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THE EXTENSION OF PRODUCTS LIABILITY TO CORPORATE ASSET TRANSFEREES— AN ASSAULT ON ANOTHER CITADEL

I. INTRODUCTION

Since the initial adoption of the rule of strict liability in tort,[1] California has considered itself a leader in the development and extension of this area of the law.[2] This development has been predicated upon the public policies of shifting the costs of product-related injuries from the consumer to the manufacturer who is better able to bear those costs.[3]

A conflict of policies arises, however, when a transferee of corporate assets is sued under the theory of strict liability for injuries sustained from a transferor's product subsequent to the transfer and the transferor's dissolution. While the courts have employed a number of tests[4] to determine a transferee's or successor's liability for its transferor's torts, all have been those traditional corporate tests designed before the adoption of strict liability and used primarily to protect business creditors or shelter corporate transferees from unassumed liabilities.[5] As a result of applying these traditional tests, there has been a clash between the policies underlying strict liability and those supporting predictability in corporate transactions, with the courts until very recently consistently protecting the corporate interests.[6]

Recent decisions addressing this issue should serve as a warning to business transferees because they strongly suggest a departure from the

1. Greenman v. Yuba Power Prods., Inc., 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963). *Greenman* held that "a manufacturer is strictly liable in tort when an article he places on the market, knowing that it is to be used without inspection for defects, proves to have a defect that causes injury to a human being." *Id.* at 62, 377 P.2d at 900, 27 Cal. Rptr. at 700.

2. Pike v. Frank G. Hough Co., 2 Cal. 3d 465, 474, 467 P.2d 229, 235, 85 Cal. Rptr. 629, 635 (1970).

3. Greenman v. Yuba Power Prods., Inc., 59 Cal. 2d 57, 63, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1963).

4. *See* text accompanying notes 55 & 56 *infra*.

5. *See generally* W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, §§ 7122-7123 (rev. perm. ed. 1975) [hereinafter cited as FLETCHER].

6. *See, e.g.*, Adams v. General Dynamics Corp., 405 F. Supp. 1020 (N.D. Cal. 1975); Bazan v. Kux Mach. Co., 358 F. Supp. 1250 (E.D. Wis. 1973); Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817 (D. Colo. 1968) (applying California law); Ortiz v. South Bend Lathe, 46 Cal. App. 3d 842, 120 Cal. Rptr. 556 (1975).

corporate rules once so strictly followed in determining a transferee's liability for its transferor's torts. Some of these courts have modified or extended the corporate rules to better align them with the public policy underlying strict liability.[7] On the other hand, the California Supreme Court has gone so far as to flatly reject the use of such rules in particular circumstances in favor of implementing the theory of strict enterprise liability.[8]

Through an examination of the competing policies underlying the law of corporate transactions and those of strict liability in tort as they have been developed in the decisional law, this Comment seeks to determine where the California courts presently stand on the issue of transferee liability, and to suggest the direction in which they are headed.

II. METHOD OF CORPORATE ACQUISITION AS DETERMINATIVE OF ASSUMPTION OF LIABILITIES—THE TRADITIONAL APPROACH

A. *Law and Policy Governing Corporate Acquisitions*

There are three basic methods by which corporate ownership of a business enterprise may be transferred: (1) statutory merger or consolidation; (2) the sale of stock by the stockholders of the transferor corporation to the transferee corporation; or (3) the purchase of the assets of the transferor corporation by the transferee corporation.[9] The particular method a corporation will choose is dictated by the factual setting, and generally two principal factors are of prime importance. The first is the extent of statutory formality[10] which must be complied with in each case. The second and most compelling factor is the differing extent to which the transferee must assume the transferor's liabilities.[11]

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7. Knapp v. North Am. Rockwell Corp., 506 F.2d 361 (3d Cir. 1974), *cert. denied,* 421 U.S. 965 (1975); Cyr. v. B. Offen & Co., 501 F.2d 1145 (1st Cir. 1974); Shannon v. Samuel Langston Co., 379 F. Supp. 797 (W.D. Mich. 1974).

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

9. Orlanski, *The Avoidance of the Assumption of Liabilities in "Stock for Assets" Acquisitions,* 45 L.A.B. BULL. 361-62 (1970) [hereinafter cited as Orlanski].

10. Statutory references are made to the new California General Corporation Law which took effect on January 1, 1977. Law of Sept. 12, 1975, ch. 682, § 7, [1975] Cal. Stat. 1516. The relevant sections are cited to CAL. CORP. CODE ANN. (West 1977).

11. Another factor of significance which influences a corporation's choice is the tax consequences. *See generally* B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ch. 14 (3d ed. Supp. 1976) [hereinafter cited as BITTKER & EUSTICE].

1. Merger and Consolidation

Corporate reorganizations by means of merger or consolidation are subject to a number of special statutory procedures and requirements which have recently have been made identical.[12] Despite this equal statutory treatment, the two processes are distinguishable in the decisional law.

A statutory merger[13] involves the absorption of one corporation by another through the acquisition of all its outstanding stock. The acquiring corporation thereby obtains the capital, franchises, and powers of the merged corporation, with the former retaining its corporate identity and the latter ceasing to exist as an entity.[14] In a consolidation, two or more corporations unite their rights, franchises, privileges and property to create a new corporation thereby dissolving the two constituent corporations.[15]

The statutory requirements with which merging or consolidating companies must comply were designed to protect the rights of both creditors and minority shareholders.[16] The concern for minority shareholders is reflected in California's requirement that a plan for merger or consolidation be approved by a majority of the outstanding shares of each class of shareholders representing each constituent corpora-

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12. CAL. CORP. CODE ANN. §§ 1100-11 (West 1977). In addition to the provisions of chapter 11, mergers are regulated by the provisions of chapter 12 which apply to corporate reorganizations. The new code eliminates any reference to consolidations, apparently treating them as a merger.

13. A statutory merger should be distinguished from a de facto merger. A de facto merger is a transaction structured as a sale but deemed by a court to be so similar in effect to a merger as to warrant its subjection to the same procedural requirements and legal consequences as a merger. *See* text accompanying notes 75-81 *infra.*

14. Knapp v. North Am. Rockwell Corp., 506 F.2d 361, 365 (3d Cir. 1974), *cert. denied*, 421 U.S. 965 (1975) (*citing* FLETCHER, *supra* note 5, § 7041); Heating Equip. Mfg. Co. v. Franchise Tax Bd., 228 Cal. App. 2d 290, 302, 39 Cal. Rptr. 453, 460 (1964).

15. *See* Jackson v. Continental Tel. Co., 212 Cal. App. 2d 510, 513-14, 28 Cal. Rptr. 1, 3 (1963); Orlanski, *supra* note 9, at 362 n.3. If the shareholders receive only voting stock of the surviving or new corporation, the transaction will qualify as a Type "A" reorganization and will enjoy tax-free status. I.R.C. § 368(a)(1)(A). Tax considerations applicable to each of the three methods of acquisitions are discussed in Darrell, *The Use of Reorganization Techniques in Corporate Acquisitions*, 70 HARV. L. REV. 1183 (1957).

16. For an excellent in-depth discussion of the purposes and effects of the new California General Corporation Law as it relates to corporate combinations, *see* Barton, *Business Combinations and the New General Corporation Law*, 9 LOY. L.A.L. REV. 738 (1976) [hereinafter cited as Barton]. *See also* Small, *Corporate Combinations Under the New California General Corporation Law*, 23 U.C.L.A. L. REV. 1190 (1976) [hereinafter cited as Small].

tion.[17] If the requisite number of shareholders of each corporation approve the plan, dissenting shareholders are provided appraisal rights as a matter of law, requiring the respective corporations to purchase back the dissenting shares, in cash, at their fair market value.[18]

Whenever the management of a prospective surviving or constituent corporation[19] contemplates pursuing a statutory merger or consolidation, one of its foremost considerations is the liability which attaches to the transaction as a matter of law. By statute, the corporation formed by a merger or consolidation is answerable for all of the acquired or constituent corporation's liabilities, whether or not they are specifically assumed.[20] In addition, this assumption of liabilities applies regardless of whether the liabilities are known or contingent,[21] or arise in contract or tort.[22] Thus, a corporation which acquires the ownership, operations, and property of another through statutory merger or consolidation would—as a matter of law—inherit any potential products liability and creditor claims existing against the acquired corporation.[23]

17. CAL. CORP. CODE ANN. §§ 152, 1201(a) (West 1977). Section 152 further provides that the articles of incorporation may require the vote of a greater proportion of the outstanding shares so entitled to vote to approve a plan for reorganization.

18. *Id.* § 1300(a). For a discussion of the development of the corporate power to merge or consolidate with less than unanimous shareholder approval, *see* Levy, *Rights of Dissenting Shareholders to Appraisal and Payment*, 15 CORNELL L.Q. 420-21 (1930).

19. A "surviving corporation" is the corporation into which one or more other corporations are merged, whereas "constituent corporation" refers to the corporation which is merged or consolidated with one or more others. Treadaway v. Camellia Convalescent Hosps., Inc., 43 Cal. App. 3d 189, 194 n.2, 118 Cal. Rptr. 341, 344 n.2 (1974).

20. The new General Corporation Law provides in pertinent part that upon merger (or, in substance, consolidation) the surviving corporation shall be subject to all the debts and liabilities of the constituent corporations "in the same manner as if the surviving corporation had itself incurred them." CAL. CORP. CODE ANN. § 1107 (West 1977).

21. Treadaway v. Camellia Convalescent Hosps., Inc., 43 Cal. App. 3d 189, 198, 118 Cal. Rptr. 341, 346 (1974). For a discussion of contingent liabilities with an emphasis on the problem of unknown tax deficiencies, *see* Freling, *Tax Consequences of Nontax Motivated Aspects and Factors in the Sale of a Corporate Business*, N.Y.U. 21st Inst. on Fed. Tax. 1107, 1130-31 (1963) [hereinafter cited as Freling]; Comment, *Transferee Liability and the C Reorganization*, 40 U. COLO. L. REV. 380, 385-86 (1968) [hereinafter cited as Comment, *Transferee Liability*].

