathetic.[192]

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184. Yamin, *Achilles Heel, supra* note 5, at 194-95.

185. *See generally* Epstein, *Commentary*, 58 N.Y.U. L. REV. 930, 933 (1983) (thorough and interesting discussion of successor liability in the area of asbestos litigation); Special Project: *An Analysis of the Legal, Social, and Political Issues Raised by Asbestos Litigation*, 36 VAND. L. REV. 573 (1983) (same).

186. Roe, *Mergers, supra* note 17, at 1561.

187. *See supra* notes 141-72 and accompanying text.

188. Comment, *Torts—Products Liability, supra* note 137, at 430.

189. See Phillips, *Successor, supra* note 16, at 920-23 for a discussion of various factors and their possible combinations.

190. *See* Roe, *Mergers, supra* note 17, at 1568.

191. *See* Yamin, *Achilles Heel, supra* note 5, at 248-56 (discussion of protective strategies).

192. *See Ramirez*, 86 N.J. at 354, 431 A.2d at 822-23.

Supporters of expanded liability agree that viable alternative avenues of recovery exist for the products liability plaintiff. Prominent among these alternatives are varying types of insurance arrangements. Other solutions range from simply having buyers pay less, to developing complex formulas for predetermining exposure.[193] There are also new suggestio ns for handling these problems. Most focus either on quantifying and reasonably limiting potential liability or on providing for sources of recovery other than the successor; some advocate extensions of traditional legal doctrines and/or legislative reform.

The solution most often mentioned is contracting for protection from unknown future claims. Insurance is, of course, the usual vehicle but there is variation as to which party to the transaction is to carry it. Coverage obtained by the successor usually does not protect against future injuries caused by products already distributed.[194] Therefore, the suggestion is often made that the transferor be required to maintain products liability insurance after the sale.[195] This insurance, coupled with an agreement that the seller retain responsibility for products distributed prior to the sale, guarantees that both successors and consumers are adequately protected.

Alternatively, a successor could obtain an assignment of the seller's rights under the policy or be named an additional insured.[196] Another method of protection is to have the seller establish an escrow account against future claims.[197] The difficulties inherent in this type of arrangement include the amounts to be set aside, the duration of the account, and the determination of how it should be funded. It is also possible to secure an agreement from the shareholders to indemnify a buyer for subsequent claims.[198] However, since limited liability is one of the attractions of corporate ownership, shareholders may be reluctant to assume ongoing personal liability for a corporation in which their interest has been liquidated.[199]

These solutions all involve greater use of contractual freedom at the time of sale; however, other solutions involve the judicial application of existing legal doctrines. For example, there is support

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193. *See* Roe, *Mergers, supra* note 17, at 1569-77 (discussion of a "lid-floor" rule which would fix a range of liability at the outset, once the attendant problem of valuation is addressed).

194. *See* Comment, *A Restoration of Certainty, supra* note 15, at 459.

195. *Id.* at 458-60. *See also* Note, *Policy Analysis, supra* note 20, at 686 n.64.

196. Comment, *Torts—Products Liability, supra* note 137, at 427 n.83.

197. Comment, *A Restoration of Certainty, supra* note 15, at 454 n.100, 459.

198. *Id.* at 459.

199. *See* Comment, *Torts—Products Liability, supra* note 137, at 426 n.80.

for a concept which is analogous to a bona fide purchaser exception.[200] By establishing "an objective standard of notice based on what would be revealed by a reasonable investigation of the predecessor's liability record, quality control, design safety, and any other available data,"[201] successors would be liable only when they had or should have had notice that defects were foreseeable.[202] The balance between the needs of injured consumers and the planning needs of business entities might be better served by such a rule.

Another writer believes that "the shift from the absolute liability of a manufacturer to a presumption of nonliability based solely on a transfer of corporate assets is too great."[203] Instead, it is suggested that a rebuttable presumption of absolute liability be adopted as a "middle course."[204] Again, the policy balance and fairness concerns are well met with this proposal.[205]

A combination of the trust fund doctrine[206] and deferred abatement rules has also been suggested as a means to make judicial expansion of successor liability unnecessary.[207] Also advocated is expansion of bankruptcy law to allow the separation of assets from outstanding and contingent tort claims to facilitate transfer of those assets.[208] Both solutions would require legislative action, as would the proposal that state regulation of manufacturers be modified to include mandatory product liability insurance covering the life of a product.[209]

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200. *See* Note, *Policy Analysis, supra* note 19, at 705.

201. *Id.* at 687.

202. *See id.* at 687-88.

203. Comment, *A Restoration of Certainty, supra* note 15, at 456.

204. *See id.* (author discusses the relevant burden of proof and evidentiary considerations he proposes; his conclusions seem to indicate that a successor corporation will rarely be able to rebut the presumption).

205. *See id.* at 462.

206. *See* Yamin, *Achilles Heel, supra* note 5, at 199-206. This is a common law theory, also known as a "creditor's bill in equity," which holds that following a sale of assets and resulting distribution of proceeds to shareholders, such proceeds are held in trust for the benefit of creditors. *See also supra* note 91.

