

No. 64192-1

IN THE COURT OF APPEALS  
OF THE STATE OF WASHINGTON, DIVISION I

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TELEKENEX IXC, INC.,

Respondent/Plaintiff,

v.

CHARLOTTE RUSSE INCORPORATED,

Appellant/Defendant.

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**APPELLANT'S REPLY BRIEF**

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**TABLE OF CONTENTS**

**I. INTRODUCTION .....1**

**II. ARGUMENT .....5**

A. THIS COURT SHOULD REVERSE THE DEFAULT JUDGMENT BECAUSE THE TRIAL COURT HAD NO AUTHORITY TO ENTER IT OR TO REFUSE TO SET IT ASIDE. .... 6

    1. *Telekenex concedes that if this Court determines, based on its de novo review, that Charlotte Russe appeared below, the Court must overturn the default judgment.*..... 6

    2. *Charlotte Russe appeared below, so the default judgment must be overturned.*..... 7

    3. *Telekenex’s argument that Charlotte Russe did not appear below cannot withstand scrutiny and, at most, confirms that the default judgment should be overturned on grounds of mistake, if not lack of notice.*..... 9

B. THIS COURT SHOULD REVERSE THE TRIAL COURT BECAUSE IT ABUSED ITS DISCRETION IN DENYING CHARLOTTE RUSSE’S MOTION TO VACATE THE DEFAULT JUDGMENT. .... 13

    1. *Charlotte Russe has strong defenses on the merits, and certainly has presented at least a “minimal” defense when the evidence and all reasonable inferences are taken in its favor, as the law requires. ....* 14

    2. *The default was the result of mistake, inadvertence, or excusable neglect.*..... 22

    3. *Telekenex’s inequitable behavior independently mandates reversal of the default judgment.* ..... 24

**III. CONCLUSION .....25**

## TABLE OF AUTHORITIES

### Cases

<i>B&amp;J Roofing v. Bd. of Indus. Ins. Appeals</i> 66 Wn. App. 871, 832 P.2d 1386 (1992).....	24
<i>Beckman v. Dep't of Soc &amp; Health Servs.</i> 102 Wn. App 687, 11 P.3d 313 (2000).....	23
<i>Boardman v. Dorsett</i> 38 Wn. App. 338, 685 P.2d 615 (1984).....	21
<i>Boss Logger, Inc. v. Aetna Cas. &amp; Sur. Co.</i> 93 Wn. App. 682, 970 P.2d 755 (1998).....	22, 23
<i>Calhoun v. Merritt</i> 46 Wn. App. 616, 731 P.2d 1094 (1986).....	14
<i>City of Des Moines v. \$81,231 in United States Currency</i> 87 Wn. App. 689, 943 P.2d 66 (1997).....	8
<i>Civic Ctr. Square v. Ford (In re Roxford Foods)</i> 12 F.3d 875 (9th Cir. 1993).....	8
<i>Eagle Pac. Ins. Co. v. Christensen Motor Yacht Corp.</i> 135 Wn.2d 894, 959 P.2d 1052 (1998).....	19, 20
<i>Gage v. Boeing Co.</i> 55 Wn. App. 157, 776 P.2d 991 (1989).....	8
<i>Griggs v. Averbek Realty, Inc.</i> 92 Wn. 2d 576 (1979).....	6
<i>Hardesty v. Stenchever</i> 82 Wn. App. 253, 917 P.2d 577 (1996).....	10, 23, 24, 25
<i>Harstad v. Frol</i> 41 Wn. App. 294, 704 P.2d 638 (1985).....	15, 16

<i>Johnson v. Cash Store</i> 116 Wn. App. 833, 68 P.3d 1099 (2003).....	23
<i>Morin v. Burris</i> 160 Wn.2d 745, 161 P.3d 956 (2007).....	7, 10, 24, 25
<i>Pfaff v. State Farm Mut. Auto. Ins. Co.</i> 103 Wn. App. 829, 14 P.3d 837 (2000).....	14, 18, 20, 22
<i>Press v. Forest Laboratories, Inc.</i> 45 F.R.D. 354 (S.D.N.Y. 1968).....	8
<i>Prest v. American Bankers Life Assurance Co.</i> 79 Wn.App. 93, 900 P.2d 595 (1995),.....	22, 23
<i>Ray v. Alad Corp.</i> 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).....	19
<i>Rosander v. Nightrunner Transp., Ltd.</i> 147 Wn. App. 392, 196 P.3d 956 (2007).....	7, 23
<i>Sacotte Constr., Inc. v. Nat’l Fire &amp; Marine Ins. Co.</i> 143 Wn. App. 410, 177 P.3d 1147 (2008).....	10, 24, 25
<i>Showalter v. Wild Oats</i> 124 Wn. App. 506, 101 P.3d 867 (2004).....	22, 23
<i>Shreve v. Chamberlin</i> 66 Wn. App. 728, 832 P.2d 1355 (1992).....	8
<i>State v. King County</i> 197 Wash. 393 (1938) .....	21
<i>Sunset Copper Co. v. Black</i> 115 Wash. 132, 196 P. 640 (1921) .....	15, 16
<i>Tiffin v. Hendricks</i> 44 Wn.2d 837, 271 P.2d 683 (1954).....	7
<i>TMT Bear Creek Shopping Ctr., Inc. v. PETCO Animal Supplies, Inc.</i> 140 Wn. App. 191, 165 P.3d 1271 (2007).....	23

*Turner v. Salvatierra*  
580 F.2d 199 (5th Cir. 1978).....8

*White v. Holm,*  
73 Wn.2d 348, 438 P.2d 581 (1968)..... 13

**Rules**

CR 55(a)(3).....6, 7

**Other Authorities**

Restatement (Second) of Contracts § 176 (1981)..... 14, 16, 17, 18

Washington Pattern Instructions 301.10..... 15, 17

## I. INTRODUCTION

In its Respondent’s Brief, Telekenex<sup>1</sup> continues the gamesmanship it has engaged in throughout this litigation and the events underlying it. Indeed, Telekenex’s brief is, at bottom, nothing more than a declaration of victory in a game of “gotcha.” Equity, which governs this Court’s decision, does not recognize such games except to condemn them.

Telekenex concedes that the default judgment entered against appellant Charlotte Russe must be overturned if Charlotte Russe appeared in the action below. Telekenex concedes that Charlotte Russe was the first to file, in California, an action relating to the events and issues presented here. Telekenex concedes that Charlotte Russe’s pleadings in the California action demonstrated its intent to defend this action in Washington state court—which is more than sufficient to constitute an appearance as a matter of law. And Telekenex concedes that its Washington counsel read those pleadings before seeking a default judgment against Charlotte Russe without notice.

Despite all of this, Telekenex argues that Charlotte Russe did not appear in this action because its original complaint in the California action named Telekenex, Inc. and AuBeta Networks Corp. (“AuBeta”) as

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<sup>1</sup> “Telekenex” refers to respondent Telekenex IXC, Inc. That entity is also sometimes referred to as “Telekenex IXC” when discussed as allegedly distinct from its alter ego, Telekenex, Inc.

defendants, but did not, at first, expressly name Telekenex IXC.<sup>2</sup>

Telekenex contends that Telekenex IXC and Telekenex, Inc. are “separate corporations,” which “do not regularly communicate about independent legal issues,” and that Charlotte Russe’s “intent to defend in Washington was never communicated to IXC or counsel for IXC prior to the entry of the default judgment at issue in this case.” RB at 5-6, 17.<sup>3</sup>

But the supposed distinction between the two companies is spurious, and the assertion that Telekenex IXC and its counsel were not aware of Charlotte Russe’s intent to defend the Washington action is false.

*Telekenex IXC’s Washington counsel admitted that he knew all about the California action, and read the papers in which Charlotte Russe expressed its intent to defend itself in the Washington action.*

Furthermore, *Brandon Chaney is the CEO of both Telekenex IXC and Telekenex, Inc.*, and never made any distinction between the two in his negotiations with Charlotte Russe. Telekenex’s protestations that the left hand didn’t know what the right was doing are disingenuous given that Mr. Chaney controls both.

Not only did Charlotte Russe’s prosecution of the California action constitute an appearance here under the governing law, Telekenex’s

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<sup>2</sup> Telekenex IXC was expressly named as a defendant later. *See* Request for Judicial Notice Ex. A at 3:10-12.

<sup>3</sup> “RB” refers to Respondent’s Brief. “AOB” refers to Appellant’s Opening Brief.

attempt to exploit the situation by seeking a default judgment without notice to Charlotte Russe or its known counsel was inequitable.

Washington courts repeatedly have condemned such behavior and found it sufficient, standing alone, to mandate reversal of judgments obtained in such a manner. This Court should overturn the default judgment because Charlotte Russe appeared below, yet Telekenex intentionally and inequitably withheld notice of its motion for default judgment.

This Court also should reverse the trial court for the independent reason that, regardless of whether Charlotte Russe appeared below, the trial court abused its discretion in refusing to vacate the default judgment. Default judgments are disfavored and motions to vacate them must be liberally granted, particularly where, as here, the defendant has a prima facie defense and its purported failure to appear was due to a mistake.

The facts here leave no doubt that Charlotte Russe has viable defenses to Telekenex's sole claim for breach of contract. As explained in further detail in the opening brief, in December 2004, Charlotte Russe entered into a Master Services Agreement ("MSA") with AuBeta for essential data networking and telecommunications services. On March 27, 2009, Telekenex bought AuBeta, which was having financial difficulties and was in arrears on its payments to underlying telecommunications carriers such as AT&T. In the Asset Purchase Agreement ("APA")

between Telekenex and AuBeta, Telekenex expressly agreed to take on AuBeta's obligations and liabilities to those carriers, and to its customers, including Charlotte Russe.

At that time, the MSA was about to become a month-to-month agreement, allowing Charlotte Russe to move to another service provider, but still requiring AuBeta (and hence Telekenex) to provide services that could only be terminated on 90-days' notice. But Telekenex threatened not to pay the underlying carriers, and to shut down service to Charlotte Russe *within a matter of hours*, unless Charlotte Russe executed an amendment to the MSA (the "Amendment"), extending its term by another two years and replacing AuBeta with Telekenex. Telekenex didn't disclose that it had already agreed to pay the underlying carriers. Rather, it claimed, falsely, that it had no obligation to do so, and no obligation to continue providing service to Charlotte Russe under the MSA, unless Charlotte Russe signed the Amendment. Charlotte Russe did so, under protest, because it had no other choice given Telekenex's threat of an immediate and crippling termination of essential services.

These facts amply support Charlotte Russe's defense of duress to Telekenex's claim that Charlotte Russe breached the Amendment by switching to another telecommunications service provider. They also show that the Amendment was not supported by valid consideration

because Telekenex already was required to do what it supposedly did in consideration of the Amendment—pay the underlying carriers and continue providing data services to Charlotte Russe.

Furthermore, Telekenex concedes that Charlotte Russe’s alleged failure to appear below was not willful, but was an innocent mistake. Telekenex relies on cases holding that a *systemic failure* in procedures for processing legal documents is not excusable neglect. But that is not what happened here. As Telekenex admits, its summons and complaint were simply lost in the mail, an isolated event. Numerous cases recognize that such a mistake is excusable. And Telekenex itself argues that Charlotte Russe erred by not suing Telekenex IXC in the original California complaint, and concedes that, if not for that supposed error, Charlotte Russe would have appeared below. Thus, Charlotte Russe’s purported failure to appear was, at worst, the result of excusable neglect.

This Court should reverse the trial court’s default judgment, as well as its denial of Charlotte Russe’s motion to vacate that judgment, and remand this case for further proceedings.

## **II. ARGUMENT**

“Default judgments are not favored in the law,” because entry of default is “one of the most drastic actions a court may take to punish disobedience to its commands,” and is contrary to “the policy of the law

that controversies be determined on the merits rather than by default.”  
*Griggs v. Averbek Realty, Inc.*, 92 Wn.2d 576, 581-82, 599 P.2d 1289  
(1979) (quoting *Dlouhy v. Dlouhy*, 55 Wn.2d 718, 721, 349 P.2d 1073  
(1960)). Motions to vacate default judgments, therefore, are liberally  
granted—indeed, *must* be granted where, as here, the defendant appeared  
but was not given notice of the motion for default judgment.

**A. This Court should reverse the default judgment because the trial court had no authority to enter it or to refuse to set it aside.**

**1. Telekenex concedes that if this Court determines, based on its *de novo* review, that Charlotte Russe appeared below, the Court must overturn the default judgment**

Telekenex concedes that “trial courts have no discretion to refuse a motion to vacate a default judgment where the defendant is not in default.” RB at 12. A defendant is not in default if it appeared in the action, yet did not receive the notice of the motion for default judgment required by CR 55(a)(3). Telekenex admits that it never gave Charlotte Russe any notice of the motion for default judgment. *See* CP 125-26 ¶ 5. As long as Charlotte Russe appeared in the action below, therefore, it was “entitled to have the judgment set aside without further inquiry as [it] cannot be said to be in default.” RB at 13.

Telekenex also concedes that this Court “reviews *de novo* questions of law, including whether, on undisputed facts, appearance has

been established as a matter of law.” RB at 1. And Telekenex states that, here, the “findings of the trial court were based on the undisputed facts of the case. . . .” RB at 19. Thus, the standard for determining whether Charlotte Russe appeared is admittedly *de novo*. *Id.*; *Rosander v. Nightrunner Transp., Ltd.*, 147 Wn. App. 392, 399, 196 P.3d 956 (2007).<sup>4</sup>

**2. Charlotte Russe appeared below, so the default judgment must be overturned.**

For well over a century, Washington’s courts have applied “the doctrine of substantial compliance” in deciding whether a party has “appeared” within the meaning of CR 55(a)(3), and therefore is entitled to notice before a valid default judgment may be entered. *Morin*, 160 Wn.2d at 755. The courts “have not exalted form over substance but have examined the defendants’ conduct to see if it was designed to and, in fact, did apprise the plaintiffs of the defendants’ intent to litigate the cases.” *Id.* Thus, a party appears if it “take[s] some action acknowledging that the dispute is in court.” *Id.* at 757.<sup>5</sup>

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<sup>4</sup> Telekenex asserts that whether a party has appeared is generally a question of fact, implying that the “substantial evidence” standard of review may apply. *See* RB at 14-15. But the Washington Supreme Court rejected that very contention in *Morin v. Burris*, 160 Wn.2d 745, 753 n.1, 161 P.3d 956 (2007), and it is beside the point here in any event since the relevant facts are admittedly undisputed. *See Rosander*, 147 Wn. App. at 399.

<sup>5</sup> Telekenex asserts that a party “must appear *in court* in some way.” RB at 15 (quoting *Rosander*, 147 Wn. App. at 399). But that statement is incorrect to the extent it purports to require anything beyond what the Washington Supreme Court has held: that a party must acknowledge that the dispute is in court, rather than merely a pre-litigation disagreement, but need not file anything or actually appear in court to do so. *See Morin*, 160 Wn.2d at 755-57; *Tiffin v. Hendricks*, 44 Wn.2d 837, 842, 271 P.2d 683 (1954).

Numerous Washington cases hold that participation in closely-related litigation in another forum constitutes an appearance. *See, e.g., City of Des Moines v. \$81,231 in United States Currency*, 87 Wn. App. 689, 697-98, 943 P.2d 66 (1997); *Shreve v. Chamberlin*, 66 Wn. App. 728, 733, 832 P.2d 1355 (1992); *Gage v. Boeing Co.*, 55 Wn. App. 157, 162, 776 P.2d 991 (1989).<sup>6</sup> When a defendant is actively defending the same rights in another court action, the plaintiff can have “no illusions regarding [defendant’s] intentions to contest the claims” in court, and must give the defendant notice of any default proceedings. *Gage*, 55 Wn. App. at 162; *accord Shreve*, 66 Wn. App. at 734.