22. It has been stated that the corporation ultimately formed assumes the debts and liabilities of the constituent corporations, "whether they arise ex contractu or ex delicto." Moe v. Transamerica Title Ins. Co., 21 Cal. App. 3d 289, 304, 98 Cal. Rptr. 547, 556-57 (1971) (surviving corporation liable in punitive damages for tort of extinct corporation).

23. Of course, this logic does not necessarily apply where the corporations fail to comply with the statutory provisions governing merger and consolidation. In such a situation, the courts would scrutinize the transaction within the context of the de facto merger doctrine, discussed at notes 75-81 *infra* and accompanying text.

2. Sale of Stock

The second method by which a corporation can acquire the ownership or business of another is through the purchase of the acquired corporation's stock. This transaction is less complex than a merger or consolidation, as there are no statutory formalities with which the parties must comply.[24] While the management of the acquiring corporation must authorize the transaction, there is no formal necessity for shareholder approval rights,[25] as the transfer is consummated directly between the acquiring corporation and the shareholders of the transferor corporation. Likewise, there are no formal appraisal rights for the shareholders of either corpoation.[26]

The transferee corporation in a purchase of stock transaction does not directly assume all of the transferor's liabilities as a matter of law.[27] Rather, the transferee becomes indirectly liable for the transferor's debts and obligations, from an economic standpoint, by virtue of the fact that it is actually a shareholder in the transferor corporation.[28] Consequently, the transferee is insulated to some degree from any catastrophic judgment since only its investment in the stock of the transferor is vulnerable to claims against the latter.[29]

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24. If the shareholders of the acquired or transferor corporation receive only voting stock of the acquiring or transferee corporation as consideration, and the transferee gains "control" of the transferor corporation, the transaction will qualify as a Type "B" reorganization and the selling shareholders will not be taxed at the time of acquisition. I.R.C. § 368(a)(1)(B). Orlanski, *supra* note 9, at 362 n.2.

25. *See generally* C. SCHARF, ACQUISITIONS, MERGERS, SALES AND TAKEOVERS 251-52 (1974) [hereinafter cited as Scharf]; INSTITUTE OF CONTINUING LEGAL EDUCATION, CREATIVE ACQUISITION TECHNIQUES 61-62 (1968).

26. *See* Freling, *supra* note 21, at 1108-09.

27. *See* note 20 *supra*.

28. This limited assumption of the transferor's liabilities by the corporation buying its stock is sensible because subsequent to such a sale the selling corporation normally continues its business and maintains its corporate existence. The buyer merely becomes a shareholder of the seller, and like any other shareholder, exposes its assets to the claims of the seller's creditors only to the extent of its investment therein. *See* INSTITUTE OF CONTINUING LEGAL EDUCATION, CREATIVE ACQUISITION TECHNIQUES 61-64 (1969); SCHARF, *supra* note 25, at 251-52.

Another potential advantage to this method of acquiring a seller's business is the fact that the buyer may attempt to complete the transaction through a tender offer, thereby avoiding the need for formal approval of the seller's shareholders or the cooperation of its management. *Id.*

Despite these advantages, the transferee must be conscious of the fact that a large judgment against the transferor could significantly decrease the value of its purchased stock. Additionally, if the transferor corporation dissolves subsequent to the transfer, and all of its assets are distributed to the transferee, the transferee may still incur liability for the former's debts as a former stockholder. *See* Darrell, *supra* note 15, at 1202.

29. *See* Freling, *supra* note 21, at 1131.

3. Sale of Assets

The third method by which corporate interests may be transferred is through the sale of corporate assets. This method is the most complex insofar as assessing liabilities is concerned. Most sale of assets transactions of any consequence are subject to statutorily imposed formalities which, although potentially less demanding than those imposed upon merger or consolidation transactions, are similar insofar as they were enacted primarily for the protection of shareholders and creditors.[30]

As in a merger, under California law[31] a corporation may sell all or substantially all[32] of its assets to another corporation upon the approval of a majority of its outstanding shares.[33] However, unlike in a merger reorganization, if its assets are exchanged solely for cash or its equivalent neither a class vote nor the approval of the transferee's stockholders is required.[34] To further relieve the parties in a sale of

30. *See* Brickston v. Federal Firearms Corp., 227 Cal. App. 2d 574, 579-80, 38 Cal. Rptr. 793, 796 (1964) (stating that CAL. CORP. CODE § 3901 (West 1947) was enacted solely for the protection of shareholders and creditors).

31. CAL. CORP. CODE ANN. § 1001(a) (West 1977). Insofar as shareholders' voting and appraisal rights are concerned, the new California General Corporation Law distinguishes between a sale-of-assets "reorganization" and other sale-of-assets transactions wherein assets are exchanged for cash or an equivalent. Under CAL. CORP. CODE ANN. § 181(c) (West 1977), a "reorganization" occurs when the transferor corporation sells substantially all of its assets in exchange for the acquiring corporation's equity securities or "debt securities which are not adequately secured and which have a maturity date in excess of five years after the consummation of the reorganization . . . ." *Id.* Just as in a merger, both corporate partners to such a reorganization must comply with sections 1201(a) and 1300(a) by securing majority shareholder approval of the "principal terms" of the reorganization, and affording appraisal rights to dissenting shareholders.

32. No particular percentage is controlling in the determination of what constitutes "substantially all" of a transferor's assets. REV. RUL. 57-518, 1957-2 CUM. BULL. 253 considers this a question of fact involving "the nature of the properties retained by the transferor, the purpose of retention, and the amount thereof." BITTKER & EUSTICE, *supra* note 11, at 41-42; Comment, *Transferee Liability, supra* note 21, at 382-84. In effect, to constitute a sale of "substantially all" assets, the transaction must result in the transfer of the transferor's business operations to the transferee.

33. If the transferor corporation transfers substantially all of its assets solely in exchange for voting stock in the transferee corporation, the transaction will qualify as a Type "C" reorganization, rendering it a tax-free transaction. I.R.C. § 368(a)(1)(C). *See* Orlanski, *supra* note 9, at 361 n.1.

In structuring a sale of assets as a Type "C" reorganization, a transferee should be aware of the tendency of such transaction to fall within the purview of the de facto merger doctrine. *See* note 80 *infra*.

34. Such a transaction is not a reorganization within the terms of CAL. CORP. CODE ANN. § 181(c) (West 1977). It therefore falls within the purview of section 1001(a), requiring approval only of the shareholders of the assets transferor. Furthermore, in contrast to section 1201(a), applying to reorganizations, holders of non-voting

assets of the burdens imposed upon merger or reorganization participants, California has not enacted an appraisal statute for the benefit of stockholders dissenting to such a sale.[35]

As compared to a merger or consolidation, a sale of substantially all assets as a means of transfering a business operation is attractive for several reasons. First, the transferee corporation can avoid the nondeductible expense and the problems inherent in holding a shareholder's meeting to approve the transaction. Second, the transaction can be effectuated without either corporation suffering the economic burden of paying off dissenting shareholders.[36]

While a transaction structured as a sale of substantially all assets may be attractive for the above reasons, its greatest advantage over a merger, consolidation or a sale of stock is the freedom from unassumed liabilities it affords the transferee. The "general rule" has been accepted in most American jurisdictions addressing the issue.[37] It provides that a transferee corporation which purchases all[38] the assets of another corporation

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stock are not entitled to participate in approving an assets-for-cash transaction. *Id.* § 1001(a). *See* Small, *supra* note 16, at 1209-14.

35. CAL. CORP. CODE ANN. § 1300(a) (West 1977) provides dissenters' rights only in reorganizations under sections 1201(a), (b), (e), and in short-form mergers. *See* Barton, *supra* note 16, at 784-87. *See generally* Small, *supra* note 16 (expressing dissatisfaction with the statutory treatment of sale-of-assets transactions under the new California General Corporation Law); Note, *Corporations: Sale of Assets: Dissenting Shareholders' Appraisal Right in Absence of Appraisal Statute* 46 CALIF. L. REV. 283 (1958) (expressing the view that the absence of an appraisal statute under the "old law" was illogical and inequitable to dissenting shareholders).

36. *See generally* Freling, supra note 21, at 1107-09. The relative advantages of a sale of assets over a merger with respect to taxes and avoidance of shareholders rights of dissent and appraisal are implied by the discussion in Farris v. Glen Alden Corp., 143 A.2d 25 (Pa. 1958).

37. *See, e.g.*, Forest Laboratories, Inc. v. Pillsbury Co., 452 F.2d 621, 625 (7th Cir. 1971); West Tex. Ref. & Dev. Co. v. Commissioner, 68 F.2d 77, 81 (10th Cir. 1933); Bazan v. Kux Mach. Co., 358 F. Supp. 1250, 1251 (E.D. Wis. 1973); Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817, 820 (D. Colo. 1968) (applying California law); Ortiz v. South Bend Lathe, 46 Cal. App. 3d 842, 846, 120 Cal. Rptr. 556, 558 (1975); FLETCHER, *supra* note 5, § 7122 at 188.

