

***Nissen Corp. v. Miller*: Maryland Courts Reject the “Continuity of Enterprise” Doctrine**

I. INTRODUCTION

The Anglo-American system of jurisprudence has greatly expanded the ability of an injured party to recover in virtually every area of tort.¹ However, for every attempt to expand liability and compensation for an injured party, there has been some faction which cries “enough, to extend liability any further will do more harm than good.”² The continuity of enterprise exception to the traditional doctrine of non-liability of successor corporations³ in product liability suits is an excellent example of an attempt to further expand liability which is meeting considerable resistance.⁴

¹ See generally GEORGE C. CHRISTIE & JAMES E. MEEKS, *CASES AND MATERIALS ON THE LAW OF TORTS*, chs. 7, 8, 9 & 12 (2d ed. 1990) (These chapters deal with expansion of the law, and resistance to this expansion, in the following areas: failure to aid, negligent infliction of emotional distress, strict liability, products liability and fetal injury.).

² A good example is Lord Abinger’s opinion in *Winterbottom v. Wright*, 10 M. & W. 109 (Exech. 1842). In this case Lord Abinger was dealing with the now universally accepted practice of allowing recovery by an individual not in privity of contract with the manufacturer. Lord Abinger stated:

There is no privity of contract between [the plaintiff and the defendant]; and if the plaintiff can sue, every passenger, or even any person passing along the road, who was injured by the upsetting of the coach, might bring a similar action. Unless we confine the operation of such contracts as this to the parties who entered into them, the most absurd and outrageous consequences, as to which I can see no limit would ensue.

In *Roberson v. Rochester Folding Box Co.*, 64 N.E. 442 (N.Y. 1902), denying the right of privacy to a woman whose likeness had been reproduced without her consent, Chief Judge Parker stated that a “vast field of litigation . . . would necessarily be opened up should this court hold that privacy exists as a legal right . . .” *Id.* at 443; see also *Dziokonski v. Babineau*, 380 N.E.2d 1295 (Mass. 1978) (discusses the abandonment of the traditional rule of inability to recover damages for negligent infliction of emotional distress); AIG Issues Forum, *Why Reforming Our Liability System Is Essential If America Is To Succeed In Overseas Markets*, TIME, FEB. 3, 1992, at 34–35.

³ The term “successor corporation,” for the purposes of this Case Comment, is defined as a corporation that has acquired all, or any part, of a pre-existing corporation (in a cash-for-assets transaction). It does not, as is generally the case, imply the assumption of rights and obligations of the corporation being succeeded. See BLACK’S LAW DICTIONARY 1431 (6th ed. 1990).

⁴ See Carol A. Rogala, *Nontraditional Successor Product Liability: Should Society Be Forced To Pay The Cost?*, 68 U. DET. L. REV. 37 (1990).

Consider the following set of facts:⁵ *P*, a health conscious individual, decides to purchase a treadmill from corporation *D*, the designer, manufacturer, and marketer of the treadmill. A few years later, corporation *D* sells all of its assets to corporation *E* in a cash-for-assets transaction.⁶ Corporation *D* then quietly dissolves. Subsequently *P*, our plaintiff, is severely injured while making an adjustment to the treadmill.

Under traditional rules of corporate successor liability, corporation *E* cannot be held liable for the torts of its predecessor, corporation *D*.⁷ There are four well recognized exceptions to this rule,⁸ but none of them is applicable here.⁹ The result is the inequitable situation that *P*, through no fault of his own, has been seriously injured and now has no party from whom he may seek

⁵ These facts are based on the facts of *Nissen Corp. v. Miller*, 594 A.2d 564 (Md. 1991). See *infra* notes 21–31 and accompanying text.

⁶ Cash-for-assets sales have traditionally received different treatment than sales of assets in which payment is in the form of stock of the buying corporation. This distinction has generally been justified on the grounds that in cash-for-assets sales the “two corporations . . . were strangers before the sale and continued to remain strangers after the sale . . .” *McKee v. Harris-Seybold Co.*, 264 A.2d 98, 104 (N.J. Super. Ct. Law Div. 1970), *aff’d*, 288 A.2d 585 (N.J. Super. Ct. App. Div. 1972). The argument continues that in sales of assets for stock the shareholders of the first corporation become, in effect, shareholders of the second corporation.

At least one court has questioned this distinction stating that “the absence of an exchange of stock should not be conclusive. The presence of stock as consideration should be one factor to use to determine whether there exists a sufficient nexus between the successor and predecessor corporations to establish successor liability.” *Turner v. Bituminous Casualty Co.*, 244 N.W.2d 873, 880 (Mich. 1976).

⁷ Howard L. Shecter, *Acquiring Corporate Assets Without Successor Liability: Is It A Myth?*, 1986 COLUM. BUS. L. REV. 137, 138–39. “The general rule of corporate successor liability has been—and in fact continues to be—that where one company sells or otherwise transfers all of its assets to another company, the acquiring company is not liable for the debts and liabilities of the selling company, including those caused by the torts of the selling company, simply by the virtue of its succession to the ownership of the assets of the selling company.” *Id.*; see also *Giraldi v. Sears Roebuck & Co.*, 687 F. Supp. 987, 990 (D. Md. 1988); *Nissen Corp. v. Miller*, 594 A.2d 564 (Md. 1991); *Flaughner v. Cone Automatic Mach. Co.*, 507 N.E.2d 331, 334 (Ohio 1987); 15 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 7122, at 231 (rev. perm. ed. 1990); John C. Dupee, *Acquisition of Goodwill: The Acid Test of Successor Liability*, 53 ALB. L. REV. 475 (1989).

⁸ See *infra* notes 32–41 and accompanying text.

⁹ *Id.*

compensation.¹⁰ In reaction to this draconian outcome, some courts have adopted a fifth continuity of enterprise exception to the general rule of non-liability of successor corporations. The continuity of enterprise exception extends liability to successor corporations which *continue the enterprise* of the predecessor corporation.¹¹ If the jurisdiction in which our hypothetical plaintiff *P* brings his action, adopts the continuity of enterprise exception, then *P* has a means by which he may receive compensation for his injuries.

The continuity of enterprise exception has caused great controversy in the courts that have dealt with it. *Nissen Corp. v. Miller*, the focus of this Case Comment, is an excellent example of the uncertainty with which courts approach the continuity of enterprise exception. Prior to the *Nissen* case, two federal district courts, within one week of each other, made opposite forecasts whether Maryland would adopt expanded successor liability in the form of continuity of enterprise. One predicted that Maryland would accept continuity of enterprise,¹² and the other predicted that Maryland would not adopt the exception.¹³ The *Nissen* case itself wound through the Special Appellate¹⁴ and Appellate divisions of the Maryland court system: the Court of Special Appeals adopting continuity of enterprise in Maryland, and the court of appeals reversed the lower court holding that Maryland would not accept extended successor liability.¹⁵

The *Nissen* court is not the only court which has expressed reservations about continuity of enterprise as a means to expand successor liability. The

¹⁰ This scenario assumes that there was no intermediate distributor of the product from whom the plaintiff might seek compensation on strict liability grounds. But, even if there were a middle-man distributor, continuity of enterprise would still be relevant insofar as it might be available to that distributor in attempting to seek indemnification from the successor corporation.

¹¹ There are several elements which factor into the determination whether a corporation *continues the enterprise* of a predecessor corporation; these will be discussed extensively *infra* Parts IV-VI.

¹² *Smith v. Navistar Int'l Transp. Corp.*, 737 F. Supp. 1436 (D. Md. 1988).

¹³ *Giraldi v. Sears, Roebuck & Co.*, 687 F. Supp. 987 (D. Md. 1988).

¹⁴ The Maryland court system is similar to the New York court system in that Maryland courts are not called trial, appeal, and supreme in the manner of most states. In Maryland, the lowest state courts are called district courts, the intermediate appellate court is the Court of Special Appeals, and the highest court is the Court of Appeals. ROBERT S. WANT, *FEDERAL-STATE COURT DIRECTORY* 132 (1992).