Here, Charlotte Russe was actively litigating precisely the issue presented in the action below—the validity of the Amendment—in the California action, which was filed first. CP 88-117. Charlotte Russe’s TRO papers in the California action, which were filed three weeks before Telekenex filed its motion and the default judgment was entered, expressly acknowledged that the dispute was in court in Washington as well as California, and made clear that Charlotte Russe intended to defend itself in the Washington action, when served. CP 81-82 ¶ 6, 110:10-26.

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Indeed, Telekenex concedes that “a party need not file anything in court to appear in an action.” RB at 15.

<sup>6</sup> *See also Civic Ctr. Square v. Ford (In re Roxford Foods)*, 12 F.3d 875, 881 (9th Cir. 1993); *Turner v. Salvatierra*, 580 F.2d 199, 201 (5th Cir. 1978); *Press v. Forest Laboratories, Inc.*, 45 F.R.D. 354, 356-57 (S.D.N.Y. 1968).

*Telekenex's Washington counsel admitted that he was aware of the California action and that, in particular, he read Charlotte Russe's TRO brief.* CP 125-26 ¶ 5, 217 ¶ 3. He also admitted that he was aware of other communications between Telekenex's California counsel and Charlotte Russe's counsel that preceded the default judgment, presumably including the latter's statement on the record at the TRO hearing—nearly two weeks before Telekenex filed its default motion—that Charlotte Russe did not believe it had been served with the Washington summons and complaint. *See* CP 81-82 ¶ 6, 125-26 ¶ 5.

Thus, as Charlotte Russe demonstrated in its opening brief, it appeared in the action below, and the default judgment must be set aside.

**3. Telekenex's argument that Charlotte Russe did not appear below cannot withstand scrutiny and, at most, confirms that the default judgment should be overturned on grounds of mistake, if not lack of notice.**

Telekenex's only argument against finding that Charlotte Russe appeared in the action below is that Charlotte Russe initially sued Telekenex, Inc. in the California action, rather than Telekenex IXC, and that the two are purportedly separate entities with separate counsel, such that Telekenex IXC cannot be charged with knowing what anyone who knew anything about the California case would—that Charlotte Russe fully intended to defend itself in court.

Telekenex's argument "exalt[s] form over substance," contrary to the applicable principles of equity. *Morin*, 160 Wn.2d at 755. Worse than that, Telekenex misstates the facts, going so far as to claim that Charlotte Russe's "intent to defend in Washington was never communicated to IXC or counsel for IXC prior to the entry of the default judgment at issue in this case." RB at 17. That is simply false. *See* CP 110:10-26, 125-26 ¶ 5.

Whatever the relationship between Telekenex IXC and Telekenex, Inc., their Washington counsel knew all about the California action, and Charlotte Russe's intent to defend its rights in the Washington action, long before Telekenex filed its motion for a default judgment. *See* CP 110:10-26, 125-26 ¶ 5, 217 ¶ 3. His strategic decision not to give notice of the motion to Charlotte Russe or the counsel he knew to be representing it fell below the "acceptable level of professional courtesy to fellow attorneys and their clients." *Sacotte Constr., Inc. v. Nat'l Fire & Marine Ins. Co.*, 143 Wn. App. 410, 417, 177 P.3d 1147 (2008). It was "inequitable to allow [Telekenex] to prevail on the motion for default where [its] attorneys could have easily informed the attorneys whom they knew to be representing the defendants of the motion for a default judgment." *Hardesty v. Stenchever*, 82 Wn. App. 253, 265, 917 P.2d 577 (1996).

Furthermore, the record contradicts Telekenex's attempt to draw a sharp distinction between Telekenex IXC and Telekenex, Inc. ***Brandon***

*Chaney is the CEO of both companies.* See CP 332, 336. He was Telekenex's primary representative in the events underlying both lawsuits. See, e.g., CP 229 ¶ 7. And he has been Telekenex's voice in the litigation itself. See, e.g., CP 253-364. Given that Mr. Chaney controls both companies and was fully aware of both lawsuits, Telekenex's current claim that "the two companies do not regularly communicate about independent legal issues" (RB at 6) is misleading.

Indeed, not even Telekenex can keep the supposed difference between Telekenex IXC and Telekenex, Inc. straight. For example, Telekenex's Payment Agreement with Silicon Valley Bank ("SVB") states that it was entered into between SVB and Telekenex IXC. CP 316. But it was signed by Mr. Chaney on behalf of Telekenex, Inc. CP 325. And while Telekenex claims that Telekenex IXC bought AuBeta and had to pay underlying carriers such as Qwest to maintain service to AuBeta's former customers, its agreement with Qwest was executed by Telekenex, Inc. and states that Telekenex, Inc. bought AuBeta. CP 337.

Moreover, pursuant to the APA, Telekenex IXC took on AuBeta's liabilities and agreed to indemnify AuBeta for any claim related to any failure by Telekenex IXC "to assume, pay, perform and discharge the Assumed Liabilities." CP 278-79 § 1.2, 289 § 9.1(a). Charlotte Russe asserted such a claim in its original California complaint, naming AuBeta,

along with Telekenex, Inc., as a defendant. Given the intimate relationship between Telekenex IXC, Telekenex, Inc., and AuBeta, as well as Telekenex IXC's express agreement to indemnify AuBeta, the idea that Telekenex IXC didn't know all about the California litigation is absurd—and, as shown above, flatly contradicted by Telekenex's own admissions. *See, e.g.*, CP 110:10-26, 125-26 ¶ 5, 217 ¶ 3, 332, 336.

Even on its own terms, Telekenex's argument boils down to the contention that Charlotte Russe made a mistake when it initially sued Telekenex, Inc., rather than Telekenex IXC, in California. Charlotte Russe maintains that it did not err, because the two Telekenex entities are alter egos of one another. But even if they are not, it certainly cannot be said, on this record, that Charlotte Russe's alleged mistake was inexcusable—all of the interactions between Telekenex and Charlotte Russe leading up to the filing of the California complaint led Charlotte Russe reasonably to believe that Telekenex IXC and Telekenex, Inc. were one and the same. *See, e.g.*, CP 228 ¶ 3. And Telekenex concedes that if Charlotte Russe had sued Telekenex IXC, rather than Telekenex, Inc., in the first place, Charlotte Russe would have appeared in this case by virtue of its conduct in the California action. *See* RB at 17-18.

Thus, Telekenex's argument, at most, shows that Charlotte Russe's alleged failure to appear was the result of a reasonable mistake, and hence

that the default judgment should be overturned for that reason—as further demonstrated in the next section—if not for lack of notice.

**B. This Court should reverse the trial court because it abused its discretion in denying Charlotte Russe’s motion to vacate the default judgment.**

Even if the Court does not overturn the default judgment as void for lack of notice—which it should, as shown above—the judgment should be overturned because the trial court’s refusal to vacate it was an abuse of discretion. It has long been the law that where, as here, a motion to vacate a default judgment is denied, “an abuse of discretion may be more readily found than in those instances where the default judgment is set aside and a trial on the merits ensues.” *White v. Holm*, 73 Wn.2d 348, 351-52, 438 P.2d 581 (1968).

The court in *White* set forth four factors to consider in determining whether a motion to vacate should have been granted. *See id.* at 352. Telekenex concedes, by not contesting on appeal, that two of these weigh in Charlotte Russe’s favor: that Charlotte Russe was diligent in asking that the default be set aside, and that Telekenex will suffer no hardship if the judgment is vacated. *See id.*; RB at 20. Telekenex argues that the other two factors weigh in its favor, claiming that (1) there is no substantial evidence to support a prima facie defense to its claim, and (2) the default

did not result from mistake, inadvertence, or excusable neglect.

Telekenex is wrong on both counts.

- 1. Charlotte Russe has strong defenses on the merits, and certainly has presented at least a “minimal” defense when the evidence and all reasonable inferences are taken in its favor, as the law requires.**

Charlotte Russe has several strong defenses to Telekenex’s claims, as demonstrated in its opening brief. Indeed, the California court held that Charlotte Russe is likely to prevail on the merits of its contention that the Amendment is invalid. *See* CP 81-82 ¶ 6, 119-20. Charlotte Russe’s defenses are sufficient, by themselves, to mandate reversal of the default judgment. *See Calhoun v. Merritt*, 46 Wn. App. 616, 619, 731 P.2d 1094 (1986) (“A strong defense requires less of a showing of excuse, provided the failure to appear was not willful.”). They certainly satisfy Charlotte Russe’s “minimal” burden for setting aside the default judgment, particularly since the “court must take the evidence and reasonable inferences in the light most favorable to” Charlotte Russe. *Pfaff v. State Farm Mut. Auto. Ins. Co.*, 103 Wn. App. 829, 834, 14 P.3d 837 (2000).

As stated in section 176 of the Restatement (Second) of Contracts, a contract is voidable for duress where it is the result of a “threat [that] is a breach of the duty of good faith and fair dealing under a contract with the recipient.” Restatement (Second) of Contracts § 176 (1981). Section 176,

which Telekenex completely ignores, is expressly adopted as the basis for Washington's Pattern Jury Instruction on duress. *See* WPI 301.10 cmt. Telekenex also ignores the Washington cases Charlotte Russe cited in its opening brief, illustrating the principle of section 176: that a threatened breach of the duty of good faith and fair dealing—precisely what Telekenex threatened here—constitutes duress.

In *Harstad v. Frol*, 41 Wn. App. 294, 704 P.2d 638 (1985), for example, the respondent “wrongfully refused to close its real estate purchase agreement,” placing the appellant “in an untenable economic position” and thereby extracting additional payments. *Id.* at 302. These facts supported a claim of duress, and this Court accordingly reversed the trial court's grant of summary judgment. *Id.*

Similarly, in *Sunset Copper Co. v. Black*, 115 Wash. 132, 196 P. 640 (1921), the defendant wrongfully demanded interest payments to which it had no right under its contract with the plaintiff, threatening to declare the contract forfeited and seize the land and the plaintiff's improvements. The plaintiff paid the interest, and then sued to recover it on grounds of duress. The Washington Supreme Court held that the claim of duress should proceed to trial. *See id.* at 135-36.

Here, Telekenex's conduct was an even clearer example of a threatened breach of the duty of good faith and fair dealing, and hence of

duress, than the conduct at issue in *Harstad* and *Sunset Copper*. As the comments to the Restatement (Second) of Contracts state, where a service provider threatens to terminate services unless his customer agrees to a contract modification, that “threat is a breach of his duty of good faith and fair dealing, and the proposed contract is voidable.” Restatement (Second) of Contracts § 176 cmt. e, ill. 9. That is precisely what Telekenex did here. It threatened to terminate Charlotte Russe’s service unless Charlotte Russe signed the Amendment. CP 131-33 ¶¶ 9-16, 147-73. The threatened termination would have crippled Charlotte Russe’s retail stores by, among other things, making them incapable of processing credit card transactions, resulting in irreparable injury to Charlotte Russe, not only in lost sales, but in lost goodwill and business reputation. CP 132-33 ¶¶ 15-17, 172-73. This is a textbook case of duress.

Instead of addressing *Harstad*, *Sunset Copper*, or the Restatement, Telekenex asserts, incorrectly, that the “only Washington authority” on duress Charlotte Russe cited is a case Charlotte Russe didn’t cite at all. *See* RB at 22 (citing *Puget Sound Power & Light Co. v. Shulman*, 84 Wn.2d 433, 526 P.2d 1210 (1974)).<sup>7</sup> Telekenex then relies exclusively on the purported requirement that a party claiming duress must show that the

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<sup>7</sup> *Puget Sound* is inapposite because there, after a full bench trial, it was clear that the party supposedly responsible for the duress had nothing to do with the circumstances that caused the other to enter into the agreement. *See* 84 Wn.2d at 442-43.

other party applied the immediate pressure and caused or contributed to the circumstances underlying that pressure. *See* RB at 20-21 (citing *Nord v. Eastside Assoc.*, 34 Wn. App. 796, 664 P.2d 4 (1983); *Barker v. Walter Hogan Enters.*, 23 Wn. App. 450, 596 P.2d 1359 (1979)). As the Washington Supreme Court Committee On Jury Instructions notes, however, those “cases apply[] the first Restatement of Contracts § 492,” which focuses “on whether a wrongful act compelled assent ‘without volition’ or without the victim ‘exercising free will and judgment.’” WPI 301.10 cmt. (citing *Nord* and *Barker*; quoting Restatement of Contracts § 492 (1932)). The Second Restatement and the Washington jury instructions adopt a broader definition of duress. *Id.* “While Washington courts have not so far explicitly adopted the newer approach, in the related area of ‘undue influence,’ the courts have followed the Restatement (Second) in abandoning an ‘overcoming the will’ analysis.” *Id.* (citing *Gerimonte v. Case*, 42 Wn.App. 611, 712 P.2d 876 (1986)).

In any case, under either approach, the elements of duress are present here. Telekenex is responsible for the immediate pressure on Charlotte Russe and the underlying circumstances.<sup>8</sup> They were not

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<sup>8</sup> Telekenex does not seriously dispute that the other elements of the test it advocates apply here—*i.e.*, that the threat at issue (1) involved serious business loss (2) in a situation so immediate as to render resolution in court impractical. RB at 20. Telekenex doesn’t even address the second of these, and with respect to the first, merely asserts that it “is questionable to argue that interruption of credit card processing by DSL is a ‘serious

caused, as Telekenex claims, “by the underlying carriers who provided services to AuBeta for resale.” RB at 21. Telekenex admits that the problems with the underlying carriers were the result of AuBeta’s failure to pay them. *See id.* at 7. And when Telekenex acquired AuBeta’s assets, it also took on AuBeta’s obligations—including its obligations to provide data services to Charlotte Russe, and to pay the underlying carriers as necessary to avoid disruption of service. *See CP 278-79 § 1.2(a)*. But instead of honoring those obligations, Telekenex exploited the situation in bad faith, threatening to terminate Charlotte Russe’s essential data services immediately—or to allow those services to be terminated by refusing to pay the underlying carriers, which amounts to the same thing—in order to force Charlotte Russe to sign the Amendment. Telekenex is responsible for its threats and the circumstances that made those threats possible.

Nevertheless, Telekenex portrays itself as a sort of “white knight,” offering to save Charlotte Russe from the mess AuBeta created, but with no obligation to do so unless Charlotte Russe agreed to the Amendment. The facts and the law prove the opposite. As a matter of law, when one company purchases the assets of another, it also assumes its liabilities if

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business loss’ where Charlotte Russe had a backup system in place.” *Id.* n.4. But Telekenex operated the backup system and threatened to shut it down, as well. CP 229 ¶ 7. And even if Charlotte Russe’s interpretation of the facts were “questionable,” all such questions must be resolved in Charlotte Russe’s favor, so Telekenex’s admission that there is at least a question as to the seriousness of the threatened business loss is fatal to its argument. *See Pfaff*, 103 Wn. App. at 834.

