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Product Liability Law: Ohio Adopts the Traditional Rule of Corporate Successor Liability

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CASENOTE

PRODUCT LIABILITY LAW: OHIO ADOPTS THE TRADITIONAL RULE OF CORPORATE SUCCESSOR LIABILITY—*Flaugher v. Cone Automatic Machine Co.*, 30 Ohio St. 3d 60, 507 N.E.2d 331 (1987).

I. INTRODUCTION

> This is a *products liability* case first and foremost. Products liability law is a fast-developing area. All the rules have not yet been formulated and products liability law, as it matures, has to shake off various impediments associated with traditional concepts, which, while relevant to other problems, are inappropriate for this new area.[1]

In the past decade, a number of courts have viewed the traditional doctrine of corporate successor liability[2] as an impediment to the development of strict products liability.[3] Product-related injuries often occur a great many years after the plaintiff has purchased a defective product.[4] During this period of time, a successor corporation may have acquired the assets of the predecessor corporation that manufactured the defective product.[5] Under the traditional rule of corporate successor li-

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1. Turner v. Bituminous Casualty Co., 397 Mich. 406, 416, 244 N.W.2d 873, 877 (1976) (emphasis added).

2. For a general discussion of the traditional doctrine of corporate successor liability, see 15 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 7123–7123.5 (rev. perm. ed. 1981 & Supp. 1987).

3. *Turner*, 397 Mich. at 416, 244 N.W.2d at 877 (maintaining that "case law . . . developed to protect the rights of creditors and minority shareholders . . . is not applicable to meeting the substantially different problems associated with products liability torts"); *see also* Ray v. Alad Corp., 19 Cal. 3d 22, 32, 560 P.2d 3, 10, 136 Cal. Rptr. 574, 581 (1977) (reasoning that the traditional theory of corporate successor liability acted as a "barrier[] to plaintiff's redress from the dissolved [corporation]"); Ramirez v. Amsted Indus., 86 N.J. 332, 341–42, 431 A.2d 811, 815–16 (1981) (noting that the traditional corporate approach is "unresponsive to the legitimate interests of the products liability plaintiff").

4. Green, *Successor Liability: The Superiority of Statutory Reform to Protect Products Liability Claimants*, 72 CORNELL L. REV. 17, 19 (1986) (as a result 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").

5. For the purposes of this note, the term "successor corporation" will refer to a corporation that purchases all, or substantially all, of the assets of another corporation. The term "predecessor corporation" will be used to refer to a corporation that has sold all, or substantially all, of its

ability, a successor corporation only assumes the products liability of its predecessor when one of four narrowly-construed exceptions is present.[6] Thus, the products-liability claimant is often left remediless by the traditional rule.[7] A number of courts have sought to accommodate strict products-liability policies in the area of successor liability either by expanding the exceptions to the traditional rule[8] or by creating a new rule of successor liability known as the product-line theory.[9] However, other courts have staunchly defended the traditional rule and refused to engage in any liberalization of corporate successor liability.[10]

In *Flaugher v. Cone Automatic Machine Co.*,[11] the Ohio Supreme Court had its first opportunity to consider the issue of corporate successor liability. This casenote will initially examine the supreme court's adoption of the traditional rule of successor liability. Then, it will analyze the court's refusal to adopt the product-line theory of successor liability. Finally, this note will discuss the impact that the *Flaugher* decision may have on Ohio products liability law.

II. FACTS AND HOLDING

Appellant Carla Flaugher was injured on April 24, 1979, by an eight spindle Conomatic screw machine.[12] On April 20, 1982, she initiated a products-liability action in the Court of Common Pleas of Clermont County, naming the following corporations as defendants: Cone Automatic Machine Company, Inc. (Cone I), Cone Automatic Machine Company, Inc. (Cone II), Pneumo Corporation (Pneumo), and Cone Blanchard Machine Company (Cone-Blanchard).[13] The machine

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assets to another corporation.

6. *See infra* notes 36–39 and accompanying text (discussing the four traditional exceptions to corporate successor liability).

7. 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, 332 (1983) ("[W]hile the traditional rules of corporate law satisfy the needs of traditional creditors whose claims arise before or soon after the predecessor's dissolution, those rules provide no adequate remedy for the typical products liability plaintiff whose claims frequently arise years after the product's purchase.").

8. *See, e.g.*, Knapp v. North Am. Rockwell Corp., 506 F.2d 361, 368–69 (3d Cir. 1974), *cert. denied*, 421 U.S. 965 (1975); Cyr v. B. Offen & Co., 501 F.2d 1145, 1154 (1st Cir. 1974).

9. *See, e.g.*, Ray v. Alad Corp., 19 Cal. 3d 22, 34, 560 P.2d 3, 11, 136 Cal. Rptr. 574, 582 (1977).

10. *See* Woody v. Combustion Eng'g, Inc., 463 F. Supp. 817, 819–21 (E.D. Tenn. 1978) (holding that there is little support for the isolated trend of expanding the scope of successor liability); Domine v. Fulton Iron Works, 76 Ill. App. 3d 253, 256–57, 395 N.E.2d 19, 22–23 (1979) (asserting that the public policy of Illinois does not favor an extension of the doctrine of corporate successor liability in the products liability context).

