

## NOTES

### CORPORATIONS—PRODUCTS LIABILITY—CORPORATE TRANSACTION STRUCTURED AS A SALE OF ASSETS TREATED AS DE FACTO MERGER SO AS TO HOLD TRANSFEREE CORPORATION ACCOUNTABLE FOR PRODUCTS LIABILITY CLAIM AGAINST DISSOLVED TRANSFEROR—*Knapp v. North American Rockwell Corp.*, 506 F.2d 361 (3d Cir. 1974)

Stanley Knapp, an employee of Mrs. Smith's Pie Company, was seriously injured on October 6, 1969, when he caught his hand in an unprotected chain of an automatic packaging machine.<sup>1</sup> The machine, manufactured by Textile Machine Works (TMW), had been delivered to Knapp's employer in 1967.<sup>2</sup>

In April of 1968, eighteen months prior to Mr. Knapp's injury, TMW had negotiated an agreement with North American Rockwell Corporation (Rockwell), whereby Rockwell acquired substantially all the assets<sup>3</sup> and liabilities<sup>4</sup> of TMW in exchange for Rockwell stock.<sup>5</sup> The agreement also stipulated that on the closing

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<sup>1</sup> Memorandum and Order, *Knapp v. North Am. Rockwell Corp.*, Civil No. 71-668 (E.D. Pa., Nov. 21, 1973), reprinted in Appendix to Appellant's Briefs at 116a, *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361 (3d Cir. 1974) [hereinafter cited as Appendix to Appellant's Briefs].

<sup>2</sup> Memorandum and Order, *Knapp v. North Am. Rockwell Corp.*, Civil No. 71-668 (E.D. Pa., Nov. 21, 1973), reprinted in Appendix to Appellant's Briefs, *supra* note 1, at 116a.

<sup>3</sup> *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361, 363 (3d Cir. 1974). Termed the "Agreement And Plan Of Reorganization" by the parties, this contract provided that Rockwell would acquire "substantially all of the property, assets and business of TMW." Appendix to Appellant's Briefs, *supra* note 1, at 3a. Among the assets acquired by Rockwell were TMW's good will, the right to use the name "Textile Machine Works" to the exclusion of TMW, and TMW's entire manufacturing operation, including existing patents, copyrights, licenses, and contract rights. *Id.* at 4a.

The plan called for TMW to retain the following assets: (1) its corporate seal, charter, minute and stock books, and various corporate records, and (2) \$500,000 in cash to cover TMW's dissolution costs, including the expenses incurred in satisfying the preferred shareholders of TMW who demanded cash for their shares. Any balance of the \$500,000 remaining at the date of TMW's dissolution was to be transferred to Rockwell. *Id.* at 4a-5a.

<sup>4</sup> *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361, 363 (3d Cir. 1974). Rockwell expressly did not assume

"liabilities against which TMW is insured or otherwise indemnified to the extent of such insurance or indemnification unless the insurer or indemnitor agrees in writing to insure and indemnify [Rockwell] to the same extent as it was so insuring and indemnifying TMW."

*Id.* (brackets added by the *Knapp* court).

<sup>5</sup> *Id.* The agreement stipulated that in consideration for the transfer of its assets to Rockwell, TMW was to receive "certificates for 285,000 shares of [Rockwell's] \$4.75 Convertible Preferred Stock." Appendix to Appellant's Briefs, *supra* note 1, at 5a.

date, TMW would change its name and promptly thereafter distribute among its shareholders the stock received from Rockwell. Additionally, "[a]s soon as practicable after the last of such distributions," TMW was required to "wind up its affairs and dissolve."<sup>6</sup>

Subsequent to the closing date of August 29, 1968, TMW changed its name to TM Company<sup>7</sup> but "could not undertake any active operations."<sup>8</sup> Rather, its corporate efforts were directed primarily toward eventual dissolution.<sup>9</sup> Thereafter, on February 20, 1970, almost eighteen months after the closing date and four months after Mr. Knapp sustained his injury, TM Company was dissolved.<sup>10</sup>

On March 22, 1971, Mr. Knapp instituted suit against Rockwell in the federal district court for the Eastern District of Pennsylvania,<sup>11</sup> alleging that TMW's negligent design and manufacture of the machine caused his injury, "and that Rockwell, as TMW's successor, [was] liable for such injuries."<sup>12</sup> Rockwell countered this allegation, in a motion for summary judgment, with the contention that it was not accountable for the liabilities of TMW which it did not expressly assume.<sup>13</sup> Rockwell's motion was granted by the court.<sup>14</sup> Subsequently, the plaintiff filed a motion for rehear-

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<sup>6</sup> *Id.* at 11a.

<sup>7</sup> Brief for Appellee at 2, *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361 (3d Cir. 1974).

<sup>8</sup> *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361, 369 (3d Cir. 1974).

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 363.

<sup>11</sup> *Id.* Jurisdiction was vested in the federal district court pursuant to 28 U.S.C. § 1332(a), (c) (1966) by virtue of the fact that Rockwell was incorporated under the laws of Delaware, Knapp was a resident of Pennsylvania, and the damages prayed for exceeded \$10,000. Complaint, *Knapp v. North Am. Rockwell Corp.*, Civil No. 71-668 (E.D. Pa., Nov. 21, 1973), reprinted in Appendix to Appellant's Briefs, *supra* note 1, at 53a.

<sup>12</sup> *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361, 363 (3d Cir. 1974).

Following Rockwell's answer denying responsibility for the alleged negligent design or manufacture of the machine, Knapp brought a separate action in July of 1972 against TMW in a Pennsylvania state court. Since this action was commenced 33 months after Knapp's injury and almost 29 months after TMW was dissolved, the suit was barred by either PA. STAT. ANN. tit. 12, § 31 (1953) (two year statute of limitations for personal injury actions) or PA. STAT. ANN. tit. 15, § 2111 (Supp. 1974-75) (statute barring suits against dissolved corporations initiated more than two years after date of dissolution). *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361, 363 n.3 (3d Cir. 1974).

<sup>13</sup> Defendant's Motion for Summary Judgment, *Knapp v. North Am. Rockwell Corp.*, Civil No. 71-668 (E.D. Pa., Nov. 21, 1973), reprinted in Appendix to Appellant's Briefs, *supra* note 1, at 83a.

Prior to moving for summary judgment, Rockwell joined Knapp's employer, Mrs. Smith's Pie Company, as a third-party defendant. *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361, 363 (3d Cir. 1974).

<sup>14</sup> *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361, 363 (3d Cir. 1974).

ing and reconsideration.<sup>15</sup> In denying this motion, the district court ruled that the agreement between Rockwell and TMW did not constitute a merger, consolidation, or continuation, and that Rockwell did not assume TMW's liability for injuries caused by defective products.<sup>16</sup> The court concluded:

Rockwell is not liable for the debts and liabilities of [TMW], which have not been assumed by it, merely by virtue of its purchase of [TMW's] assets.<sup>17</sup>

The plaintiff appealed the order granting Rockwell's motion for summary judgment on December 11, 1973.<sup>18</sup>

In *Knapp v. North American Rockwell Corp.*,<sup>19</sup> the Court of Appeals for the Third Circuit reversed the judgment of the district court, rejecting Rockwell's position that no liability should attach as a consequence of this transaction—technically structured as a sale of assets.<sup>20</sup> Although the court recognized that judicial determinations rendered in analogous cases in other jurisdictions “may suggest that the arrangement between Rockwell and TMW should be considered a sale rather than a merger or a continuation,”<sup>21</sup> it nevertheless

conclude[d] that, for the purpose of determining liability to tortiously injured parties, the . . . transaction should be treated as a merger, thereby subjecting Rockwell to liability for injuries caused by defective products distributed by TMW prior to the transaction.<sup>22</sup>

In reaching this result, the court gave primary emphasis to “public policy considerations” relevant to the question of which party may best bear the loss.<sup>23</sup> In so doing, the *Knapp* court has developed a unique, result-oriented approach to products liability claims made against a corporation purchasing substantially all the assets of another.