¹⁵ *Nissen v. Miller*, 594 A.2d 564, 573 (Md. 1991).

exception has thus far been adopted in very few jurisdictions,¹⁶ expressly rejected by several states,¹⁷ and is still a matter of uncertainty in others.¹⁸ Not surprisingly, those commentators who have discussed the continuity of enterprise exception appear as torn as the courts that have faced the issue.¹⁹

The objective of this Case Comment is to survey a number of cases and comments leading up to the recent Maryland Court of Appeals decision in *Nissen Corp. v. Miller*.²⁰ In Section II, the facts and procedural history of *Nissen* are discussed. Section III contains a brief summary of the history of successor liability. Next, Section IV discusses and analyzes a number of rationales which are often advanced to justify extended liability doctrines such as continuity of enterprise. Section V examines the decisions of the Maryland Court of Special Appeals and the Maryland Court of Appeals in the *Nissen* case. Finally, in Section VI, this Case Comment will attempt to assess the future of the continuity of enterprise exception and the likelihood of its continuing acceptance, or further rejection.

¹⁶ *Holloway v. John E. Smith's Sons Co.*, 432 F. Supp. 454 (D.S.C. 1977); *Monzingo v. Correct Mfg. Corp.*, 752 F.2d 168 (Miss. 1985); *Turner v. Bituminous Casualty Co.*, 244 N.W.2d 873 (Mich. 1976).

¹⁷ See *Florum v. Elliott Mfg.*, 867 F.2d 570 (10th Cir. 1989) (applying Colorado law); *Conn v. Fales Div. of Mathewson Corp.*, 835 F.2d 145 (6th Cir. 1987) (applying Kentucky law); *Tucker v. Paxson Mach. Co.*, 645 F.2d 620 (8th Cir. 1981) (applying Missouri law); *Swayze v. A.O. Smith Corp.*, 694 F. Supp. 619 (E.D. Ark. 1988) (applying Arkansas law); *Bernard v. Kee Mfg. Co., Inc.*, 409 So. 2d 1047 (Fla. 1982); *Green v. Firestone Tire & Rubber Co., Inc.*, 460 N.E.2d 895 (Ill. App. Ct. 1984); *DeLapp v. Xtraman, Inc.*, 417 N.W.2d 219 (Iowa 1987); *Jones v. Johnson Mach. & Press Co.*, 320 N.W.2d 481 (Neb. 1982); *Downtowner, Inc. v. Acrometal Prods., Inc.*, 347 N.W.2d 118 (N.D. 1984); *Niccum v. Hydra Tool Corp.*, 438 N.W.2d 96 (Minn. 1989); *Goucher v. Parmac, Inc.*, 694 P.2d 953 (Okla. Ct. App. 1984); *Hamaker v. Kenwel-Jackson Mach., Inc.*, 387 N.W.2d 515 (S.D. 1986); *Ostrowski v. Hydra-Tool Corp.*, 479 A.2d 126 (Vt. 1984); *Harris v. T.I., Inc.*, 413 S.E.2d 605 (Va. 1992); *Fish v. Amsted Indus., Inc.*, 376 N.W.2d 820 (Wis. 1985).

¹⁸ *Holloway v. John E. Smith's Sons Co.*, 432 F. Supp. 454 (D.S.C. 1977); *Salavati v. Blaw-Knox Food & Chem. Equip.*, 497 N.Y.S.2d 242 (N.Y. Sup. Ct. 1985); *Flaugher v. Cone Automatic Mach. Co.*, 507 N.E.2d 331 (Ohio 1987).

¹⁹ See Michael D. Green, *Successor Liability: The Superiority of Statutory Reform to Protect Products Liability Claimants*, 72 CORNELL L. REV. 17, 21 (1986); Rogala, *supra* note 4; Shecter, *supra* note 7.

²⁰ 594 A.2d 564 (Md. 1991).

II. THE FACTS OF *NISSEN CORP. V. MILLER*

The actors in *Nissen Corp. v. Miller*²¹ are many and varied. There are doctors, foreign corporations, retail merchants, dissolved successor corporations, and a cast of thousands. The event that engendered this litigation occurred on January 31, 1981.²² On this day, Dr. Fredrick B. Brandt [hereinafter Brandt] purchased from Atlantic Fitness Products [hereinafter Atlantic] a treadmill that was designed, manufactured and marketed by American Tredex Corporation [hereinafter Tredex].

Six months later, on July 31, 1981, Nissen entered into an asset purchase agreement with Tredex. Pursuant to this agreement, Nissen purchased the name, patent, inventory, and other assets from Tredex. Nissen also assumed some of Tredex's liabilities and obligations, but the contract *expressly excluded assumption of liabilities arising from any product previously sold by Tredex*.²³ Pursuant to the terms of the contract,²⁴ the selling corporation, Tredex, continued in existence for five years renamed as the AT Corporation. Nissen continued to sell replacement parts for equipment sold by Tredex before the sale of the assets.

On October 18, 1986, over five years after his purchase of the treadmill and the sale of Tredex's assets to Nissen, Brandt was seriously injured while trying to adjust the running treadmill. Approximately one year later on December 31, 1987, Tredex was administratively dissolved.²⁵

Brandt and his wife filed suit in the Circuit Court for Baltimore City on September 1, 1988, against Tredex, AT Corporation, Nissen and Atlantic alleging negligence and strict liability.²⁶ Atlantic and Nissen answered the

²¹ *Id.*

²² The following facts are excerpted from *Miller v. Nissen*, 575 A.2d 758, 758-59 (Md. Ct. Spec. App. 1990); and *Nissen v. Miller*, 594 A.2d 564, 564-66 (Md. 1991).

²³ This is a fact of singular importance in the litigation. See *Miller*, 575 A.2d at 759 n.1.

²⁴ Also pursuant to the terms of the contract, Nissen was required to pay Tredex a \$600,000 advance on the contract's execution. In addition to the purchase price, Nissen agreed to pay, for five years, a fee of 4% of their net sales and Tredex was required to keep all accounts receivable. *Nissen*, 594 A.2d at 565.

²⁵ *Id.*

²⁶ Breach of express and implied warranties of fitness were also alleged, but need not be dealt with here. This Case Comment deals specifically with the issue of strict liability in products liability, as the *Nissen* court said, "[I]f we reject the imposition of liability based on

complaint denying liability and asserting affirmative defenses. In May 1989, Nissen filed a motion for summary judgment, contending that it was not responsible for any injuries involving equipment sold or manufactured by American Tredex prior to the date of the Asset Purchase Agreement.²⁷

The Maryland trial court granted summary judgment for the Nissen Corporation based on the traditional rule of non-liability of successor corporations.²⁸ The case was then appealed by Miller to the Maryland Court of Special Appeals.²⁹ The Court of Special Appeals held that Maryland would recognize the continuity of enterprise exception.³⁰ Finally, the court of appeals granted Nissen's petition of certiorari and reversed the holding of the court of special appeals, rejecting the continuity of enterprise doctrine.³¹

III. THE RULE OF SUCCESSOR LIABILITY

As stated above, the general rule of corporate successor liability, when one company sells or otherwise transfers all of its assets to another company, is non-liability for the successor corporation. There are, however, four historic exceptions to the traditional rule of non-liability of successor corporations: (1) when there is an express or implied agreement to assume the liabilities; (2) if the transaction amounts to a consolidation or merger; (3) if the successor entity is a mere continuation or reincarnation of the predecessor entity; or (4) if the transaction was fraudulent, not made in good faith, or made without sufficient consideration.³²

To more fully explain why these exceptions were not available to the plaintiff in the *Nissen* case, it is useful to discuss each in turn. The first exception can only be invoked when a successor corporation makes an express or implied agreement to assume the predecessor corporation's liabilities. The

continuity of enterprise in the strict liability count, it follows that we reject it in the negligence and breach of warranty counts." *Nissen*, 594 A.2d at 567.

²⁷ *Miller*, 575 A.2d at 760 n.1.

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.* at 762. For a discussion of the court of special appeals decision, see *infra* notes 90-100 and accompanying text.

