Left Holding the Bag?

By Justin K. Beyer

Understanding the Successor Liability Defense

Imagine the following scenario: One day a new complaint crosses your desk. In it, the plaintiff claims to have suffered injuries from using a product allegedly manufactured by your company and claims that the company is liable for his injuries. However, you seem to recall that the company did not own the business that manufactured that product but acquired that business later. The next question most attorneys would ask is, what now? The answer is tied directly to how that previous sale was structured. And when the company purchased assets, the answer should be the successor liability defense, which, in most circumstances, will bar a plaintiff from recovering in strict liability or negligence.

In the vast majority of jurisdictions, liabilities of a selling predecessor will not be imposed on the asset purchaser. The rule's importance is that it serves as a complete defense to claims that arise as a result of a predecessor's defective product. This applies to a broad spectrum of circumstances, but this article mainly focuses on using the successor liability defense to escape product liability claims and analyzing the exceptions to the general rule.

In many ways, though, the exceptions are better known than the rule itself. This article first outlines and analyzes the traditional exceptions to the general rule. It then discusses certain nontraditional excep-

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tions that courts have crafted to address product claims, examining which states employ the rule's nontraditional exceptions and why those states that have considered these nontraditional exceptions have almost universally rejected them.

Successor Liability— Traditional Exceptions

As mentioned above, throughout the United States, liabilities of a selling predecessor will not be imposed on the asset buyer. As the Illinois Supreme Court explained in *Vernon v. Schuster*, 688 N.E.2d 1172, 1175 (Ill. 1997), this general rule preventing liability for buyers "developed as a response to the need to protect bonafide purchasers from unassumed liability and was designed to maximize the fluidity of corporate assets." While attorneys typically use this defense in product liability actions, they have used it in actions involving breaches of contract, ERISA, Comprehensive Environment Response, Compensation, and Liability Act (CERCLA) matters, labor law violations, and security trading cases, to name a few.

While the traditional rule exists, a court always confirms that a successor corporation has impunity from liability by analyzing whether a successor's asset purchase from the predecessor is made outside the exceptions to the general rule. Those exceptions fall into two categories: traditional and nontraditional. The vast majority of states only recognize four traditional exceptions. For a plaintiff to defeat a defendant's successor liability defense in a state only recognizing the traditional exceptions, a plaintiff must show that the successor (1) expressly or implicitly assumed the predecessor's liabilities, referred to as the "assumption-of-liability" exception; (2) merged with the predecessor, referred to as the "de facto merger" exception; (3) merely continued the predecessor's business, referred to as the "mere-continuation" exception; or (4) completed the transaction for fraudulent purposes, referred to as the "fraudulent transfer" exception. The nontraditional exceptions consist of the "product-line" and "continuity-of-enterprise" exceptions.

For the assumption-of-liability exception to apply and impose liability on a successor, a buyer must assume the seller's liabilities. When an agreement is silent, a plaintiff generally cannot show that the successor assumed the predecessor's liabilities. And, when an agreement expressly disclaims liability, liability assumption does not occur. However, many courts still will permit a successor to assume certain liabilities, such as tax liabilities or ERISA contribution liabilities, without negating the defense.

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Additionally, a number of courts have held that, when a successor agrees to purchase insurance on the predecessor's behalf, the agreement does not constitute an assumption of liability. *See*, *e.g.*, *George v. Parke-Davis*, 684 F. Supp. 249, 253–254 (E.D. Wash. 1988) (holding that evidence that the buyer agreed to name the seller as an additional insured did not transfer the seller's product liabilities to the buyer); *Weaver v. Nash Int'l, Inc.*, 562 F. Supp. 860, 862 (S.D. Iowa 1983) (finding no assumption of liability for the buyer even though the buyer to name the seller as an additional insured); *In the Matter of New York City Asbestos Litig.*, 15 A.D.3d 254, 257–258 (N.Y. App. Div. 2005) (finding no assumption of liability even though the successor agreed to provide product liability insurance for the predecessor's pre-closing operations); *Green v. Firestone Tire & Rubber Co., Inc.*, 460 N.E.2d 895, 899 (Ill. App. Ct. 1984) (finding no assumption of liability when the agreement was silent about which party assumed liability and the successor agreed to name the predecessor as an additional insured).