Traditionally, courts dealing with questions of liability following a joinder of corporate entities or assets have begun their

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<sup>15</sup> *Id.*

<sup>16</sup> Memorandum and Order, *Knapp v. North Am. Rockwell Corp.*, Civil No. 71-668 (E.D. Pa., Nov. 21, 1973), reprinted in Appendix to Appellant's Briefs, *supra* note 1, at 118a-20a.

<sup>17</sup> *Id.* at 120a.

<sup>18</sup> *Knapp v. North Am. Rockwell Corp.*, 506 F.2d 361, 363 (3d Cir. 1974).

<sup>19</sup> 506 F.2d 361 (3d Cir. 1974).

<sup>20</sup> *Id.* at 364, 370.

<sup>21</sup> *Id.* at 367.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* at 367, 369-70.

analysis by stating a well-recognized general rule that a transferee of corporate assets does not, by reason of its succession to the ownership of the property, become liable for the obligations of the transferor.<sup>24</sup> Nevertheless, courts have recognized exceptions to the foregoing rule<sup>25</sup> where: (1) there is an express or implied assumption by the transferee of such liabilities;<sup>26</sup> (2) the transaction is tantamount to a merger or consolidation of the two entities;<sup>27</sup> (3)

<sup>24</sup> See, e.g., *West Tex. Ref. & Dev. Co. v. Commissioner*, 68 F.2d 77, 81 (10th Cir. 1933); *Shannon v. Samuel Langston Co.*, 379 F. Supp. 797, 800 (W.D. Mich. 1974); *Kloberdanz v. Joy Mfg. Co.*, 288 F. Supp. 817, 820 (D. Colo. 1968); *W. FLETCHER, PRIVATE CORPORATIONS* § 7122, at 188 (rev. ed. 1973) [hereinafter cited as *FLETCHER*].

The *Kloberdanz* court recognized that this "rule speaks of a transfer of all a corporation's assets," however, it felt that the applicability of this rule should not turn on whether all the assets were transferred, but rather on whether the sale was bona fide, i.e., made for consideration sufficient to enable the transferor to respond to claims of liability made against it. *Kloberdanz v. Joy Mfg. Co.*, *supra* at 820-21 & n.2 (emphasis by the court). *Accord*, *Pierce v. Riverside Mortgage Sec. Co.*, 25 Cal. App. 2d 248, 257, 77 P.2d 226, 230-31 (Dist. Ct. App. 1938).

<sup>25</sup> For an extensive compilation of cases addressing these exceptions see *FLETCHER, supra* note 24, § 7122 & 192-96 nn.6-11. The general rule and its exceptions are also applicable to questions of the transferor's liability for tortious conduct of the transferee. See *id.* § 7123.

<sup>26</sup> See, e.g., *Bouton v. Litton Indus., Inc.*, 423 F.2d 643, 652 (3d Cir. 1970); *FLETCHER, supra* note 24, § 7122, at 188, 192-93 nn. 6-7.

<sup>27</sup> *FLETCHER, supra* note 24, § 7122, at 188, 193-94 n.8. Although the terms consolidation and merger have often been used interchangeably, each has its own distinct legal meaning. *Id.* § 7041, at 6-7, 12-13 nn.13-15.

A consolidation describes a unification of two or more corporations into a new corporate enterprise. All their assets and liabilities inure to the new amalgamation, while the constituent corporations cease to exist. *Applestein v. United Bd. & Carton Corp.*, 60 N.J. Super. 333, 342, 159 A.2d 146, 151 (Ch.), *aff'd per curiam*, 33 N.J. 72, 161 A.2d 474 (1960). A consolidation cannot occur if any of the constituent corporations fail to terminate their corporate existence. *Kloberdanz v. Joy Mfg. Co.*, 288 F. Supp. 817, 821 (D. Colo. 1968) (no consolidation found where a consequence of purchase agreement did not result in a new corporation being created).

A merger signifies the absorption by one corporation of another's entire operations, with the absorbing entity continuing in the expanded corporate form and the absorbed corporation relinquishing its corporate identity. *Applestein v. United Bd. & Carton Corp.*, 60 N.J. Super. at 342, 159 A.2d at 151.

A merger is distinguishable from a sale of assets. In *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 302-03, 93 A.2d 107, 112 (Sup. Ct. 1952), the court noted that

[a] merger may be said to "involve" a sale of assets, in the sense that the title to the assets is by operation of law transferred from the constituent corporation to the surviving corporation; but it is not the same thing. . . . A merger ordinarily contemplates the continuance of the enterprise and of the stockholder's investment therein, though in altered form; a sale of all assets . . . ordinarily contemplates the liquidation of the enterprise. In the first case the stockholder of the merged corporation is entitled to receive directly securities substantially equal in value to those he held before the merger; in the latter case he receives nothing directly, but his corporation is entitled to receive the value of the assets sold.

In *Forest Laboratories, Inc. v. Pillsbury Co.*, 452 F.2d 621, 626 (7th Cir. 1971), no merger was found when the transferor corporation continued to operate by leasing buildings which housed the assets sold.

the transferee was a mere continuation of the transferor;<sup>28</sup> (4) the transaction was fraudulently undertaken in order to avert liability;<sup>29</sup> and (5) there is an absence of adequate consideration for the transfer.<sup>30</sup> A judicial finding that one or more of these enumerated exceptions is present will lead to the imposition of some measure of liability on the transferee corporation.

Cognizant of the foregoing general rule and its exceptions, the *Knapp* court directed considerable attention to the plaintiff's allegation that the transaction constituted a merger.<sup>31</sup> Heretofore, courts confronted with similar allegations have structured their analysis of a case exclusively within the framework provided by the judicially developed de facto merger doctrine.<sup>32</sup> This doctrine has permitted

