WALTER E. LORD and LLYOD D. BURNS,	:	IN THE COURT OF COMMON PLEAS OF LYCOMING COUNTY, PENNSYLVANIA
Plaintiffs	:	
vs.	:	NO. 04-01,658
HENRY DUNN, INC.,	:	
Defendant	:	MOTION FOR SUMMARY JUDGMENT

Date: August 11, 2005

OPINION and ORDER

Before the court for determination is the Motion for Summary Judgment of Defendant Henry Dunn, Incorporated (hereafter "HDI") filed June 15, 2005. The court will deny in part and grant in part the motion. Plaintiffs have presented sufficient evidence to establish a prima facia case for the de facto merger exception to the successor liability rule. However, Plaintiffs have failed to present sufficient evidence to establish a prima facia case for the mere continuation exception to the successor liability rule.

Background

Plaintiffs are attempting to hold HDI liable for the claims they had against Mallalieu-Golder Insurance Agency, Incorporated (hereafter "MGI"). Plaintiffs contend that HDI is responsible for those claims based upon the theory of successor liability. Plaintiffs' claims against MGI are based upon the following facts.

On December 19, 1988, Walter Lord sold stock that he owned in MGI and a covenant not to compete to MGI for the sum of $175,000.00. Complaint, ¶5; Answer, ¶5. MGI

executed a promissory note agreeing to pay Lord the amount of $137,000.00 in monthly installments for a period of years, with interest. Complaint, ¶5; Answer, ¶5. Also on December 19, 1988, Lloyd D. burns sold stock he owned in MGI and a covenant not to compete to MGI for the sum of $175,000.00. Complaint, ¶6; Answer, ¶6. MGI executed a promissory note agreeing to pay Burns, through monthly installments, the amount of $141,200.00, with interest. Complaint, ¶6; Answer, ¶6. Both promissory notes were subsequently modified and extended. Complaint, ¶7; Answer, ¶7.

MGI defaulted on both promissory notes. Complaint, ¶8; Answer, ¶8. On July 1, 2002, Lord and Burns filed Confessions of Judgment against MGI pursuant to their promissory notes. Complaint, ¶9; Answer, ¶9. Judgment was entered in the amount of $90,239.38 for Lord and $95,816.14 for Burns.

MGI had been engaged in the business of insurance sales. Lawrence Fiorini and David Eakin had owned MGI. Defendant's Motion for Summary Judgment, ¶13; Plaintiffs' Answer to Motion for Summary Judgment, ¶13. Both Fiorini and Eakin owned fifty percent of the MGI stock. Defendant's Motion for Summary Judgment, ¶13; Plaintiffs' Answer to Motion for Summary Judgment, ¶13. On June 14, 1991, Fiorini and Eakin pledged all of their MGI stock to Woodlands Bank as collateral for a loan. Defendant's Motion for Summary Judgment, ¶15; Plaintiffs' Answer to Motion for Summary Judgment, ¶15. Woodlands Bank repossessed and took control of all outstanding MGI stock upon the loan being defaulted. Defendant's Motion for Summary Judgment, ¶16; Plaintiffs' Answer to Motion for Summary Judgment, ¶16. On March 22, 2002, Lawrence Fiorini died and was survived by his wife Barbara Fiorini.

Defendant's Motion for Summary Judgment, ¶14; Plaintiffs' Answer to Motion for Summary Judgment, ¶14.

HDI is engaged in the business of insurance and real estate sales. Defendant's Motion for Summary Judgment, ¶9; Plaintiffs' Answer to Motion for Summary Judgment, ¶9. Its principle place of business and principle office is in Towanda, Pennsylvania. Defendant's Motion for Summary Judgment, ¶9; Plaintiffs' Answer to Motion for Summary Judgment, ¶9. Henry C. Dunn and Henry E. Dunn, II own eighty and twenty percent respectively of HDI. Defendant's Motion for Summary Judgment, ¶18; Plaintiffs' Answer to Motion for Summary Judgment, ¶18.