To defeat impunity from liability under the de facto merger exception, a plaintiff must establish (1) a continuity of management, personnel, physical location, assets, and business operations between the successor and predecessor corporations; (2) a continuity of shareholders from the predecessor to the successor; (3) the predecessor ceased its business operations, liquidated, and dissolved as soon as legally and practically possible; and (4) the successor assumed the predecessor's liabilities and obligations ordinarily necessary for the uninterrupted continuation of the predecessor's business.

When a plaintiff seeks to defeat the successor liability defense by invoking the mere-continuation exception, the plaintiff must show that (1) no corporation existed before the asset purchase, (2) the officers and directors of the two corporations were similar, and (3) stock was transferred between the predecessor and the successor corporations as a result of the asset purchase. It is important to note, however, that the mere-continuation exception and the de facto merger exception are often treated as a single exception, with courts deciding applicability based on whether or not the two corporations have common shareholders. If not, then neither exception applies. *See*, *e.g.*, *Douglas v. Stamco*, 363 F. App'x 100, 102 (2d Cir. 2010); *Berg Chilling Sys. v. Hull Corp.*, 435 F.3d 455, 464–65 (3d Cir. 2005); *Ruiz v. Blentech Corp.*, 89 F.3d 320, 325 (7th Cir. 1996).

Fraudulent transfer is the last traditional exception that will defeat impunity from assuming a predecessor's liability. When a selling company uses fraudulent means to escape liability, the successor can later be found liable for the predecessor's debts or liabilities. While not all states have established a test for what constitutes a fraudulent transfer, 43 states and the District of Columbia have adopted the Uniform Fraudulent Transfer Act, which presents a list of factors that a court may consider to decide if this exception applies. *See* Uniform Law Comm's, Fraudulent Transfer Act, Enactment Status Map, http://www.nccusl.org/Act.aspx?title=Fraudulent%20Transfer%20Act (accessed Nov. 9, 2011). For example, courts consider it fraudulent when a company sells its assets to another company in which the seller's shareholders hold a stake for far below market value. *See*, *e.g.*, *Welco Indus., Inc. v. Applied Companies*, 617 N.E.2d 1129, 1134 (Ohio 1993) (citing *Turner v. Bituminous Cas. Co.*, 244 N.W.2d 873, 887 (Mich. 1977)) (Coleman, J., dissenting).

In those states that only recognize the traditional exceptions, the successor liability defense is generally applicable as long as (1) the successor did not agree to assume the liabilities of the predecessor, (2) there is discontinuity of shareholders, and (3) the successor paid substantial and fair consideration for the assets. It is important to note, however, that courts in certain states have found that a successor may still owe an independent duty to warn about a predecessor's defective product, meaning that the defense will not defeat a failure-to-warn claim in that context. Those state courts finding that a successor owes such a duty decide whether the successor breached that duty using the postsale, duty-to-warn analysis offered in the Restatement (Third) of Torts: Product Liability §10 (1998).

Successor Liability—The Nontraditional Exceptions

For decades, plaintiffs' attorneys have tried to convince courts to expand the traditional exceptions to shift liability to successor corporations in the product liability and the federal remedial statute context even though those successors did not harm the plaintiffs. The first decision of prominence in which a court expanded the traditional exceptions occurred in *Cyr v. B. Offen & Co.*, 501 F.2d 1145 (1st Cir. 1974), a decision in which the First Circuit, interpreting New Hampshire law, held that a court should not be bound by the traditional exceptions and instead should review the specific claims of a lawsuit to determine if successor liability was appropriate. The New Hampshire Supreme Court later rejected the *Cyr* interpretation of New Hampshire successor liability law in *Simoneau v. South Bend Lathe, Inc.*, 543 A.2d 407 (N.H. 1988), and *Bielagus v. EMRE of New Hampshire Corp.*, 826 A.2d 559 (N.H. 2003).

Three years after the *Cyr* decision, the Michigan Supreme Court created the "continuity-of-enterprise" exception, also known as the "substantial continuity" exception, in *Turner v. Bituminous Cas. Co.*, 244 N.W.2d 873 (Mich. 1976). In *Turner*, the Michigan Supreme Court held that a merger may occur as a result of a cash transaction even without the two corporations having the same shareholders.