11. 30 Ohio St. 3d 60, 507 N.E.2d 331 (1987).

12. *Id.* at 60–61, 507 N.E.2d at 331–33.

13. *Id.* at 61, 507 N.E.2d at 333.

that injured Mrs. Flaugher was manufactured by Cone I in 1953.[14] In July of 1963, the assets of Cone I were purchased by Pneumo.[15] Subsequently, Cone I was dissolved on September 5, 1963, and Cone II was formed on the next day by Pneumo as a dormant holding company for the "Cone" name.[16]

After purchasing the assets of Cone I, Pneumo established the Pneumo Dynamics Machine Tool Group (PDMTG), which consisted of the assets of three dissolved corporations, Cone I, Blanchard Machine Company, and Springfield Machine Company.[17] PDMTG manufactured the Conomatic line of machines from August 1963 until December 1972.[18] At this time, Pneumo sold the assets of PDMTG and the stock of Cone II to Cone-Blanchard, which continued the production of the Conomatic line of machines.[19]

The trial court granted a motion to dismiss made by Cone I and a motion for summary judgment made by Pneumo.[20] Likewise, motions for summary judgment made by Cone II and Cone-Blanchard were sustained.[21] In April of 1986, Mrs. Flaugher challenged the motions for summary judgment in favor of Cone II and Cone-Blanchard in the Court of Appeals for the Twelfth District of Ohio.[22] However, the appellate court affirmed the trial court's holding.[23]

The decision was later appealed to the Ohio Supreme Court, which, in a six-to-one decision, affirmed the lower court's ruling.[24] The supreme court held that the appellees in this case did not fall within any of the traditional exceptions to successor liability. First, the court reasoned that neither Cone-Blanchard nor Cone II expressly or impliedly agreed to assume the tortious liabilities of Cone I.[25] Second, it

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14. *Id.* at 60, 507 N.E.2d at 333.

15. Flaugher v. Cone Automatic Mach. Co., No. CA84-05-040, slip op. at 2 (Ohio Ct. App., Clermont County Apr. 14, 1986) (LEXIS, States library, Ohio file).

16. *Flaugher,* 30 Ohio St. 3d at 60, 507 N.E.2d at 333.

17. *Id.* at 60–61, 507 N.E.2d at 333.

18. *Id.* at 61, 507 N.E.2d at 333.

19. *Id.*

20. *Id.* The trial court sustained Cone I's motion to dismiss because applicable Vermont law bars claims against dissolved corporations where the claim did not exist prior to dissolution. The court sustained Pneumo's motion for summary judgment on the grounds that the appellant's complaint was time-barred. *Id.*

21. *Id.* The trial court reasoned that neither Cone-Blanchard nor Cone II fell within the traditional exceptions to the general rule of successor liability. Moreover, the trial court rejected appellant's contention that the product-line theory of liability was applicable and held that Cone-Blanchard had no duty to warn Mrs. Flaugher of the alleged defect in the machine. *Id.*

22. *Id.*

23. *Id.*

24. *Id.* at 67, 507 N.E.2d at 338.

25. *Id.* at 62–65, 507 N.E.2d at 334–36. The appellant argued that the purchase agreement between Pneumo and Cone-Blanchard was unclear with regard to whether Cone-Blanchard would

found that neither corporation was a "mere continuation" of Cone I.[26] Third, the court held that even under a liberal interpretation of the continuation exception, no liability could be attached to either Cone-Blanchard or Cone II.[27] The Ohio Supreme Court also refused to adopt the product-line theory of liability reasoning that such a radical policy change should be implemented—if at all—by the legislature.[28] Finally, the supreme court held that Cone-Blanchard had no duty to warn of defects in a machine manufactured by Cone I where it had no prior knowledge of the alleged defect.[29]

III. BACKGROUND

Historically, the doctrine of successor liability developed in a corporate law context.[30] As a general rule, the liability of the successor corporation is dependent upon the nature of the transaction by which it acquires the assets of the predecessor corporation.[31] If the successor acquires the predecessor by means of a statutory merger or consolidation, the successor assumes the liabilities of its predecessor.[32] But where the acquisition consists of a sale of the predecessor's assets for sufficient consideration, the successor corporation does not assume the liabilities unless one of four well-recognized exceptions is present.[33] The original

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assume Pneumo's products liability. However, the court concluded:

> Section 5.2 [of the purchase agreement] provides that Pneumo shall indemnify Cone-Blanchard for all claims against PDMTG asserted after the effective date of the agreement "arising out of any transaction entered into, or any state of facts existing" prior thereto, where liability for such claims has not already been assumed by Cone-Blanchard elsewhere in the contract. This section unambiguously relieves Cone-Blanchard of any liabilities predating the purchase agreement which are not expressly assumed by Cone-Blanchard.
>
> Section 5.1 specifically limits the liabilities assumed by Cone-Blanchard to those expressly enumerated in that section, none of which applies to the instant cause.

Id. (footnotes omitted).

26. *Id.* (stressing that the mere-continuation exception should be narrowly construed so as to protect acquiring corporations from unassumed liabilities).