On September 18, 2002, HDI entered into an agreement for the purchase of MGI's assets. Complaint, ¶10; Answer, ¶10. At the time of the agreement, MGI owed debts in excess of $700,000. Defendant's Motion for Summary Judgment, ¶23; Plaintiffs' Answer to Motion for Summary Judgment, ¶23. The contract sale price for MGI's assets was $700,000. Defendant's Motion for Summary Judgment, Exhibit E. Under the contract, payment was to be made in four installments and $200,000 at closing. Ibid. MGI and HDI modified the agreement so that the total purchase price was to be paid at the closing. Defendant's Motion for Summary Judgment, Exhibit F. The reason for this modification was to enable MGI to pay debts owed to insurance carriers so that those carriers would continue and do business with HDI. Ibid. On November 2, 2002, the sales agreement closed. Complaint, ¶14; Answer, ¶14. HDI paid the purchase price in cash. Defendant's Motion for Summary Judgment, ¶12; Plaintiffs' Answer to Motion for Summary Judgment, ¶12. None of MGI's former owners acquired an ownership interest in HDI as a result of the purchase of MGI's assets. Defendant's

Motion for Summary Judgment, ¶19; Plaintiffs' Answer to Motion for Summary Judgment, ¶19.

After the sale, MGI ceased operations. Eakin, who had been the Secretary and fifty percent owner of MGI, became an employee of HDI. Defendant's Motion for Summary Judgment, ¶21, 22; Plaintiffs' Answer to Motion for Summary Judgment, ¶21, 22. HDI employed Eakin as a producer and vice president. Defendant's Motion for Summary Judgment, ¶22; Plaintiffs' Answer to Motion for Summary Judgment, ¶22. In addition to these duties, Eakin manages HDI's Williamsport and Pittsburgh offices. Plaintiffs' Brief in Opposition to Motion for Summary Judgment, Exhibit 1.

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Eakin was not the only MGI employee to join HDI. HDI employed the following five MGI employees after the sale: Robert Rausauri (producer); Irene Hoover (underwriter); Kim Robinson (customer service representative); Marcia Confer (customer service representative); and Traci Robinson (receptionist). Plaintiffs' Brief in Opposition to Motion for Summary Judgment, Exhibit 1.

Following the sale, HDI continued to engage in the insurance sales business, as well as real estate sales. HDI was able to obtain agency contracts from some of the insurance agencies with whom MGI formerly did business. Defendant's Motion for Summary Judgment, ¶26; Plaintiffs' Answer to Motion for Summary Judgment, ¶26. As part of its insurance sales business, HDI operates out of MGI's former Williamsport and Pittsburgh offices.

In its motion for summary judgment, HDI contends that Plaintiffs have failed to produce sufficient evidence to establish a de facto merger or mere continuation exception. HDI argues that in order to establish both exceptions Plaintiffs are required to establish a

continuity of ownership between the successor and predecessor companies. HDI contends that Plaintiffs have failed to do this because the evidence demonstrates that no former owner of MGI received or acquired an ownership interest in HDI following the sale of MGI's assets.

Issues

Three issues confront the court. The first is whether Plaintiffs have presented sufficient evidence to establish a prima facie case for the existence of the de facto merger exception. In order to resolve this issue, the court must first answer the second issue, which is whether the de facto merger exception requires that continuity of ownership be established. The final issue is whether Plaintiffs have presented sufficient evidence to establish a prima facie case for the existence of the mere continuation exception.

Discussion

This opinion will initially set forth the standard for a motion for summary judgment as well as the successor liability rule and its exceptions. The opinion will then address whether the de facto merger exception requires that there be continuity of ownership. Finally, the opinion will address whether Plaintiffs have presented sufficient evidence to make out a prima facie case for the de facto merger exception and the mere continuation exception.

I. Summary Judgment Standard

A party may move for summary judgment after the pleadings are closed. Pa.R.C.P. 1035.2. Summary judgment may be properly granted "… when the uncontraverted allegations in the pleadings, depositions, answers to interrogatories, admissions of record, and submitted affidavits demonstrate that no genuine issue of material fact exists, and that the moving party is entitled to judgment as a matter of law." ***Rauch v. Mike-Mayer***, 783 A.2d 815, 821 (Pa. Super.