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<sup>28</sup> See, e.g., *Alexander & Baldwin, Inc. v. Peat, Marwick, Mitchell & Co.*, 385 F. Supp. 240, 242-43 (S.D.N.Y. 1974). This exception has been recognized to embrace a corporate reorganization, such as is sometimes achieved pursuant to Chapter X of the Bankruptcy Act. *J.F. Anderson Lumber Co. v. Meyers*, 296 Minn. 33, 38, 206 N.W.2d 365, 369 (1973). See Bankruptcy Act §§ 101-276, 11 U.S.C. §§ 501-676 (1970). Unlike a merger or consolidation, where two distinct corporate entities exist before the transaction is consummated, a continuation contemplates a situation where a single corporation transfers all its property, management, and shareholders to a second corporation created for the purpose of acquiring these interests. *FLETCHER*, *supra* note 24, § 7205, at 393-94. A continuation has been described as "simply a change in the manner and form of carrying on the same business by the same persons." *Andres v. Morgan*, 62 Ohio St. 236, 245, 56 N.E. 875, 877 (1900). For liability to be imposed in such a situation, the transferee "corporation must represent merely a 'new hat' for the seller." *McKee v. Harris-Seybold Co.*, 109 N.J. Super. 555, 570, 264 A.2d 98, 106 (L. Div. 1970) (citing *Bergman & Lefkow Ins. Agency v. Flash Cab Co.*, 110 Ill. App. 2d 415, 431-32, 249 N.E.2d 729, 737 (1969)). Nevertheless, the mere continuation of the business activities of the transferor by the transferee will not be sufficient to invoke this exception if the consideration received by the transferor was adequate. *J.F. Anderson Lumber Co. v. Meyers*, *supra* at 40, 206 N.W.2d at 370. See *Jackson v. Diamond T. Trucking Co.*, 100 N.J. Super. 186, 196-97, 241 A.2d 471, 477 (L. Div. 1968) (continuation found where consideration only nominal). *But see Fena v. Peppers Fruit Co.*, 185 Minn. 137, 140-41, 239 N.W. 898, 899-900 (1931) (receiving corporation held liable despite paying adequate consideration where there was continuity of business, corporate name, and management).

<sup>29</sup> *FLETCHER*, *supra* note 24, § 7122, at 188, 194 n.9; *id.* § 7125, at 201.

<sup>30</sup> *McKee v. Harris-Seybold Co.*, 109 N.J. Super. 555, 561, 264 A.2d 98, 101-02 (L. Div. 1970). In *McKee*, the court noted the primary policy consideration for impos[ing] liability upon the purchasing corporation when it has not given adequate consideration is that the seller will be thereby rendered insolvent and unable to pay its debts.

*Id.* at 571, 264 A.2d at 107.

This exception has not been expressly recognized in all jurisdictions. See, e.g., *Shane v. Hobam, Inc.*, 332 F. Supp. 526, 527-28 (E.D. Pa. 1971). Some courts, however, have construed lack of adequate consideration to act as a fraud upon creditors, thus warranting the imposition of liability. See, e.g., *Economy Ref. & Serv. Co. v. Royal Nat'l Bank*, 20 Cal. App. 3d 434, 439, 97 Cal. Rptr. 706, 710 (Dist. Ct. App. 1971).

<sup>31</sup> 506 F.2d at 363-64.

<sup>32</sup> For the specific criteria used by courts to determine the presence of a de facto merger see notes 34-37 *infra* and accompanying text.

courts to attach the incidents of a statutory merger to a given transaction if the consequences of the transaction bear a close resemblance to those which would have resulted had the parties effected their corporate restructuring by following prescribed statutory merger procedures.<sup>33</sup> Among the consequences considered by courts in determining whether a specific corporate combination should be treated as a merger are: (1) the dissolution of the transferor's corporate existence immediately following the transaction;<sup>34</sup> (2) the absorption by the transferee of the shareholders of the transferor;<sup>35</sup> (3) a broad assumption of the transferor's liabilities by the transferee;<sup>36</sup> and (4) the lack of sufficient assets by the transferor with which to meet its financial obligations following the transaction.<sup>37</sup>

The de facto merger doctrine developed as a judicial reply to situations in which a transaction between two corporations resulted in the transferor corporation being financially incapable of satisfying claims of creditors or tort victims.<sup>38</sup> The applicability of this

<sup>33</sup> See, e.g., *Applestein v. United Bd. & Carton Corp.*, 60 N.J. Super. 333, 344-45, 348-49, 159 A.2d 146, 152-55 (Ch.), *aff'd per curiam*, 33 N.J. 72, 161 A.2d 474 (1960).

<sup>34</sup> See, e.g., *McKee v. Harris-Seybold Co.*, 109 N.J. Super. 555, 566-67, 264 A.2d 98, 104-05 (L. Div. 1970) (no de facto merger where, *inter alia*, the transferor operated and functioned as a corporation for fourteen months following the sale).

<sup>35</sup> See, e.g., *Good v. Lackawanna Leather Co.*, 96 N.J. Super. 439, 452-54, 233 A.2d 201, 208-09 (Ch. 1967) (no de facto merger where, *inter alia*, neither transferor nor its stockholders acquired shares of transferee).

<sup>36</sup> See, e.g., *Shannon v. Samuel Langston Co.*, 379 F. Supp. 797, 801 (W.D. Mich. 1974) (de facto merger where, *inter alia*, transferee assumed those obligations of transferor necessary to continue transferor's business operations without interruption).

<sup>37</sup> See, e.g., *Ruedy v. Toledo Factories Co.*, 61 Ohio App. 21, 28-29, 22 N.E.2d 293, 296 (1939) (de facto merger where, *inter alia*, transferor was left with no assets with which to meet obligations following transfer). See notes 29-30 *supra*.

<sup>38</sup> See Annot., 11 L.R.A. 1119 (1907). Typically, a corporation would transfer all its assets in exchange for stock and subsequently distribute the stock to its shareholders without satisfying all claims of creditors. Courts viewed such a transaction as a depletion of the creditors' "trust fund" and adopted an equitable doctrine permitting the assets to be traced into the hands of the transferee. See, e.g., *City of Altoona v. Richardson Gas & Oil Co.*, 81 Kan. 717, 106 P. 1025 (1910), in which the court recognized that

"[w]here . . . there is an absorption of the business and assets—in other words, a merger *de facto*—by either a corporation formed for the purpose or one already in business, the liability of the corporation receiving the assets is rested upon the familiar trust-fund doctrine . . ."

*Id.* at 718-19, 106 P. at 1025 (quoting from Annot., 11 L.R.A. 1120 (1907)) (emphasis in original). *Accord*, *Grenell v. Detroit Gas Co.*, 112 Mich. 70, 70 N.W. 413 (1897).

It has been held that the mere transfer of all the assets of one corporation to another for stock is not, of itself, sufficient to make the transferee liable for the debts of the transferor. *Ozan Lumber Co. v. Davis Sewing Mach. Co.*, 284 F. 161, 172-73 (D. Del. 1922) (creditor cannot invoke equitable principle of tracing the assets unless it can be shown that the consideration paid was inadequate); *American Ry. Exp. Co. v. Commonwealth*, 190 Ky.

doctrine subsequently took on a second perspective as courts confronted the question of whether to grant dissenting shareholders appraisal rights in transactions not conforming to a state's statutory merger provisions. Corporations often circumvented the statutory scheme by structuring a transaction as a straight sale of assets or exchange of stock, thereby avoiding the incidents of merger.<sup>39</sup> To counteract such corporate circumventions, courts have invoked the de facto merger doctrine in an attempt to afford minority shareholders the statutory safeguards of dissent and appraisal.<sup>40</sup>

The degree to which an intercorporate transaction must resemble a statutory merger, thereby warranting a judicial finding of de facto merger and its accompanying liability, can best be determined by analyzing past decisions which have significantly contributed to the development of the de facto merger doctrine. In

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636, 644, 228 S.W. 433, 437 (1920) (transferee not liable for debts of transferor without showing of actual fraud or contract obligation).