(1) the purchaser expressly or impliedly agrees to assume liability; (2) the purchase is a de facto merger or consolidation; (3) the purchaser is a mere continuation of the seller; or (4) the transfer of assets is for the fraudulent purpose of escaping liability. *Eagle Pac. Ins. Co. v. Christensen Motor Yacht Corp.*, 135 Wn.2d 894, 901, 959 P.2d 1052 (1998).<sup>9</sup>

The first of these independently sufficient conditions for imposing AuBeta's liabilities on Telekenex is satisfied by the APA, which was executed well before the Amendment. Pursuant to the APA, Telekenex expressly agreed to assume the "obligations and liabilities of [AuBeta] under customer and vendor contracts relating to the Business." CP 278-79 § 1.2(a). Those obligations and liabilities include AuBeta's obligations to Charlotte Russe under the MSA. They also include AuBeta's obligations to pay the underlying carriers, as is clear from the plain language of the APA and confirmed by Telekenex's agreement with SVB, which states that "[p]ursuant to the terms of the APA, Telekenex is acquiring the payment liabilities of AuBeta to AT&T, Verizon, Qwest, Covad, and any other vendor . . . that is required to keep the former AuBeta network operational. . . ." CP 320 § 4.1 (emphasis added). Telekenex's assertion

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<sup>9</sup> The successor-liability rule in California, the other state with a significant relationship to this matter, is even broader, imposing liability on Telekenex *a fortiori* given that Washington's rule does. See *Ray v. Alad Corp.*, 19 Cal. 3d 22, 28-34, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).

that it only agreed to pay the underlying carriers after Charlotte Russe agreed to the Amendment, therefore, is false.<sup>10</sup>

The fourth factor in *Eagle* is also satisfied here. Where a company attempts to take all and only the assets of another company, leaving behind all the liabilities with no means to discharge them, “the net result is in legal effect a fraud; and the courts will subject the transferee to liability for the satisfaction of claims against the corporation whose assets it has absorbed.” *Eagle*, 135 Wn.2d at 906 (quoting *Avery v. Safeway Cab, Transfer & Storage Co.*, 148 Kan. 321, 80 P.2d 1099, 1101 (1938)). Telekenex’s claim “that the transaction was designed to ‘save the business’ does not defeat imposition of successor liability.” *Id.* at 910; *see* RB at 7-8. The law thus refutes Telekenex’s assertion that, after acquiring all of AuBeta’s assets, it had the right to ignore AuBeta’s contractual obligations to its customers unless they agreed to extend their contracts.

Telekenex also cannot blame the underlying carriers for the pressure placed on Charlotte Russe because when Charlotte Russe offered to pay the underlying carriers directly in order to ensure continued service,

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<sup>10</sup> Telekenex completely ignores the provisions of the APA under which it assumed AuBeta’s liabilities to vendors and customers, focusing instead on the provision stating that the assets Telekenex acquired included “customer relationships” subject to the customers’ agreement. *See* RB at 8; CP 278 § 1.1. But the *assets* provision of the APA is not relevant here; the *liabilities* provision is. *See* CP 278-79 § 1.2. In any event, whatever the assets provision means in light of the liabilities provision, it creates at most an ambiguity that must be resolved in Charlotte Russe’s favor at this point. *See Pfaff*, 103 Wn. App. at 834.

Telekenex refused. CP 229-30 ¶ 8. Telekenex blocked every avenue Charlotte Russe proposed for avoiding the service disruption—including direct payments to the carriers and using the back-up system—making the Amendment an “all or nothing” proposition that Charlotte Russe had no choice but to accept, under protest. CP 229-30 ¶¶ 7-8.

Even if there is a question whether Telekenex or some other party is responsible for the admitted threat to Charlotte Russe’s business, it is a question of fact that cannot be resolved in Telekenex’s favor on this record. *See State v. King County*, 197 Wash. 393, 400 (1938) (“The question of whether or not there is duress is a question of fact to be determined from all of the surrounding circumstances and personal characteristics of the parties involved in each particular case.”).

Furthermore, Telekenex did not address, much less refute, Charlotte Russe’s argument that the Amendment is invalid for lack of consideration. *See* AOB at 38. “[I]t is well established that an agreement to do that which one is already obliged to do does not constitute consideration to support a contract. Also, a subsequent agreement modifying an existing contract must be supported by new consideration independent of the consideration involved in the original agreement.” *Boardman v. Dorsett*, 38 Wn. App. 338, 341, 685 P.2d 615 (1984) (citations omitted). Telekenex was already required to do what it offered

to do as purported consideration for the Amendment—pay the underlying carriers and provide uninterrupted service to Charlotte Russe.<sup>11</sup>

Thus, Charlotte Russe has strong defenses, and certainly has “minimal” defenses when the evidence and inferences are taken in its favor, which is all the law requires. *See Pfaff*, 103 Wn. App. at 834.

**2. The default was the result of mistake, inadvertence, or excusable neglect.**

The facts and the law also leave no doubt that Charlotte Russe’s mistake in not demurring to the Washington complaint should be excused.

As this Court held in *Boss Logger, Inc. v. Aetna Cas. & Sur. Co.*, 93 Wn. App. 682, 970 P.2d 755 (1998), a defendant’s failure to answer or demur to the complaint is the result of “a mistake, and not inexcusable neglect,” where, as here, the individual responsible for processing legal documents never received the summons and complaint because “someone in the process lost the papers.” *Id.* at 689; *see also Pfaff*, 103 Wn. App. at 836; *Showalter v. Wild Oats*, 124 Wn. App. 506, 514, 101 P.3d 867 (2004); CP 121-22 ¶¶ 1-4, 126 ¶ 7, 134 ¶ 21.

Telekenex cites *Prest v. American Bankers Life Assurance Co.*, 79 Wn.App. 93, 97, 900 P.2d 595 (1995), for the proposition that failure to

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<sup>11</sup> Telekenex also does not dispute Charlotte Russe’s defenses that because the California action was filed first, the action below must be stayed or dismissed under the priority of action rule; that Telekenex breached the Amendment and the covenant of good faith and fair dealing; and that Charlotte Russe did not breach the contract because it paid all outstanding invoices. See AOB at 38-39.

answer a complaint due to “a breakdown in internal office procedure” is not excusable neglect. RB at 25. But this Court in *Boss Logger* distinguished *Prest* on grounds equally applicable here. In *Prest*, the “failure to respond was . . . a systemic failure which would prevent all litigants from achieving actual notice.” *Boss Logger*, 93 Wn. App. at 689. Here, on the other hand, as in *Boss Logger*, the “system itself was not flawed, but someone in the process lost the papers,” which “was a mistake, and not inexcusable neglect.” *Id.*

This Court distinguished *Prest* further in *Hardesty*, also on grounds that apply here. Unlike the plaintiff in *Prest*, the plaintiff in *Hardesty*—like Telekenex—did not serve the attorney she knew “would be ultimately responsible for the case.” *Hardesty*, 82 Wn. App. at 266. “Furthermore, the *Prest* court’s discussion of excusable neglect is dicta because it relied on the defendant’s failure to produce prima facie evidence of a defense in disposing of the case.” *Id.*; accord *Boss Logger*, 93 Wn. App. at 689; *Showalter*, 124 Wn. App. at 515. The other cases Telekenex relies on are likewise inapplicable.<sup>12</sup>

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<sup>12</sup> See *TMT Bear Creek Shopping Ctr., Inc. v. PETCO Animal Supplies, Inc.*, 140 Wn. App. 191, 213, 165 P.3d 1271 (2007) (finding “a breakdown in internal office management and procedure”); *Rosander*, 147 Wn. App. at 407 (same); *Johnson v. Cash Store*, 116 Wn. App. 833, 848-49, 68 P.3d 1099 (2003) (manager’s unexplained failure to forward the summons and complaint or the notice of default hearing “constituted at least inexcusable neglect, if not willful noncompliance”); *Beckman v. Dep’t of Soc & Health Servs.*, 102 Wn. App. 687, 693, 11 P.3d 313 (2000) (addressing failure to timely file a notice of appeal, which is governed by a different, far stricter standard); *B&J Roofing v.*

Furthermore, as demonstrated above, Telekenex concedes that Telekenex would have appeared in this action, by virtue of its litigation of the California action, if Telekenex IXC had been named in that action in the first place. *See* RB at 17-18. Thus, Charlotte Russe’s purported failure to appear is excusable on two independent grounds: that the summons and complaint were lost in the mail, and that Charlotte Russe initially sued Telekenex, Inc., rather than Telekenex IXC, in California, reasonably believing them to be the same entity.

**3. Telekenex’s inequitable behavior independently mandates reversal of the default judgment.**

Finally, “a default judgment should be set aside if the plaintiff has done something that would render enforcing the judgment inequitable.” *Morin*, 160 Wn.2d at 755. Here, it was “inequitable to allow [Telekenex] to prevail on the motion for default where [its] attorneys could have easily informed the attorneys whom they knew to be representing the defendants of the motion for default.” *Hardesty*, 82 Wn. App. at 265; *see also Morin*, 160 Wn.2d at 759; *Sacotte*, 143 Wn. App. at 417.

To the extent Telekenex addresses this argument at all, it is by asserting that Charlotte Russe’s “intent to defend in Washington was never communicated to IXC or counsel for IXC prior to the entry of the default

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*Bd. of Indus. Ins. Appeals*, 66 Wn. App. 871, 832 P.2d 1386 (1992) (addressing petition for review of administrative decision, not default judgment).

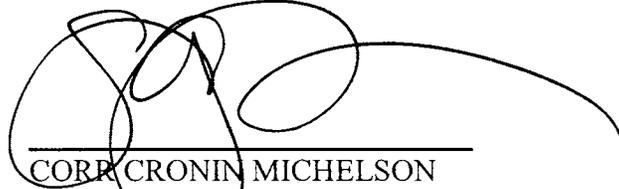
judgment at issue in this case,” and that Telekenex was not required to “track down” Charlotte Russe. RB at 17. Telekenex cannot avoid the consequences of its inequitable conduct by glossing it over with statements that are themselves misleading. Again, Telekenex IXC’s Washington counsel knew that Charlotte Russe was represented by Cooley Godward Kronish LLP. *See* CP 110:10-26, 125-26 ¶ 5, 217 ¶ 3. No “tracking down” was required—Telekenex’s counsel could have simply called the Cooley telephone number printed on the front of the TRO papers he admits he read. *See id.* But he did not. He gave neither Charlotte Russe nor its lawyers at Cooley any notice of the motion for default judgment. Just as in *Morin*, *Hardesty*, and *Sacotte*, it would be inequitable to allow the default judgment to stand under these circumstances.

Thus, the trial court’s refusal to vacate the default judgment was an abuse of discretion, and should be reversed.

### **III. CONCLUSION**

For all the foregoing reasons, this Court should reverse the trial court’s default judgment, as well as its denial of Charlotte Russe’s motion to vacate that judgment, and remand this case for further proceedings.

Respectfully submitted this 15th day of January, 2010,

A large, stylized handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

---

CORR CRONIN MICHELSON  
BAUMGARDNER & PREECE LLP  
William F. Cronin, WSBA No. 8667  
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KEKER & VAN NEST, LLP  
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Daniel E. Jackson, *Admitted Pro Hac Vice*

Attorneys for Appellant/Defendant

**CERTIFICATE OF SERVICE**

The undersigned hereby certifies as follows:

I am employed at Corr Cronin Michelson Baumgardner & Preece  
LLP, attorneys of record for Defendant herein.

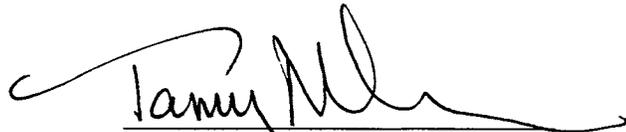
On January 15, 2010, I: (1) caused a true and correct copy of the  
foregoing document to be filed with the Clerk of the Court; and (2) caused  
a true and correct copy of the foregoing document to be duly served legal  
messenger (hand delivery) on the following party:

Jefferson Coulter  
Coulter Martin Smith PLLC  
1741 First Avenue South, Suite 200  
Seattle, WA 98134

*Attorneys for Respondent/Plaintiff*

I declare under penalty of perjury under the laws of the State of  
Washington that the foregoing is true and correct.

DATED: January 15, 2010, at Seattle, Washington.

  
\_\_\_\_\_  
Tammy Miller

FILED  
COURT OF APPEALS DIV #1  
STATE OF WASHINGTON  
2010 JAN 15 PM 4:34

No. 64192-1

IN THE COURT OF APPEALS  
OF THE STATE OF WASHINGTON, DIVISION I

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TELEKENEX IXC, INC.,

Respondent/Plaintiff,

v.

CHARLOTTE RUSSE INCORPORATED,

Appellant/Defendant.

---

RECEIVED  
COURT OF APPEALS  
DIVISION ONE

JAN 15 2010

**APPENDIX OF NON-WASHINGTON AUTHORITIES  
SUPPORTING APPELLANT'S REPLY BRIEF**

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Seattle, Washington 98154-1051  
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Attorneys for Appellant/Defendant

Appellant Charlotte Russe, Inc. respectfully submits the following  
non-Washington authorities in support of Appellant's Reply Brief:

*Civic Ctr. Square v. Ford (In re Roxford Foods)*, 12 F.3d 875  
(9th Cir. 1993);

*Turner v. Salvatierra*, 580 F.2d 199 (5th Cir. 1978);

*Press v. Forest Laboratories, Inc.*, 45 F.R.D. 354 (S.D.N.Y. 1968);

*Ray v. Alad Corp.*, 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).

Respectfully submitted this 15th day of January, 2010,



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Attorneys for Appellant/Defendant

**CERTIFICATE OF SERVICE**

The undersigned hereby certifies as follows:

I am employed at Corr Cronin Michelson Baumgardner & Preece LLP, attorneys of record for Defendant herein.

On January 15, 2010, I: (1) caused a true and correct copy of the foregoing document to be filed with the Clerk of the Court; and (2) caused a true and correct copy of the foregoing document to be duly served legal messenger (hand delivery) on the following party:

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*Attorneys for Respondent/Plaintiff*

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DIVISION ONE  
JAN 15 2010

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED: January 15, 2010, at Seattle, Washington.

  
\_\_\_\_\_  
Tammy Miller

12 F.3d 875, 139 A.L.R. Fed. 801, 27 Fed.R.Serv.3d 1235, 25 Bankr.Ct.Dec. 85, Bankr. L. Rep. P 75,639  
**(Cite as: 12 F.3d 875)**

United States Court of Appeals,  
 Ninth Circuit.

In re ROXFORD FOODS, INC., Debtor.  
 CIVIC CENTER SQUARE, INC., Plaintiff-Appellee,  
 v.

James M. FORD, as trustee of the Estate of Roxford Foods, Inc., Defendant-Appellant.  
 PURINA MILLS, INC.; James M. Ford, as trustee of the Estate of Roxford Foods, Inc., Plaintiffs-Appellants,  
 v.

CIVIC CENTER SQUARE, INC., Defendant-Appellee,  
 and

Roxford Foods, Inc., Debtor.  
**Nos. 92-16245, 92-16259.**

Argued and Submitted Nov. 2, 1993.  
 Decided Dec. 20, 1993.

Creditor brought adversary proceeding for declaratory judgment regarding named defendants' right to marshal senior creditors' liens. On Chapter 11 trustee's motion for relief from default judgment entered in adversary proceeding, the United States Bankruptcy Court for the Eastern District of California, denied motion, and trustee appealed. The District Court, Robert E. Coyle, Chief Judge, affirmed, and trustee appealed. The Court of Appeals, Choy, Circuit Judge, held that: (1) even though trustee never entered a formal appearance in adversary proceeding, the contacts between creditor and trustee in bankruptcy case constituted an "informal appearance" requiring that a trustee be notified of creditor's motion for entry of default judgment, and (2) failure to provide such notice violated due process and required that default judgment be set aside.

