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PRODUCTS LIABILITY—ASSUMPTION OF LIABILITY IN SALE OF ASSETS

One of the usual factors to be considered in the acquisition of one corporation by another is whether the transferee is to assume the transferor's liabilities. Often the intent of the parties can be effectuated by choosing one form of acquisition over another. For example, if the parties intend that the transferee assume all of the liabilities of the transferor, the transaction could be structured as a merger because, by operation of law, the transferee assumes all of the transferor's liabilities in a merger.\(^1\) On the other hand, if the parties decide that the transferee will assume none of the transferor's liabilities, the acquisition could be structured as a sale of assets. Subject to a few well-recognized exceptions, the general rule is that such a transaction will shield the transferee from the assumption of any of the transferor's liabilities.\(^2\)

Several recent decisions have dealt with the issue of whether this general rule of nonassumption applies where a person is injured by a defective product manufactured and sold by a corporation that has since transferred its assets to another corporation. The courts have used two types of analyses to assign liability in such situations. On the basis of public policy, some cases have held that the rule of nonassumption does not apply to products liability claims arising after the asset transfer. Other cases have held the rule of nonassumption applicable in such situations and have construed the contract of sale to determine whether the transferee expressly or impliedly assumed such liability.

This article will engage in a brief discussion of these cases and will attempt to demonstrate that these two seemingly disparate types of analysis must be welded into a single rule to insure compensation for an injured plaintiff while at the same time permitting maximum flexibility as to form in corporate acquisitions.

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\(^1\) W. Fletcher, Cyclopedia of the Law of Corporations, §§ 7117-21 (Revised Volume 1973) (hereinafter cited as Fletcher).

\(^2\) Fletcher § 7122. The exceptions to this general rule of nonassumption are where there is (1) an express or implied assumption of such liability, (2) a finding that the transaction was a consolidation or a merger, (3) a finding that the transaction was fraudulent in fact, or (4) a finding that the transferee is a mere continuation of the transferor. Id.
I. The Public Policy Decisions

When confronted with a choice between applying the general rule of nonassumption or not, some courts have held the rule inapplicable to products liability claims on the basis of public policy. The justifications given by the courts in these decisions are substantially the same as those given for imposing strict liability on a manufacturer in an ordinary products liability suit.

For example, in *Ray v. Alad Corp.*, the Alad Corporation (hereinafter "Alad I") sold its assets to the Light Maintenance Corporation, which later changed its name to Alad Corporation (hereinafter "Alad II") in 1968. One of the provisions of the contract of sale was that Alad II would not assume any liability for defective work or materials for which Alad I was responsible. Alad I was dissolved in 1968 under the laws of the State of California.

In 1969, the plaintiff was injured as the result of an allegedly defective ladder produced and sold by Alad I. The plaintiff sued Alad II and the trial court granted a motion for summary judgment in favor of the defendant. The opinion of the trial court was based on an application of the general rule of nonassumption and a finding that the transferee, Alad II, did not assume the liability of the transferor by contract.

The California Court of Appeals reversed the trial court, holding that the case could not be decided on the basis of contract law, but instead that the principles of tort law should apply. The court held that the liability of Alad I for defective products would, in effect, follow its assets to Alad II, because the public policy justifications for imposing strict liability on Alad I, as the manufacturer of the defective product, were substantially the same when applied to Alad II, the transferee of the assets.

The court first noted that, as a matter of public policy, the incentive to improve defective products is most effectively placed

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4 127 Cal. Rptr. at 819.

5 With respect to its decision, the trial court stated:

Alad II did not assume the unspecified liabilities of Alad I and further

... Alad II was not a mere continuation or reincarnation of the old corporation but a new organization, resulting from a purchase based on substantial consideration of the assets and the trade-name of the old corporation. Id. at 819.

