Successor-liability options in a product-liability case.

by Oliver Vallejo[1]

I. Introduction.

Generally, a successor corporation does not assume the liabilities of its predecessor.[2] So what options does a plaintiff have when the manufacturer of a defective product no longer exists?

II. Traditional theories against successor corporations.

California recognizes four traditional exceptions to the rule of successor non-liability: (1) where the successor expressly or impliedly agrees to assume the predecessor's liabilities; (2) where the transaction between the successor and predecessor amounts to a consolidation or merger of the two corporations; (3) where the successor is a "mere continuation" of the predecessor; or (4) where the predecessor transfers assets to the successor for the fraudulent purpose of avoiding liability for debts.[3]

---

[1] Oliver Vallejo is an attorney with the Veen Firm, P.C., 711 Van Ness Avenue, Suite 220, San Francisco, California 94102, (415) 673-4800.

[2] *Ray v. Alad Corp.* (1977) 19 Cal.3d 22, 28.

[3] *Id.;* see *Franklin v. USX Corporation* (2001) 87 Cal.App.4th 615, 621-627 (discussing what constitutes "assumption of liabilities," "merger," and "mere continuation" for successor liability).

III. The product-line successor theory of liability under *Ray v. Alad Corp.*

In 1977, the Supreme Court in *Ray v. Alad Corp.* created a fifth exception to the rule of successor non-liability: "product-line successor" liability.[4] Alad I, a ladder manufacturer, sold its assets to Alad II. After the sale, the plaintiff sustained injuries when he fell from a defective ladder sold by Alad I. The plaintiff sued Alad II for strict product liability. The record established that Alad II:

- continued Alad I's ladder manufacturing business;
- manufactured the same line of ladder as the ladder that injured plaintiff;
- used the same equipment, designs, and personnel as Alad I to manufacture ladders;
- used the same sales representatives as Alad I to solicit Alad I's customers;
- gave no outward indication of any change in the ownership of the business; and
- held itself out as the same enterprise as Alad I.

The Supreme Court reversed the trial court's summary judgment in Alad II's favor. The court recognized the strong public policy behind strict product liability. "The purpose of the rule of strict liability 'is to insure that the costs of injuries resulting from defective products are borne by the manufacturers that put such products on the market rather than by the injured persons who are powerless to

[4] *Ray v. Alad*, *supra*, 19 Cal.3d at 31.

protect themselves.'"[5] The court explained, "'[t]he cost of an injury and the loss of time or health may be an overwhelming misfortune to the person injured, and a needless one, for the risk of injury can be insured by the manufacturer and distributed among the public as a cost of doing business.'"[6] The court reiterated that "'the paramount policy to be promoted by the rule [of strict liability] is the protection of otherwise defenseless victims of manufacturing defects and the *spreading throughout society* of the cost of compensating them.'"[7]

Applying these policies in favor of strict liability, the Supreme Court held that a successor is strictly liable for injuries caused by a predecessor's defective product when the facts establish:

- The "virtual destruction of the plaintiff's remedies against the original manufacturer caused by the successor's acquisition of the business,"
- "[T]he successor's ability to assume the original manufacturer's risk-spreading role;" and
- "[T]he 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."[8]

The *Ray v. Alad* court reasoned that the plaintiff, with a claim against a dissolved and assetless corporation, faced "the formidable and probably insuperable

[5] *Id.* at 30 (quoting *Greenman v. Yuba Power Products, Inc.* (1963) 59 Cal.2d 57, 63).
[6] *Id.* at 30-31 (quoting *Escola v. Coca Cola Bottling Co.* (1944) 24 Cal.2d at 462).
[7] *Id.* at 31 (quoting *Price v. Shell Oil Co.* (1970) 2 Cal.3d 245, 251), italics in original.
[8] *Id.*

obstacles in attempting to obtain satisfaction from former stockholders or directors."[9] The court also found that Alad II acquired the resources formerly available to Alad I for meeting its responsibilities to persons injured by defective ladders it had produced, including the plant, equipment, inventories, and know-how. In addition, the court reasoned that Alad II had the opportunity of passing on to purchasers of new products the costs of meeting the risks of defective products.[10] Finally, the court reasoned:

> [T]he imposition upon Alad II of liability for injuries from Alad I's defective products is fair and equitable in view of Alad II's acquisition of Alad I's trade name, good will, and customer lists, its continuing to produce the same line of ladders, and its holding itself out to potential customers as the same enterprise.[11]

The court emphasized that the legitimate exploitation of Alad I's reputation gave Alad II a "substantial benefit which its predecessor could not have enjoyed without the burden of potential liability for injuries from previously manufactured units."[12]

Ray v. Alad's progeny initially broadened the scope of the decision. For example, in *Rawlings v. D.M. Oliver, Inc.* the court said that "In our view, *Alad* should not be construed so narrowly as to create an exclusive exception to the general rule

---

[9] *Id.* at 32.
[10] *Id.* at 33.
[11] *Id.* at 34.
[12] *Id.*

for successor [non]liability … only in an *Alad* clone."[13] The court then held that a successor which bought a going business, including its good will, and continued that business at the same location under the same fictitious name as its predecessor could be strictly liable under *Ray v. Alad*, even though the successor did not continue manufacturing the identical product which caused plaintiff's injury.[14]

IV. Recent decisions have narrowed the scope of the product-line successor theory.

Recent decisions have narrowed *Ray v. Alad's* scope. As the Court of Appeal noted, "Successor liability has generally been *denied* for a lack of causation in situations showing no contributory cause in the predecessor's demise, *such as when the predecessor sells product line assets but dissolves at a later date and for an independent reason*."[15] Many courts have denied successor liability because the plaintiff was unable to establish a causal relationship between the successor's acquisition of the predecessor's assets and the destruction of plaintiff's remedies.

---

[13] (1979) 97 Cal.App.3d 890, 900.
[14] *Id.* at 901.
[15] *Phillips v. Cooper Laboratories, Inc.* (1989) 215 Cal.App.3d 1648, 1657 (quoting *Kaminski v. Western MacArthur Co.* (1985) 175 Cal.App.3d 445, 458), italics in original.

V. The independent-duty-to-warn theory of liability under the Third Restatement.

A possible sixth exception to the rule of successor non-liability applies where a successor incurs an *independent* duty to warn about a predecessor's defective product. Section 13 of the Third Restatement states the elements of the independent-duty-to-warn theory:

> (a) A successor corporation or other business entity that acquires assets of a predecessor corporation or other business entity, whether or not liable under the rule stated in §12 [traditional theories for successor liability], is subject to liability for harm to persons or property caused by the successor's failure to warn of a risk created by a product sold or distributed by the predecessor if:
>
> (1) the successor undertakes or agrees to provide service for maintenance or repair of the product or enters into a similar relationship with purchasers of the predecessor's products giving rise to actual or potential advantage to the successor and
>
> (2) a reasonable person in the position of the successor would provide a warning.
>
> (b) A reasonable person in the position of the seller would provide a warning if:
>
> (1) the seller knows or reasonably should know that the product poses a substantial risk of harm to persons or property; and;
>
> (2) those to whom a warning might be provided can be identified and can reasonably be assumed to be unaware of the risk of harm; and
>
> (3) a warning can be effectively communicated to and acted on by those to whom a warning might be provided; and

(4) the risk of harm is sufficiently great to justify the burden of providing a warning.[16]

California law has neither rejected nor expressly adopted the independent-duty-to-warn theory. In *Gee v. Tenneco, Inc.*, the Ninth Circuit said that "It is clear that a successor corporation may acquire an independent duty to warn where defects in a predecessor's products come to its attention."[17] But the successor in *Gee* did not incur a duty under the facts of the case.[18]

