Life After Death: Corporate Dissolution and the Continuing Corporate and Shareholder Liability Doctrine in California

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LIFE AFTER DEATH: CORPORATE DISSOLUTION AND THE CONTINUING CORPORATE AND SHAREHOLDER LIABILITY DOCTRINE IN CALIFORNIA

I. INTRODUCTION

A. The Doctrine

The doctrine of continuing corporate and shareholder liability after dissolution has recently undergone a major evolution in California resulting in severe inequities for large classes of potential claims. Presently, dissolved corporations can be sued after dissolution regardless of whether the claims arise before or after the date of dissolution. Furthermore, the shareholders of dissolved corporations can be sued to the extent of the assets distributed to them upon dissolution, as long as suit is filed not later than four years after the date of dissolution. This doctrine is inequitable because it prevents recov-

1. Under the current law, claims arising against corporations dissolved before January 1, 1992, are limited to those foreseeable claims provided for at dissolution. Pacific Scene, Inc. v. Penasquitos, Inc., 758 P.2d 1182, 1187 (Cal. 1988). Claims arising against corporations after dissolution can be brought against the dissolved corporation, but there is little chance for recovery. Penasquitos, Inc. v. Superior Court, 812 P.2d 154, 159 (Cal. 1991). This state of the law effectively eliminates recoveries in cases where the claims do not arise until after the corporation has dissolved.

A recent revision to the California Corporations Code attempted to alleviate this inequity for claims arising against corporations dissolved on or after January 1, 1992. The revised statute provides that shareholders can be sued on claims arising after corporate dissolution to the extent of the corporate assets distributed to them upon dissolution. CAL. CORP. CODE § 201(a)(1)(B) (West Supp. 1992). However, this law limits recovery to claims likely to arise within a four year period of time. Id. § 2011(a)(2)(B). Thus, the current law continues to eliminate recovery on construction, pharmaceutical cases, and all other claims not likely to arise for a long period of time. See discussion infra part IV.B.1.a. Indeed, the four year provision provides for a better chance of recovery, but claims arising against corporations dissolved on or after January 1, 1992, that are not likely to arise in a four year period of time continue to be prevented from making any recovery beyond those assets retained by the corporation after dissolution. See discussion infra part IV.A.2.

2. Penasquitos, 812 P.2d at 160.

ery on any claims arising later than four years after the date of dissolution.⁴

Although the doctrine permits a greater number of claims to be made today than in prior years,⁵ the current state of the law results in inadequate protection of potential claimants and should be recognized as an inappropriate public policy. As the law now exists, California corporations operating businesses with a high degree of risk of harm to the public are permitted to operate for limited periods of time, distribute their profits, and later dissolve and reincorporate the same basic business enterprise without being held accountable for damages incurred by the original corporation.⁶ As the result of legal planning through incorporating, operating, and then ultimately dissolving, potential claimants may be left with no recourse for serious harms caused by corporate activities, while the shareholders escape liability without relinquishing their profits. The current state of the law results in severe inequities which are developed in this comment.⁷

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⁴ This section of the California Corporations Code in October 1991 to include claims against shareholders. See discussion infra part II.D. It is effective only against shareholders of corporations dissolved after January 1, 1992. Claims against corporations dissolved prior to January 1, 1992, are governed by the California Supreme Court's decision in Pacific Scene, Inc. v. Penasquitos, Inc., 758 P.2d 1182 (Cal. 1988) which held that shareholders cannot be sued on claims arising after dissolution. See discussion infra part II.B.2. and accompanying notes.

⁵ Under the common law, dissolved corporations were not permitted to be sued at all after dissolution. See infra part II.B.1 and accompanying notes for a discussion of the common law treatment of continuing corporate liability after dissolution. The 1988 California Supreme Court decision in Pacific Scene abolished this common law notion and held that corporations could be sued after dissolution to the extent of their undistributed assets. Pacific Scene, 758 P.2d at 1188. The 1991 statutory revision of California Corporations Code § 2011 then overruled Pacific Scene, extending liability to shareholders of dissolved corporations, thereby increasing the number of potential defendants that could be held liable for claims arising after dissolution. Cal. Corp. Code § 2011(a)(1)(B) (West Supp. 1992). See infra part II.B. for a complete discussion of the aforementioned cases and a detailed description of the California Legislature's intent in revising the code.

⁶ This is not a hypothetical situation, but one that was brought to life in the California Supreme Court decision that prompted revision of the California Corporations Code. In Pacific Scene, claimants could recover against the corporation and its shareholders so long as the claim arose prior to dissolution. Pacific Scene, 758 P.2d at 1188. If a claim arose after dissolution, only the corporation could be sued. Penasquitos, Inc. v. Superior Court, 812 P.2d 154, 160 (Cal. 1991). The legislature amended § 2011 of the California Corporations Code to overrule the Pacific Scene decision, thereby extending liability to shareholders for a period of up to four years after the date of dissolution. Cal. Corp. Code § 2011(a)(2)(A)-(B) (West Supp. 1992). See infra part II.B. for a complete discussion of the aforementioned cases and a detailed description of the California Legislature's intent in revising the code.

⁷ See infra part IV.
B. Recent California Supreme Court Decisions

Within the past four years, the California Supreme Court decided two major cases on the issue of continuing liability after corporate dissolution. In Pacific Scene, Inc. v. Penasquitos, Inc., the court presented its interpretation of California Corporations Code section 2011, holding that corporate dissolution shields the shareholders from claims arising as a result of the dissolved corporation's business activities. In Penasquitos, Inc. v. Superior Court, the court explained that causes of action survive dissolution, to the extent of a corporation's undistributed assets. Penasquitos established the novel concept of the "retirement" of a corporation upon dissolution, rather than its "death." Under this doctrine, a corporation continues to exist after dissolution for the purpose of winding up its affairs, including the defense of lawsuits and the payment of any claims made against it. These cases left unresolved the issue of compensation for innocent customers of dissolved corporations where the corporate assets have been fully distributed prior to the discovery of their claims. Subsequent to these decisions, the legislature attempted to rectify the situation by amending the California Corporations Code § 2010 which provides:

A corporation which is dissolved nevertheless continues to exist for the purpose of winding up its affairs, prosecuting and defending actions by or against it and enabling it to collect and discharge obligations, dispose of and convey its property and collect and divide its assets, but not for the purpose of continuing business except so far as necessary for the winding up thereof.

CAL. CORP. CODE § 2010(a) (West 1992). The court's interpretation of this statute supports its decision that corporations continue in existence after dissolution. The court explained:

At common law, dissolution extinguished the corporation's existence; this corporate "death" explained why the corporation could not be sued and why any judgment taken against it was void. Not only would it be unfair to sue an entity that was incapable of defending itself, it would also be senseless to render judgment against an entity that had become nonexistent. The modern survival statutes render these rationales inapplicable. It would be incongruous to allow a corporation that exists for purposes of defending actions and discharging obligations to defend a lawsuit on the basis that it did not exist.


15. In Penasquitos, the California Supreme Court recognized that suing corporations after dissolution and distribution of assets is generally a fruitless endeavor. Id. at 161; see discussion infra part IV.A.2.
tions Code with provisions intended to provide for a more equitable result.\textsuperscript{16}

C. Senate Bill No. 1188

The response of the California State Legislature was a modification of the provisions of Corporations Code section 2011.\textsuperscript{17} Senate Bill 1188 (hereinafter S.B. 1188)\textsuperscript{18} retained the Penasquitos rule that causes of action continue to be viable against a dissolved corporation, whether arising before or after dissolution of the corporation.\textsuperscript{19} The revised statutory scheme provides that actions may be enforced against the dissolved corporation to the extent of its undistributed assets.\textsuperscript{20} However, the new law also provides for the recovery of any assets which have been distributed on dissolution to the shareholders, but only to the extent of their pro rata share\textsuperscript{21} of the distributed assets.\textsuperscript{22} This new rule limits suits against the shareholders to a period of time not exceeding the earlier of four years or the expiration of the statute of limitations for the particular cause of action,\textsuperscript{23} while the corporation itself \textsuperscript{24} may be sued indefinitely.\textsuperscript{25}

\textsuperscript{16} In an attempt to provide some form of recovery for claimants, the California Legislature developed Senate Bill No. 1188. S.B. No. 1188 was developed to amend § 2011 of the Corporations Code, relating to shareholder liability after the dissolution of a corporation. S.B. No. 1188, amending Cal. Corp. Code § 2011(a)(1) (West 1991). See infra note 27.

\textsuperscript{17} S.B. 1188 was approved by the Governor of California on October 5, 1991, and filed with the Secretary of State on October 7, 1991. LEGISLATIVE COUNSEL OF CALIFORNIA, LEGISLATIVE COUNSEL'S DIGEST at 2302 (1991). This bill amended California Corporations Code § 2011(a) and is effective for claims arising against corporations dissolved on or after January 1, 1992. CAL. CORP. CODE § 2011(a)(4) (West Supp. 1992).