27. *Id.* at 65, 507 N.E.2d at 336.

28. *Id.* at 66–67, 507 N.E.2d at 337.

29. *Id.* at 67, 507 N.E.2d at 337–38. The court held that Cone-Blanchard's receipt of a summons for a products liability action involving a Conomatic machine was not sufficient notice to give rise to a duty to warn the appellant. The court emphasized that the notice was only received five weeks before the appellant's injury and that it involved a different type of Conomatic machine. *Id.*

30. *See* Turner v. Bituminous Casualty Co., 397 Mich. 406, 416, 244 N.W.2d 873, 878 (1976) (maintaining that the doctrine of successor liability was developed in a corporate-law context to deal with problems involving creditors' rights, tax assessments, and shareholders' rights); Johnson v. Marshall & Huschart Mach. Co., 66 Ill. App. 3d 766, 769, 384 N.E.2d 141, 142–43 (1978) (noting that most jurisdictions addressing the issue of successor liability have viewed it as a question of corporate law).

31. L. FRUMER & M. FRIEDMAN, PRODUCTS LIABILITY § 2.06[2], at 2-172 (1987).

32. *Id.*

33. *Id.* at 2-173.

purpose of this doctrine was to protect the rights of the commercial creditors and dissenting shareholders of the predecessor corporation.[34]

Yet, many courts have also applied this traditional corporate doctrine to products liability cases.[35] In those jurisdictions that follow the traditional rule of successor liability, a corporation that purchases the assets of another corporation only assumes the products liability of the selling corporation when one of the following exceptions is present:

(1) the successor corporation expressly or impliedly agrees to assume such liabilities;[36]

(2) the transaction amounts to a de facto merger or consolidation;[37]

(3) the successor corporation is simply a continuation of the predecessor corporation;[38] or

(4) the transaction is entered into fraudulently to avoid such liability.[39]

However, in recent years a number of courts across the nation have observed that while these traditional exceptions provide adequate protection for commercial creditors and dissenting shareholders, they

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34. Comment, *A Search for the Outer Limits to Successor Corporation Liability for Defective Products of Predecessors*, 51 U. CIN. L. REV. 117, 119 (1982) (citing Applestein v. United Board and Carton Co., 60 N.J. Super. 333, 350–51, 159 A.2d 146, 155–56, *aff'd*, 33 N.J. 72, 161 A.2d 474 (1960)).

35. Woody v. Combustion Eng'g, Inc., 463 F. Supp. 817, 819 (E.D. Tenn. 1978) (applying corporate doctrine of successor liability to a products-liability action where plaintiffs had allegedly been exposed to various asbestos products); Bernard v. Kee Mfg. Co., 394 So. 2d 552, 553 (Fla. Dist. Ct. App. 1981) (applying corporate concept of successor liability in a strict-liability suit involving injuries sustained by a plaintiff while operating an allegedly defective lawn mower), *aff'd*, 409 So. 2d 1047 (1982); Johnson v. Marshall & Huschart Mach. Co., 66 Ill. App. 3d 766, 768, 384 N.E.2d 141, 143 (1978) (applying corporate doctrine of successor liability to a products-liability action where the plaintiff had been injured by a punch press).

36. *See* Bouten v. Litton Indus., 423 F.2d 643, 652 (3d Cir. 1970) (successor corporation held liable where assumption of liabilities in transfer agreement was so broad as to constitute an implied assumption of predecessor's tort liability for defective products).

37. Generally, the requirements of a de facto merger have been stated as follows: (1) a continuity of enterprise, i.e., continuity of predecessor's management personnel, location, and assets; (2) continuity of ownership, i.e., shareholders of predecessor corporation become shareholders of successor corporation; (3) dissolution of predecessor corporation as soon as practically possible; and (4) an assumption by the successor corporation of those liabilities ordinarily necessary for the uninterrupted continuation of the predecessor's business operations. Shannon v. Samuel Langston Co., 379 F. Supp. 797, 801 (W.D. Mich. 1974).

38. The common law elements of the mere-continuation exception include: (1) a continuation of the officers, directors and shareholders of the predecessor corporation in the successor corporation; (2) inadequacy of the consideration given for the assets acquired; and (3) dissolution of the predecessor corporation in either fact or law. Jackson v. Diamond T. Trucking Co., 100 N.J. Super. 186, 196, 241 A.2d 471, 477 (1968); *see also* L. FRUMER & M. FRIEDMAN, *supra* note 31, § 2.06[3], at 2-183 (emphasizing that the gravamen of the mere-continuation exception is the continuity of the corporate entity, rather than the continuity of the business operations).

