IN THE SUPERIOR COURT OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

JOSHUA ROSS, Plaintiff, v. DESA HOLDINGS CORPORATION; DESA INTERNATIONAL, LLC; DESA INTERNATIONAL, INC.; C&C DRYWALL CONTRACTOR, INC.; AND ZAMARRIPA DRYWALL CONTRACTORS, INC., Defendants. v. PETTINARO CONSTRUCTION CO., INC.; PETTINARO & ASSOCIATES, INC.; PETTINARO ENTERPRISES; AND PETTINARO ENTERPRISES, LLC, Third-Party Defendants. -and- JOSHUA ROSS, Plaintiff, v. DESA, LLC; DESA HEATING, LLC; KEEN COMPRESSED GAS CO.; and OLIVIA BETENCOURT, Defendants.	)	C.A. No. 05C-05-013 MMJ CONSOLIDATED

OPINION

Submitted: August 13, 2008
Decided: September 30, 2008

On Cross Motions for Summary Judgment

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JOHNSTON, J.

PROCEDURAL CONTEXT

DESA International, Inc. ("Old DESA"), a Delaware corporation, manufactured residential and commercial heating products. On June 8, 2002, Old DESA filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court for the District of Delaware. On August 7, 2002, the bankruptcy court authorized the sale of Old DESA's assets. DESA, LLC, a Florida limited liability company, was the successful bidder.

The bankruptcy court's order approving the sale ("Sale Order") provides:

> 4. The sale of the Acquired Assets to the Buyer shall be free and clear of Liens (other than Liens created by the Buyer) pursuant to section 363(f) of the Bankruptcy Code, whether known or unknown, including, but not limited to, any of the Debtors' creditors, vendors, suppliers, employees, executory contract counterparties, lessors, customers or users of goods manufactured or sold by the Debtors, and the Buyer shall not be liable in any way (under any theory of successor liability or otherwise) for any claims that any of the foregoing or any other third party may have against any of the Debtors, provided further that, except as expressly provided in the Final Asset Purchase Agreement, with regard to employees' claims, the free and clear delivery of the Acquired Assets shall include, but not be limited to, all asserted or unasserted, known or unknown, employment regulated claims, payroll taxes, employee contracts, employee seniority accrued while employed with any of the Debtors and successorship liability, with any and all valid and enforceable Liens thereon, including those asserted by the Lenders, shall be transferred, affixed, and attached to the net proceeds of such sale, with the same

validity, priority, force, and effect as such Liens had upon the Acquired Assets immediately prior to the Closing.

Old DESA and DESA, LLC entered into an Asset Purchase Agreement on November 27, 2002, which provides:

> **"Assumed Liabilities"** means (a) all current postpetition trade accounts payable (other than a trade account payable to any affiliate of the Sellers) generated in the Ordinary Course of Business, (b) any obligation to the Sellers' customers through purchase orders and sales agreements entered into by the Sellers in the Ordinary Course of Business for nondelinquent orders outstanding as of the Closing reflected on the Sellers' books (other than any liability arising out of or relating to a breach that occurred prior to the Closing), (c) any liability to Sellers' customers under written warranty agreements given by the Sellers to their direct customers in the Ordinary Course of Business prior to the Closing, (d) any liability arising after the Closing Date under the Assumed Contracts, (e) all obligations under the Collective Bargaining Agreements arising after the Closing and (f) all obligations under the Sellers Plans (other than with respect to the Key Employee Retention Program described in Exhibit B and other than any material Seller Plan not listed on Schedule 1A attached hereto) , including obligations of the Sellers under the Severance Benefit Plan for any Key Employee that is terminated by Buyer within six (6) months, at a minimum, after the Closing Date.
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> **"Excluded Liabilities"** means all liabilities and obligations of the Sellers other than the Assumed Liabilities including, without limitation: ... (i) any liability arising out of or relating to products of Seller (other than liabilities under written warranty agreements assumed as Assumed Liabilities) to the extent manufactured or sold prior to the Closing, ... and (u) any other liability or obligation of the Sellers based upon the Sellers' acts or omissions whether or not occurring before or after the Closing.

On December 10, 2002, DESA, LLC formed DESA Heating, LLC ("New DESA") to operate and manage the purchased assets. New DESA retained most of Old DESA's workers, including those in executive and management positions. However, with one exception, none of the former directors of Old DESA became directors of New DESA.

Plaintiff Joshua Ross was injured on January 15, 2004. Ross suffered burns allegedly caused by a defective propane convection construction heater. Ross was an employee of third-party defendant Pettinaro Construction Co., Inc.

