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Recommended Citation

Micheal D. Green, *Successor Liability The Superiority of Statutory Reform to Protect Products Liability Claimants*, 72 Cornell L. Rev. 17 (1986)

Available at: <http://scholarship.law.cornell.edu/clr/vol72/iss1/2>

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SUCCESSOR LIABILITY: THE SUPERIORITY OF STATUTORY REFORM TO PROTECT PRODUCTS LIABILITY CLAIMANTS

Michael D. Green†

In the last decade, products liability claimants have challenged the limitations on a successor corporation's liability for the obligations of another corporation acquired by the successor. These challenges have shared a common denominator: each involved products that cause injury many years after their manufacture and sale.¹ The multidecade life of a punch press or the lengthy latency period of an insidious disease,² combined with the inevitable corporate evolution that is the hallmark of a dynamic market economy,³ and state corporate law provisions, which deny claimants any effective remedy against the manufacturers' shareholders,⁴ have forced products liability claimants to seek redress from the corporations that acquired the manufacturers' assets.

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¹ Scholars and lawyers are paying increased attention to the impact of the chronological dimension on the development of products liability theory. Changes in societal attitudes toward acceptable levels of risk, concomitant reform in tort law governing the production and sale of products having a capacity to injure, the development of new technology, and increasing knowledge about hazards over time are all elements of the chronological dimension. See Symposium, *The Passage of Time: The Implications for Product Liability*, 58 N.Y.U. L. REV. 733 (1983); Henderson, *Coping with the Time Dimension in Products Liability*, 69 CALIF. L. REV. 919 (1981).

² See *infra* note 11.

³ One corporation may acquire another through a number of methods. Stock purchases are common, but not of substantial concern here. Stock purchases only change the predecessor's ownership; its existence, assets, and ability to meet its liabilities remain unaffected. A parent corporation's liability for its subsidiary's obligations is distinct from the successor liability questions addressed here. Unfortunately, not all courts have recognized the distinction. In *Fenton Area Pub. Schools v. Sorensen-Gross Constr. Co.*, 124 Mich. App. 631, 641-44, 335 N.W.2d 221, 225-26 (1983), the court improperly applied successor liability analysis to a parent-subsidiary relationship. In rare instances, both successor and parent-subsidiary questions may arise out of the same series of corporate transactions. See, e.g., *Kelly v. American Precision Indus., Inc.*, 438 So. 2d 29 (Fla. Dist. Ct. App. 1983), *review denied*, 447 So. 2d 885 (Fla. 1984). Because statutory mergers and consolidations are subject to well-defined statutory provisions and therefore rarely generate controversy over liability, the transactions of primary concern here are purchases of corporate assets for cash or stock.

⁴ See *infra* notes 143-50 and accompanying text.

Court response, in the finest products liability tradition, has been diverse. Some courts have expanded the scope of existing successor liability doctrine.⁵ For example, the California and New Jersey supreme courts pioneered new theories of successor liability.⁶ I will refer to the combined efforts of the common law courts to broaden successor liability as "liberal successor liability law." Predictably, many jurisdictions refuse to budge from longstanding doctrine less favorable to products liability claimants.⁷

The successor liability issue arises if a product manufacturer⁸ is no longer a viable juridical entity⁹ when a claimant brings suit for injuries caused by the product. Typically, the manufacturer has dissolved and liquidated after selling its assets to another entity (the "successor"), although a wide variety of corporate genealogies are addressed in the numerous successor liability cases. The successor phenomenon, largely a creature of the last decade,¹⁰ reflects in microcosm the increasing significance and impact of the products liability revolution.

All indications are that the successor liability issue will be of

⁵ See *infra* text accompanying notes 34-41.

⁶ See *infra* note 20; text accompanying notes 40-41. Several other state courts have followed the lead of the California and New Jersey supreme courts. See *Dawejko v. Jorgensen Steel Co.*, 290 Pa. Super. 15, 434 A.2d 106 (1981); *Martin v. Abbott Laboratories*, 102 Wash. 2d 581, 689 P.2d 368 (1984).

⁷ See, e.g., *Bernard v. Kee Mfg. Co.*, 409 So. 2d 1047 (Fla. 1982); *Jones v. Johnson Mach. & Press Co.*, 211 Neb. 724, 320 N.W.2d 481 (1982). A number of courts have also imposed a somewhat sketchy postmanufacture duty to warn on successors. See *infra* notes 98, 100-01 and accompanying text.

⁸ Liability for injuries caused by a defective product is not limited to the manufacturer. See RESTATEMENT (SECOND) OF TORTS § 402A (1965). However, ultimate responsibility rests with the entity responsible for the defect in the product. *Vandermark v. Ford Motor Co.*, 61 Cal. 2d 256, 261-63, 391 P.2d 168, 170-72, 37 Cal. Rptr. 896, 898-900 (1964). Generally the manufacturer is that entity.

⁹ Even though the predecessor is a viable legal entity, a successor may be sued if the predecessor is financially unsound, but one must distinguish the predecessor experiencing financial difficulty from the predecessor that has distributed its assets to shareholders. See *infra* text accompanying notes 108, 130-33.

¹⁰ The paucity of cases contained in an article published 11 years ago helps to demonstrate the growth of successor liability litigation in the past decade. Annotation, *Products Liability: Liability of Successor Corporation for Injury or Damage Caused by Product Issued by Predecessor*, 66 A.L.R.3d 824 (1975). The characterization of the impact of successor liability law contained in the annotation also provides some insight:

[I]n applying the common-law rule of successor liability to cases involving the liability of a corporation which acquires assets from another for the damages or injuries caused by the transferor's product, the courts seem generally to have narrowly construed its provisions, with the result that the facts of only a few cases have brought such cases within the rule.

Id. at 827-28. A 1976 article in the *Wall Street Journal* further demonstrates the evolution of successor law. The article analyzed the popularity of asset purchases for cash, yet made no mention of the successor products liability implications of cash purchases. *Ricklefs, Mergers, Acquisitions Come Back into Style but the Style Is New*, *Wall St. J.*, Apr. 28, 1976, at 1, col. 6.

increasing importance in the future. Each product manufacturer that ceases to exist creates a potential source for successor liability claims. Because of the longevity of certain products and the capacity of other products to produce injury generations after use, existing successors will continue to face claims based on products manufactured by their predecessors. Moreover, some evidence suggests that injuries suffered by plaintiffs in successor liability cases tend to be more serious than those suffered in all products liability cases.¹¹

Many courts¹² and commentators¹³ have viewed the successor liability issue as one involving an inherent tension between the policies underlying products liability and traditional corporate law, with its emphasis on the free alienability of property.¹⁴ However, deeper probing reveals that the issue is both simpler and more complex than the conventional wisdom suggests.¹⁵

The issue is simpler because traditional corporate law has always provided substantial protection for creditors when a corporation engages in a reorganization or an asset transfer that may impair its creditors' ability to assert and collect their claims.¹⁶ In this re-

¹¹ As the time from manufacture to injury increases, the amount paid also tends to increase. An Insurance Services Office closed claim survey found that only 2.8% of injured parties make claims that involve at least a 10-year gap from manufacture to injury, but they receive 6.6% of the total payments. INSURANCE SERVICES OFFICE, *PRODUCT LIABILITY CLOSED CLAIM SURVEY: A TECHNICAL ANALYSIS OF SURVEY RESULTS* 81 (1977).

My own casual and unscientific survey of reported successor liability cases reveals that of 54 reported decisions, 57% involved some type of industrial machinery and 20% involved insidious disease.

¹² *E.g.*, *Cyr v. B. Offen & Co.*, 501 F.2d 1145, 1152-54 (1st Cir. 1974); *Ray v. Alad Corp.*, 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).

¹³ *E.g.*, Aylward & Aylward, *Successor Liability for Defective Products—Misplaced Responsibility*, 13 *STETSON L. REV.* 555, 557 (1984); Fegan, *Successor Corporations and Strict Liability in Tort—A Convergence of Two Opposing Doctrines*, 69 *ILL. B.J.* 142 (1980); Hyman, *The Liability of Successor Corporations for Defective Products of a Predecessor Corporation—A Switch From Corporate to Tort Law*, 10 *S.U.L. REV.* 165, 167 (1984).

¹⁴ *See, e.g.*, J. CRIBBET, *PRINCIPLES OF THE LAW OF PROPERTY* 187-88, 286-89 (2d ed. 1975).

¹⁵ To the extent that there is any real conflict, it occurs at the outer fringe of property and tort law: ownership of private property conflicts with the tort principle that one must cede ownership of property when found liable to another. That theoretical and highly generalized conflict hardly seems useful in evaluating the successor liability issue.

¹⁶ The devices providing protection for creditors of a corporation reorganizing or transferring its assets include: (1) the Bulk Transfer provisions in the Uniform Commercial Code, U.C.C. §§ 6-101 to -111 (1977), requiring that the purchaser give notice to the creditors of a seller engaging in a bulk transfer of its assets; (2) a common law trust fund theory allowing claims by a dissolved corporation's creditors against the corporation's stockholders who received distributions in connection with the dissolution, *e.g.*, *Wood v. Dummer*, 30 F. Cas. 435 (C.C.D. Me. 1824) (No. 17,944); *see* Schoone, *Shareholder Liability upon Voluntary Dissolution of Corporation*, 44 *MARQ. L. REV.* 415, 417 (1961); (3) the expanded abatement period in modern corporation statutes permitting suits against corporations for a period of time after dissolution, *see, e.g.*, *MODEL BUSINESS CORP. ACT* § 105 (1979); 16A *W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPO-*

spect, products liability claimants¹⁷ are merely long-tail creditors of the predecessor who, because their claims accrue after the predecessor's demise and perhaps because of their relatively recent arrival on the legal landscape, have not been afforded the same protection that traditional corporate law has provided other creditors.¹⁸

At the same time, the successor liability issue is more complex because the policies underlying products liability do not compel imposing liability on the successor. Indeed, court analyses of successor liability reflect internal inconsistencies in the policies cited to justify products liability,¹⁹ the manipulation of those policies,²⁰ and

RATIONS § 8166 (rev. perm. ed. 1979); (4) state statutes requiring notice to creditors of intent to dissolve, *see, e.g.*, MODEL BUSINESS CORP. ACT § 87(a) (1979); (5) restrictions on conveyances made without fair consideration that leave the corporation insolvent, *see, e.g.*, UNIF. FRAUDULENT CONVEYANCE ACT §§ 1, 4, 10, 7A U.L.A. 430, 474, 630 (1985); (6) statutory provisions imposing liability on the surviving corporation for the obligations of each predecessor corporation absorbed in a merger, *see, e.g.*, MODEL BUSINESS CORP. ACT § 11.06(a)(3) (1984); and (7) statutes imposing liability on directors of a corporation who authorize distributions to stockholders that render the corporation insolvent, *see, e.g.*, MODEL BUSINESS CORP. ACT § 8.33 (1984).

¹⁷ To clarify, only those products liability claimants who would have recovered from the manufacturer absent the acquisition have a legitimate claim to creditor status.

¹⁸ I believe this rationale—the protection of products liability claimant-creditors, who, because of fortuities of time, corporate organization, and their relationship with the debtor, are unable to make adequate provision to protect themselves as most commercial creditors can—is a powerful one that requires some reform of our traditional method of handling corporate acquisitions involving the dissolution of the seller. This principle is illustrated by the extensive efforts made to protect unknown future asbestos victims in the bankruptcy proceedings of three asbestos manufacturers. *See* N.Y. Times, Jan. 24, 1984, at D1, col. 3 (representative appointed for future claimants in Manville bankruptcy proceedings); N.Y. Times, Mar. 23, 1984, at D3, col. 6 (proposal to create trust fund for future claimants).

To the extent one is less sympathetic to products liability creditors than to other creditors, reform becomes less alluring.

¹⁹ One of the most obvious anomalies in justifying products liability concerns the question of precisely who should bear the costs of injuries associated with a product. Some assert that the defendant is merely a conduit for passing the costs on to all consumers of the product. *See, e.g.*, Hall v. E.I. DuPont de Nemours & Co., 345 F. Supp. 353, 368-69 (E.D.N.Y. 1972); Dippel v. Sciano, 37 Wis. 2d 443, 450, 155 N.W.2d 55, 58 (1967); Keeton, *Products Liability*, 50 F.R.D. 338, 339 (1970). Others insist that the entity distributing a defective product should pay the price of resulting injuries. *E.g.*, Santor v. A & M Karagheusian, Inc., 44 N.J. 52, 64-65, 207 A.2d 305, 312 (1965). A few courts speak of insurance as if it affords a mechanism by which nobody ultimately suffers the loss. *See, e.g.*, Ray v. Alad Corp., 19 Cal. 3d 22, 33, 560 P.2d 3, 10, 136 Cal. Rptr. 574, 581 (1977); *see also* Escola v. Coca Cola Bottling Co., 24 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944) (Traynor, J., concurring in judgment). Needless to say, there is considerable debate about where the costs of products liability claims should ultimately fall, and it is probably a question to which no general answer exists. *See* L. DE-ALESSI & R. STAAF, *LIABILITY, CONTROL, AND THE ORGANIZATION OF ECONOMIC ACTIVITY* 24-26 (Law and Economics Center, Univ. of Miami Working Paper No. 2, 1986).

²⁰ Ramirez v. Amsted Indus., Inc., 86 N.J. 332, 431 A.2d 811 (1981) provides an interesting illustration. In the course of adopting the product line theory of successor liability, the court suggested that imposing liability on the successor would enable the manufacturer to spread accident costs to product users. *Id.* at 352, 431 A.2d at 822. In

rationalizations used to reach particular results in specific cases.²¹ This much is clear, however: simply because a products liability claimant—indeed, any claimant—has no other viable entity from which to obtain redress does not itself justify imposing liability on an entity that has not contributed to the claimant's injury.²²

Thoughtful resolution of the successor liability question requires an inquiry that transcends the immediate, "snapshot" factual situation presented at the time of suit. Properly viewed, an injured claimant attempting to impose liability on a viable successor is merely a delayed creditor of the predecessor. An analysis of the policy considerations of successor liability reveals that, contrary to the prevailing view, only one valid reason exists for holding successors liable: a successor can serve as a conduit to place the financial burden of future products liability claims on the predecessor by discounting the price the successor is willing to pay for the predecessor by the predecessor's projected future products liability. Other rationales for successor liability collapse under close scrutiny. Thus, a statutory solution restricting a corporation's right to dissolve and distribute its assets to shareholders emerges as the most sensible, direct, and efficient way to protect long-tail products liability claimants.

Part I of this article briefly describes the common law evolution of successor liability, a topic more extensively examined elsewhere.²³ Part II critically assesses the justifications offered by courts adopting liberal successor liability law. The question of which entity should ultimately bear the burden of the claimant's loss, an issue that courts have often overlooked in their attempt to justify the expansion of successor liability, is essential to the analysis in this part. Part III compares the capacity of liberal successor liability law to perform comprehensively and efficiently the conduit function—the sole valid rationale for holding successors liable—with the capacity

the next breath, the court suggested that the successor should discount the price paid to a predecessor by the potential liability assumed, thereby passing future accident costs to the predecessor. *Id.* at 354, 431 A.2d at 822; *see also* A.B.A. SPECIAL COMM. ON THE TORT LIABILITY SYSTEM, TOWARDS A JURISPRUDENCE OF INJURY: THE CONTINUING CREATION OF A SYSTEM OF SUBSTANTIVE JUSTICE IN AMERICAN TORT LAW 4-85 to -87 (1984) (examining how courts erroneously commingle terms of "risk" and "loss" in discussions of spreading).