In 1977, the California Supreme Court in *Ray v. Alad Corp.*, 560 P.2d 3 (Cal. 1977), rejected the continuity-of-enterprise exception, instead crafting a new exception, known as the "product-line" exception. Based on the product-line exception, a successor may be held liable for a predecessor's defective product if the successor continued to manufacture the same product line from which the defective product came and as long as the predecessor dissolved soon after the asset sale.

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Over the past three-plus decades, state and federal courts around the country have struggled with whether they should create new exceptions specifically to address product liability law and federal remedial statutes. The vast majority of those states, however, have rejected expanding the traditional exceptions. The following sections discuss the *Turner* and *Ray* decisions and explain the reasons why state courts around the country have rejected the nontraditional exceptions.

Continuity-of-Enterprise Exception

In *Turner*, the Michigan Supreme Court considered whether a court should treat a cash purchase of assets the same as a stock purchase when deciding if product liability transfers to a successor corporation. 244 N.W.2d 873 (Mich. 1976). In holding that it should, the *Turner* court determined that, under certain circumstances, an asset-purchase agreement would bind a successor corporation to a predecessor when shareholders of each completely differed.

In reaching this decision, the *Turner* court posited that successor corporations were not structuring their asset-purchase deals as such for the purpose of defeating a plaintiff's later strict liability claim, writing that "there is no basis for treating a purchase of corporate assets different from a de facto merger. Both the injured party and the transferee corporation have common goals in each situation. It would make better sense if the law had a common result and allowed products liability recovery in each case." 244 N.W.2d at 880. The *Turner* court found that a successor's acquisition and use of a predecessor's goodwill justified holding the successor liable for a predecessor's manufacturing defects. With that rationale serving as its springboard, the *Turner* court held that, when a plaintiff presented evidence proving the following elements, the continuity-of-enterprise exception would defeat the general rule establishing impunity from assuming the liability of a successor:

(1) There is a continuation of the enterprise of the seller corporation so that continuity of management, personnel, physical location, assets, and general business operations exists;
(2) The seller corporation ceases its ordinary business operations, liquidates, and dissolves as soon as legally and practically possible; and
(3) The purchasing corporation assumes those liabilities and obligations of the seller ordinarily necessary for the uninterrupted continuation of normal business operations of the seller corporation.

244 N.W.2d at 879, 883 (citing *McKee v. Harris-Seybold Co., Div. of Harris-Intertype Corp.*, 264 A.2d 98, 103–105 (N.J. Super. Ct. 1970), *aff'd*, 288 A.2d 585 (N.J. Super. Ct. 1972)). In essence, the new exception took form as the de facto merger test without the continuity-of-shareholders element.

Courts in Alabama and Alaska explicitly adopted this exception. *Andrews v. John E. Smith's Sons Co.*, 369 So. 2d 781, 785–86 (Ala. 1979); *Savage Arms, Inc. v. Western Auto Supply Co.*, 18 P.3d 49, 55 (Alaska 2001). Courts in Pennsylvania and New

Jersey referred favorably to the exception, but both eventually adopted the product-line exception. *See Dawejko v. Jorgensen Steel Co.*, 434 A.2d 106, 111 (Pa. Super. Ct. 1981); *Ramirez v. Amsted Indus., Inc.*, 431 A.2d 811, 818–819 (N.J. 1981). And Ohio and Mississippi courts signaled that the exception may apply in the context of a product liability lawsuit, but neither seemingly adopted the theory. *Flaugher v. Cone Automatic Mach. Co.*, 507 N.E.2d 331, 336 (Ohio 1987) (suggesting that the theory may be applicable but not expressly adopting because the case facts did not show continuation of the predecessor's business to the successor's). *But cf. Welco Indus., Inc. v. Applied Companies*, 617 N.E.2d 1129, 1133 (Ohio 1993) (rejecting the exception for contract claims). *See also Paradise Corp. v. Amerihost Dev., Inc.*, 848 So. 2d 177, 180–181 (Miss. 2003) (while signaling that it was adopting the continuity-of-enterprise exception, the opinion turned on questions of fraud and unjust enrichment, throwing into doubt whether the state truly has adopted this exception or merely found that a fraudulent transfer occurred).