Counsel for New DESA notified plaintiff's counsel, by letter in August 2004, that the heater had been manufactured by Old DESA and that Old DESA was in bankruptcy. On March 30, 2005, the bankruptcy court ruled that the "automatic stay provision of section 362 of the Bankruptcy Code shall be modified for the sole and limited purpose of permitting [Ross] to pursue or litigate the Ross claim against the Debtors and any other potentially responsible parties in a non-bankruptcy forum of competent jurisdiction."[1]

[1] *In re DESA Holdings Corp.,* 353 B.R. 419, 422 (Bankr. D. Del. 2006) (quoting Lift Stay Order, Mar. 30, 2005).

Plaintiff filed this action on April 29, 2005 against, *inter alia*, Old DESA. A separate action against New DESA, *inter alia*, was filed on January 17, 2006. The two cases were consolidated on August 28, 2007.

New DESA moved to dismiss on the ground that the Sale Order precluded liability. During oral argument, this Court directed the parties to ask for clarification from the bankruptcy court as to whether the Sale Order intended that the automatic stay be lifted to permit Ross to pursue the Superior Court litigation against New DESA.

The bankruptcy court graciously accepted the question for review and issued a detailed opinion:[2]

> In summary, this Court finds that: (1) the Lift Stay Order was not necessary to prosecute a claim against Buyer [New DESA], (2) having obtained the Lift Stay Order, Movant still did not pursue Buyer, (3) there was no mention of Buyer in the negotiations leading to the Lift Stay Order, (4) the Lift Stay Order does not name Buyer and (5) Movant did not object to the Confirmation Order which ratified the injunctive relief to Buyer under the Sale Order. These findings establish conclusively that the Lift Stay Order did not in any way amend or modify the Sale Order. The Court concludes therefore that Movant's effort to impose successor liability on Buyer through the Lift Stay Order is an afterthought which neither the Court nor the parties contemplated.
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[2] *In re DESA Holdings Corp.*, 353 B.R. at 419.

> The Delaware Court's defining of this issue is all together appropriate because the applicable law to which the capable Delaware Court will apply the facts is Delaware law, not federal law.[3] Delaware courts recognize successor liability as a viable legal theory and, as well, that there are exceptions to the general principle that purchasers of assets do not succeed to a seller's liability.[4] Accordingly, the Delaware Superior Court has jurisdiction to rule on whether successor liability claims against Buyer are viable under Delaware law.[5]

Cross Motions for Summary Judgment

Defendants New DESA and DESA Heating, LLC moved for summary judgment on three grounds: (1) plaintiff's claims against New DESA are based on the theory of successor liability; (2) the bankruptcy court's orders expressly bar and enjoin successor liability by users of products manufactured or sold by Old DESA; and (3) there is no evidentiary support for any of the exceptions to the general rule that a purchaser of assets does not assume responsibility for the seller's liabilities. Plaintiff filed a cross motion for summary judgment on the issue of successor liability.

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[3] *See Schwinn Cycling & Fitness, Inc. v. Benonis*, 217 B.R. 790, 796-97 (Bankr. N.D. Ill. 1997) (explaining that the successorship doctrine is predominately a creature of state law); *cf. Conway v. White Trucks*, 885 F.2d 90, 97 (3rd Cir. 1989) (applying Pennsylvania law on the issue of successor liability).

[4] *Corporate Property Associates 8, L.P. v. Amersig Graphics, Inc.*, 1994 WL 148269, at *4 (Del. Ch.).

[5] *In re DESA Holdings Corp.,* 353 B.R. at 427.

Superior Court Civil Rule 56(h) provides that where the parties have filed cross motions for summary judgment, and there is no argument that there is an issue of material fact, "the Court shall deem the motions to be the equivalent of a stipulation for decision on the merits based on the record submitted with the motions."

Undisputed Facts

During oral argument, the parties agreed that the following facts are undisputed:

1. New DESA and Old DESA were organized at different times and in different places by different people.

2. The sale of Old DESA's assets was conducted under the auspices of the bankruptcy court and occurred because the bankruptcy court determined it was "essential to the continued operation of the Debtors' Businesses and in the best interest of Debtors' estates and creditors" and "essential and required to fund a Chapter 11 plan for the Debtors."

3. The sale was an "arm's length transaction" and resulted in Old DESA's assets being sold for cash as a "going concern" for approximately $185 million, a sum deemed fair and reasonable by everyone, including the bankruptcy court and the plaintiff.

4. Old DESA had no interest in or control over New DESA before or after the sale.

5. Pursuant to the bankruptcy court's orders and directives, New DESA paid the sale price for Old DESA's assets in cash to the Old DESA bankruptcy estate(s), and New DESA had no control over or involvement with Old DESA's use and disposition of such funds.

6. In conjunction with and as a material inducement for New DESA's purchase of Old DESA's assets, the bankruptcy court expressly represented to New DESA that New DESA would not be liable in any way under any theory of successor liability or otherwise for any claims made by the users of products manufactured or sold by Old DESA and that any such claimants would be enjoined from taking any such action against New DESA.