Liability for the tortious acts of the transferor prior to the transfer were sometimes ascribed to the transferee where the transfer included all assets of the transferor leaving the transferor with insufficient funds with which to respond to tort claims. *See, e.g.,* *Malone v. Red Top Cab Co.*, 16 Cal. App. 2d 268, 272-74, 60 P.2d 543, 545-46 (Dist. Ct. App. 1936) (transferee liable where consideration received by transferor was merely assumption of transferor's liabilities).

<sup>39</sup> *See, e.g.,* *Farris v. Glen Alden Corp.*, 393 Pa. 427, 143 A.2d 25 (1958). In *Farris*, the advantages to be gained by avoiding the appropriate statutory merger procedure were seen to be: (1) the evasion of a state realty transfer tax; (2) the retention of considerable tax loss carryovers; and (3) the effectuation of the transaction without having to grant dissenting shareholders the right of appraisal. Note, *Intercorporate Sale of Assets Unifying Stockholder Interests Held De Facto Merger and Enjoined for Failure to Notify of Appraisal Rights Under Merger Statute*, 59 COLUM. L. REV. 366, 366 (1959).

<sup>40</sup> The right of appraisal has been granted to shareholders of merging corporations in almost all jurisdictions. *See* *Latin, Minority and Dissenting Shareholders' Rights in Fundamental Changes*, 23 LAW & CONTEMP. PROB. 307, 310-11 (1958). This right was not popular at common law since it was generally recognized that fundamental corporate change could be accomplished only with unanimous shareholder approval. *See, e.g.,* *Meyerhoff v. Bankers Sec., Inc.*, 105 N.J. Eq. 76, 78-79, 147 A. 105, 105-06 (Ch. 1929); *Kean v. Johnson*, 9 N.J. Eq. 401, 413-15, 419-23 (Ch. 1853). *But see* *Treadwell v. Salisbury Mfg. Co.*, 73 Mass. (7 Gray) 393, 404-06 (1856). Each shareholder was considered to have a contractual right to demand that the corporation continue to fulfill the purposes for which it was created. *See* *Folk, De Facto Mergers in Delaware: Hariton v. Arco Electronic, Inc.*, 49 VA. L. REV. 1261, 1264 (1963). *Cf. Latin, supra* at 308. However, modern business needs required legislatures to take a fresh approach in order to facilitate corporate growth through merger and consolidation. Thus, corporations were granted the power to merge with less than unanimous shareholder approval. *See* *Levy, Rights of Dissenting Shareholders to Appraisal and Payment*, 15 CORNELL L.Q. 420, 420-21 (1930).

Although dissenters could not thereafter individually block such corporate change elicited by a proper vote of shareholders, it was felt that some relief should be granted to those unwilling to continue as members of a venture vastly different from that to which they had originally subscribed. This relief was provided in the form of appraisal rights. *See id.* at 421. Many states have extended this right to minority shareholders of corporations selling all or substantially all their assets. *See Latin, supra* at 311 & n.6.

*Farris v. Glen Alden Corp.*,<sup>41</sup> Glen Alden, a corporation engaged primarily in coal mining, and List Industries, a diversified holding company, entered into a "reorganization agreement," approved by a majority of Glen Alden's shareholders, whereby Glen Alden would acquire all of the assets and assume the liabilities of List in exchange for stock. The stock was to be distributed to List shareholders and thereafter List would dissolve.<sup>42</sup> A minority shareholder of Glen Alden sued to enjoin the plan, asserting that the transaction amounted to a merger and, as such, management's failure to comply with the Pennsylvania statutory provision requiring shareholder notification of dissent and appraisal rights under merger proposals must render the Glen Alden shareholder votes, and consequently the agreement, invalid.<sup>43</sup> A unanimous Pennsylvania supreme court agreed.<sup>44</sup> In granting the injunction, the court placed primary emphasis on the following common law rationale upon which the aforementioned statute was based:

[W]hen a corporation combines with another so as to lose its essential nature and alter the original fundamental relationships of the shareholders among themselves and to the corporation, a shareholder who does not wish to continue his membership therein may treat his membership in the original corporation as terminated and have the value of his shares paid to him.<sup>45</sup>

Since the plaintiff would lose his Glen Alden stock and have "the stock of a new company thrust upon him in its place,"<sup>46</sup> and since the "essential nature" of Glen Alden would be transformed from a coal mining corporation to a diversified holding company, the requisites of the foregoing principle were deemed satisfied.<sup>47</sup> The court concluded that despite the form of the agreement, its substance

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<sup>41</sup> 393 Pa. 427, 143 A.2d 25 (1958).

<sup>42</sup> *Id.* at 428-30, 143 A.2d at 26-27. List was to retain a small amount of cash to defray expenses connected with its dissolution. *Id.* at 429, 143 A.2d at 27.

<sup>43</sup> *Id.* at 430-31, 143 A.2d at 27-28.

<sup>44</sup> *Id.* at 438, 143 A.2d at 31.

<sup>45</sup> *Id.* at 433, 143 A.2d at 29. This principle was initially espoused in *Lauman v. Lebanon Valley R.R.*, 30 Pa. 42, 46-49 (1858), in which, despite the absence of statutory protection, a shareholder of a transferor corporation, objecting to a planned corporate consolidation, was held to have the right of appraisal. In *Bloch v. Baldwin Locomotive Works*, 75 Pa. D. & C. 24 (C.P. Del. County 1950), the court adopted the *Lauman* rationale to support its finding that shareholders of a transferee corporation had appraisal rights. *Id.* at 34-37, 43. *Lauman* was regarded in *Marks v. Autocar Co.*, 153 F. Supp. 768, 771 (E.D. Pa. 1954), as representing a sound legal principle which could not be circumvented merely by failing to follow the statutory merger procedures. This position was reaffirmed in *Troupiansky v. Henry Disston & Sons*, 151 F. Supp. 609, 611-12 & n.4 (E.D. Pa. 1957).

<sup>46</sup> 393 Pa. at 435, 143 A.2d at 30.

<sup>47</sup> *Id.* at 434-35, 143 A.2d at 29-30.



and consequences necessitated the recognition of a de facto merger in order that the protective provisions of the statute could be invoked.<sup>48</sup>

The "substance over form" approach developed in *Farris* was subsequently adopted in New Jersey in *Applestein v. United Board & Carton Corp.*,<sup>49</sup> wherein a judicial finding of de facto merger was reached. In *Applestein*, two corporations, Interstate and United, proposed an exchange of stock whereby all of the shares of Interstate were to be transferred to United in exchange for 160,000 previously unissued shares of United's common stock and the assumption by United of Interstate's liabilities.<sup>50</sup> Additionally, Epstein, the sole shareholder of Interstate, would assume the presidency of United following Interstate's dissolution.<sup>51</sup> The proxy statement issued by United to its shareholders did not designate the agreement as a merger, and further advised that shareholders voting against the proposal would not be afforded the right of appraisal.<sup>52</sup> Minority shareholders of United brought an action to restrain this plan, claiming the proposed corporate action was, in legal effect, a merger and, as such, entitled them to appraisal rights.<sup>53</sup>

Relying on the weight of established authority, including *Farris*, the court was satisfied

that it is proper to disregard the *form* of a sale or purchase of assets transaction, when its characteristics are virtually identical to those of a statutory merger . . . for the purpose of insuring dissenting stockholders their appraisal rights.<sup>54</sup>

Hinting that the "outward appearance" of the proposal was "de-

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<sup>48</sup> *Id.* at 438, 143 A.2d at 31. The court recognized that modern federal tax laws have prompted lawyers and accountants to develop "hybrid forms" of reorganization, the true implications of which are not always easily discernible "solely by reference to the various elements therein." *Id.* at 432, 143 A.2d at 28. Thus, to properly characterize a transaction, not only must the terms of the agreement be analyzed, "but also . . . the consequences of the transaction and . . . the purposes of the provisions of the corporation law said to be applicable." *Id.*

<sup>49</sup> 60 N.J. Super. 333, 350-51, 159 A.2d 146, 155-56 (Ch.), *aff'd per curiam*, 33 N.J. 72, 161 A.2d 474 (1960).