District court judgment reversed; bankruptcy court judgment vacated in part.

West Headnotes

**[1] Bankruptcy 51**  **2394.1**

51 Bankruptcy

51IV Effect of Bankruptcy Relief; Injunction and Stay

51IV(B) Automatic Stay

51k2394 Proceedings, Acts, or Persons Affected

51k2394.1 k. In General. Most Cited Cases

Automatic stay did not apply to proceeding brought in same court where bankruptcy case was pending. Bankr.Code, 11 U.S.C.A. § 362.

**[2] Federal Courts 170B**  **829**

170B Federal Courts

170BVIII Courts of Appeals

170BVIII(K) Scope, Standards, and Extent

170BVIII(K)4 Discretion of Lower Court

170Bk829 k. Amendment, Vacation, or Relief from Judgment. Most Cited Cases

Court of Appeals reviews district court's denial of motion for relief from judgment under abuse-of-discretion standard. Fed.Rules Civ.Proc.Rule 60(b), 28 U.S.C.A.

**[3] Federal Civil Procedure 170A**  **2641**

170A Federal Civil Procedure

170AXVII Judgment

170AXVII(G) Relief from Judgment

170Ak2641 k. In General. Most Cited Cases

Federal Rule of Civil Procedure specifying the grounds on which party may be granted relief from judgment is remedial in nature and must be liberally applied. Fed.Rules Civ.Proc.Rule 60(b), 28 U.S.C.A.

**[4] Federal Civil Procedure 170A**  **2441**

170A Federal Civil Procedure

170AXVII Judgment

170AXVII(B) By Default

12 F.3d 875, 139 A.L.R. Fed. 801, 27 Fed.R.Serv.3d 1235, 25 Bankr.Ct.Dec. 85, Bankr. L. Rep. P 75,639  
(Cite as: 12 F.3d 875)

170AXVII(B)2 Setting Aside

170Ak2441 k. In General. Most Cited

Cases

Default judgments are disfavored, and cases should be decided on their merits if possible.

**[5] Federal Civil Procedure 170A ↪2453**

170A Federal Civil Procedure

170AXVII Judgment

170AXVII(B) By Default

170AXVII(B)2 Setting Aside

170Ak2451 Proceedings

170Ak2453 k. Affidavits and Other

Evidence. Most Cited Cases

(Formerly 170Ak2451.1)

As long as motion for relief from default judgment is timely filed, and movant has meritorious defense, any doubt should be resolved in favor of setting default judgment aside. Fed.Rules Civ.Proc.Rule 60(b), 28 U.S.C.A.

**[6] Federal Civil Procedure 170A ↪2420**

170A Federal Civil Procedure

170AXVII Judgment

170AXVII(B) By Default

170AXVII(B)1 In General

170Ak2418 Proceedings for Judgment

170Ak2420 k. Application for

Judgment. Most Cited Cases

Failure to provide notice of motion for entry of default judgment as required under Federal Rule of Civil Procedure is serious procedural irregularity that usually justifies setting default judgment aside. Fed.Rules Civ.Proc.Rules 55(b)(2), 60(b), 28 U.S.C.A.

**[7] Federal Civil Procedure 170A ↪2420**

170A Federal Civil Procedure

170AXVII Judgment

170AXVII(B) By Default

170AXVII(B)1 In General

170Ak2418 Proceedings for Judgment

170Ak2420 k. Application for

Judgment. Most Cited Cases

Notice need be provided of motion for default judgment only to parties who have made an appearance. Fed.Rules Civ.Proc.Rule 55(b)(2), 28 U.S.C.A.

**[8] Federal Civil Procedure 170A ↪2420**

170A Federal Civil Procedure

170AXVII Judgment

170AXVII(B) By Default

170AXVII(B)1 In General

170Ak2418 Proceedings for Judgment

170Ak2420 k. Application for

Judgment. Most Cited Cases

Party need not have entered a formal appearance in order to be entitled to notice of motion for default judgment; in limited situations, informal contacts between parties may suffice, where party in default has thereby demonstrated a clear purpose to defend suit. Fed.Rules Civ.Proc.Rule 55(b)(2), 28 U.S.C.A.

**[9] Federal Civil Procedure 170A ↪2420**

170A Federal Civil Procedure

170AXVII Judgment

170AXVII(B) By Default

170AXVII(B)1 In General

170Ak2418 Proceedings for Judgment

170Ak2420 k. Application for

Judgment. Most Cited Cases

Even though bankruptcy trustee never formally appeared in proceeding brought by creditor for declaratory judgment regarding defendant's right to marshal liens, trustee's contacts with creditor in related bankruptcy action sufficiently demonstrated purpose on part of trustee to defend declaratory judgment proceeding that creditor should have provided notice to trustee of its motion for default judgment. Fed.Rules Civ.Proc.Rule 55(b)(2), 28 U.S.C.A.

**[10] Federal Civil Procedure 170A ↪2641**

170A Federal Civil Procedure

170AXVII Judgment

170AXVII(G) Relief from Judgment

12 F.3d 875, 139 A.L.R. Fed. 801, 27 Fed.R.Serv.3d 1235, 25 Bankr.Ct.Dec. 85, Bankr. L. Rep. P 75,639  
(Cite as: 12 F.3d 875)

170Ak2641 k. In General. Most Cited Cases

Discretion of district court to deny motion for relief from judgment is limited by significant policy considerations. Fed.Rules Civ.Proc.Rule 60(b), 28 U.S.C.A.

**[11] Federal Civil Procedure 170A ⚡2444.1**

170A Federal Civil Procedure

170AXVII Judgment

170AXVII(B) By Default

170AXVII(B)2 Setting Aside

170Ak2444 Grounds

170Ak2444.1 k. In General. Most

Cited Cases

Absent special circumstances, movant's failure to give necessary notice regarding its motion for entry of default judgment will require that default judgment be set aside when attacked on direct appeal or by motion to vacate judgment. Fed.Rules Civ.Proc.Rule 55(b)(2), 28 U.S.C.A.

**[12] Constitutional Law 92 ⚡4010**

92 Constitutional Law

92XXVII Due Process

92XXVII(E) Civil Actions and Proceedings

92k4007 Judgment or Other Determination

92k4010 k. Default. Most Cited Cases

(Formerly 92k315)

**Federal Civil Procedure 170A ⚡2420**

170A Federal Civil Procedure

170AXVII Judgment

170AXVII(B) By Default

170AXVII(B)1 In General

170Ak2418 Proceedings for Judgment

170Ak2420 k. Application for

Judgment. Most Cited Cases

Creditor's failure to give required notice of motion for default judgment to party who had entered an informal appearance violated due process, and required that default judgment be vacated. U.S.C.A.

Const.Amend. 14; Fed.Rules Civ.Proc.Rule 55(b)(2), 28 U.S.C.A.

\*876 Claudia L. Greenspoon, Bronson, Bronson & McKinnon, Los Angeles, CA, for defendant-appellant.

Malcolm Leader-Picone and Debra Murphy Lawson, Kennedy & Wasserman, Oakland, CA, for plaintiffs-appellants.

David R. Jenkins, Lang, Richert & Patch, Fresno, CA, for plaintiff-appellee.

\*877 Appeal from the United States District Court for the Eastern District of California.

Before: CHOY, CANBY, and NOONAN, Circuit Judges.

CHOY, Circuit Judge:

This appeal arises out of an adversary proceeding brought in the bankruptcy case of Roxford Foods, Inc. (Roxford) by appellee Civic Center Square, Inc. (CCS). James M. Ford, as Trustee for Roxford (the Trustee), and Purina Mills, Inc. (Purina) appeal the decision of the district court affirming the bankruptcy court's Order Denying Motion to Vacate Judgment. We reverse.

**I. FACTUAL AND PROCEDURAL BACKGROUND**

In March of 1990, Roxford filed for Chapter 11 in bankruptcy. In order to facilitate the sale of certain of its real property and equipment, Roxford filed three motions, including a Joint Motion for Order Authorizing Distribution of Sale Proceeds. On April 6, 1990, Purina filed an objection to this motion, contending that distribution should not proceed without requiring Caisse Nationale de Credit Agricole ("Credit Agricole") and Farm Credit Leasing Services Corporation ("Farm Credit"), who held claims secured by the facilities, to draw down approximately \$2.5 million under letters of credit.

12 F.3d 875, 139 A.L.R. Fed. 801, 27 Fed.R.Serv.3d 1235, 25 Bankr.Ct.Dec. 85, Bankr. L. Rep. P 75,639  
(Cite as: 12 F.3d 875)

These letters of credit were issued on appellee CCS's application, and are secured by a deed of trust against a CCS building.

As a result of these objections and subsequent negotiations and stipulations, the bankruptcy court issued an order authorizing the sale of assets and the assumption of certain contracts (the "Sale Order"). Paragraph 11.2 of the Sale Order was included essentially to protect any marshalling rights of the estate and of creditors junior to Credit Agricole and Farm Credit, and to enable the bankruptcy court to require Credit Agricole and Farm Credit to draw down on the letters of credit should the court determine that such marshalling rights exist.

The Roxford bankruptcy was converted from Chapter 11 to Chapter 7 on June 7, 1990, and shortly thereafter appellant James M. Ford was named as trustee. Apparently the Trustee had difficulty obtaining counsel to represent him due to insufficient funds in the bankrupt estate, as well as the fact that because of the complexity of the case many Fresno law firms were already representing the numerous parties in the proceeding.

Between the appointment of the Trustee and October of 1990, several hearings in the bankruptcy proceeding were postponed to enable the Trustee to obtain counsel. Eventually the court issued an order stating that if the Trustee did not obtain counsel by December 14, 1990, certain claims against Purina and another creditor would be deemed abandoned.

Meanwhile, on September 19, 1990, CCS commenced the adversary proceeding from which this appeal was taken, by filing a complaint seeking a declaratory judgment determining whether the named defendants could marshal the Credit Agricole and Farm Credit liens. This complaint was filed in the same bankruptcy court as the underlying pending bankruptcy. The complaint named the Trustee and other parties that CCS believed had the potential to assert marshalling rights as defendants. It did not name Purina because Purina's lien attached within 90 days of the Roxford petition, and

therefore CCS contends it had been terminated under California Code of Civil Procedure § 493.030(b).<sup>FN1</sup>

FN1. CCS filed a separate declaratory relief action against Purina and other similarly situated Roxford creditors. Summary judgment was granted in favor of CCS. An appeal was taken, but it was dismissed because CCS, at the request of Purina, executed a stipulation to dismiss the appeal on the ground that the order appealed from was not a final order.

On September 21, 1990, all defendants in the declaratory relief action, including the Trustee, were served the summons and complaint by mail at their correct addresses, pursuant to Rule of Bankruptcy Procedure 7004(b)(1). Summons and proofs of service were filed on September 24, 1990. On November 1, 1990, CCS sent the Trustee a letter advising him to respond within five days or face default. The Trustee never responded to this letter. At the pretrial \*878 conference, on November 19, 1990, the Trustee did not appear, and the court granted CCS's request to take default. On November 26, 1990, CCS served the Trustee a proposed entry of default by mail, to which the Trustee did not respond. On December 4, 1990, a formal order of default was signed by the court, and on December 13, 1990, notice of entry of default was entered and the clerk's office was served.

The Trustee claims that he does not recall receiving the summons and complaint, or any notice of the intent of CCS to seek default, or any pleading in the adversary proceeding.

In the meantime, on November 30, 1990, Purina notified all parties in the underlying bankruptcy action, including CCS, that the Trustee proposed to retain Cindy Dennis of Dennis, Shafer, Fennelly & Creim ("DSF & C") as counsel. CCS responded by a letter on December 6, 1990, stating that retention of DSF & C as counsel was not appropriate, because Purina would be paying for the representa-

12 F.3d 875, 139 A.L.R. Fed. 801, 27 Fed.R.Serv.3d 1235, 25 Bankr.Ct.Dec. 85, Bankr. L. Rep. P 75,639  
(Cite as: 12 F.3d 875)

tion. According to CCS this created a conflict of interest if Purina asserted marshalling rights independent of the Trustee. On December 14, 1990, Purina responded with a letter to DSF & C and all parties stating that it was their position that it would be appropriate for the Trustee to pursue the marshalling claim. DSF & C was appointed as counsel for the Trustee on January 24, 1991, and notice of this was served on all parties.

On March 25, 1991, CCS filed a motion in the declaratory judgment action for summary judgment against all defendants. In reliance on the entry of default, CCS never served this motion on the Trustee or DSF & C, the counsel the Trustee had retained in the underlying bankruptcy proceeding. On April 25, 1991, summary judgment with respect to answering defendants and default judgment with respect to the Trustee was entered in favor of CCS, with no sustainable opposition offered by any party. The judgment made three determinations: (1) The letters of credit were not assets of the debtor; (2) Marshalling was not available against the letters of credit as to any defendant; and (3) No facts existed to support a claim of equitable subordination against CCS.

On June 14, 1991, the Trustee timely filed a motion to vacate the declaratory judgment under Fed.R.Civ.P. 60(b). Purina also moved to vacate the judgment. The bankruptcy court struck Purina's motion for lack of standing, and granted the portion of the Trustee's motion seeking to vacate the judgment pertaining to equitable subordination, but denied the Trustee's motion to vacate the rest of the judgment. On appeal, the district court affirmed the Order Denying Motion to Vacate Judgment.

## II. DISCUSSION

### A. The Automatic Stay was not Violated:

The Trustee asserts that the declaratory judgment should be vacated as void pursuant to Rule 60(b) because the adversary proceeding was commenced

in violation of the automatic stay, under 11 U.S.C. § 362. The bankruptcy court rejected this argument as inapplicable, because the declaratory relief sought "merely seeks to establish what is or is not property of the estate," rather than an attempt to obtain property from the estate. The district court also rejected this argument, but on a different ground. The court relied on *In re North Coast Village, Ltd.*, 135 B.R. 641 (9th Cir. BAP 1992), which held that the stay did not apply to proceedings against the debtor commenced in the same bankruptcy court where the debtor's bankruptcy was pending. *Id.* at 643-44. The district court noted that *In re North Coast Village* followed this court's holding in *In re Teerlink Ranch Ltd.*, 886 F.2d 1233, 1237 (9th Cir.1989), where this court held that "[t]he stay does not operate against the court with jurisdiction over the bankrupt."

[1] Our decision on this issue is controlled by our decision in *Teerlink Ranch*, where this court found the automatic stay inapplicable to a suit commenced in the same court where the bankruptcy was pending. Therefore, the district court was correct in finding that the declaratory judgment is not void on this ground, as it was not commenced in violation of the automatic stay.

### \*879 B. Failure to give 55(b)(2) Notice:

[2][3][4][5] The Trustee contends that the declaratory judgment should be vacated pursuant to Fed.R.Civ.P. 60(b) because it is void for lack of notice under Fed.R.Civ.P. 55(b)(2).<sup>FN2</sup> The standard of review for the denial of a 60(b) motion is for an abuse of discretion. *In re Hammer*, 940 F.2d 524, 525 (9th Cir.1991). The discretion of the court is limited by three policy considerations. First, because of the remedial nature of Rule 60(b), it must be liberally applied. Second, because default judgments are disfavored, cases should be decided on their merits if possible. Thirdly, so long as relief is timely sought, and there is a meritorious defense, any doubt should be resolved in favor of setting aside a default judgment. *Wilson v. Moore and As-*

12 F.3d 875, 139 A.L.R. Fed. 801, 27 Fed.R.Serv.3d 1235, 25 Bankr.Ct.Dec. 85, Bankr. L. Rep. P 75,639  
(Cite as: 12 F.3d 875)

*socs., Inc.*, 564 F.2d 366, 368 (9th Cir.1977).