³¹ *Nissen Corp. v. Miller*, 594 A.2d 564, 573 (Md. 1991). For a discussion of the court of appeals decision see *infra* notes 101-25 and accompanying text.

³² *Rogala*, *supra* note 4; see also *Cyr v. B. Offen & Co.*, 501 F.2d 1145, 1151 (1st Cir. 1974); *Smith v. Navistar Int'l Transp. Corp.*, 737 F. Supp. 1446, 1448 (D. Md. 1988); *Miller v. Nissen Corp.*, 575 A.2d 758, 760 (Md. Ct. Spec. App. 1990); *Turner v. Bituminous Casualty Co.*, 244 N.W.2d 873, 877 n.3 (Mich. 1976); *Flaughner v. Cone Automatic Mach.*, 507 N.E.2d 331, 334 (Ohio 1987).

application of this exception is fairly straight forward; if a successor corporation agrees, either expressly or impliedly,³³ to assume the liabilities of the predecessor corporation, then it will be held culpable for any liability that arises after the dissolution of the predecessor corporation. In the *Nissen* case, there was, in fact, an express agreement that the *Nissen* corporation *would not* assume the liabilities of American Tredex.³⁴

The second exception is applicable in situations in which there is a transaction which amounts to a consolidation or merger. This is also known as a "de facto" merger.³⁵ Two of the factors which must be present in order to constitute a de facto merger are a continuity of the corporations' shareholders and a prompt dissolution of the selling corporation.³⁶ The *Nissen* case

³³ An implied assumption of liability means that "[a]bsent agreement by the successor corporation, its conduct must manifest an intent to assume the tort liability of its predecessor, or the equities must be sufficiently strong to impose that liability on the successor corporation." *Smith*, 737 F. Supp. at 1449.

³⁴ See *supra* note 33 and accompanying text.

³⁵ The following factors are often used by courts in order to determine whether an asset acquisition amounts to a de facto merger rather than an ordinary purchase and sale of assets:

(1) Whether there is a continuation of the enterprise of the seller corporation, so that there is a continuity of management, personnel, physical location, assets, and general business operations.

(2) Whether the seller corporation ceases its ordinary business operations, liquidates, and dissolves as soon as legally and practically possible.

(3) Whether the purchasing corporation assumes those obligations of the seller ordinarily necessary for the uninterrupted continuation of normal business operations of the seller corporation.

(4) Whether there is a continuity of shareholders which results from the purchasing corporation paying for the acquired assets with shares of its own stock, this stock ultimately coming to be held by the shareholders of the seller corporation so that they become a constituent part of the purchasing corporation.

Philadelphia Elec. Co. v. Hercules, Inc., 762 F.2d 303, 310 (3d Cir. 1985).

In performing an analysis under these elements, the courts consider substance over form and look to the nature of the transaction as a whole, as reflected in the sale agreement and its actual consequences. *Philadelphia Elec.*, 762 F.2d at 310; *Travis v. Harris Corp.*, 565 F.2d 443 (7th Cir. 1977); *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361, 366 (3d Cir. 1974).

³⁶ *Shecter*, *supra* note 7, at 139

concerned a cash-for-assets transaction³⁷ which negates the possibility of any continuity of shareholders. Also, American Tredex was required to continue in existence for five years as the AT Corporation; thus there was no prompt dissolution.

The third exception requires that the successor corporation be a mere continuation of the predecessor corporation. This exception is the progenitor of the continuity of enterprise exception, but it is applied very strictly. The successor corporation must be virtually identical to the prior corporation before this exception can be utilized.³⁸ Unfortunately for Brandt, the Nissen corporation was not virtually identical to American Tredex: all of the Corporation's facilities were relocated from Indiana to Iowa, the name was changed and Nissen was not required to retain any of American Tredex's employees.³⁹

The fourth exception applies only if the conveyance was made fraudulently or in bad faith. A corporation might use these tactics to avoid liability for debts.⁴⁰ In the present case, however, there was no suggestion of any collusion or wrongdoing.

As courts applied this rule and its exceptions, situations arose in which injured plaintiffs were forced to remain remediless because they were unable to squeeze into the narrow definitions of the four traditional exceptions. To abrogate the harshness of such results, the courts have developed further exceptions,⁴¹ such as continuity of enterprise, in order to reach more equitable results.

³⁷ See *supra* note 7 and accompanying text.

³⁸ "The mere continuation or continuity of entity exception applies where 'there is a continuation of directors and management, shareholder interest and . . . continuation of the corporate entity . . .'" *Nissen Corp. v. Miller*, 594 A.2d at 567 (quoting LOUIS R. FRUMER & MELVIN I. FRIEDMAN, PRODUCTS LIABILITY § 2.06[2][c], at 2-182-83); see also *Green*, *supra* note 19, at 21.

³⁹ *Nissen*, 594 A.2d at 565. The *Nissen* court dismisses this exception with the statement that not even the respondents contended "that Nissen is a 'mere continuation' of American Tredex . . ." *Id.* at 567.

⁴⁰ *Green*, *supra* note 19, at 23.

⁴¹ Another doctrine of expanded successor liability is the product-line theory. The product-line theory primarily evolved out of two cases: *Ray v. Alad Corp.*, 560 P.2d 3 (Cal. 1977) and *Ramirez v. Amsted Indus.*, 431 A.2d 811 (N.J. 1981).

In *Ray*, the plaintiff sustained injuries from a defective ladder manufactured by Alad Corporation [hereinafter "Alad I"]. Prior to the plaintiff's accident, Alad I had sold its assets for cash consideration and thereafter dissolved. The successor corporation bought and retained the name "Alad Corporation." *Alad*, 560 P.2d at 3-5.

IV. RATIONALES OFFERED IN SUPPORT OF EXTENDING LIABILITY TO ENCOMPASS CONTINUITY OF ENTERPRISE

Before analyzing the decisions of the Maryland Court of Special Appeals and Court of Appeals, it greatly facilitates the goal of this Case Comment (the determination of whether the continuity of enterprise doctrine should be further adopted or rejected) to examine several of the rationales that are proffered in order to bolster the imposition of liability on successor corporations. These rationales will then be utilized as a framework for the analysis and discussion of the Maryland courts' decisions.

Through the evolution of expanded successor liability doctrines, such as continuity of enterprise, six rationales have developed which support the imposition of expanded liability on a successor corporation.⁴² These rationales are: (1) even though a change of ownership has taken place, the fact that no change is obvious to the consumer should cause the courts to treat the successor as if it were the predecessor;⁴³ (2) if a successor corporation obtains goodwill

The court held Alad I liable and ruled that "a party which acquires a manufacturing business and continues the output of its line of products . . . assumes strict tort liability for defects in units of the same product line previously manufactured and distributed by the entity from which the business was acquired." *Alad*, 560 P.2d at 11.

The court's justification for imposing liability on the successor was threefold:

- (1) the virtual destruction of the plaintiff's remedies against the original manufacturer caused by the successor's acquisition of the business,
- (2) the successor's ability to assume the original manufacturer's risk-spreading rule [sic], and
- (3) the fairness of requiring the successor to assume a responsibility for defective products that was a burden necessarily attached to the original manufacturer's goodwill being enjoyed by the successor in the continued operation of the business.

With regard to numbers one and three above, the court reasoned the successor caused the plaintiff to be remediless by virtue of the successor acquiring the resources that the original manufacturer would have used to compensate the plaintiff. The successor should bear the burden of the manufacturing business because it is receiving the benefits from it. *Alad*, 560 P.2d at 3.

⁴² Green, *supra* note 19, at 17.