<sup>50</sup> 60 N.J. Super. at 338-39, 159 A.2d at 149-50. The result of this "exchange" would give the sole shareholder of Interstate a 40 percent controlling interest of United. *Id.* at 339, 159 A.2d at 149.

<sup>51</sup> *Id.* at 338-40, 159 A.2d at 149-50.

<sup>52</sup> *Id.* at 340-41, 159 A.2d at 150. The proposal was submitted to the United shareholders in compliance with a New York Stock Exchange requirement calling for majority shareholder approval of a corporate issuance of common stock. If the agreement had been pursued under the New Jersey merger statute, a two-thirds shareholder vote would have been required. *Id.*

<sup>53</sup> *Id.* at 336-37, 159 A.2d at 148.

<sup>54</sup> *Id.* at 350-51, 159 A.2d at 156 (emphasis by the court).

ceptive," the court noted that the agreement had every element that would be present in a statutory merger "except, perhaps, a formal designation of the transaction as a 'merger.'"<sup>55</sup>

This examination of the "substance" of the agreement led the court to conclude that the transaction constituted a merger, "or what the court described in the *Farris* case . . . as a 'de facto merger,'"<sup>56</sup> particularly in light of the alteration of the "fundamental relationship" between United and its shareholders, the shift in "working control of United to Epstein and his [Interstate] associates,"<sup>57</sup> and the total "pooling of interests" of the two corporate entities with the contemplated dissolution of Interstate following the transfer.<sup>58</sup>

While *Farris* and *Applestein* concerned the application of the de facto merger doctrine for the limited purpose of ascertaining shareholders' rights of dissent and appraisal, the criteria adopted therein for the finding of a de facto merger have been subsequently utilized by courts dealing with issues of corporate liability in products liability actions. In *Kloberdanz v. Joy Manufacturing Co.*,<sup>59</sup> Joy purchased for cash the bulk of the assets and certain specified liabilities of Web-Wilson, a manufacturer of oil drilling machinery.<sup>60</sup> Among the liabilities not expressly assumed by Joy were

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<sup>55</sup> *Id.* at 348-49, 159 A.2d at 154.

The court noted that the following factors found to exist here would also have been present had the parties merged under the New Jersey statute:

(1) a transfer of all the shares and all the assets of Interstate to United; (2) an assumption by United of Interstate's liabilities; (3) a "pooling of interests" of the two corporations; (4) the absorption of Interstate by United, and the dissolution of Interstate; (5) a joinder of officers and directors from both corporations on an enlarged board of directors; (6) the present executive and operating personnel of Interstate will be retained in the employ of United; and (7) the shareholders of the absorbed corporation, Interstate, as represented by the sole stockholder, Epstein, will surrender his 1,250 shares in Interstate for 160,000 newly issued shares in United, the amalgamated enterprise.

*Id.* at 348, 159 A.2d at 154.

<sup>56</sup> *Id.* at 351, 159 A.2d at 156 (quoting from *Farris v. Glen Alden Corp.*, 393 Pa. 427, 431, 143 A.2d 25, 28 (1958)) (emphasis in original). After concluding that a de facto merger was present, the court addressed the defendant's contention that the de facto merger doctrine should not be applied so as to give dissenting shareholders of the "purchasing" corporation rights of appraisal. In rejecting this position, the court noted that since dissenting shareholders of both corporations are given appraisal rights when a statutory merger is consummated, these rights should be extended to all shareholders, whether of the acquiring or the acquired corporation, when a de facto merger is found. 60 N.J. Super. at 351-52, 159 A.2d at 156.

<sup>57</sup> *Id.* at 351, 159 A.2d at 156.

<sup>58</sup> *Id.* at 349, 159 A.2d at 155.

<sup>59</sup> 288 F. Supp. 817 (D. Colo. 1968).

<sup>60</sup> *Id.* at 818-19. Evidence indicated that none of the Web-Wilson officers acquired any stock interest in Joy. *Id.* at 820.

those arising from Web-Wilson's torts.<sup>61</sup> During the eleven months following the transaction, until its dissolution, Web-Wilson continued to function as a corporation by leasing buildings not sold to Joy and investing the cash received from the sale.<sup>62</sup> More than three years after Web-Wilson's dissolution, the plaintiff was injured by an allegedly defective product manufactured by Web-Wilson, and subsequently brought suit on a products liability theory, naming Joy as a defendant.<sup>63</sup> The plaintiff claimed that the transaction between Joy and Web-Wilson was not a mere sale of assets but rather a merger either in law or fact, which would justify the imposition of liability on Joy for the tortious acts of Web-Wilson.<sup>64</sup>

Refusing to find a de facto merger, the court detailed certain factual considerations present which compelled it to conclude "that there is no basis for plaintiff's claim against Joy."<sup>65</sup> Among the factors strongly indicating to the court that the transaction amounted to only a sale of assets were: the continued corporate operations of Web-Wilson; the lack of a mixture of stockholders or management of the two corporations following the sale; and the fact that "[b]oth companies were strangers and dealt at arms length before and after the sale."<sup>66</sup> Thus, the court's examination of Joy's potential liability was limited exclusively to a weighing of the specific facts of the case against established corporate law concepts of merger and consolidation and did not include any analysis of the policy considerations underlying the plaintiff's products liability theory.

A similar approach to the question of a corporation's liability following a transfer of assets was undertaken in *McKee v. Harris-Seybold Co.*<sup>67</sup> In *McKee*, the plaintiff sought to invoke the protective nature of the de facto merger doctrine in order to hold Harris-Seybold (Harris), the successor in interest of Seybold, liable for injuries caused by a product alleged to have been defectively manufactured by Seybold.<sup>68</sup> In 1926, Seybold agreed to sell all of its assets

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<sup>61</sup> *Id.*

<sup>62</sup> *Id.* at 819-20.

<sup>63</sup> *Id.* at 818, 820.

<sup>64</sup> *Id.* at 820. The plaintiff argued in the alternative that the transaction should be considered a consolidation and, as such, would warrant the imposition of liability on Joy. *Id.* This contention was rejected by the court since the agreement did not create a "new" corporation. *Id.* at 821.

<sup>65</sup> *Id.* at 822.

<sup>66</sup> *Id.* at 821-22. The court felt that the adequacy of the consideration received by Web-Wilson and the non-fraudulent nature of the agreement were factors additionally indicating that Joy should not be held liable for the torts of Web-Wilson. *Id.* at 822.

<sup>67</sup> 109 N.J. Super. 555, 264 A.2d 98 (L. Div. 1970).