38. There has been some inconsistency with the inclusion of the word *all* in reference to the quantity of assets transferred when reciting the "general rule." *Compare, e.g.*, Knapp v. North Am. Rockwell Corp., 506 F.2d 361, 364 (3d Cir. 1974), *cert. denied*, 421 U.S. 965 (1975); Forest Laboratories, Inc. v. Pillsbury Co., 452 F.2d 621, 625 (7th Cir. 1971) which exclude the term *all, with, e.g.*, Lopata v. Bemis Co., Inc., 406 F. Supp. 521, 525 (E.D. Pa. 1975) and Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817, 820 (D. Colo. 1968) which include the term *all.* The *Kloberdanz* court, applying California law, discounted the apparent inconsistency by stating that as far as the application of the "general rule" was concerned, the emphasis should be on whether the sale was a bona fide one involving the payment of money or property sufficient for the transferor to respond to liability claims against it. *Id.* at 820-21. It appears, then,

for adequate consideration, does not, by reason of the transfer, assume any of the transferor's debts or liabilities.[39] This freedom from any liability not specifically assumed is functional when examined in the context of creditor protection and the traditional rights of bona fide purchasers.[40]

A sale of assets, unlike a merger or consolidation, leaves the corporate structure of the transferor virtually intact. If the assets are purchased for adequate consideration[41] by a transferee who has no notice of any prior claims against them,[42] the transferor's creditors are

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that the "general rule" would be applicable to a transfer of any amount of assets as long as it was accomplished by means of a bona fide purchase.

39. While the "general rule" protects the transferee corporation from assuming any of the transferor's liabilities by reason of the sale, many times the transferor will wield enough bargaining power to make the purchaser contractually assume some of them, resulting in reduction in the price of the assets transferred. The specific liabilities assumed by the purchaser are normally enumerated in a schedule accompanying the contract of sale. *See, e.g.*, Adams v. General Dynamics Corp., 405 F. Supp. 1020, 1022 (N.D. Cal. 1975) (contract containing a disclaimer of assumption of any nondisclosed liabilities); Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817, 819 (D. Colo. 1968).

40. *See* Note, *Assumption of Products Liability in Corporate Acquisitions*, 55 B.U.L. REV. 86, 91-95 (1975) [hereinafter cited as Note, *Assumption of Products Liability*] for an excellent analysis of the development of the "general rule" within the context of creditor protection.

41. It was explained in Pierre v. Riverside Mortgage Sec. Co., 25 Cal. App. 2d 248, 257, 77 P.2d 226, 230-31 (1938), that "sufficient consideration" consists of money or property equal to the fair market value of the assets conveyed which the transferor can then apply to the payment of its debts and liabilities. As the following language indicates, failure to tender sufficient consideration may have grievous results for the purchaser:

> It would be manifestly unfair, unjust, and contrary to equity that it [the transferee] should thus acquire all the assets of the other corporation . . . leaving no one to be sued by its creditors and no property to satisfy its debts and other liabilities, and not itself become responsible for such debts and other liabilities. If it takes the benefit, it must as has so often been said, take the burden, which equitably attaches with it.

Malone v. Red Top Cab Co., 16 Cal. App. 2d 268, 273, 60 P.2d 543, 545-46 (1936) (*quoting* McAlister v. American Ry. Express Co., 103 S.E. 129, 130 (N.C. 1920)). The California courts, when dealing with situations in which the transferor and the transferee have substantially the same ownership, have consistently held that the lack of adequate consideration constitutes a fraud on the former's creditors. *See, e.g.*, Atkinson v. Western Dav. Syndicate, 170 Cal. 503, 510, 150 P. 360, 363 (1915); Economy Ref. & Serv. Co. v. Royal Nat'l Bank, 20 Cal. App. 3d 434, 439, 97 Cal. Rptr. 706, 710 (1971); notes 56 & 69 and text accompanying notes 67-69 *infra*.

42. It is a well settled common-law rule that as between a creditor and a bona fide purchaser, the latter will prevail. A transferee who has purchased in good faith, for valuable consideration, and with no notice of prior claims to the property in question, is a "bona fide purchaser." Frankish v. Federal Mortgage Co., 30 Cal. App. 2d 700, 716, 87 P.2d 90, 97 (1939). It follows that a corporation which purchases the assets of another in good faith, for valuable consideration, and with no notice of creditors' claims to the assets, will prevail over the creditors. *See* Pringle v. Hunsicker, 154

left with an entity capable of satisfying their claims and should be logically precluded from pursuing the innocent transferee. It is the value of the transferor's assets, not the assets themselves, which represent the creditors' security.[43]

The array of potential liabilities from which the "general rule" shields bona fide purchasers of corporate assets consists not only of creditors' claims against the transferor, but also of claims founded in tort.[44] At first glance, it would seem that the reasoning underlying the "general rule" would be equally applicable to tort victims as it is to creditors. The valuable consideration tendered to the transferor could be utilized equally for the satisfaction of judgments based in tort and those based on the demands of creditors. This reasoning breaks down, however, in those situations increasingly encountered in the area of products liability, where the transferor corporation has liquidated, dissolved or otherwise become insolvent[45] before the tort claimant's cause

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Cal. App. 2d 789, 795, 316 P.2d 742, 746 (1957).

It is interesting to note that the surviving corporation in a merger or consolidation is deemed to have constructive notice of the claims of creditors of the acquired corporation, thereby making it impossible to take it in "good faith." One court claimed that a contrary rule would work a "constructive fraud" upon the creditors of the acquired corporation. Treadaway v. Camellia Convalescent Hosps., Inc., 43 Cal. App. 3d 189, 199, 118 Cal. Rptr. 341, 348 (1974).

43. The rights of creditors are further provided for by statute in the form of the Bulk Sales Transfer Act, CAL. COM. CODE ANN. §§ 6101-6111 (West Supp. 1977). This Act essentially requires a transferee of assets to provide notice of a transfer in bulk to all of the transferor's creditors prior to the transaction. Failure to comply with this procedure will result in the transfer being deemed fraudulent and will subject the acquired assets to liability. One consolation to prospective transferees, however, is the relatively narrow scope of the Act. Neither manufacturers nor service enterprises not specifically listed in the Act are subject to its application. CAL. COM. CODE ANN. § 6102, comment 9 (West 1964). *See generally* Orlanski, *supra* note 9, at 388-91. Because it is not applicable to manufacturers, it is questionable whether the Bulk Transfer Act would be of much assistance to products liability claimants.

44. *See, e.g.,* Forest Laboratories Inc. v. Pillsbury Co., 452 F.2d 621 (7th Cir. 1971); Adams v. General Dynamics Corp., 405 F. Supp. 1020 (N.D. Cal. 1975); Ortiz v. South Bend Lathe, 46 Cal. App. 3d 842, 120 Cal. Rptr. 556 (1975).

45. Dissolution and liquidation are defined and distinguished in N. LATTIN, LATTIN ON CORPORATIONS § 175 (2d ed. 1971), *quoted in* Juenger & Schulman, *Assets Sales and Products Liability,* 22 WAYNE L. REV. 39, 40-41 n.6 (1975) [hereinafter cited as Juenger & Schulman] as follows:

> "Dissolution," as in partnership law, means the termination of the legal existence of the corporation so that the unit may no longer carry on under its former franchises, for it has none with which to function. Liquidation or winding up involves the process of liquidating the assets, paying the creditors, and distributing whatever is left, after liquidation expenses, to the shareholders in accordance with their contracts and, if there are no special contracts, then pro rata according to their shareholding interest.

Id.

of action has even accrued.[46] While the "general rule" may protect creditors and facilitate corporate business acquisitions by eliminating the transferee's need to provide for contingent liabilities, it may, at the same time, seriously prejudice a products liability claimant in his search for a viable defendant.

B. *The Plaintiff's Dilemma in a Post-Dissolution Products Liability Action*

When a products liability victim is injured by a defective product subsequent to the manufacturer's sale of all its assets, he is left with two options in his search for redress. The first would be to sue the manufacturer of the product hoping that the consideration it receives in exchange for its assets will be sufficient to satisfy his claim. A second option would be to assert a theory other than that of the "general rule," so as to enable him to sue the present owner of the assets.

The first of these two options is of dubious practical value in the event that the manufacturer who produced the defective item, and later sold its assets, has liquidated and dissolved prior to the claimant's injury.[47] As provided by law, a corporation in the process of dissolution or winding up must adequately provide for the satisfaction of its "known debts and liabilities" before it can distribute its assets among its shareholders (or the consideration received from the sale of those assets).[48] While this section provides an adequate remedy to "known" or ascertainable creditors at the time of corporate dissolution, it provides no

46. In California, a cause of action for personal injury resulting from a defective product or defective condition created by a defendant does not accrue until the date of the injury. Howe v. Pioneer Mfg. Co., 262 Cal. App. 2d 330, 340, 68 Cal. Rptr. 617, 623 (1968). In the event that a victim is "blamelessly ignorant" of the cause of his injury, and can later prove so, the statute of limitations has been deemed not to begin to run "until the person knows or, by the exercise of reasonable diligence, should have discovered the cause of injury." G.D. Searle & Co. v. Superior Court, 49 Cal. App. 3d 22, 25, 122 Cal. Rptr. 218, 220 (1975). Likewise, a cause of action for damage to property under a theory of products liability is deemed not to accrue until the date of the damage. Avner v. Longridge Estates, 272 Cal. App. 2d 607, 617, 77 Cal. Rptr. 633, 640 (1969). The same applies to a cause of action based upon a theory of breach of express or implied warranty. Aced v. Hobbs-Sesack Plumbing Co., 55 Cal. 2d 573, 584, 360 P.2d 897, 903, 12 Cal. Rptr. 257, 263 (1961).

47. For an exhaustive study of corporate liability for "post-dissolution claims" *see* Henn & Alexander, *Effect of Corporate Dissolution on Products Liability Claims*, 56 CORNELL L. REV. 865, 896-915 (1971) [hereinafter cited as Henn & Alexander]. For a more brief but nevertheless valuable discussion of the potential remedies available to post-dissolution products liability claimants, *see* Juenger & Schulman, *supra* note 45, at 40-44.