In *Burroughs v. Precision Airmotive Corp.* the California Court of Appeal held that an independent duty was "not warranted under the circumstances of this case."[19] In *Burroughs*, the plaintiffs' aircraft crashed because of a carburetor malfunction.[20] The defendant had not manufactured or sold that model of carburetor, but had acquired the product line from a predecessor.[21] The *Burroughs* court held that a federal statutory scheme defined the defendant's duties: federal aviation statutes protected the defendant from liability, and general tort principles did not apply to the highly regulated aviation industry.[22]

However, the *Burroughs* court discussed the independent-duty-to-warn theory of liability, citing *Patton v. TIC United Corp.* (10th Cir. 1996) 77 F.3d 1235, 1240, among

---

[16] Restat 3d of Torts: Products Liability, §13 (1998).
[17] *Gee v. Tenneco, Inc.* (9th Cir., 1980) 615 F.2d 857, 866.
[18] *Id.*
[19] (2000) 78 Cal.App.4th 681, 698.
[20] *Id.* at 683.
[21] *Id.*
[22] *Id.* at 698-700.

other out-of-state decisions which have recognized the theory.[23] The *Burroughs* court cited four factors which courts have considered to determine whether a successor had a duty to warn: (1) whether the successor assumed the predecessor's service contracts; (2) whether the particular product was covered under a service contract with the predecessor's customer; (3) whether the successor actually serviced the product; and (4) whether the successor knew of the alleged defects and knew how to reach the predecessor's customers.[24]

In *Sherlock v. Quality Control Equipment Co.*, the Eight Circuit said that these factors "are merely useful tools which provide guidance in resolving the ultimate inquiry: whether there is an adequate nexus between the successor and the predecessor's customers."[25] The court said that other duty factors must be considered:

> [R]ather than relying only on the four specific factors above, which are not exhaustive in establishing a nexus between the successor and its predecessor's customers sufficient to justly impose an independent duty to warn upon notice of dangers or potential dangers, the courts also employ a risk/benefit analysis. Thus, the focus in deciding whether the relationship between the successor corporation and the preexisting customer is sufficient to create a duty to warn has been upon the actual or potential **economic advantage** to the successor corporation.[26]

[23] *Id.* at 695-696.
[24] *Id.* at 696.
[25] (8th Cir. 1996) 79 F.3d 731, 734.
[26] *Id.* (emphasis added), quoting 15 William M. Fletcher, Fletcher Cyclopedia of the Law of Private Corporations § 7123.08 (perm. ed. rev. vol. 1990).

Other courts have recognized that the successor-duty analysis requires a risk-benefit analysis and is not limited to the four factors cited in *Burroughs*. The Ninth Circuit said that "The rationale of these decisions is consistent with a benefit/burden analysis."[27]

The risk-benefit analysis comports with California's traditional tort-duty analysis, which involves the factors listed in *Rowland v. Christian*:[28]

- The foreseeability of harm to the plaintiff—the most important factor;[29]
- The degree of certainty that the plaintiff suffered injury;
- The closeness of the connection between the defendant's conduct and the injury suffered;
- The moral blame attached to the defendant's conduct; the policy of preventing future harm; and
- The extent of the burden to the defendant and consequences to the community of imposing a duty to exercise care with resulting liability for breach.
- The availability, cost, and prevalence of insurance for the risk involved.

Some courts have rejected the independent-duty-to-warn theory where the evidence failed to establish a connection between the successor and the particular

[27] See *Gee*, *supra*, 615 F.2d at 866; see also *Downtowner, Inc. v. Acrometal Products, Inc.* (Supreme Ct. N.D. 1984) 347 N.W.2d 118, 125 (recognizing that four factors above are not conclusive).
[28] (1968) 69 Cal.2d 108, 112-113.
[29] *Megeff v. Doland* (1981) 123 Cal.App.3d 251, 256.

plaintiff.[30] So does the "ongoing relationship" element of the theory require an ongoing relationship with the predecessor's customers generally or with the particular plaintiff?

