K&LNG Alert

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Toxic Tort

New York Court of Appeals Refuses to Impose Additional Tort Liabilities Upon Purchasers of Corporate Assets

On June 13, 2006, in *Semenetz v. Sherling & Walden, Inc.*,[1] the New York Court of Appeals joined a majority of states and rejected unanimously the "product line" exception[2] to the general rule against successor liability, thereby resolving a split between New York Appellate Departments. In so doing, the Court reaffirmed its 1983 decision in *Schumacher v. Richards Shear Co.*,[3] in which it held that a corporation that purchases another corporation's assets is not liable for the seller's torts unless one of four narrow circumstances apply:

(1) there is an express or implied assumption of liability;

(2) there is a consolidation or merger of the seller and purchaser;

(3) the purchasing corporation is a "mere continuation" of the seller; and

(4) the transaction was entered fraudulently to escape liability.

FACTUAL BACKGROUND

In May 1998, defendant S & W Edger Works, Inc. ("Edger Works"), an Alabama corporation, sold a sawmill device to Semenetz Lumber Mill, Inc. of Jeffersonville, New York. On July 26, 1999, an infant's hand became caught in the sawmill, resulting in the amputation of several fingers.

On October 5, 2000, Edger Works sold most of its assets to Sawmills and Edgers, Inc. ("Sawmills"), another Alabama corporation. The purchase contract provided that Sawmills assumed no liabilities of Edger Works, except for obligations related to merchandise ordered but not yet received. Subsequent to the transaction, Edger Works changed its name and paid its outstanding debts, while Sawmills continued to market and manufacture sawmills under the Edger Works name, using Edger Work's former facility and many of the same employees. Plaintiff sought personal injury damages from both Sawmills and Edger Works.

Sawmills moved for summary judgment on jurisdictional grounds. The trial court denied the motion, but upon finding that none of the *Schumacher* exceptions applied, the court stated that further inquiry was required to determine whether the "product line" or "continuing enterprise" exceptions set forth in the Appellate Division, 3rd Department's opinion in *Hart v. Bruno Mach. Corp.*[4] applied to this action. The trial court read *Hart* as encompassing these two exceptions and, as such, the trial court indicated that, under these facts, Sawmills would be held responsible for the allegedly defective sawmill.

On appeal, the New York Supreme Court, Appellate Division, 3rd Department, dismissed the complaint

1 2006 N.Y. Slip. Op. 04750, __ N.E.2d __, 2006 WL 1593951 (N.Y. June 13, 2006).

2 As a general proposition, the "product line" exception provides that a corporation that acquires assets from another, and continues to maintain the seller's product lines, assumes the liabilities associated with those product lines when the asset sale effectively ends the seller's business. Id. at 3 (*quoting Ray v. Alad Corp.*, 19 Cal. 3d 22, 34 (1977)).

3 59 N.Y.2d 239 (1983).

4 250 A.D.2d 58 (3rd Dep't 1998).

against Sawmills on jurisdictional grounds. While it limited its opinion to jurisdictional grounds, the court acknowledged that the Appellate Departments (*see City of New York v. Pfizer, Co.*)[5] were split on whether the "product line" exception applied in New York, and it noted that the Court of Appeals had not resolved this issue. The Court of Appeals granted plaintiff's request for permission to appeal.[6]

THE DECISION

In accepting the Appellate Department's invitation to address the "product line" exception, the Court of Appeals examined the history of that exception, which originated with the California Supreme Court decision of *Ray v. Alad Corp*.[7] In so doing, the Court recognized three primary justifications for the "product line" exception:

(1) the asset sale effectively destroyed plaintiff's available remedies against the original manufacturer;

(2) the successor corporation is able to assume the risk-spreading role of the predecessor and;

(3) the successor benefits from the predecessor's goodwill concerning the continued product line.[8]

The Court, then, rejected all three rationales. Following the reasoning of the Supreme Court of Wisconsin, the Court held that:

(1) the destruction of plaintiff's remedies is a basis for concern, but not a basis for imposing liability upon one who did not cause an injury;

(2) small manufacturers have difficulty obtaining product liability insurance, which makes them less able to assume the predecessor's risk-spreading role; and

(3) because the parties negotiated goodwill as part of the sale price, the imposition of additional liabilities would force the purchaser to pay for goodwill twice.[9]

The Court went on to adopt the Florida Supreme Court's view[10] that, by imposing additional liability upon manufacturers, the "product line" exception threatens "economic annihilation" for small businesses.[11] Finally, the Court justified its decision by noting that extending liability through the "product line" exception shifts the responsibility for personal injuries to a party that did not place the product into the stream of commerce, which is inconsistent with the rationale behind strict products liability. In sum, the Court found that acceptance of the "product line" exception would mark "a radical change from existing law implicating complex economic considerations better left to be addressed by the Legislature."[12] Accordingly, the Court applied the *Schumacher* exceptions, and held – as did the trial court – that, under *Schumacher*, Sawmills was not liable for products manufactured and sold by Edger Works. Beyond holding conclusively that the "product line" exception is not the law of New York, the *Semenetz* opinion provides strong justification for abandoning that doctrine in all jurisdictions, particularly those in which the highest-level appellate courts have not opined upon this issue.

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5 260 A.D.2d 174 (1st Dep't 1999).

6 On appeal, plaintiff did not rely on the "continuing enterprise" exception. Furthermore, the Court of Appeals did not address plaintiff's argument that "personal jurisdiction may properly be imputed to a successor corporation whenever it is substantially responsible for its predecessor's allegedly tortious conduct." *Semenetz* at fn. 2.

7 19 Cal. 3d 22 (1977).

8 *Semenetz* at 3 (*citing Ray*, 19 Cal. 3d at 31).

9 *Semenetz* at 3-4 (*citing Fish v. Amsted Indus., Inc.*, 126 Wisc.2d 293, 308-309 (1985)).

10 *Bernard v. Kee Manufacturing Co., Inc.*, 409 So.2d 1047 (1982).

11 *Id.* at 1049.

12 *Semenetz* at 4 (*citing City of New York*, 260 A.D.2d at 176).

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