²¹ For an example of a court able to persuade itself that imposing liability on a successor could further virtually all products liability policies, *see* *Cyr v. B. Offen & Co.*, 501 F.2d 1145, 1154 (1st Cir. 1974). Another court found that imposing liability on a successor furthered *none* of the policy bases underlying products liability. *See* *Domine v. Fulton Iron Works*, 76 Ill. App. 3d 253, 257-58, 395 N.E.2d 19, 23 (1979).

²² That many claimants cannot collect their claims from a liable party because of its financial inadequacy cannot justify selecting some other entity to provide substitute compensation without some further rationale.

²³ *See infra* note 25.

of a dissolution-restricting statute to effect the same ends. Part IV contains a proposal for a statute that requires a corporation, prior to dissolution or distribution of its assets to shareholders,²⁴ to make adequate provision for future products liability that may arise from products manufactured by that corporation. Such a statute would preserve the rights of future claimants, provide greater certainty for corporate acquisitions and asset transfers, assure that the liability for defective products is placed where it belongs, and still allow substantial flexibility to corporations contemplating dissolution.

1

THE DEVELOPMENT OF LIBERAL SUCCESSOR LIABILITY LAW

A number of traditional exceptions to the basic principle that a successor is not liable for the obligations of a predecessor have been articulated.²⁵ I will attempt to show that these supposed exceptions are illusory; instead they are simply indirect methods of imposing liability on the predecessor. By contrast, much of the expansion of liberal successor liability law appears grounded in a desire either to impose liability on successors qua successors or to expand the ability of injured claimants to obtain compensation from some entity, regardless of its connection to the risk that caused the claimants' harm.

The established instances in which courts impose liability on a successor corporation include: (1) merger or consolidation of the purchasing and selling corporation; (2) de facto merger; (3) continuation; (4) contractual assumption; and (5) fraud.²⁶

Statutes imposing liability on the surviving entity of a merger or consolidation of two corporations²⁷ rest on the theory that the survi-

²⁴ See *infra* Proposed Statute § 1(b); note 160.

²⁵ Substantial commentary has addressed and discussed the traditional exceptions to successor liability in the context of products liability claimants. See Juenger & Schulman, *Assets Sales and Products Liability*, 22 WAYNE L. REV. 39 (1975); Nielsen, *Liability of Successor Corporations*, 32 FED'N INS. COUNS. Q. 63 (1981); Wallach, *Products Liability: A Remedy in Search of a Defendant—The Effect of a Sale of Assets and Subsequent Dissolution on Product Dissatisfaction Claims*, 41 MO. L. REV. 321 (1976); Note, *Assumption of Products Liability in Corporate Acquisitions*, 55 B.U.L. REV. 86 (1975) [hereinafter Note, *Assumption of Liability*]; Note, 9 FLA. ST. U.L. REV. 525 (1981); Note, *Expanding the Products Liability of Successor Corporations*, 27 HASTINGS L.J. 1305 (1976) [hereinafter Note, *Expanding Liability*]; Comment, *Successor Liability in Corporate Acquisitions—An Examination of Attempts to Limit the Use of the De Facto Merger Doctrine*, 46 J. AIR L. & COM. 483, 483-89, 492-510 (1981) [hereinafter Comment, *De Facto Merger*]; Comment, *Extension of Strict Tort Liability to Successor Corporations*, 61 MARQ. L. REV. 595 (1978); Recent Development, 44 TENN. L. REV. 905 (1977); Annotation, *supra* note 10.

²⁶ See, e.g., *Leannais v. Cincinnati, Inc.*, 565 F.2d 437, 439 (7th Cir. 1977); *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361, 363-65 & 364 n.8 (3d Cir. 1974), *cert. denied*, 421 U.S. 965 (1975).

²⁷ See, e.g., MODEL BUSINESS CORP. ACT § 11.06(a)(3) (1984).

vor represents an amalgamation of the predecessor or predecessors. Thus, imposing liability on the survivor is tantamount to imposing it on the entities that joined together to make up the successor. Liability is not imposed on an entity distinct from the predecessor, but on an entity which has absorbed the predecessor.

The de facto merger exception developed to encompass sales of assets for stock that were functionally equivalent to a merger. Although originally designed to enhance the rights of dissenting shareholders,²⁸ the predecessor's creditors subsequently used it to impose liability on the successor.²⁹ Courts have limited the de facto merger exception to acquisitions in which the predecessor's assets were acquired in exchange for stock,³⁰ reasoning that because the predecessor's stockholders own part of the successor, those shareholders assume the burden for the predecessor's liabilities.³¹

Until recently, courts narrowly construed the continuation exception, imposing liability on an entity that differed only formally from its predecessor.³² A successor whose ownership, management, and corporate operations are the same as its predecessor is not a separate economic entity simply because of formalistic changes. Thus, the economic unit that incurred the liability remains responsible for it.

Similarly, a successor may contractually assume the predecessor's liability. The successor has agreed, through market exchange, to assume a liability of the predecessor, presumably in exchange for consideration sufficient to make the assumption attractive. The concessions or reduction in price made by the predecessor means that

²⁸ See, e.g., *Applestein v. United Bd. & Carton Corp.*, 60 N.J. Super. 333, 159 A.2d 146 (Ch. Div.) (corporate combination deemed de facto merger and declared invalid if notice to shareholders insufficient), *aff'd*, 33 N.J. 72, 161 A.2d 474 (1960); *Farris v. Glen Alden Corp.*, 393 Pa. 427, 143 A.2d 25 (1958) (reorganization agreement deemed merger in which shareholders had right to dissent).

²⁹ See *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 316 (3d Cir. 1974), *cert. denied*, 421 U.S. 965 (1975).

³⁰ E.g., *Travis v. Harris Corp.*, 565 F.2d 443, 447 (7th Cir. 1977); *Shannon v. Samuel Langston Co.*, 379 F. Supp. 797, 801 (W.D. Mich. 1974).

³¹ This theory is flawed. The acquiring corporation's shareholders also bear a portion of the selling entity's products claims. If the ratio of stock paid for the purchase to total outstanding stock is very low, acquiring shareholders may bear the lion's share of this liability. The successor can, of course, discount its purchase offer to reflect this liability, but that opportunity exists regardless of the method of acquisition. Recognition of this flaw by the Michigan Supreme Court contributed to its decision to expand the de facto merger doctrine to include purchases of assets for cash. *Turner v. Bituminous Casualty Co.*, 397 Mich. 406, 422-23, 244 N.W.2d 873, 880 (1976).

³² See, e.g., *Lopata v. Bemis Co.*, 406 F. Supp. 521, 526-27 (E.D. Pa. 1975) (refusing to apply exception where so-called predecessor retained independent existence despite sale of bulk of assets to defendant), *aff'd*, 546 F.2d 417 (3d Cir. 1976); see also Comment, *De Facto Merger*, *supra* note 25, at 498 (discussing court treatment of continuity exception).

it, not the successor, bears the estimated future costs that were assumed.

Finally, although one might view the fraud or inadequate consideration exception as a means of retribution, it is also consistent with a theory of imposing the predecessor's liabilities on the successor to offset the economic advantage obtained by the successor in paying less than full value for the predecessor's assets. The low purchase price received by the predecessor represents payment for liabilities transferred to the successor.³³

Liberal successor liability law has substantially expanded the scope of these five limited justifications for successor liability and has even fashioned an additional theory. Although not yet widely embraced, the trend is clear and quite sensible. Assuming that products liability claimants have an otherwise valid claim, those claimants are creditors whose claims should not be extinguished by some form of corporation reorganization. Indeed, in one respect products liability claimants have an even stronger claim for legal protection. Unlike contract creditors, who voluntarily choose to become creditors and have the opportunity to bargain for protection for their claims, products liability creditors do not voluntarily assume their status and do not have the opportunity to obtain concessions from their debtors providing greater security for their claims.³⁴

The principal expansion of traditional successor liability doctrine has taken place in the de facto merger and continuation areas.³⁵ Courts have eliminated the requirements that the

³³ Neither the fraud nor the inadequate consideration theory has played any significant role in successor products liability. One commentator noted in 1979 that as of that date no claimant had attempted to utilize § 7 of the Uniform Fraudulent Conveyances Act. Note, *Products Liability: Developments in the Rule of Successor Liability for Product-Related Injuries*, 12 U. MICH. J.L. REF. 338, 354 n.79 (1979). That statement is still true as of 1985, at least with regard to reported decisions. Nor have I uncovered any case in which a products claimant has asserted fraud against a successor. The reason for this, I suspect, is the difficulty of reconstructing, many years after the fact, the value of assets at their time of transfer from a now-defunct corporation.

³⁴ See Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 506 (1976).

The market-oriented skeptic might respond that purchasers of products have the opportunity to take into account the likelihood of some future reorganization by the product manufacturer in making a decision whether to purchase. The flawed assumptions in the skeptic's response, not to mention that many long-tail products liability claimants are bystanders, are sufficiently evident that further elaboration seems unnecessary.

³⁵ There is substantial overlap between the de facto merger and the expanded continuation theories. See Note, *Products Liability of Successor Corporations: A Policy Analysis*, 58 IND. L.J. 677, 699-700 (1983).

predecessor cease to exist immediately after the acquisition³⁶ and that the consideration paid to the predecessor consist only of stock.³⁷ Rather than focusing on whether a successor is in all functional aspects a continuation of the predecessor, courts have fashioned an amorphous "totality of the circumstances" test.³⁸ Under this test, for example, a change in ownership does not necessarily prevent a finding of continuation.³⁹

An equally significant element of liberal successor liability law is the creation of a new theory of successor liability. In *Ray v. Alad Corp.*,⁴⁰ the California Supreme Court fashioned a product line theory to impose liability on a successor. After considering such factors as the successor's acquisition of all the assets necessary to continue the predecessor's manufacturing operations, the successor's continuation of the predecessor's manufacturing enterprise, the plaintiff's inability to assert a claim against the predecessor because of the predecessor's sale and subsequent dissolution, and the successor's ability to spread products liability losses to users, the court imposed liability on the successor to the same extent that the predecessor would have been liable for losses from its defective products.⁴¹

³⁶ See *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361 (3d Cir. 1974), cert. denied, 421 U.S. 965 (1975).

³⁷ See *Turner v. Bituminous Casualty Co.*, 397 Mich. 406, 422-23, 244 N.W.2d 873, 880 (1976). Recent literature discussing the liberalization of successor liability law includes: Aylward & Aylward, *supra* note 13; Fegan, *supra* note 13; Kadens, *Practitioner's Guide to Treatment of Seller's Products Liabilities in Assets Acquisitions*, 10 U. Tol. L. Rev. 1 (1978); D. Phillips, *Products Liability of Successor Corporations: A Corporate and Commercial Law Perspective*, 11 Hofstra L. Rev. 249 (1982); J. Phillips, *Product Line Continuity and Successor Corporation Liability*, 58 N.Y.U. L. Rev. 906 (1983); Note, *Imposing Strict Liability upon a Successor Corporation for the Defective Products of Its Corporate Predecessor: Proposed Alternatives to the Product Line Theory of Liability*, 23 B.C.L. Rev. 1397 (1982); Note, *Continued Expansion of Corporate Successor Liability in the Products Liability Arena*, 58 Chi.-Kent L. Rev. 1117 (1982); Note, *supra* note 35; Comment, *A Restoration of Certainty: Strict Products Liability and Successor Corporations*, 43 Ohio St. L.J. 441 (1982) [hereinafter Comment, *Restoration of Certainty*]; Note, *Products Liability: Successor Corporations: Liability for Defective Products*, 35 Okla. L. Rev. 846 (1982); Comment, *A Search for the Outer Limits to Successor Corporation Liability for Defective Products of Predecessors*, 51 U. Cin. L. Rev. 117 (1982) [hereinafter Comment, *Search for Outer Limits*]; Casenote, *Successor Liability in Washington: When a Successor Should Be Liable for a Predecessor's Products Liability*—Meisel v. M & N Modern Hydraulic Press Company, 6 U. Puget Sound L. Rev. 323 (1983).

³⁸ See, e.g., *Trimper v. Bruno-Sherman Corp.*, 436 F. Supp. 349 (E.D. Mich. 1977) (continuation found where seller remained in existence but trained and assisted buyer's employees, anticipated buyer's use of seller's name, agreed not to compete against buyer, and agreed to forward business inquiries to buyer); *Turuer v. Bituminous Casualty Co.*, 397 Mich. 406, 244 N.W.2d 873 (1976) (listing guidelines for determining continuation).

³⁹ E.g., *Cyr v. B. Offen & Co.*, 501 F.2d 1145 (1st Cir. 1974).

⁴⁰ 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977). The product line theory adopted by the California Supreme Court was first proposed in Note, *Expanding Liability*, *supra* note 25, at 1325.

⁴¹ A qualification is necessary. The *Ray* court, along with most other courts that have subscribed to liberal successor liability law, only addressed the successor's liability

The increasing entrenchment, albeit with fits and starts, of liberal successor liability law continues. More and more plaintiffs are attempting to convert courts and, once converted, to induce them to expand the outer reaches of the doctrine. At the same time, corporate acquisition specialists have taken note of this trend and have modified the structure of corporation acquisitions so as to minimize the likelihood of incurring successor liability.⁴² Through all the maneuvering and legal debate, two important questions remain obscured: (1) on whom are we attempting to impose this liability?; and (2) is liberal successor liability law the appropriate method by which to do it? Analyzing and answering these two questions will provide insight into the underlying goals of successor liability law and furnish guidelines for the most effective means of achieving those policies.

II

LEGITIMATING LIBERAL SUCCESSOR LIABILITY LAW: WHOSE LIABILITY IS IT ANYWAY?

A. Introduction

Courts that have used their common law prerogative to adopt liberal successor liability law have never coherently answered the question of who, ultimately, should bear the costs that are not left with those who suffer product-related injuries.⁴³ Justifying the ex-

for compensatory damages. *But see, e.g.*, *Krull v. Celotex Corp.*, 611 F. Supp. 146 (N.D. Ill. 1985) (holding successor liable for punitive damages because it merged with predecessor); *Hanlon v. Johns-Manville Sales Corp.*, 599 F. Supp. 376, 379 (N.D. Iowa 1984) (holding successor liable for punitive damages because it merged with predecessor and expressly agreed to assume all liabilities). The concerns relevant to punitive damages, which if truly punitive constitute a windfall to the plaintiff, are sufficiently different from those of compensatory damages that this article is limited to consideration of successor liability for compensatory damages. For a discussion of successor liability for punitive damages, see Comment, *Killing the Son for the Sins of the Father: The Impropriety of Punitive Damages Against a Successor Corporation*, 1986 ARIZ. ST. L.J. 101; Note, *A Proposal for the Proper Use of Punitive Damages Against a Successor*, 11 J. CORP. L. 765 (1986).