6 Id. at 820-21.
on the firm which now produces the product. Another public policy justification for applying strict liability in this instance, according to the court, is that a business which continues a particular business activity is better able to distribute the individual and social costs of that enterprise. These factors lead the court to determine that the liability for defective products should be placed on the transferee of the corporate assets as a continuation of the manufacturing entity which produced the defective product. In doing so, the court rejected the general rule of nonassumption, stating:

The manufacturing entity's responsibility to victims of defective products it has placed in circulation cannot be hostage to the niceties which distinguish a sale from a merger.\(^7\)

It is interesting to note that the court specifically refused to base its decision on the fact that, as a dissolved corporation, Alad I could not be held liable for the plaintiff's injuries; holding instead that the liability of the transferee of corporate assets does "not depend on whether or not former owners of the business can respond in damages."\(^8\)

A more in-depth example of this type of analysis is found in *Cyr v. B. Offen & Co., Inc.*,\(^9\) where the plaintiffs were injured as the result of an alleged defect in a printing machine. The jury returned a verdict against B. Offen & Co., which the defendant appealed alleging that, as a matter of law, it could not be held liable because it was not a legal entity at the time the defective printing press was sold.

The printing press which injured the plaintiff was designed, manufactured, and sold in 1959 by B. Offen Company, then a sole proprietorship owned by Bernard Offen. In 1962, Offen died and employees took over the business. In 1963, the employee group was joined by a single financier and the company was purchased, apparently from the Offen estate.

Although the defendant assumed many of the proprietorship's liabilities, the contract specifically provided against the assumption of liability for costs incurred in tort.\(^10\) Despite this contractual

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\(^7\) *Id.* at 821.

\(^8\) *Id.* at 820 n.7.

\(^9\) 501 F.2d 1145 (1st Cir. 1974).

\(^10\) The contract of sale provided that the purchaser assumed the following:

the liability for all costs of any kind or nature incurred on or after January
disclaimer and the general rule of nonassumption, the court found the defendant liable. The court disposed of the defendant's two major defenses holding, first, the fact that the defendant was not in legal existence at the time the defective product was sold was of no consequence because the defendant could be held liable as a continuation of the transferor, and second, although the contract negating the assumption of liability might be binding between the parties, it was not binding on third parties who had no notice of the change of ownership.

Having disposed of these threshold issues, the court found the defendant liable as a continuation of B. Offen & Co. on the basis of public policy. The holding was based on a finding that the public policy justifications for imposing strict liability on a manufacturer are also applicable to a transferee of the manufacturer's assets. The court listed the justifications for imposing strict liability on the manufacturer as follows: (1) the manufacturer is better able to protect itself and bear the cost of injury than a consumer; (2) the manufacturer produced the product and put it on the market; (3) the manufacturer breached the product warranty; (4) the manufacturer can improve the product; and (5) the manufacturer's employees are the ones who negligently produced the product.

The court found the first of these justifications applicable to the situation before it because the transferee of the assets is sufficiently familiar with the product to insure itself against suits for defective products. Since the transferee reaps the goodwill of having the goods of the transferor placed on the market, the court found the second and third justifications applicable. The court found the fourth justification present because the transferee is the only one who can improve the product after the asset sale. Regarding the fifth factor, the court seemed to hold that it would be applicable any time the transferee continues the transferor's operation with the same employees, as the defendant did in this case.

16, 1963 on Old Dryer and Service Contracts, . . . but excluding specifically liability for costs incurred in tort. Id. at 1151.

"Id. at 1154.

"Id. at 1153.

"Id. at 1154.

"With respect to this justification the court stated:
Finally, a corporation itself cannot act. It can conduct its business only
From these decisions it is clear that at least some courts are unwilling to apply the general rule of nonassumption to product liability claims on the basis of public policy where the original justifications for imposing strict liability on the manufacturer also apply to the transferee of corporate assets.  

II. THE NONASSUMPTION CASES

Despite this trend, most recent decisions have applied the general rule of nonassumption to product liability actions. In such cases the courts are forced to analyze the contract of sale to determine whether the transferee has either expressly or impliedly assumed liability for defective products manufactured by the transferor. Furthermore, the court must examine the transaction in order to determine whether any of the exceptions to the general rule of nonassumption are applicable.