\textsuperscript{18} Supra note 17.


\textsuperscript{20} Id.

\textsuperscript{21} The amended statute does not distinguish among the different types of shareholders of corporations (for example, those shareholders holding common as opposed to preferred stock). Id. § 2011(a)(1)(B).

\textsuperscript{22} Id.

\textsuperscript{23} Id. § 2011(a)(2)(A)-(B).

\textsuperscript{24} This comment addresses only voluntary dissolutions that do not involve any fraud or legally inappropriate corporate activities. In such cases, the corporation's officers and board of directors have not committed any illegal acts. Because the amended portion of the statute does not include such aforementioned individuals, they are not affected by it. The legislature intended S.B. 1188 to amend existing law with regard to shareholders and was not intended to affect other individuals associated with the corporation.

\textsuperscript{25} In a letter from the author of S.B. 1188, California Senator Ed Davis, to Rick Rollens, Secretary of the Senate, the Senator explained: "S.B. 1188 is not intended to affect any existing provision of law imposing personal liability upon officers, major stockholders, or other persons having charge of the affairs of a corporation." Letter from Ed Davis, California State Senator, to Rick Rollens, Secretary of the Senate, State of California (Aug. 30, 1991) (on file with the
Indeed, the revised version of the code generally expands a claimant’s potential for recovery by increasing the number of defendants. However, the statute as it now stands fails to provide a solution for serious claims that may arise more than four years after dissolution.26

D. Problems With the Current State of the Law

Presently, the revised statute does not fully resolve the potentially inequitable results of corporate dissolution. By amending section 2011, the legislature attempted to correct the problem created by the California Supreme Court’s recent interpretation of the Corporations Code.27 While the revised statute has broadened the types of recovery against dissolved corporations, large classes of claimants are still left with no remedy. For example, many causes of action are not discovered within the four year time period28 and, as a result, these claims are eliminated before the statute of limitations has even started to run.29

Moreover, the statute has even eliminated a significant number of formerly recoverable claims. Prior to the statutory amendment, claimants whose claims are now cut off could recover against the shareholders of a dissolved corporation under the equitable trust fund theory.30 This theory provided for recovery against the share-
holders for claims which arose before the dissolution but only to the extent of the assets distributed to each shareholder. No time limit was imposed on these suits so long as the claim arose prior to dissolution. Presently, where a corporation anticipates unasserted claims, the law requires that it set aside assets to meet such claims. In contrast, claimants could still have recovered distributed assets from the shareholders under the equitable trust fund theory prior to the effective date of S.B. 1188, regardless of whether the corporation had anticipated such claims. Since the enactment of the statutory revision, claimants' recoveries of assets actually distributed to shareholders must be filed within four years after dissolution. As a result, all claims not filed within four years after dissolution are now unrecoverable.

The newly revised statute also shields the corporation itself from claims which are unknown to the officers of the corporation at dissolution even though they may be anticipated. The revision of Corporations Code section 2011 results in a rule which only requires corporations to set aside funds on dissolution to meet claims which are expected to be filed within four years after dissolution. In some cases, this set-aside is substantially less than prior to the revision of the statute. Consider, for example, the claims likely to arise in construction defect cases. In these instances, a real estate company in the business of developing lots for the building of residential homes may know that twenty of the houses in a subdivision are subsiding only very slightly. The corporation may also know that all twenty homes will be completely destroyed when a severe storm (for example, a storm so severe that the occurrence of it is not likely more than every twenty years or so) hits the area. If a storm of this magnitude occurred twelve years ago, then the corporation can empirically calculate the amount of corporate funds to set aside to meet all such claims which are expected to be filed within four years after dissolution. Under the old rule, funds would have to be retained to repair

32. Id. In its discussion of § 2011 of the California Corporations Code, the court recognized that as long as claims arise prior to dissolution, there are no restrictions on how long suit can be brought. Id. at 1184.
33. CAL. CORP. CODE § 2010(a) (West 1992).
34. Pacific Scene, 758 P.2d at 1183.
36. Id.
37. Id.
38. Although the legislature intended to provide a more equitable result, the revised statute fails to provide a remedy for large classes of claims. See infra notes 104 and 148 for
all twenty subsiding houses in full.\textsuperscript{39} Under the new rule, actuarial calculations may result in insufficient funds being retained for the repair of a single home.\textsuperscript{40} Unfortunately, the owners of any homes destroyed after the retained funds have been disbursed are prevented from recovery since the corporation has only set aside a limited amount of funds.

A final shortcoming of the revised statute is the limitation of recovery against shareholders solely to those assets distributed upon dissolution.\textsuperscript{41} Corporations could cunningly plan their liquidations so as to eliminate major distributions upon dissolution by declaring dividends to the extent legally possible immediately prior to the dissolution.\textsuperscript{42} Such careful planning could further deny legitimate claimants the recovery contemplated by the statute because the assets distributed upon dissolution would be reduced pro tanto. In light of the inequitable situations presented herein, this comment addresses the following question: Should shareholders be allowed to avoid serious tort, products liability, and other claims, by dissolving the corporate form, and thereafter reincorporating or transferring the corporate assets to other business enterprises?

E. Scope of this Comment

This comment inquires into the scope of the continuing corporate liability doctrine after dissolution and the newly revised corporate dissolution statute in California.\textsuperscript{43} Further, this comment discusses relevant statutes and historical case law development, and

\textsuperscript{39} Since this law applies to claims arising on or after January 1, 1992, inventive financial planners will be able to exercise this option inappropriately. For example, a corporation deciding to dissolve could declare a large dividend payment to its shareholders right before dissolution. Upon dissolution, consequently, there would be little left in the way of cash assets to distribute to the shareholders and therefore little for claimants to recover, since the statute as it now stands precludes recovery in excess of the amounts distributed to the shareholders upon dissolution. \textit{Cal. Corp. Code} \textsection{2011(a)(1)(B)} (West Supp. 1992). The inequitable results of this possibility, however, could lie dormant for years until claims against the dissolved corporation arise, at which point, all proceeds from dissolution have been reinvested or spent and recovery on such claims becomes a virtual impossibility. See discussion \textit{infra} part IV.B.2-3, for a discussion of the balancing of shareholders’ rights to reinvest the proceeds of the assets distributed to them upon dissolution.

\textsuperscript{40} See discussion \textit{infra} part IV.B.1.c.


\textsuperscript{42} See discussion \textit{infra} part IV.B.1.c.

\textsuperscript{43} See \textit{infra} part IV.
examines the current state of the law in the context of the two recent California Supreme Court decisions and the recent legislative enactment passed in response thereto. In addition, this comment analyzes the competing public policy considerations underlying the current state of the law. This comment also analyzes several classes of potential claims that currently are without remedies. Finally, this comment proposes a solution that would better effectuate public policy concerns.

II. BACKGROUND

A. General Corporate Law Principles

California law provides business people with an opportunity to invest in business enterprises without incurring personal liability via a vehicle known as the corporation. The corporate form is a legal entity, distinct from those who form it, with its own legally recognized existence. The corporation is statutorily created, recognized by the government, and is responsible to its debtors and creditors similar to an individual.

The main reason individuals decide to utilize the corporate form

44. See infra part II.
45. See infra part II.
46. See discussion infra part II.C.
47. See infra Part V. The proposed solution amends existing law by adopting many aspects of formerly applicable common law remedies as well as reflecting California's statutes of limitations. Most importantly, the proposed solution more equitably provides for the interests of claimants as well as shareholders and insures that reasonable recoveries can be made. Unlike the present circumstances, the solution offered will achieve the Legislature's intended balance, without disrupting the underlying premises behind corporations law. The proposed solution should be adopted, because it will put an end to the cycle of inequity that traps the seriously injured in large classes of claims and will ultimately benefit society by presenting equitable solutions to remedy the problems involved.

48. CAL. CORP. CODE § 200(a) (West 1992). Section 200(a) provides: "One or more natural persons, partnerships, associations or corporations, domestic or foreign, may form a corporation under this division by executing and filing articles of incorporation." Id.
49. Id. § 200(c). Section 200(c) provides: "The corporate existence begins upon the filing of the articles and continues perpetually, unless otherwise expressly provided by law or in the articles." Id.
50. Id § 200.
51. Id. § 200(a), (c). Filing the articles of incorporation with the Secretary of State begins the existence of the corporation. Id.
52. Id. § 207(a)-(h). This section empowers a corporation to qualify and do business in any other state; to issue, purchase, redeem, receive, take, or otherwise acquire, own, hold, sell, lend, exchange, transfer, or otherwise dispose of shares, bonds, debentures and other securities; to assume obligations, enter into contracts; and to participate with others in any partnership, joint venture, or other association, transaction or arrangement. Id.
is to shield themselves from liability. By so doing, the corporation itself is solely responsible for any claims arising out of its business dealings. This limited liability prevails during the existence of the corporation and thereafter. While claimants are concerned with recovery after corporations dissolve, shareholders seek reasonable assurances that the completion of one business investment is final, with concomitant protection of the proceeds received upon dissolution for reinvestment in new corporate activities.