<sup>68</sup> *Id.* at 559, 563, 264 A.2d at 100, 103.

to Harris Automatic Press Co., for which it would receive almost two million dollars and 5,500 shares of Harris Automatic's common stock as consideration for the transfer.<sup>69</sup> Harris Automatic was also to relieve Seybold of a number of the latter's liabilities.<sup>70</sup> Prior to the consummation of the contract, it was assigned to the defendant, a corporation created for the purpose of carrying on the operations of both Harris Automatic and Seybold.<sup>71</sup> Fourteen months thereafter, Seybold, which had changed its name to Washington Machine Co. (Washington) was dissolved. Almost forty years after this dissolution, the plaintiff was injured.<sup>72</sup>

In rejecting plaintiff's claim, the court's analysis focused primarily upon the degree of affiliation between Seybold and Harris following the transfer. Despite the absorption by the purchaser of the seller's entire manufacturing operation, the court, using language found in *Kloberdanz*, determined that Seybold and Harris "remain[ed] strangers after the sale."<sup>73</sup> Because of this indepen-

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<sup>69</sup> *Id.* at 559, 565-66, 264 A.2d at 100, 104. The agreement also contained a covenant not to compete, which forbade Seybold from engaging in manufacturing operations resembling those sold to Harris. *Id.* at 566, 264 A.2d at 104.

<sup>70</sup> *Id.* at 559, 264 A.2d at 100. Among the liabilities not assumed by Harris were "'undisclosed or contingent obligations' of Seybold." *Id.* at 562, 264 A.2d at 102. The court concluded that the "restrictive language" of the contract effectively precluded a finding of either an "express or implied assumption of contingent tort liability." *Id.* at 563, 264 A.2d at 102-03.

<sup>71</sup> *Id.* at 559, 264 A.2d at 100.

<sup>72</sup> *Id.*

<sup>73</sup> *Id.* at 566, 264 A.2d at 104 (citing *Kloberdanz v. Joy Mfg. Co.*, 288 F. Supp. 817 (D. Colo. 1968)). The *McKee* court also cited *Lamb v. Leroy Corp.*, 85 Nev. 276, 454 P.2d 24 (1969), as additional authority for the proposition advanced in *Kloberdanz* that a de facto merger should not be found to exist where the transferor and transferee corporations "remain strangers after the sale." 109 N.J. Super. at 566, 264 A.2d at 104. In *Lamb*, a creditor attempted to recover a debt from Leroy Corporation after the latter had purchased the assets of the indebted corporation, Nevada Land and Mortgage (N.L.M.) for stock. *Lamb v. Leroy Corp.*, *supra* at 277-78, 454 P.2d at 25-26. The court refused to find a de facto merger where the Leroy stock used as consideration was originally issued to the transferor corporation, but later, at the request of the transferor, reissued directly to the N.L.M. shareholders. *Id.* at 281, 454 P.2d at 28. The court reasoned that the second stock transfer did not "relate back to the original sale" and, therefore, that the initial transfer "effectively terminated the relationship of the two corporations." *Id.*

A close analysis of *Kloberdanz*, *Lamb*, and *McKee* reveals that the type of "strangers" the corporations in *Kloberdanz* and *McKee* may have "remained" following the transfer was not comparable to the resulting relationship of the corporations in *Lamb*. In *Kloberdanz* and *McKee*, the corporations dealt primarily with cash, thus preventing any continuity of transferor shareholder interest in the transferee. Additionally, there was no intermingling of directorates. See 288 F. Supp. at 819, 822; 109 N.J. Super. at 565-66, 264 A.2d at 104. This, it appears, was the basis for classifying the corporations' alliance subsequent to the sales as one of "strangers." In *Lamb*, however, the shareholders of the transferor became shareholders of the transferee corporation, and the transferee's board of directors was increased in size with 40 percent control going to the transferor's appointees. *Lamb v. Leroy Corp.*, *supra* at 278, 454 P.2d at 26.

dent relationship, a sufficient basis upon which to impose liability could not be established. Among the elements essential to the finding of a de facto merger, determined to be lacking in *McKee*, were a sufficient "continuity of [Seybold] stockholder interest in the purchasing corporation," as well as the assimilation of the corporate identity of the seller into the purchasing corporation.<sup>74</sup> Stressing the absence of this latter element, the court noted that while Seybold

could no longer function as a manufacturer . . . it could and did operate and function as a corporation for some time after the sale. The vendor corporation, as a corporate entity, was not absorbed into [Harris].<sup>75</sup>

Thus, the court, relying strictly upon corporate theory as did the *Kloberdanz* court, was satisfied that the continued existence of the corporate entity of Seybold, in the form of Washington, was sufficient to rule out a finding of de facto merger, despite its failure to take on any active business operations.<sup>76</sup>

A recent decision of a Michigan federal district court looked to *McKee* when faced with the question of determining New Jersey's corporate law vis-à-vis de facto mergers. In *Shannon v. Samuel Langston Co.*,<sup>77</sup> Harris-Intertype Corp. (Harris) had purchased all the assets of Samuel M. Langston Company, the payment consisting exclusively of Harris stock. Harris then created a wholly-owned subsidiary to take over the Langston operation.<sup>78</sup> Pursuant to the

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Thus, it is not altogether clear from *McKee* exactly how remote an intercorporate relationship must be following a transfer so as to classify the parties as "strangers," and thereby preclude a finding of a de facto merger.

<sup>74</sup> 109 N.J. Super. at 566, 264 A.2d at 104. While some shares of Harris Automatic stock were transferred to Seybold, any continuity of stockholder interest was "negligible." *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Id.* at 566-67, 264 A.2d at 104-05. The exact manner in which Washington functioned after the agreement until its dissolution is unclear.

Additionally, it would appear that the result reached by the court would have been the same had the consideration received by the transferor been exclusively Harris stock instead of predominantly cash. While the court hinted that the presence of a shareholder continuity of interest would have been helpful to plaintiff's argument, it nevertheless was very clear in concluding that a transferor corporation will be deemed to continue its existence, thus ruling out a finding of de facto merger, if it is the transferor that "receives the consideration for the transfer, as opposed to those situations where the stockholders directly receive the same." *Id.* at 566, 264 A.2d at 104. The court made no distinction between types of consideration which may be received by a transferor, and its support of *Lamb v. Leroy Corp.*, 85 Nev. 276, 454 P.2d 24 (1969), further seems to solidify the notion that the result would have been identical. See 109 N.J. Super. at 566, 264 A.2d at 104.

<sup>77</sup> 379 F. Supp. 797 (W.D. Mich. 1974).