2001); ***Godlewski v. Pars Mfg. Co.***, 597 A.2d 106, 107 (Pa. Super. 1991). The movant has the burden of proving that there are no genuine issues of material fact. ***Rauch***, 783 A.2d at 821. In determining a motion for summary judgment, the court must examine the record " '… in the light most favorable to the non-moving party, accepting as true all well pleaded facts in its pleading and giving that party the benefit of all reasonable inferences ….'" ***Godlewski***, 597 A.2d at 107 (quoting ***Banker v. Valley Forge Ins. Co.***, 585 A.2d 504, 507 (Pa. Super. 1991)). Summary judgment will only be entered in cases that are free and clear from doubt and any doubt must be resolved against the moving party. ***Garcia v. Savage***, 586 A.2d 1375, 1377 (Pa. Super. 1991).

Summary judgment may be properly entered if the evidentiary record "… either (1) shows that the material facts are undisputed or (2) contains insufficient evidence of facts to make out a *prima facie* cause of action or defense." ***Rauch***, 783 A.2d at 823-24; *See also*, Pa.R.C.P. 1035.2. If the defendant is the moving party under Pa.R.C.P. 1035.2(2), then "… he may make the showing necessary to support the entrance of summary judgment by pointing to material which indicates that the plaintiff is unable to satisfy an element of his cause of action." ***Rauch***, 783 A.2d at 824. "Conversely, the [plaintiff] must adduce sufficient evidence on an issue essential to [his] case and on which [he] bears the burden of proof such that a jury could return a verdict favorable to the [plaintiff]." ***Ibid***. If the plaintiff fails to establish a prima facie case, then summary judgment is proper as a matter of law. ***Ack. v. Carrol Township***, 661 A.2d 514, 516 (Pa. Cmwlth. 1995).

II. Successor Liability Rule

The successor liability rule states that when a company sells or transfers all of its assets to another company, the purchasing or receiving company is not responsible for the debts and liabilities of the selling company. ***Cont'l Ins. Co. v. Schneider, Inc.***, 810 A.2d 127, 131 (Pa. Super. 2002), *aff'd*, 873 A.2d 1286 (Pa. 2005); ***Carlos R. Leffler, Inc. v. Hutter***, 696 A.2d 157, 167 (Pa. Super. 1997). Under the rule, the mere act of acquisition is insufficient to hold the successor company responsible for the liabilities of the predecessor company. ***Lefffler***, 696 A.2d at 167. However, as with many general rules, there are exceptions. In order to hold the successor company liable, one of the following must be established:

> (1) the successor company expressly or impliedly agreed to assume the obligation;
>
> (2) the transaction was a consolidation or merger;
>
> (3) the successor company is merely a continuation of the selling company;
>
> (4) the transaction was a fraudulent attempt to escape liability;
>
> (5) the transfer lacked adequate consideration and no provisions were made for creditors of the predecessor.

Bird Hill Farms, Inc. v. United States Cargo & Courier Serv., Inc., 845 A.2d 900, 905 (Pa. Super. 2004); ***Cont'l Ins.***, 810 A.2d at 131. A successor company may also be held liable for the predecessor's conduct under the product line exception. ***Hill v. Trailmobile, Inc.***, 603 A.2d 602, 606 (Pa. Super. 1992); ***Dawejko v. Jorgensen Steel Co.***, 434 A.2d 106, 110 (Pa. Super. 1981). Generally, this exception involves personal injuries resulting from the predecessor's defective products. ***Hill***, 603 A.2d at 606.