Additionally, when considering successor liability issues arising under federal remedial statutes such as CERCLA or the Fair Labor Standards Act (FLSA), some federal courts have used a test similar to the continuity-of-enterprise test to analyze whether a successor could be found liable. However, the recent trend appears to be that federal courts apply state law interpretations of successor liability rather than craft separate, federal common law. *See, e.g.*, *United States v. Bestfoods*, 524 U.S. 51, 63 (1998).

Other than these states, however, courts considering the continuity-of-enterprise exception have almost universally renounced it, with courts in 23 states including Florida, Illinois, Maryland, New York, Virginia, and Wisconsin rejecting or criticizing the exception. Courts criticize the *Turner* decision because the decision disregards fundamental premises of product liability, contract, and corporate law.

From the product liability standpoint, the *Turner* decision and its progeny ignore that strict liability seeks to hold the actual manufacturer of a defective product responsible for manufacturing that product. The Minnesota Supreme Court summarized the arguments against applying this exception in *Niccum v. Hydra Tool Corp.*, 438 N.W.2d 96, 99 (Minn. 1989). There, the Court wrote:

> Opponents of the expansion argue liability should not be imposed on a successor corporation because (1) the successor corporation did not create the risk by placing the defective product into the market; (2) any profit realized on the product is only received in a remote way; and (3) the successor has not represented to the public the safety of the predecessor's product.

Id.

The Florida Supreme Court, echoing the *Niccum* Court's sentiments, wrote:

> Extending liability to the corporate successor is not consistent with at least one major premise of strict liability, which is to place responsibility for a defective product on the manufacturer who placed that product into commerce. The corporate successor has not created the risk, and only remotely benefits from the product. The successor has not invited usage of the product or implied its safety. Since the successor was never in a position to eliminate the risk, a major purpose of strict liability in modifying a manufacturer's behavior is also lost.

Bernard v. Kee Mfg. Co., Inc., 409 So. 2d 1047, 1050 (Fla. 1982).

Other courts have criticized the *Turner* decision and, by extension, the continuity-of-enterprise exception, because the analytical foundation upon which *Turner* rests disregards fundamental principles of contract and corporate law. Specifically, while the *Turner* court acknowledged that corporate parties "wish to know as exactly as possible what they are buying and selling in order to establish an appropriate price," 244 N.W.2d at 878, a successor is required to bear the financial responsibility for unknown defects in a predecessor's product, unknowable future injuries to a predecessor's customers, and the successor must bear such responsibility for an unforeseeable period of time. Rather than eliminating uncertainties between contracting corporations, the exception instead creates potentially chaotic results.

This specific criticism is best articulated in *Johnston v. Amsted Indus., Inc.*, 830 P.2d 1141, 1146–47 (Colo. Ct. App. 1992):

> [W]e disagree with plaintiffs that the elimination of the requirement of continuity of shareholders to establish a merger is an "insignificant change" in traditional corporate law. To the contrary, rather than being a meaningless requirement in finding a *de facto* merger, it is probably the most important element.
>
> In a traditional merger, the shareholders of the predecessor become the shareholders of the successor. And, in a merger, the liability of the predecessor corporation necessarily becomes that of the successor. This is so, in part, because it is the shareholders that ultimately enjoy the profits, if any. Therefore, they cannot move as a group to another corporation to enjoy the continuing profits of the same business earned before merger but escape all possible losses that accumulated before the merger.
>
> On the other hand, in a sale of assets with no continuity of shareholders, all that has transferred is the business. The predecessor corporation is left behind with liabilities and with "money in hand." The imposition of liability in these circumstances defeats the legitimate expectations of the parties held during negotiations.

(internal citations omitted). *See also Nguyen v. Johnson Mach. & Press Corp.*, 433 N.E.2d 1104, 1110 (Ill. App. Ct. 1982) ("There is little logic and little justice in requiring the successor to assume the liabilities of the predecessor. The successor has paid a substantial price for the assets of the predecessor, and the law should not require the successor to pay a greater price, especially after the fact of sale when it is impossible for the successor to return to negotiations to change the price. Left behind is the predecessor corporation with money in hand. It should meet whatever liabilities it had with the price it has exacted. Its shareholders should ultimately suffer the losses from liabilities the corporation had, not the shareholders of the successor").

Instead of creating contractual certainty, the continuity-of-enterprise exception perpetuates uncertainty for successors and unfairly shifts liability away from the actual tortfeasors to innocent parties. Based on that, the vast majority of states considering this nontraditional exception have rejected it.