FN2. Rule 55 is applicable to the bankruptcy court declaratory judgment proceedings. *See* Bankruptcy Rule 7055.

Fed.R.Civ.P. 55(b)(2) provides in part:

If the party against whom judgment by default is sought has appeared in the action, the party (or, if appearing by representative, the party's representative) shall be served with written notice of the application for judgment at least 3 days prior to the hearing on such application.

The Trustee contends that because he was never given notice of the hearing on CCS's motion for summary judgment<sup>FN3</sup>, the resulting declaratory judgment should be vacated.

FN3. This motion was in essence an "application to the court for default judgment" under Rule 55(b)(2) with respect to the Trustee against whom default had previously been entered.

[6][7][8] While it is true that "[t]he failure to provide 55(b)(2) notice, if the notice is required, is a serious procedural irregularity that usually justifies setting aside a default judgment or reversing for the failure to do so," *Wilson*, 564 F.2d at 369, notice is only required where the party has made an appearance. "The appearance need not necessarily be a formal one, *i.e.*, one involving a submission or presentation to the court. In limited situations, informal contacts between the parties have sufficed when the party in default has thereby demonstrated a clear purpose to defend the suit." *Id.*

[9] The record clearly shows that the Trustee never formally appeared in the adversary proceeding. Additionally, the Trustee never informally responded directly to the complaint. The Trustee did make informal contacts with CCS and other parties involved in regards to the underlying bankruptcy action, which directly related to the issue decided in the adversary proceeding. CCS was fully aware of

the Trustee's posture in regards to the bankruptcy action. At issue here then, is whether or not the Trustee's contacts with CCS in regard to the related bankruptcy action constituted sufficient contacts demonstrating a clear purpose to defend the declaratory judgment action, such that it may be deemed an "appearance" for the purpose of Fed.R.Civ.P. 55(b)(2).

The benchmark case with regards to Rule 55(b)(2) is *H.F. Livermore Corp. v. Aktiengesellschaft Gebruder Loepfe*, 432 F.2d 689, 691 (D.C.Cir.1970). In that case, the parties had engaged in both written and oral settlement discussions following the service of the complaint, after which the plaintiff filed a motion for default judgment, without any indication to the defendant of his intention to do so. The court found that the defendant's settlement attempts demonstrated a clear purpose to defend, and reversed the district court's denial of a motion to vacate.

In *Wilson*, we distinguished *Livermore* in finding that the defendant had not made an appearance. In that case, the defendant sent two letters to plaintiff's counsel in response to the complaint and summons, setting forth certain facts which could be construed as a defense to the complaint. A copy of one of the letters was sent to the Clerk of the District Court of Hawaii. After each letter, the plaintiff's counsel responded by suggesting that the defendant retain counsel, and stating that they would seek default if a timely answer was not filed. Under these facts we found that *Livermore* was distinguishable, and declined to reverse the denial of a motion to vacate. Basing the decision on the absence of settlement negotiations, the two warnings given by plaintiff that the defendant\*880 should seek counsel, and the two warnings of plaintiff's intent to seek default, we were "unwilling to hold that Moore's 'informal contacts' constituted the equivalent of a formal court appearance requiring strict 55(b)(2) notice." *Wilson*, 564 F.2d at 369.

As evidence of an intent to defend the declaratory judgment action, the Trustee first cites the fact that

CCS named him as a defendant in the complaint. This cannot be construed as evidence of an appearance, otherwise any defendant would be deemed to have appeared.

The Trustee then refers to communications between CCS and the Trustee regarding the Trustee's proposed retention of counsel, and CCS's subsequent objections thereto. First, on November 30, 1990, CCS was sent a copy of a letter indicating that the Trustee had retained Cindy Dennis, who would represent the estate in the bankruptcy proceeding. Then, on December 6, 1990, CCS sent a letter objecting to the retention of Cindy Dennis. The objection was based on a potential conflict of interest due to the fact that Purina was paying for this representation, combined with Purina's interest in asserting independent marshalling rights. Finally, on December 14, 1990, CCS received a copy of a letter from Purina to Cindy Dennis advising that it was Purina's position that "it would be most appropriate for the trustee to pursue the marshalling claim."

The district court found that these facts were similar to those in *Wilson*, and that these contacts were not enough to constitute an "appearance".

It is true that the facts above, if viewed in isolation, are not enough to indicate a clear intention to defend, such as to constitute an appearance to trigger Rule 55(b)(2) notice. It is unclear, however, whether the district court adequately considered the underlying bankruptcy action. While we have never considered whether an appearance is made by formally appearing in a related case, other courts have held that where a party has appeared in a closely related or identical case, it constitutes an appearance such as to require Rule 55(b)(2) notice.

For instance, in *Turner v. Salvatierra*, 580 F.2d 199 (5th Cir.1978), the court found that two complaints were sufficiently identical that an answer to the first constituted an appearance in the second such as to require 55(b)(2) notice. The plaintiff in that case was notified that his case would be dismissed without prejudice for lack of prosecution if he did

not file an affidavit showing good cause for lack of diligence. On the day the affidavit was due, the plaintiffs moved for an entry of default, and on that same day the defendant filed an answer and an affirmative defense. The court dismissed the complaint for lack of prosecution. When the plaintiff filed a new complaint, which was given the same docket number, the defendant did not respond for four months, resulting in an entry of default, followed by a default judgment. On appeal, the court vacated the default judgment, finding that the defendant's answer to the first complaint constituted an appearance, since the two cases were really "one and the same," *id.* at 201, and thus Rule 55(b)(2) notice of the hearing for default judgment was required.

A similar holding was made by the district court in *Press v. Forest Lab., Inc.*, 45 F.R.D. 354 (S.D.N.Y.1968). In that case, three different actions were commenced by the plaintiff against the defendants over a ten year period, two of which were in federal court. In the first federal action, the plaintiff attempted to amend his complaint to add other defendants, including the current defendant's attorney. When this was denied by the court, the plaintiff initiated the second action while the first action was still pending. The second complaint was identical to the first except that it named the defendant's attorney and contained additional allegations against defendant's attorney for unethical conduct and libel. Rather than respond to the second complaint, the attorney answered only the first complaint, and commenced a proceeding against plaintiff's attorney before the Grievance Committee of the Bar Association. Default judgment was entered against defendants for failure to respond to the second complaint. On a motion to vacate the default judgment, the district court held that the two actions were really one and the same, and that the dispute in the second **\*881** grew out of the same activity as the first. Therefore, the court held that the contacts in regard to the first action constituted an appearance in the second action. *Id.* at 356-57.

12 F.3d 875, 139 A.L.R. Fed. 801, 27 Fed.R.Serv.3d 1235, 25 Bankr.Ct.Dec. 85, Bankr. L. Rep. P 75,639  
(Cite as: 12 F.3d 875)

The case at bar is distinguishable from *Wilson* because of the Trustee's posture in the original bankruptcy action. Both cases were assigned the same docket number, and the right to marshal the letters of credit was an issue in both cases. We find that the claims in the bankruptcy action were sufficiently identical such that the Trustee's contacts with CCS in regards to that proceeding were sufficient to constitute an appearance in the declaratory judgment action.

Additionally, up to the time that CCS filed for entry of default, they were aware that the Trustee was attempting to procure counsel. Several hearings were set in the underlying bankruptcy proceeding during the period from May to October of 1990, but were continued for the express purpose of allowing the Trustee to obtain counsel. Subsequently, the court entered an order providing that if the Trustee did not obtain counsel by December 14, 1990, certain claims against Purina and another creditor would be abandoned. Yet the formal order of default in the declaratory judgment action was signed by the court on December 4, 1990, and entered on December 13, 1990.

The concerns raised by CCS in its letter to the Trustee, dated December 6, 1990, clearly indicate that CCS was aware that the Trustee intended to pursue marshalling claims on behalf of the estate. The letter states that Purina's assertion of marshalling rights independent of the estate would "apparently diminish to zero any potential claims of the estate." This would only be true if the Trustee intended to assert the marshalling rights, and yet this letter was sent after CCS had taken the Trustee's default (but before filing for summary judgment). Once the Trustee did retain counsel, no notice concerning the adversary proceeding was ever sent to the Trustee or his counsel.

[10] Because Rule 60(b) is remedial, discretion of a district court to deny a 60(b) motion is limited by significant policy considerations. In a case such as this "[w]here timely relief is sought from a default judgment and the movant has a meritorious defense,

doubt, if any, should be resolved in favor of the motion to set aside the judgment so that cases may be decided on their merits." *Schwab v. Bullock's Inc.*, 508 F.2d 353, 355 (9th Cir.1974) (quoting 7 Moore's Federal Practice ¶ 60.19). Because of the Trustee's default, the issue of the estate's right to require marshalling of the letters of credit has never been decided on the merits. Any doubt as to whether or not the Trustee's actions in the underlying bankruptcy proceeding constituted an appearance in the adversary proceeding should be resolved in favor of finding that the Trustee did make an appearance so as to require 55(b)(2) notice.

In addition, "bankruptcy itself is an equitable proceeding in which equity operates within the terms of the bankruptcy code." *In re J.F. Hink & Son*, 815 F.2d 1314, 1318 (9th Cir.1987). By filing an adversary proceeding while CCS knew that the Trustee was having difficulty retaining counsel, without naming any other party who had a sustainable interest in requiring marshalling of the letters of credit, CCS managed to obtain a default judgment against the Trustee without any opposition. Once the Trustee had retained counsel, neither he nor his counsel was ever given notice of the hearing that ultimately decided that no marshalling rights existed. It would be more equitable if the default judgment were vacated so that the case may be decided on its merits.

[11][12] We therefore hold that the Trustee did make an appearance in the declaratory judgment action, triggering the requirement of Rule 55(b)(2) notice. Because no such notice was given, we reverse the district court's contrary holding, and vacate the bankruptcy court's declaratory judgment in so far as it applies to the Trustee. "Absent special circumstances, the failure to give necessary notice will require that the default judgment be set aside where attacked on direct appeal or by a motion to vacate the judgment." 6 Moore's Federal Practice, ¶ 55.05[3] at 55-39 (1993). *See also Wilson*, 564 F.2d at 369. No such special circumstances exist here. Therefore, the failure to give required Rule 55(b)(2)

12 F.3d 875, 139 A.L.R. Fed. 801, 27 Fed.R.Serv.3d 1235, 25 Bankr.Ct.Dec. 85, Bankr. L. Rep. P 75,639  
(Cite as: 12 F.3d 875)

notice violated \*882 due process, and the judgment should be vacated. *Cf. In re Center Wholesale, Inc.*, 759 F.2d 1440, 1448-49 (9th Cir.1985) (failure to give proper notice required by Bankruptcy Code before hearing allowing debtor to use cash collateral violated due process).<sup>FN4</sup>

FN4. Because we reverse on the ground that the Trustee appeared in the action such as to require Rule 55(b)(2) notice, we need not reach the Trustee's other contention that the district court erred in failing to vacate the judgment based on excusable neglect under Fed.R.Civ.P. 60(b). In addition, we need not decide whether appellant Purina has standing to move to vacate the judgment under Rule 60(b), as that issue is rendered moot by our decision.

The district court judgment is REVERSED and the bankruptcy court declaratory judgment is VACATED IN PART.

C.A.9 (Cal.),1993.

*In re Roxford Foods, Inc.*

12 F.3d 875, 139 A.L.R. Fed. 801, 27 Fed.R.Serv.3d 1235, 25 Bankr.Ct.Dec. 85, Bankr. L. Rep. P 75,639

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580 F.2d 199, 26 Fed.R.Serv.2d 182  
(Cite as: 580 F.2d 199)

United States Court of Appeals,  
Fifth Circuit.  
James TURNER and Linda Chase, Plaintiffs-Appellees,

v.

Julio C. SALVATIERRA, Defendant-Appellant.  
No. 78-1710

**Summary Calendar.[FN\*]**

FN\* Rule 18, 5 Cir.; See Isbell Enterprises, Inc. v. Citizens Casualty Co. of New York et al., 5 Cir., 1970, 431 F.2d 409, Part I.

Sept. 18, 1978.

Defendant appealed from an order of the United States District Court for the Southern District of Florida, Norman C. Roettger, Jr., J., denying his motion to vacate final default judgment entered in action for recovery of wages and damages. The Court of Appeals held that: (1) where defendant filed answer and affirmative defenses and deposed prospective witnesses in connection with original complaint and original and second complaints received same docket number, appeared on same record and were identical in content, two complaints were really one and the same so defendant's actions in response to first complaint constituted an appearance requiring plaintiffs to give notice of motion for entry of default judgment and (2) where plaintiffs' failure to notify defendant of motion provided sufficient reason for defendant's failure to respond and defendant claimed he had meritorious defense, trial court should have granted motion for relief from default judgment.

Vacated and remanded.

West Headnotes

**[1] Federal Civil Procedure 170A ⚡2420**

170A Federal Civil Procedure

170AXVII Judgment  
170AXVII(B) By Default  
170AXVII(B)1 In General  
170Ak2418 Proceedings for Judgment  
170Ak2420 k. Application for Judgment. Most Cited Cases  
Where defendant filed answer and affirmative defenses and deposed prospective witnesses in connection with plaintiffs' original complaint in action for recovery of wages and damages and original and second complaints received same docket number, appeared on same record and were identical in content, two complaints were really one and the same so defendant's actions in response to first complaint constituted an appearance so that plaintiffs were required to serve written notice of motion for default judgment under rule providing that if party against whom judgment is sought has appeared in action he shall be served with written notice of application for judgment. Fed.Rules Civ.Proc. rule 55(b)(2), 28 U.S.C.A.

**[2] Federal Civil Procedure 170A ⚡2444.1**

170A Federal Civil Procedure  
170AXVII Judgment  
170AXVII(B) By Default  
170AXVII(B)2 Setting Aside  
170Ak2444 Grounds  
170Ak2444.1 k. In General. Most Cited Cases  
(Formerly 170Ak2444)

**Federal Civil Procedure 170A ⚡2450**

170A Federal Civil Procedure  
170AXVII Judgment  
170AXVII(B) By Default  
170AXVII(B)2 Setting Aside  
170Ak2450 k. Meritorious Cause of Action or Defense. Most Cited Cases  
Where plaintiffs' failure to notify defendant of default motion provided sufficient reason for defendant's failure to respond and where defendant

580 F.2d 199, 26 Fed.R.Serv.2d 182  
(Cite as: 580 F.2d 199)

claimed that he had meritorious defense by his denial of privity of contract or any other relationship creating any liability, district court should have granted defendant's motion for relief from final default judgment. Fed.Rules Civ.Proc. rules 55(b)(2), (c), 60(b)(6), 28 U.S.C.A.

\*200 Robert W. Stern, Miami, Fla., for defendant-appellant.

Arthur Roth, Miami, Fla., for plaintiffs-appellees.

Appeal from the United States District Court for the Southern District of Florida.

Before GOLDBERG, AINSWORTH and HILL, Circuit Judges.

PER CURIAM:

Defendant Julio C. Salvatierra seeks to vacate a final default judgment of \$8,458.53 entered in favor of plaintiffs James Turner and Linda Chase. Since plaintiffs did not meet the notice requirements of Fed.R.Civ.P. 55(b)(2) when applying to the court for the default judgment, we vacate the judgment and remand the case for further proceedings.