In *Patton v. TIC United Corp.*, the Tenth Circuit found successor liability under Section 13 without evidence that the successor had contacted the plaintiff or serviced the product which injured the plaintiff.[31] In *Patton*, a defective vertical-wing cultivator severed a farmer's spine in 1990.[32] The cultivator was manufactured by Wil-Rich at its factory in Wahpeton, North Dakota.[33] Between 1981 and 1987, Wil-Rich's assets and stock were transferred among a number of entities through merger, acquisition and reorganization.[34] In 1987, a wholly-owned subsidiary of TIC bought the assets, goodwill and trade name of the former Wil-Rich. In 1993, the subsidiary merged with TIC, who continued to operate the Wahpeton facility and market cultivators under the "Wil-Rich" name.[35] The farmer sued TIC arguing that as a successor to Wil-Rich, TIC incurred a duty to warn users about the dangers the cultivator posed.[36]

Affirming a judgment in the farmer's favor, the Tenth Circuit held that under Kansas law, a successor corporation could have a duty to warn about defects in a

---

[30] See, e.g., *LaFountain v. Webb Indus. Corp.* (3d Cir. 1991) 951 F.2d 544, 549; see also, *Pesce v. Overhead Door Corp.* (D.Conn 1998) 1998 LEXIS 20665 at *14.
[31] (10th Cir. 1996) 77 F.3d 1235, 1241.
[32] *Id.*
[33] *Id.* at 1239.
[34] *Id.*
[35] *Id.*
[36] *Id.* at 1239, 1241.

predecessor's product "if it has knowledge of the defective condition of the predecessor's product, and has a 'more than casual' relationship with the customers of the predecessor entity that is an 'economic benefit' to the successor."[37] The court held that the evidence established both criteria.[38]

First, the evidence showed that TIC knew that operators of the Wil-Rich vertical-wing cultivator were being seriously injured in accidents like the farmer's.[39] Second, the evidence showed that TIC benefitted economically from its relationship with its predecessors' customers through its authorized Wil-Rich dealership network.[40] Finally, the Court found that TIC could have warned the farmer because TIC knew that its authorized dealers kept lists of prior buyers of Wil-Rich equipment.[41] The court does not cite any evidence that TIC had provided service or replacement parts to the plaintiff or the plaintiff's cultivator, although there was evidence that TIC's predecessor had done so through an authorized dealership.[42]

The Tenth Circuit *Patton* decision demonstrates that a successor corporation can incur a duty to warn about a predecessor's defective product even where there is no evidence of prior contact between the successor and the plaintiff or the product which injured the plaintiff. Imposing a duty on a successor who benefits financially

---

[37] *Id.* at 1240 (citing *Stratton v. Garvey Int'l, Inc.* (1984) 9 Kan.App.2d 254 (1984)).
[38] *Id.* at 1241.
[39] *Id.*
[40] *Id.*
[41] *Id.* at 1243.
[42] See *Id.*; see also *Patton v. Hutchinson Wil-Rich Mfg. Co.* (Supreme Ct. Kan., 1993) 253 Kan. 741, 746.

from maintaining an ongoing relationship with the predecessor's customers generally advances the strong public policy of (a) protecting otherwise defenseless victims from dangerously defective products, (b) delegating the risk of injury to the party who is best able to insure against the risk, and (c) spreading throughout society the cost of insuring against the risk.

VI. Conclusion.

Under California law, a successor corporation can assume strict liability for a predecessor's defective products. Under the Restatement, a successor can incur an independent duty to warn about a predecessor's defective product under certain circumstances. California has not expressly adopted the independent-duty-to-warn theory but it should. The theory is grounded in public policy—protecting consumers and delegating risk to those who are in the best position to assume it—which California already recognizes as important.

189017_1.doc