III. De Facto Merger Exception

A. Statement of the Exception

A de facto merger exists if there is sufficient continuity between the successor and predecessor company which demonstrates the new business enterprise was created by what in fact is a merger or consolidation regardless as to how it may technically be termed by the parties and legal documentation. ***Commonwealth v. Lavelle***, 555 A.2d 218, 227 (Pa. Super. 1989), *app. denied*, 568 A.2d 1246 (Pa. 1989). That continuity may be evidenced by: (1) continuity of ownership; (2) cessation of the ordinary business by, and dissolution of, the predecessor as soon as practicable; (3) assumption by the successor of liabilities ordinarily necessary for the uninterrupted continuation of the business; and (4) continuity of management, personnel, physical location, and the general business operation. ***Cont'l Ins.***, 810 A.2d at 135; ***Lavelle***, 555 A.2d at 227. The existence of all four factors is not required to establish a de facto merger. ***Cont'l Ins.***, 810 A.2d at 135; ***Lavelle***, 555 A.2d at 227. These four factors are only indicators that tend to demonstrate the existence of a de facto merger. ***Id.*** at 227-28.

The de facto merger exception to the successor liability rule is a well recognized legal principle. "It is a general tenet of corporate law that a corporation which absorbs another corporation in a merger becomes legally responsible in every sense of the word for the latter's liabilities and debts." ***Ieropoli v. AC & S Corp.***, 842 A.2d 919, 932 (Pa. 2004). The de facto merger exception tries to give effect to this tenet.

B. Continuity of Ownership Requirement

Pennsylvania law is clear that the presence of all four factors which evidence a de facto merger is not required to establish a de facto merger. It is not clear whether Pennsylvania law requires that the first factor, continuity of ownership, must exist to establish a de facto merger. The court has not located any Pennsylvania appellate decision which explicitly states that the de facto merger exception requires continuity of ownership to be established. HDI cites to a number of federal cases which held that the failure to establish continuity of ownership was fatal to the de facto merger claim. ***Forrest v. Beloit Corp.***, 278 F. Supp.2d 471 (E.D.Pa. 2003); ***Pol Am Pack v. Redicon Corp.,*** 2000 U.S. Dist. LEXIS 15173 (E.D.Pa.); ***Stutzman v. Syncro Machine Co., Inc.,*** 1991 U.S. Dist. LEXIS 5308 (E.D.Pa.); ***Tracey v. Winchester Repeating Arms Co.,*** 745 F. Supp. 1099 (E.D.Pa. 1990); ***Savini v. Kent Machine Works, Inc.,*** 525 F. Supp. 711 (E.D.Pa. 1981). The court does not find these decisions persuasive.[1] Nor does the court find persuasive the argument that continuity of ownership is a required factor because in the Pennsylvania cases where a de facto merger was found to exist there was a continuity of ownership. In each of the Pennsylvania cases cited to the court by the parties and discovered through our research, additional factors evidencing a de facto merger were present. Specifically, in ***Continental Insurance Company v. Schnieder, Incorporated***, 810 A.2d 127 (Pa. Super. 2002), there was continuity of business operations, continuity of personnel, and continuity of physical location; in ***Carlos R. Leffler, Incorporated v. Hutter***, 696 A.2d 157 (Pa. Super. 1997), there was continuity of business operations, continuity of management and

[1] Decisions of federal district courts, even when applying Pennsylvania law, are not binding upon Pennsylvania courts. ***Bird***, 845 A.2d at 905.

personnel, and assumption of liabilities ordinarily necessary for uninterrupted continuation of the business; in ***Simmers v. American Cyanamid Corporation***, 576 A.2d 376 (Pa. Super. 1991), *app. denied*, 593 A.2d 413 (Pa. 1991), *cert. denied*, 502 U.S. 813 (1991), there was continuity of management and personnel, continuity of business operations, and dissolution of the predecessor company; and in ***Commonwealth v. Lavelle***, 555 A.2d 218 (Pa. Super. 1989), there was continuity of management and personnel, continuity of physical location, and continuity of general business operations. Therefore, it is clear under Pennsylvania law no one evidentiary factor is required to establish a de facto merger and a de facto merger is not necessarily created or defeated by the presence or absence of a specific sole factor.