B. Liability Upon Dissolution

When a business operating in the corporate form ends, the corporation is normally dissolved. The theory of corporate limited liability requires reasonable protection of shareholders in corporations from liability once the business is discontinued. Often, claims arise

53. California Corporations Code § 200 authorizes individuals to associate and do business as a corporation. See supra note 48. The law permits the creation of this type of entity for the promotion of business activity while limiting an individual’s personal liability. Authors Cary and Eisenberg, noted corporate law scholars, explain this doctrine:

Conventionally, the most attractive nontax attributes of the corporate form are said to be limited liability . . .

. . . [whereas] [s]ole proprietors and general partners are personally liable for obligations that arise out of the conduct of their business[,] . . . the shareholder-owners of a corporation are not personally liable for their debts . . . .

This legal rule is conventionally expressed by the statement that shareholders have “limited liability.”


54. California corporate law provides:

[A]ny contract or conveyance made in the name of a corporation which is authorized or ratified by the board, or is done within the scope of the authority, actual or apparent, conferred by the board or within the agency power of the officer executing it, except as the board’s authority is limited by law other than this division, binds the corporation, and the corporation acquires rights thereunder, whether the contract is executed or wholly or in part executory.

CAL. CORP. CODE § 208(b) (West 1992).

55. California corporate law provides:

A corporation which is dissolved nevertheless continues to exist for the purpose of winding up its affairs, prosecuting and defending actions by or against it and enabling it to collect and discharge obligations, dispose of and convey its property and collect and divide its assets, but not for the purpose of continuing business except so far as necessary for the winding up thereof.

Id. § 2010(a).

56. See infra part II for a discussion of the balancing of shareholders’ rights to reinvest the proceeds of the assets distributed to them upon dissolution.

57. California Corporations Code Chapter 20 provides the statutory authorization and requisite procedures for dissolution of the corporate form. CAL. CORP. CODE ch. 20 (West 1992).

58. See discussion infra part II.
after the final distribution of assets for which the business would have been held responsible were the corporation still functioning as a business entity. Upon dissolution, the corporation is required to retain sufficient assets to meet existing claims, and the remaining assets are distributed to the shareholders of the corporation.

Theoretically, the philosophy of limited liability of shareholders attempts to balance the competing interests of those who consume corporate products and services with those who invest in the corporations. However, California corporations law reflects a public policy favoring the shareholders' interests and resulting in an uneven distribution of rights and liabilities among these two types of parties. Although the law recognizes the shareholders' rights to complete one business transaction, accumulate the proceeds, and reinvest them in new corporate activities, it is important not to sacrifice the rights of injured claimants in the meantime.


Originally, at common law, the dissolution of a corporation completely "terminate[d] its existence as a legal entity, and render[ed] it incapable of suing or being sued as a corporate body or in its corporate name." This rule allowed corporations to shield their assets from the reach of creditors through distribution to share-

59. Two recent California Supreme Court cases, Pacific Scene, Inc. v. Penasquitos, Inc., 758 P.2d 1182 (Cal. 1988), and Penasquitos, Inc. v. Superior Court, 812 P.2d 154 (Cal. 1991), clearly illustrate this point. In both cases, claims arose against the corporation that graded the lots on which claimants' homes were built. The cases both involved Penasquitos, Inc., a corporation which had dissolved prior to the discovery of both causes of action.

60. CAL. CORP. CODE § 2010(a) (West 1992).

61. Id. § 2010(c).

62. See infra part II for a discussion of the balancing of shareholders' rights to reinvest the proceeds of the assets distributed to them upon dissolution.

63. See infra part II for a discussion of the balancing of shareholders' rights to reinvest the proceeds of the assets distributed to them upon dissolution.

64. See discussion infra part II.B.1 for a complete discussion of the equitable trust fund theory. Under this theory, claimants were permitted to reach assets distributed to shareholders upon dissolution as recovery for injuries caused by the former corporation's business activities. This theory is no longer viable since it was overruled in Pacific Scene, Inc. v. Penasquitos, Inc., 758 P.2d 1182, 1183 (Cal. 1988).

65. Crossman v. Vivienda Water Co., 150 Cal. 575, 580 (1907). In Crossman, plaintiffs commenced an action against the defendant, alleged to be a corporation, for an accounting and the recovery thereon of some $33,250, and also against certain persons alleged to be stockholders thereof, to recover from their proportionate shares of the amount sought from the corporation. Id. at 577. Crossman established the equitable trust fund theory. See supra note 59.
holders pursuant to dissolution. Essentially, claimants had no means of recovery against a dissolved corporation. The courts developed the equitable trust fund theory to ameliorate the severe inequities of this common law rule.

Under the equitable theory, "a creditor of the dissolved corporation may follow such assets as in the nature of a trust fund into the hands of stockholders." When the theory was invoked, creditors of the corporation were permitted to recover the distributed assets, and the stockholders were treated as though they held the assets as trustees. In other words, the assets of the dissolved corporation were deemed to be a trust fund against which corporate creditors had a claim superior to that of the stockholders.

Although the equitable trust fund theory was developed by courts sitting in equity to accomplish the most fair result to all interested parties, it has been abolished in California through a combination of the ruling of the supreme court in Pacific Scene, Inc. v. Penasquitos, Inc. and the recent statutory changes attempting to expand the potential recovery after dissolution of a corporation.

2. California Supreme Court Abolishes the Equitable Trust Fund Theory

a. Pacific Scene, Inc. v. Penasquitos, Inc.

In 1988, the California Supreme Court substantially modified the common law equitable trust fund theory. The supreme court's

67. Koch v. United States, 138 F.2d 850, 852 (10th Cir. 1943). In Koch, a creditor of a dissolved corporation was permitted to reach assets distributed to shareholders of a dissolved corporation under the equitable trust fund theory. Id.; see also supra note 59.
68. Koch, 138 F.2d at 852.
69. Id.
70. Id.
72. Cal. Corp. Code § 2011(a) (West Supp. 1992). Sections 1800 to 2011 of the Corporations Code were enacted as part of a comprehensive statutory revision and these laws comprise a broad and detailed scheme regulating virtually every aspect of corporate dissolution. Pacific Scene, 758 P.2d at 1184. Although the aforementioned provisions were enacted in 1977, recognition of the legislature's domination of the area of corporate liability after dissolution was not recognized by the judiciary until the Pacific Scene decision in 1988. That decision clearly articulated the point that the equitable trust fund theory was abolished by the enactment of the statutory provisions pertaining to corporate dissolution. Pacific Scene, 758 P.2d at 1184.
73. Pacific Scene, 758 P.2d at 1187.
ruling in *Pacific Scene, Inc. v. Penasquitos, Inc.*,\(^74\) was based on an action brought by homeowners against the builder of tract homes when the homes in their development sustained damage as a result of subsidence.\(^75\) The builder, Pacific Scene, Inc. (hereinafter Pacific), cross-complained against the developer of the residential lots, Penasquitos, Inc. (hereinafter Penasquitos), a dissolved corporation.\(^76\) The Superior Court of San Diego County dismissed the cross-complaint.\(^77\) The court of appeal upheld the dismissal of the cross-complaint, agreeing the dissolved corporation itself could not be sued.\(^78\) Yet the court of appeal reversed with directions to grant Pacific leave to cross-complain against the former shareholders of Penasquitos under the equitable trust fund theory.\(^79\)

On review, the California Supreme Court examined the impact of the California Corporations Code provisions enacted in 1977\(^80\) on the trust fund theory.\(^81\) The court concluded that the legislature intended to occupy the field with respect to the remedies available against former shareholders of a dissolved corporation, "thus preempting antecedent common law remedies,"\(^82\) and barring any recovery under the trust fund theory.\(^83\) The supreme court held Pacific's post-dissolution claim was barred, and that claimants whose causes of action arise after the dissolution of a corporation cannot sue the shareholders of a dissolved corporation.\(^84\)

As a result of the *Pacific Scene* decision, customers who purchase defective products and unpaid creditors whose causes of action arise after dissolution have little or no remedy against the shareholders who profited from engaging in high risk business practices.\(^85\) Moreover, because of the court's indepth discussion and analysis of