The first step, then, in applying the general rule of nonassumption to a sale of assets is a construction of the contract. If the contract does not speak to the assumption of product liability, the general rule applies and the transferee is not liable for the plaintiff's injuries. One problem courts are often faced with, therefore, is a need to determine whether a particular contractual provision evidences an intent by the parties that the transferee assume such liability. For example, in Bouton v. Litton Industries Inc., the plaintiff was injured by a defective aircraft arresting engine. The plaintiff sued both the M-T Liquidation Corporation, seller of the defective engine, and Litton Industries, transferee of all of M-T's assets. Both defendants contended that the following contractual provision shielded them from liability.

through its officers and employees. The negligence of employees in carrying out that business is the responsibility of the corporate body. If as a group the same employees continue, without pause to produce the same products in the same plant, with the same supervision, the ownership of the entity which maintains essentially the same name cannot be the sole controlling determinant of liability. Id. at 1154.

15 In anticipation of the discussion to follow, it is important to keep in mind that, although the justification mentioned would apply where the transferor was still a viable corporate entity at the time of the suit, the transferors in these cases were dissolved at the time of the lawsuit in question.

16 See note 2 supra.
17 See FLETCHER § 7122.
18 423 F.2d 643 (3rd Cir. 1970).
[Litton assumes] all other contracts and commitments entered
into in the regular and ordinary course of M-T's business at
anytime before or after May 31, 1962 and prior to the transfer
date.\textsuperscript{19}

The court held that this language was sufficiently broad to
encompass future claims for defective products and held Litton
liable for the plaintiff's injuries.\textsuperscript{20} The court was aided in its inter-
pretation of the contract by provisions which indicated that Litton
was to assume debts, such as that owed to the plaintiff, which
could be contested and had not been insured against by M-T.\textsuperscript{21}

Another case where the court had difficulty in interpreting
provisions of a contract of sale is \textit{Husak v. Berkel, Inc.},\textsuperscript{22} where the
plaintiff was injured by an allegedly defective food grinding ma-
chine. The plaintiff sued SCM, the successor in a merger of the
manufacturer of the machine, along with Berkel, Inc., the eventual
transferee\textsuperscript{23} of the business and assets that had produced the defec-
tive machine.

The only issue facing the court was whether the following
contractual provision evidenced an intent on the part of the parties
that the transferee assume liability for defective products pro-
duced by the transferor.

[The transferee] agrees to assume all liabilities, obligations,
contracts, orders for the purchase of material and warranties of
[the transferor] made in connection with the manufacture and
sale of products assigned hereunder to [the transferee] as part
of the commercial and industrial line.\textsuperscript{24}

The court held that this language was so ambiguous that it
was not clear whether the transferee had assumed liability for
defective products manufactured by the transferor. However, this
ambiguity was construed most strongly against SCM, since its
counsel had prepared the contract.\textsuperscript{25} As a result, Berkel was not
liable for the plaintiff's injuries.

\textsuperscript{19} Id. at 649.
\textsuperscript{20} Id. at 650.
\textsuperscript{21} Id.
\textsuperscript{23} Berkel was actually the successor of the original transferee, Enterprise-1956,
in a merger. As a result, all liabilities assumed by Enterprise-1956 were subse-
quently assumed by Berkel.
\textsuperscript{24} 234 Pa. Super. at 457, 341 A.2d at 177.
\textsuperscript{25} Id. at 461, 341 A.2d at 178.
It is important to note that in the *Bouton* and *Berkel* decisions, both the transferee and the transferor were viable corporate entities, capable of satisfying the plaintiffs' claims at the time of the respective suits. As a result, the courts in these two decisions were not faced with a situation where the plaintiff could recover only against the transferee, if he was to recover at all. Thus, it can be argued that the facts in these cases would not lead a court to disregard the general rule of nonassumption on public policy grounds.

Assuming that the court finds no express or implied assumption of liability in the contract of sale, its next step in applying the general rule of nonassumption is to determine whether the transaction is of such a nature that it fits within one of the exceptions to the general rule of nonassumption. These exceptions dictate that the general rule will not apply where the transaction results in a mere continuation or consolidation of the original business, a de facto merger or is entered into in order to fraudulently avoid liability.²

*Wilson v. Fare Well Corp.*,²⁷ presents a situation where a court failed to apply the general rule of nonassumption because the transferee of the corporate assets was merely a continuation of the transferor. The court found the argument for applying the continuation exception convincing because all of the operations of the transferor were taken over by the transferee, much of the management remained the same, and there was a recognition by both parties that the transferee was "'taking over and carrying on'" the transferor's business.²⁸

