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Determining Successor **Liability**

Subtle differences in pleading and fact development may be outcome-determinative.

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SUCCESSOR LIABILITY is a well-established doctrine that can be used in certain circumstances to extend liability to a party who may otherwise be far removed from the allegedly offending conduct or defective product alleged to have caused injury.

In some areas, such as asbestos personal injury litigation, successor liability claims are commonplace, and are asserted against a large number of companies that had no direct involvement with asbestos in their corporate history. Rather, it is argued that such defendants should be held liable for the acts of another company (probably now long gone) because of some past relationship or prior corporate transaction.

Defendants in a variety of product liability and other litigations have come to the realization that through operation of law they may have inherited a problem not of their own making.

Just this year the New York Court of Appeals addressed successor liability in *American Standard Inc. v. OakFabco Inc.*, 14 N.Y.3d 399 (2010), holding that, pursuant to the terms of an asset purchase and sale agreement, the buyer of a boiler business assumed certain of the seller's tort liabilities. This decision, turning on contractual interpretation, underscores one of the most fundamental rules in this area: A company must use care in drafting transactional documents to make clear what specific assets

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and liabilities it is, and is not, assuming.

However, issues of successor liability go well beyond careful drafting of transactional agreements. Recent New York decisions illustrate that subtle differences in pleading and fact development may be outcome determinative on a claim of successor liability.

Indeed, every New York litigator should know the basic rules governing successor liability. For plaintiffs, establishing successor liability may be the only realistic hope for recovery where the predecessor corporation has long since ceased to exist or has few or no remaining assets. For defendants, successfully invoking the general rule against successor liability may cut off liability altogether and end the litigation.

Thus, counsel on both sides of the "v" are well-advised to carefully plan at the very outset of a case how they intend to prove or defend against such a claim.

The General Rule and Its Exceptions

As a general rule, a corporation that purchases the assets of another is not liable for the predecessor's tort or contract obligations. See *Aguas Lenders Recovery Group LLC v. Suez, S.A.*, 585 F.3d 696, 702 (2d Cir. 2009); *In re N.Y. City Asbestos Litig.*, 15 A.D.3d 254, 255 (1st Dept. 2005).

For this reason, parties often seek to structure corporate transactions as asset deals, making explicit in the controlling deal documents that certain pre-existing liabilities are not being assumed by the buyer. However, as discussed below, even with an asset deal there can be no assurance that a claim for successor liability will fail in all circumstances.

New York courts have carved out four common law exceptions to the general rule against successor liability. Sometimes referred to as the "*Schumacher* exceptions" after the Court of Appeals' decision in *Schumacher v. Richards Shear Co.*, 59 N.Y.2d 239 (1983), successor liability may be imposed only where: "(1) [the successor corporation] expressly or impliedly assumed the predecessor's…liability, (2) there was a consolidation or merger of seller and purchaser, (3) the purchasing corporation was a mere continuation of the selling corporation, or (4) the transaction [was] entered into fraudulently to escape such obligations." Id. at 245; accord *Aguas*, 585 F.3d at 702.

Courts have stated that the policies that guide an assessment of successor liability include "the concept that a successor that effectively takes over a company *in its entirety* should carry the predecessor's liability as a concomitant to the benefits it derives from the good will purchased," *Grant-Howard Associates v. General Housewares Corp.*, 63 N.Y.2d 291, 296 (1984) (emphasis added), and "the desire to ensure that a source remains to pay for the victim's injuries." Id. at 297; but see *Semenetz v. Sherling & Walden Inc.*, 7 N.Y.3d 194 (2006)

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(limiting the expansive rationale articulated in *Grant-Howard* by rejecting a fifth exception, the "product line" exception, in cases of strict products liability).

Tort Cases

One recent case addresses perhaps the most commonly litigated exception to the general rule against successor liability: de facto merger. On May 11, 2010, Justice Daniel Palmieri of the Supreme Court, Nassau County, issued an opinion in *Rodriguez v. Printco Industries*, 28 Misc. 3d 1206(A), 2010 WL 2679898, at *1 (Sup. Ct. Nassau County May 11, 2010) (unpublished table decision), addressing this exception in the products liability context.

In *Rodriguez*, plaintiff allegedly was cleaning printing press plates in 2005 when his hand was pulled into the press between the roller and the drum, and injured. Id. The press was owned by plaintiff's employer and manufactured by co-defendant FMC. Id.

The machine's original ink pans had been replaced by a "doctor blade" system manufactured by the predecessor of Princto Industries LLC (Printco), Printco Industries Ltd., and included a guard to protect the operator from putting his hand into that part of the machine where plaintiff's hand was injured, but that guard had been removed. Id. at *1, 3.

After finding that "plaintiff's claims against Printco for failure to warn and design defect present triable issues of fact," and thus denying Printco's summary judgment motion in that regard, the court turned to the issue of successor liability. Id. at *3. Printco had purchased the assets, but not the debts or liabilities, of Printco Industries Ltd. in 2003. Id. Relying on the general rule that a corporation that purchases the assets of another corporation is not liable for torts of its predecessor, Printco denied liability on the ground that it was Printco Industries Ltd., not itself, that manufactured the subject "doctor blade" system. Id.