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74. *Id.*
75. *Id.* at 1183.
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.*
80. *Id.*; see also supra note 13.
82. *Id.*
83. *Id.* As a result of this decision, the claimants had virtually no remedy for the injuries caused by the negligence of Penasquitos, Inc. The court affirmed the lower court's dismissal of the case. Since this case abolished the common law doctrine of the equitable trust fund theory, no recovery was permitted. This case only applies to claims against corporations dissolved before January 1, 1992. The amendment to California Corporations Code § 2011 overruled the *Pacific Scene* decision. See supra part I.C.
84. *Pacific Scene*, 758 P.2d at 1186.
85. This eliminates large classes of claims in construction defect and pharmaceutical drug manufacturing cases. See discussion infra part IV.
the procedural posture of the case (having originally been brought against the corporation rather than the shareholders), it was generally inferred from *Pacific Scene* that potential claimants also could not sue the corporation after dissolution.\textsuperscript{86} Because a number of issues remained unclear after the *Pacific Scene* decision, the supreme court again faced the issue of continuing corporate liability in a case that clarified any former misconceptions regarding suits against dissolved corporations.\textsuperscript{87}

\textbf{b. *Penasquitos*, Inc. v. Superior Court}

Within three years after the *Pacific Scene* decision, the California Supreme Court held dissolved corporations could be sued so long as the statute of limitations did not bar the claim.\textsuperscript{88} In *Penasquitos*, Inc. v. Superior Court, homeowners brought an action to recover damages for construction defects against a dissolved corporation which had graded residential lots for the building of homes.\textsuperscript{89} The supreme court held that there is no legal barrier to any suit against a dissolved corporation itself for injury or damage caused by the corporation’s pre-dissolution activities even though the claim occurs or is discovered after dissolution.\textsuperscript{90} This decision expressly clarified the misconception created by *Pacific Scene*, by specifically holding claimants can sue a corporation after it has been dissolved.\textsuperscript{91}

In reaching its conclusion, the *Penasquitos* court reaffirmed its pronouncement in *Pacific Scene* that, "California no longer follows the common law rules with respect to the dissolution of a corporation."\textsuperscript{92} Instead, the court explained, claims against corporations are governed by the California statutory scheme.\textsuperscript{93} According to the court, section 2010 of the California Corporations Code specifically

\textsuperscript{86} The court held that "the statute bars the assertion of postdissolution claims in equity." *Pacific Scene*, 758 P.2d at 1187. Use of this language left the issue of corporate liability unclear by failing to specify if this decision was limited to shareholders, or if it also extended to suits against dissolved corporations as well.

\textsuperscript{87} *Penasquitos*, Inc. v. Superior Court, 812 P.2d 154 (Cal. 1991).

\textsuperscript{88} Id. at 161.

\textsuperscript{89} Id. at 157. *Pacific Scene* and *Penasquitos* both involved the same company, Penasquitos, Inc. In the first case, the cause of action arose nearly four years after the date of dissolution. *Pacific Scene*, Inc. v. Penasquitos, Inc., 758 P.2d 1182, 1183 (Cal. 1988). In the later case, the claim also arose nearly four years after the dissolution of the corporation. *Penasquitos*, Inc. v. Superior Court, 812 P.2d 154, 155 (Cal. 1991).

\textsuperscript{90} *Penasquitos*, 812 P.2d at 160.

\textsuperscript{91} Id. at 157.

\textsuperscript{92} Id. at 156.

\textsuperscript{93} Id.
permits parties to sue dissolved corporations. The court further concluded post-dissolution actions are not limited to pre-dissolution claims, but that unlike actions against shareholders, permissible actions against the corporation include claims arising after the corporation has filed its certificate of dissolution. Penasquitos attempted to clarify some of the issues concerning the liability of dissolved corporations by holding that corporations do not disappear upon dissolution. Essentially, they live forever and potential claimants can always sue the corporation after dissolution. This determination failed to completely resolve the issue, however, because suing a corporation after dissolution generally results in no recovery.

C. Problems With the State of the Law After Penasquitos

Despite the Penasquitos holding, which clarified the right of claimants to bring causes of action against a dissolved corporation at any time, as a practical matter, the assets have usually been distributed to the shareholders and the corporation has nothing left for the claimants to recover. Virtually any claim discovered after a corporation dissolves, therefore, has no realistic remedy. This is because the law does not require assets to be retained unless the claims are known to the corporation's board of directors upon dissolution. The greatest inequity in the dissolution of corporations, however, is that only causes of action arising before the corporation has dissolved can realistically receive a recovery from the shareholders. Examples of this inequity include situations similar to the Pacific Scene.

94. Id. at 157. The court explained the purposes for which the corporate existence continues after dissolution, emphasizing in particular the provisions of California Corporations Code § 2010 that identify the purposes of prosecuting and defending actions by or against it and enabling it to discharge obligations. Id.

95. Id. at 160.

96. Id. The court stated, "[A] corporation's dissolution is best understood not as its death, but merely as its retirement from active business." Id.

97. Id. The court's pronouncement of retirement rather than death was based on the California corporate law statutory scheme, and the court was persuaded that "our statutes permit the corporate existence to continue indefinitely for the purpose of such actions." Id.

98. Penasquitos held that a claimant is free to sue a dissolved corporation, but, "bringing suit against a dissolved corporation on a postdissolution claim will often be a pointless exercise, because the corporation will have no assets with which to satisfy a judgment against it." Penasquitos, 812 P.2d at 161. See discussion infra part IV.A for a discussion of the numerous problems claimants face when suing corporations dissolved before January 1, 1992, on claims that occurred after the corporate dissolution.


100. Id.


102. See supra note 98.
and Penasquitos cases where the claim is not likely to be discovered until many years after dissolution.\footnote{103}

Other classes of ignored claims include individuals who purchase medicine from pharmaceutical companies, or obtain medical treatment, the defects of which do not show up until a later generation.\footnote{104} Although the Penasquitos decision succeeded in clarifying that dissolved corporations could be sued,\footnote{105} the supreme court left unresolved the issue of recovery for claimants who can recover nothing from a corporation that has distributed all of its assets to its shareholders.

D. Legislative Revisions to the California Corporations Code

Recognizing the limitations of the Pacific Scene decision, the legislature immediately sought to modify the existing state of the law by amending the Corporations Code.\footnote{106} Prompted by suggestions from the California State Bar Association,\footnote{107} the legislature revised section 2011 of the California Corporations Code in October

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\footnote{103. Although in these two cases the claims arose within a four year time period, many construction defect cases do not arise within such a short period of time. For example, in Redarowicz v. Oelendorf, 92 Ill. 2d. 171 (1982), the plaintiff filed a complaint against the builders of his residence. The decision held that in construction defect cases, a long statute of limitations is required to reveal latent defects which do not manifest themselves for a significant period of time. \textit{Id.} at 174.}

\footnote{104. A classic example of this is the DES (in the medical world known as diethylstilbestrol, a drug developed to assist in the prevention of miscarriage during pregnancy) cases. In the most famous DES case, Sindell v. Abbott Labs., 607 P.2d 924 (1980), women brought a class action against drug companies manufacturing DES, seeking to recover for injuries sustained as a result of administration of the drug to their mothers during pregnancy. \textit{Id.} In Sindell, plaintiffs were exposed to the drug prior to birth. \textit{Id.} at 926. Because of defendants' advertised assurances that DES was safe and effective to prevent miscarriage, plaintiffs' mothers had ingested the drug during pregnancy. \textit{Id.} Plaintiffs became aware of the danger from such exposure only after entering their teen years and in many cases, not until reaching adulthood. \textit{Id.} As a result of the DES ingested by their mothers, many of the plaintiffs developed malignant tumors, and suffered from other severe maladies that required constant monitoring to insure early detection of additional malignancy. \textit{Id.} This case represents the potential for pharmaceutical companies like Abbott Laboratories to use subsidiary corporations for the development of such drugs as DES, to dissolve, and then to escape liability when medical disorders arise many years after the business has ceased its corporate activities.}

\footnote{105. Penasquitos, Inc. v. Superior Court, 812 P.2d 154 (Cal. 1991).}

\footnote{106. A telephone conversation with Charles Fennessey, Attorney for California State Senator Ed Davis' office, revealed that it was the California State Bar Association that sponsored Senate Bill 1188. See supra notes 16-17. The State Bar drafted a preliminary version of the bill and forwarded it to the Legislature to be passed shortly after the Pacific Scene decision. Telephone Interview with Charles Fennessey, Attorney for the Office of Senator Ed Davis of California, Sacramento, California (Jan. 6, 1992).}

\footnote{107. \textit{Supra} note 106.}
This revision changed the existing law by providing that upon the dissolution of a corporation, its shareholders may be sued in the corporate name upon a cause of action arising before or after its dissolution.109

This newly revised version of section 2011 allows claimants to collect from the shareholders to the extent of their pro rata share of the claim110 or to the extent of corporate assets which have been distributed to them upon dissolution of the corporation, whichever is less.111 Section 2011 now requires claims against the shareholders to be commenced before the expiration of the claim's statute of limitations, but in no case later than four years after the dissolution of the corporation.112 The law also codifies the holding of Penasquitos by providing that causes of action against a dissolved corporation, whether arising before or after the dissolution of the corporation, may be enforced against it, to the extent of its undistributed assets.113