*Wilson* should, however, be contrasted with *Oritz v. South Bend Lathe²⁹* where many of the same factors were present. In that case the plaintiff was injured by a defective lathe produced by the transferor. The transferor had sold its assets and dissolved prior to the suit, leaving the plaintiff with no recourse but to sue the transferee. Although the transferee carried on the same operations in the same place as the transferor, the court failed to find that it was a continuation of the transferor. The holding was based on the fact that the transferee had paid an adequate consideration for the

²⁶ See note 2 supra.
²⁸ 356 A.2d at 466-67.
transferor's assets. This made it impossible for the court to find a continuation because "[b]efore one corporation can be said to be a mere continuation or reincarnation of another it is required that there be insufficient consideration running from the new company to the old." Thus, it appears that the decision in *Oritz* is in direct opposition to the holding in *Wilson* where no allegation or finding of insufficient consideration occurred.

The most litigated exception to the general rule of nonassumption is the de facto merger exception. In *Shannon v. Samuel Langston Co.*, the court held that a de facto merger had occurred where (1) the consideration for the assets of the transferor was common stock of the transferee; (2) all of the transferor's employees became employees of the transferee; (3) the operating management of the transferor was left substantially intact by the transferee; and (4) the headquarters, operation, and organization of the corporation remained basically the same before and after the transfer.

A similar result was reached in *Cinocca v. Baxter Laboratories, Inc.*, where the plaintiff allegedly died because of the malfunction of a defective Mitral Heart Valve Prosthesis manufactured by Surgitool, Inc. Prior to the malfunction, Surgitool had sold substantially all of its assets to Travenol Laboratories, Inc. In considering Travenol's motion for a summary judgment, the court applied the general rule of nonassumption, but failed to absolve Travenol because it could not hold as a matter of law that no merger had taken place. The finding was based on the fact that the consideration paid the transferor was common stock of the transferee and that the parties treated the sale as a nontaxable reorganization under the Internal Revenue Code rather than as a sale of assets which would have been a taxable exchange.

One factor which has dissuaded courts from applying the de facto merger exception in situations such as that presented in *Baxter* is the continuation of the transferor as a corporate entity after the asset acquisition. In *Lopata v. Bemis Company, Inc.*,}

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20 Id. at 847, 120 Cal. Rptr. at 558.
23 Id. at 530.
the Rock Wool Engineering & Equipment Corp. transferred all of its physical assets to the defendant Bemis Co. A year later Rock Wool dissolved. Subsequently, the plaintiff was injured while operating an allegedly defective machine produced by Rock Wool prior to the asset transfer. The court rejected the plaintiff's claim that the transaction was not an asset sale, but was in fact a merger between Bemis and Rock Wool. The holding was based on the fact that Rock Wool had continued to exist for a year after the asset acquisition and, as a result, the absorption of one corporation by another implied by a merger could not have occurred.36

A similar analysis was presented in McKee v. Harris-Seybold Company,37 where, in 1926, Seybold, by contract, sold all of its assets to Harris Automatic Press Company. Seybold subsequently changed its name and dissolved in 1928. The plaintiff was injured in 1968 while operating an allegedly defective paper machine manufactured by Seybold in 1916. In rejecting the plaintiff’s claim of a de facto merger, the court noted that the continued existence of Seybold for eighteen months after the acquisition indicated that the transferor had not been merged into the transferee.38 In addition, the court noted that the consideration passing from the transferee to the transferor contained only a small amount of the transferee’s securities making the finding of a merger in this case difficult.39

III. Conclusions

The decisions discussed above indicate that there is a split of authority in United States jurisdictions regarding whether the general rule of nonassumption of liabilities in a corporate asset acquisition should be applied to products liability claims. Although it might be normal to conclude that one rule is better than the other in such situations, a thorough analysis indicates that neither rule alone is sufficient to promote a just result, and therefore, concur-

36 Id. at 526-27.
38 Id. at 563-64, 264 A.2d at 104-05.
39 Id. at 564, 264 A.2d at 104. This factor mitigates against finding a merger because a merger generally is distinguished by a continuation of the enterprise and the stockholders’ interests therein, whereas a sale of assets normally contemplates the liquidation of the enterprise. Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 93 A.2d 107 (1952).
rent application of the two rules seems desirable. This conclusion results from an analysis of the goals which courts should strive to attain in this area. The first of these goals is that of compensating the plaintiff regardless of the form of the transaction and the present status of the corporations involved. The second goal which appears to be desirable in this area is to make the law flexible enough to permit the parties to a corporate transaction to determine which of them will bear the burden for products liability claims. This second goal, however, should be subordinate to the first goal so the parties, in their decision regarding who should bear this burden, will not be able to deny the plaintiff an effective remedy.