⁴² See Heitland, *Survival of Products Liability Claims in Assets Acquisitions*, 34 BUS. LAW. 489 (1979); Winthrop, *Structuring a Corporate Acquisition to Avoid the De Factor Merger Doctrine*, 6 SEC. REG. L.J. 195 (1978); Yamin, *The Achilles Heel of the Takeover: Nature and Scope of Successor Corporation Products Liability in Asset Acquisitions*, 7 HARV. J.L. & PUB. POL'Y 185 (1984).

⁴³ A definitive answer to this question is well beyond the scope of this article. Nevertheless, some explication of the range of issues that this question presents will assist the analysis of legitimate rationales for liberal successor liability law.

A number of initial loss-bearing candidates exist, each of which then raises additional possibilities and increasingly more difficult questions. Sellers of defective products have been touted as the appropriate entity to bear related losses. But modern methods of distribution often involve several sellers. Spreading the loss to all consumers of the product involved is often suggested. But the loss cannot be placed on each of these entities at the same time. And even after selecting one, further questions exist. If notions of deterrence (and perhaps retribution) take primacy, then the seller responsible

tension of liability to successors raises questions about whether the predecessor or the successor more desirably bears the loss.

An initial assessment of the appropriate loss bearer in the successor context points toward imposing liability on the entity responsible for the defective product that caused the injury—the predecessor. In the absence of the predecessor, the next analytical step might lead to a conclusion that the successor serves as a second-best cost bearer, particularly if some ground justifying imposition of liability on the successor can be identified. A number of courts have reasoned in this fashion⁴⁴ and provided a variety of rationales—ranging from the successor's role in compromising the continuing existence of the predecessor to pure notions of compensation—to justify imposing liability on the successor. Other courts have transcended this second-best reasoning and suggested that the successor is an equal or preferred loss bearer to the predecessor.⁴⁵

Before a sensible analysis of liberal successor liability law can be attempted, the justifications for imposing liability on the successor must be examined. Only after identifying the legitimate justifica-

for the defect is the obvious loss-bearing candidate—but do we want the stockholders of the company, who likely had no involvement in the manufacture or sale of a defective product, the management of the company, or perhaps the employees of the company (some of whom may be the true culprits) to bear the loss? If spreading the loss is the answer, do we want to spread as widely as possible to reduce the secondary accident costs that Dean Calabresi, among others, has discussed? G. CALABRESI, *THE COSTS OF ACCIDENTS* 27-28, 39-45 (1970). Or is the purpose to impose a tax on each user of the product equal to her proportionate share of the total personal injury costs involved, thereby effectuating “market deterrence,” through a decreased demand for and consumption of the injury-causing product? See *id.* at 68-75.

⁴⁴ See, e.g., *Hickman v. Thomas C. Thompson Co.*, 592 F. Supp. 1282 (D. Colo. 1984) (holding successor manufacturer liable when predecessor had been liquidated).

⁴⁵ See, e.g., *Ray v. Alad Corp.*, 19 Cal. 3d 22, 33, 560 P.2d 3, 10, 136 Cal. Rptr. 574, 581 (1977) (asserting that successor is in better position to distribute losses than predecessor); *Turner v. Bituminous Casualty Co.*, 397 Mich. 406, 244 N.W.2d 873 (1976) (dissolution of predecessor only one factor in determining whether de facto merger took place); *Tift v. Forage King Indus., Inc.*, 108 Wis. 2d 72, 322 N.W.2d 14 (1982) (both predecessor and successor can be held liable for plaintiff's injuries); see also J. Phillips, *supra* note 37, at 915-17 (asserting that predecessor and successor are joint tort-feasors); Comment, *Restoration of Certainty*, *supra* note 37 (endorsing presumption of successor liability; nonexistence of predecessor only one factor relevant to rebut presumption); Recent Development, *Products Liability—Liability of Transferee for Defective Products Manufactured by Transferor*, 30 VAND. L. REV. 238, 257 (1977) (successor should be liable only on continuity of product line theory because of “the paramount strict liability policy of spreading the risk of loss to all the consumers of the product line so that the product will bear the social and individual costs of its own defects”).

These proposals are most commonly made in conjunction with advocating the adoption of the product line theory. As one student commentator explained, “Under the product line approach, the successor assumes the predecessor's liability, not because it represents a continuation of that corporation, but because it is a continuation of the manufacturing operation.” New Jersey Development, *The Product Line Theory of Corporate Successor Products Liability: An Evaluation After Ramirez v. Amsted Industries, Inc.*, 35 RUTGERS L. REV. 389, 413 (1983).

tions for liberal successor liability and assessing their implications to determine the appropriate loss bearer can the ultimate question—how to impose the losses most efficiently—be confronted.

B. Analyzing the Rationales Proffered in Support of Liberal Successor Liability Law

Courts that adopt and commentators that advocate liberal successor liability law have tendered a variety of justifications that can be separated into eight individual rationales. These rationales are: (1) despite a change in ownership, courts should treat the successor as if it were the predecessor because no change apparent to customers has taken place; (2) the successor that obtains the predecessor's goodwill and benefits from it should also assume the predecessor's liabilities; (3) the successor is best able to provide compensation, spread the risk, and obtain insurance; (4) from the perspective of the injured claimant, the details of a corporate acquisition are irrelevant and therefore should not operate to prevent successor liability; (5) by purchasing the predecessor's assets, the successor contributes to the destruction of the plaintiff's remedies; (6) after acquiring the predecessor's business, the successor can gauge the risks of the products involved; (7) accident losses can best be minimized by imposing liability on the successor, thereby deterring manufacture of dangerous products and encouraging postsale safety measures; and (8) the successor can act as a conduit to channel losses back to the predecessor by discounting the purchase price in accordance with the predecessor's projected products liability.

I examine each of these rationales below.

1. *The "Holding Out" Doctrine*

It is well-settled in the law of agency that one who holds another out as his agent is liable for obligations created by the agent.⁴⁶ According to courts that have adapted this doctrine to successor liability law, when the successor corporation represents itself as "a continuation of the original manufacturing enterprise, a strong indication of continuity is established. Justice would be offended if a corporation which holds itself out as a particular company for the purpose of sales, would not be estopped from denying that it is that company for the purpose of determining products liability."⁴⁷

⁴⁶ See G. REINHARD, A TREATISE ON THE LAW OF AGENCY § 90 (1902); RESTATEMENT (SECOND) OF AGENCY § 31 (1958); see also RESTATEMENT (SECOND) OF TORTS § 400 (1965) (entity that holds itself out as manufacturer of product is liable as if it were manufacturer).

⁴⁷ *Turner v. Bituminous Casualty Co.*, 397 Mich. 406, 426, 244 N.W.2d 873, 882 (1976); see also *Holloway v. John E. Smith's Sons Co.*, 432 F. Supp. 454, 456 (D.S.C.

Despite the superficial appeal of this analogy, it contains a substantial flaw. Essential to the holding out theory is the reliance of a third party on representations made by the principal. This reliance forms the causal link between the holding out and the third party's claim. In the products liability context, however, third parties do not rely on representations made by the successor. By definition, the predecessor, not the successor, manufactured and then sold the product that injured the victim.⁴⁸ Thus, the attempted analogy fails because of the absence of reliance. The holding out theory provides no support for liberal successor liability.⁴⁹

2. *Acquiring Goodwill: Bearing the Burden Along with the Benefit*

Related to the holding out theory is the more popular rationale that a successor that profits from the predecessor's goodwill must also bear the burden of the predecessor's liabilities.⁵⁰ According to this theory, the successor must assume the obligation for the predecessor's products liability claims if it desires to reap the benefits of the predecessor's goodwill.

This reasoning is specious. Goodwill⁵¹ is simply an intangible property right. The successor has, by hypothesis, paid adequate compensation to obtain the goodwill and has put it to productive use. Unless the courts relying on this argument are creating a new concept of property rights,⁵² no justification exists for requiring a purchaser to pay more for an asset than the parties have agreed it is worth.⁵³ Despite substantial criticism,⁵⁴ courts blithely continue to

1977) (successor operating under virtually identical name cannot deny liability); *Andrews v. John E. Smith's Sons Co.*, 369 So. 2d 781, 785-86 (Ala. 1979) (successor holding itself out as predecessor estopped from denying liability).

⁴⁸ See J. Phillips, *supra* note 37, at 919-20.

⁴⁹ See Note, *supra* note 35, at 704; Note, *supra* note 33, at 376.

⁵⁰ See, e.g., *In re Related Asbestos Cases*, 566 F. Supp. 818, 823 (N.D. Cal. 1983); see also Comment, *Search for Outer Limits*, *supra* note 37, at 131.

⁵¹ The term "goodwill" represents the difference between the value of a firm as a going concern and the value of its assets if they were liquidated. See, e.g., J. GUARDINO, *ACCOUNTING, LEGAL AND TAX ASPECTS OF CORPORATE ACQUISITIONS* 50-52 (1973).

⁵² Even if they were, why liabilities created at the time of the manufacture and sale of the defective product should attach to goodwill at some future time is less than clear.

⁵³ A distinct justification, sometimes asserted in conjunction with the goodwill argument, is that the successor can discount the price paid for the predecessor to take account of future products claims. It is important to recognize that these are two very different arguments. The first relies on a notion that the successor, as owner of the predecessor's goodwill, must pay for defective products losses. The latter simply relies on the successor to play the role of a conduit, passing on the costs of future claims to the predecessor. See *infra* text accompanying notes 105-06.

⁵⁴ See *Woody v. Combustion Eng'g, Inc.*, 463 F. Supp. 817, 821 (E.D. Tenn. 1978) (purchase of goodwill by successor does not justify imposing liability on successor); *Tift v. Forage King Indus., Inc.*, 108 Wis. 2d 72, 99, 322 N.W.2d 14, 26 (1982) (Callow, J., dissenting) (imposing liability based on goodwill forces successor to pay for goodwill at time of acquisition and again as products claims arise); *Aylward & Aylward*, *supra* note

rely on the goodwill justification to support liberal successor liability law.

3. *Compensating, Loss Spreading, and Insurance*

Three related rationales that courts frequently invoke to justify liberal successor liability law are the ability of the successor to: (1) provide compensation to an otherwise remediless claimant;⁵⁵ (2) spread the burden of product injuries;⁵⁶ and (3) obtain insurance.⁵⁷ These arguments do not justify imposing liability on the successor.

Although compensation is an important goal in the development of modern products liability, this rationale provides no reason for selecting the successor to provide it, rather than another industry manufacturer, the United States government or, to pick a random wealthy entity, IBM.⁵⁸ Single-minded pursuit of the compensation goal always leads one toward finding liability⁵⁹ without providing any coherent rationale as to the entity from whom the compensation should come.⁶⁰

13, at 580-81; Kadens, *supra* note 37, at 18; D. Phillips, *supra* note 37, at 254-55; Schulman, *Commentary: Successor Corporation Liability and the Inadequacy of the Product Line Continuity Approach*, 31 WAYNE L. REV. 135, 136 (1984).

⁵⁵ In some instances the claimant possesses a remedy despite the predecessor's nonexistence. Other potential defendants, such as a retailer, may exist. *See, e.g.,* Stratton v. Garvey Int'l, Inc., 9 Kan. App. 2d 254, 676 P.2d 1290 (1984). Imposing liability on the other entity, as against the successor, would appear preferable. However, when the liability is imposed on the successor as conduit to the predecessor, *see infra* text accompanying notes 105-06, then preferring the successor makes sense. *See* Ray v. Alad Corp., 19 Cal. 3d 22, 33, 560 P.2d 3, 10, 136 Cal. Rptr. 574, 581 (1977) (recognizing that retailer has indemnification claim against predecessor).

⁵⁶ *See, e.g.,* Ramirez v. Amsted Indus., Inc., 86 N.J. 332, 350-52, 431 A.2d 811, 820-22 (1981).

⁵⁷ *See, e.g.,* Knapp v. North Am. Rockwell Corp., 506 F.2d 361, 369 (3d Cir. 1974) (noting importance of insurance in performing loss-spreading function), *cert. denied*, 421 U.S. 965 (1975).

⁵⁸ D. Phillips, *supra* note 37, at 254. *See generally* Y. AHARONI, THE NO-RISK SOCIETY 76-98 (1981) (detailing growth of government insurance programs).

⁵⁹ *See* Owen, *Rethinking the Policies of Strict Products Liability*, 33 VAND. L. REV. 681, 703-07 (1980).

⁶⁰ The theory that the successor's continuation of the product line enables it to distribute losses to consumers of the product purports to address the "where" question in a way that the unadorned compensation rationale does not. *See infra* text accompanying notes 88-97.

The tort system has always addressed where the compensation should come from through causal requirements, which permit effectuation of other goals such as deterrence, nondiffuse risk spreading, and distributive justice. *See* Aylward & Aylward, *supra* note 13. Professor Phillips has also made the point, quite persuasively, that the spreading rationale is an inadequate justification for liberal successor liability doctrine. D. Phillips, *supra* note 37, at 251-52; *see also* Note, *supra* note 35, at 695-96. I disagree with Professor Phillips, however, on the legitimate rationales for expanding successor liability. *See infra* text accompanying notes 71-77.

Similarly, a rationale based on loss spreading purely for its own sake⁶¹ provides no basis for imposing successor liability. A universal, publicly funded compensation system would far better achieve maximum spreading.⁶² There is simply no coherent basis for selecting successors as preferred risk spreaders.

Finally, the successors' ability to obtain insurance for liability imposed on them for injuries caused by products manufactured and sold by their predecessors is offered by courts as a justification for liberal successor liability law.⁶³ Indeed, some courts have embraced the insurance rationale as though it enables successors to avoid liability simply by purchasing insurance.⁶⁴

These courts fail to recognize that premiums paid to purchase an insurance policy, if properly underwritten and rated, reflect the entire cost of liability imposed on successors through liberal successor liability law.⁶⁵ Although insurance may spread out the costs across a number of manufacturers with small exposures, it does not eliminate or even reduce the overall burden. Indeed, the overhead costs and conservative underwriting practices of many liability insurers and the uncertain path of future legal doctrine have led (or forced) many manufacturers to employ self-insurance to deal with products liability risks.⁶⁶

In sum, although compensation, loss spreading, and insurance are important underlying goals of modern products liability law, they do not provide any reasoned basis for imposing liability on successors.

4. *The Plaintiff's Perspective*

In *Turner v. Bituminous Casualty Co.*,⁶⁷ the Michigan Supreme

⁶¹ Here, I distinguish pure spreading rationales from more instrumental spreading, which is intended to effectuate market deterrence or some similar, independent goal. With regard to market deterrence, see *infra* text accompanying notes 88-97.

⁶² New Zealand has adopted this approach. See Palmer, *Compensation for Personal Injury: A Requiem for the Common Law in New Zealand*, 21 AM. J. COMP. L. I (1973).

⁶³ Indeed, my own suspicion is that some of the courts that have most avidly embraced liberal successor liability have been influenced by the fact that the successor was represented by an attorney hired by an insurer that had written a products liability policy on the risk.

⁶⁴ See, e.g., *Ray v. Alad Corp.*, 19 Cal. 3d 22, 33, 560 P.2d 3, 10, 136 Cal. Rptr. 574, 581 (1977); see also *Escola v. Coca Cola Bottling Co.*, 24 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944) (Traynor, J., concurring in judgment).