39. *See* 15 W. FLETCHER, *supra* note 2, § 7122 & n.10 (discussing cases that apply the fraud exception).

often leave products-liability claimants without a remedy.[40] In order to deal with this perceived injustice, some courts have sought to expand the scope of the traditional de-facto-merger and mere-continuation exceptions in the products-liability context.[41]

One of the leading cases advocating an expansion of the de-facto-merger exception is *Knapp v. North American Rockwell Corp.*[42] In *Knapp*, the United States Court of Appeals for the Third Circuit held that a successor corporation could be liable for the tortious conduct of its predecessor despite the fact that the predecessor continued to exist for eighteen months after the acquisition and possessed adequate funds to compensate the claimant.[43] This ruling expanded the de-facto-merger exception by relaxing the traditional requirement that the predecessor corporation be dissolved as soon as possible after its acquisition.[44] One of the leading cases broadening the mere-continuation exception is *Cyr v. B. Offen & Co.*[45] In *Cyr*, the United States Court of Appeals for the First Circuit found that a successor corporation could be held liable even where it had paid adequate consideration for its predecessor's assets, and where there was no continuity of ownership interest.[46] This decision expanded the mere-continuation exception by doing away the traditional requirement of continuity of ownership interest.[47]

Other courts have attempted to deal with the perceived inequities of the traditional rule by developing a tort concept of successor liability—the product-line theory.[48] The California Supreme Court's deci-

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40. *See, e.g.*, Turner v. Bituminous Casualty Co., 397 Mich. 406, 419, 244 N.W.2d 873, 878–79 (1976); Ray v. Alad Corp., 19 Cal. 3d 22, 32, 560 P.2d 3, 10, 136 Cal. Rptr. 574, 581 (1977); Ramirez v. Amsted Indus., 86 N.J. 332, 341–42, 431 A.2d 811, 815–16 (1981).

41. *See infra* notes 42–47 and accompanying text.

42. 506 F.2d 361 (3d Cir. 1974), *cert. denied*, 421 U.S. 965 (1975).

43. 506 F.2d at 368–69. The *Knapp* court reasoned that during the eighteen months, the predecessor corporation existed only as a mere shell. Thus, the court held that the dissolution requirement was met in substance—if not in form—and that the successor corporation should be held liable for the tortious conduct of its predecessor. *Id.*

44. *See supra* note 37.

45. 501 F.2d 1145 (1st Cir. 1974).

46. *Id.* at 1154. The *Cyr* court argued that ownership interest cannot be an inflexible barrier to finding corporate successor liability where "the same employees continue . . . to produce the same products in the same plant, with the same supervision [under] . . . the same name." *Id.*

47. *See supra* note 38.

48. It should be noted that there is some ambiguity as to what constitutes a "product line" for purposes of assessing corporate successor liability. Although the *Ray* decision involved a successor corporation that continued an identical product line, other decisions have held that the continuance of a specific product line need not be controlling. It may be sufficient for the successor to continue a line of products that is essentially the same as its predecessor's. *See, e.g.*, Ramirez v. Amsted Indus., 86 N.J. 332, 358, 431 A.2d 811, 825 (1981) (maintaining that "[t]he social policies underlying strict products liability in New Jersey are best served by extending strict liability to a successor corporation that acquires the business assets and continues to manufacture essen-

sion in *Ray v. Alad Corp.*,[49] exemplifies this approach.[50] In *Ray*, the court determined that California's strict-products-liability policies called for a departure from the traditional analysis of corporate successor liability.[51] Thus, the court held that even in the absence of any of the traditional exceptions, a successor corporation assumes the products liability of its predecessor when it receives the business and continues the production of the predecessor's product line.[52]

Finally, it should be noted that in recent years some courts have held that liability can attach to a successor corporation under a failure-to-warn theory.[53] In the typical products-liability situation, a manufacturer can be held liable for failing to warn of risks that it knew about or should have known about under the exercise of reasonable diligence.[54] In the corporate-successor-liability context, regardless of the nature of the acquisition, a successor may assume an independent duty to warn of defects in a predecessor's products where the successor has actual or constructive knowledge of the defect and a continuing relationship exists between the successor and the predecessor's customers.[55]

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tially the same line of products as its predecessor").

49. 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).

50. The product-line theory has been adopted in some jurisdictions. *See* Ramirez, 86 N.J. at 358, 431 A.2d at 811; Dawejko v. Jorgensen Steel Co., 290 Pa. Super. 15, ___, 434 A.2d 106, 111 (1981); Martin v. Abbott Laboratories, 102 Wash. 2d 581, 615, 689 P.2d 368, 388 (1984). *Contra* Woody v. Combustion Eng'g, Inc., 463 F. Supp. 817, 820–21 (E.D. Tenn. 1978) (applying Pennsylvania law); Travis v. Harris Corp., 565 F.2d 443, 448 (7th Cir. 1977) (applying Ohio and Indiana law); Domine v. Fulton Iron Works, 76 Ill. App. 3d 253, 256–57, 395 N.E.2d 19, 22–23 (1979).

51. *Ray*, 19 Cal. 3d at 31, 560 P.2d at 8, 136 Cal. Rptr. at 579. The *Ray* court stated that the "paramount policy to be promoted by . . . [strict products liability] is the protection of otherwise defenseless victims of manufacturing defects and the *spreading throughout society* of the cost of compensating them." *Id.*

52. *Id.* at 31, 560 P.2d at 9, 137 Cal. Rptr. at 580. The California Supreme Court justified their imposition of corporate successor liability on the following grounds: (1) the plaintiff's remedy against the predecessor corporation is destroyed by the successor's acquisition of the business; (2) the successor corporation has available to it the means necessary to estimate the risks of injuries caused by previously manufactured defective products and to insure against such risks; and (3) it is only equitable for the successor corporation to bear the burdens of the predecessor's products liability while it enjoys the benefits of the predecessor's goodwill. *Id.*

53. Gee v. Tenneco, Inc., 615 F.2d 857, 865–66 (9th Cir. 1980); *Travis*, 565 F.2d at 448–49; Gonzalez v. Rock Wool Eng'g & Equip., 117 Ill. App. 3d 435, 437–38, 453 N.E.2d 792, 794–95 (1983); Straton v. Garvey Int., Inc., 9 Kan. App. 2d 254, ___, 676 P.2d 1290, 1295–96 (1984).