An analysis of the cases in this area leads to the conclusion that neither a rigid application nor a rejection of the general rule of nonassumption, as stated by the courts, can satisfy both of these goals. Regarding the public policy decisions rejecting the general rule of nonassumption, it appears that a rigid application of the analysis forwarded by those decisions will not necessarily satisfy either one of the goals discussed above. A superficial analysis might indicate that rejection of the general rule of nonassumption would provide the plaintiff with a recovery in every instance. A closer examination, however, discloses that the plaintiff, under the rules established in the decisions to date, would be able to recover only from the transferee and, then, only if certain conditions are fulfilled.

In *Alad* and *Cyr* the courts shifted responsibility to the transferee for defective products produced by the transferor by demonstrating that public policy requires such a transfer, regardless of the status of the two corporations at the time of the suit. The application of such a rule will not provide a plaintiff with compensation in every instance. For example, if the transferor of the corporate assets is in existence at the time of the plaintiff's injury, but the transferee has since dissolved, it is clear that the plaintiff will be denied effective relief if the burden is shifted to the transferee, despite the fact that the corporation which pro-

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41 501 F.2d 1145 (1st Cir. 1974).
42 See text accompanying notes 3-15 supra, especially that accompanying note 8 supra.
duced the defective product is still able to compensate the plaintiff.\footnote{Although this type of fact situation has never been faced by a court, the posited result would seem to be dictated by the analysis presented in the public policy cases.}

It is also clear that the courts under the public policy rationale will compensate the plaintiff only when the justifications for ignoring the general rule of nonassumption are present. For example, the \textit{Cyr}\footnote{501 F.2d 1145 (1st Cir. 1974).} decision was based on a finding by the court that the public policy justifications for imposing strict liability on a manufacturer was sufficiently present to impose liability on the transferee of those assets which produced the product. Whatever the analysis used, it is clear that these justifications will not be present in the same degree and quantity in every case. As a result, there is a question whether the public policy analysis would provide compensation to a plaintiff even in a situation where the transferee of corporate assets is able to satisfy the plaintiff's claim. For example, regarding the justification that the transferee is the only one who can correct the defective product,\footnote{See text accompanying note 13 supra.} it is clear that this element will not be present in every case. In the area of products liability, the alleged defective product is sometimes as much as fifty years old.\footnote{In \textit{McKee v. Harris-Seybold Co.}, 109 N.J. Super. 555, 264 A.2d 98 (L. Div. 1970), the allegedly defective machine was produced in 1916 while the plaintiff's injury occurred in 1968.} As a result, it is likely that at least in some cases the corporation which originally produced the product or the transferee of that corporation's assets has corrected the defect occurring in the older machine, or has even completely changed the particular model of the machine. If this is the case, there is no justification for imposing liability on the transferee in the hope that it will cause the corporation to correct a now nonexistent defect.

Another justification mentioned by the courts is that the transferee obtains the goodwill benefits of having the transferor's goods on the market.\footnote{See text accompanying note 13 supra.} This may be the case in some instances, but it is clearly not true in all situations. For example, if the transferee changes the name of the product or significantly alters it, the transferee would reap no benefits from having the transferor's products on the market.\footnote{For example, in \textit{Wilson Athletic Goods Mfg. Co. v. Comm'r}, 222 F.2d 355} Also, it is doubtful that the transferee would receive any benefits from having the product on the market.
will continue the transferor's operation with the same employees in all situations. Thus, this justification for imposing liability on the transferee will not always be present.  