⁶⁵ See M. GREENE, *RISK AND INSURANCE* 640-49 (3d ed. 1973); INTERAGENCY TASK FORCE ON PRODUCTS LIABILITY, FINAL REPORT I-23 to -24 (1978) (under direction of U.S. Department of Commerce).

For a cogent argument that liability insurance has played a significant role in expanding tort liability, see E. BERNZWEIG, *BY ACCIDENT NOT DESIGN* 104-11 (1980).

⁶⁶ G. EADS & P. REUTER, *DESIGNING SAFER PRODUCTS* 132-37 (1983).

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

Court observed that a plaintiff, unable to recover from a predecessor, is indifferent to the precise form of corporation acquisition used by the successor to acquire the predecessor. Accordingly, the court relied on this ground in holding that a successor who purchased assets for cash, rather than stock, could still be held liable on an expanded de facto merger theory.⁶⁸

The *Turner* rationale, related to the compensation rationale and sharing its common weakness, provides no basis for selecting the successor as the provider of the plaintiff's compensation. The plaintiff is not only indifferent as to the details by which the successor acquired the predecessor's assets, but is also unconcerned about which entity serves as a compensation surrogate for the predecessor. The plaintiff's perspective rationale contains no logical stopping point; this rationale would presumably hold liable an entity that purchased only the tangible assets of a predecessor undergoing bankruptcy.⁶⁹ Ultimately, the plaintiff's perspective provides no more justification for imposing successor liability than does an unadorned appeal for compensation.⁷⁰

5. *The Successor's Actions Contributing to the Destruction of Plaintiff's Remedies*

A fifth and more popular rationale for liberal successor liability law is that the successor's acquisition of the predecessor's assets contributed to the plaintiff's inability to recover from the predecessor. Professor David Phillips has characterized this as the successor's role in increasing the recourse risk to the injured claimant, arguing that this justifies imposing liability on the successor.⁷¹

This rationale does have the advantage of recognizing that the successor's liability is secondary to that of the predecessor. Moreover, it strikes closer to the core of the successor liability problem: the dissolution and liquidation of the predecessor. This rationale also focuses on those actions of the successor having a nexus to the plaintiff's predicament. Ultimately, however, this rationale is unpersuasive and inadequate.

Before detailing the weaknesses of this justification, a pause to clarify a misconception is necessary. An asset purchase does not di-

⁶⁸ *Id.* at 429-30, 244 N.W.2d at 883.

⁶⁹ See *infra* text accompanying notes 116-20; *cf.* *Kline v. Johns-Manville*, 745 F.2d 1217 (9th Cir. 1984) (refusing to impose liability on successor of predecessor that was in reorganization under chapter 11). *But cf.* *Timmerman v. American Trencher, Inc.*, 220 Neb. 175, 368 N.W.2d 502 (1985) (permitting successor that purchased assets of insolvent corporation to be held liable as continuation of predecessor).

⁷⁰ See *supra* text accompanying notes 58-60.

⁷¹ See D. Phillips, *supra* note 37.

minish or destroy the plaintiff's remedies against the predecessor,⁷² despite intimations otherwise by a number of courts.⁷³ Rather, an asset purchase provides the predecessor with a readily transferable asset (cash or stock) for distribution to its stockholders and thereby facilitates its ability to wind up its affairs, dissolve, and liquidate.

The first difficulty with the destruction of the remedy rationale is the implicit amorphous predicate that the successor, by engaging in an asset acquisition, has committed a wrong that justifies imposing liability.⁷⁴ This assumption becomes troublesome 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.⁷⁵ The weakness in this rationale is further illustrated by several hypotheticals. Would a supplier that entered into what ultimately proved to be a very favorable long-term supply contract that threatened the purchaser's financial viability be liable to the purchaser's creditors because the supplier contributed to the destruction of the creditors' remedies? Similarly, would entities that contributed to a debtor's inability to meet its obligations—a successful personal injury claimant or the author of a scathing review about a new Broadway production—be held liable to disappointed creditors?⁷⁶

Finally, if we wish to focus on the forces that led to the plaintiff's inability to recover from the predecessor, we should examine the state dissolution and liquidation statutes that permit a corporation to avoid its obligations to future creditors. Statutes that allow a corporation to distribute the cash or stock received from an asset sale without making any provision for future claimants play a far more significant role than successors in compromising a products liability plaintiff's ability to obtain compensation. As I shall explain later, the appropriate solution lies in modifying those statutes to

⁷² See Schulman, *supra* note 54, at 145 n.30 (pointing out seller is in "as strong a position to meet [future] claims as in the presale period").

⁷³ See *Ray v. Alad Corp.*, 19 Cal. 3d 22, 31, 560 P.2d 3, 9, 136 Cal. Rptr. 574, 580 (1977) (relying in part on "virtual destruction of the plaintiff's remedies against the original manufacturer caused by the successor's acquisition of the business" to impose liability on successor); *Kline v. Johns-Manville*, 745 F.2d 1217, 1220 (9th Cir. 1984) (distinguishing *Ray* because there "sale had the effect of eliminating an avenue of recovery which the plaintiff would otherwise have had").

⁷⁴ See J. Phillips, *supra* note 37, at 916-17.

⁷⁵ See R. POSNER, *ECONOMIC ANALYSIS OF LAW* § 1.1, at 9 (3d ed. 1986).

⁷⁶ Admittedly, I have chosen examples in which the entity's actions compromise the debtor's financial capacity, rather than merely facilitate a viable debtor's ability to shield assets from creditors, as is more commonly the case in the successor liability context. This emphasizes, rather than detracts from, the point: the "contributed to the destruction" rationale relies on the predecessor's absence and the successor's role in that absence, not on a "passing through" or "conduit" role for the successor. See *infra* text accompanying note 105.

protect future products liability claimants.⁷⁷

6. *The Successor's Ability to Gauge Products' Risks*

The rationale that "the successor possesses the ability to gauge the risk of injury which could result from previously manufactured products"⁷⁸ has not played a significant role in the development of liberal successor liability law. Nevertheless, unlike several previously surveyed rationales, it explains why the successor, as opposed to any other wealthy entity, should bear responsibility for injuries caused by the predecessor's products. This rationale, however, does little to advance the cause of liberal successor liability because of weaknesses both in its empirical generalization and in the normative standard it necessarily, albeit implicitly, adopts.

First, the empirical assumption that successors have adequate information to make an informed assessment of the predecessor's potential products liability is probably unjustified at least in successor liability cases involving insidious disease, which comprise a significant class of successor liability cases. Many acquisitions took place before the risks of a particular product were fully appreciated, at a time when neither the successor nor the predecessor had the capacity to make informed judgments about potential liability.⁷⁹ Even in the durable goods area, many corporate acquisitions transpired decades ago amid a legal landscape in which products liability was not a significant force.⁸⁰ Thus, even if factual information about risks was available at the time of the acquisition, the legal environment did not provide incentives to obtain or analyze the data.

The normative judgment that the successor's access to information about risks justifies holding the successor liable for injuries that ultimately occur is even more troubling than the empirical assumptions made by this rationale.⁸¹ Tort law generally rejects the notion

⁷⁷ See *infra* notes 143-67 and accompanying text.

⁷⁸ Comment, *Products Liability for Successor Corporations: A Break from Tradition*, 49 U. COLO. L. REV. 357, 373 (1978) (describing basis for decision in *Ray v. Alad*, 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977)).

⁷⁹ See, e.g., *Kline v. Johns-Manville*, 745 F.2d 1217, 1218 (9th Cir. 1984) (acquisition of asbestos product line in 1962); *Gee v. Tenneco, Inc.*, 615 F.2d 857, 860 (9th Cir. 1980) (acquisition in 1950s and 1960s of manufacturing division that produced X-ray contrast dye later alleged carcinogenic); cf. Green, *The Inability of Offensive Collateral Estoppel to Fulfill Its Promise: An Examination of Estoppel in Asbestos Litigation*, 70 IOWA L. REV. 141, 192-94 (1984) (describing controversy over when risks of asbestos were known).

⁸⁰ See, e.g., *Chown v. USM Corp.*, 297 N.W.2d 218, 219 (Iowa 1980) (industrial machine manufactured at turn of century involved in accident in 1975); see generally Henderson, *supra* note 1; Schwartz, *New Products, Old Products, Evolving Law, Retroactive Law*, 58 N.Y.U. L. REV. 796 (1983).

⁸¹ This rationale overlaps with one aspect of the deterrence rationale: imposing liability on the party with the best information about the risks creates an incentive to eliminate those risks whose future costs are greater than the retrospective precaution

that parties are liable for an injury simply because of information they possess about the risks that led to the loss. Certainly foreseeability plays a central role⁸² in establishing the existence of a duty, but the liable party's participation in creating or enhancing the risk has always been an important element.⁸³ That participation is absent in the case of a successor.

7. Deterrence

To address comprehensively the various elements of deterrence that courts and commentators have raised in the successor liability context, I will first define deterrence broadly and then examine three distinct areas in which liberal successor liability may play a role. First, deterrence encompasses all cost-justified methods of reducing the incidence of accidents. Products liability laws can serve to deter inefficient behavior by: (1) encouraging the addition of cost-justified safety measures to a product at the time of manufacture; (2) reducing the incidence of a product's use, and thereby related injuries, by passing the costs of product-related injuries on to consumers in the form of higher prices; or (3) providing incentives for postsale, cost-justified remedial safety measures. Each of these aspects of potential deterrence deserves separate consideration.

a. *Encouraging Cost-Justified Safety Measures.* Providing financial incentives for a manufacturer to incorporate safety measures in the design and manufacture of its products, despite intractable valuation problems,⁸⁴ has served as a cornerstone of the products liability reformation. However, imposing liability on an entity that by definition did not contribute to a product's design or manufacture quite obviously cannot further this deterrence function.⁸⁵ Indeed, impos-

costs. This may have been part of the court's reasoning in *Ramirez v. Amsted Indus., Inc.*, 86 N.J. 332, 352, 431 A.2d 811, 822 (1981) (successor has information necessary to insure against risks and to avoid costs of injuries). I deal separately with this aspect of the deterrence rationale. See *infra* text accompanying notes 98-104.

⁸² See, e.g., *Tarasoff v. Regents of the Univ. of Cal.*, 17 Cal. 3d 425, 434, 551 P.2d 334, 342, 131 Cal. Rptr. 14, 22 (1976) (foreseeability most important consideration in establishing therapist's duty to warn of danger posed by patient).

⁸³ See generally W. PROSSER & W.P. KEETON, *THE LAW OF TORTS* § 56, at 373-77 (5th ed. 1984) (highlighting act/omission distinction by examining duty to aid one in peril). Otherwise, this "knowledge" rationale could provide the basis for finding liable a governmental agency that gathers information about accidental injuries or a trade organization that promulgates safety standards based on data provided by members. See also *Griggs v. Capitol Mach. Works, Inc.*, 690 S.W.2d 287, 292-94 (Tex. Ct. App.) (rejecting product line successor liability as inconsistent with general tort principles which require that defendant contribute to injury), *writ of error refused*, 701 S.W.2d 238 (Tex. 1985).

⁸⁴ See, e.g., *Green*, *supra* note 79, at 216-17 & 217 n.424; see also *Graham & Vaupel, Value of a Life: What Difference Does It Make?*, 1 RISK ANALYSIS 89, 93-94 (1981) (finding enormous variation in governmental agency valuations of human life).

⁸⁵ See *Bernard v. Kee Mfg. Co.*, 409 So. 2d 1047, 1050 (Fla. 1982) (imposing liabil-

ing liability on the successor, not only for its product injuries but also for its predecessor's, should result in, as the economists describe it, safety overincentive.⁸⁶

If products liability law is to allocate accident costs properly, the entity that had the opportunity to take safety measures—the predecessor—should bear the costs of product-related injuries. To be effective, successor liability law must influence corporate decisions at the time of product design and manufacture. Although generalizations about the response of manufacturers to products liability law are perilous,⁸⁷ it seems unlikely that many corporations will reduce their investment in safety because they believe that a future corporate transfer will enable them ultimately to externalize products liability costs.

b. *Market Deterrence.* The second aspect of deterrence, borrowed from welfare economists and popularized in the legal community by Dean Calabresi,⁸⁸ reduces accidents by making products reflect the costs of injuries associated with their use.⁸⁹ Among other

ity on successor who "was never in a position to eliminate the risk" is not consistent with goals of strict liability); Note, *supra* note 35, at 691-98.

⁸⁶ Such a successor would bear both the losses associated with the products it manufactured and those involving the predecessor's products. The only additional effective precautions the successor can take to avoid the predecessor's liability is to cease manufacturing the product line, or, when cost justified, to engage in remedial measures, *see infra* notes 98-104 and accompanying text. The manufacturer cannot diminish its successor liability by increasing the safety of the products it manufactures.

An advocate of the product line theory of liberal successor liability law might contend that successor liability provides successors with important safety information in the form of suits filed against them. Given the long time lag between design decisions and products liability suits, as well as the weak role that specific products liability suits play in influencing the design process, this argument is unpersuasive. *See* G. EADS & P. REUTER, *supra* note 66, at 106-09.

⁸⁷ An increasing effort has been devoted to the study of corporate responses, both short- and long-term, to the development of increased responsibility for product defects. That response remains quite diffuse. *See generally id.* For a more theoretical assessment of the implications of a divergence of interest between a corporation and its management, *see* Henderson, *Product Liability and the Passage of Time: The Imprisonment of Corporate Rationality*, 58 N.Y.U. L. REV. 765 (1983).

⁸⁸ *See* G. CALABRESI, *supra* note 43, at 70-73.

⁸⁹ The articulation of the market deterrence goal is rarely as explicit as I have stated in the text. Most often it is articulated as a more undifferentiated risk-spreading approach that the courts implicitly limit to the product involved. *See, e.g.,* Ramirez v. Amsted Indus., Inc., 86 N.J. 332, 352, 431 A.2d 811, 822 (1981) (successor "was in the same position as its predecessors . . . to spread the risk of accident injuries to users of defective . . . power presses").

This version of risk spreading seems inherent in the enterprise notions that form the core of the product line theory. *See* Ray v. Alad Corp., 19 Cal. 3d 22, 33, 560 P.2d 3, 10, 136 Cal. Rptr. 574, 581 (1977); Ramirez, 86 N.J. at 352, 431 A.2d at 822; New Jersey Development, *supra* note 45, at 417 (examining New Jersey case law); Recent Development, *supra* note 45, at 253 (examining Ray).

The market deterrence theory fails to explain successor liability that is premised on continuity of ownership, such as a de facto merger. If the costs of successor liability are

inadequacies, use of market deterrence to justify liberal successor liability law suffers from underbreadth. The theory does not justify imposing liability on a successor who eliminates the dangerous aspects of the product involved, or a successor who discontinues a product line and is therefore unable to pass accident and safety costs on to consumers of the product.⁹⁰ The market deterrence theory also compels the conclusion that a successor continuing the product line should be liable even if the predecessor is still in existence and conducting different operations; only the successor is in a position to pass costs along to the consumers of the product. Indeed, if carried one more logical step, market deterrence would shift products liability to a corporation that purchased only one of several product lines from a seller.⁹¹

A theoretical clarification is required to demonstrate further difficulties with the market deterrence theory as a justification for liberal successor liability law. In a perfect products liability system that only imposes liability in a post-hoc manner, based on findings of defectiveness, financial incentives induce manufacturers to employ all cost-justified safety precautions. In such a system, courts do not impose liability on manufacturers for injuries that such measures could not prevent.⁹² Thus, no products liability judgments should exist for manufacturers to pass to previous purchasers of a product. The Calabresian scheme, one should recall, involved an ex ante evaluation of the cheapest cost avoider and then imposed all product-related losses on the chosen entity.⁹³

Obviously, the market deterrence model is far too simplistic given the distortions and imperfections of the real world.⁹⁴ Market

simply being passed on to consumers, there is little need to examine who is acting as the conduit.