E. Intentions of the California Legislature

Prior to the statutory revision, corporate law distinguished between pre- and post-dissolution claims against dissolved corporations. Before January 1, 1992, shareholders could not be sued upon a cause of action arising after the corporation's effective date of dissolution.114 The revised version of section 2011 of the California Corporations Code is an attempt by the California Legislature to resolve the inequities raised by the supreme court's decisions and to provide a more equitable solution. The purpose of this comment is to address the fact that although the statutory response provides a more just result in a few limited circumstances, it does not go far enough in remedying the truly inequitable situations.115

108. S.B. 1188 was passed by a unanimous vote on October 7, 1991. See supra note 17. See supra part III. for a full discussion of the history and intent of the revision of California Corporations Code § 2011.
110. Id. The result of the revised statute is to overrule Pacific Scene, Inc. v. Penasquitos, Inc., 758 P.2d 1182 (1988). Pacific Scene prohibited recovery against the shareholders of a dissolved corporation on claims arising after dissolution. Id. at 1186.
113. Id. § 2011(a)(1)(A).
115. The amendment to § 2011 of the California Corporations Code, effective January 1, 1992, overrules the Pacific Scene decision by establishing that shareholders can be sued for claims arising after dissolution of a corporation for a period of four years after the date of dissolution. See supra part II.B.1. for a discussion of the Pacific Scene decision. Pacific Scene held that shareholders could never be sued for claims arising against a corporation after disso-
III. IDENTIFICATION OF THE PROBLEM

A. In General

In very general terms, the current state of the law denies large classes of claimants adequate recoveries from defendants that were solvent at the time of their corporate dissolution. Furthermore, the shareholders of dissolved corporations are also being permitted to escape liability after engaging in business activities involving potentially serious harm to claimants and from which they have derived substantial profits. The law as it now stands treats dissolved corporations differently depending on the effective date of their dissolution, and the problems vary accordingly.

B. Problems for Claimants Suing Corporations Dissolved Before January 1, 1992

As the Penasquitos case recognized, the major limitation of the law applicable to claims against corporations dissolved before January 1, 1992, is the number of potential defendants. The number of potential defendants arbitrarily varies depending on when the claim arises. For claims arising prior to dissolution, the claimant is entitled to sue the corporation and its shareholders. Claimants whose claims arise after dissolution, are not afforded the same rights. For those claims arising after dissolution, claimants are limited to bringing suit against the dissolved corporation only, and are prevented from recovering against the shareholders of the dissolved corporation. The later claimants can recover only to the extent the corporation holds any assets not already distributed to the shareholders upon dissolution. The legislative revision to the California Corporations Code attempted to rectify this arbitrary distinction.

116. Prior to January 1, 1992, claimants whose causes of action arose after a corporation had dissolved were limited to suing only the dissolved corporation. Once a corporation has dissolved and distributed its assets, however, there is very little left for recovery. See supra part II.B.2. The revised California statute, effective against corporations dissolved after January 1, 1992, increases the number of potential defendants for a claimant to sue. Under the new law, claimants can sue the shareholders of a dissolved corporation on claims arising against the corporation after dissolution. CAL. CORP. CODE § 2011(a) (West Supp. 1992).

117. Pacific Scene, 758 P.2d at 1185.
118. Id.
119. Id.
120. Id.
121. See supra note 27.
C. Shortcomings of the Amendment to Section 2011

The amendment to section 2011 solves only some of the problems left unresolved by the supreme court's decisions in *Pacific Scene* and *Penasquitos*. As a result of the amendment, claims arising against corporations dissolved after January 1, 1992, have a greater number of potential defendants, but recoveries are still inadequate in several significant ways. Indeed, while the legislature attempted to balance the competing interests of the finality of claims and compensation of creditors, the amendment to the code fails to properly balance the rights of claimants and shareholders of dissolved corporations in three specific ways.

First, the statute fails to fully consider the ramifications of the four year limitation incorporated into the bill. The four year rule is an inappropriate public policy decision because it fails to address very serious tort and products liability claims that typically arise well after the four year period has expired. As a result, corporations are currently permitted to segment their businesses, operate them for limited periods of time, dissolve and reincorporate later. This process allows corporations to escape liability for damages caused to claimants by those dissolved businesses whose former shareholders have made a fortune.

This scenario has been brought to life in the *Pacific Scene* and *Penasquitos* cases which permitted a residential land developer to incorporate and do business, dissolve the company, and reincorporate later doing exactly the same kind of work. Had the statute been applicable to the defendants in these two cases, the claimants still would have had some recovery since their causes of action arose within the four year time limitation. But this is the exception in a construction defect case, not the rule. Hence, a statute designed to alleviate discrepancies failed to achieve its intended result in the very type of case that brought about the change in the law.

The second problem with the amendment is that the statute eliminates claims formerly recoverable prior to its enactment. For

122. This is common in construction defect cases where the defect is often discovered more than four years after completion but well within the 10 year statute of limitations. Interview with Douglas Scott Maynard, Esq., Maynard Law Offices, in Campbell, CA. (Sept. 29, 1991). It could be a common practice among pharmaceutical companies with the development of new drugs. See infra note 148.

123. See supra note 6.


example, case law effective prior to the statutory enactment permitted the shareholders of dissolved corporations to be sued for claims arising prior to dissolution.\footnote{126} Their claims were not subject to any time limitation such as the four year rule, except the claim’s statute of limitations.\footnote{127} Moreover, when claims arose prior to dissolution, The corporation’s board of directors was required to set aside assets to satisfy those claims only if the board knew of the claims at dissolution,\footnote{128} and the remaining funds were distributed to the shareholders.\footnote{129} A claim brought five to ten years after it arises can still be valid absent dissolution. As a result of the revised code, however, the claim is barred against a dissolved corporation since setting aside assets is only required when the board of directors knows about the claim.\footnote{130} With the amendment to the statute, claimants cannot pursue claims against shareholders after four years, and any retained funds not claimed within the four year time period can be distributed to the shareholders.\footnote{131}

Finally, the statute denies adequate recovery to claimants by limiting recovery against the shareholders of dissolved corporations to the value of the assets distributed to those shareholders pursuant to the dissolution.\footnote{132} In this instance, the statute fails to consider the potential for slick corporate planning by greedy shareholders. The statute fails to address the situation where a corporation heavily laden with potential claims against it declares dividends to the maximum extent legally permissible just prior to dissolution. In this fashion, the corporation could distribute a large portion of its assets prior to dissolution, completely free of all claims. Since the claimants are only entitled to recover assets distributed upon dissolution,\footnote{133} they recover only what little was retained for distribution at dissolution, and will be unable to touch the large sums received by the shareholders through the dividend distribution.

\footnotesize
\begin{enumerate}
\item[126.] Id. at 1182.
\item[127.] Id.
\item[128.] CAL. CORP. CODE § 2010 (West 1992).
\item[129.] Id.
\item[130.] The four year limit was a suggestion made by the California State Bar Association, thought to be more equitable than not being able to sue the shareholders at all. Interview with Larry Doyle, Deputy Attorney of the Legislative Bar Committee and Lobbyist for the Business Law Section of the California State Bar Association, (Jan. 24, 1992).
\item[131.] CAL. CORP. CODE § 2011(a) (West Supp. 1992).
\item[132.] Id. § 2011(a)(1)(B).
\item[133.] Id.
\end{enumerate}
D. Summary of the Problem

In general, the statutory enactment is sufficient to provide fair results in the garden variety types of cases; cases that are expected to arise in a relatively short period of time. This amendment is helpful, for instance, in the case of an auto mechanic who has failed to repair a claimant's car properly, or a grocery store that has sold sour milk, but the amendment does not address a number of truly inequitable situations.

Indeed, the statute helps provide for recovery where claims arise within a four year time frame. However, it does not resolve the problem for claimants whose causes of action arise four years and one day after the effective date of dissolution. In particular, it does not help in cases where the claim is not likely to arise for a long period of time. For example, the statute does not help the elderly couple who spent their entire life savings to build a retirement home, only to learn that the builder negligently tested the land for its solidity and the home was damaged due to subsidence ten years after it was built. Nor does the statute provide a remedy for the woman who recently had breast implants and whose arm becomes paralyzed fifteen years after the surgery. In the latter situation, there exists the potential for pharmaceutical companies to set up subsidiary corporations to develop new, risky medical technologies. These subsidiaries can be dissolved, and years later, when serious medical damage is discovered, the four year limitation has passed and the claimant is again without a remedy. In both cases, the well advised corporations will have dissolved and the individual claimants will have no remedy for their tort claims. Moreover, these are the types of claims which are generally unforeseeable as that term is used in California Corporations Code. This means that the corporation is not re-

134. For example, a homeowner may have his or her home remodeled by a corporate contractor. Perhaps four years later the corporation dissolves. One day before dissolution, the homeowner discovers the defect. Under existing law, this claim may be pursued against the dissolved corporation and its shareholders. However, if the defect is discovered one day after the dissolution, under existing law, the claim may not be pursued against the shareholders of the dissolved corporation. This provides for an inequitable result because it is the shareholders who have received the bulk of the corporation's assets pursuant to dissolution. See discussion supra part II.B.