From this analysis it is apparent that the only justification which will be present in every case is that the transferee is more capable of sustaining the loss and spreading its burden than is the plaintiff. One could question whether this would be a sufficient justification to impose liability on a transferee. If so, it is not apparent from the Alad and Cyr decisions where the respective courts relied on much more than this factor alone in making their decisions. Therefore, until a more definitive statement of the law in this area is rendered it must be assumed that this justification alone is not sufficient. Thus, it is not clear that the rejection of the nonassumption rule will necessarily lead to an effective remedy for the plaintiff in all cases.

In addition, it is apparent from the decisions rejecting the general rule of nonassumption that such rejection makes corporate transactions in this area unnecessarily rigid. The rationale behind these decisions is that the liability for defective products belongs to the transferee regardless of a contractual stipulation to the contrary. As a result, courts may not give effect to contractual provisions placing liability on the transferor for defective products produced by it, even though the transferor is in a position to satisfy the claim of the plaintiff at the time of suit. Given this conclusion, it becomes impossible for the transferee to shift the burden of liability for defective products manufactured

(7th Cir. 1955), the court held that the taxpayer did not acquire the goodwill of the purchased corporation where the taxpayer intended to sell the same product under its own name.

50 See text accompanying note 13 supra.
51 See text accompanying note 13 supra.
53 501 F.2d 1145 (1st Cir. 1974).
54 If superior loss-bearing ability were the sole rationale, the burden could be placed on any corporation regardless of its connection with the assets as long as it, in fact, had the ability to bear the loss.
55 This is clear from Cyr v. B. Offen & Co., Inc., 501 F.2d 1145 (1st Cir. 1974), in which the court held the contract between the transferor and the transferee to be of no effect on the plaintiff, and from Ray v. Alad Corp., 55 Cal. App. 3d 855, 127 Cal. Rptr. 817 (1976), where the court noted that the general rule of nonassumption would not be applied even where the transferor is in a position to satisfy the plaintiff's claim at the time of suit.
by the transferor. It is evident, therefore, that any negotiations regarding the sale of corporate assets in a jurisdiction not applying the general rule of nonassumption will have to take this factor into account, with the result that the transferor will probably be required to accept a lower price for its assets because of this contingent and speculative liability which may be placed on the transferee sometime in the future. The transaction is thus rigidified because it does not permit the transferor to obtain a price equal to the value of his assets and forces the transferee to assume a liability of unknown proportions at the time of the sale. It would appear to make much more sense to permit the parties to negotiate the price of the assets separately and then arrive at some decision with respect to products liability, rather than predetermining where such liability will be placed.

It can be argued, of course, that this result can be accomplished if the contract is made binding between the parties, but not binding between an injured plaintiff and the transferee. While this may be true, it still presents a less desirable state of affairs than if the contract is binding between the plaintiff and the transferee. For example, suppose that C transfers its assets to C with a contractual provision stating that C will assume all liability for defective products manufactured by it. Suppose further that X is injured as the result of a defective product manufactured by C. X then sues C and C. If the nonassumption rule is applied C is entitled to a summary judgment and C would bear the loss of any verdict rendered in favor of X. If, however, the general rule of nonassumption is rejected C would be entitled to a summary judgment as against the plaintiff. However, since C is contractually bound to reimburse C for X's recovery, it might desire to remain a party to the suit to protect its economic interest. In addition, it is clear that C can keep C in the suit as a party who will be liable to C if X prevails. As a result, both C and C will have to endure a trial and the consequent legal fees. This is clearly more inefficient than a situation whereby the contract is enforced and C is the only defendant in the suit.

54 See note 53 supra.
55 The following discussion assumes that both the transferor and the transferee are viable entities at the time of the suit, with resources sufficient to satisfy the plaintiff's claim.
It is evident, therefore, that the rejection of the nonassumption rule, as announced by the courts, does not provide a clear path to the attainment of the goals of compensating the plaintiff and permitting flexibility in corporate transactions. It is equally clear, however, that an application of the general rule of nonassumption is deficient in rendering these goals attainable. Although the general rule of nonassumption gives the transferor and the transferee the power to allocate liability for defective products manufactured by the transferor, it does not insure that an injured plaintiff will be compensated. The reason is that if the liability rests with the transferor or the transferee under the general rule and that corporation dissolves prior to the suit, the plaintiff is denied an effective remedy.