48. CAL. CORP. CODE ANN. § 2004 (West 1977).

such security to a "contingent" products liability claim which arises after the distribution.[49]

California also provides by statute that a dissolved corporation continues to exist for the purpose of defending lawsuits and discharging its obligations.[50] Under this statute, post-dissolution products liability claimants could conceivably attempt to satisfy their claims by proceeding against the directors of the dissolved transferor under the theory that they were responsible for making adequate provisions for the satisfaction of corporate liabilities before distribution.[51] However, this approach may be of limited value since it has never been effectively utilized to satisfy post-dissolution claims.[52] Even if the products liability claimant was successful in bringing such an action, it would be questionable whether the directors involved could financially satisfy a judgment.

The final means by which a post-dissolution claimant might reach the transferor is through a "creditor's bill in equity."[53] This remedy is based on the common law doctrine that the consideration received by the transferor for its assets is to be treated as a trust fund subject to an equitable charge for all debts owed by the dissolved corporation.[54] After the transferor has liquidated and dissolved however, a judgment cannot be recovered without tracing the dispersed trust fund into the hands of the shareholders. In the case of a claimant whose cause of action may not arise for several years after this distribution, the probability of collecting a satisfactory judgment, or of even locating the numerous co-defendants, would be slight. Faced with these practical difficulties and the meager chances of successful recovery against a transferor corporation which has dissolved prior to his injury, a products

49. Two approaches to the problem by means of indemnity and escrow agreements are suggested in Barton, *supra* note 16, at 807 n.262.

50. CAL. CORP. CODE ANN. § 2010 (West 1977).

51. *Id.* §§ 316(a)(2), 2009.

52. Zinn v. Bright, 9 Cal. App. 3d 188, 87 Cal. Rptr. 736 (1970). *See* Henn & Alexander, *supra* note 47, at 908 & n.220.

53. Zinn v. Bright, 9 Cal. App. 3d 188, 192-93, 87 Cal. Rptr. 736, 739-40 (1970).

54. *Id.* at 192-93, 87 Cal. Rptr. at 739. *See also* Updike v. United States, 8 F.2d 913, 917 (8th Cir. 1925). While this theory was developed to satisfy pre-dissolution claims, one authority suggests that there is no reason why it should not be applied to post-dissolution products liability claims, absent legislation to the contrary. Henn & Alexander, *supra* note 47, at 909 & n.222. See Wallach, *Products Liability: A Remedy in Search of a Defendant—The Effect of a Sale of Assets and Subsequent Dissolution on Product Dissatisfaction Claims,* 41 MO. L. REV. 321, 327-35 (1976), for an argument in support of the "trust fund" theory as a viable means of recovering post-dissolution product liability claims.

liability claimant may alternatively pursue the transferee corporation in his search for relief.

1. Exceptions to the "General Rule"

Just as the courts have traditionally recognized the general rule that a transferee corporation does not, by reason of its purchase of another's assets assume the transferor's liabilities, so they have recognized four exceptions to that rule. Liability incurred by the seller-transferor, whether it be liability to creditors or to tort victims,[55] may be imposed on the purchaser-transferee where: (1) the purchaser expressly or impliedly agrees to assume such liability; (2) the transaction is entered into fraudulently to escape such liability; (3) the transaction amounts to a consolidation or merger of the seller and purchaser; or (4) the purchasing corporation is merely a continuation of the selling corporation.[56]

Four California cases have utilized the exceptions to the "general rule" in determining the liability of a transferee of assets for products liability claims resulting from the transferor's defective products and have denied recovery to the plaintiff.[57] A detailed examination of each exception may assist in determining its appropriate use in products liability suits.

C. Traditional Tests for the Imposition of Liability on Business Assets Transferees—Exceptions to the "General Rule"

An examination of the four exceptions leads to the conclusion that inadequate consideration and the extinction of the transferor as a corpo-

55. *See* note 44 *supra*.

56. Some courts have recognized the absence of adequate consideration for the sale or transfer of assets as being a fifth exception to the "general rule." *See, e.g.*, McKee v. Harris-Seybold Co., 264 A.2d 98, 102 (N.J. L. Div. 1970), *aff'd per curiam*, 288 A.2d 585 (N.J. App. Div. 1972). The reason for imposition of liability on the transferee in such cases "is that the seller will be thereby rendered insolvent and unable to pay its debts." *Id.* at 107. California has not recognized lack of consideration as being a separate exception, but rather treats it as an element of each of the other exceptions, most notably that of fraud. *See, e.g.*, Ortiz v. South Bend Lathe, 46 Cal. App. 3d 842, 847, 120 Cal. Rptr. 556, 558 (1975); Economy Ref. & Serv. Co. v. Royal Nat'l Bank, 20 Cal. App. 3d 434, 439, 97 Cal. Rptr. 706, 710 (1971).

57. Adams v. General Dynamics Corp., 405 F. Supp. 1020 (N.D. Cal. 1975); Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817 (D. Colo. 1968) (diversity case applying California law); Ortiz v. South Bend Lathe, 46 Cal. App. 3d 842, 120 Cal. Rptr. 556 (1975); Schwartz v. McGraw-Edison Co., 14 Cal. App. 3d 767, 92 Cal. Rptr. 776 (1971). *Schwartz* was the only case which failed to specifically mention that the transferor dissolved before the injury in question occurred.

rate entity as a consequence of the sale are the common denominators of transferee liability.[58] This suggests that the exceptions, like the rule itself, were developed primarily for the protection of known creditors and the facilitation of corporate transactions.

Freedom to contract for the assumption or non-assumption of specific liabilities is basic to a transferee's ability to calculate the precise economic consequences of a particular transaction. The "general rule," as it has been applied to transferees of corporate assets for adequate consideration, apparently protects this freedom.[59] The specific liabilities assumed by the transferee of assets are usually enumerated in the contract for sale.[60] Where the interpretation of the contract does not rest on the credibility of extrinsic evidence, the court has been forced to decide which of the transferor's liabilities the transferee may have specifically or impliedly assumed.[61]

It has been the practice in California for the courts to narrowly construe any specific contractual assumption by the transferee of the transferor's liabilities. For example, where a contract for sale of assets did not specifically enumerate the transferee's assumption of the transferor's tort liability, the court found an intent on the part of the parties that the transferor retain that liability.[62] This standard of interpretation ultimately shielded the transferee from a products liability claim which arose after the transfer and after the transferor had dissolved.[63] The claimant was left without a remedy. In addition, the purchasers of corporate assets have been permitted to specifically exclude or disclaim the assumption of any non-disclosed or contingent liabilities which may arise from the transferor's former activities.[64]

Courts have sometimes found an *implied* assumption of liability on behalf of the transferee, depending upon the circumstances of the

58. *See* Knapp v. North Am. Rockwell Corp., 506 F.2d 361, 366 & n.16 (3d Cir. 1974), *cert. denied*, 421 U.S. 965 (1975); FLETCHER, *supra* note 5, § 7122 (footnotes omitted).

59. *See* note 39 *supra*.

60. *Id.*; FLETCHER, *supra* note 5, §§ 7114-7115 (footnotes omitted).

61. Schwartz v. McGraw-Edison Co., 14 Cal. App. 3d 767, 778-79, 92 Cal. Rptr. 776, 782 (1971).

62. Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817, 821 (D. Colo. 1968) (applying California law).

63. *Id.* at 817.

64. Ortiz v. South Bend Lathe, 46 Cal. App. 3d 842, 846, 120 Cal. Rptr. 556, 558 (1975); Adams v. General Dynamics Corp., 405 F. Supp. 1020, 1022 (N.D. Cal. 1975).

Other jurisdictions have construed similar contractual terms more stringently. *See, e.g.*, Husak v. Berkel, Inc., 341 A.2d 174, 178 (Pa. Super. Ct. 1975) (finding that a disclaimer of liability for strict liability claims lacked sufficient precision to relieve the transferor from assuming liability).

case.[65] This most frequently occurs when the transferee receives all of the transferor's assets in exchange for inadequate consideration, the transferee having reason to know that the selling company would be unable to meet its obligations.[66]

The essence of the fraudulent transfer exception is the sale of corporate assets for insufficient consideration. This leaves little money for the satisfaction of the selling corporation's debts.[67] As explained by one California court:

> Transfers of all of the assets of a person or corporation in straitened circumstances, without fair consideration, to a corporation having substantially the same ownership, by which the just claims of creditors are defeated, are of such fraudulent nature that the new corporation may be held to the debt of the old.[68]

Generally, a sale of total assets will not be deemed a fraudulent transaction imposing liability on the transferee if the purchase is made in good faith, for fair consideration, and without notice of prior claims to the property in question.[69]

While the corporate rule discouraging fraudulent conveyances serves to protect the rights of creditors as well as those of the bona fide pur-

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65. *See* Hoche Prods., S.A. v. Jayark Films Corp., 256 F. Supp. 291 (S.D.N.Y. 1966), *cited in* FLETCHER, *supra* note 5, § 7124 n.3. Apparently, courts infrequently utilize this form of an exception to the "general rule," preferring one of the established exceptions.

66. FLETCHER, *supra* note 5, § 7126.

67. *See* note 56 *supra*.

68. Economy Ref. & Serv. Co. v. Royal Nat'l Bank, 20 Cal. App. 3d 434, 439, 97 Cal. Rptr. 706, 710 (1971). *Accord*, Ortiz v. South Bend Lathe, 46 Cal. App. 3d 842, 849, 120 Cal. Rptr. 556, 560 (1975); Malone v. Red Top Cab Co., 16 Cal. App. 2d 268, 273, 60 P.2d 543, 545-46 (1936).

69. *See* note 41 *supra*. California treats stock in the purchasing corporation as sufficient consideration in a sale of assets if that stock is marketable and can be applied to the satisfaction of the transferor's debts. In one California case, the court indicated that "the emphasis should be on whether the sale was a bona fide one involving the payment of money *or property* to the selling corporation . . . ." Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817, 820-21 (D. Colo. 1968) (emphasis added). *Accord*, Pierce v. Riverside Mortgage Sec. Co., 25 Cal. App. 2d 248, 257, 77 P.2d 226, 231 (1938).