54. W. KEETON, D. DOBBS, R. KEETON, & D. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS 685 (5th ed. 1984).

55. *See* 15 W. FLETCHER, *supra* note 2, § 7123.5 (cum. supp. 1987). Generally, the following factors have been considered relevant in determining whether a successor corporation has a continuing relationship with its predecessor's customers: (1) has the successor succeeded to the predecessor's service contracts; (2) has the successor provided coverage for the particular machine under a service contract; (3) has the successor serviced the actual machine; and (4) does the successor have knowledge of the defects and the location of the owner or the particular machine.

IV. ANALYSIS

Flaugher v. Cone Automatic Machine Co.[56] presented the Ohio Supreme Court with its first opportunity to confront the issue of corporate successor liability. The court's adoption of the traditional rule of successor liability is worthy of analysis as is its refusal to adopt the product-line theory. Moreover, the impact that the *Flaugher* decision could have on Ohio products-liability law deserves consideration.

A. The Court's Adoption of the Traditional Rule

In *Flaugher*, the Ohio Supreme Court clearly embraced the traditional doctrine of corporate successor liability:

> We hold that a corporation which purchases the assets of a manufacturer is not liable for injury resulting from a defective machine produced by that manufacturer unless there is an express or implied assumption of such liability, or the transaction constituting the sale of assets amounts to a de facto merger or consolidation, where the purchaser corporation is a mere continuation of the seller corporation, or the transaction is a fraudulent attempt to escape liability.[57]

What is not so clear, however, is *why* the court adopted this position. The majority opinion in *Flaugher* fails to elaborate on any of the policy arguments that the court considered in adopting the traditional theory of corporate successor liability. This jurisprudential void leaves the court's decision open to recent criticisms leveled by many courts and commentators against the traditional doctrine.[58]

Before adopting any rule, the Ohio Supreme Court should have discussed the policy arguments underlying corporate successor liability. The primary argument in favor of the traditional doctrine is that it provides an established rule of corporate successor liability that businesses can rely upon in the planning and structuring of corporate ac-

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Id.

56. 30 Ohio St. 3d 60, 507 N.E.2d 331 (1987).

57. *Id.* at 65, 507 N.E.2d at 336.

58. *See* Cyr v. B. Offen & Co., 501 F.2d 1145, 1154 (1st Cir. 1974) (noting that the underlying policy reasons for the doctrine of strict products liability favor its application to successor corporations); Ramirez v. Amsted Indus., 86 N.J. 332, 341, 431 A.2d 811, 815–16 (1981) (stressing that the traditional approach to corporate successor liability is "inconsistent with the developing principles of strict products liability and unresponsive to the interests of persons injured by defective products in the stream of commerce"); Note, *Successor Liability for Defective Products: A Tort Exception to a Corporate Rule*, 10 HOFSTRA L. REV. 831, 840 (1982) (discussing judicial dissatisfaction with the traditional rule of corporate successor liability in the products-liability context); Comment, *supra* note 34, at 119 (noting that injustice may occur when a products-liability claimant must fall within one of the four traditional exceptions to corporate successor liability in order to recover damages).

quisitions.[59] Under the traditional theory, a successor corporation can—with a fair degree of certainty—control which of its predecessor's liabilities it will assume and which it will not.[60] This aspect of control enables corporate planners to make accurate assessments of the long range costs of acquiring assets. Hence, it can be argued that the traditional theory of corporate successor liability promotes the free alienability of corporate assets and encourages economically-desirable acquisitions by reducing the level of uncertainty involved in such transactions.[61]

Yet, there are also strong policy arguments on the side of those who call for the rejection of the traditional doctrine in the products-liability context. The traditional doctrine of corporate successor liability was not developed in response to the needs of products-liability claimants.[62] Rather, it was fashioned long before the birth of strict products liability and was designed primarily to protect the interests of the commercial creditors and dissenting shareholders of the predecessor corporation.[63] The traditional rule of successor liability can provide adequate protection for shareholders and creditors because their claims arise before or soon after the dissolution of the predecessor corporation. However, this theory often fails to provide an adequate remedy for products-liability plaintiffs whose claims may arise many years after the predecessor's acquisition. For this reason, Justice Sweeney's dissenting opinion in *Flaugher* maintains that the traditional rule of corporate successor liability is a legal anachronism that ignores the social policies underlying the modern doctrine of strict products liability.[64]

Moreover, as at least one commentator has noted, any doctrine for

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59. *See* Note, *Products Liability of Successor Corporations: A Policy Analysis*, 58 IND. L.J. 677, 685 (1983).