For example, if the transferee fails to assume liability and the transferor dissolves, the plaintiff will be left without remedy unless he is able to establish the transaction as an exception to the general rule of nonassumption.\textsuperscript{59}

The above demonstrates that neither of these rules, by itself, satisfies the two goals which appear desirable in this area of the law. As a result, either a new rule or a synthesis of these two rules is needed. It appears that a synthesis of the public policy opinions and the nonassumption opinions would produce a rule which satisfies the two goals and does not involve a great departure from existing law.

The first goal, that of compensating the plaintiff, can easily be satisfied by a modification of the public policy analysis which led to the rejection of the general rule of nonassumption. Thus, the first tenet of the new rule would be that the plaintiff must be compensated by the transferee or the transferor. This rule can be justified solely on the basis of public policy, since either one of these entities is better able to bear the burden of the plaintiff's injury than is the plaintiff. This will require that the other public policy justifications for rejecting the general rule of nonassumption be forgotten. Furthermore, it will somewhat restrict the ability of the parties to allocate the burden for defective products in any way they choose.

The parties will, however, still have the power to allocate this

burden subject to the constraint that those injured by defective products be compensated. Thus, the parties may allocate the burden in the contract of sale and this allocation would be binding on both the parties and the plaintiff, except where the party to which the burden is allocated is dissolved or unable to respond in damages. In the exceptional situation, the other party would be liable for the plaintiff's injury.

The case which comes closest to articulating this type of analysis is *Knapp v. North American Rockwell Corp.*, where the defendant was injured in the course of his employment, in 1969, by an alleged defect in a machine known as a packomatic. The machine had been manufactured by Textile Machine Works, hereinafter referred to as TMW, and sold to the defendant's employer in 1966 or 1967. In 1968, TMW sold all of its assets with the exception of its corporate seal, its articles of incorporation, its corporate records and $500,000 in cash to American Rockwell. The sales agreement specified that Rockwell would assume certain obligations and liabilities of TMW, but did not provide for the assumption of liability for defective products. Subsequent to the consummation of the sale, TMW technically continued to exist until its dissolution approximately eighteen months later. During that time TMW had none of its former assets and was required to dissolve by contract as soon as possible.

The analysis which the court used in holding the defendant liable is interesting because, unlike the analyses in the other cases mentioned in this article, it neither fully accepts nor fully rejects the general rule of nonassumption as controlling in this type of situation. Rather, the court uses an analysis similar to that suggested above which blends these two disparate positions into a somewhat consistent whole. First, the court notes the general rule of nonassumption and its exceptions. The court then considers the plaintiff's claim that the transaction in question is within the merger exception to the general rule of nonassumption, noting that generally a merger does not take place when, as here, the selling corporation continues to exist after the sale. Despite this, the court held the defendant liable on the basis of the insubstantiality of that continued existence and more importantly on the public

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60 506 F.2d 361 (3rd Cir. 1974).
61 Id. at 363-64.
62 Id. at 365.
policy implications that the finding of a merger would have. These public policy considerations involved the plaintiff's inability to recover from the transferor and the transferee's ability to insure against and spread the burden of the plaintiff's loss.

It is apparent, therefore, that the court in *Knapp* was result-oriented and was not willing to establish a rigid rule to control such situations. As a result, this decision permits maximum flexibility in corporate transactions while protecting against the undesired result of a plaintiff not being compensated. The court does so by finding what is in essence a public policy exception to the general rule of nonassumption.

Whether the *Knapp* decision goes so far as to hold that the plaintiff must be compensated regardless of the status of the transferor and transferee at the time of the suit is uncertain. What is certain is that the decision is a step in that direction.

Despite the well-reasoned analysis in *Knapp*, it is probable that most courts will continue to cling to one of the two divergent positions, one denying the plaintiff an effective remedy in some instances, the other unduly rigidifying corporate transactions.

*James Ronald Snyder*

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Note the following statement by the court:

If we are to follow the philosophy of Pennsylvania courts that questions of an injured party's right to seek recovery are to be resolved by an analysis of public policy considerations rather than by a mere procrustean application of formalities, we must, in considering whether the TMW-Rockwell exchange was a merger, *evaluate the public policy implications of that determination*. *Id.* at 369. (Emphasis added).