⁴³ Turner v. Bituminous Casualty Co., 244 N.W.2d 873, 882 (Mich. 1976); see also Holloway v. John E. Smith's Sons Co., 432 F. Supp. 454 (D.S.C. 1977) (if a successor operates under a virtually identical name then they are estopped from denying liability); Andrews v. John E. Smith's Sons Co., 369 So. 2d 781, 785-86 (Ala. 1979).

and benefits from its predecessor, it is only equitable that it should also assume the burdens that flow with the benefits;⁴⁴ (3) the successor is in the best position to provide compensation⁴⁵ and spread the risk;⁴⁶ (4) by purchasing the predecessor's assets with cash, the successor contributes to the destruction of the plaintiff's remedies;⁴⁷ (5) a deterrence rationale which holds that losses can best be minimized by imposing liability on the successor, thereby encouraging post-sale safety measures;⁴⁸ and (6) the successor has the ability to act as a "conduit" to channel losses back to the predecessor by prospectively discounting the purchase price in accordance with the predecessor's projected liability for defective products.⁴⁹

A. *Holding Out*

The first rationale relies on actions by the successor corporation by which it essentially holds itself out as the predecessor. An example would be a corporation which buys the assets of another corporation yet continues to run the business of the predecessor corporation under the predecessor's name and with no notice to the public that the ownership has changed.⁵⁰ Some commentators have suggested that while there is superficial appeal to this analogy, there are substantial flaws in the reasoning.⁵¹ The flaw primarily asserted is that the reliance of third parties must be based on representations by the principal.⁵²

However, this argument ignores the fact that the *raison d'être* of an extended liability doctrine is to hold a successor corporation liable for the acts of its predecessor. Any representation made by the successor corporation for all

⁴⁴ See *In re Related Asbestos Cases*, 566 F. Supp. 818, 823 (N.D. Cal. 1983).

⁴⁵ See *Ray v. Alad Corp.*, 560 P.2d 3, 10 (Cal. 1977).

⁴⁶ See, e.g., *Ramirez v. Amsted Indus., Inc.*, 431 A.2d 811, 820-22 (N.J. 1981).

⁴⁷ David Morris Phillips, *Products Liability of Successor Corporations: A Corporate and Commercial Law Perspective*, 11 HOFSTRA L. REV. 249 (1982).

⁴⁸ Green, *supra* note 19, at 21.

⁴⁹ *Id.*

⁵⁰ See *Andrews v. John E. Smith's Sons Co.*, 369 So. 2d 781, 785 (Ala. 1979) (stating that it is unfair if a corporation "holds itself out as if it were the old family firm with which they originally dealt. It is only when an injury occurs that they inform their customers that they are not really the . . . [predecessor corporation] who manufactured the [product]"); *Turner v. Bituminous Casualty Co.*, 244 N.W.2d 873, 882 (Mich. 1976).

⁵¹ Green, *supra* note 19, at 28; Jerry J. Phillips, *Product Line Continuity and Successor Corporation Liability*, 58 N.Y.U. L. REV. 906, 912 (1983).

⁵² See *supra* note 51.

intents and purposes is retroactive. That is, any claim the successor corporation makes about a product it produces will necessarily apply to products the predecessor corporation manufactured. The average consumer, not knowing that ownership of the corporation has changed, will rely upon any further representations by the corporation. When dealing with representations made by the predecessor corporation, it is not unfair to say that the successor corporation now guarantees these same representations by holding itself out as the predecessor corporation. When applying liberal liability doctrines like continuity of enterprise, it places form over substance to adhere to strict definitions of reliance. As the court in *Shannon v. Samuel Langston Co.*⁵³ stated, "solvent corporations . . . should not be permitted to discharge their liabilities to injured persons simply by shuffling paper and manipulating corporate entities."⁵⁴

B. Burdens Should Flow with the Benefits

The second rationale utilized by courts finding extended liability is essentially a "burdens should flow with benefits" rationale.⁵⁵ At least two scholars assert that this is a viable means by which to determine whether a successor corporation should be held liable for the torts of its predecessor.⁵⁶

⁵³ *Shannon v. Samuel Langston Co.*, 379 F. Supp. 797 (W.D. Mich. 1974).

⁵⁴ *Id.* at 802.

⁵⁵ See *Shannon*, 379 F. Supp. at 801 (The court stated: "public policy requires that . . . [the predecessor corporation] having received the benefits of a going concern, should also assume the costs which all other going concerns must ordinarily bear."); *Flaughner v. Cone Automatic Mach. Co.*, 507 N.E.2d 331, 340 (Ohio 1987) (Sweeney, J., dissenting).

⁵⁶ Jerry Phillips asserts:

One approach might be to determine whether the purchaser has paid for intangible items having what might be described as ongoing business value. If it buys this value, it buys product line continuity; if it does not, then it buys only assets. Business value might include intangibles such as trade names, trademarks, trade secrets, logo, customer lists, and goodwill. If the buyer purchases one or any combination of these intangibles for a significant consideration, then it seems fair to conclude that the corporation as an ongoing business has been purchased.

This approach has two apparent advantages. First, liability could not easily be circumvented under this test. If the purchaser, in collusion with the seller, attempted to hide the purchase of ongoing business value by overpricing tangible assets, such a

Other commentators contend that this rationale is specious and weak.⁵⁷ Those that take the latter position argue that the benefits a successor corporation receives are largely in the form of goodwill. "Unless the courts relying on this argument are creating a new concept of property rights . . .",⁵⁸ making the imposition of liability based solely on the acquisition of goodwill seems patently inequitable.⁵⁹ While both arguments against liability predicated on the acquisition of intangibles such as goodwill are cogent, the former is the one that is most in line with the equitable goals of an extended liability doctrine. The caveats given by the opponents of this rationale are worth heeding to the extent that it is probably unwise to base extended liability solely on the purchase of intangibles; there should be some other rationale or policy satisfied at the same time.

C. *Compensation and Loss/Risk Spreading*

The third rationale is actually composed of two different policies: compensation and loss/risk spreading. These same rationales are generally espoused as the underlying policies used to impose strict liability on product manufacturers.⁶⁰ The extension of these rationales into the realm of expanded successor liability is more strained than in regular products liability cases. Traditional notions of culpability must be set aside in order to hold a

practice would normally be detectable and be set aside as fraudulent. Second, this approach would give the buyer the option of not purchasing ongoing business value if it does not want to.

Phillips, *supra* note 51, at 921. David Phillips asserts:

[I]t may be argued that the value which the successor paid the predecessor for goodwill reflected not only the probability of favorable sales from use of the trade name, but also the probability of loss of sales because the successor's products would be associated with products previously manufactured by the predecessor that would prove to be defective. If the probable benefit exceeded the risk of loss of goodwill from the predecessor's defective products, the goodwill still had a positive value to the successor.

Phillips, *supra* note 47, at 255.

⁵⁷ Green, *supra* note 19.

⁵⁸ *Id.*

⁵⁹ See *Woody v. Combustion Eng'g, Inc.*, 463 F. Supp. 817, 821 (E.D. Tenn. 1978); *Tift v. Forage King Indus., Inc.*, 322 N.W.2d 14, 26 (Wisc. 1982).

⁶⁰ James A. Henderson, *Coping With The Time Dimension in Products Liability*, 69 CAL. L. REV. 919, 931-39 (1981).

corporation, which may bear absolutely no relation to a particular product, liable for injuries caused by that product.

1. *Compensation*

Compensation is perhaps the strongest motivating force in our legal system. The American courts are anchored in a solid foundation of commitment to the injured party.⁶¹ The need for compensation is obviously present in a situation in which, through no fault of his or her own, a plaintiff is left remediless because a corporation has sold its assets in a cash rather than stock transaction. Yet, some commentators suggest that imposing liability on a successor corporation is as capricious as arbitrarily choosing a random corporation, bearing no relation at all to the product, and imposing liability upon it.⁶² However, the validity of this argument is questionable. A successor corporation always has the option of negotiating the risk of future litigation into the price paid for the assets. Imposing liability on a corporation that has fully negotiated a transaction, with all the liabilities and risks therein concerned, is hardly the same as imposing liability on some unlucky corporation chosen at random out of a phonebook.

Also inherent in the compensation rationale is a basic notion of fairness. When a consumer pays value for a product, she has a right to expect that it will not fail dangerously in its intended use.⁶³ Moreover, manufacturers and distributors oftentimes try to market their product as though it were infallible. Intuitively, it seems fair to allow a plaintiff in such a case to claim compensation based on the unfair disappointment of reasonable expectations.