60. *See* Note, *Products Liability: Developments in the Rule of Successor Liability for Product-Related Injuries*, 12 U. MICH. J.L. REF. 338, 356 (1979).

61. *Id.* at 356 n.93. Many courts considering the successor liability issue have also discussed the business "certainty" argument. *See, e.g.*, Woody v. Combustion Eng'g, Inc., 463 F. Supp. 817, 821 (E.D. Tenn. 1978) (maintaining that a deviation from the traditional rule of successor liability would "greatly burden[] business transfers and turn ordinary business transactions into traps for unwary successor corporations"); Ray V. Alad Corp., 19 Cal. 3d 22, 25, 560 P.2d 3, 5, 136 Cal. Rptr. 574, 576 (1977) (stating that the insulation provided by the traditional rule has the "undoubted advantage of promoting the free availability and transferability of capital"); Turner v. Bituminous Casualty Co., 397 Mich. 406, 417–18, 244 N.W.2d 873, 878 (1976) (observing the economic reality that in corporate acquisitions "both the transferor and the transferee wish to know as exactly as possible what they are buying and selling in order to establish an appropriate price").

62. *See Turner*, 397 Mich. at 417–18, 244 N.W.2d at 878.

63. *See Ray*, 19 Cal. 3d at 32, 560 P.2d at 10, 136 Cal. Rptr. at 581; *Turner*, 397 Mich. at 418, 244 N.W.2d at 878; Ramirez v. Amsted Indus., 86 N.J. 332, 341, 431 A.2d 811, 815–16 (1981).

64. *Flaugher*, 30 Ohio St. 3d at 68, 507 N.E.2d at 338 (Sweeney, J., dissenting).

determining corporate successor liability should be one that accommodates both the consumer and the business interests involved.[65] Plaintiffs suffering from product-related injuries must be compensated when it is justifiable to do so. But, the law must also continue to recognize business concerns regarding the free alienability of corporate assets. The critical weakness of the traditional rule of corporate successor liability is that it satisfies only one of the interests involved: it focuses singularly on the business concerns and ignores the needs of products-liability claimants. Thus, the traditional doctrine adopted by the Ohio Supreme Court in *Flaugher* will frustrate the necessary accommodation of competing business and consumer interests in the area of corporate successor liability.

B. The Court's Refusal to Adopt the Product-Line Theory

In *Flaugher*, the Ohio Supreme Court refused to adopt the product-line theory of corporate successor liability.[66] The court reasoned that the product-line theory is such a "far-reaching and radical departure from traditional principles . . . that its adoption is a matter for the legislature rather than the courts."[67] As a practical matter, the legislature would be the most effective vehicle for developing a solution to the successor-liability dilemma.[68] However, from a legal standpoint, the majority's argument for judicial restraint in this instance is not entirely persuasive. As Justice Sweeney notes in his dissent, the traditional theory of successor liability and the product-line theory are both common-law concepts.[69] Since these doctrines were created by the courts, it should also be within the province of the courts to examine the policy rationales underlying them.[70]

A number of policy rationales have been offered in support of the product-line theory of corporate successor liability. One argument is that where a successor corporation holds itself out as its predecessor for the purpose of sales, it should be estopped from denying that it is the predecessor for the purpose of assessing products liability.[71] The weak-

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65. Note, *supra* note 59, at 687 (suggesting a rule of corporate successor liability whereby the "successor would not be liable [to the consumer] if it acquired the predecessor's assets in good faith without notice of the existence or likelihood of the type of product defect in question," but would be liable to the consumer where awareness of the defect was established by a preponderance of the evidence).

66. *Flaugher*, 30 Ohio St. 3d at 66–67, 507 N.E.2d at 337.

67. *Id.*

68. *See infra* notes 95–99 and accompanying text.

69. *Flaugher*, 30 Ohio St. 3d at 72, 507 N.E.2d at 341 (Sweeney, J., dissenting).

70. *See id.*

71. *E.g.*, Ray v. Alad Corp., 19 Cal. 3d 22, 34, 560 P.2d 3, 10, 136 Cal. Rptr. 574, 581 (1977) (reasoning that it is "fair and equitable"to attach liability to a successor corporation for a product manufactured by its predecessor where the successor has held itself out as its predecessor

ness of this argument becomes apparent when one considers that an essential element of the holding-out doctrine—reliance—is absent in the successor-liability context.[72] Under the holding-out doctrine, if a third party relies upon representations made by a principal, the principal is responsible to the third party.[73] In the corporate successor context, however, the injured products-liability plaintiff has not relied upon any representations made by the successor corporation.[74] Instead, the claimant has relied upon the predecessor's representations in purchasing the defective product.