⁹⁰ Cf. *Bernard v. Kee Mfg. Co.*, 409 So. 2d 1047 (Fla. 1982) (successor discontinued particular model of lawn mower that injured plaintiff). But see *Rawlings v. D. M. Oliver, Inc.*, 97 Cal. App. 3d 890, 159 Cal. Rptr. 119 (1979) (imposing liability on successor for injury inflicted by machine custom-built by predecessor).

⁹¹ Cf. *Trimper v. Brnno-Sherman Corp.*, 436 F. Supp. 349 (E.D. Mich. 1977) (second successor, which purchased product line from first successor, could be held liable despite continuing existence of first successor). The logic of this theory would allow Johns-Manville to avoid future asbestos claims because it no longer manufactures asbestos products. Johns-Manville's attempt to do just that by insulating future earnings from personal injury claimants in bankruptcy proceedings resulted in considerable moral outrage and condemnation. *N.Y. Times*, Sept. 5, 1982, § 3, at 2, col. 3; *N.Y. Times*, Aug. 27, 1982, at D4, col. 5.

⁹² This is the essence of the risk-benefit test for determining defectiveness. See, e.g., R. POSNER, *supra* note 75, § 6.1 (describing risk-benefit model for negligence). Courts in a number of jurisdictions employ a variety of other, less economically oriented, tests. See Keeton, *Products Liability—Design Hazards and the Meaning of Defect*, 10 CUMB. L. REV. 293, 300-13 (1979) (discussing five tests for determining design defect).

⁹³ G. CALABRESI, *supra* note 43, at 136-43, 241.

⁹⁴ One contemporary example of the inability to allocate costs appropriately is the

competitiveness, the difficulty of obtaining information, and industry entry costs are some of the important variables that affect the actual degree of risk spreading and the extent to which it furthers more efficient resource allocation.⁹⁵ The haphazard and imperfect way that entities distribute accident costs cautions against taking market deterrence too seriously in the contemporary tort landscape.⁹⁶

The crowning blow to the market deterrence theory is the successor's inability to distribute costs to the appropriate consumers: purchasers from the predecessor. A successor can only spread to its own customers. Forcing the successor to pass both its and the predecessor's products liability costs to its own customers requires an act of supererogation by the successor.⁹⁷

c. *Financial Incentives to Take Corrective Measures.* A third facet of the deterrence rationale focuses on remedial safety measures that successors can undertake. This aspect of deterrence includes two distinct strands. First, the successor, independent of its relationship with the predecessor, has a duty to warn based on the knowledge that the successor obtains when servicing and inspecting the defective product.⁹⁸ Second, courts should impose liability on the successor to induce it to take any cost-justified remedial safety measures.⁹⁹

The first argument, employed primarily by courts that refuse to accept liberal successor liability law, exemplifies the courts' search for entities other than the manufacturer that have an opportunity to prevent injuries.¹⁰⁰ As such this is not at all a justification for suc-

prospect of asbestos insurers raising homeowners' insurance rates to provide funds to meet asbestos claims. Wall St. J., June 14, 1982, at 1, col. 6; *see also* N.Y. Times, Feb. 14, 1982, § 3, at 3, col. 1.

⁹⁵ The "theory of second best," as applied to this context, suggests that if other distortions in the market prevent an optimal resource allocation, tying losses to the products that cause them will not necessarily contribute to more efficient allocation. *See* Lipsey & Lancaster, *The General Theory of Second Best*, 24 REV. ECON. STUD. 11 (1956).

⁹⁶ *See* Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499, 503-14, 520-27 (1961).

⁹⁷ *See* Henderson, *supra* note 1, at 942-44; Page, *Generic Product Risks: The Case Against Comment k and for Strict Tort Liability*, 58 N.Y.U. L. REV. 853, 878-79 (1983); Note, *supra* note 33, at 375 n.181. In the long run, when successor liability rules are clearly defined, successors will insist on spreading back to the predecessor the cost of claims attributable to the predecessor's operations. *See infra* text accompanying note 106.

⁹⁸ *See, e.g.,* Leannais v. Cincinnati, Inc., 565 F.2d 437, 441-43 (7th Cir. 1977).

⁹⁹ *See* Ramirez v. Amsted Indus., Inc., 86 N.J. 332, 351, 431 A.2d 811, 821 (1981) (court imposed successor liability in part because successor was only entity available to avoid risks presented by predecessor's products still on market); Tift v. Forage King Indus., Inc., 108 Wis. 2d 72, 97, 322 N.W.2d 14, 26 (1982) (Callow, J., dissenting) (disagreeing with rationale that successor held liable because it "has the knowledge necessary to improve the product and the imposition of liability acts as an incentive to ensure the product's improvement").

¹⁰⁰ *See supra* notes 8 & 55.

cessor liability, but a limited attempt to find a viable substitute defendant.¹⁰¹

The latter argument—designating an entity to bear the costs of injuries caused by a defective product—can promote deterrence, especially when the designated entity has information and technological expertise relating to the product. In this respect, successors are in effect appointed to act as surrogates for the original manufacturers, who, absent dissolution, would retain incentives for cost-justified retroactive safety measures because of their liability for defective product injuries.¹⁰²

In spite of this argument's appeal, knowledge and expertise alone are insufficient to justify transferring liability from the predecessor to the successor.¹⁰³ Beyond equity concerns, the designated surrogate theory does not justify holding a successor liable when retrospective safety measures are not cost justified. Logically, courts should hold the successor liable only when retrospective measures are cost justified and liability should not depend on whether the product was defective when initially sold. The successor would then become the designated entity to minimize the sum of accident costs and accident prevention, although the fairness of imposing that burden on it, given its nonparticipation in the creation of the risk, is debatable.¹⁰⁴

In sum, creating financial incentives for entities to minimize accident costs is an instrumentally sound idea. These deterrence theories, however, do not justify imposing liability on successors.

8. *The Successor As a Conduit*

The analysis of each of the previous justifications for liberal successor liability law deliberately omitted any reference to or reliance on the conduit rationale. Any rationale that purports to justify im-

¹⁰¹ In any event, this theory would have little utility in protecting long-tail claimants; only a fraction of successors would have sufficient knowledge of the dangers to justify imposition of a duty on them. Moreover a warning, at least in the context of industrial machinery, is unlikely to make any significant contribution to accident prevention. The dangers of machinery are usually self-evident, and accident prevention is dependent on additional safety devices, not warnings. See, e.g., *Micallef v. Miehle Co.*, 39 N.Y.2d 376, 348 N.E.2d 571, 384 N.Y.S.2d 115 (1976); *Bexiga v. Havir Mfg. Corp.*, 60 N.J. 402, 290 A.2d 281 (1972).

¹⁰² See *TIME*, Apr. 15, 1985, at 86 (A. H. Robins spent \$5 million to warn women using Dalkon Shields and to pay for their removal). Aside from their at-risk status as the manufacturers of defective products, manufacturers have had their retroactive obligations expanded by courts where greater knowledge of risk or safety technology had been obtained after manufacture. See Schwartz, *supra* note 80.

¹⁰³ See *supra* notes 81-83 and accompanying text.

¹⁰⁴ See, e.g., *RESTATEMENT (SECOND) OF TORTS* § 321 (1964) (imposing duty to take remedial measures only on one whose initial act "created an unreasonable risk of causing physical harm to another").

posing liability on the successor, whether as a primary or secondary choice, is inherently inconsistent with the conduit theory. Unlike all of the other rationales, the conduit theory expressly acknowledges that the predecessor is liable for injuries caused by defects in its products. The conduit theory imposes liability not on the successor qua successor, but only as a vehicle to transfer the costs of future products liability back to the predecessor. The successor acts as a conduit by discounting the purchase price of the acquisition by the amount of the predecessor's predicted future products liability.¹⁰⁵

The conduit theory also furthers the goals of compensation, deterrence, risk spreading, and moral retribution that form the foundation of modern products liability law. Moreover, once liberal successor liability laws are adopted and become known, successors will inevitably insist on creating some mechanism to ensure that they avoid the predecessor's future products liability. 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.¹⁰⁶

Having cut through much of the rhetoric used to justify liberal successor liability law and with its policies and limitations more clearly in focus, this article proceeds to evaluate the efficiency and accuracy of the doctrine in protecting long-tail products liability claimants.

¹⁰⁵ Thus, one court that adopted an expanded continuation theory candidly acknowledged that an indemnification agreement obtained by the successor from the parent of the predecessor justified its holding:

If [the successor] is kept as a defendant in this case, in all probability it will be [the parent] which will bear the risk of loss. [The parent] owned [the predecessor] and caused its dissolution. [The parent] is the entity to whom the risk of loss should be shifted under a public policy argument in the context of this case.

Polius v. Clark Equip. Co., 608 F. Supp. 1541, 1546 (D.V.I. 1985), *rev'd*, 802 F.2d 75 (3d Cir. 1986); *see also* Schulman, *supra* note 54, at 139.

Perhaps a case in which the successor obtained the assets of an insolvent predecessor and used them to continue making the same product line with the same employees, management, and physical facilities would provide the ultimate test of the primacy of the conduit function. Although I have not found any case squarely posing these facts, at least two cases suggest that conduit is king. *See* R. J. Enstrom Corp. v. Interceptor Corp., 555 F.2d 277, 282 (10th Cir. 1977); *Hall v. Armstrong Cork, Inc.*, 103 Wash. 2d 258, 692 P.2d 787 (1984). *But cf.* *Timmerman v. American Trencher, Inc.*, 220 Neb. 175, 368 N.W.2d 502 (1985) (summary judgment for successor reversed despite liquidation of predecessor while in financial distress).

¹⁰⁶ This may overstate the matter. In the absence of perfect information, the successor will attempt to protect itself, but it may nevertheless accept arrangements that do not guarantee that the predecessor bears all future products liability costs. *See infra* notes 134-38 and accompanying text.

III THE SUPERIORITY OF A DISSOLUTION-RESTRICTING STATUTE

Liberal successor liability law can provide a measure of protection for long-tail products liability claimants. In the long run, as the boundaries of liberal successor liability law become more familiar, the products liability costs likely to be imposed on the successor will become a bargaining point in the acquisition process, ultimately transferring the costs imposed on the successor to the predecessor, estimation problems aside. Within the constraints of the common law process, this may provide the only means to protect long-tail products liability creditors.

A preferable reform, however, is a statute restricting the right of corporations to dissolve and distribute their assets to shareholders.¹⁰⁷ A dissolution-restricting statute ensures that the predecessor's assets are available to future products liability claimants. The statute also ensures that the predecessor bears the financial burden of claims arising out of injuries caused by its defective products. The statute can provide flexibility without diminishing the effectuation of those goals by allowing the predecessor to dissolve and distribute its assets by arranging for another entity to assume the predecessor's future liability.

This section compares the relative strengths of liberal successor liability law and a dissolution-restricting statute and focuses on their respective ability to protect long-tail products claimants in a manner that is consistent with basic corporate and tort system objectives. This analysis evaluates the extent to which each reform comprehensively, efficiently, and fairly performs its protection goal.

The ensuing discussion of both liberal successor liability law and a dissolution-restricting statute requires a caveat. No system designed solely to protect the rights of creditors against the debtor corporation can untangle the conflicting claims of an insolvent corporation's creditors. Intracreditor claims, whether they arise in the successor context or not, raise bankruptcy issues and are outside the province of a solution to the successor liability question.¹⁰⁸

¹⁰⁷ The term "liquidation" is sometimes used to include both the process of winding up the corporation's business and the distribution of its assets to stockholders. Here I use the narrower term "distribution," because engaging in other aspects of the liquidation process, including ceasing business operation, should not impair claimants' rights.

¹⁰⁸ See Roe, *Bankruptcy and Mass Tort*, 84 COLUM. L. REV. 846 (1984) (addressing bankruptcy solution to large tort liability); Roe, *Mergers, Acquisitions, and Torts: A Comment on the Problem of Successor Corporation Liability*, 70 VA. L. REV. 1559, 1578-80 (1984) [hereinafter Roe, *Successor Liability*] (same); Note, *The Manville Bankruptcy: Treating Mass Tort Claims in Chapter 11 Proceedings*, 96 HARV. L. REV. 1121, 1123-28 (1983).

A. Comprehensiveness and Discrimination

Initially, a dissolution-restricting statute starts with a significant advantage: it directly addresses the problem raised when a nonexistent manufacturer is called upon to answer the claims of persons injured by its product. Although this statute as structured might not provide complete protection for claimants,¹⁰⁹ it would reach far beyond liberal successor liability law, which does not protect claimants if product line or corporate continuity is lacking.¹¹⁰

A dissolution-restricting statute also provides superior protection when a predecessor's products liability burden exceeds the value of its goodwill.¹¹¹ Under any existing version of liberal successor liability law, piecemeal sale of the predecessor's assets would not impose successor liability on the purchasers of the assets, thus leaving claimants without any remedy once the predecessor had dissolved. By contrast, a dissolution-restricting statute removes the incentive for piecemeal dismantling in this situation and incidentally avoids the loss to society of the value of the predecessor as a going concern.¹¹²

¹⁰⁹ See, e.g., *infra* note 164.

¹¹⁰ See, e.g., *Bullington v. Union Tool Corp.*, 254 Ga. 283, 328 S.E.2d 726 (1985) (successor not liable because it did not continue product line in question); see also Schulman, *supra* note 54, at 143 (criticizing product line continuity theory).

The incentive of parties to an acquisition to exploit the inadequacies of liberal successor liability law exacerbates its lack of comprehensiveness. If the parties succeed in structuring an acquisition so as to avoid successor liability, they increase their collective wealth to the extent that they avoid successor liability.

¹¹¹ See *supra* notes 50-54 and accompanying text.

¹¹² See Schwartz, *Products Liability, Corporate Structure, and Bankruptcy: Toxic Substances and the Remote Risk Relationship*, 14 J. LEGAL STUD. 689, 720-28 (1985).

It is difficult to assess the pervasiveness of this problem. Here in particular, reliance on appellate court opinions as an empirical measure is misconceived. Some commentators have speculated that this piecemeal liquidation phenomenon is relatively rare because of the low value of a piecemeal liquidation. Juenger & Schulman, *supra* note 25, at 57; Roe, *Successor Liability*, *supra* note 108, at 1590 & n.78. Equally important in predicting the incidence of piecemeal liquidation is the number of corporations that, although solvent, have a high burden of future products liability claims. In the capital-intensive industrial machine industry, which provides a great deal of grist for the successor liability mill, a greater likelihood exists that the predecessor would find piecemeal liquidation financially advantageous. See also Wall. St. J., Aug. 27, 1982, at 1, col. 6 (UNR Industries considered liquidation before filing for chapter 11 reorganization); Wall St. J., June 3, 1976, at 1, col. 6 (small industrial press manufacturer liquidated piecemeal).