With all this in mind, there is no reason that compensation will not serve as an effective rationale upon which to expand successor liability. An exception to the traditional rule of non-liability of successor corporations, such as continuity of enterprise, is well supported by the rationale of compensation.⁶⁴

⁶¹ See *supra* note 1 and accompanying text.

⁶² Green, *supra* note 19.

⁶³ Henderson, *supra* note 60.

⁶⁴ Cf. Rogala, *supra* note 4, at 43.

The expansion of liability is an overzealous attempt to compensate. It cripples the minimization of accident costs and risk spreading—two policies underlying strict product liability—and it fails to place the liability of compensation on one who has reaped the fruits from the defective product's sale . . . the sole strict liability goal that is

2. Loss Spreading

Effective loss spreading can be achieved through the expansion of successor liability. As between the two, the successor corporation is in a much better position than the consumer to spread the risk of loss. The corporation can analyze the predecessor corporation's records and calculate the probability of a particular product causing injury to a consumer, and increase or decrease the price of the product accordingly. Albeit this is not an exact science, but it is obvious that a corporation is in a better position to make these determinations than the consumer.

The theory of loss allocation or burden spreading, holds that the greater the number of people who share in the loss, the more that burden is alleviated in respect to any particular individual.⁶⁵ It is unjust if a single entity is forced to bear the entire burden for an injury. A manufacturer, by obtaining products liability insurance, is in a superior position to bear the cost.⁶⁶

Another means a manufacturer has of passing on the costs is raising the price of the good to reflect an estimate of the burden that will be incurred by defective products.⁶⁷ For there to be efficient loss allocation, the price of the good must accurately reflect its cost to society.⁶⁸ If the good is particularly costly to society and its price does not reflect this, then the level of injury-causing activity will not decrease. Nor is it beneficial if a product that is particularly useful is given an injury cost that is too high, because the beneficial activity will fall below the desired level.

D. Destruction of Plaintiff's Remedies

The fourth rationale holds that by choosing to purchase a corporation's assets for cash, the successor corporation has contributed to the destruction of the plaintiff's remedies and should therefore be held culpable for the plaintiff's injuries. Predictably, there are differing viewpoints as to the validity of this rationale. One side asserts that imposing liability on a corporation that engages

realized by expanding successor liability is compensation. Thus, the courts' action to expand successor product liability takes on a social insurance function . . .

Id.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ Henderson, *supra* note 60, at 932.

⁶⁸ Rogala, *supra* note 4, at 42.

in an asset acquisition is implying that it has committed some wrong that requires punishment, especially when "one recognizes that a successor is merely engaged in that most cherished of free market ideals—purchasing assets that it believes it can put to more productive uses."⁶⁹ The other side of the coin holds that a successor corporation, when deciding to purchase the assets of another corporation, can make an analysis to determine how great the "recourse risk" (the probability of leaving a plaintiff without recourse or remedy) is likely to be and adjust its purchase price accordingly.⁷⁰ Perhaps an even more cherished "free market ideal" than the ability to purchase assets is the right to enter into a fully negotiated bargain. It is hardly offensive to any traditional notions of equity or justice to impose liability upon a party if he or she has freely contracted with that liability in mind.

E. Deterrence

The fifth rationale, deterrence, is one of the most traditional bases for imposing liability in any products liability situation.⁷¹ The goal of general deterrence in products liability law is to cause certain activities to become more expensive and, therefore, less attractive to manufacturers.⁷² If manufacturers know that they will be held liable for the costs that their defective products cause, the deterrence theory encourages them to produce safer products to avoid the cost of these injuries.⁷³

In the context of products liability suits brought against successor corporations, the deterrence rationale is applied to the successor corporation so

⁶⁹ Green, *supra* note 19.

⁷⁰ Phillips, *supra* note 47, at 257.

[t]he successor corporation . . . can construct a posterior probability with respect to the recourse risk, which is both far higher and more accurate than the anterior probability that the consumer would be able to construct when purchasing the product. When negotiating with the predecessor corporation to purchase the assets, the successor can protect itself without an undue expenditure of transaction costs. The successor, in short, can protect against the recourse risk at a lower cost than can the consumer or product user.

Id.

⁷¹ Green, *supra* note 19.

⁷² See generally STUART M. MADDEN, PRODUCTS LIABILITY §§ 6.1, 6.2 (2d ed. 1988).

⁷³ *Id.*

that it will have a stronger incentive to increase post-sale safety measures.⁷⁴ The camps are perhaps more deeply divided over the deterrence rationale than any other in the battle to rationally justify expanded successor liability.⁷⁵ Some argue that the deterrence rationale is simply "inapplicable to every case"⁷⁶ If the ultimate goal of expanded liability is to compensate the injured party *and* encourage manufacturers to produce a safer product, then using a deterrence rationale is an inefficient means to reach these goals as "nothing the new owner does now can shield it from liability for products his predecessor has already distributed."⁷⁷

It is argued that the imposition of liability on successor corporations through doctrines such as continuity of enterprise is justified on the grounds that liability acts in a deterrent fashion insofar as corporations will be far more careful in putting untested products on the market.⁷⁸ The most comprehensive arguments presented against the deterrence rationale in expanded liability doctrines are offered by Professor Michael D. Green.⁷⁹ Green suggests that if the deterrence rationale is to be properly relied upon to extend traditional liability, it should serve to deter the manufacturer by: (1) encouraging pre-distribution safety measures; and (2) passing the costs of product-related injuries on to the consumer.⁸⁰

There are several problems with the application of these rationales to an expanded liability situation such as continuity of enterprise. First, the encouragement of pre-distribution safety measures poses problems insofar as imposing liability on a corporation that was incapable of contributing to a product's design or manufacture cannot, by definition, further this deterrence function.⁸¹ A successor corporation has no opportunity to minimize liability

⁷⁴ See Green, *supra* note 19; George L. Lenard, *Products Liability of Successor Corporations: A Policy Analysis*, 58 IND. L.J. 677 (1983).

⁷⁵ See *supra* note 17 and accompanying text.

⁷⁶ Sharon L. Cloud, *Purchase of Assets And Successor Liability: A Necessarily Arbitrary Limit*, 11 DEL. J. CORP. L. 791, 810 (1986).

⁷⁷ *Id.*

⁷⁸ See Timothy J. Murphy, *A Policy Analysis of A Successor Corporation's Liability For Its Predecessor's Defective Products When The Successor Has Acquired The Predecessor's Assets For Cash*, 71 MARQ. L. REV. 815, 838 (1988) ("The deterrence rationale is a sufficient justification for imposing liability in our tort system even though it is shown that this rationale does not support all of the successor liability theories.").

⁷⁹ Green, *supra* note 19.

⁸⁰ *Id.*

⁸¹ *Id.*

risks; it is simply saddled with whatever degree of safety precautions the predecessor chose to take.

Next, the market deterrence rationale suggests that accidents will be reduced by making products reflect the costs of injuries associated with their use.⁸² This rationale suffers from several inadequacies. The theory does not justify imposing liability on a corporation that takes steps to eliminate the dangerous aspects of a product, or a successor who discontinues a product line altogether and is therefore unable to pass the costs on to the consumer through the market.⁸³ Furthermore, if the market rationale is taken a step further, a successor corporation which has purchased only a particular line of products from a corporate entity that continues after the sale will be held liable even though the predecessor corporation is still in existence. This is because only the successor corporation is in the position to pass the costs of that particular line of products on to the market.⁸⁴

F. Conduit Theory

The sixth and final rationale for the imposition of liability on a successor corporation is the "conduit theory."⁸⁵ The conduit theory holds that liability is imposed upon the successor not merely because they are the successor, but because they act as a conduit by discounting the purchase price of the acquisition by the amount of the predicted future products' liability of the predecessor.⁸⁶ The conduit rationale is unique among the rationales presented to justify expanded successor liability; it is the only one that expressly recognizes that the predecessor is liable for the defects in its products.⁸⁷ It is asserted that once liberal successor liability laws are adopted and promulgated, successors will take it upon themselves to create some mechanism by which

⁸² See *Ramirez v. Amsted Indus., Inc.*, 431 A.2d 811, 822 (N.J. 1981).