135. See discussion infra part IV.A.1. and note 148.

136. See discussion infra part IV.A.1. and note 148.

137. The corporations code provides for setting aside assets to pay foreseeable claims upon dissolution. CAL. CORP. CODE § 2011(a) (West Supp. 1992). Claims not likely to arise for a long period of time are generally unforeseeable at dissolution.
required to retain any assets to pay the potential claimants.\textsuperscript{138}

While the law has generally experienced a great expansion over the last fifty years in the areas of tort, products liability, and other types of claims, corporate law is now permitting shareholders to make their fortunes in enterprises with a high degree of risk of harm to the public, and then failing to hold them sufficiently responsible for these activities.

IV. Analysis

A. Claims against corporations dissolved before January 1, 1992

1. Pre-Dissolution Claims

According to \textit{Pacific Scene} and \textit{Penasquitos}, any claims brought against a corporation dissolved prior to January 1, 1992, can be brought against the dissolved corporation and its shareholders, to the extent the claims arose prior to dissolution.\textsuperscript{139} These decisions represent the supreme court's interpretations of the California Corporations Code statutory provisions prior to amendment.\textsuperscript{140} These provisions provide for the continuing existence of corporations after they are dissolved for the purposes of winding up and settling pre-dissolution claims related to the corporation's business activities.\textsuperscript{141}

Recognition by the supreme court of the legislature's intent in developing the statutory provisions concerning corporate dissolution is a relatively new concept in California law.\textsuperscript{142} \textit{Pacific Scene} represented a change from the common law notion that after a corporation dissolved, it could no longer be held responsible for any claims made against it.\textsuperscript{143} The California Supreme Court's decision essentially formalized the legislature's conclusion that dissolution of a corporation means the "retirement" of the corporation, rather than its death.\textsuperscript{144}

While the law requires corporations to set aside money on dissolution for expected claims, claimants whose claims are discovered later may also be able to reach those funds.\textsuperscript{145} However, in many...
such cases there will not have been enough money set aside to ade-
quately cover all of the claims. This state of the law gives corpora-
tions significant but inappropriate financial planning opportuni-
ties; particularly in large corporations like pharmaceutical
companies, construction firms, and companies making dangerous
products. When serious problems regarding defects and resultant
damages begin to surface, the corporation can set up a fund to take
care of claims that have already arisen and then dissolve.

A hypothetical example illustrates the point. Recently, the
United States Food and Drug Administration ordered pharma-
tical companies who manufacture the materials necessary to perform
breast-implant surgeries to cease production. Even if no claims
have been made against these companies by women who have suf-
f ered harm as a result of undergoing this surgery, the potential is
now there. Previously there was some doubt that the breast-implant
situation would require money to be set aside to meet expected
claims. That is, the product has a design defect that has been discov-
ered with the first lawsuits. But, section 2011 provides that if the
claim is not brought within four years after dissolution, it is unfore-
seeable. Thus, the company need only figure out how many
women will discover the defect and file claims within the next four
years and set aside enough money upon dissolution to cover those
claims. Those women whose claims arise after the four year pe-
riod has expired will be prevented from obtaining any recovery and

146. California Corporations Code § 2010(a) only requires corporations to set aside a
sufficient amount of assets to meet expected claims. CAL. CORP. CODE § 2010(a) (West 1992).
In the event claims arise against Dow-Corning, the company can dissolve its subsidiary corpo-
rati on responsible for developing and marketing the breast-implant product, set aside enough
funds for claims expected to arise within a four year time frame, and distribute the remaining
assets to its shareholders. Under the current law, claims arising after the four year period will
essentially have no remedy against the subsidiary corporation.

The aforementioned situation must be distinguished from the corporate doctrine known as
"Piercing the Corporate Veil." That doctrine applies only against existing, as opposed to dis-

147. See discussion infra part IV.B.3.

148. After disclosure of documents suggesting that the Dow-Corning’s 50%-owned ven-
ture, Dow-Corning Corp., may have rushed a new breast-implant product to market without
sufficient safety tests, the company could face legal liability for the silicone-gel breast-implants
now under scrutiny by the Food and Drug Administration. Dow Corning is the nation’s larg-
est manufacturer of the devices, with some 600,000 implanted over the past 30 years. Thomas
M. Burton, Corning Stock Plunges on Disclosures About Breast-Implant Testing,


150. This could be calculated actuarially. Claims figures to the date of dissolution could
be used to calculate estimated liability or products liability insurance could simply be main-
tained for the four years after dissolution.
will be severely penalized because their damages have shown up at a later date.\textsuperscript{151}

2. Post-Dissolution Claims

The \textit{Pacific Scene} decision established the principle that corporations and shareholders are generally liable to claimants for claims arising prior to dissolution.\textsuperscript{152} The decision further held that, for corporations dissolved prior to January 1, 1992, shareholders are not responsible for such claims if they arise after dissolution.\textsuperscript{153}

Although a claimant suing a corporation dissolved prior to January 1, 1992, is entitled to a judgment, once the corporation has been dissolved and its assets have been distributed there is often, as a practical matter, little or no chance for recovery from the corporation.\textsuperscript{154} As a result, claimants whose claims arise prior to dissolution can also recover from the shareholders and are in a much better position than those claimants whose claims arise after the dissolution of the corporation.\textsuperscript{155} As \textit{Penasquitos} recognizes, a dissolving corporation is required by statute to set aside funds for claims it is aware of at the time of dissolution.\textsuperscript{156} But where does that leave claimants whose injuries arise after dissolution? By definition, a claim arising after dissolution is generally unknown and will not subject the corporation to the provisions regarding retention of assets. According to \textit{Penasquitos}, the claimant can still sue the corporation, but in reality, once it has been dissolved and its assets have been distributed (and possibly even reinvested in new business enterprises), there is little or no recovery.\textsuperscript{157}

There is the option of recovery from the corporation’s insurance carrier for injury sustained via the corporate enterprise.\textsuperscript{158} However, this type of claimant is faced with the various problems in collecting on expired insurance policies. These problems include meeting the requirements of the insurance policy for submitting claims, and in the case of mass claims, competing with other claimants for what little funds exist under the policy itself.\textsuperscript{159} Also, the shareholders are

\begin{itemize}
\item \textsuperscript{151} As in the DES cases, \textit{see supra} note 104, these claims are not likely to arise for a long period of time.
\item \textsuperscript{152} \textit{Pacific Scene, Inc. v. Penasquitos, Inc.}, 758 P.2d 1182, 1183 (Cal. 1988).
\item \textsuperscript{153} \textit{Penasquitos, Inc. v. Superior Court}, 812 P.2d 154, 160 (Cal. 1991).
\item \textsuperscript{154} \textit{See discussion infra} part III.B.
\item \textsuperscript{155} \textit{Penasquitos}, 812 P.2d at 160.
\item \textsuperscript{156} \textit{Id}.
\item \textsuperscript{157} \textit{Id}.
\item \textsuperscript{158} \textit{CAL. CORP. CODE} § 2011(a) (West Supp. 1992).
\item \textsuperscript{159} Because insurance policies typically are limited in terms of their dollar amount,
\end{itemize}
unlikely in many instances to continue to carry insurance after dissolution. Only if they expect claims would they even consider this. Even then, they are unlikely to substantially deplete the corporate assets for the purpose of carrying insurance. Moreover, there may be practical problems in obtaining insurance to continue error and omissions policies or products liability policies on a dissolving company.

For claims against corporations dissolved prior to January 1, 1992, California corporate law requires the dissolved corporation to remain responsible for its debts even after it ceases to exist. Furthermore, the shareholders are not responsible for those debts. The rule that only the corporation remains responsible for its debts was developed with the intention of protecting shareholders' future investments. The premise behind this public policy is the notion that shareholders should not have to be concerned with potential liability because they cannot safely reinvest their corporate earnings if they may eventually have large judgments to pay. The California Supreme Court case law as well as the California Corporations Code have both recognized the policy that shareholders need to be able to retrieve their funds from one business venture and reallocate those funds into another business enterprise. Pacific Scene also recognized this need in holding that shareholders of a dissolved corporation cannot be sued for claims arising after dissolution, even if those claims relate to the activities in which their corporations were engaged. By protecting shareholders' investments, the law sacrifices the

many claimants will never receive adequate compensation, if they are compensated at all, for their injuries.


161. Since shareholders have invested in the corporation for the purpose of producing a profit and shielding themselves from liability, it is unlikely they will expend any more in insurance expenses than is required by law. See supra part II.A.