In addition, in the closely held company, much of its value may be made up of human capital—the knowledge and experience the owners gain in operating the firm. That value is not likely to be lost in a piecemeal liquidation; the owners can reap that benefit by establishing another corporation after liquidation. See Roe, *Corporate Strategic Reaction to Mass Tort*, 72 VA. L. REV. 1, 55-56 (1986) [hereinafter Roe, *Strategic Reaction*]. Whether that experience and knowledge constitute “capital” of the company upon which its creditors have a legitimate claim upon dissolution raises an interesting question that liberal successor liability law has not yet squarely confronted or resolved. Cf. *Timmerman v. American Trencher, Inc.*, 220 Neb. 175, 368 N.W.2d 502 (1985) (closely

A dissolution-restricting statute also avoids the inevitable tension in liberal successor liability law between providing comprehensive protection for future claimants and adhering to the conduit function. Because the successor is only held liable when the predecessor is unavailable, the predecessor's dissolution is a prerequisite to successor liability.¹¹³ But the successor's only practical opportunity to demand reimbursement for the predecessor's future products liability occurs at the time of the acquisition. If successor liability is limited to asset acquisitions in which the predecessor's subsequent dissolution is contemplated or even foreseeable, long-tail claimants are not comprehensively protected.¹¹⁴ If, on the other hand, successor liability is imposed whenever the predecessor is absent, regardless of the contemplation of the parties at the time of the acquisition, the conduit function is impaired because the successor is deprived of the opportunity to pass the costs back to the predecessor.¹¹⁵ A dissolution-restricting statute avoids these problems by keeping the predecessor's assets available for future products liability claimants if the successor does not assume liability at the time of the acquisition.

Another problem is presented when, after the acquisition, unanticipated claims arise that exceed the predecessor's value.¹¹⁶ Because the predecessor is the entity properly liable for injuries caused by its defective products,¹¹⁷ the predecessor's capacity to pay should mark the outside limit of claimants' recoveries from a successor. Under liberal successor liability law, claimants may "piggyback" onto the successor's wealth unless a ceiling is placed on the total

held predecessor in financial distress liquidated; principals of predecessor formed successor, which was sued by long-tail products claimant).

¹¹³ More accurately, the practical unavailability of the predecessor's assets to the claimant—because of a distribution to the predecessor's stockholders—should trigger successor liability.

¹¹⁴ A similar conflict between comprehensiveness and conduit effectuation arises in the myriad situations that do not conform to classic acquisitions of corporate assets. To illustrate by way of example, a successor may continue a product line simply by acquiring a trademark or trademark license, by renting assets necessary for production, *see* Kadens, *supra* note 37, at 21-22; Note, *Expanding Liability*, *supra* note 25, at 1329, or by purchasing a division of a corporation that later dissolves.

¹¹⁵ This conflict might be obviated by an agreement between the predecessor and the successor either restricting the predecessor's ability to dissolve, or providing compensation to the successor in the event of dissolution. The former solution is simply a private agreement to adopt a dissolution-restricting scheme, which may not be entirely effective. *See* Cowan v. Harris Corp., [May 1983-May 1984] Prod. Liab. Rep. (CCH) ¶ 9667 (D. Kan. Dec. 6, 1982). The latter injects yet another layer of uncertainty into the acquisition-bargaining process. *See infra* notes 134-38 and accompanying text.

¹¹⁶ Circumstances in which the predecessor's projected future claims exceed its value give rise to insolvency problems. *See supra* text accompanying note 108. Moreover, a successor who anticipates a products liability burden that exceeds the value of the predecessor will not purchase it if those liabilities are transferred along with the assets.

¹¹⁷ *See supra* notes 105-06 and accompanying text.

recovery.¹¹⁸ Unfortunately, as Professor Roe has pointed out, there is no entirely satisfactory method for establishing what the ceiling should be.¹¹⁹ Initially, a statutory restriction on dissolution appears to avoid the piggyback problem by isolating the predecessor's assets from those of the successor. However, when the successor agrees to assume the predecessor's liability, the potential for piggybacking still exists. Thus, while the statute does not always eliminate the problem, it allows the successor to make a calculated decision based on the perceived extent of the predecessor's liability and the risk of unforeseen claims, and to structure the purchase so as to avoid piggybacking.¹²⁰

B. Efficiency

Common law regulation is notoriously imprecise, and liberal successor liability law has done nothing to diminish that reputation. While tort law remains unapologetic about its amorphousness,¹²¹ corporate and commercial law have traditionally struggled to achieve greater certainty and specificity for those they regulate. The uncertainty created by liberal successor liability law's lack of a coherent theoretical framework and multiple indefinite standards adopted retroactively is costly, inefficient, and no doubt disconcerting to the corporate acquisitions community.

¹¹⁸ A successor might attempt to protect itself from piggybacking either by purchasing the predecessor's stock rather than its assets or by forming a subsidiary to purchase the predecessor's assets. The latter method, known as a triangular acquisition, is often employed in an attempt to avoid piggybacking. However, neither alternative is useful if the successor wishes to integrate the predecessor's operations into its own.

¹¹⁹ Roe, *Successor Liability*, *supra* note 108, at 1569-71.

The value the parties place on the predecessor's assets provides an obvious ceiling. The price paid by the successor to the predecessor, which is readily determinable, is already discounted by the anticipated future products liability burden. Absent a reliable measure of that burden, one cannot calculate the predecessor's total value at the time of sale. The incentive is thus created for the parties to minimize their valuation of the future products liability burden in order to set a low ceiling for future products liability claims. *Id.* at 1570 n.29.

A retrospective judicial determination of the predecessor's total value at the time of sale provides a second source for a ceiling. As Professor Roe has explained, however, courts are not particularly capable of making that sort of finding. *Id.* at 1570. Moreover, to litigate such complex financial matters in each claimant's case against a successor that asserted the ceiling had been reached would consume a colossal amount of resources over a collateral matter.

¹²⁰ Under the statute, assuming that parties correctly identify those instances in which the risk of a high products liability burden (in relation to the predecessor's value) exists, the predecessor's legitimate interest in making arrangements for immediate dissolution and distribution is diminished. This is precisely the situation in which a successor would likely be most reluctant to agree to assume the predecessor's obligations.

¹²¹ See Green, *supra* note 79, at 162.

1. *Identifying the Appropriate Defendant*

Any rule adopted to protect long-tail products liability claimants should strive to minimize the costs associated with identifying the appropriate defendant. A dissolution-restricting statute identifies clearly the predecessor as the entity liable to the claimant. Any predecessor that had obtained insurance or assigned its liability to another entity before dissolving could be required to record that information with other corporate records maintained by the state. Thus, identifying the appropriate defendant becomes no more difficult than determining the manufacturer of the product involved.

Liberal successor liability law, by contrast, virtually mandates that the plaintiff use substantial resources to identify the appropriate defendant. The expanded continuation theory requires an inquiry into factors such as whether the predecessor's assets, physical location, employees, management, and operations are identical or similar to the successor's, essentially guaranteeing that the parties expend substantial efforts to flesh out the underlying facts;¹²² moreover, the uncertainty created by the indeterminate "totality of the circumstances" standard¹²³ results in higher litigation costs.¹²⁴ Although the product line continuation theory should provide greater clarity and ease of proof, one must be careful not to underestimate the efforts required to obtain the relevant facts of a corporate acquisition from an uncooperative defendant.¹²⁵

Because of the lack of a coherent theoretical framework, liberal successor liability law also encourages joinder of superfluous defendants and wasteful litigation over which of several entities should assume liability.¹²⁶ This squandering of resources often arises when

¹²² See *Ramirez v. Amsted Indus., Inc.*, 86 N.J. 332, 348 n.3, 431 A.2d 811, 819 n.3 (1979); see also Comment, *Restoration of Certainty*, *supra* note 37, at 457 (proposing laundry list of factors relevant to extended continuation analysis).

¹²³ *Trimper v. Bruno-Sherman Corp.*, 436 F. Supp. 349, 350 (E.D. Mich. 1977). Although the court in *Turner v. Bituminous Casualty Co.*, 397 Mich. 406, 244 N.W.2d 873 (1976) gave conflicting signals as to whether the determination of continuity was one of fact or law, other courts have interpreted *Turner* as leaving the determination to the jury. See *Mozingo v. Correct Mfg. Corp.*, 752 F.2d 168, 175-76 (5th Cir. 1985); *Trimper*, 436 F. Supp. at 350. This exacerbates the uncertainty created by a continuation standard by shrouding the outcome of each case with the jury's factual blanket.

¹²⁴ *Green*, *supra* note 79, at 181 (discussing uncertainty and consequent increased costs in settlement context).

¹²⁵ See *Parra v. Production Mach. Co.*, 611 F. Supp. 221 (E.D.N.Y. 1985) (court denied cross-motions for summary judgment because of paucity of evidence presented as to material facts; evidence which, one would expect, defendant had access to and would have brought forth if favorable to it).

¹²⁶ See, e.g., *Roy v. Bolens Corp.*, 629 F. Supp. 1070 (D. Mass. 1986).

Recent reform efforts in products liability have attempted to reduce squandering of resources in the litigation process by seeking to clarify which of the entities involved in producing a product is liable. See, e.g., Model Uniform Product Liability Act § 105(c), 44 Fed. Reg. 62,714, 62,726 (1979); S. 44, 98th Cong., 2d Sess. § 8 (1983).

there are multiple, sequential successors,¹²⁷ or when there are multiple, continuous successors, one of whom has purchased the product line and one or more of whom have purchased the remainder of the predecessor.¹²⁸ The incoherence of liberal successor liability law makes definitive determinations as to which entity should assume liability extremely difficult, causing courts to hold multiple successors liable in some cases, and no successor liable in others.¹²⁹

The unavailability of the predecessor trigger and adherence to the conduit function require further inquiry into the existence vel non of the predecessor, its financial status and, where appropriate, the reason for its nominal status. Not only is the predecessor's financial insufficiency a prerequisite to the imposition of successor liability, but to remain true to the conduit function, courts must limit successor liability to those circumstances in which the predecessor's financial insufficiency is caused by a distribution of assets to stockholders.¹³⁰ To the extent that the predecessor's financial inability is a result of insolvency incurred during continuing operations, the problem is one for bankruptcy law, and liability should not be imposed on the successor.¹³¹

Although most courts have managed, albeit somewhat circuitously, to avoid imposing successor liability when the predecessor's insolvency did not result from a distribution to stockholders,¹³² numerous decisions display indifference to the reason for the predecessor's insolvency, either because of a lack of appreciation for the analytics of successor theory or the difficulties of proof.¹³³

¹²⁷ See, e.g., *Nieves v. Bruno Sherman Corp.*, 86 N.J. 361, 431 A.2d 826 (1981).

¹²⁸ See, e.g., *Gee v. Tenneco, Inc.*, 615 F.2d 857 (9th Cir. 1980).

¹²⁹ Perhaps the most egregious lapse of logic in this regard occurred in *Tift v. Forge King Indus., Inc.*, 108 Wis. 2d 72, 322 N.W.2d 14 (1982). In the same breath, the court asserted both that the successor could be held liable because it was "the 'same' business that produced the original product" and that the successor could assert an indemnification claim against the predecessor. *Id.* at 79-80, 322 N.W.2d at 17.

¹³⁰ As long as the predecessor is solvent (including its future products liability burden) at the time of sale, the successor can discount its purchase price and protect itself from ultimately bearing the costs of the predecessor's products claims. However, if the future products liability burden exceeds the asset value of the predecessor, and if the parties miscalculate, the successor will ultimately bear some portion of the predecessor's liability. Logically, the asset value of the predecessor at the time of acquisition should provide a cap on the liability imposed on a successor. See *Roe, Successor Liability, supra* note 108, at 1569-71.

¹³¹ See *supra* text accompanying note 108.

¹³² See, e.g., *In re Related Asbestos Cases*, 578 F. Supp. 91, 93 (N.D. Cal. 1983) (no successor liability where because of bankruptcy reorganization predecessor could not respond to plaintiffs' claims); *Downtown, Inc. v. Acrometal Prods., Inc.*, 347 N.W.2d 118 (N.D. 1984) (no liability for successor who purchased bulk of assets from predecessor in receivership); *Hall v. Armstrong Cork, Inc.*, 103 Wash. 2d 258, 692 P.2d 787 (1984) (no successor liability where predecessor was in chapter 11 bankruptcy reorganization).

¹³³ E.g., *Mozingo v. Correct Mfg. Corp.*, 752 F.2d 168 (5th Cir. 1985) (upholding

2. *Minimizing Interference with the Sale of a Going Concern*

Any scheme to protect long-tail products claimants should minimize disincentives to asset transfers. Because some owners can put assets to more productive use than others, asset transfers are economically desirable. A dissolution-restricting statute is preferable to liberal successor liability law because the statute minimizes interference with, and the costs of, corporate asset acquisitions.

The conduit function of liberal successor liability law requires that the parties estimate the value of the predecessor's future products liability. Valuing this liability can be extremely complex, if not impossible. The parties must evaluate risks that are not fully understood, predict the impact of any reforms in the underlying substantive law, estimate the likelihood of successor liability,¹³⁴ and actuarialize the effect of different successor liability rules across the fifty states.¹³⁵ Moreover, the buyer must often undertake the valuation having to rely on the seller to provide critical information.¹³⁶

The difficulty and uncertainty in valuing the predecessor's potential products liability inhibits corporate assets sales.¹³⁷ These problems also make the acquisition process more expensive, because the parties incur the costs of obtaining or developing the information needed to make the valuation.

By contrast, a dissolution-restricting statute would not require that the parties determine the predecessor's future liability, or require that the successor assume the risk of an erroneous valuation. When the predecessor and successor do decide to bargain for the assumption of future claims to enable the predecessor to dissolve

successor liability of purchaser of manufacturing assets without addressing existence or financial status of predecessor); *Schumacher v. Richards Shear Co.*, 59 N.Y.2d 239, 244, 451 N.E.2d 195, 198, 464 N.Y.S.2d 437, 439 (1983) (no successor liability when predecessor survived purchase as distinct entity; court noting only that predecessor "has few assets").

¹³⁴ See *supra* text accompanying notes 122-24. One practicing attorney noted: "[G]iven the disparate definitions applied to 'de facto' merger in various jurisdictions, combined with the multijurisdictional nature of many acquisitions, the obstacles to satisfying relevant judicial criteria may seem hopelessly blocked with undecipherably intricate or even invisible barriers." Winthrop, *supra* note 42, at 206.

¹³⁵ This process also requires the parties to consider conflict-of-law provisions and their impact on successor liability. See, e.g., *Standal v. Armstrong Cork Co.*, 356 N.W.2d 380 (Minn. Ct. App. 1984); see generally Comment, *Choice-of-Law in Minnesota Corporate Successor Products Liability: Which Rule Is the "Better Rule"?*, 8 HAMLINE L. REV. 373, 388-409 (1985).

¹³⁶ See *Roe, Successor Liability*, *supra* note 108, at 1573-74 (The seller "will usually have better information than [the buyer] about [the seller's] operations. And [the seller] will have an incentive to overstate its value and understate any associated problems.").