⁸³ *Green*, *supra* note 19, at 27-30.

⁸⁴ *Id.*

⁸⁵ See Lynda G. Wilson, *Corporate Successor Liability For Punitive Damages in Products Liability Litigation*, 40 S.C. L. REV. 509 (1989) ("In this test the purchase price is discounted by the amount of damages the successor reasonably could have foreseen, thus punishing the predecessor by reducing the amount it otherwise would have received from its assets." *Id.* at 539.); Jeffrey Allen Mullins, Case Comment, *Product Liability Law: Ohio Adopts The Traditional Rule of Corporate Successor Liability—Flaughner v. Cone Automatic Machine Co.*, 507 N.E.2d 331 (Ohio 1987), 13 U. DAYTON L. REV. 329 (1988).

⁸⁶ *Lenard*, *supra* note 71.

⁸⁷ *Green*, *supra* note 19, at 30-33.

they are able to avoid the predecessor's future liability and still make sure that injured plaintiffs receive compensation.⁸⁸ "Potential successors will either discount the purchase price to reflect the future liability, demand that the predecessor acquire insurance or provide some other mechanism to ensure that the predecessor bears the costs of future claims, or, if no acceptable mechanism can be fashioned, withdraw from the proposed acquisition."⁸⁹

These six rationales are the most commonly used by a court that wishes to expand successor liability to encompass a non-traditional exception such as continuity of enterprise. Keeping in mind these rationales, the next section analyzes the decisions of the Maryland Court of Special Appeals and Court of Appeals.

V. THE HOLDINGS AND RATIONALES OF THE MARYLAND COURTS

A. *The Maryland Court of Special Appeals*

The continuity of enterprise exception to the traditional rule of non-liability of successor corporations is essentially judicial caulking which attempts to seal the cracks between the four traditional exceptions to the rule of non-liability and compensate hapless plaintiffs like Brandt. Very few courts have as yet adopted the exception,⁹⁰ yet the Maryland Court of Special Appeals opined that it was time for Maryland to join the ranks of states embracing the continuity of enterprise exception.⁹¹

The court of special appeals in *Nissen* did not spend much time reviewing the evolution of continuity of enterprise; instead, it relied largely upon *Smith v. Navistar International Transport Corp.*,⁹² a case decided by the United States District Court for the District of Maryland.⁹³ In *Navistar*, approving of continuity of enterprise, Judge Niemeyer asserted "the underlying policy for imposing product liability on a successor corporation . . . under this doctrine of continuity of enterprise is the demonstration that the successor corporation has taken the place of the predecessor corporation and therefore is assumed to take

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ See *supra* notes 11-13 and accompanying text.

⁹¹ *Miller v. Nissen Corp.*, 575 A.2d 758 (Md. Ct. Spec. App. 1990).

⁹² 737 F. Supp. 1446 (D. Md. 1988).

⁹³ The *Navistar* case did not itself accept continuity of enterprise. Judge Neimeyer held that on the facts of the case, the continuity of enterprise doctrine was inapplicable, but not that Maryland would reject the doctrine altogether. *Id.* at 1450-51.

on liability."⁹⁴ Referring back to the rationales discussed in the previous section, it is obvious that the rationale of the *Navistar* decision was based largely upon the "holding-out" rationale.⁹⁵ Based on Judge Niemeyer's decision that the Maryland Court of Appeals, when faced squarely with the issue, would accept continuity of enterprise, the court of special appeals held, "we adopt an expanded interpretation of the third exception, which Judge Niemeyer terms the 'substantial continuation'⁹⁶ exception."⁹⁷

The court of special appeals, in its decision, does not make any effort to analyze the continuity of enterprise doctrine. The court relies almost entirely on the reasoning and rationale of Judge Niemeyer in the *Navistar* case. The fact that the court of special appeals relies so heavily upon the *Navistar* decision is troublesome, especially since another case, *Giraldi v. Sears, Roebuck & Co.*,⁹⁸ written just one month later by another judge from the United States District Court of Maryland, reached an opposite conclusion. In the *Giraldi* case, Judge Smallkin, writing that Maryland courts *would not* accept the continuity of enterprise doctrine, asserted "this court forecasts that the Court of Appeals of Maryland would accept the 'pure' version of the traditional rule . . . [of] limited successor liability."⁹⁹

Given the fact that two Maryland district courts arrived at opposite conclusions within one month of each other and that the *Nissen* case was the first time the Maryland courts were forced to deal squarely with the continuity of enterprise exception, the court of special appeals should have engaged in a much more thorough analysis than it did. As a result of the court of special appeals' cursory analysis, its opinion adopts the continuity of enterprise doctrine without considering the ramifications or effects from such a ruling. In particular, the decision completely ignores the several rationales that are advanced in support or opposition to the expansion of successor liability.¹⁰⁰

⁹⁴ *Miller*, 575 A.2d at 761 (quoting *Smith v. Navistar Int'l Transp. Corp.*, 687 F. Supp. 201, 206 (D. Md. 1988)).

⁹⁵ See *supra* notes 50-54 and accompanying text.

⁹⁶ Judge Niemeyer's factors for "substantial continuation" are virtually identical to the test espoused for continuity of enterprise. *Navistar*, 737 F. Supp. at 1450.

⁹⁷ *Miller*, 575 A.2d at 762.

⁹⁸ 687 F. Supp. 987 (D. Md. 1988)

⁹⁹ *Id.* at 991.

¹⁰⁰ See generally *Miller v. Nissen*, 575 A.2d 758 (Md. Ct. Spec. App. 1990).

B. *The Maryland Court of Appeals*

The court of appeals makes a much more thorough analysis of the history and consequences of adopting the continuity of enterprise doctrine. While the court of appeals' decision may not necessarily be the one that is most beneficial to society, it makes a reasoned analysis of the goals and rationales which underlie the continuity of enterprise exception before rejecting it.

In deciding to reject the continuity of enterprise exception, the *Nissen* court considered several earlier cases from various jurisdictions that dealt with the exception. The *Nissen* court began its discussion with the case that is generally considered to contain the genesis of the continuity of enterprise exception. This case is the landmark successor products liability case, *Turner v. Bituminous Casualty Co.*¹⁰¹ In *Turner*, the plaintiff was injured at work while handling a power press.¹⁰² As a result of the accident, both of the plaintiff's hands were amputated.¹⁰³ The manufacturer of the press, T.W. & C.B. Sheridan Company [hereinafter Sheridan], sold all of its assets in a cash-for-assets transaction to Harris Intertype Corporation. Four years prior to *Seaman Manufacturing Co.*, Turner's employer purchased the press.¹⁰⁴ Sheridan ceased to exist as a separate entity shortly thereafter.¹⁰⁵

It is interesting to note that the fact patterns in the *Turner* and *Nissen* cases are virtually identical. *Both* cases concern plaintiffs injured by a product manufactured by a corporation subsequently purchased in a cash-for-assets transaction. The circuit judge in *Turner*, as did the judge in *Nissen*, acknowledged that "Harris [successor corporation] had . . . no relationship to the equipment sold and manufactured by . . . Sheridan [predecessor corporation]."¹⁰⁶

The Michigan Supreme Court, disturbed by the inequity of Turner's plight, granted certiorari¹⁰⁷ after the Michigan Court of Appeals denied leave to hear the case. The *Turner* court began by dispensing with the distinction between cash-for-asset transactions and de facto mergers.¹⁰⁸ "To the injured person . . .

¹⁰¹ 244 N.W.2d 873 (Mich. 1976).

¹⁰² These facts are taken directly from the *Turner* case. *Id.* at 875.

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Turner v. Bituminous Casualty Co.*, 244 N.W.2d 873 (Mich. 1976).