Plaintiffs Turner and Chase were hired by a boat delivery service to transport a yacht owned by defendant Salvatierra from Pompano Beach, Florida to Venezuela, defendant's native land. The yacht sank en route, and plaintiffs brought suit against Salvatierra to recover wages and damages for loss of personal effects. They filed their complaint on March 5, 1976, serving defendant with process pursuant to Fla.Stat. ss 48.161, 48.19 [FN1] by serving the Florida Secretary of State on March 12 and notifying defendant of such service by registered mail on March 29. The case lay dormant until August 31, when the District Court, pursuant to Rule 13 of the Local Rules for the Southern District of Florida, entered an order of dismissal for lack of prosecution, providing that the action would be dismissed without prejudice on September 15 unless plaintiffs filed before that date with the clerk of the court an affidavit showing good cause and the court deter-

ined that plaintiffs had demonstrated good cause for their lack of diligence. Without having filed that affidavit, on September\*201 15 plaintiffs moved for entry of default. That same day, defendant filed an answer and affirmative defenses. Although the complaint was dismissed for lack of prosecution on September 15, later in the year plaintiffs took depositions from officials of the yacht brokerage company that had sold the sunken vessel to defendant and defendant deposed those individuals as well as plaintiffs.

FN1. Fla.Stat. s 48.161. Method of substituted service on nonresident.

(1) When authorized by law, substituted service of process on a nonresident . . . by serving a public officer designated by law shall be made by leaving a copy of the process with a fee of \$5.00 with the public officer or in his office or by mailing the copies by certified mail to the public officer with the fee. The service is sufficient service on a defendant who has appointed a public officer as his agent for the service of process. Notice of service and a copy of the process shall be sent forthwith by registered or certified mail by the plaintiff or his attorney to the defendant, and the defendant's return receipt and the affidavit of the plaintiff or his attorney of compliance shall be filed on or before the return day of the process or within such time as the court allows . . . . The fee paid by the plaintiff to the public officer shall be taxed as cost if he prevails in the action. The public officer shall keep a record of all process served on him showing the day and hour of service.

Fla.Stat. s 48.19. Service on nonresidents operating aircraft or watercraft in the state. The operation, navigation or maintenance by a nonresident of an aircraft or a boat, ship, barge or other watercraft in the state, either in person or through others, and the acceptance thereby by the nonresident of

the protection of the laws of this state for the aircraft or watercraft, or the operation, navigation or maintenance by a nonresident of an aircraft or a boat, ship, barge, or other watercraft in the state, either in person or through others, other than under the laws of the state, . . . constitutes an appointment by the nonresident of the Secretary of State as the agent of the nonresident . . . on whom all process may be served in any action or proceeding against the nonresident . . . growing out of any accident or collision in which the nonresident . . . may be involved while, either in person or through others, operating, navigating, or maintaining an aircraft or a boat, ship, barge, or other watercraft in the state. The acceptance by operation, navigation or maintenance in the state of the aircraft or watercraft is signification of the nonresident's . . . agreement that process against him so served shall be of the same effect as if served on him personally.

Plaintiffs refiled their complaint on December 28, 1976, and by permission of the court the complaint was reassigned the same docket number as that of the original action. On January 4, 1977, plaintiffs again served process on defendant by serving the Florida Secretary of State and on January 25 they informed defendant of that service by registered mail. After four months passed, without response by defendant, on May 4 plaintiffs moved for entry of default against defendant; the clerk entered the default on the same date.

Plaintiffs filed a motion for entry of final judgment on May 25. The District Court issued an order granting the motion for default judgment, limited to the issue of liability, on July 5, and scheduled a hearing on the damages issue for July 15. The District Court entered its final judgment on July 18, awarding plaintiffs aggregate damages of \$8,428.53 plus costs. On July 28 defendant moved to vacate the final judgment and filed both a motion to vacate

default and a third party complaint. The District Court denied defendant's motion to vacate the final judgment on January 30, 1978 and defendant filed this appeal.

This Court has recognized that "(t)he entry of judgment by default is a drastic remedy and should be resorted to only in extreme situations. (Citations omitted) It is only appropriate where there has been a clear record of delay or contumacious conduct." *E. F. Hutton & Co. v. Moffatt*, 5 Cir., 1972, 460 F.2d 284, 285; *Charlton L. Davis & Co. P.C. v. Fedder Data Center*, 5 Cir., 1977, 556 F.2d 308, 309. Moreover, under Fed.R.Civ.P. 55(b)(2), "(i)f the party against whom judgment is sought has appeared in the action, he (or, if appearing by representative, his representative) shall be served with written notice of the application for judgment at least 3 days prior to the hearing on such application." To qualify as an appearance and thereby trigger the foregoing notice requirement, defendant's actions must "at least" "be responsive to plaintiff's formal Court action." *Baez v. S. S. Kresge Company*, 5 Cir., 1975, 518 F.2d 349, 350, Cert. denied, 425 U.S. 904, 96 S.Ct. 1495, 47 L.Ed.2d 754 (1976).

[1] Here, defendant filed an answer and affirmative defenses and deposed prospective witnesses in connection with plaintiffs' original complaint of March 5, 1976. The two complaints received the same docket number, appear on the same record and are identical in content. Thus, the two are "really one and the same," *Press v. Forest Laboratories, Inc.*, 45 F.R.D. 354, 356 (S.D.N.Y.1969), so defendant's actions in response to the first complaint constitute an appearance for purposes of Rule 55(b)(2). Plaintiffs were therefore required to comply with the notice provisions of the rule.

[2] Rule 55(c) provides that judgments of default may be set aside in accordance with Rule 60(b) "(f)or good cause shown." Because plaintiffs' failure, in violation of Rule 55, to notify defendant of their default motion "provides sufficient reason for (defendant's) failure to respond," and because de-

580 F.2d 199, 26 Fed.R.Serv.2d 182  
(Cite as: 580 F.2d 199)

defendant claims that he has a meritorious defense by his denial of privity of contract or any other relationship creating any liability to defendants, the District Court should have granted defendant's motion for relief from the final default judgment pursuant to Rule 60(b)(6). *Charlton L. Davis & Co. P. C. v. Fedder Data Center*, 5 Cir., 1977, 556 F.2d 308, 309. Accordingly, that judgment is hereby vacated and the case remanded.

VACATED AND REMANDED.

C.A.Fla.,1978.

Turner v. Salvatierra

580 F.2d 199, 26 Fed.R.Serv.2d 182

END OF DOCUMENT

45 F.R.D. 354, 180 U.S.P.Q. 783  
(Cite as: 45 F.R.D. 354)

United States District Court S. D. New York.  
Howard A. PRESS, Plaintiff,

v.

FOREST LABORATORIES, INC., Hans Lowey  
and Bonded Laboratories, Inc., Defendants.

No. 65 Civ. 2975.

Nov. 8, 1968.

Proceeding on motion to set aside a default judgment. The District Court, Motley, J., held that where both earlier and later actions against many of the same defendants were really one and later action was instituted only because court refused to allow plaintiff to amend complaint in earlier action, defendants and their representatives, who had made a formal appearance in earlier action, had sufficient contact with plaintiff's attorney to constitute an appearance in later action and were entitled to notice of application for default judgment prior to its entry.

Default judgment vacated, and defendants given ten business days in which to file answer.

#### West Headnotes

#### [1] Federal Civil Procedure 170A ⚡2420

170A Federal Civil Procedure  
170AXVII Judgment  
170AXVII(B) By Default  
170AXVII(B)1 In General  
170Ak2418 Proceedings for Judgment  
170Ak2420 k. Application for  
Judgment. Most Cited Cases

Where both earlier and later actions against many of the same defendants were really one and later action was instituted only because court refused to allow plaintiff to amend complaint in earlier action, defendants and their representatives, who had made a formal appearance in earlier action, had sufficient contact with plaintiff's attorney to constitute an appearance in later action and were entitled to notice

of application for default judgment prior to its entry. U.S.Dist.Ct.Rules S. and E.D.N.Y., Gen. rule 9(m); Fed.Rules Civ.Proc. rules 55(b, c), 60(b), 28 U.S.C.A.

#### [2] Federal Civil Procedure 170A ⚡2444.1

170A Federal Civil Procedure  
170AXVII Judgment  
170AXVII(B) By Default  
170AXVII(B)2 Setting Aside  
170Ak2444 Grounds  
170Ak2444.1 k. In General. Most  
Cited Cases

(Formerly 170Ak2444)

Where notice of motion for default judgment is required but not given, a default judgment entered without notice must be vacated as a matter of law. Fed.Rules Civ.Proc. rule 55(b) (2), 28 U.S.C.A.

\*354 McGlew & Toren, New York City, for plaintiff.

Koch, Lankenau, Schwartz & Kovner, New York City, for defendants.

MEMORANDUM OPINION UPON REARGUMENT  
MOTLEY, District Judge.

This is a motion by defendants pursuant to Rule 9(m) of the General Rules of this Court for reargument of their motion for an order setting aside a default judgment entered on November 28, 1967 and granting defendants leave to answer or otherwise move with respect to the complaint. Rules 55(b), (c) and 60(b) Fed.R.Civ.P.

On April 12, 1968, defendants moved for an order setting aside the default judgment. The motion was denied after oral argument on June 6, 1968. On June 17, 1968, defendant moved for reargument. In support of that motion, on June 26, 1968, with the permission of the court, defendants filed an affidavit of the defendant Hans Lowey, who is also

president of the defendants Bonded Laboratories, Inc. (hereinafter referred to as 'Bonded') and Forest Laboratories, Inc. (hereinafter referred to as 'Forest'), detailing the circumstances under which a default judgment was entered in this action without notice to any of the defendants. On August 19, 1968, the court granted reargument limited to a question overlooked by it on the first argument, i. e., whether, as a matter of law, the default must be vacated because plaintiff failed to notify defendants of the application to enter a default judgment. Failure to give notice had been raised by defendants in their original moving papers.

The parties were directed to and did submit briefs on the question and the \*355 court permitted the question to be reargued. The court now sets aside its former decision and grants defendants' motion to set aside the default judgment.

The present action is the third of three actions commenced by plaintiff against defendants over a ten-year period, all involving a running dispute between the parties in regard to a claim of breach of contract, patent infringement, and patent appropriation. In all three actions, plaintiff and defendants were represented by attorneys. The earliest action, commenced in 1956 in the Supreme Court of New York, Kings County, was settled by a stipulation executed by plaintiff and defendants and their respective attorneys on May 6, 1957.

Thereafter, in 1963, plaintiff commenced the first of two actions in this court (hereinafter referred to as the 'first action') alleging a patent infringement. The first action was brought solely against Forest. In the course of the litigation of the first action, plaintiff's attorney (Harry Price) and defendants' attorney (Bernard H. Goldstein) fought bitterly and as a result, plaintiff's attorney sought to amend the complaint in the first action to add as defendants, among others, Mr. Goldstein and another member of the firm of defendants' attorneys. This court, by order of Judge Tenney, denied plaintiff permission to name additional defendants. Plaintiff, blocked in his attempt to add defendants in the first action,

commenced this action (hereinafter sometimes referred to as the 'second action') while the first action was still pending.

In the second action, this action, plaintiff added as defendants Bonded and Hans Lowey (president of both Forest and Bonded), and, in addition, added as a defendant one of the defendants' attorneys, Mr. Goldstein. The complaint in the second action, paragraph for paragraph, contained the identical claim of patent infringement recited in the first action. In addition, it alleged causes of action against Mr. Goldstein for libel and unethical conduct. Further, the complaint in the second action contained allegations referring to the earliest action in 1956 in the Supreme Court of New York and sought to set aside the stipulation of settlement disposing of that action on the grounds of alleged misrepresentations.

The complaint in the second action was served on all defendants except Mr. Goldstein and, prior to the service of the complaint, a copy of the complaint was forwarded by plaintiff's attorney to Mr. Goldstein at his office informing him that a complaint had been filed. As a result of the allegations made by plaintiff's attorney, Mr. Goldstein went to the Grievance Committee of the Bar Association and commenced a proceeding against plaintiff's attorney, Harry Price. In the latter part of 1965, the two actions were pending in this court, as well as a proceeding in the Bar Association.

Throughout all these proceedings plaintiff's attorney recognized that defendants were represented by the same attorneys and, in fact, forwarded correspondence and papers, including notice of taking depositions and interrogatories, to defendants' attorneys.

Defendants interposed an answer and counterclaim in the first action, but did not interpose an answer or enter a written appearance in the second action; instead both plaintiff's attorney and defendants' attorney proceeded before the Grievance Committee. During the pendency of the proceedings before the Grievance Committee, the first action was called

45 F.R.D. 354, 180 U.S.P.Q. 783  
(Cite as: 45 F.R.D. 354)

for a pre-trial conference before Judge Cooper of this court. After a hearing on January 25, 1966, at which both plaintiff's attorney and defendants' attorney were present, an order was entered by Judge Cooper on March 9, 1966, discontinuing the first action. The order recited that all claims between the parties had been settled. No further proceedings were had by either party in this action during the remainder of the \*356 year 1966. The Bar Association proceedings continued. On December 26, 1965, during the pendency of both actions and during the pendency of the Bar Association proceedings, plaintiff's attorney wrote to defendants' attorney, Mr. Goldstein, seeking to meet with him 'in an effort to discuss some way of disposing of this entire situation.'

In April 1967, plaintiff's attorney filed a Notice of Discontinuance in this action but only against defendants' attorney, Mr. Goldstein. Mr. Goldstein never informed defendants that the action was dismissed only against himself but contended that he told trial counsel, Mr. March, of March, Gillette, and Wyatt. Mr. March informed defendants (who have proceeded at all times in good faith believing that they were being actively defended against plaintiff's claim) that he understood that two discontinuances had been filed and that both cases had been discontinued. It must be noted also that plaintiff's attorney, who had served notices of deposition and interrogatories in this action, took no further steps with respect to these pretrial proceedings.

On May 29, 1967, a review calendar hearing was held before Judge Sugarman. It is not clear what notice, if any, defendants received of this hearing. It appears that they received none since they had not entered any formal appearance and had not filed any responsive pleading. In any event, all defendants failed to answer the review calendar call. Judge Sugarman advised plaintiff, who at that time appeared *pro se* in this action, that he was entitled to a default judgment and explained to him the steps he had to take to obtain entry of such judgment.

Plaintiff's attorney withdrew as counsel on November 20, 1967, and plaintiff, a layman, thereafter proceeded in this action as attorney *pro se*. Plaintiff, with the advice of the Clerk of the Court, prepared the papers for the default judgment. According to plaintiff's statement, the Clerk advised him that he was not legally bound to serve copies of the proposed default judgment on defendants since they had made no formal appearance in the action. The default judgment was entered on November 28, 1967, by Judge Mansfield, in accordance with the Rules of this Court, without prior notice to defendants or to defendants' attorneys. Plaintiff thereafter directed a notice of inquest and a copy of the default judgment to defendants at an address set forth in the complaint, 834 Sterling Place, Brooklyn, New York, which defendants had vacated in December, 1964, almost a year before the second action was commenced and about three and one half years prior to the date of the inquest. As a result, defendants did not learn of the default judgment until defendant Hans Lowey was served with a notice of inquest at his home in Mamaroneck in the last week in March, 1968, four months after the default judgment had been entered.

Rule 55(b)(2) of the Federal Rules of Civil Procedure provides that judgment by default may be entered by the court with the following proviso:

'If the party against whom judgment by default is sought has appeared in the action, he (or if appearing by representation, his representative) shall be served with written notice of the application for the judgment at least 3 days prior to the hearing on such application.