Product-Line Exception

In *Ray*, the California Supreme Court considered whether a successor, which was not responsible for placing a defective product into the stream of commerce, was strictly liable for a predecessor's defective products when the successor *did not* acquire the assets in a way that offended the traditional exceptions. 560 P.2d 3 (Cal. 1977). The *Ray* court held that "a party which acquires a manufacturing business and continues the output of its line of products… assumes strict tort liability for defects in units of the same product line previously manufactured and distributed by the entity from which the business was acquired." *Ray*, 560 P.2d at 11.

There, the plaintiff was injured after falling off an allegedly defective ladder manufactured by the predecessor. The trial court held that the successor was not liable for such injuries, further holding that it was not a successor under the traditional exceptions. The California Supreme Court reversed, finding that

> [t]he purpose of the rule of strict tort 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" and "that the cost of an injury and the loss of time or health may be an overwhelming misfortune to the person injured, and a needless one, for the risk of injury can be insured by the manufacturer and distributed among the public as a cost of doing business."

Id., 560 P.3d at 8 (internal citations omitted). The *Ray* court continued its analysis of product liability law by stating that "the paramount policy to be promoted by the rule is the protection of otherwise defenseless victims of manufacturing defects and the *spreading throughout society* of the cost of compensating them." *Id.* (emphasis in original).

Having analyzed what it believed was the thrust of strict liability law, the *Ray* court held:

> Justification for imposing strict liability upon a *successor* to a manufacturer under the circumstances here presented rests upon (1) the virtual destruction of the plaintiff's remedies against the original manufacturer caused by the successor's acquisition of the business, (2) the successor's ability to assume the original manufacturer's risk-spreading role, and (3) the fairness of requiring the successor to assume a responsibility for defective products that was a burden necessarily attached to the original manufacturer's good will being enjoyed by the successor in the continued operation of the business.

Instead of creating contractual certainty, the continuity-of-enterprise exception perpetuates uncertainty for successors and unfairly shifts liability away from the actual tortfeasors to innocent parties.

560 P.3d at 9. Further justifying its conclusion, the *Ray* court wrote, "imposing this liability upon successor manufacturers… not only causes the one who takes the benefit to bear the burden but precludes any windfall to the predecessor that might otherwise result from (1) the reflection of an absence of such successor liability in an enhanced price paid by the successor for the business assets and (2) the liquidation of the predecessor resulting in avoidance of its responsibility for subsequent injuries from its defective products." 560 P.3d at 11.

Four years later, in *Ramirez v. Amsted Indus., Inc.*, 431 A.2d 811 (N.J. 1981), and in *Dawejko v. Jorgensen Steel Co.*, 434 A.2d 106 (Pa. Super. Ct. 1981), the New Jersey Supreme Court and Pennsylvania Superior Court each adopted the product-line exception. Since 1981, only two other jurisdictions have adopted the product-line exception. *See Martin v. Abbott Labs.*, 689 P.2d 368, 388 (Wash. 1984); *Garcia v. Coe Mfg. Co.*, 933 P.2d 243, 249 (N.M. 1997). While not completely clear, Mississippi may have also adopted the product-line exception, albeit in dicta, in a case in which the facts did not give rise to liability based on the product-line exception. *See Huff v. Shopsmith, Inc.*, 786 So. 2d 383, 388 (Miss. 2001) ("even though we view the product line theory as a viable basis for recovery, the present situation does not meet the standards utilized by other courts that have adopted the theory"). *But cf. Huff*, 786 So. 2d at 390 (J. Cobb, concurring) ("I concur with the result in this case and with all of the majority opinion except for its adoption by dicta of the 'product line' theory… Such a major expansion of our state's product liability law should only be done where warranted by the facts and after due and deliberate evaluation and discussion by this Court").

Other than these states, however, courts in 29 states including Florida, Illinois, Massachusetts, New York, Ohio, Texas, Virginia, and Wisconsin rejected applying the product-line exception. In rejecting this exception, three particular arguments proved persuasive: "(1) the exception is inconsistent with elementary product liability principles, and strict liability principles in particular, in that it results in an imposition of liability without a corresponding duty; (2) the exception threatens small successor businesses with economic annihilation because of the difficulty involved in obtaining insurance for defects in a predecessor's product; and (3) the exception is essentially a radical change in the principles of corporation law and, as such, should be left to legislative action." *DeLapp v. Xtraman, Inc.*, 417 N.W.2d 219, 221 (Iowa 1987).