¹⁰⁸ This was an extremely important step in holding the successor corporation liable. See *supra* note 8 and accompanying text.

no matter what corporate process led to the transfer of the first corporation . . . so long as the first corporation in each case . . . became defunct. [The plaintiff] has no place to turn for relief except to the second corporation."¹⁰⁹

The *Turner* court also suggested that the abolition of this traditional bar to liability was not repugnant to the usual business practices of corporations. "[I]f there are no real business reasons for choosing a cash acquisition of corporate assets and the only real reason is to avoid products liability suits, then it would seem that the machinery of corporate law is unreasonably geared up to accomplish a purpose not really intended for it or in the public interest."¹¹⁰

Having dispensed with the most serious traditional bar to imposition of liability, the Michigan Supreme Court then formulated "guidelines to establish whether there is continuity between the transferee and transferor corporations."¹¹¹ These guidelines are: (1) there is a basic continuity of the enterprise of the seller corporation, including the retention of such things as the name, employees, assets and general business operations; (2) the seller corporation dissolves soon after the distribution of the consideration received from the sale; (3) the purchasing corporation assumed those liabilities of the successor corporation necessary to continue the normal business operations of the predecessor corporation; and (4) the successor corporation held itself out as the effective continuation of the predecessor corporation.¹¹²

Despite the great similarity of the factual situations between the two cases, the *Nissen* court brushed aside the *Turner* court's opinion with a minimum of consideration. The *Nissen* court asserted that the *Turner* court's rationale was "nebulous" and that it did "not agree that traditional rules of successor liability should be 'shaken off' as 'impediments.'"¹¹³ By rejecting the *Turner* case, the *Nissen* court, by implication, also rejected the holding-out rationale.

The next case the *Nissen* court considered was *Andrews v. John E. Smith's Sons Co.*,¹¹⁴ in which the Alabama Supreme Court chose to adopt the

¹⁰⁹ *Turner*, 244 N.W.2d at 878.

¹¹⁰ *Id.* at 880.

¹¹¹ *Id.* at 883.

¹¹² *Id.* at 883-84.

¹¹³ *Nissen*, 594 A.2d at 572. Other courts are similarly unimpressed with the reasoning of the Michigan Supreme Court in *Turner* and reject the continuity of enterprise exception. In *Bernard v. Kee Mfg. Co.*, 409 So. 2d 1047 (Fla. 1982), the Supreme Court of Florida expressly rejected the doctrine stating "we choose not to join this vanguard of courts [accepting continuity of enterprise] due in part to the threat of economic annihilation that small business would face under such a rule of expanded liability." *Id.* at 1049.

¹¹⁴ 369 So. 2d 781 (Ala. 1979).

continuity of enterprise exception. In the *Andrews* case, the plaintiff was stuffing ground beef into a commercial meat grinder with his hand when it was caught and pulled into the grinding mechanism.¹¹⁵ The Alabama Supreme Court stated, "The reasoning of *Turner* is persuasive . . . [t]here was a basic continuity of the enterprise between the original Smith Co. and Hobam: [the predecessor and successor corporations] the same products were manufactured by the same people in the same place."¹¹⁶

The *Andrews* case suggests a rationale that is most closely analogous to the benefits and burden rationale discussed above.¹¹⁷ The *Nissen* court does not state what it finds objectionable or incorrect about the decision in *Andrews*, but its rejection of the *Andrews* case can be considered a *sub silentio* rejection of the goodwill rationale. Similarly, the *Nissen* court elides the issue of why it rejects the rationale presented in *Holloway v. John E. Smith's Sons Co.*¹¹⁸ In its brief discussion of the case, the *Nissen* court simply states that the opinion was "unconvincing."¹¹⁹ An analysis of the *Holloway* court's decision yields the finding that the court essentially relied on a "holding-out" rationale¹²⁰ similar to that rejected by the *Nissen* court in its opinion of the *Turner* case.

The *Nissen* court then looked at *Monzingo v. Correct Manufacturing Corp.*, a Mississippi case which is purported to adopt the continuity of enterprise exception.¹²¹ The *Nissen* court asserted that since a traditional continuity of entity could be found "there was no need to expand the traditional mere continuation exception to encompass the continuity of enterprise theory in that case"¹²² The *Nissen* court, therefore, is not basing its rejection of this case on any particular rationale.

In its discussion of the *Bonee v. L & M Construction Chemicals*¹²³ case,¹²⁴ the *Nissen* court recognizes that the *Bonee* case applied an interpretation of Ohio law that "recognizes the strict liability policy of spreading the risk of loss to all consumers of a product so that the product will bear the social and

¹¹⁵ *Id.* at 782.

¹¹⁶ *Id.* at 785.

¹¹⁷ See *supra* notes 56-59 and accompanying text.

¹¹⁸ *Holloway v. John E. Smith's Sons Co.*, 432 F. Supp. 454 (D.S.C. 1977).

¹¹⁹ *Nissen*, 594 A.2d at 572.

¹²⁰ *Holloway*, 432 F. Supp. at 455.

¹²¹ This is apparently a matter of some contention. The *Nissen* court asserts that in *Monzigo*, "the court's reasoning illustrates that the successor corporation in that case was a continuity of entity, in the traditional sense" *Id.* at 572.

¹²² *Nissen*, 594 A.2d at 571-72.

¹²³ 518 F. Supp. 375 (M.D. Tenn. 1981) (applying Ohio law).

¹²⁴ *Nissen*, 594 A.2d at 572.

individual costs of its own defects."¹²⁵ The rationale in *Bonee* sounds similar to the market deterrence rationale. Since the *Nissen* court rejects the *Bonee* case, it can be inferred that it therefore rejects this rationale as a basis to extend successor liability.

In its decision, the *Nissen* court does not explicitly reject any rationale for the imposition of liability under the continuity of enterprise exception. By its rejection of the *Turner*, *Andrews*, *Holloway*, *Monzingo*, and *Bonee* cases, it rejects the holding-out, goodwill/benefits and burdens, and market deterrence rationales.

Three additional rationales remain that the *Nissen* court did not consider: compensation, destruction of plaintiff's remedies and the conduit theory. The next section of this Case Comment will apply these three rationales to the facts of the *Nissen* case in order to determine if they provide any additional insight into the *Nissen* court's decision.

VI. COMPENSATION, DESTRUCTION OF PLAINTIFF'S REMEDIES AND THE CONDUIT THEORY RATIONALES APPLIED TO THE NISSEN CASE

A. Compensation

As discussed earlier, the desire to compensate an injured party has long been one of the primary goals of our legal system.¹²⁶ The goal of compensating an injured party, particularly a blameless one, should not be subrogated to other needs unless these concerns sufficiently further a societal good that outweighs the needs of the individual.

The *Nissen* court never fully addressed the issue of compensation in its analysis. It is possible that it considered rejection of the cases used in its analysis, all of which relied at least partially on a compensation rationale, as an implicit rejection of the compensation justification. Even so, this rationale needs a more thorough analysis before such a summary dismissal.

As between the two parties, Brandt and Nissen, Nissen is clearly in a superior position to allocate risk, be it through the price paid for assets, or some other means. As a result, the Nissen Corporation at least had the opportunity to effectively bargain for its position. Brandt never had this opportunity. Brandt's position is due to the negligence of a manufacturer.

¹²⁵ *Id.* at 572 (quoting *Bonee*, 518 F. Supp. at 380).

¹²⁶ *See supra* notes 60–63 and accompanying text.

While Nissen is not legally considered to be the same manufacturer as Tredex, because it used cash instead of stock to purchase Tredex's assets, equity and fairness demand that a successor corporation, which is the effective continuation of a predecessor enterprise and which possesses the ability to compensate an individual to whom they should be culpable, should be made to do so.