[1] The question here is whether defendants or their representative had appeared in the action and were, therefore, entitled to notice prior to the entry of the default judgment. The court holds that the contacts in this case between plaintiff's attorney and defendants' attorneys were sufficient to constitute an appearance in the action and defendants therefore were entitled to notice of the application for the default judgment prior to its entry.

45 F.R.D. 354, 180 U.S.P.Q. 783  
(Cite as: 45 F.R.D. 354)

The 1963 and 1965 actions are really one and the same. It is now clear from the papers on this reargument and the \*357 oral argument that plaintiff and defendant Lowey have had a running dispute for many years growing out of a joint venture or joint activity of some kind relating to a patent. Since plaintiff was unsuccessful in amending his complaint in the first action, he instituted a second action involving the same claim. Defendant Lowey, who is president of both of the defendant corporations and who had been a defendant in the 1956 action, had clearly made a formal appearance in the 1956 action in the state court and in the first action in this court. When the second action was filed against Lowey and the other defendants, it is clear that plaintiff knew that defendant Lowey and the other defendants were represented by the same counsel who appeared in the prior actions. Moreover, it is undisputed that plaintiff's attorney wrote defendants' attorney regarding settlement of the entire matter and served on them notices of taking depositions and interrogatories.

In *Hutton v. Fisher*, 359 F.2d 913 (3rd Cir. 1966), plaintiff's senior counsel had acquiesced in the request of defendants' counsel for more time to answer. Two months later plaintiff's junior counsel, ignorant of this acquiescence, obtained an order of default without notice to defendants' counsel. The court there held that defendants were entitled to have the default set aside almost three years later because of the improper procedure.

In *Dalminter, Inc. v. Jessie Edwards, Inc.*, 27 F.R.D. 491 (S.D.Tex., 1961), the court held that defendant's letter mailed to plaintiff's counsel in answer to a summons requiring defendant to serve upon plaintiff's counsel an answer constituted an appearance. In the instant case, the contact between attorneys involved far more than a letter. These contacts were sufficient to constitute an appearance within the meaning of Rule 55(b)(2).

[2] Where notice of a motion for a default judgment is required, but not given, such a judgment entered without notice must be vacated as a matter of law.

*Hutton v. Fisher*, supra; *Wilver v. Fisher*, 387 F.2d 66 (10th Cir. 1967); *Swallow v. United States*, 380 F.2d 710 (10th Cir. 1967); *Dalminter v. Jessie Edwards, Inc.*, supra. Accordingly, the default judgment herein is vacated, and defendants are given ten business days from the date of this opinion to file an answer to the complaint.

S.D.N.Y., 1968  
*Press v. Forest Laboratories, Inc.*  
45 F.R.D. 354, 180 U.S.P.Q. 783

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HERBERT C. RAY, Plaintiff and Appellant,  
 v.  
 ALAD CORPORATION, Defendant and Respondent  
 L.A. No. 30613.

Supreme Court of California  
 February 24, 1977.

## SUMMARY

Plaintiff brought a strict tort liability action for injury sustained in a fall from a defective ladder. The injury had occurred more than six months after defendant corporation had acquired the assets of the dissolved ladder manufacturer. After the acquisition, defendant had continued to manufacture the same line of products as its predecessor, utilizing the same personnel, designs, and customer lists, with no outward indication of the change in ownership. The trial court granted defendant's motion for summary judgment. (Superior Court of Los Angeles County, No. C967150, Robert M. Olson, Judge.)

On appeal by plaintiff, the Supreme Court reversed, holding that plaintiff's claim constituted a special exception to the general rule against imposition upon a successor corporation of its predecessor's liabilities. While noting that none of the traditional exceptions to the rule were applicable in this case, the court held that the primary policy underlying strict tort liability was to protect otherwise defenseless victims and to spread throughout society the cost of compensating them; therefore, in this situation, where plaintiff had no viable remedy against the manufacturer, and where defendant's opportunity to evaluate the risks of production and to pass on the cost of meeting those risks was almost identical to that of the original manufacturer, imposition of liability was justified. (Opinion by Wright, J., <sup>FN\*</sup> with Tobriner, Acting C. J., Mosk, Clark and Richardson, JJ., and Sullivan, J., <sup>FN†</sup> concurring.)

FN\* Retired Chief Justice of California sitting under assignment by the Acting Chairman of the Judicial Council.

FN† Retired Associate Justice of the Supreme Court sitting under assignment by the Chairman of the Judicial Council.

## HEADNOTES

Classified to California Digest of Official Reports

(1a, 1b) Products Liability § 37--Strict Liability in Tort--Liability of Successor Corporation.

In a strict tort liability action against a defendant that had purchased all of the assets of the manufacturer of the defective product which had caused plaintiff's injuries, plaintiff's claim constituted an exception to the general rule against imposition upon a successor corporation of its predecessor's liabilities, where plaintiff's injury occurred more than six months after the dissolution of the manufacturer corporation and thus plaintiff had essentially no remedy against that manufacturer or its previous insurer; where, furthermore, defendant had acquired all of the resources, including designs and personnel, of the manufacturer, and was thus in a position to insure against claims arising out of previous defects and to pass on to purchasers the cost of meeting those risks; and where defendant acquired the manufacturer's trade name, good will and customer lists, and continued to produce the same product line, holding itself out to potential customers as the same enterprise. (Disapproving anything to the contrary in *Ortiz v. South Bend Lathe* (1975) 46 Cal.App.3d 842 [120 Cal.Rptr. 556], or *Schwartz v. McGraw-Edison Co.* (1971) 14 Cal.App.3d 767 [92 Cal.Rptr. 776].)

[Products liability: Liability of successor corporation for injury or damage caused by product issued by predecessor, note, 66 A.L.R.3d 824. See also, Cal.Jur.2d, Rev., Sales, § 126; Am.Jur.2d, Products Liability, § 145.]

(2) Corporations § 8--Consolidation and Reincorporation--Assumption of Predecessor's Liability.

A corporation purchasing the principal assets of another corporation does not generally assume the seller's liabilities unless there is an express or implied agreement of assumption, the transaction amounts to a consolidation or merger of the two corporations, the purchasing corporation is a mere continuation of the seller, or the transfer of assets to the purchaser is for the fraudulent purpose of escaping liability for the seller's debts.

(3) Products Liability § 37--Strict Liability in Tort--Liability of Successor Corporation.

In a strict tort liability action against a defendant that had purchased all of the assets of the manufacturer of the defective product, the rule that the purchaser assumes the seller's liability in a situation where the sales transaction amounts to a consolidation or merger was inapplicable, where the sole consideration given for the assets was cash and where there was no contention that the consideration was inadequate.

(4) Corporations § 8--Consolidation and Reincorporation--Assumption of Predecessor's Liability.

The rule that a corporation acquiring the assets of another corporation is the other's mere continuation and is therefore liable for its debts is applicable only where no adequate consideration was given and made available for meeting the claims of unsecured creditors, or where one or more persons were officers, directors, or shareholders of both corporations.

#### COUNSEL

Silver & McWilliams, Lawrence Weitzer and Thomas G. Stolpman for Plaintiff and Appellant.

Robert E. Cartwright, Edward I. Pollock, Leroy Hersh, David B. Baum, Stephen I. Zetterberg, Robert G. Beloud, Ned Good, Arne Werchick, Sanford M. Gage, Roger H. Hedrick, Leonard Sacks and Joseph Posner as Amici Curiae on behalf of Plaintiff and Appellant.

Yusim, Cassidy, Stein, Hanger & Olson and Robert E. Levine for Defendant and Respondent.

Bell, Dunlavey & Rosenberg and James Dunlavey as Amici Curiae on behalf of Defendant and Respondent.

**WRIGHT, J.**<sup>FN\*</sup>

FN\* Retired Chief Justice of California sitting under assignment by the Acting Chairman of the Judicial Council.

Claiming damages for injury from a defective ladder, plaintiff asserts strict tort liability against defendant Alad Corporation (Alad II) which neither manufactured nor sold the ladder but prior to plaintiff's injury succeeded to the business of the ladder's manufacturer, the now dissolved "Alad Corporation" (Alad I), through a purchase of Alad I's assets for an adequate cash consideration. Upon acquiring Alad's plant, equipment, inventory, trade name, and good will, Alad II continued to manufacture the same line of ladders under the "Alad" name, using the same equipment, designs, and personnel, and soliciting Alad I's customers through the same sales representatives with no outward indication of any change in the ownership of the business. The trial court entered summary judgment for Alad II and plaintiff appeals.

(1a) Apart from tort liability for defective products, the hereinafter discussed rules of law applicable to Alad II's acquisition of this manufacturing business imposed no liability upon it for Alad I's obligations other than certain contractual liabilities that were expressly assumed. This insulation from its predecessor's liabilities of a corporation acquiring business assets has the undoubted advantage of promoting the free availability and transferability of capital. However, this advantage is outweighed under the narrow circumstances here presented by considerations favoring continued protection for injured users of defective products. As will be explained, these considerations include (1) the nonavailability

to plaintiff of any adequate remedy against Alad I as a result of Alad I's liquidation prior to plaintiff's injury, (2) the availability to Alad II of the knowledge necessary for gauging the risks of injury from previously manufactured ladders together with the opportunity to provide for meeting the cost arising from those risks by spreading it among current purchasers of the product line and (3) the fact that the good will transferred to and enjoyed by Alad II could not have been enjoyed by Alad I without the burden of liability for defects in ladders sold under its aegis. Accordingly we have concluded that the instant claim of strict tort liability presents an exception to the general rule against imposition upon a successor corporation of its predecessor's liabilities and that the summary judgment should be reversed.

Plaintiff alleges in his complaint that on March 24, 1969, he fell from a defective ladder in the laundry room of the University of California at Los Angeles while working for the contracting company by which he was employed. The complaint was served on Alad II as a "Doe" defendant alleged to have manufactured the ladder. (See Code Civ. Proc., § 474.)<sup>FN1</sup> The Regents of the University of California (Regents) were named and served as a defendant on the basis of their ownership and control not only of the laundry room but of the ladder itself.\*26

FN1 The complaint also named Howard Manufacturing Company as manufacturer of the ladder, but plaintiff apparently had that company dismissed as a defendant before serving Alad II.

In granting summary judgment to Alad II,<sup>FN2</sup> the trial court considered not only the supporting and opposing declarations of witnesses with attached exhibits but also excerpts from depositions and answers to interrogatories. (See Code Civ. Proc., § 437c.) It is undisputed that the ladder involved in the accident was not made by Alad II and there was testimony that the ladder was an "old" model manufactured by Alad I. Hence the principal issue ad-

ressed by the parties' submissions on the motion for summary judgment was the presence or absence of any factual basis for imposing any liability of Alad I as manufacturer of the ladder upon Alad II as successor to Alad I's manufacturing business.

FN2 Alad II was granted separate summary judgments against plaintiff and against the Regents on their cross-complaint. Although only plaintiff has appealed, Alad II and the Regents have stipulated that the summary judgment against the Regents will stand or fall in accordance with the disposition of the summary judgment against plaintiff.

Prior to the sale of its principal business assets, Alad I was in "the specialty ladder business" and was known among commercial and industrial users of ladders as a "top quality manufacturer" of that product. On July 1, 1968, Alad I sold to Lighting Maintenance Corporation (Lighting) its "stock in trade, fixtures, equipment, trade name, inventory and goodwill" and its interest in the real property used for its manufacturing activities. The sale did not include Alad I's cash, receivables, unexpired insurance, or prepaid expenses. As part of the sale transaction Alad I agreed "to dissolve its corporate existence as soon as practical and [to] assist and cooperate with Lighting in the organization of a new corporation to be formed by Lighting under the name 'Alad Corporation.'" Concurrently with the sale the principal stockholders of Alad I, Mr. and Mrs. William S. Hambly, agreed for a separate consideration not to compete with the purchased business for 42 months and to render nonexclusive consulting services during that period. By separate agreement Mr. Hambly was employed as a salaried consultant for the initial five months. There was ultimately paid to Alad I and the Hamblys "total cash consideration in excess of \$207,000.00 plus interest for the assets and goodwill of ALAD [I]."

The only provisions in the sale agreement for any assumption of Alad I's liabilities by Lighting were that Lighting would (1) accept and pay for materi-

als previously ordered by Alad I in the regular course of its business and (2) fill uncompleted orders taken by Alad I in the regular course of its business and hold Alad I harmless from any damages or liability resulting from failure to do so. The possibility of Lighting's or\*27 Alad II's being held liable for defects in products manufactured or sold by Alad I was not specifically discussed nor was any provision expressly made therefor.

On July 2, 1968, the day after acquiring Alad I's assets, Lighting filed and thereafter published a certificate of transacting business under the fictitious name of "Alad Co." (See former Civ. Code, § 2466.) Meanwhile Lighting's representatives had formed a new corporation under the name of "Stern Ladder Company." On August 30, 1968, there was filed with the Secretary of State (1) a certificate of winding up and dissolution of "Alad Corporation" (Alad I) and (2) a certificate of amendment to the articles of Stern Ladder Company changing its name to "Alad Corporation" (Alad II). The dissolution certificate declared that Alad I "has been completely wound up ... [its] known debts and liabilities have been actually paid ... [and its] known assets have been distributed to the shareholders." (See Corp. Code, former § 5200, now § 1905, subd. (a).) In due course Lighting transferred all the assets it had purchased from Alad I to Alad II in exchange for all of Alad II's outstanding stock.<sup>FN3</sup>

FN3 No contention is made that this transfer of the purchased assets to Alad II, contemplated as part of the overall purchase transaction, did not burden Alad II with whatever liabilities for Alad I's defective products Lighting had assumed by acquiring and operating the "Alad" business. (Cf. *Gordon v. Aztec Brewing Co.* (1949) 33 Cal.2d 514, 521-523 [203 P.2d 522].)

The tangible assets acquired by Lighting included Alad I's manufacturing plant, machinery, offices, office fixtures and equipment, and inventory of raw materials, semi-finished goods, and finished goods. These assets were used to continue the manufactur-

ing operations without interruption except for the closing of the plant for about a week "for inventory." The factory personnel remained the same, and identical "extrusion plans" were used for producing the aluminum components of the ladders. The employee of Lighting designated as the enterprise's general manager as well as the other previous employees of Lighting were all without experience in the manufacture of ladders. The former general manager of Alad I, Mr. Hambly, remained with the business as a paid consultant for about six months after the takeover.

The "Alad" name was used for all ladders produced after the change of management. Besides the name, Lighting and Alad II acquired Alad I's lists of customers, whom they solicited, and continued to employ the salesman and manufacturer's representatives who had sold ladders for\*28 Alad I. Aside from a redesign of the logo, or corporate emblem, on the letterheads and labels, there was no indication on any of the printed materials to indicate that a new company was manufacturing Alad ladders, and the manufacturer's representatives were not instructed to notify customers of the change.

(2) Our discussion of the law starts with the rule ordinarily applied to the determination of whether a corporation purchasing the principal assets of another corporation assumes the other's liabilities. As typically formulated the rule states that the purchaser does not assume the seller's liabilities unless (1) there is an express or implied agreement of assumption, (2) the transaction amounts to a consolidation or merger of the two corporations, (3) the purchasing corporation is a mere continuation of the seller, or (4) the transfer of assets to the purchaser is for the fraudulent purpose of escaping liability for the seller's debts. (See *Ortiz v. South Bend Lathe* (1975) 46 Cal.App.3d 842, 846 [120 Cal.Rptr. 556]; *Schwartz v. McGraw-Edison Co.* (1971) 14 Cal.App.3d 767, 780-781 [92 Cal.Rptr. 776]; *Pierce v. Riverside Mtg. Securities Co.* (1938) 25 Cal.App.2d 248, 255 [77 P.2d 226]; *Golden State Bottling Co. v. NLRB* (1973) 414 U.S.