The Texas Court of Appeals further explained the incongruence of the product-line exception with principles of strict liability, writing:

> At bottom, the rationale for imposing tort liability under the 'product line' theory amounts to imposing upon the 'successor corporation' a legal duty that it cannot possibly perform to prevent the specific injury it is called upon to redress

> by money damages. Thus, the 'duty' so imposed is not the 'duty' normally associated with tort law—the duty to avoid conduct that poses an unreasonable risk of harm to others—but instead a 'duty' to make whole one who has suffered an injury, as an insurer is required more or less to do by its contract of insurance.

Griggs v. Capitol Mach. Works, Inc., 690 S.W.2d 287, 291–292 (Tex. App. 1985).

Also rejecting this exception, the Massachusetts Supreme Court wrote, "[I]t is not the purchase by the successor corporation that deprived the plaintiff of a remedy, but rather the demise of the predecessor. Furthermore, the plaintiff's lack of a remedy against the original manufacturers is not a justification for imposing liability on another absent fraud and causation." *Guzman v. MRM/Elgin*, 567 N.E.2d 929, 931 (Mass. 1991). *See also Johnston*, 830 P.2d at 1144 ("strict liability should not be imposed because: the successor corporation did not create the risk nor did it directly profit from the predecessor's sale of the defective product; it did not solicit the use of the defective product nor make any representations as to its safety; and it is not able to enhance the safety of a product that is already on the market").

Other courts have been persuaded not to adopt the product-line exception due to the potentially devastating effects it would have on small businesses if they were held liable for injuries caused by predecessors' defective products. In *Fish v. Amsted Indus., Inc.*, 376 N.W.2d 820, 827–828 (Wis. 1985), the Wisconsin Supreme Court wrote that

> [s]mall manufacturers have a difficult problem obtaining products liability insurance and find it impossible to cover the risks by raising prices because they have to compete with larger manufacturers who can keep the price down. Additionally, it is one thing to assume that a manufacturer can acquire insurance against potential liability for its own products and another to assume it can acquire such insurance for the products made by a different manufacturer.

Citing *Nguyen*, 433 N.E.2d at 1111. *See also Semenetz v. Sherling & Walden, Inc.*, 851 N.E.2d 1170, 1173–1174 (N.Y. 2006); *Bernard*, 409 So. 2d at 1049 (refusing to adopt the product-line exception "due in part to the threat of economic annihilation that small businesses would face under such a rule of expanded liability").

From the strict liability standpoint, these decisions highlight the major flaw in the *Ray* decision, namely that (1) the successor did not create the defective product; (2) similar to the plaintiff, the successor likely had no reason to suspect or know that the product was defective when it purchased the assets; and (3) the successor likely did not know who the ultimate

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722–23 (10th Cir. 2010). Courts will generally void the indemnity provision and enforce other portions of the contract.

Even where it is not against public policy to indemnify another for that person's sole negligence, most courts have held that such an agreement must be clear and explicit, or otherwise the contract will not be construed to allow for such indemnity. *See Mantilla v. NC Mall Assoc.*, 167 N.J. 262, 274 (2001); *Nabholz Constr. Corp. v. Graham*, 892 S.W.2d 456, 459 (Ark. 1995).

Some jurisdictions have recognized an exception to this requirement, distinguishing "between contracts with consumers and contracts between businesses of equal power and sophistication." *Util. Serv.*, 163 S.W.3d at 913. The notion is that sophisticated business parties require less precision in the terms of the indemnity clause, and it is irrelevant whether the businesses bargained for the provision. *Id.* at 913–14 ("Courts enforce the objective terms of contracts between sophisticated businesses, without regard to the parties' subjective intent. The character and quality of negotiations do not vary the terms of a written contract between sophisticated businesses.").