On the other hand, stock delivered directly to the shareholders of the selling corporation in return for all of its assets, instead of to the corporation itself, has been deemed a fraudulent conveyance since it leaves the transferor insolvent and incapable of satisfying its creditors. Upon such a delivery, the purchaser will be a "party to a diversion of the trust fund" to the exclusion of the transferor's creditors and will incur the liabilities of the latter. Lamb v. Leroy Corp., 454 P.2d 24, 27 (Nev. 1969). The rule is supported by the theory that the purchaser has constructive knowledge that the rights of creditors will be impaired by his action. *See* Comment, *Transferee Liability, supra* note 21, at 397. For an explanation of "trust fund" *see* text accompanying note 54 *supra*.

chaser of assets, it is of virtually no significance to a products liability claimant whose cause of action may not arise until after the "trust fund" has been dispersed.

A corporation selling its assets to another corporation will typically include both intangible and tangible property.[70] As previously discussed,[71] the transferee can avoid satisfying dissenters' appraisal rights if it pays cash consideration. It may enjoy the benefits of the transferor's business operations, without incurring its liabilities, even if it pays with marketable securities, by structuring what is in effect a total transfer of the seller's business as a sale of assets, rather than a merger or consolidation. It was in order to scrutinize these types of transactions for possible prejudice to creditors and dissenting shareholders that the courts developed the third[72] and fourth[73] exceptions to the "general rule."[74]

The courts have implemented the third exception to the "general rule" by what has come to be known as the de facto merger doctrine. This consists of an examination by the court of the contract for sale of assets together with the consequences of the transaction to determine whether or not it has the "indicia" or consequences of a merger.[75] In the event that it does, the purchaser will be required to comply with the provisions controlling a statutory merger, *i.e.*, grant dissenters' appraisal rights[76] and assume all of the acquired corporation's liabilities.

70. These include not only the transferor's machinery, equipment, and inventory, but many times the use of the seller's name, the trade names of its products, its customer lists, licenses, patents, trademarks, and business good will. *See, e.g.*, Ortiz v. South Bend Lathe, 46 Cal. App. 3d 842, 847, 120 Cal. Rptr. 556, 559 (1975); Schwartz v. McGraw-Edison Co., 14 Cal. App. 3d 767, 779, 92 Cal. Rptr. 776, 782 (1971). The intangible assets are equally as valuable as the tangible property insofar as the transferee's ability to continue the transferor's business operations is concerned. Their acquisition will be reflected in the purchase price.

71. *See* text accompanying notes 36-39 *supra*.

72. The purchasing corporation will incur the seller's liabilities if the transaction amounts to a merger or consolidation.

73. The purchasing corporation will incur the seller's liabilities if it is merely a continuation of the selling corporation.

74. *See generally* Note, 6 SETON HALL L. REV. 477, 482-86 (1975).

75. *See* Bazan v. Kux Mach. Co., 358 F. Supp. 1250, 1251 (E.D. Wis. 1973); Farris v. Glen Alden Corp., 143 A.2d 25, 28 (Pa. 1958). *See also* Note, 6 SETON HALL L. REV. 477, 482 (1975), which enumerates some of the factors which have been considered by courts in finding de facto mergers.

76. The de facto merger doctrine has traditionally been used for the purpose of ascertaining dissenting shareholders' appraisal rights. *See, e.g.*, Applestein v. United Bd. & Carton Corp., 159 A.2d 146 (N.J. Super. Ct. Ch. Div.), *aff'd per curiam*, 161 A.2d 474 (1960); Farris v. Glen Alden Corp., 161 A.2d 25 (Pa. 1958). The *Applestein* court concluded that: "[I]t is proper to disregard the *form* of a sale or purchase of assets transaction, when its characteristics are virtually identical to those of a statutory

The only definitive use of the de facto merger doctrine as it has been applied in products liability suits against transferee corporations under California law may be found in *Kloberdanz v. Joy Manufacturing Co.*[77] The facts in *Kloberdanz* are typical of those involving a determination of a transferee's liability for the products liability of its transferor. In 1960, the defendant Joy purchased the bulk of the assets, including the name and trademark of a manufacturer of oil drilling machinery for cash consideration. By the terms of the sale, the manufacturer would retain some real and personal property and Joy *would not* assume any liabilities arising from the transferor's torts.[78] The manufacturer-seller continued as a corporate entity, leasing its property and investing the consideration received until its dissolution ten months after the sale. The plaintiff was injured three years after the manufacturer-seller's dissolution. He then brought suit against Joy contending that the sale of assets in effect constituted a merger, thereby imputing liability to the purchaser for the seller's torts.[79]

The court rejected plaintiff's contention by not finding a de facto merger. In so doing, it described two primary characteristics indicative of a merger. First, there was no evidence of there being any continuity of management or stockholder interest from the transferor to the transferee, as "both companies were strangers and dealt at arms length before and after the sale."[80] Second, the transferor continued

merger . . . for the purpose of insuring dissenting stockholders their appraisal rights." 159 A.2d at 156 (emphasis in original).

77. 288 F. Supp. 817 (D. Colo. 1968) (applying California law); *accord*, Ortiz v. South Bend Lathe, 46 Cal. App. 3d 842, 120 Cal. Rptr. 556 (1975). The *Kloberdanz* criteria for determining a de facto merger (or consolidation) has also been cited as authoritative in other jurisdictions. *See* Bazan v. Kux Mach. Co., 358 F. Supp. 1250, 1252 (E.D. Wis. 1973); McKee v. Harris-Seybold Co., 264 A.2d 98, 104 (N.J.L. Div. 1970), *aff'd per curiam*, 288 A.2d 585 (N.J. App. Div. 1972). While no California court has actually imposed liability by means of the de facto merger doctrine, its use in Farris v. Glen Alden Corp., 143 A.2d 25 (Pa. 1958) was cited with approval by the California Supreme Court in Jones v. H. F. Ahmanson & Co., 1 Cal. 3d 93, 117, 460 P.2d 464, 477-78, 81 Cal. Rptr. 592, 605-06 (1969).

78. Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817, 818-20 (D. Colo. 1968).

79. *Id.* at 818, 820.

80. *Id.* at 821-22. Implicit in this statement is the determination by the court that the consideration passing from the purchaser to the seller was "adequate." The fact that the purchaser paid cash insured that there would be no mixture of stockholders following the sale. Whereas stock in the purchasing company in exchange for assets is not itself inadequate consideration, see note 69 *supra*, it can, under certain circumstances, indicate an absorption by the transferee of the transferor's stockholders. Such a transaction highly suggests that it is a merger. *See, e.g.*, Good v. Lackawanna Leather Co., 233 A.2d 201, 208-09 (Super. Ct. Chi. Div. 1967). In any event, it would dismiss the possibility of the companies being "strangers after the sale."

The danger that a stock-for-assets sale might fall within the purview of the de facto

as a separate and distinct corporate entity, for however short a time, after the transfer.[81] Basic to the court's determination that the transaction lacked the requisite elements of a merger was that the fact that by the continued existence of the seller as a separate corporate entity after the sale, its creditors would not be prejudiced. Therefore, it is clear that a de facto merger will not be found if cash is paid in consideration for a company's assets and the company exists as an entity after the sale, capable of responding to its debts.

The fourth exception to the general rule applies when the transferee is but a "mere continuation" of the transferor. This exception reflects the preoccupation with the concepts of "separate entities" and "adequate consideration" similar to that of the de facto merger doctrine. As most frequently interpreted, liability for the obligations of the transferor will be imposed on the transferee when it is determined that the latter is in effect a reincarnation of the former.[82] Application of the exception requires that the relationship between the transacting companies be characterized by a continuity of management,[83] stockholder interest,[84] and, most importantly, "insufficient consideration running from the new company to the old."[85] It is interesting to note, how-

merger doctrine takes on added significance when it is the intention of the parties to structure a transaction which will qualify as a "Type C" reorganization and thereby be tax free. I.R.C. § 368(a)(1)(C). *See* note 26 *supra*. One of the several requirements which must be met to qualify for tax free status is that only voting stock of the purchasing corporation may be paid to the seller as consideration. Compliance with this requirement has in turn been interpreted as importing "a continuity of interest on the part of the transferor or its shareholders in the properties transferred." Cinnocca v. Baxter Laboratories, Inc., 400 F. Supp. 527, 531-32 (E.D. Okla. 1975). *See* Comment, *Transferee Liability, supra* note 21, at 382-84; Daugherty v. Ball, 43 F.R.D. 329, 334 (C.D. Cal. 1967) (holding that a "Type C" reorganization constituted a "practical merger").

81. Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817, 821 (D. Colo. 1968).

82. *See* Note, *Assumption of Products Liability, supra* note 40, at 100-01.

83. Pringle v. Hunsicker, 154 Cal. App. 2d 789, 793, 316 P.2d 742, 745 (1957) (finding continuity of management and absence of adequate consideration as being essential elements of the continuation exception).

84. Stanford Hotel Co. v. M. Schwind Co., 180 Cal. 348, 354, 181 P. 780, 783 (1919) (stating that the continuation exception contemplates the continued activity of "practically the same stockholders and directors"). The court further stated that "equity will strip off the mask of a separate corporate identity, when it is but a mask . . . ." *Id.* *See* Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817, 821 (D. Colo. 1968) (no continuation when there was no common identity of stock, directors, officers, or stockholders).