<sup>78</sup> *Id.* at 799. The newly created corporation was known as The Langston Corporation. Two years after its creation, this corporation was statutorily merged with Harris. *Id.*

purchase agreement, the selling corporation changed its name to SML Corporation. Shortly after the consideration for the transfer was received by SML, it voluntarily dissolved and distributed the acquired stock to its shareholders.<sup>79</sup> Following the dissolution, plaintiff was injured by a product manufactured fifteen years earlier by the original Samuel M. Langston Company, and subsequently brought suit to hold both Harris and Langston, then a division of Harris, liable for the damages on a products liability claim.<sup>80</sup>

Applying the criteria propounded in *McKee*, the court unhesitatingly perceived the presence of a de facto merger.<sup>81</sup> Noting that "[t]he cases in which the courts have found that there was no de facto merger are all distinguishable on their facts,"<sup>82</sup> the *Shannon* court found the following consequences of the transaction to support its conclusion: (1) the continuation of Samuel Langston's management, personnel, and overall business operations in Harris; (2) the resulting continuity of Samuel Langston's shareholder interest in Harris by virtue of the stock given by Harris; (3) the cessation of all operations by Samuel Langston as an independent entity following the transfer; (4) the contractual provision that Samuel Langston liquidate and dissolve as soon as possible; and (5) the assumption by Harris of all obligations "which were necessary for the uninterrupted continuation of normal operations of the Samuel M. Langston Company."<sup>83</sup> The foregoing findings underscore the significance which the relationship between the transferor and transferee following the transaction plays in a court's analysis of a de facto merger. The court observed that while both Langston and Harris "were strangers before the transaction, they were not," like the parties in *Kloberdanz* and *McKee*, "strangers afterwards."<sup>84</sup>

While the specific facts of *Shannon* were sufficient in them-

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<sup>79</sup> *Id.*

<sup>80</sup> *Id.* at 798-99. The parties stipulated "that the plaintiffs would be entitled to damages . . . from the Samuel M. Langston Company if that company were still in existence." *Id.* at 798. Thus, the issue presented to the court was whether the liabilities of the original Samuel M. Langston Company inured to Harris by virtue of its purchase. The court noted that "[i]f The Langston Company . . . is liable, Harris Intertype is liable as a matter of law." *Id.* at 799.

<sup>81</sup> *Id.* at 801. The court cited with approval *McKee's* conclusion that "merger contemplates . . . the practically contemporaneous dissolution of the acquired corporation as a legal entity" after the transfer. *Id.* (citing *McKee v. Harris-Seybold Co.*, 109 N.J. Super. 555, 563-64, 264 A.2d 98, 103 (L. Div. 1970)).

<sup>82</sup> 379 F. Supp. at 801 (emphasis by the court).

<sup>83</sup> *Id.*

<sup>84</sup> *Id.* The court concluded that the most distinguishing factor in *McKee* was that the transferor shareholders, "never became a part of the purchasing corporation," since the consideration was mostly cash. *Id.*

selves to support a judicial finding of a de facto merger, the court went further, commenting incidentally on "[t]he public policy behind the evolving common law of products liability."<sup>85</sup> In the court's opinion, damages caused by defective products are a burden which, out of social and economic necessity, must be borne by those corporations acquiring all "the benefits of a going concern."<sup>86</sup> That a purchasing corporation may, unlike a victim of a defectively manufactured product, protect itself by continuing the products liability insurance of the seller, was a factor supporting the court's view that a purchasing corporation would be better able to bear the loss.<sup>87</sup> The *Shannon* court also noted that while "New Jersey is careful to retain a 'favorable corporate climate,'"<sup>88</sup> this did not imply that an "unrestricted laissez faire" approach to corporate

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<sup>85</sup> *Id.* at 802. Similarly, in *Cyr v. B. Offen & Co.*, 501 F.2d 1145 (1st Cir. 1974), the First Circuit had before it facts which were, in themselves, undoubtedly sufficient to support the plaintiff's allegation of continuation. *Id.* at 1153-54. However, the court felt compelled to expand its analysis to include a discussion of the strong policies underlying the plaintiff's products liability theory. The *Cyr* court observed that a successor corporation is in a better position to predict "the risks and the costs of meeting them" and can acquire insurance to protect itself against claims arising from products defectively manufactured by its predecessor. *Id.* at 1154. Additionally, the court noted:

[I]t is true that the successor, by definition, was not the legal entity which launched the product on the stream of commerce or made an implied representation as to its safety. But in the most real sense it is profiting from an [*sic*] exploiting all of the accumulated good will which the products have earned, both in its outward representations of continuity and in its internal adherence to the same line of equipment.

*Id.*

<sup>86</sup> 379 F. Supp. at 802. The court observed that among the benefits acquired by Harris were "expertise, reputation, [and] established customers." *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> *Id.* (quoting from *Jackson v. Diamond T. Trucking Co.*, 100 N.J. Super. 186, 198, 241 A.2d 471, 478 (L. Div. 1968)).

In *Jackson*, a prior employee of a dissolved corporation sought to hold the defendant corporation, which had absorbed the plaintiff's former employer, liable for an uncollected workmen's compensation claim. 100 N.J. Super. at 188-90, 241 A.2d at 473-74. Addressing itself to the plaintiff's allegation that Diamond T. was a continuation of the transferor corporation and thus should be liable for its debts, the court commented that

the factual conclusion that the transferee corporation is a continuation of the transferor corporation does not inexorably lead to the legal conclusion that the transferee is therefore liable for its transferor's obligations. Many facts and policy factors must be weighed in the balance, most importantly, the policy protecting corporate creditors must be weighed against the equally important policy respecting separate corporate entities.

*Id.* at 196, 241 A.2d at 477. After balancing the competing interests, the court concluded that liability would be imposed on Diamond T. for the debts of the transferor corporation. *Id.* at 196-98, 241 A.2d at 477-78. The court felt this conclusion was warranted after noting that the transfer was devoid of consideration, that the person serving as director, president, and controlling shareholder of both corporations had knowledge of the plaintiff's claim prior to the transfer, and that the transferor was left without sufficient assets with which to satisfy the plaintiff's claim. *Id.* at 196-97, 241 A.2d at 477.

transactions should be adopted by courts when dealing with questions of liability for injured parties.<sup>89</sup> The court concluded that "solvent corporations, going concerns, should not be permitted to discharge their liabilities to injured persons simply by shuffling paper and manipulating corporate entities."<sup>90</sup> Although the discussion in *Shannon* of the policy considerations relevant to products liability claims against asset-purchasing corporations was only dictum, it foreshadowed what was to become a basis of the *Knapp* court's rationale for imposing liability on transferee Rockwell.

In deciding *Knapp*, the Third Circuit was acutely aware of its duty to apply the substantive law of Pennsylvania to the facts of the case.<sup>91</sup> However, the issue of tort liability following a purported sale of corporate assets had never been addressed by Pennsylvania state courts.<sup>92</sup> Thus, without the aid of established Pennsylvania case law, the *Knapp* court's inquiry led to a review of the treatment this question had been accorded in other jurisdictions.<sup>93</sup> This analysis suggested that those courts would conclude that the Rockwell-TMW agreement had more indicia of a sale than a merger, especially since TMW existed for eighteen months following the sale and possessed substantial assets during that period with which to reply to tort claims.<sup>94</sup>

Nonetheless, the court in *Knapp* limited the applicability of this analogous case law by focusing on the substance of the transaction and distinguishing *Knapp* on its facts. Of primary importance was the presence of a "unique" combination of facts not found in any case decided prior to *Knapp* and which "indicate[d] the insubstantiality of the continued existence of TMW."<sup>95</sup> The court considered the following to give *Knapp* this "unique" status:

the brevity of the corporation's continued life, the contractual requirement that TMW be dissolved as soon as possible, the

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<sup>89</sup> 379 F. Supp. at 802.

<sup>90</sup> *Id.* at 803 (emphasis added).

<sup>91</sup> 506 F.2d at 364.

<sup>92</sup> *Id.* at 365. Although the plaintiff argued that the transaction was essentially a merger or consolidation, "or, alternatively, that Rockwell [was] a 'continuation' of TMW," the *Knapp* court recognized the essence of plaintiff's case to be praying for a finding of a de facto merger. *Id.* at 364.

<sup>93</sup> *Id.* at 365-67.