But plaintiff argued that Printco could not avoid liability on that basis because, in plaintiff's view, Printco's purchase of Printco Industries Ltd. constituted a de facto merger and thus triggered the "consolidation or merger" exception to the general rule against successor liability. Id. at *4. After reciting the general rule and its exceptions, the court held that evidence supported plaintiff's position.

"The hallmarks of a de facto merger are the 'continuity of ownership; cessation of ordinary business and dissolution of the predecessor as soon as possible; assumption by the successor of the liabilities ordinarily necessary for the uninterrupted continuation of the business of the acquired corporation; and a continuity of management, personnel, physical location, assets, and general business operation.'" Id. (quoting *In re AT&S Transp., LLC*, 22 A.D.3d 750, 752 (2d Dept. 2005)).

Here, Printco "took over the address of the predecessor corporation, and purchased its customer list, good will, telephone numbers, and Web site. Indeed, the Web site for the new LLC provides a statement that the company was founded in 1983, yet the asset purchase did not take place until twenty years later in 2003." Id.

For plaintiffs, establishing successor liability may be the **only** realistic **hope for recovery** where the predecessor corporation has long since ceased to exist or has few or no remaining assets; for defendants, successfully invoking the **general rule** against successor liability may **cut off** liability **altogether**.

The court further reasoned that "[p]laintiff alleges that the two entities have some of the same owners and most of the same employees," and that "[t]here is no evidence that the predecessor continued operations." Id. Accordingly, the court found a triable issue of fact as to whether a de facto merger had occurred and denied Printco's summary judgment motion in this respect as well. Id.

In contrast, the opinion issued by Justice Martin Schneier of the Supreme Court, Kings County on June 23, 2009, in *Broydo v. Baxter D. Whitney & Sons Inc.*, 24 Misc. 3d 1207(A), 2009 WL 1815092, at *1 (Sup. Ct. Kings County June 23, 2009) (unpublished table decision), a factually similar work-related products liability action, illustrates that issues of successor liability can be disposed of effectively before trial in some cases.

There, the plaintiff was allegedly attempting to clean the feed roller of a woodworking machine known as the "Double Surfacer" in 2002 when his left hand came into contact with the machine's roller and was pulled into fast-spinning knives, resulting in the loss of four fingers. Id. Plaintiff commenced an action asserting a number of products liability claims against, inter alia, Newman Machine Co. Inc. ("Newman"). Id.

It was not disputed, however, that the "Double Surfacer" was manufactured in 1946 by Baxter D. Whitney and Son Inc. ("Old Whitney"). Id. Thus, in addressing Newman's motion for summary judgment, the court noted that plaintiff's "products liability claims are contingent upon his successful assertion that Newman is liable as a successor to Old Whitney." Id.

In 1955 Newman had purchased specified assets from Old Whitney, but not the company itself, its goodwill or name. Id. Simultaneously, Old Whitney sold its name, goodwill and other assets to an agent for a company to be formed a day later bearing the same name, "Baxter D. Whitney and Son Inc." ("New Whitney"), the shares of which were held by Newman's president and two other individuals. Id. Subsequently, in 1975, New Whitney merged with and became a wholly owned subsidiary of Newman. Id.

After observing that "there is no allegation of fraud that would implicate the fourth exception," id. at *2, the court addressed each of the other three theories of successor liability.

"With respect to the first exception, there was no express assumption of liability in the contract. Nor is there any evidence of an implied assumption of liability. In fact, the entire transaction appears to be designed to evade any assumption of liability." Id.

With respect to the second exception, the court found that there was no formal consolidation or merger of Old Whitney and Newman, and also rejected the contention that the "hallmarks" of a de facto merger were present. Id. at *3.

"In the instant case, there was…no continuity of ownership, management, personnel or physical location. Although Newman marketed machinery under the name Baxter D. Whitney and Son, it did not continue the manufacture of any of the machines that had been made by Old [Whitney]. Thus, there is insufficient evidence to support a claim of de facto merger." Id. In addition, "since Old Whitney survived the transactions, even as a 'meager' entity," the court held that "Newman cannot be considered a 'mere continuation' of Old Whitney under the third exception." Id. (citation omitted).

These cases demonstrate that courts will take a "substance over form" approach when considering dispositive motions in cases involving successor liability. It is crucial to

advise clients of these potential risks when the nature of the newly formed business presents a "close call." It should be understood that the more the successor looks and sounds like the predecessor simply wearing a different hat, the more inclined a court might be to find successor liability.

However, where only specific assets are assumed, and other liabilities are clearly excluded, and the selling corporation continues to do business and goes on its merry way after the transaction, a defendant should be able to marshal sufficient evidence to defeat a claim that it is somehow a responsible successor entity. Discovery on both sides must of course be tailored to seek information relevant to the assertion of successor liability.