85. Ortiz v. South Bend Lathe, 46 Cal. App. 3d 842, 847, 120 Cal. Rptr. 556, 558 (1975). *See* Adams v. General Dynamics Corp., 405 F. Supp. 1020, 1022 (N.D. Cal. 1975) (no continuation when, *inter alia*, the consideration was sufficient to pay all the known debts of the transferor). The *Ortiz* court further indicated that any deliberate effort to effect a change in corporate ownership for the purpose of cutting off liabil-

ever, that it is of no consequence that the purchaser continues the business operations of the seller virtually intact, so long as the consideration tendered is adequate and the seller maintains its existence as an entity capable of responding to its creditors.[86] The business may be continued without imposing the transferor's liabilities on the transferee because, "the test is not the continuation of the business operation but the continuation of the corporate entity."[87]

The rationale developed for the "mere continuation" test,[88] like the other three corporate exceptions to the "general rule," was primarily for the protection of creditors. Whereas the traditional rules governing corporate acquisitions have served their purpose admirably, they have failed to provide an adequate remedy to persons injured by defective products subsequent to the manufacturer's sale of its business and its dissolution. In effect, products liability claimants have been defeated by corporate rules which are unrelated to the theory of strict liability in California.

III. From Entity Liability to Enterprise Liability—The Courts' Response

A. The Conflicting Policies Underlying the "General Rule" and Strict Liability in Tort

Strict liability is but one of three causes of action which make up the field of products liability, the other two being negligence and the law of express or implied warranty.[89] The doctrine of strict liability originated as a hybrid of the other two doctrines;[90] it relies on neither

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ity would fall within the fraudulent transfer exception to the general rule. 46 Cal. App. 3d 842, 849, 120 Cal. Rptr. 556, 560.

86. The court in McKee v. Harris-Seybold Co., 264 A.2d 98 (N.J.L. Div. 1970), *aff'd per curiam*, 288 A.2d 585 (N.J. App. Div. 1972) explained:

> When one company purchases all the assets of another, it is to be expected that the purchasing corporation will continue the operations of the former, but this does not by itself render the purchaser liable for the obligations of the former. For liability to attach, the purchasing corporation must represent merely a "new hat" for the seller.

Id. at 570, 264 A.2d at 106.

87. National Dairy Prods. Corp. v. Borden Co., 363 F. Supp. 978, 980 (E.D. Wis. 1973).

88. For a discussion of the "mere continuation" exception as it has been applied to the issue of a corporation's duties under its transferor's collective bargaining agreements, *see* Note, 27 Maine L. Rev. 305, 313-15 (1975). For a recent case on point *see* Acheson v. Falstaff Brewing Corp., 523 F.2d 1327 (9th Cir. 1975). *See also* note 148 *infra*.

89. W. Prosser, Handbook of the Law of Torts 641-82 (4th ed. 1971).

90. *See* Restatement (Second) of Torts § 402A, comment *b* (1965); Santor v. A & M Karagheusian, Inc., 207 A.2d 305, 311 (N.J. 1965).

of the above causes of action for its effect[91] and has virtually superseded the law of warranty as a basis of recovery for injury due to defective products.[92]

The history of products liability law has been characterized by the steady abolition of various bars to recovery. Among these were such requirements as privity, disclaimer, and notice of breach, all elements stemming from the law of warranty.[93] The doctrine of strict liability was adopted in California largely in response to the recognized inadequacy of the law of warranty as a means of providing a remedy for products related injuries.[94] The public policy underlying the doctrine was first espoused by Justice Traynor in *Escola v. Coca-Cola Bottling Co.*,[95] and later became the analytical basis for the strict liability cause of action adopted as the law of California in *Greenman v. Yuba Power Products, Inc.*[96] As formulated in the *Greenman* opinion, "a manufacturer is strictly liable in tort when an article he places on the market, knowing that it is to be used without inspection for defects, proves to have a defect that causes injury to a human being."[97] The rule was "to insure that the costs of injuries resulting from defective products are borne by the manufacturers who put such products on the market rather than by the injured persons who are powerless to protect themselves."[98]

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91. *See* Greenman v. Yuba Power Prods., Inc., 59 Cal. 2d 57, 63-64, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1963).

92. Grinnell v. Charles Pfizer & Co., 274 Cal. App. 2d 424, 432, 79 Cal. Rptr. 369, 373 (1969). It has been suggested by one authority that if the plaintiff can make out a case in negligence or breach of warranty he will also most probably have a case in strict liability. J. COTCHETT & R. CARTWRIGHT, CALIFORNIA PRODUCTS LIABILITY ACTIONS § 2.0-[4] (Supp. 1975) [hereinafter cited as COTCHETT & CARTWRIGHT].

93. *See* Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099, 1127-34 (1960).

94. *See* Prosser, *Strict Liability to the Consumer in California*, 18 HASTINGS L.J. 9, 16-17 (1966) [hereinafter cited as Prosser].

95. 24 Cal. 2d 453, 462, 150 P.2d 436, 440-41 (1944) (concurring opinion).

> Even if there is no negligence . . . public policy demands that responsibility be fixed wherever it will most effectively reduce the hazards to life and health inherent in defective products. . . . Those who suffer injury from defective products are unprepared to meet its consequences. The cost of an injury and the loss of time or health may be an overwhelming misfortune to the person injured, and a needless one for the risk of injury can be insured by the manufacturer and distributed among the public as a cost of doing business. It is to the public interest to discourage the marketing of products having defects that are a menace to the public. . . . However intermittently such injuries may occur and however haphazardly they may strike, the risk of their occurrence is a constant risk and a general one. Against such a risk there should be general and constant protection and the manufacturer is best situated to afford such protection.

Id.

96. 59 Cal. 2d 57, 62-64, 377 P.2d 897, 900-01, 27 Cal. Rptr. 697, 700-01 (1963).

97. *Id.* at 62, 377 P.2d at 900, 27 Cal. Rptr. at 700.

98. *Id.* at 63, 377 P.2d at 901, 27 Cal. Rptr. at 701.

The intent that the manufacturer and not the consumer bear the risk of injuries due to defective products was clearly expressed.[99]

The strict liability cause of action as formulated in *Greenman* eliminated the need for a claimant to prove either a breach of warranty or a breach of duty by the manufacturer to recover for product-related injuries. Justice Traynor made it vividly clear that the liability of a manufacturer of a defective product was to be governed by the law of strict liability in tort and not by the law of contract warranties.[100] Thus, the contractual procedures inherent in the law of warranty which had previously buffered manufacturers from liability no longer served as a bar to recovery.[101] They simply were not consistent with the court's intention that the costs of product-related injuries be shifted to those better able to absorb and distribute them. "Accordingly, rules defining and governing warranties that were developed to meet the needs of commercial transactions cannot properly be invoked to govern the manufacturer's liability to those injured by their defective products unless those rules serve the purposes for which such liability is imposed."[102]

It is not necessary to go to extremes to recognize an analogy between the corporate "general rule" which shields a purchaser of assets from any liabilities that it does not contractually assume, and the law of warranty which once allowed a manufacturer to limit the scope of its liability to consumers. The "general rule," like the rules of warranty, functions well in a commercial setting. However, under certain cir-

99. California has been more progressive in its adherence to this policy than the majority of other jurisdictions which follow the Restatement approach to strict liability. RESTATEMENT (SECOND) OF TORTS § 402A(1) (1965) provides in part:

> One who sells any product in a defective condition *unreasonably dangerous* to the user or consumer or his property is subject to liability for physical harm thereby caused to the user or consumer, or to his property. . . .

(Emphasis added). While the necessity of proving a defective product "unreasonably dangerous" is an element of the strict liability cause of action under the Restatement, California has rejected this requirement with the rationale that it is inconsistent with the *Greenman* formulation (see text accompanying note 97 *supra*), that it increases the plaintiff's burden, and that it "represents a step backward in the area pioneered by this court." Cronin v. J.B.E. Olson Corp., 8 Cal. 3d 121, 133, 501 P.2d 1153, 1162, 104 Cal. Rptr. 433, 442 (1972).

100. Greenman v. Yuba Power Prods. Inc., 59 Cal. 2d 57, 63, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1963).

101. These bars included the statutory provisions of the UNIFORM SALES ACT and the UCC which provided such defenses to breach of warranty actions as lack of notice of injury to the seller and disclaimers of liability by the manufacturer. *See* Prosser, *supra* note 94, at 20, 46-48.

102. Greenman v. Yuba Power Prods. Inc., 59 Cal. 2d 57, 63, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1963).

cumstances, like the rules of warranty, it can "frustrate rational compensation for physical injury."[103] For example, the transaction which frequently occurs[104] is where a corporate purchaser of assets acquires the business of another company, knowing that the seller will subsequently dissolve, but contractually disclaims any assumption of contingent liabilities. Insofar as any future products liability claim is concerned,[105] the claimant's chances of recovery are frustrated by the "general rule" just as much as if by the rules of warranty. By means of a contract for the sale of assets, two corporations have effectively bartered away the rights of any future products liability claimants. This is difficult to reconcile with the California public policy governing actions in strict liability. "The remedies of injured consumers ought not to be made to depend upon the intricacies of the law of sales."[106]

The "general rule" and its exceptions were applied to assets sales primarily to preserve the property rights of bona fide corporate purchasers.[107] The fact that the rule in effect only shielded from the unassumed liabilities of their vendors "good faith" purchasers who paid adequate consideration suggests that the application of the rule rests on an absence of fault on the part of the purchaser. This reliance on the idea of fault reinforces the inapplicability of the "general rule" to claims based on strict liability. Fault is a negligence concept and has no place in a strict liability action. It is a well settled rule that a seller is strictly liable in tort for injury caused by his defective product "al-

103. Seeley v. White Motor Co., 63 Cal. 2d 9, 16, 403 P.2d 145, 150, 45 Cal. Rptr. 17, 22 (1965) (discussing how warranty theory is not suited to the field of liability for personal injuries).

104. *See* notes 62-64 *supra* and accompanying text.