Those who support the product-line theory of liability also contend that where a successor corporation has obtained the goodwill and benefits of the predecessor, it also should be required to bear the burden of the predecessor's liabilities.[75] Two challenges can be raised against this line of reasoning. First, the successor has already paid adequate compensation to acquire the goodwill of its predecessor.[76] No reason exists for charging it twice for the receipt of these benefits. Second, the goodwill from which the successor is supposed to benefit may not materialize when the product line acquired becomes associated with defective products.[77]

Another rationale for the adoption of the product-line theory is that the successor corporation has a greater ability to spread the cost of injuries caused by defective products and to obtain insurance against such claims.[78] However, cost-spreading ability alone should never be considered a sufficient reason for holding a manufacturer liable.[79] Fur-

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to potential customers); Ramirez v. Amsted Indus., 86 N.J. 332, 353, 431 A.2d 811, 822 (1981) ("Through acquisition of . . . [the predecessor's] trade name, plant, employees, manufacturing equipment, designs and customer lists, and by holding itself out to potential customers as the manufacturer of the same line of . . . [the predecessor's product, the successor] benefit[s] substantially from the legitimate exploitation of the accumulated good will earned by the . . . [predecessor].").

72. Green, *supra* note 4, at 28–29.

73. *Id.*

74. One court noted that although the reliance argument would be appropriate where a successor has actually sold the defective product to the plaintiff, it would be totally inappropriate where the defective product was purchased from the predecessor. In fact, the court reasoned that the successor corporation in the latter instance "bears no closer relationship to a defective product produced by . . . [its] predecessor than does any other company in the industry which is producing the same product." Woody v. Combustion Eng'g, Inc., 463 F. Supp. 817, 820–21 (E.D. Tenn 1978).

75. Ray v. Alad Corp., 19 Cal. 3d 22, 31, 560 P.2d 3, 9, 136 Cal. Rptr. 574, 580 (1977).

76. Green, *supra* note 4, at 29.

77. Woody v. Combustion Eng'g, Inc., 463 F. Supp. 817, 821 (E.D. Tenn. 1978) (applying Pennsylvania law).

78. *Ray*, 19 Cal. 3d at 33, 560 P.2d at 10, 136 Cal. Rptr. at 581.

79. *See Woody*, 463 F. Supp. at 821. Here, the district court pointed out that although a plaintiff may deserve compensation, such a "charitable instinct is insufficient . . . to justify holding liable a successor corporation, more or less at random, in order simply that a wealthier party

thermore, one commentator has suggested that there is a sharp contrast between business realities and judicial assumptions concerning an enterprise's ability to obtain products-liability insurance.[80] In recent years, the high cost of obtaining such insurance has made it unaffordable to many small- and medium-sized corporations.[81] Moreover, in some cases such insurance is unavailable at any price.[82] Thus, the cost-spreading rationale alone, does not justify the imposition of liability upon the successor corporation.

A fourth line of reasoning that has been used to support the product-line doctrine is the deterrence theory.[83] Generally, under the deterrence theory, liability is imposed upon a manufacturer for its defective products in order to discourage the production of unsafe products and to encourage improvements in product quality.[84] Although the deterrence theory has served as a cornerstone in the products-liability revolution, its relevance in the area of successor liability is questionable. First, in the successor-liability context, the successor corporation has no opportunity to improve the safety of the actual product that has injured the plaintiff.[85] The decisions regarding the design and manufacture of that product were made solely by the predecessor. Second, even without successor liability, the successor corporation has ample incentive to improve the safety of product lines that it acquires since the successor knows that it will be liable for injuries caused by the products that it manufactures.[86] Moreover, one commentator has questioned the very assumption of corporate rationality that underlies the deterrence theory.[87] Managers in "real world" corporations often focus on short-term profits and ignore the implementation of costly changes for improving product safety in the long run.[88] Hence, imposing liability for a predecessor's unsafe products would do little to increase the incentive for the successor to design and manufacture safer products.

A final argument made by proponents of the product-line doctrine

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be burdened." *Id.*

80. Note, *supra* note 59, at 686–87.

81. *Id.* at 686 n.64.

82. One survey conducted for a congressional committee indicated that 21.6% of the businesses seeking products-liability insurance were unable to obtain it at any price. *Id.*

83. Ramirez v. Amsted Indus., 86 N.J. 332, 351, 431 A.2d 811, 821 (1981).

84. *See generally* G. CALABRESI, THE COSTS OF ACCIDENTS 73–75 (1970) (discussing how general deterrence reduces both the number and the severity of accidents in our society).

85. Note, *supra* note 59, at 701 (reasoning that to hold "the successor liable for the predecessor's products cannot improve the quality of those products, as they have already been produced and distributed").

86. *Id.*

87. Henderson, *Product Liability and the Passage of Time: The Imprisonment of Corporate Rationality*, 58 N.Y.U. L. REV. 765 (1983).

88. *Id.* at 781–82.

is that liability should be imposed on the successor corporation because it can act as a conduit for channeling losses back to the predecessor corporation.[89] Some have argued that the successor can accomplish this goal by discounting the purchase price of the predecessor in accordance with its expected future liability.[90] The strength of this rationale lies in its recognition that the predecessor corporation should bear the costs of injuries caused by its defective products.[91] Conversely, the obvious weakness is that successor corporations that have already engaged in acquisitions cannot channel losses back to their predecessors.[92] Thus, when applied retrospectively, the conduit theory fails to offer a sound basis for imposing liability upon a successor corporation.