The objective of the de facto merger inquiry is to determine whether the facts demonstrate a merger between the successor and predecessor companies. A merger occurs when two or more companies combine and one of the companies continues in existence and absorbs the others. ***Freeman v. Hiznay***, 36 A.2d 509, 511 (Pa. 1944). When there is a merger, the absorbing company "… retains its name and corporate identity with the added capital, franchises and powers of the merged corporation." Fletcher Cyc. Corp. §7041 (1999 Ed.). That is, the absorbing company has taken parts of the other company and integrated them into itself. Therefore, the focus of the de facto merger exception inquiry is whether the facts demonstrate that the successor company has absorbed the predecessor company.

A rule requiring continuity of ownership to establish a de facto merger would limit the definition of merger and the scope of inquiry thereby excluding a number of situations that would rightfully be considered a merger of successor and predecessor companies. By definition, a merger may occur between the successor company without continuity of

ownership. For instance, the facts may demonstrate that the successor company retained personnel from the predecessor, retained managers and supervisors from the predecessor, and continued the business of the predecessor. In this instance, a conclusion may be drawn that the successor company has taken parts of the predecessor and integrated them into itself thereby constituting a merger. Such a conclusion could be drawn despite the fact that there is no continuity of ownership. As such, the court is unwilling to limit the de facto merger exception absent a clear directive from a Pennsylvania appellate court.

Accordingly, we hold the existence of continuity of ownership is not required to establish the existence of the de facto merger exception.

C. Evidence of De Facto Merger

Plaintiffs have presented sufficient evidence to establish a prima facie case for the de facto merger exception. Plaintiffs have presented evidence of continuity of management (Eakin manages two of HDI's offices); continuity of personnel (several MGI employees are HDI employees); continuity of location (HDI operates out of MGI's former Williamsport and Pittsburgh offices); continuity of general business operations (HDI continues to sell insurance and related services; HDI does business with some of the same insurance agencies as did MGI). Accordingly, the motion for summary judgment is denied in this respect.

IV. Mere Continuation Exception

A continuation occurs when "'a new corporation is formed to acquire the assets of an extant corporation, which then ceases to exist.'" ***Cont'l Ins.***, 810 A.2d at 136 (quoting ***Lavelle***, 555 A.2d at 227). In a continuation situation, there exists " 'one corporation which merely changes its form and ordinarily ceases to exist upon creation of the new corporation which is its

successor.'" ***Ibid***. The elements of the continuation exception are: (1) one corporation after the sale and (2) common identity of officers, directors or shareholders between the selling and purchasing corporation. ***Ibid***; ***Hill***, 663 A.2d at 606.

The evidence presented by Plaintiffs fails to establish the mere continuation exception. The evidence does demonstrate that there was one company after the sale, HDI. But, the evidence does not establish a common identity of officers, directors, or shareholders between HDI and MGI. None of the former MGI owners obtained an ownership interest in HDI as a result of the assets sale. Based upon the motion for summary judgment and response thereto, Henry C. Dunn and Henry E. Dunn, II possess the only ownership interests in HDI. Defendant's Motion for Summary Judgment, ¶18; Plaintiffs' Answer to Motion for Summary Judgment, ¶18. On this point, Plaintiffs have conceded in their brief that there is no continuity of ownership between MGI and HDI. Plaintiffs' Brief in Opposition to Motion for Summary Judgment, 16. Accordingly, the motion for summary judgment will be granted in this regard.

Conclusion

The motion for summary judgment will be denied in part and granted in part.

ORDER

It is hereby ORDERED that the Motion for Summary Judgment of Defendant Henry Dunn, Incorporated filed June 15, 2005 is DENIED IN PART and GRANTED IN PART.

The Motion is DENIED IN PART in that Plaintiffs have presented sufficient evidence to establish a prima facie case for the de facto merger exception to the successor liability rule.

The Motion is GRANTED IN PART in that Plaintiffs have failed to present sufficient evidence to establish a prima facie case for the mere continuation exception to the successor liability rule. Plaintiffs' claim against Defendant based upon this theory is DISMISSED.

BY THE COURT:

William S. Kieser, Judge

cc: David C. Shipman, Esquire
Evan S. Williams, III, Esquire
Judges
Christian J. Kalaus, Esquire
Gary L. Weber, Esquire (Lycoming Reporter)