105. Recall that a cause of action in strict liability does not accrue until the date of the injury. *See* note 46 *supra*. While this may result in hardship to persons injured by defective products after the dissolution of the manufacturer, it is certainly more consistent with the public policy supporting strict liability than the statute which governed breach of warranty actions. CAL. COM. CODE ANN. § 2725 (West Supp. 1977) provides in part that a cause of action for breach of any contract for sale accrues when the breach occurs, and an action for breach of warranty occurs on tender of delivery. Utilization of this rule in products liability cases would provide manufacturers with a means of assessing the extent of their contingent liabilities, as they would cease upon delivery of the product and the running of the statute of limitations. The courts' refusal to use this statute in products liability cases indicates that their concern for consumer protection is greater than their concern for the ability of manufacturers to assess their liabilities. *See generally* COTCHETT & CARTWRIGHT, *supra* note 92, § 8.02; Thrailkill, *Statutes of Limitations: Their Selection and Application in Products Liability Cases*, 23 VAND. L. REV. 775 (1970).

106. Greenman v. Yuba Power Prods. Inc., 59 Cal. 2d 57, 64, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1963).

107. *See* note 41 and text accompanying notes 40-46 *supra*.

though [he] has exercised all possible care in the preparation and sale of his product."[108] This principle, unlike the rules governing corporate transactions, requires a manufacturer to assume the risk of injuries due to defective products when he places them on the market regardless of the reasonableness or care with which he does so.[109]

The facts in *Greenman* restricted the imposition of strict liability to a manufacturer. Since that decision, courts have applied the same rationale to all members of the marketing chain. Strict liability for defective products was first extended to retailers, with Chief Justice Traynor's introduction of the concept of enterprise liability: "Retailers like manufacturers are engaged in the business of distributing goods to the public. They are an integral part of the overall producing and marketing enterprise that should bear the cost of injuries resulting from defective products."[110] In addition to reiterating his cost-shifting rationale for imposing liability, Justice Traynor further justified this expansion by remarking that in some cases the retailer may be the only member of the marketing enterprise reasonably available to the injured plaintiff.[111] It is interesting to note that in those instances where the seller corporation dissolves, a purchaser of assets would likewise be the only entity reasonably available to a plaintiff injured by the seller's defective product. Recovery requires merely that the courts deem a purchaser of assets to be a member of the marketing enterprise. This, in

108. RESTATEMENT (SECOND) OF TORTS § 402A(2)(a) (1965); *see* note 106 *supra.*

109. Even though a plaintiff does not have to prove a breach of a duty of care under the theory of strict liability, he does have to prove that he was injured by a defect in the product and that the product was defective when it left the hands of the manufacturer. This requirement, given certain circumstances such as the plaintiff's inability to identify the particular defect which caused the injury, may make it more profitable to seek recovery under a negligence theory, especially, the doctrine of res ipsa loquitur. In this manner, he may avoid having to prove the existence of a defect in favor of establishing an inference of negligence. *See* Jiminez v. Sears, Roebuck & Co., 4 Cal. 3d 379, 483 P.2d 681, 93 Cal. Rptr. 769 (1971) (allowing alternative strict liability and res ipsa loquitur jury instructions).

Since under a negligence theory the plaintiff must at least establish an inference of a breach of duty on behalf of the defendant, problems arise when this theory is employed to impose liability on a successor corporation for its predecessor's torts. Theoretically, when a transferee of assets has no control over production and marketing, he has no duty to insure the safety of the products manufactured.

For an interesting discussion of the creation of such a duty based on a transferee's continuing to represent himself as the transferor in the same enterprise, see Note, *Assumption of Products Liability, supra* note 40, at 107-10; *cf.* Shane v. Hobam, Inc., 332 F. Supp. 526 (E.D. Pa. 1971).

110. Vandermark v. Ford Motor Co., 61 Cal. 2d 256, 262, 291 P.2d 168, 171, 37 Cal. Rptr. 896, 899 (1964).

111. *Id.*

turn, becomes more likely with each judicial extension of the theory of enterprise liability.

Supported by the policy that the risk of injury can best be borne and insured by the marketing enterprise and distributed among the public as a cost of doing business,[112] courts have expanded the scope of strict liability beyond manufacturers and retailers to include such defendants as wholesale-retail distributors,[113] real estate developers,[114] lessors of real and personal property,[115] and trademark licensors.[116] In 1977, the ever lengthening reach of strict liability was extended to include purchasers of business assets.[117]

B. *Judicial Recognition of the Policy Conflict: California Considers Rejecting the Corporate Rules as Governing a Transferee's Liability for Defective Products*

California's departure from corporate analysis as a means of determining the liability of an assets transferee for the defective products of its transferor was preceded by three other decisions which handled the conflict between corporate law and strict liability. In *Shannon v. Samuel Langston Co.*,[118] a plaintiff was injured by a defective machine after the manufacturing company had sold all its assets in exchange for stock in the purchasing company and subsequently dissolved. The purchaser continued the business operations of the seller without interruption. Noting the continuation of operations by the transferee, the continuation of stockholder interest in the two corporations, and the extinction of the seller as a corporate entity shortly after the sale, the court found that the parties to the transfer, unlike those in *Kloderdanz v. Joy Manufacturing Co.*,[119] were not "strangers after the sale."[120] The facts were sufficient to find a de

112. This risk-spreading policy espoused by Justice Traynor in his concurring opinion in Escola v. Coca-Cola Bottling Co., 24 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944), was adopted by the California State Supreme Court in Seeley v. White Motor Co., 63 Cal. 2d 9, 18-19, 403 P.2d 145, 151, 45 Cal. Rptr. 17, 23 (1965).

113. Barth v. B.F. Goodrich Tire Co., 265 Cal. App. 2d 228, 71 Cal. Rptr. 306 (1968).

114. Kriegler v. Eichler Homes, Inc., 269 Cal. App. 2d 224, 74 Cal. Rptr. 749 (1969).

115. Price v. Shell Oil Co., 2 Cal. 3d 245, 466 P.2d 722, 85 Cal. Rptr. 178 (1970).

116. Kasel v. Remington Arms Co., 24 Cal. App. 3d 711, 101 Cal. Rptr. 314 (1972).

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

118. 379 F. Supp. 797 (W.D. Mich. 1974).

119. 288 F. Supp. 817 (D. Colo. 1968). *See* note 80 *supra*.

120. 379 F. Supp. at 801.

facto merger, but the court went on to discuss "[t]he public policy behind the evolving common law of products liability"[121] which requires that the transferee, "having received the benefits of a going concern, should also assume the costs which all other going concerns must ordinarily bear."[122] These "costs" were the damages done by defective products which can best be absorbed and distributed by the enterprise.[123]

In *Knapp v. North American Rockwell Corp.*,[124] a suit based on facts very similar to those in *Shannon*, a federal court of appeals imposed liability on a purchaser of business assets employing the de facto merger rationale. In supporting its finding, the court made it known that an injured party's right to seek recovery was "to be resolved by an analysis of public policy considerations rather than by a mere procrustean application of formalities . . . ."[125] Public policy considerations entailed deciding who was better able to spread the burden of loss through insurance.[126] The most obvious choice was the assets transferee.

To date, the most expansive of those cases which have employed public policy considerations to bolster their corporate analyses of transferee liability has been *Cyr v. B. Offen & Co.*[127] The court in *Cyr* found a purchaser of all the assets of its predecessor liable for the seller's torts through the application of the mere continuation exception to the "general rule."[128] What distinguishes this case from traditional "continuation" cases is the fact that while the purchaser continued the business operations of the seller, it paid cash consideration, thereby avoiding any implication of continuity of stockholder interest or ownership. Both of these interests were traditional elements of the exception.[129] Therefore, a finding by the court of sufficient continuation to impose liability based on the mere fact that the purchaser carried on the business operations of the seller intact indicates a shift in emphasis from continuation of corporate entity to simple continuation of enterprise. The risk allocation and loss distribution rationale underlying

121. *Id.* at 802.

122. *Id.* Such benefits received from the going-concern included its expertise, reputation, and established customers.

123. *Id.*

124. 506 F.2d 361 (3d Cir. 1974), *cert. denied,* 421 U.S. 965 (1975), *noted in* 6 SETON HALL L. REV. 477 (1975).

125. *Id.* at 369.

126. *Id.* at 370.

127. 501 F.2d 1145 (1st Cir. 1974), *noted in* 27 MAINE L. REV. 305 (1975).

128. *Id.* at 1154.

129. *Id.* at 1151. *See* notes 82-87 *supra* and accompanying text.

strict enterprise liability was used to substantiate this obvious expansion of the corporate rules governing transferee liability. The court explained:

> The very existence of strict liability for manufacturers implies a basic judgment that the hazards of predicting and insuring for risk from defective products are better borne by the manufacturer than by the consumer. The manufacturer's successor, carrying over the experience and expertise of the manufacturer, is likewise in a better position than the consumer to gauge the risks and the costs of meeting them. The successor knows the product, is as able to calculate the risk of defects as the predecessor, is in position to insure therefor and reflect such cost in sale negotiations, and is the only entity capable of improving the quality of the product.[130]

Although this emphasis on the continuation of the seller's enterprise rather than on the entity served only as a means by which the *Cyr* court could impose liability on the purchaser by the application of corporate law, it foreshadowed what was to become the basis for the rejection of corporate law in such cases altogether.

In *Ray v. Alad Corp.*,[131] the California Supreme Court was confronted with facts similar to those in *Cyr.* Plaintiff was seeking damages for injuries caused by an allegedly defective ladder manufactured by what the court referred to as the "Alad I" corporation.[132] A year prior to the injury, Alad I sold, for adequate cash consideration, all its manufacturing assets, including real estate, plant, offices, equipment, trade name, inventory, and good will to "Alad II" before subsequently dissolving. The contract for sale did not provide for Alad II to assume any of its predecessor's liabilities for defective products.[133] The court had to decide whether Alad II, by reason of its continuing to "manufacture the same line of ladders under the 'Alad' name, using the same equipment, designs, and personnel, and soliciting Alad I's customers through the same sales representatives with no outward indication of any change in the ownership of the business,"[134] inherited its predecessor's liability for defective products.