Insurance Procurement Requirements

Requiring another party to obtain insurance on your behalf is another effective risk-transfer vehicle. Generally, a party can require another party to purchase insurance covering the first party's negligence without violating the prohibition against being indemnified for one's own negligence. *See Shea v. Royal Enters.*, 2011 U.S. Dist. LEXIS 1192 at *12–13 (S.D.N.Y. 2011); *Cappello v. Phillips*, 2011 Conn. Super. LEXIS 1371 at *48–50 (Conn. Super. 2011). If done via insurance, a party can be indemnified for its own negligence because an agreement to procure insurance is generally not considered an agreement to indemnify. *Cappello*, 2011 Conn. Super LEXIS at *48.

While the purpose of an indemnification agreement is to relieve the promisee of liability, an agreement to procure insurance specifically anticipates the promisee's continued responsibility for its own negligence for which the promisor is obligated to furnish insurance. *Id.* Moreover, this particular distinction is what renders indemnification, but not insurance-procurement, agreements violative of the public policies underlying "sole-negligence" anti-indemnity statutes. *Id.* at *49. While an agreement purporting to hold an owner or a general contractor free from liability for its own negligence undermines the strong public policy of placing and keeping responsibility for maintaining a safe workplace on those parties, the same cannot be said for an agreement that simply obligates one of the parties to a construction contract to obtain a liability policy insuring the other. *Id.*

Not all states allow an indemnitee to procure insurance from another for the indemnitee's own negligence. *See, e.g.*, *Walsh Const. Co. v. Mutual of Enumclaw*, 104 P.3d 1146 (Or. 2005) (citing *Walsh Const. Co. v. Mutual of Enumclaw*, 76 P.3d 164, 168 (Or. App. 2003); (Or. Rev. Stat. §30.140 "prohibits not only 'direct' indemnity arrangements between parties to construction agreements but also 'additional insurance' arrangements by which one party is obligated to procure insurance for losses arising in whole or in part from the other's fault").

Additional Insured

Businesses looking to protect themselves from potential liability should also require that subordinate parties name them as additional insureds under an indemnitor's insurance policies. These are prevalent in the construction context, as well as under vendor's agreements, leases and services contracts. The rights and obligations of the additional insured are generally controlled by the specific policy language, and some provisions are narrower than others. For that reason, contracting parties will want to pay close attention to these additional insured provisions to make sure they provide the necessary protection sought. Additional insured endorsements are typically construed broadly in conjunction with the underlying contractual obligations between the parties. *See, e.g.*, *County of Hudson v. Selective Ins. Co.*, 332 N.J. Super. 107, 113 (App. Div. 2000).

Conclusion

Each business faces a unique set of circumstances and associated risks, some of which may be unavoidable. When the unforeseen happens, you want to be ready. As highlighted by the discussion above, owners and in-house counsel should become familiar with the basic types of coverage available—and the way these policies are interpreted—as one path to protecting against losses and managing potential risks. Contractual risk transfer is also an important part of an effective mitigation strategy, and business are well-served by knowing when potential liability can be allocated or transferred downstream to other parties and their insurers. IDQ

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consumer of the allegedly defective product was. Moreover, the economic ramifications for businesses—particularly in an era of economic uncertainty—served as further justification for courts to reject a new exception that punishes parties that did not create defects, did not benefit from the sale of the products, and paid good and valuable consideration for the assets, including the public goodwill toward other corporations. Each of these reasons has proven persuasive within the vast majority of jurisdictions considering whether to expand beyond the traditional exceptions recognized under the successor liability defense.

Conclusion

The upside to using the successor liability defense is profound. When it applies, a successor can escape all liability for product liability claims, including in a case in which a plaintiff asserts both strict liability and negligence claims related to the same alleged product defect. Applying this defense, however, requires an attorney to know a business's corporate history. To determine whether the defense applies, an attorney should know a company's acquisition history, review copies of prior purchase agreements, and pay particular attention to the structure of the asset purchase deal.

Given that an asset purchase may have taken place decades before an actual claim arises, it is also important to identify those persons within and outside a company who may assist with analyzing questions relating to the successor liability defense, particularly in jurisdictions that analyze the mere-continuation or the de facto merger elements closely. If you can contact former management personnel, depending on your internal policies, it may make sense to interview those persons and, if appropriate, secure affidavits or statements for future use. Specifically, counsel may wish to secure affidavits or statements that demonstrate that not all of a predecessor's assets were purchased in the sale, that the successor corporation was not aware of the future business plans of the predecessor corporation, that not all employees or management personnel came aboard the successor corporation, and other facts that tend to show that the predecessor and successor corporations were separate.