168, 182 fn. 5 [38 L.Ed.2d 388, 402, 94 S.Ct. 414]; *Kloberdanz v. Joy Manufacturing Company* (D.Colo. 1968) 288 F.Supp. 817, 820 (applying California law); 15 Fletcher, *Cyclopedia Corporations*, § 7122.)

If this rule were determinative of Alad II's liability to plaintiff it would require us to affirm the summary judgment. None of the rule's four stated grounds for imposing liability on the purchasing corporation is present here. There was no express or implied agreement to assume liability for injury from defective products previously manufactured by Alad I. Nor is there any indication or contention that the transaction was prompted by any fraudulent purpose of escaping liability for Alad I's debts.

(3) With respect to the second stated ground for liability, the purchase of Alad I's assets did not amount to a consolidation or merger. This exception has been invoked where one corporation takes all of another's assets without providing any consideration that could be made available to meet claims of the other's creditors (*Malone v. Red Top Cab Co.* (1936) 16 Cal.App.2d 268, 272-274 [60 P.2d 543]) or where the consideration consists wholly of shares of the purchaser's stock which are promptly distributed to the seller's shareholders in conjunction with the seller's liquidation (*Shannon v. Samuel Langston Company* (W.D.Mich.\*29 1974) 379 F.Supp. 797, 801). In the present case the sole consideration given for Alad I's assets was cash in excess of \$207,000. Of this amount Alad I was paid \$70,000 when the assets were transferred and at the same time a promissory note was given to Alad I for almost \$114,000. Shortly before the dissolution of Alad I the note was assigned to the Hamblys, Alad I's principal stockholders, and thereafter the note was paid in full. The remainder of the consideration went for closing expenses or was paid to the Hamblys for consulting services and their agreement not to compete. There is no contention that this consideration was inadequate or that the cash and promissory note given to Alad I were not included in the assets available to meet claims of

Alad I's creditors at the time of dissolution. Hence the acquisition of Alad I's assets was not in the nature of a merger or consolidation for purposes of the aforesaid rule.

(4) Plaintiff contends that the rule's third stated ground for liability makes Alad II liable as a mere continuation of Alad I in view of Alad II's acquisition of all Alad I's operating assets, its use of those assets and of Alad I's former employees to manufacture the same line of products, and its holding itself out to customers and the public as a continuation of the same enterprise. However, California decisions holding that a corporation acquiring the assets of another corporation is the latter's mere continuation and therefore liable for its debts have imposed such liability only upon a showing of one or both of the following factual elements: (1) no adequate consideration was given for the predecessor corporation's assets and made available for meeting the claims of its unsecured creditors; (2) one or more persons were officers, directors, or stockholders of both corporations. (See *Stanford Hotel Co. v. M. Schwind Co.* (1919) 180 Cal. 348, 354 [181 P. 780]; *Higgins v. Cal. Petroleum etc. Co.* (1898) 122 Cal. 373 [55 P. 155]; *Economy Refining & Service Co. v. Royal Nat. Bank of New York* (1971) 20 Cal.App.3d 434 [97 Cal.Rptr. 706, 49 A.L.R.3d 872]; *Blank v. Olcovich Shoe Corp.* (1937) 20 Cal.App.2d 456 [67 P.2d 376]; cf. *Malone v. Red Top Cab Co.*, *supra*, 16 Cal.App.2d 268.) There is no showing of either of these elements in the present case.

Plaintiff relies on *Cyr v. B. Offen & Co., Inc.* (1st Cir. 1974) 501 F.2d 1145, 1152, where tort liability for injury from a defective product manufactured by an enterprise whose assets a corporation had acquired for adequate consideration in an arm's-length transaction was imposed on the corporation as a mere continuation of the enterprise.<sup>FN4</sup> We\*30 hereafter refer to the *Cyr* case as helpful authority on the separate issue of what if any *special* rule should be applicable to a successor corporation's tort liability for its predecessor's defective products.

We disagree, however, with any implication in *Cyr* or contention by plaintiff that the settled rule governing a corporation's succession to its predecessor's liabilities *generally* should be modified so as to require such succession merely because of the factors of continuity present in *Cyr* and in the instant case.

FN4 The assets were acquired not from a corporation but from the estate of a decedent who had operated the business as a sole proprietorship. (See 501 F.2d at p. 1151.)

We therefore conclude that the general rule governing succession to liabilities does not require Alad II to respond to plaintiff's claim. (1b) In considering whether a special departure from that rule is called for by the policies underlying strict tort liability for defective products, we note the approach taken by the United States Supreme Court in determining whether an employer acquiring and continuing to operate a going business succeeds to the prior operator's obligations to employees and their bargaining representatives imposed by federal labor law. Although giving substantial weight to the general rules of state law making succession to the liabilities of an acquired going business dependent on the form and circumstances of the acquisition, the court refuses to be bound by these rules where their application would unduly thwart the public policies underlying the applicable labor law. (See *Howard Johnson Co. v. Hotel Employees* (1974) 417 U.S. 249, 257 [41 L.Ed.2d 46, 53-54, 94 S.Ct. 2236]; *Golden State Bottling Co. v. NLRB*, *supra*, 414 U.S. 168, 182 fn. 5.) Similarly we must decide whether the policies underlying strict tort liability for defective products call for a special exception to the rule that would otherwise insulate the present defendant from plaintiff's claim. (See *Turner v. Bituminous Cas. Co.* (1976) 397 Mich. 406 [244 N.W.2d 873, 877-878]; Note, *Assumption of Products Liability in Corporate Acquisitions* (1975) 55 B.U.L. Rev. 86, 107.)

The 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." (*Greenman v. Yuba Power Products, Inc.* (1963) 59 Cal.2d 57, 63 [27 Cal.Rptr. 697, 377 P.2d 897, 13 A.L.R.3d 1049].) However, the rule "does not rest on the analysis of the financial strength or bargaining power of the parties to the particular action. It rests, rather, on the proposition that 'The cost of an injury and the loss of time or health may be an overwhelming misfortune\*31 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.' ( *Escola v. Coca Cola Bottling Co.*, 24 Cal.2d 453, 462 [150 P.2d 436] [concurring opinion].)" (*Seely v. White Motor Co.* (1965) 63 Cal.2d 9, 18-19 [45 Cal.Rptr. 17, 403 P.2d 145].) Thus, "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." (Italics added.) (*Price v. Shell Oil Co.* (1970) 2 Cal.3d 245, 251 [85 Cal.Rptr. 178, 466 P.2d 722].) 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. We turn to a consideration of each of these aspects in the context of the present case.

We must assume for purposes of the present proceeding that plaintiff was injured as a result of defects in a ladder manufactured by Alad I and therefore could assert strict tort liability against Alad I under the rule of *Greenman v. Yuba Power*

*Products, Inc.*, *supra*, 59 Cal.2d 57. However, the practical value of this right of recovery against the original manufacturer was vitiated by the purchase of Alad I's tangible assets, trade name and good will on behalf of Alad II (see fn. 3, *ante*) and the dissolution of Alad I within two months thereafter in accordance with the purchase agreement. The injury giving rise to plaintiff's claim against Alad I did not occur until more than six months after the filing of the dissolution certificate declaring that Alad I's "known debts and liabilities have been actually paid" and its "known assets have been distributed to its shareholders." This distribution of assets was perfectly proper as there was no requirement that provision be made for claims such as plaintiff's that had not yet come into existence.<sup>FN5</sup> Thus, even if plaintiff could obtain\*32 a judgment on his claim against the dissolved and assetless Alad I (see Corp. Code, former § 5400, now § 2010, subd. (a)) he would face formidable and probably insuperable obstacles in attempting to obtain satisfaction of the judgment from former stockholders or directors. (See *Hoover v. Galbraith* (1972) 7 Cal.3d 519 [120 Cal.Rptr. 733, 498 P.2d 981]; *Trubowitch v. Riverbank Canning Co.* (1947) 30 Cal.2d 335, 345 [182 P.2d 182]; *Zinn v. Bright* (1970) 9 Cal.App.3d 188 [87 Cal.Rptr. 736]; Henn & Alexander, *Effect of Corporate Dissolution on Products Liability Claims* (1971) 56 Cornell L.Rev. 865; Wallach, *Products Liability: A Remedy in Search of a Defendant - The Effect of a Sale of Assets and Subsequent Dissolution on Product Dissatisfaction Claims* (1976) 41 Mo.L.Rev. 321; cf. Corp. Code, § 2009 (eff. Jan. 1, 1977).)

FN5 Former section 5000 of the Corporations Code, which was then in effect and has since been replaced by section 2004, provided:

"After determining that all the *known debts and liabilities* of a corporation in the process of winding up have been paid or adequately provided for, the directors shall distribute all the remaining corporate as-

sets among the shareholders and owners of shares according to their respective rights and preferences. If the winding up is by court proceeding or subject to court supervision, the distribution shall not be made until after the expiration of any period for the presentation of claims which has been prescribed by order of court." (Italics added.)

In a liquidation proceeding subject to court supervision "the amount of any unmatured, contingent, or disputed claim against the corporation which has been presented and has not been disallowed" must be "paid into court" and suit on rejected claims must be commenced within 30 days after notice of rejection. (Corp. Code, former § 4608, now § 1807.) No provision need be made for the satisfaction of claims that may arise in the future on account of defective products the corporation has manufactured in the past.

The record does not disclose whether Alad I had insurance against liability on plaintiff's claim. Although such coverage is not inconceivable (see *Kelley v. Indemnity Ins. Co. of North America* (1937) 252 App.Div. 58 [297 N.Y.S. 228], *affd.*, 276 N.Y. 606 [12 N.E.2d 599] (coverage afforded by policy rider)) products liability insurance is usually limited to accidents or occurrences taking place while the policy is in effect. (See *Protex-A-Kar Co. v. Hartford Acc. etc. Co.* (1951) 102 Cal.App.2d 408 [227 P.2d 509]; *Bouton v. Litton Industries, Inc.* (3d Cir. 1970) 423 F.2d 643, 645-646; 11 Couch, *Cyclopedia of Insurance Law* (2d ed. 1963) § 44:385 (including cases cited in 1975-1976 cum. supp.)) Thus the products liability insurance of a company that has gone out of business is not a likely source of compensation for injury from a product the company previously manufactured.

These barriers to plaintiff's obtaining redress from the dissolved Alad I set him and similarly situated victims of defective products apart from persons

entitled to recovery against a dissolved corporation on claims that were capable of being known at the time of its dissolution. Application to such victims of the general rule that immunizes Alad I's successor from the general run of its debts would create a far greater likelihood of complete denial of redress for a legitimate claim than\*33 would the rule's application to most other types of claimants. Although the resulting hardship would be alleviated for those injured plaintiffs in a position to assert their claims against an active and solvent retail dealer who sold the defective product by which they were injured, the retailer would in turn be cut off from the benefit of rights against the manufacturer. (See *Vandermark v. Ford Motor Co.* (1964) 61 Cal.2d 256, 262-263 [37 Cal.Rptr. 896, 391 P.2d 168]; *Escola v. Coca Cola Bottling Co.* (1944) 24 Cal.2d 453, 464 [150 P.2d 436] (conc. opn.)<sup>FN6</sup>)

FN6 In contrast to the present case in which the injury occurred after the liquidation and dissolution of the manufacturer is the situation found in *Schwartz v. McGraw-Edison Co.*, *supra*, 14 Cal.App.3d 767. There the minor plaintiff's injuries occurred two years and ten months *before* the manufacturer's sale of its trade name and operating assets for cash. In connection with the sale the manufacturer gave its successor a 10-year lease of the real property on which the manufacturing business was conducted. Thus the *Schwartz* plaintiff's claim could have been asserted against the original manufacturer as a going concern for a substantial period following the injury, and even after the manufacturer had sold its operating assets the possibility of recovery against it was given practical value by its continued corporate existence and its retention of substantial assets. (See 14 Cal.App.3d at pp. 776-781.)

While depriving plaintiff of redress against the ladder's manufacturer, Alad I, the transaction by which Alad II acquired Alad I's name and operating assets

had the further effect of transferring to Alad II the resources that had previously been available to Alad I for meeting its responsibilities to persons injured by defects in ladders it had produced. These resources included not only the physical plant, the manufacturing equipment, and the inventories of raw material, work in process, and finished goods, but also the know-how available through the records of manufacturing designs, the continued employment of the factory personnel, and the consulting services of Alad I's general manager. With these facilities and sources of information, Alad II had virtually the same capacity as Alad I to estimate the risks of claims for injuries from defects in previously manufactured ladders for purposes of obtaining insurance coverage or planning self-insurance. (See *Cyr v. B. Offen & Co., Inc.*, *supra*, 501 F.2d 1145, 1154.) Moreover, the acquisition of the Alad enterprise gave Alad II the opportunity formerly enjoyed by Alad I of passing on to purchasers of new "Alad" products the costs of meeting these risks. Immediately after the takeover it was Alad II, not Alad I, which was in a position to promote the "paramount policy" of the strict products liability rule by "spreading throughout society ... the cost of compensating [otherwise defenseless victims of manufacturing defects]" (*Price v. Shell Oil Co.*, *supra*, 2 Cal.3d 245, 251). (See *Knapp v. North American Rockwell Corp.* (3d Cir. 1974) 506 F.2d 361, 372-373 (conc. opn.).)\*34

Finally, the imposition upon Alad II of liability for injuries from Alad I's defective products is fair and equitable in view of Alad II's acquisition of Alad I's trade name, good will, and customer lists, its continuing to produce the same line of ladders, and its holding itself out to potential customers as the same enterprise. This deliberate albeit legitimate exploitation of Alad I's established reputation as a going concern manufacturing a specific product line gave Alad II a substantial benefit which its predecessor could not have enjoyed without the burden of potential liability for injuries from previously manufactured units. Imposing this liability upon successor manufacturers in the position of Alad II not

only causes the one “who takes the benefit [to] bear the burden” (Civ. Code, § 3521) 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. (See *Turner v. Bituminous Cas. Co.*, *supra*, 397 Mich. 406; *Cyr v. B. Offen & Co., Inc.*, *supra*, 501 F.2d 1145, 1154; *Shannon v. Samuel Langston Company*, *supra*, 379 F.Supp. 797, 802; Note, *Expanding the Products Liability of Successor Corporations* (1976) 27 *Hastings L.J.* 1305.) By taking over and continuing the established business of producing and distributing Alad ladders, Alad II became “an integral part of the overall producing and marketing enterprise that should bear the cost of injuries resulting from defective products” (*Vandermark v. Ford Motor Co.*, *supra*, 61 Cal.2d 256, 262).

We therefore conclude that a party which acquires a manufacturing business and continues the output of its line of products under the circumstances here presented 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. Anything to the contrary in *Ortiz v. South Bend Lathe*, *supra*, 46 Cal.App.3d 842, or *Schwartz v. McGraw-Edison Co.*, *supra*, 14 Cal.App.3d 767 (see fn. 6, *ante*) is disapproved.

The judgment is reversed.

Tobriner, Acting C. J., Mosk, J., Clark, J., Richardson, J., and Sullivan, J.,<sup>FN†</sup> concurred.

FN† Retired Associate Justice of the Supreme Court sitting under assignment by the Chairman of the Judicial Council.

Respondent's petition for a rehearing was denied March 31, 1977.

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Ray v. Alad Corp.  
19 Cal.3d 22, 560 P.2d 3, 136 Cal.Rptr. 574

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