As the analysis of the rationales above indicates, the product-line theory of corporate successor liability satisfies the needs of the injured plaintiff but fails to provide any justification for shifting the loss from the plaintiff to the successor corporation. In the final analysis, the product-line theory—like the traditional doctrine—fails to provide for the necessary accommodation of competing business and consumer interests in the area of corporate successor liability.

C. *The Impact of* Flaugher

The *Flaugher* decision clearly illustrates the dilemma that a court faces when confronting the issue of corporate successor liability: if the court adopts the traditional theory, the interests of injured products liability claimants will be frustrated. If the court adopts the product line theory, successor corporations will be forced to compensate products liability claimants even though there is no sound legal rationale for doing so. The Ohio Supreme Court has chosen the former theory and rejected the latter.[93] Thus, in Ohio the interests of the business community will continue to be satisfied at the expense of injured plaintiffs left remediless by the traditional doctrine of corporate successor liability.

Yet, one positive outcome could result from the *Flaugher* decision. The harshness of the traditional doctrine on consumer interests may prompt the Ohio General Assembly to consider the issue of corporate successor liability. In fairness, it should be noted that courts are in many ways ill-equipped to deal with the issue of successor liability.[94]

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89. Green, *supra* note 4, at 39–40.

90. *Id.*

91. *See id.*

92. *See* Note, *supra* note 58, at 854.

93. *Flaugher*, 30 Ohio St. 3d at 60, 507 N.E.2d at 337.

94. *See* Leannais v. Cincinnati, Inc., 565 F.2d 437, 494 n.7 (7th Cir. 1977) (applying Wisconsin law). In *Leannais*, the Court of Appeals for the Seventh Circuit stated that the issue of successor liability raised several questions that were more amenable to legislative investigation and determination than to judicial resolution. Among the questions were the following: (1) whether the

Legislatures, on the other hand, are the most effective vehicles for developing a solution to the successor-liability dilemma. At least one commentator has contended that a legislative solution to the successor-liability issue would avoid many of the pitfalls facing judicial solutions.[95] First, the legislature has the power to make the necessary changes in insurance law that must accompany any major expansion of successor liability.[96] Second, a precise and comprehensive statute on the successor liability issue could both avoid the amorphousness that is inherent in common-law regulation and provide corporate planners with the degree of certainty and specificity that they require.[97] Finally, a legislative solution to the successor-liability issue could channel the costs of product-related injuries back to the predecessor corporation in a fair and equitable manner.[98] A prospective successor-liability statute could notify a future successor corporation to discount the purchase price of the predecessor corporation in accordance with its expected products liability.[99] Such a solution would rightfully place the costs of compensating the injured claimant on the entity that designed, manufactured, and sold the defective product—the predecessor. Realistically, a legislative solution to the successor-liability dilemma would face significant political opposition.[100] However, this solution may represent the only hope for accommodating both business and consumer interests in the area of successor liability.

V. CONCLUSION

The Ohio Supreme Court faced a difficult decision in *Flaugher v.*

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mounting costs of such change can be absorbed by insurance; (2) whether products liability costs may grow so high in one state as to encourage business emigration; (3) whether the relationship of workmen's compensation laws to product liability laws should be adjusted; and (4) whether the many other economic and social effects of such an exception can be justified. *Id.*

95. Note, *supra* note 60 at 393–94 (discussing the superiority of legislative reform in the area of corporate successor liability).

96. *See generally* Note, *Products Liability and Successor Corporations: Protecting the Product User and the Small Manufacturer Through Increased Availability of Products Liability Insurance,* 13 U.C. DAVIS L. REV. 1000, 1025–32 (1980) (suggesting legislative reforms that would make products-liability insurance both more affordable and more available).

97. Green, *supra* note 4, at 44.

98. It is, of course, true that courts could also implement a prospective solution to the successor-liability dilemma. However, no court has done so as of September 14, 1988. And, even if courts were to do so, a judicial solution would still face the problems of the need for expanded insurance availability and the amorphousness of common-law regulation.

99. Note, *supra* note 58, at 854.

100. While consumer-interest groups would support such legislation, business interests, in general, would oppose the idea of expanding corporate successor liability. Insurance companies, in particular, would have the most to lose from such legislation because it would probably necessitate increased government regulation of the insurance industry in order to make products-liability insurance more affordable and more available.

Cone Automatic Machine Co.[101] The court was asked to decide whether successor-liability law in Ohio should satisfy the business community's needs for certainty in corporate acquisitions or the injured claimant's needs for recovery in products liability. The supreme court's adoption of the traditional theory evidences its desire to meet the needs of the former at the expense of the latter. Some excuse for this decision may lie in the elusive nature of a judicial solution for accommodating both the business and consumer interests involved. However, what cannot be excused is the court's failure to discuss the relevant policy arguments underlying the various doctrines of corporate successor liability. The Ohio Supreme Court offered little or no justification for its adoption of the traditional theory of successor liability. Moreover, the court avoided any consideration of the rationales behind the product-line theory by invoking an inappropriate argument for judicial restraint. It can only be hoped that the inequities of this decision will prompt the Ohio General Assembly to examine and justly resolve the issue of corporate successor liability.

Jeffrey Allen Mullins

101. 30 Ohio St. 3d 60, 507 N.E.2d 331 (1987).