164. See infra part IV.B.3 for a discussion of the balancing of shareholders rights to reinvest the proceeds of the assets distributed to them upon dissolution with the rights of claimants to damages for corporate misconduct.

165. See infra part IV.B.3 for a discussion of the balancing of shareholders rights to reinvest the proceeds of the assets distributed to them upon dissolution with the rights of claimants to damages for corporate misconduct.

166. See infra part IV.B.3 for a discussion of the balancing of shareholders rights to reinvest the proceeds of the assets distributed to them upon dissolution with the rights of claimants to damages for corporate misconduct.

rights of creditors and customers with claims against the corporation. Statutes of limitations have long existed to protect potential defendants from having to worry endlessly about causes of action being raised against them. The issue is whether shareholders should be given a significantly shorter time period than the usual statute of limitations for claims to be brought against them.

B. Claims Arising Against Corporations Dissolved On or After January 1, 1992

1. Three Main Problems

Indeed, while the legislature attempted to balance the competing interests of the finality of claims and compensation of creditors, the revised code fails to appropriately balance the rights of claimants and shareholders of dissolved corporations in three specific ways. While claims arising against corporations dissolved after January 1, 1992, have a greater number of potential defendants than before, the revised statutory scheme is still woefully inadequate.

a. Four Year Time Limit Eliminates Recoveries on Large Classes of Claims

First, the revised code fails to fully consider the ramifications of the four year limitation incorporated into the bill. This current state of the law is an inappropriate public policy failing to address very serious tort and products liability claims that may arise well after four years. Because certain types of businesses present long term risks to society, the law has evolved to provide for liability extending over long periods of time, even generations, where necessary, to protect the public. Despite this long history of judicial precedent and experience, the revised code allows corporations to circumvent the centuries of legal evolution and precedent by segmenting their businesses, operating them for limited periods of time, dissolving, and reincorporating later. This new legal policy allows devious corporations to escape all liability for damages caused by their high risk businesses, and allows the shareholders to withdraw a fortune without ever being accountable for the long term risks and damage they have imposed on society.

The above described scenario was vividly brought to life in the

168. Section 337.15 of California's Code of Civil Procedure provides for a ten year statute of limitations in construction defect cases. CAL. CIV. PROC. CODE § 337.15 (West 1989).
169. See supra note 6.
Pacific Scene and Penasquitos cases where the supreme court sanctioned the transparent scheme of a residential land developer who had incorporated, developed a single project, dissolved his company, and reincorporated again for each new development while continuing to do exactly the same kind of work. Each time a project was completed, the developer withdrew his profits from the business by dissolving. This scheme has now been given permanent protection from the victims of the company's shoddy and irresponsible business practices. Had the statute been enacted at an earlier date, the claimants in the lead cases may have been able to recover a portion of their damages since their causes of action had, in fact, arisen within the four year limit. However, many similar causes of action will not arise within four years. The legislature has long recognized this truth by developing a number of statutes of limitations providing for periods longer than four years for cases where the damage is not likely to be discovered for a long period of time.

For example, section 337.15 of the California Code of Civil Procedure provides a ten year statute of limitations for real estate and construction related claims. This statute of limitations contemplates the reality that real estate construction claims are not likely to show up until many years after the structure or other development has been completed. The legislature has already developed a comprehensive scheme to balance the competing interests of corporations and potential claimants by developing specific statutes of limitations which are tailored to the differing types of claims. The revised section 2011 of the Corporations Code, however, provides a loophole for those businesses intelligent enough to plan for it. For these businesses, the statute of limitations is effectively nullified.

171. See supra note 89.
172. See supra notes 104 and 148 for illustrations of pharmaceutical cases not likely to arise within a four year time frame.
173. See supra note 168.
175. See supra note 103.
176. See id. § 337.15.
177. California Corporations are required by statute to set aside funds to meet only those claims known about at dissolution. CAL. CORP. CODE § 2011 (West Supp. 1992).
178. Charles Fennessey, Attorney for State Senator Ed Davis' office, revealed that the four year limitation was an arbitrary decision, made primarily because the causes of action against Penasquitos, Inc. arose within four years after the corporation's effective date of dissolution. Interview with Charles Fennessey, Attorney for the Office of State Senator Ed Davis of California, Sacramento, CA (Jan. 6, 1992.) When it was pointed out that construction cases actually have a ten year statute of limitations, it was further revealed that the four year limit
The four year time limit not only prevents recovery in construction defect cases, but it also eliminates claims arising in innumerable other areas. Potential claims not likely to arise within a four year time frame include all claims where the statute of limitations begins to run upon discovery of the problem rather than with a product sale or project completion. Such claims include fraud, professional malpractice, drug and pharmaceutical companies manufacturing medications, and medical procedures whose dangers are not fully revealed for many years after their implementation on humans. An obvious new example of the potential for harm involves the newly discovered breast implant procedures that have been developed in the last twenty to thirty years. This is a fertile new area of litigation involving severe disfiguration, paralysis, and even death. Because the effects of such new medical procedures are not fully known or may be intentionally hidden in the development phases, any defects will inevitably show up many years after the four year time limit. Injured claimants will have no recovery in these instances despite a strong policy of the law to the contrary.

b. Elimination of Formerly Recoverable Claims

The second problem with the amendment is that the statute in its present form eliminates claims which were specifically recoverable

was not well thought out and that neither that statute of limitations nor the potential for drug companies to manufacture and dissolve were taken into consideration in drafting the bill. Id. Such claims include fraud cases. For example, if a fraud is not discovered within four years, the statute of limitations for the fraud-based cause of action does not start running until the fraud has been discovered. The statute in its current state, however, will still cut off liability for any cases of fraud not discovered within four years of the date of corporate dissolution.

179. Such claims include fraud cases. For example, if a fraud is not discovered within four years, the statute of limitations for the fraud-based cause of action does not start running until the fraud has been discovered. The statute in its current state, however, will still cut off liability for any cases of fraud not discovered within four years of the date of corporate dissolution.

181. Id. § 340.6.
182. Id. § 340.5.
183. Id.
184. See supra part IV.A.
185. See supra note 104 (discussing the DES cases which did not arise for many years after the drug manufacturer distributed the drug).
186. Burton, supra note 148. In the early part of January 1992, the United States Food and Drug Administration ordered producers of silicon breast-implants to cease all production and implantation. After disclosure of documents suggesting that Dow-Corning's 50%-owned venture, Dow-Corning Corp., may have rushed a new breast-implant product to market without sufficient safety tests, the company could face legal liability for the silicone-gel breast-implants now under scrutiny by the Food and Drug Administration. Dow Corning is the nation's largest manufacturer of the devices, with some 600,000 implanted over the past 30 years. Id.
187. Id.
prior to its enactment.\textsuperscript{188} For example, the case law prior to the statutory enactment permitted the shareholders of dissolved corporations to be sued for claims arising prior to dissolution forever, under the equitable trust fund theory, to the extent of distributed assets and subject to the statute of limitations.\textsuperscript{189} All such claims are now eliminated after four years from the date of dissolution.\textsuperscript{190} In addition, when claims are known prior to the corporate dissolution, assets must be set aside by law to meet those claims while the remaining assets may be distributed to the shareholders.\textsuperscript{191} While this procedure provides an available fund for some claims, no assets are required to be set aside if the claim has not yet come to the attention of the corporation's board of directors.\textsuperscript{192} So, where claims for unknown matters could previously have been made against the shareholders under the equitable trust fund theory, now they are eliminated.\textsuperscript{193} With the amendment to the statute, claimants cannot file additional claims against shareholders under any circumstance after a period of four years.\textsuperscript{194} Whereas claimants could sue without any time limitations prior to the statutory enactment, their claims are now limited to a four year time frame. Thus, some claimants will be denied recovery for their injuries.

c. Recovery Limited to Distributed Assets

Finally, the statute denies adequate recovery to claimants by limiting any recovery against the shareholders to the value of the assets distributed to each individual shareholder at dissolution.\textsuperscript{195} In this instance, the statute fails to consider the potential for illegitimate corporate planning of greedy shareholders. In these cases, the statute fails to address the situation where a corporation heavily laden with potential claims against it disposes of a large portion of its assets prior to dissolution.\textsuperscript{196} Upon dissolution, the corporation distributes the remaining pithy assets to its shareholders and claimants are permitted to sue only for what little was distributed at dissolution. In such a case the claimants are unable to touch the large sums distrib-

\textsuperscript{188} See discussion supra part I.D.
\textsuperscript{190} CAL. CORP. CODE § 2011 (West Supp. 1992).
\textsuperscript{191} Id. § 2010(a).
\textsuperscript{192} Id.
\textsuperscript{193} California Corporations Code § 2011 in its present form was revised by the Legislature in October 1991. See supra notes 16-17.
\textsuperscript{195} Id.
\textsuperscript{196} See supra part IV.B.3.
uted to the shareholders prior to dissolution.