Breach of Contract Cases

Successor liability is certainly not limited to tort actions.

For example, plaintiffs relying on a breach of contract theory may also seek to hold a successor corporation liable for contractual obligations of its predecessor. See, e.g., *Fitzgerald v. Fahnestock & Co.*, 286 A.D.2d 573, 575 (1st Dept. 2001). The opinion issued by Judge Glenn Suddaby of the Northern District of New York on Aug. 27, 2010, in *Perceptron Inc. v. Silicon Video Inc.*, No. 5:06-CV-0412 (GTS/DEP), 2010 WL 3463098, at *1 (N.D.N.Y. Aug. 27, 2010), is demonstrative.

In that case, plaintiff Perceptron Inc. (Perceptron) sought a judgment declaring the rights of the parties with regard to the successor liability of defendants for an arbitration award granted against non-party PVS in plaintiff's favor. Id.

In particular, Perceptron alleged that, after PVS breached a contract with plaintiff for the development and production of certain video imaging technology in 2002, but before plaintiff obtained an arbitration award against PVS in 2004, PVS transferred its assets to defendant Silicon Video Inc., which in turn transferred those assets to defendant Panavision Imaging, LLC. Id. The court denied plaintiff's motion and defendants' cross-motion for summary judgment, both of which concerned de facto merger and fraudulent transaction theories of successor liability. Id. at *3-5.

Record evidence cited by plaintiff and defendants conflicted with respect to the existence of virtually each of the "hallmarks" of a de facto merger, including, but not limited to, continuity of ownership, and continuity of management, personnel, physical location, assets and general business operation. Id. Accordingly, the court held that "a genuine issue of material fact exists regarding whether Defendants are liable to Plaintiff for breach of contract under a 'de facto merger' theory of successor liability." Id. at *3.

With respect to its fraudulent transaction theory of successor of liability, plaintiff adduced evidence indicating that PVS's assets were transferred to defendants with the intent to defraud plaintiffs. Id. at *5. But here too the court denied summary judgment. Although defendants failed to squarely rebut plaintiff's argument, defendants' evidence raised a fact question as to when they actually became aware of Perceptron's claim against PVS.

"Simply stated, the Court finds that, based on the current record, a genuine issue of material fact exists regarding whether Defendants possessed sufficient knowledge of Plaintiff's claim when PVS's assets were transferred in March 2003." Id.

All New York litigators should understand the basic rules governing successor liability because such claims are asserted in a variety of tort, contract and other kinds of litigation.

Thus, lawyers on both sides must develop a keen understanding of the age-old question, "Who knew what when?" when litigating dispositive motions in successor liability contracts cases.

Finally, another recent case illustrates that allegations of breach of contract predicated on successor liability may be ripe for dismissal on the pleadings. See *Key Items Inc. v. Ultima Diamonds Inc.*, No. 09 Civ. 3729(HBP), 2010 WL 3291582, at *1 (S.D.N.Y. Aug. 17, 2010) (Pitman, Mag.). There, plaintiff Key Items Inc. (Key Items) brought a breach of contract claim against Ultima Diamonds Inc., Global Jewellery Solutions Ltd., Ultima 2008 Ltd. and Edward Maierovitz for alleged failure to pay for large orders of jewelry. Id.

Global Jewellery Solutions Ltd. and Ultima 2008 Ltd. (the "Global Defendants") moved to dismiss this count on the ground that to the extent Key Items even pled the existence of a contract, the contract was between it and Ultima Diamonds Inc., not with either or both of the Global Defendants. Id. at *6.

Nonetheless, Key Items sought to hold the Global Defendants liable for Ultra Diamonds Inc.'s alleged contractual obligations on a theory of de facto merger. Id. at *10. After listing established indicia of a de facto merger, the court dismissed plaintiff's contract claim for failure to state a claim. Id. at *10-11.

"Key Items does not allege that Maierovitz owned Ultima Diamonds, Ultima 2008 or Global Jewellery Solutions… [I]t alleges only that the three companies 'are singularly controlled and dominated by' Maierovitz… In the absence of an allegation of continuity of ownership, Key Items has not stated a claim for de facto merger." Id. at *11.

Moreover, the court opined that "although Key Items alleges that the Global Defendants had the same business address as Ultima Diamonds, that all three entities are Ontario corporations, and that Maierovitz controlled all three entities, it does not allege that Ultima Diamonds ceased operating, or that the Global Defendants assumed Ultima Diamonds' liabilities. Thus, even if continuity of ownership were alleged, the paucity of allegations concerning the other relevant factors defeats any de facto merger claim." Id.

Conclusion

All New York litigators should understand the basic rules of successor liability. Such claims are asserted in a variety of tort, contract and other kinds of litigation. Only by planning early on in litigation can a lawyer be sure that she asks the right questions, gets the right proofs, and is fully armed at the dispositive motion stage and trial to deal with such a claim.

The courthouse steps are not the place where you want to ask yourself, "How again was I going to try to hold these guys responsible for what those other guys did?"