¹³⁷ See, e.g., *Allied Drops Bid to Purchase Chemical Division of GAF Corp.*, [1983] *Asbestos Litig. Rep.* (Andrews) 6995 (Aug. 12, 1983) [hereinafter *Allied Drops Bid*] (uncertainty about successor liability for GAF's asbestos liability undermined proposed purchase of product line from GAF; transaction ultimately cancelled).

and liquidate, the certainty provided by the statute should reduce the efforts required to make a valuation.¹³⁸

In addition to reducing the efforts associated with valuation, a dissolution-restricting statute clearly releases the successor from any of the predecessor's obligations that the successor does not expressly agree to assume,¹³⁹ thus assuring potential purchasers that they are not at risk for subsequent claims arising from the predecessor's products.¹⁴⁰ This certainty makes a dissolution-restricting statute preferable to liberal successor liability law whenever the predecessor's continued existence is subject to doubt.

A dissolution-restricting statute may have a dampening effect on asset acquisitions¹⁴¹ when the predecessor cannot find an entity to assume its future liability, thereby preventing the predecessor's shareholders from receiving the proceeds of the sale.¹⁴² But these difficulties should not impede an acquisition when another party

¹³⁸ Complete uniformity would require the enactment of a dissolution-restricting statute in every state or inclusion of a similar provision in a federal products liability statute. A number of federal products liability bills have received serious congressional attention in recent years, e.g., 14 Prod. Safety & Liab. Rep. (BNA) 448 (June 27, 1986); 13 *id.* at 902 (Nov. 29, 1985), and the current administration has also supported the concept of a federal products liability statute, in part because of the "uniformity" it could provide in regulating manufacturers who are engaged in interstate distribution of their products. 14 *id.* at 350 (May 23, 1986); *id.* at 379-80 (June 6, 1986). Politics being what it is, one should not be surprised that no consideration of a provision to protect long-tail products claimants has surfaced in the proposals for a federal statute, to my knowledge.

In any case, if the jurisdiction in which the predecessor was incorporated had adopted a dissolution-restricting statute, the parties to the acquisition would recognize that there was no way to structure the sale to avoid future liability. This knowledge would force the parties to confront the future liability issue and make adequate provision for future claims. With that provision in place, there would be no need for liberal successor liability law, with its attendant uncertainty, to be invoked, even for a plaintiff who could take advantage of the tort laws of a state other than the one in which the predecessor was incorporated.

Candor compels me to confess that one wholly undesirable incentive created by enacting dissolution-restricting statutes in some, but not all, states, would be for an incipient corporation to avoid incorporating in those states with dissolution-restricting statutes. Of course, similar incentives already exist given the variations in state corporate law provisions.

¹³⁹ See *infra* Proposed Statute § 1(f).

¹⁴⁰ It was precisely this concern that thwarted the proposed sale of GAF Corporation's chemical group to Allied Corporation. *Allied Drops Bid*, *supra* note 137.

¹⁴¹ A dissolution-restricting statute also eliminates incentives to engage in asset acquisitions for the purpose of avoiding some portion of future products claims. Eliminating this incentive, which amounts to an involuntary subsidy of asset acquisitions by future products claimants, should reduce the incidence of economically unjustified asset acquisitions.

¹⁴² Shareholders of a publicly traded company can always sell their stock to extricate their investment. This is not true for shareholders who have no market for their shares. An exception to a dissolution-restricting statute might be provided for some very closely held corporations, subject to the shareholders assuming liability in their individual capacities. See *infra* note 164.

places a higher value on the assets than the current owner—the paradigm of the efficient market transaction.

IV

A PROPOSAL FOR A DISSOLUTION-RESTRICTING STATUTE

The inadequacy of state dissolution statutes to protect long-tail claimants has been well documented.¹⁴³ Indeed, that inadequacy has stimulated the development of liberal successor liability law. Until its revision in 1984, the Model Business Corporation Act made no provision for claims arising after dissolution and imposed a two-year limitation on predissolution claims.¹⁴⁴ Some authorities suggest that statutory dissolution provisions do not preempt the common law trust fund theory, which permits creditors to recover from shareholders to the extent that shareholders receive distributions in dissolution from a corporation.¹⁴⁵ The trust fund theory, however, provides little practical relief to the long-tail products claimant. In all but the most closely held corporations, the difficulties and expense of identifying shareholders and prosecuting multiple suits against them present insuperable barriers to utilizing this remedy. In sum, neither existing state dissolution statutes nor the trust fund theory provides a realistic remedy for most long-tail products claimants.

The 1984 revision of the Model Act for the first time recognized the problems faced by the long-tail claimant.¹⁴⁶ However, the drafters' solution—a five-year limitation on claims against dissolved corporations and their shareholders¹⁴⁷—does little to alleviate the situation. In the vast majority of successor liability cases suits are not filed within five years of the predecessor's sale of assets.¹⁴⁸ The limitation on a shareholder's liability to the lesser of her pro rata

¹⁴³ See Henn & Alexander, *Effect of Corporate Dissolution on Products Liability Claims*, 56 CORNELL L. REV. 865 (1971); Juenger & Schulman, *supra* note 25, at 40-43; Roe, *Successor Liability*, *supra* note 108, at 1564 nn.14 & 15; Wallach, *supra* note 25, at 323-35.

¹⁴⁴ MODEL BUSINESS CORP. ACT. § 105 (1979).

¹⁴⁵ Friedlander & Lannie, *Post-Dissolution Liabilities of Shareholders and Directors for Claims Against Dissolved Corporations*, 31 VAND. L. REV. 1363 (1978); Henn & Alexander, *supra* note 143, at 894-96.

¹⁴⁶ MODEL BUSINESS CORP. ACT § 14.07 official comment (1984).

¹⁴⁷ MODEL BUSINESS CORP. ACT § 14.07 (1984). The Model Act's attempt to accommodate long-tail products claimants raises several questions. For example, § 14.07(c) bars postdissolution claims not asserted within five years after the publication of notice of dissolution. However, the Model Act does not speak to postdissolution claims if the dissolved corporation does not publish notice in accordance with the Model Act.

¹⁴⁸ I base this assertion on the reported cases that I have come across, as well as the types of products claims that lead to successor liability cases. See *supra* note 11 and text accompanying notes 1-2. Because most courts' successor liability opinions do not provide the date of the predecessor's dissolution, but do identify the date of the asset sale, I have used the latter as an approximation for the former.

share of the claim or the amount of assets distributed to her in connection with the dissolution¹⁴⁹ further reduces the utility of the expanded abatement period.¹⁵⁰ Although the expanded period in which to bring suit may provide a practical remedy for a few successor liability claims, it does not resolve the problems of most long-tail claimants—problems that lead to the development of liberal successor liability law.

The proposed statute confronts the long-tail products claimant problem more directly and effectively than do the Model Act and existing state dissolution statutes. The proposed statute is also flexible enough to accommodate the varying circumstances surrounding sales of corporate assets by dissolving corporations.¹⁵¹

§ 1 LIMITATIONS ON DISSOLUTION AND DISTRIBUTIONS IN CONNECTION WITH DISSOLUTION

(a) Definitions

(1) "Product" means any object, substance, mixture, raw material, or mineral that:

- (A) has intrinsic economic value;
- (B) is capable of delivery itself or as a component part or ingredient; and
- (C) is produced for distribution in trade or commerce.

(2) "Manufacturing" means engaging in business to produce, make, create, construct, assemble, or fabricate any product or component part of a product. The term also includes the remanufacturing of any existing product or component part of an existing product.

(3) "Postdissolution Products Liability Claim" means any claim for damages arising out of the manufacture, sale, or lease of a product by a corporation that is based at least in part on events occurring after the effective date of the corporation's dissolution.

(b) Notwithstanding the provisions of this Act, no corporation that has engaged in manufacturing products that it sells or leases may dissolve or distribute its assets to its shareholders in connection with its dissolution until the corporation has made adequate

¹⁴⁹ MODEL BUSINESS CORP. ACT § 14.07(d)(2) (1984).

¹⁵⁰ The utility decreases even more because the stockholder's liability for *all* claims is limited to the amount of assets distributed to her. *Id.*

¹⁵¹ As drafted, the statute can easily be incorporated into the Model Business Corporation Act or a similar statute. It provides cross-references to a number of existing provisions in the Model Act and the Uniform Fraudulent Conveyance Act. The Proposed Statute would preempt portions of §§ 14.06 and 14.07 of the Model Act.

provision for postdissolution products liability claims. A distribution made in the ordinary course of business does not violate this section if it complies with the requirements of section 6.40(c) of the Model Business Corporation Act¹⁵² and sections 4-7 of the Uniform Fraudulent Conveyance Act.¹⁵³

(1) Provision for postdissolution products liability claims may be made by:

(A) obtaining liability insurance for postdissolution products liability claims;

(B) transferring, as part of the sale of the corporation's assets, liability for future products liability claims to the purchaser of the corporation's assets; or

(C) any other method that provides protection for those asserting postdissolution products liability claims against the corporation equivalent to the protection that would have existed if the corporation had continued to carry on its business and not undergone dissolution.

(2) Provision for postdissolution products liability claims shall be adequate if the amount of insurance cover-

¹⁵² MODEL BUSINESS CORP. ACT § 6.40(c) (1984) provides:

No distribution may be made if, after giving it effect:

(1) the corporation would not be able to pay its debts as they become due in the usual course of business; or

(2) the corporation's total assets would be less than the sum of its total liabilities plus (unless the articles of incorporation permit otherwise) the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

¹⁵³ UNIF. FRAUDULENT CONVEYANCE ACT § 4, 7A U.L.A. 474 (1985) provides:

Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration.

UNIF. FRAUDULENT CONVEYANCE ACT § 5, 7A U.L.A. 504 (1985) provides:

Every conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors and as to other persons who become creditors during the continuance of such business or transaction without regard to his actual intent.

UNIF. FRAUDULENT CONVEYANCE ACT § 6, 7A U.L.A. 507 (1985) provides:

Every conveyance made and every obligation incurred without fair consideration when the person making the conveyance or entering into the obligation intends or believes that he will incur debts beyond his ability to pay as they mature, is fraudulent as to both present and future creditors.

UNIF. FRAUDULENT CONVEYANCE ACT § 7, 7A U.L.A. 509 (1985) provides:

Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors.

age or other assets available to satisfy postdissolution products liability claims is not less than:

(A) the corporation's net current value at the time of dissolution;¹⁵⁴ plus

(B) the value of any prior distributions made to shareholders in contemplation of dissolution.

(c) When a corporation makes provision for postdissolution products liability claims, the articles of dissolution shall include:

(1) the name and address of any entity that, by insurance or otherwise, has agreed to assume any obligations arising out of the corporation's postdissolution products liability claims; and

(2) a description of the assuming entity's obligations.

(d) A corporation may bring a proceeding in the [name of appropriate court] to seek modification of its obligation to make adequate provision for postdissolution products liability claims.

(1) Upon the filing of a petition for modification, the court shall appoint a guardian to represent the interests of all potential postdissolution products liability claimants.

(2) After conducting a hearing, the court may enter an order modifying the corporation's obligation to make adequate provision for postdissolution products liability claims if it finds that:

(A) despite diligent efforts by the corporation to make adequate provision for postdissolution products liability claimants, it cannot reasonably do so;

(B) the shareholders of the corporation will suffer manifest injustice unless modification of the obligation of adequate provision is permitted; and

(C) an alternative plan to protect postdissolution products liability claimants strikes a reasonable balance between the interests of the postdissolution products liability claimants and the stockholders' interest in avoiding the manifest unfairness identified in section 1(d)(2)(B).

(3) If the court enters an order modifying the corporation's obligation to make adequate provision for postdissolution products liability claims, it shall specify in the order any conditions that the corporation or its shareholders must satisfy in order to protect postdissolution products liability claimants.

¹⁵⁴ These assets would include the value of any agreement by another entity to assume liability for any postdissolution products liability claims against the dissolving corporation.

(4) The court shall award compensation and expenses to the guardian out of the assets of the corporation, or out of the proceeds from the sale of the corporation's assets. Compensation and expenses may be paid from time to time during the proceeding or at its conclusion, at the discretion of the court.

(e) Officers and Directors

(1) Any director who:

(A) votes for, assents to, or resigns her position in contemplation of a distribution or dissolution that is not in compliance with this section; and

(B) in so doing fails to comply with the applicable standards of conduct contained in section 8.30 of the Model Business Corporation Act¹⁵⁵

shall be personally liable to any postdissolution products liability claimant to the same extent that the corporation would have been liable had it not dissolved.

(2) Any officer who:

(A) recommends, acts to further, or resigns her position in contemplation of a distribution or dissolution that is not in compliance with this section; and

(B) in so doing fails to comply with the applicable standard of conduct contained in section 8.42 of the Model

¹⁵⁵ MODEL BUSINESS CORP. ACT § 8.30 (1984) provides:

(a) A director shall discharge his duties as a director, including his duties as a member of a committee:

(1) in good faith;

(2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and

(3) in a manner he reasonably believes to be in the best interests of the corporation.

(b) In discharging his duties a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:

(1) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented;

(2) legal counsel, public accountants, or other persons as to matters the director reasonably believes are within the person's professional or expert competence; or

(3) a committee of the board of directors of which he is not a member if the director reasonably believes the committee merits confidence.

(c) A director is not acting in good faith if he has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.

(d) A director is not liable for any action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this section.

Business Corporation Act¹⁵⁶

shall be personally liable to any postdissolution products liability claimant to the same extent that the corporation would have been liable had it not dissolved.

(3) A director or officer sued for an unlawful distribution or dissolution under this Act may assert a claim for contribution against:

(A) any other director or officer liable under section 1(e)(1) or 1(e)(2); and

(B) each shareholder who received proceeds from the distribution.

(4) The contribution share of

(A) each officer or director shall be a pro rata share of the claim less the amount recovered from shareholders pursuant to section 1(e)(3)(B).

(B) each shareholder shall be the shareholder's ratable share of the claim. The maximum liability of any shareholder for contribution claims shall be the amount received from distributions made in violation of this section.

(5) A director's or officer's liability pursuant to section 1(e)(1) or 1(e)(2) shall not exceed the amount that would have been available from the corporation to satisfy the claimants' claims if this section had not been violated.

(f) Except as otherwise provided in this Act or other statutory provisions, the acquisition of assets from a corporation does not subject the acquiring corporation to liability for claims relating to

¹⁵⁶ MODEL BUSINESS CORP. ACT § 8.42 (1984) provides:

(a) An officer with discretionary authority shall discharge his duties under that authority:

(1) in good faith;

(2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and

(3) in a manner he reasonably believes to be in the best interests of the corporation.

(b) In discharging his duties an officer is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:

(1) one or more officers or employees of the corporation whom the officer reasonably believes to be reliable and competent in the matters presented; or

(2) legal counsel, public accountants, or other persons as to matters the officer reasonably believes are within the person's professional or expert competence.

(c) An officer is not acting in good faith if he has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.

(d) An officer is not liable for any action taken as an officer, or any failure to take any action, if he performed the duties of his office in compliance with this section.

products manufactured or sold by the selling corporation prior to the acquisition. Notwithstanding the foregoing provision of this subsection, the acquiring corporation may expressly assume any liabilities of the selling corporation.