<sup>94</sup> *Id.* at 367. The *Knapp* court determined that courts foreign to Pennsylvania established the following test upon which to analyze an allegation of de facto merger:

[W]hether, immediately after the transaction, the selling corporation continued to exist as a corporate entity and whether, after the transaction, the selling corporation possessed substantial assets with which to satisfy the demands of its creditors.

*Id.* at 365.

<sup>95</sup> *Id.* at 367.



prohibition on engaging in normal business transactions, and the character of the assets TMW controlled.<sup>96</sup>

More significantly, the court adopted a collateral line of analysis as it focused on public policy considerations,<sup>97</sup> thereby transcending the traditional adherence to "corporate theory" and its emphasis on "the continued existence of the corporate entity."<sup>98</sup> This approach to the question of liability was felt to be consistent with the philosophy espoused by the Pennsylvania courts.<sup>99</sup> From *Farris*, the court inferred that its study of "whether the TMW-Rockwell exchange was a merger" should encompass a consideration of the societal advantages to be gained from the imposition of liability on Rockwell,<sup>100</sup> rather than be restricted to "a mere procrustean application of formalities" of corporate law.<sup>101</sup> This downplay of corporate formality led the court to question which party could most easily sustain the financial loss. Confident that Pennsylvania courts would attempt to discern the "'better loss-distributing'" party of the two,<sup>102</sup> the court hinted that Rockwell, if found liable for TMW's negligence, could spread the loss among its customers, a group which, if compared to the plaintiff, would suffer relatively little hardship.<sup>103</sup>

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<sup>96</sup> *Id.* The court emphasized TMW's lack of control in the period between the transfer and dissolution over the Rockwell stock it received as consideration. The court noted that, although TMW had possession of these assets, it could not distribute them prior to the dissolution. Additionally, "the reorganization agreement required letters of investment intent from TMW's controlling shareholders, rather than from TMW." *Id.* at 369 & n.31.

<sup>97</sup> *Id.* at 367-70.

<sup>98</sup> *Id.* at 366.

<sup>99</sup> *Id.* at 369-70.

<sup>100</sup> *Id.* at 368-69. Although recognizing that the *Farris* court was concerned with determining the legislative intent "in the field of dissenting shareholders' rights," the *Knapp* court surmised "that the Pennsylvania Supreme Court would find that the legislature intended to permit tort liability in cases like [*Knapp*]." *Id.* at 368 n.27.

<sup>101</sup> *Id.* at 369.

<sup>102</sup> *Id.* at 369-70. The loss-spreading policies enunciated in *Knapp* recall considerations which provided the rationale underlying the evolving doctrine of products liability. In *Greenman v. Yuba Power Prods., Inc.*, 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963), the Supreme Court of California, in adopting the theory of strict liability in tort, noted that

[t]he purpose of such liability is to insure that the costs of injuries resulting from defective products are borne by the manufacturers that put such products on the market rather than by the injured persons who are powerless to protect themselves.

*Id.* at 63, 377 P.2d at 901, 27 Cal. Rptr. at 701. Such costs have been recognized to be allocable with greater ease by "those involved in the chain of marketing . . . by means of insurance and indemnity agreements." *Caruth v. Mariani*, 11 Ariz. App. 188, 192, 463 P.2d 83, 87 (Ct. App. 1970).

<sup>103</sup> 506 F.2d at 369-70. The *Knapp* court looked to *Ayala v. Philadelphia Bd. of Pub. Educ.*, 453 Pa. 584, 305 A.2d 877 (1973), in order to determine the attitude of Pennsylvania courts vis-à-vis spreading the burden of loss. 506 F.2d at 369. In *Ayala*, the doctrine of governmen-

The court also indicated that the availability of liability insurance has been a factor considered by Pennsylvania courts when questioning which party may better spread the loss.<sup>104</sup> Noting that TMW had purchased insurance prior to the transfer which would have indemnified it against such claims as the plaintiff's, the court felt obliged to question why Rockwell had not "protected itself . . . by securing from TMW an assignment of TMW's insurance."<sup>105</sup>

Rockwell's failure to insure itself against losses such as the plaintiff's did not deter the court from determining that "Rockwell [was] better able to spread the burden of the loss,"<sup>106</sup> and therefore should be subjected to liability for the tortious conduct of TMW. In reaching this conclusion, the *Knapp* court was satisfied that it had arrived at a result consistent with social philosophies advanced in recent Pennsylvania cases.<sup>107</sup>

The significance of *Knapp* becomes apparent when the court's justification for imposing ultimate responsibility on Rockwell is evaluated and compared to rationales employed by other courts assessing similar questions of corporate liability. Prior to *Knapp*, a transferee of assets was not accountable to a party alleging de facto merger unless a court first reached an unequivocal determination that a de facto merger existed. Interestingly, the *Knapp* court was able to hold Rockwell accountable without a clear-cut finding of de facto merger by supplementing its analysis with relevant public policy considerations.<sup>108</sup> While neither adherence to corporate

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tal immunity was abrogated in Pennsylvania with the state supreme court concluding that "it is clear that no public policy considerations presently justify its retention." 453 Pa. at 592, 305 A.2d at 881. The *Ayala* court accepted the opinion advanced in other jurisdictions that liability for injuries occurring within the normal course of a private business or public administrative operation must be considered a cost of carrying on such activities and shouldered by the corporation or governmental body, not the injured party. *Id.* at 592-95, 305 A.2d at 881-82.

<sup>104</sup> 506 F.2d at 369.

<sup>105</sup> *Id.* at 370.

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> Whether the court's broad use of public policy was a proper anticipation of the method of analysis that would have been employed by Pennsylvania courts is uncertain. Judge Rosenn, in a concurring opinion, concluded, without any consideration of public policy, that the courts of Pennsylvania would view this transaction as a merger. 506 F.2d at 371-72. Judge Rosenn was strongly influenced, as was the majority, by the barren corporate existence of TMW following the transfer. *Id.* at 372. Additionally, he felt that a corporation purchasing the bulk of the assets of another should be liable, in Pennsylvania, for the tortious conduct of the transferor,

at least if the following attributes of merger are present:

(1) an ongoing business, including its name and good will, is transferred to the acquiring corporation; and

theory nor reliance on social policy would have been alone sufficient to allow the court to reach its decision, the combined weight of these considerations warranted such a finding. This dual implementation of law and policy represents a pronounced departure from the strict corporate approach heretofore utilized by courts addressing issues of liability following a transaction structured as a sale of assets.

Whether future courts will adopt the *Knapp* method of analysis is open to speculation. If this approach is utilized, the question remains—how close must a given transaction resemble a traditional de facto merger to trigger a court's invocation of public policy? While *Knapp* does not supply a clear answer, it does suggest that when a transferor's corporate existence following a transfer is "insubstantial," with the bulk of its remaining assets being stock in the transferee corporation, a court may be inclined to impose liability.<sup>109</sup> Despite this uncertainty, the decision does signal a novel and admirable method of piercing the apparent nature of specific intercorporate transactions and should provide a caveat to corporations purchasing a substantial set of assets without securing accompanying liability insurance to guard against unforeseen products liability claims.

*Robert E. Smith*

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- (2) the corporation whose assets are acquired is dissolved after distribution to its shareholders of the consideration received from the acquiring corporation.

*Id.* at 371.

<sup>109</sup> *Id.* at 367, 369.