The court recognized that under the corporate "general rule," the transaction between Alad I and Alad II could not constitute a continuation since there was adequate consideration running from the purchaser

130. 501 F.2d at 1154.
131. 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).
132. *Id.* at 24, 560 P.2d at 4-5, 136 Cal. Rptr. at 575-76.
133. *Id.* at 26-27, 560 P.2d at 5-6, 136 Cal. Rptr. at 576-77.
134. *Id.* at 25, 560 P.2d at 5, 136 Cal. Rptr. at 576.

to the seller, and there was no continuity of management or stockholder interest.[135] Thus Alad II would not inherit any liability it did not specifically assume. Under an analysis similar to that employed in *Cyr*,[136] Alad II might have been deemed a continuation of Alad I's enterprise and therefore subject to the "expanded version" of the continuation exception to the "general rule."[137] The court in *Ray*, however, chose to reject the *Cyr* approach in favor of imposing liability on Alad II by means of an independent "special exception" to the "general rule" called for by the policies underlying strict liability in tort.[138]

While expressly restricting its analysis to "the narrow circumstances here presented,"[139] the California Supreme Court based its rejection of the corporate "general rule" in this case on three grounds. First, the court recognized that the application of the corporate "general rule" would virtually deprive the plaintiff of any adequate remedy against the manufacturer of the product causing his injury. The injury had not occurred until more than six months after Alad I had dissolved.[140] The court then buttressed its departure from corporate theory by utilizing the risk allocation and cost distribution rationales espoused earlier by former Chief Justice Traynor.[141] The court reasoned that given Alad II's successorship to all the resources and information enjoyed by Alad I, the former "had virtually the same capacity as Alad I to estimate the risks of claims for injuries from defects in previously manufactured ladders for purposes of obtaining insurance coverage or planning self-insurance."[142] Furthermore, subsequent to the sale of assets "it was Alad II, not Alad I, which was in a position to promote the 'paramount policy' of the strict products liability rule by 'spreading throughout society . . . the cost of compensating [otherwise defenseless victims

135. *Id.* at 29, 560 P.2d at 7, 136 Cal. Rptr. at 578. *See* Ortiz v. South Bend Lathe, 46 Cal. App. 3d 842, 120 Cal. Rptr. 556 (1975); text accompanying notes 83-87 *supra*.

136. 501 F.2d 1145 (1st Cir. 1974).

137. *See* text accompanying notes 129-30 *supra*.

138. The court recognized the *Cyr* case as "helpful authority on the separate issue of what if any *special* rule should be applicable to a successor corporation's *tort* liability for its predecessor's *defective products*," but rejected any implication in *Cyr* "that the settled rule governing a corporation's succession to its predecessor's liabilities *generally* should be modified so as to require such succession merely because of the factors of continuity present in *Cyr* and in the instant case." 19 Cal. 3d at 29-30, 560 P.2d at 8, 136 Cal. Rptr. at 579.

139. *Id.* at 25, 560 P.2d at 5, 136 Cal. Rptr. at 576.

140. *Id.* at 31-33, 560 P.2d at 9-10, 136 Cal. Rptr. at 580-81. *See* notes 45-54 *supra* and accompanying text.

141. *See* note 95 *supra*, and text accompanying note 98 *supra*.

142. 19 Cal. 3d at 33, 560 P.2d at 10, 136 Cal. Rptr. at 581.

of manufacturing defects].' "[143] What the court has in effect done, at least within the confines of the particular facts of the case, is to impose liability upon the business enterprise itself, rather than on any particular entity. Finally, despite the fact that Alad II had exercised no control over the defective product in question, the court felt that the imposition of liability would cause no injustice since Alad II had legitimately and continually exploited the good will and established reputation of its predecessor.[144] This exploitation and continuation of its predecessor's product line constituted sufficient participation on the part of Alad II in the ladder manufacturing enterprise to make it strictly liable in tort for defective products manufactured by that enterprise.[145] This is a logical conclusion since the seller's previous business created the present demand for the successor's products, and the successor's continuance of the enterprise could very well reinforce consumer reliance on the safety of those products.

The *Ray* court restricted its holding to the narrow circumstances presented, *i.e.*, where the successor corporation acquired its dissolved predecessor's manufacturing business virtually intact and continued its product line without change. The significance of the decision transcends its narrow facts, however, for it was the first case to substitute the strict liability concept of enterprise for the corporate law concept of entity as the primary consideration for determining the liability of a corporate asset transferee for the torts of its transferor. Further utilization of this concept would virtually destroy the value of the "general rule" as a shield against unassumed product liabilities.

Although this result conflicts with traditional corporate expectations, the California Supreme Court decision is in total harmony with the spirit of strict liability in tort as it has developed in California. What *Greenman v. Yuba Power Products, Inc.* did to the law of warranty,[146] the court's opinion in *Ray v. Alad Corp.* may have done to the traditional law governing corporate acquisitions. Both laws buffered the manu-

143. *Id., (quoting* Price v. Shell Oil Co., 2 Cal. 3d 245, 251, 466 P.2d 722, 725-26, 85 Cal. Rptr. 178, 181-82 (1970)).

144. 19 Cal. 3d at 34, 560 P.2d at 10-11, 136 Cal. Rptr. at 581-82. The *Cyr* court expressed this same view when it said:

> [I]t is true that the successor, by definition was not the legal entity which launched the product on the stream of commerce or made an implied representation as to its safety. But in the most real sense it is profiting from an exploiting of all the accumulated good will which the products have earned, both in its outward representations of continuity and in its internal adherence to the same line of equipment.

501 F.2d at 1154.

145. 19 Cal. 3d at 34, 560 P.2d at 10-11, 136 Cal. Rptr. at 581-82.

146. *See* note 102 *supra* and accompanying text.

facturer from contingent liability for product-related claims, and both fell to a public policy which favored the interests of consumers. Just as Chief Justice Traynor remarked that "[t]he remedies of injured consumers ought not to be made to depend upon the intricacies of the law of sales,"[147] so the court in *Ray* noted that those remedies ought not to depend upon "the general rules of state law making succession to the liabilities of an acquired going business dependent on the form and circumstances of the acquisition . . . ."[148]

Although the application of strict enterprise liability in the *Ray* case was confined to a business transferee who continued its dissolved predecessor's manufacturing business and product line virtually intact, the potential scope of the doctrine has yet to be defined. For instance, would a minor modification of the predecessor's product line or a change of plant location be enough to cut off the successor's liability? Indeed, what if the successor drastically changed the product line but nevertheless continued to profit from its predecessor's former customers and good will?

Ray leaves a myriad of questions presently unanswered concerning the scope of liability of corporate asset transferees. At some point the interests favoring corporate acquisitions will appear to outweigh those interests underlying the risk of loss theory in product-liability cases. The courts will inevitably address these questions in the future, and any potential litigant should be aware that they will most likely be addressed in the context of the fertile law of enterprise liability, susceptible to expansion at any time. It can be safely concluded, however, that any corporation contemplating the acquisition of another's business, by whatever means and for whatever purpose, should acquire products liability insurance as an essential safeguard in the acquisition.[149]

147. Greenman v. Yuba Power Prods., Inc., 59 Cal. 2d 57, 64, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1963).

148. 19 Cal. 3d at 30, 560 P.2d at 8, 136 Cal. Rptr. at 579. The court cited this as being the approach taken by the United States Supreme Court when determining whether an employer, after acquiring and continuing an ongoing business operation, is bound by its predecessor's collective bargaining obligations imposed by federal labor law. *See* Howard Johnson Co. v. Hotel Employees, 417 U.S. 249, 257-58 (1974) (successor employer not bound after acquiring only some assets and predecessor remained in existence as a viable corporate entity); Golden State Bottling Co. v. NLRB, 414 U.S. 168, 180-83 & n.5 (1973) (successor employer considered in privity with its predecessor after acquiring the employing enterprise with knowledge of an unfair labor practice); John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 549-51 (1964) (successor employer bound after acquiring predecessor through merger, there being a substantial continuity of identity in the business enterprise); Note, 27 MAINE L. REV. 305, 313-15 & n.40 (1975).

149. A number of precautionary arrangements may be made by an acquiring com-

IV. CONCLUSION

The "general rule" that a transferee corporation does not, by reason of its purchase of another's assets, assume the transferor's liabilities, was promulgated to facilitate the bona fide purchase of business assets by individual corporate entities. The rule itself allows the purchasing entity to calculate precisely the extent of liability it will assume, while the four exceptions to the general rule serve to insure the rights of creditors and minority shareholders throughout the transaction.

Strict liability in tort—founded in tort, rather than commercial law—serves to insure the rights of injured persons to compensation from those who market defective products. The policies underlying each of these areas of the law are necessarily incompatible, and when the spheres in which they operate overlap, as in products liability suits against a purchaser of business assets, the courts have indicated a willingness to apply the public policy supporting strict liability.

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pany to offset the risk of any contingent liabilities. One of these is for the assets transferee to arrange for the continuation of the seller's products liability insurance, with the consideration paid for the assets reflecting any premiums yet to be paid. *See* Shannon v. Samuel Langston Co., 379 F. Supp. 797, 802 (W.D. Mich. 1974). Another arrangement would be for the shareholders of the transferor to personally indemnify the transferee against any contingent liabilities that the latter may incur. *See* Freling, *supra* note 21, at 1131. Finally, it has been suggested that a portion of the consideration passing from the transferee to the transferor could be placed in escrow to indemnify the transferee for contingent product liabilities. *See* Comment, *Transferee Liability*, *supra* note 21, at 386. This last solution is often impractical, however, because there is no way of determining the amount of time the consideration will be tied up. Similarly, in those cases where the transferor wishes to liquidate and dissolve after the sale, the full purchase price will be needed to satisfy the claims of creditors and shareholders.