7. The bankruptcy court noted that absent such a guarantee Old DESA's assets would be significantly less valuable and that such a guarantee was necessary and proper to ensure maximum benefit to Old DESA's estates.

8. Plaintiff's claims against New DESA arise from his use of a product manufactured or sold by Old DESA. Plaintiff's claim arose from an accident after the sale of Old DESA's assets, but before Old DESA's plan of reorganization had been confirmed by the bankruptcy court.

9. Old DESA had no involvement in or control over the affairs of New DESA before or after the sale.

10. New DESA is owned and controlled by persons and entities different from those persons who owned and controlled Old DESA.

ANALYSIS

"Mere Continuation" Exception

In Delaware, when one company sells or otherwise transfers all of its assets to another company, the buyer generally is not responsible for the seller's liabilities, including claims arising out of the seller's tortious conduct. In limited situations, where avoidance of liability would be unjust, exceptions may apply to enable transfer of liability to the seller. Exceptions include: (1) the buyer's assumption of liability; (2) defacto merger or consolidation; (3) mere continuation of the predecessor under a different name; or (4) fraud.[6]

Plaintiff contends that New DESA is a mere continuation of Old DESA. Citing *In re Asbestos Litigation (Bell)*,[7] plaintiff emphasizes the disjunctive listing of the primary elements of the continuation exception: common identity of

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[6]*Fountain v. Colonial Chevrolet Co.,* 1988 WL 40019, at *7 (Del. Super.) (citing *Fehl v. S.W.C. Corp.,* 433 F. Supp. 939, 945 (D. Del.1977)); *Elmer v. Tenneco Resins, Inc.,* 698 F. Supp. 535, 540 (D. Del. 1988).

[7]517 A.2d 697 (Del. Super. 1986).

officers, directors ***or*** stockholders in the predecessor and successor corporations, and the existence of only one corporation at the end of the transaction.[8] Because New DESA retained five of seven Old DESA officers, one of six Old DESA directors, and virtually all of Old DESA's managers, plaintiff argues that the continuation exception to the rule against successor liability applies.

Defendants argue that plaintiff must prove a common identity between New and Old DESA. Plaintiff must show that New DESA retained all or substantially all of the ownership and control of Old DESA.

The continuation theory of corporate successor liability has been construed narrowly by Delaware courts.[9] Mere continuation requires that the new company be the same legal entity as the old company. "The test is not the continuation of the business operation; rather, it is the continuation of the corporate entity."[10] Imposition of successor liability is appropriate only where the new entity is so

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[8] *Id.* at 699-700. The Court notes that in *In re Asbestos Litigation (Bell),* the issue of successor liability and the legal effect of the transaction explicitly were considered by applying Pennsylvania law. However, because the Court does not find plaintiff's argument to be persuasive, the Court need not determine whether Delaware and Pennsylvania law are at variance.

[9] *Fountain,* 1988 WL 40019, at *8.

[10] *Fountain,* 1988 WL 40019, at *9.

dominated and controlled by the old company that separate existence must be disregarded.[11]

The sale of Old DESA was an arms-length, cash transaction. Old DESA continued to exist after the sale. There was no continuity of ownership[12] or control, with the exception of certain non-voting stock options (in a related corporation), offered to former Old DESA shareholders, as part of their employment agreements with New DESA. The retention of five of seven officers and one of six directors does not rise to the level of continuity sufficient to impose successor liability. Having considered all of the undisputed facts, the Court finds that New DESA is not a "mere continuation" of Old DESA.

Additionally, the Court finds that pursuant to the explicit language in the Sale Order, as further considered by the bankruptcy court, New DESA did not assume the tort liabilities of Old DESA. As demonstrated by the stipulated facts, there was no merger or consolidation. Plaintiff has not provided any evidence of fraud justifying an exception to the general prohibition against transfer of the seller's liabilities to the buyer.

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[11] *Elmer,* 698 F.Supp. at 542.

[12] *See In re Asbestos Litigation (Stalvey),* 1994 WL 89643, at *3-4 (Del. Super.).

CONCLUSION

Pursuant to Superior Court Civil Rule 56(h), the parties have filed cross motions for summary judgment. The Court, having considered the motions on stipulated facts, deems the motions to be the equivalent of a stipulation for decision on the merits based on the record submitted with the motions.

The Asset Purchase Agreement and orders of the United States Bankruptcy Court for the District of Delaware provide that the purchaser shall not be liable under a successor liability theory. The Court finds that the sale of assets did not result in a "mere continuation" of the legal existence of the old entity.

THEREFORE, Defendants DESA, LLC and DESA Heating, LLC's Motion for Summary Judgment is hereby **GRANTED.** The Cross Motion of Plaintiff, Joshua Ross, for Partial Summary Judgment, on the Issue of Successor Liability is hereby **DENIED.**

IT IS SO ORDERED.

/s/ *Mary M Johnston*
The Honorable Mary M. Johnston