207. Yamin, *Achilles Heel, supra* note 5, at 203-04.

208. *See* Roe, *Mergers, supra* note 17, at 1577-83, 1586 n.70.

209. Comment, *A Restoration of Certainty, supra* note 15, at 459-60. *See also* Note, *Policy Analysis, supra* note 19, at 683, 686 (citing Note, *Products Liability and Successor Corporations: Protecting the Product User and the Small Manufacturer Through Increased Availability of Products Liability Insurance*, 13 U.C.D. L. REV. 1000, 1025-32 (1980), and Note, *Products Liability: Developments in the Rule of Successor Liability for Product-Related Injuries*, 12 U. MICH. J.L. REF. 338, 393-94 (1979) (both notes contain suggested legislative reforms and the advantage of legislative rather than judicial solutions). *See also* Polius v. Clark Equip. Co., 802 F.2d 75 (3d Cir. 1986) (suggests

Legislation in the area of successor liability is relatively new. In 1975 there were no statutes dealing specifically with this problem; by 1977 three-fifths of the states were considering statutes.[210] In recent years some legislation has focused on limiting claims by placing caps on recovery and by beginning statutory periods of limitation from the date of a product's sale.[211]

The most recent revisions of the Model Business Corporation Act, adopted in half of the states by 1979, have changed the limitation period for unknown claims against dissolved corporations from two to five years.[212] The Official Comment to this section acknowledges that five years is, to some extent, an arbitrary choice; however, the cut-off is defended on the basis that most claims are likely to arise within that period and that corporations need the certainty provided by a fixed time period.[213] As one writer bluntly noted: "The [Model Act] is a lawyer's product."[214] Nevertheless, the Comment asserts the belief that five years is a "reasonable compromise between the competing considerations."[215] The feature common to all of these proposals is the effort to balance all concerns. Whether responsive to injured plaintiffs or corporate laments over uncertainties, most acknowledge a basic need for a fair result. The point at which both interests are best served has not been identified and where it will be found continues to be the subject of debate.

V. CONCLUSION

It is true that "[t]o the injured person the problem of recovery is substantially the same, no matter what corporate process led to

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modification of state dissolution proceedings in order to make provision for creditors whose claims have not yet accrued).

210. Comment, *A Restoration of Certainty*, *supra* note 15, at 462 n.155.

211. *See* CAL. CIV. CODE § 3333.2(b) (West Cum. Supp. 1986) (California has a $250,000 ceiling on tort recovery). *See generally* Comment, *California's Medical Injury Compensation Reform Act: An Equal Protection Challenge*, 52 S. CAL. L. REV. 829 (1979) (discussing the impact of Medical Injury Compensation Reform Act (MICRA) on California's medical malpractice insurance industry).

Such statutes may raise due process and equal protection objections in that they actually abrogate substantive rights rather than serve as procedural defenses. Comment, *A Restoration of Certainty*, *supra* note 15, at 462 n.156.

212. MBCA, *supra* note 1, § 14.07.

213. *Id.* at 1501, § 14.07 Official Comment.

214. Branson, *Countertrends in Corporation Law: Model Business Corporation Act Revision, British Company Law Reform, and Principles of Corporate Governance and Structure*, 68 MINN. L. REV. 53, 69 (1983).

215. MBCA, *supra* note 1, § 14.07, Official Comment.

the transfer of the first corporation and/or its assets."[216] It is equally true that "[c]oncerns over successor liability may already be affecting, and possibly stymieing, asset sales."[217] Competing policy concerns have led to the abandonment of the long established rule of non-liability for successors who purchase assets and opened a resulting "Pandora's Box of complications."[218] Few, if any, of the goals supported by a non-liability rule remain attainable when any theory of expanded liability is adopted. As one writer noted, "At some point the interest favoring corporate acquisitions will appear to outweigh those interests underlying the risk of loss theory in product liability cases."[219] Indeed, the pendulum appears to be swinging back toward the center.[220]

It is generally true, of course, that if parties to asset transfers provide for these eventualities, the courts will not be called upon to do so later. The changing climate of court action on this issue may provide added incentives to negotiate and settle such matters early. Without careful planning in this area, the judicial alternatives to the traditional rule may ultimately serve to eliminate access for favored plaintiffs by eliminating the defendant.

Sharon L. Cloud

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216. Yamin, *Achilles Heel, supra* note 5, at 229; Turner v. Bituminous Casualty Co., 397 Mich. 406, 419, 244 N.W.2d 873, 878 (1976).

217. Roe, *Mergers, supra* note 17, at 1561.

218. Comment, *Torts—Products Liability, supra* note 137, at 431.

219. Comment, *Corporate Asset, supra* note 46, at 611.

220. *See supra* note 41. *See also* Polius v. Clark Equip. Co., 802 F.2d 75 (3d Cir. 1986) (criticizes rationales relied upon to extend product liability theory into corporate law and refuses to do so just because a "deep pocket" exists).