The economic argument for compensation is one that has given a great deal of ammunition to those that oppose the acceptance of the continuity of enterprise doctrine.¹²⁷ The main contention of those that oppose the continuity of enterprise doctrine on economic grounds was succinctly stated by the court in *Polius v. Clark Equipment Co.*¹²⁸ The *Polius* court asserted that because "a corporation the size of General Motors may be able to spread the cost . . . among its millions of customers does not mean that a machine shop employing five or ten individuals has similar capabilities."¹²⁹ The *Nissen* court echoed a similar fear when it stated, "[W]ere we to adopt continuity of enterprise, not only would liability be imposed upon 'a major corporation,' but it would also be imposed upon the small business operation which may not be in a position to spread the risk or insure against it."¹³⁰

The concern about the economic ramifications of utilizing compensation as a basis for the imposition of liability under an expanded liability doctrine such as continuity of enterprise is a valid one. At least one scholar has asserted that wide acceptance of the continuity of enterprise doctrine would sound the death knell for small businesses.¹³¹ Yet, both scholars and courts overlook the fact that it might be possible to compensate an injured individual using the continuity of enterprise doctrine without driving any great number of small businesses into bankruptcy. A system of garnishment¹³² could be created by

¹²⁷ See Rogala, *supra* note 4, at 54.

¹²⁸ 802 F.2d 75 (3d Cir. 1986).

¹²⁹ *Id.* at 81.

¹³⁰ *Nissen*, 594 A.2d at 570.

¹³¹ See Rogala, *supra* note 4, at 42.

¹³² The concept of garnishment is one that has been around for several centuries. See generally JOHN R. ROOD, A TREATISE ON THE LAW OF ATTACHMENTS, GARNISHMENTS, JUDGMENTS, AND EXECUTIONS (1901) (discussing the history of garnishment and various leading cases). Garnishment can arise "out of a tort action (personal injury, property damage, etc.) or any type of claim. Basically, any claim which is due from one person to another can be satisfied in whole or in part by the use of garnishment . . ." STANLEY MORGANSTERN, LEGAL PROTECTION IN GARNISHMENT AND ATTACHMENT 1 (1971).

which even a small business, assuming that a determination of liability was made, could provide compensation for the injured party, without forcing it to liquidate. A system of award caps could also be established, limiting the amount of damages possible, taking into account net worth, profit, debts, and other relevant factors.

This scheme would undoubtedly face challenges on several fronts. There is a basic equity question: is it fair to penalize one company more or less simply because it is larger? Viewed from a societal standpoint, choosing between penalizing a small business up to a point without forcing it into bankruptcy while at the same time compensating an injured person, or simply leaving a plaintiff utterly without remedy, would seem to be clear.

The groundwork for such a scheme would best be laid by the legislature, since reform of this sort is not generally initiated by the courts. Given the need for tort reform in our system,¹³³ it would not be inconsistent to award payments in product liability suits on what is essentially an "ability-to-pay" basis. There are few plaintiffs who would not accept a reduced award, assuming liability could be shown under continuity of enterprise, in lieu of being left remediless. The compensation rationale, therefore, is quite possibly a very compelling rationale for the continuity of enterprise doctrine in and of itself.

B. Destruction of Plaintiff Remedies

As discussed above,¹³⁴ destruction of the plaintiffs' remedies is another rationale sometimes invoked to justify the imposition of expanded successor liability.¹³⁵ In the present case, Nissen purchased Tredex in such a fashion that

While garnishment is generally used as a method to satisfy a claim that is not paid, there is no reason that some percentage of a corporation's profits could not be diverted into an account for the benefit of the injured plaintiff.

¹³³ See generally Eliot M. Blake, *Rumors of Crisis: Considering The Insurance Crisis and Tort Reform in an Information Vacuum*, 37 EMORY L.J. 401 (1988); Neil K. Komesar, *Injuries and Institutions: Tort Reform, Tort Theory, and Beyond*, 65 N.Y.U. L. REV. 23 (1990); John P. Marshall, *The Battle at Little Big Horn Has Moved to Raleigh—Is This Custer's Last Stand Against Tort Reform?*, 10 CAMPBELL L. REV. 439 (1988). Each article discusses troubled aspects of the tort system and various proposals for reform.

¹³⁴ See *supra* notes 69–70 and accompanying text.

¹³⁵ For several cases which discuss destruction of plaintiff's remedies as a basis for liability, see *Holloway v. John L. Smith's Son's Co.*, 432 F. Supp. 454 (D.S.C. 1977); *Phillips v. Cooper, Inc.*, 264 Cal. Rptr. 311 (Cal. Ct. App. 1989); *Lundell v. Sidney Mach. Tool Co.*, 236 Cal. Rptr. 70 (Cal. Ct. App. 1987); *Kaminski v. Western MacArthur Co.*,

Tredex was required to dissolve within five years.¹³⁶ The fact that the corporation was in existence for five years, presumably for the specific purpose of dealing with any litigation that might arise after the sale,¹³⁷ mitigates against the use of this rationale in this case.

C. *The Conduit Theory*

The final theory that the *Nissen* court did not take into account is the conduit theory.¹³⁸ The conduit theory is simple and succinct; it expressly accepts that the successor corporation is not in any way responsible for the tort of its predecessor.¹³⁹ Facing the reality of leaving a plaintiff without remedy, some courts choose to use the successor as a conduit by discounting the price of sale by the amount of predicted future products liability.¹⁴⁰ The *Nissen* case is an excellent situation for the application of the conduit theory. The Nissen Corporation, when negotiating the deal with Tredex, could have attempted to take into account future products liability that might occur *after* the five year period, and discount the purchase price by that figure. Nissen would essentially be acting as a conduit, funneling the risk of loss back to the Tredex Corporation by a reduction in purchase price. The fact that there was an express agreement that Tredex would continue for five years after the sale suggests that future product liability was thought to be highly likely. Also, the Nissen Corporation undoubtedly had full access to the records of Tredex relating to accidents, law suits, and other relevant factors. Given all of these factors, it would not have been too onerous a burden to place a requirement on the Nissen Corporation to factor into the purchase price possible litigation costs after the five year period. The fact that Nissen had all of the information available and chose not to do so, should not result in an innocent plaintiff suffering from the oversight of a corporation.

220 Cal. Rptr. 895 (Cal. Ct. App. 1985); *Wilkerson v. C.O. Porter Mach. Co.*, 567 A.2d 598 (N.J. 1989); *Nieves v. Bruno Sherman Corp.*, 431 A.2d 826 (N.J. 1981); *Tift v. Forage King Indus., Inc.*, 322 N.W.2d 14 (Wis. 1982).

¹³⁶ See *supra* note 24 and accompanying text.

¹³⁷ *Nissen v. Miller*, 594 A.2d 564, 565 (Md. 1991).

¹³⁸ See generally *id.*

¹³⁹ *Green*, *supra* note 19, at 30-33.

¹⁴⁰ *Id.*

VII. CONCLUSION

The question whether the continuity of enterprise doctrine should gain further acceptance or continuing rejection is a difficult one to answer. As the discussion of the various rationales (both supporting and undercutting the doctrine) shows, there are serious repercussions no matter which way the judicial pendulum swings.

Yet, given that the central tenet of our tort system is to compensate the injured party, even if we must go to heretofore unthought of lengths, an eventual acceptance of continuity of enterprise seems inevitable. Tort reform is a growing and pervasive movement.¹⁴¹ It is certain that reform in this area will eventually be instituted. With the introduction of a cap on damages, and the possibility of alternative systems of compensation,¹⁴² there is no reason that our legal system should not continue to expand remedies to those who are injured by a defective product. In the meantime, courts should carefully scrutinize all of the available rationales and justifications for the imposition of liability. If there is any possibility to equitably compensate the plaintiff, these steps should be taken.

Continuity of enterprise is a doctrine that obviously still has some problems, but its acceptance should continue. Between a blameless individual and a corporation who at least had the opportunity to bargain against future product liability suits, the corporation should be made to bear the cost. The court in *Shannon v. Samuel Langston*,¹⁴³ summed up the issue succinctly when, after accepting the continuity of enterprise doctrine, it stated, "[t]he decision of the court simply means that the seller and purchaser corporations will not both be able to profit by cutting off liability for damages to battered and maimed people."¹⁴⁴

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¹⁴¹ See *supra* note 133 and accompanying text.

¹⁴² See *supra* note 132 and accompanying text.

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

¹⁴⁴ *Id.* at 802.