Finally, to the extent that a business does not possess all of the necessary documents related to an asset-purchase agreement or subsequent corporate reorganization, many states preserve corporate records, usually in the Secretary of State's office, allowing counsel to order any documents necessary to demonstrate sufficiently that the successor liability defense does apply and that none of the four traditional exceptions would bar use of the defense.

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is paying (both defense counsel and plaintiff, as well as the mediator), and in-house counsel is quite capable of evaluating the case, too, based upon the information that outside counsel has obtained and reported. It may not be easy for some defense counsel who are used to "being in charge" at trial to leave room for in-house counsel. If they cannot, those attorneys should stay in the courtroom and leave mediation to others.

Even with the conclusion of an unsuccessful mediation, the process is not complete. Many times, the seeds for settlement will be sown at mediation. In those instances, it is the decision of in-house counsel, with the opinion of outside counsel, if requested, on whether, when, and which cases should be pursued for settlement post-mediation. The mediator has been seeking progress, all it may take is a call to the mediator to "keep the conversation going" with the result that a case is settled a couple of weeks after the so-called "failed mediation." Again, the decision on whether to pursue further settlement efforts is that of in-house counsel, as is the level of authority to be given to the mediator, with outside counsel available for input and opinions. In this context, very often following a failed mediation, counsel for plaintiff and defendant may discuss the case either while addressing additional issues involved in the litigation or perhaps seeing each other in court on other cases. The comments and attitude evinced by plaintiffs' counsel should be communicated by outside defense counsel to the client for evaluation for further settlement possibilities.

Conclusion

In sum, the relationship between in-house and outside counsel allows for many opportunities for each to step on the toes of the other. However, it can also be a powerful weapon that forms a strong team for settling cases—together.

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holder property damage claims that assert that a decrease in market value attributable to the stigma attached to damaged property ought to be compensable as a covered form of direct physical loss or damage. The issue of whether diminution in value attributed to stigma from damage has historically been litigated in the auto insurance context, with widely varying results. *Compare*, *e.g.*, *Given v. Commerce Insurance Co.*, 440 Mass. 207, 212–13, 796 N.E.2d 1275, 1280 (2003) (the plain meaning of the terms "repair" and "replace" do not encompass "repair" or "replace[ment]" of damage caused by stigma, a form of damage that, by definition, defies a remedy by way of "repair" or "replace[ment]") *with State Farm Mutual Automobile Insurance Co. v. Mabry*, 274 Ga. 498, 556 S.E.2d 114 (2001) (the provision affording the insurer the option to repair serves only to abate, not eliminate, the insurer's liability for a diminution in value).

Whether stigma-related diminution in value can constitute covered direct physical loss or damage could have dramatic import when applied to property damage claims in contexts beyond the auto insurance realm. The United States Court of Appeals recently considered precisely that question in *Royal Capital Developments, LLC v. Maryland Casualty Company*, ___ F.3d ___, No. 10-15716, 2011 WL 4552307 (Oct. 4, 2011). In *Royal Capital*, the insured owned an eight story commercial building in Georgia. Construction activity on an adjacent building caused physical damage to the insured building. *Id.* at *1. The insured submitted a claim for both the property damage and the post-repair diminution in value resulting from the damage. The court acknowledged *Mabry*, *supra*, in which the Georgia Supreme Court ruled that a consumer automobile insurance policy afforded coverage for both physical damage and diminution in value of the property attributable to the damage, and observed that there are arguments in extending the holding in *Mabry* to policies insuring commercial buildings. *Id.* at *3. In *dicta* responding to the insurer's argument that diminution in value should not be covered under the standard grant of coverage in a commercial property policy for "direct physical loss or damage," the court observed that "it is not a stretch to conclude that diminution in value due to physical damage and subsequent repair is a type of 'physical damage' under Georgia law." *Id.* at *4. Having considered the arguments both for and against coverage for diminution in value attributable to stigma, and in light of the absence of controlling Georgia law on the issue, the Eleventh Circuit certified to the Georgia Supreme Court the following question:

> For an insurance contract providing coverage for "direct physical loss of or damage to" a building that allows the insurer the option of paying either "the