The statute is narrowly tailored to affect only manufacturers and component part manufacturers, the parties in the distribution chain who are ultimately responsible for the defective product. Although others in the distribution chain may be liable to the injured claimant, the ultimate liability remains with manufacturers and component part manufacturers. Limiting the statute to those primary products liability defendants avoids the undesirable effect of casting too wide a net and placing unnecessary restrictions on dissolution.

By clearly stating that the liability belongs to the predecessor and that the predecessor must make adequate provision for that liability before dissolution and distribution, the statute cuts to the heart of the successor liability issue. The statute unequivocally imposes liability on the predecessor unless the successor expressly agrees to assume the predecessor's liability. Of course, the statute permits the predecessor to use an alternative means to satisfy its obligations provided that the resources available to satisfy future claims are equivalent to the resources that were available prior to its dissolution.

No doubt, in many asset sales, the successor will be the preferred entity to assume the predecessor's liabilities as a term of the acquisition.¹⁵⁷ Insurance coverage, particularly in situations in which the predecessor's products liability burden is low, may present an attractive alternative.¹⁵⁸ The predecessor may even choose to continue to exist,¹⁵⁹ especially if a market for its shares exists,

¹⁵⁷ Insurance coverage of the successor for liability for the predecessor's products has become relatively common. Telephone interview with George Tsui, Vice-President, St. Paul Ins. Co., St. Paul, Minn. (Feb. 21, 1985). Many lenders require successor liability insurance as a condition for providing the financing for asset acquisitions. Telephone interview with John Gross, Marsh & McLennan, Inc., New York City (Feb. 21, 1985).

¹⁵⁸ Long-tail products liability insurance is generally available. See *supra* note 157. A number of factors bear on how attractive this option will be for any particular corporation. The useful product life, previous loss exposure, and product risk will affect the terms of any insurance policy, including the period of coverage. The transaction costs associated with the underwriting process may make this option economically infeasible for small corporations. Telephone interview with John Gross, Marsh & McLennan, Inc., New York City (Feb. 21, 1985); telephone interview with George Tsui, Vice-President, St. Paul Ins. Co., St. Paul, Minn. (Feb. 21, 1985).

¹⁵⁹ Continued existence, however, might foreclose the predecessor from taking advantage of I.R.C. § 337 (1982), which permits a liquidating corporation to avoid corporate tax liability on the sale of its assets if, within one year after adopting a liquidation plan, the corporation completes the liquidation and distribution of its assets to stock-

enabling its stockholders to withdraw their investment by simply trading their shares.¹⁶⁰ Regardless of the alternative chosen, the statute ensures that future products claimants can assert claims against a pool of resources comparable to the value of the predecessor's predissolution assets.

holders. See 13 B. FOX & E. FOX, *BUSINESS ORGANIZATIONS: CORPORATE ACQUISITIONS AND MERGERS* § 5.04 (1986). Section 337 does, however, contain a provision permitting the corporation to retain assets beyond the 12-month period to pay its contingent liabilities. I.R.C. § 337(a) (1982); see 1 N. GOFF, *FEDERAL INCOME TAXATION OF CORPORATE LIQUIDATIONS* § 6.53 (1985).

¹⁶⁰ If the proposed statute is to be effective in protecting long-tail products claimants, there must be a mechanism regulating distributions, i.e., dividends and stock purchases, to stockholders. Otherwise, the predecessor could be liquidated through such distributions, with later products claimants being squeezed out. The statute, in § 1(b), prohibits distributions that violate either MODEL BUSINESS CORP. ACT § 6.40 (1984) or UNIF. FRAUDULENT CONVEYANCE ACT §§ 4-7, 7A U.L.A. 474, 504, 507, 509 (1985). These provisions provide some measure of protection to long-tail claimants.

The provisions from the Uniform Fraudulent Conveyance Act are included for four reasons. First, the scarcity of case law raises some doubt as to whether the Model Business Corporation Act provides protection to contingent claimants against current distributions to shareholders. See Kummert, *State Statutory Restrictions on Financial Distributions by Corporations to Shareholders* (pt. 1), 55 WASH. L. REV. 359, 394 & n.157 (1980); Murphy, *Equity Insolvency and the New Model Business Corporation Act*, 15 U. RICH. L. REV. 839, 870 (1981).

Second, fraudulent conveyance law appears to provide greater and more flexible, if not ironclad, protection to long-tail products liability claimants against distributions to shareholders that would impair the predecessor's ability to satisfy its obligations to those claimants. See Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505, 554-59 (1977).

Third, explicitly including the Uniform Fraudulent Conveyance Act requirements negates any implication from some extant authority that state corporate law provisions preempt fraudulent conveyance doctrine. See 2 G. GLENN, *FRAUDULENT CONVEYANCES AND PREFERENCES* § 604, at 1043-44 (rev. ed. 1940); R. JORDAN & W. WARREN, *BANKRUPTCY* 412-14 (1985); see also Clark, *supra*, at 558 n.154; Roe, *Strategic Reaction*, *supra* note 112, at 21 n.53.

Finally, by incorporating the creditor protective provisions of the Uniform Fraudulent Conveyance Act into the proposed statute, the remedial provisions of the statute—personal liability of directors and officers who assent to any improper distribution—would be available to long-tail claimants, in contrast to the Uniform Fraudulent Conveyance Act's remedies, which, at least in a widely held company, may not prove effective.

To the extent that wily corporate management can evade the protection provided by corporate and fraudulent conveyance law and other, less formal constraints, the fault lies not with the proposed statute, but more generally with inadequate protection for creditors who do not have the opportunity to bargain for, and the leverage to obtain, more rigorous limitations on corporate distributions. See Clark, *supra*, at 557-60; Easterbrook & Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 91 (1985). See generally Roe, *Strategic Reaction*, *supra* note 112.

A further concern in the investment corporation context is the type of risk that the corporation might undertake in its investment decisions. If the corporation has distributed all of its equity to stockholders, as § 6.40 of the Model Act permits, then the stockholders cannot lose with regard to the corporation's investments: the shareholders receive the benefits of a successful investment, but future products claimants suffer the loss if the investments turn sour. See Roe, *Successor Liability*, *supra* note 108, at 1588-89 & 1589 n.75. Treating the directors and officers as fiduciaries for future claimants might alleviate these concerns.

The statute's enforcement mechanism imposes personal liability on any director who approves, and any officer who furthers, a distribution to stockholders in violation of the statute.¹⁶¹ Officers and directors may obtain contribution from stockholders who receive distributions but directors and officers—not long-tail claimants—bear the onerous burden of asserting a claim against a potentially large and geographically diverse group of stockholders. To eliminate incentives to leave an illegal dissolution to a few judgment proof directors and officers, the statute also imposes liability on directors and officers who resign in contemplation of a dissolution or distribution that violates the statute.¹⁶²

The statute also provides an exception to the adequate provision requirement.¹⁶³ This exception allows for some flexibility, but the statute adopts a strict standard for releasing the predecessor from its obligations.¹⁶⁴ The provision requiring appointment of a guardian for future claimants ensures an adversarial process and is derived from the apparently successful employment of a guardian

¹⁶¹ This enforcement mechanism is not unfamiliar. See MODEL BUSINESS CORP. ACT § 8.33 (1984) (director liability for unlawful distributions); cf. I.R.C. § 3505(b) (1982) (personal liability of third parties supplying funds to employers when third parties have actual notice or knowledge that employer will not satisfy its tax liability); U.P.C. § 3-807(b) (1982) (personal liability of personal representative to creditors of estate whose claim is compromised by premature payments to other creditors). See generally Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857 (1984); Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53 (1986).

Section 8.30 of the Model Business Corporation Act permits directors to authorize distributions based on financial statements prepared by corporate employees and public accountants. If a director's reliance is in good faith, she is exempted from liability.

This raises the concern that a director might approve an illegal distribution to stockholders, yet be insulated from personal liability because she was unaware of potential future products liability claims. This scenario is unlikely, however. Generally accepted accounting principles require that a corporation charge a loss contingency against current income when available information indicates the likelihood that the corporation will incur the loss and the corporation can estimate the amount of the loss. FINANCIAL ACCOUNTING STANDARDS BOARD, STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 5: ACCOUNTING FOR CONTINGENCIES (1975). Even if these conditions are not satisfied, disclosure of the nature of the contingency and an estimate of the possible loss or range of loss, if the corporation can make such an estimate, are required if there is a reasonable possibility of loss. FINANCIAL ACCOUNTING STANDARDS BOARD, ACCOUNTING STANDARDS 8303 (1986). The accounting standards recognize future products liability claims as loss contingencies. *Id.* at 8309-10.

¹⁶² See *supra* Proposed Statute § 1(e)(1)(A), (e)(2)(A).

¹⁶³ See *supra* Proposed Statute § 1(d).

¹⁶⁴ See *supra* Proposed Statute § 1(d)(2). The best candidate for the exception is a very closely held corporation in which most or all of the principals' assets are invested. Indeed, a blanket exception for all very closely held corporations, coupled with shareholder liability for any distributions, has some appeal. Ultimately, however, the inability to control lifetime transfers of wealth and the short time period provided for asserting claims against estates or distributees, U.P.C. §§ 3-803, 3-1006 (1982), caution against this exception.

for future claimants in the Manville bankruptcy proceedings.¹⁶⁵

No dissolution-restricting statute will obviate all successor liability problems. A dissolution-restricting statute acts prospectively; product manufacturers that have already dissolved and distributed their assets cannot be shoehorned into such a statute. Further, the proposed statute may not be comprehensive enough to encompass all primary products liability defendants.¹⁶⁶ The statute does not even purport to address the successor question in areas other than products liability.¹⁶⁷ Despite these limitations, the proposed statute directly confronts the successor liability problem and provides, with some degree of certainty, an answer that requires the predecessor to recognize that postdissolution claims are its responsibility and ensures that it makes adequate provision for those claims.

Corporations with low potential liability should have no difficulty convincing the successor or an insurer to assume responsibility for future liability. Inevitably, some corporations with high potential liabilities will be unable either to make adequate alternative provisions for their obligations or to demonstrate manifest injustice. Stockholders of these corporations will not be able to withdraw their investment if there is no market for their shares. Initially, one may sympathize with the stockholders' predicament, but as between them and long-tail creditors, the creditors' right to protection of their claims should trump the shareholders' desire to withdraw their investment from an entity with outstanding obligations. Moreover, the stagnant predecessor phenomenon will likely be limited to corporations with high products liability burdens, and the stockholders' residual rights in these instances should be relatively small.

CONCLUSION

The resolution of the successor liability issue initially requires recognition that products liability claimants are creditors of the

¹⁶⁵ See 13 Prod. Safety & Liab. Rep. (BNA) 946 (Dec. 20, 1985).

¹⁶⁶ The statute does not reach noncorporate manufacturers that operate as sole proprietorships or partnerships, for example. See *Cyr v. B. Offen & Co.*, 501 F.2d 1145, 1151 (1st Cir. 1974) (sole proprietorship manufactured product).

¹⁶⁷ The successor liability issue has arisen in a number of other areas. See *Howard Johnson Co. v. Detroit Local Joint Executive Bd.*, 417 U.S. 249 (1974) (obligation of successor to arbitrate pursuant to collective bargaining agreement entered into by predecessor); *Bates v. Pacific Maritime Ass'n*, 744 F.2d 705 (9th Cir. 1984) (successor obligated by consent decree entered in employment discrimination case); *Goldstein v. Gardner*, 444 F. Supp. 581 (N.D. Ill. 1978) (liability of successor brokerage firm for churning committed by predecessor); *National Dairy Prods. Corp. v. Borden Co.*, 363 F. Supp. 978 (E.D. Wis. 1973) (successor liability for patent infringement); *Department of Transp. v. PSC Resources, Inc.*, 175 N.J. Super. 447, 419 A.2d 1151 (Law Div. 1980) (successor liability for discharge of hazardous substances). I suspect that the incongruence of the problems presented in these areas makes a universal solution neither feasible nor desirable.

predecessor corporation who have been precluded from submitting their claims because of state dissolution and liquidation statutes that never contemplated long-tail creditors. The law should not allow corporations to cease operations in a manner that frustrates claims of legitimate creditors. Most corporate creditors are protected either by statutes or contractual provisions bargained for during the existence of the corporate debtor. Long-tail products liability claimants are not afforded statutory protection and are uniquely unable to bargain with the predecessor. Predictably, a number of courts have responded within the common law framework by fashioning liberal successor liability law.

Careful analysis of the rationales provided by courts fashioning liberal successor liability law reveals much jurisprudential rhetoric. Given the luxury of time, reflection, and others' inquiry, it is easy to criticize the courts' explanations for the development of liberal successor liability law. In fairness, much of the tortured reasoning results from systemic constraints on the common law process; the courts can only impose successor liability in a post hoc fashion, which in the short run saddles successors with unanticipated liability that they had no realistic opportunity to pass on to the predecessor during the acquisition process. But it is time to consolidate our learning and get on with the game. In the long run, liberal successor liability law inevitably will channel the costs of products claims back to the predecessor.

An alternative method to ensure that the predecessor bears its products liability burden is to enact a statute limiting the ability of corporations to place their assets beyond the reach of long-tail products claimants. Although such a statute would provide only a prospective solution, it would provide protection for long-tail claimants and give corporations involved in an acquisition the incentive to allocate successor liability in the most efficient fashion. A statute should remove uncertainty, enhance the alienability of ongoing manufacturing businesses, and, at the same time, preserve a viable remedy for the injured claimant.

Realistically, the proposed statute would confront significant political hurdles. The lobby for long-tail products liability claimants is exceedingly weak. In the absence of a statute, successors may be able to escape liability to the extent that they can persuade courts not to jump on the liberal successor liability bandwagon. Moreover, the medicine may be bitter for some: the inability of some corporations to make adequate provision for postdissolution claims may impinge on the stockholders' ability to withdraw or transfer their investment. Finally, a state adopting a dissolution-restricting statute will place a burden on corporations incorporated within that state

that will inure to the benefit of long-tail claimants in other states to which the corporations' products are shipped.¹⁶⁸ All of these factors are likely to generate substantial resistance to legislative reform.

Nevertheless, a dissolution-restricting statute provides a measure of certainty that should appeal to corporations engaging in corporate acquisitions. States have already enacted statutory provisions that allocate liabilities in the merger and consolidation context. Even if a statutory solution founders in unfriendly political waters, this article's analysis of the rationales behind liberal successor liability law should provide some guidance to courts that will, absent legislative action, inevitably face the claims of long-tail products liability claimants.

¹⁶⁸ State legislation that favors a wider class of beneficiaries at the expense of citizens because of choice-of-law provisions is not unknown. Most products liability reform statutes make recovering from products liability defendants, many of whom are located outside the state, more difficult for the state's citizens. See Twerski, *National Product Liability Legislation: In Search for the Best of All Possible Worlds*, 18 IDAHO L. REV. 411, 412-14, 412 n.7 & 414 n.9 (1982). The analogy between these state reform statutes and the dissolution-restricting statute is not perfect: the entities benefitted by the state reform efforts were manufacturing entities; those are the same parties who would suffer if a dissolution-restricting statute were enacted.