2. Intention of the Legislature

Senate Bill 1188 was developed with the intention of overturning the result in Pacific Scene and to permit causes of action to be brought against the shareholders of dissolved corporations, within specified limits, regardless of whether the claims arose before or after dissolution.\(^{197}\) The law was developed by the California State Bar Association in response to the Pacific Scene case based on the argument that the current law created an arbitrary and unfair distinction between pre-dissolution and post-dissolution claims.\(^{198}\)

Senate Bill 1188 was intended to enact a comprehensive system regulating the manner in which such claims, whether they arise pre-dissolution or post-dissolution, may be pursued.\(^{199}\) The bar argued that S.B. 1188 properly balances the competing needs of dissolved corporations and shareholders to have finality and certainty with regard to corporate matters with the needs of creditors to have some opportunity to pursue legal remedies against dissolved corporations and their shareholders.\(^{200}\) The California State Legislature, by amending the corporations code and overruling the Pacific Scene decision, agreed with the notion that claimants ought to be able to recover for injuries against dissolved corporations. Recognizing that it is the corporation's decision to dissolve and not the creditor's or other claimant's, the legislature concluded that it was unfair to distinguish between pre-dissolution and post-dissolution claims.\(^{201}\) The final amendment to section 2011 is also sensitive to this need. Moreover, the sponsor notes that this bill is based on the Model Business Corporations Act, which, in fact, provides a five year statute of limitations after dissolution.\(^{202}\)

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197. See supra notes 24-27.
198. See supra note 27.
200. Id.
201. See id.
S.B. [sic] 1188 enacts a comprehensive system regulating the manner in which claims, whether they arise pre-dissolution [sic] or post-dissolution [sic], may be pursued. Moreover, the sponsor notes that this bill is based on the Model Business Corporations Act, which in fact, provides a five year statute of limitations after dissolution. [Note that S.B. 1188 contains a four year period in which to bring these actions.]

Id.
It should be noted that the Model Business Corporations Act had originally provided for a two year limitation. After its implementation in several states, this was found unsatisfactory because it eliminated too many just claims. In fact, the two year limit was not much different from the rule prevailing before 1834. It was exactly this problem and its abuses which caused the courts to abandon the legal concept of the immediate cessation of the existence of a corporation upon dissolution and the concomitant development of the equitable trust fund theory. While the legislature’s concern and attempt to correct the supreme court’s apparent tendency to revert to antiquated theories of corporate law appears to have been motivated by a desire to bring corporate law back in line with modern legal theories, this attempt has failed. The four year time limit fails to consider the vast and intricate theories of modern law. Long term environmental damage and personal injuries from unsafe substances are obvious examples where modern law has made massive changes in the continuing liability of businesses which cause damage to innocent victims. This revised statute may be acceptable for the types of claims that have been brought for centuries, but it fails to provide in any way for modern tort and product defect cases. As a result, the legislature’s attempt to balance competing interests has utterly failed to consider the inequitable ramifications for claimants in these situations.

3. Major Legal Concerns

The problems with tort product defect cases are numerous. Among the greatest concerns to be considered are the opportunities for large pharmaceutical companies to abuse the law. For example, when pharmaceutical companies develop new drugs or cosmetic surgery treatments, there are no restrictions on setting up subsidiary corporations to develop these products or services. Where subsidi-
aries are used in this manner, the subsidiary corporation can manufacture the drug or supply the service. In the event problems arise with these products or services, the subsidiary can be dissolved with all of its assets distributed to its parent corporation free of creditors' claims. Thus, when problems arise after the four year time frame, no one will be held responsible, not even the large parent corporation.

The only area in which S.B. 1188 will have minimal impact is in the garden variety of claims, such as contract disputes, debt collection cases, and tort actions where the damages become apparent immediately. For example, had the statute been in place before the *Pacific Scene* case, those particular claimants would have been protected because the land subsidence occurred immediately. Most hidden construction defects do not appear within the four year time limitation, and it is those plaintiffs who will suffer from the effects of this inadequately considered statute.

Corporate law is designed to protect shareholder investments. On the other hand, claimants have a right to compensation for legitimate damages caused by corporate business activities. Part of the public policy allowing shareholders to be sued for causes of action arising after dissolution, is that the shareholders now hold corporate assets from which claimants would have recovered absent dissolution. Allowing a return to the antiquated corporate law theories of the nineteenth century is simply inappropriate today.

and procedures until there is sufficient evidence that they are safe. Burton, *supra* note 148.

208. *Id.*

209. This issue is not to be confused with the doctrine of "Piercing the Corporate Veil." *See supra* note 146.

210. *See supra* note 146.

211. For example, the statute is useful in the case of the dissolved dairy that sold bad milk at the local grocery stores and the auto mechanic who has closed shop the day after he negligently fixed your brakes.

212. The legislature intended S.B. 1188 to amend existing law with regard to shareholders and not to affect the corporation's liability. In a letter from the author of the Bill, California Senator Ed Davis, to Rick Rollens, Secretary of the Senate, the Senator explained: "S.B. 1188 is intended to make the statutory changes ... necessary to overturn the result in *Pacific Scene v. Penasquitos, Inc.*, 250 Cal. Rptr. 135 (1988)." Letter from Ed Davis, California State Senator, to Rick Rollens, Secretary of the Senate, State of California, (Aug. 30, 1991) (on file with the Office of the California State Senate).

213. *See supra* note 53.

214. Were claimants not entitled to remedies for their injuries, few people would engage in transactions with corporations and the whole notion of the corporate shield in order to encourage people to go into business without incurring personal liability would be utterly lost.
V. PROPOSED SOLUTION

A. Claims Arising Against Corporations Dissolved Before January 1, 1992

Because the law varies according to when the claim arose and when the corporation was dissolved, the solutions to the problems must also vary accordingly. The California Supreme Court’s current treatment of post-dissolution claims arising against dissolved corporations results in an inequitable situation for injured parties. The legislature should provide a system to defer specific situations to the courts for a more equitable approach to dealing with the different claims. A legislated return to the equitable trust fund theory for the recovery of distributed corporate assets suggests a more fair result to all interested parties. Under this theory, corporate assets should be distributed to the shareholders upon dissolution, but should remain subject to the theoretical trust for claimants whose claims arise after dissolution. In lawsuits, judges can make equitable allocations to the various claimants and defendants, thereby balancing the interests among the parties.

B. Claims Arising Against Corporations Dissolved After January 1, 1992

Since cases after January 1, 1992, are governed by statute, it is most appropriate that the current statute be revised to rectify the situation. The recently revised statute should be used as a general rule for most claims, but two major exceptions should be made. The first exception would be for areas of the law where the legislature has already provided for long statutes of limitations. For example, many years of experience resulted in a ten year statute of limitations in real estate construction cases.\(^\text{216}\) Most serious defects in real property are not discovered until many years after the construction has been completed. In construction defect cases, therefore, the time period for bringing a cause of action should be lengthened to at least ten years. The result of the statute in its current state is to cut off the statute of limitations by six years.\(^\text{216}\)

The second exception would pertain to activities which are likely to result in a high degree of risk of harm to the public. In such

\(^{215}\) See discussion supra part IV.B.1.a.

cases, reasonably foreseeable harms are often not discovered in four years time.\textsuperscript{217} For example, in cases where a new drug or medical procedure is imparted on an individual, the results often cannot be precisely determined for years.\textsuperscript{218} The time period for bringing an action against the shareholders of dissolved corporations which were engaged in businesses with a high degree of risk of harm to the public should be determined under the formerly applicable equitable trust fund theory with the added proviso that the doctrine should be applied to claims arising after dissolution in addition to claims arising prior to dissolution. Whether a particular activity falls within the extended liability period can be determined on an individual basis with a factual determination made by a judge. Because these types of claims often do not arise for many years afterward, allowing the shareholders to escape with the profits without liability is inequitable.\textsuperscript{219} These two exceptions to the general rule provide for a much more equitable result for individuals suffering the aforementioned types of harm from corporations that existed long enough to generate a profit and cause the claimant's damage.

Incorporating these two exceptions into section 2011 of the California Corporations Code, the amended statute might read as follows:

\textsuperscript{217} See supra note 104 for examples of claims not likely to arise within four years.
\textsuperscript{218} See supra notes 104, 148.
\textsuperscript{219} See supra notes 146, 148.
distributed to the shareholder upon dissolution of the corporation.

(2) Except as set forth in subparts (C) and (D), herein, and subdivision (c), below, all causes of action against a shareholder of a dissolved corporation arising under this section are extinguished unless the claimant commences a proceeding to enforce the cause of action against that shareholder of a dissolved corporation prior to the earlier of the following:

(A) The expiration of the statute of limitations applicable to the cause of action.

(B) Four years after the effective date of the dissolution of the corporation except that:

(i) In cases involving real estate development and or construction, as defined under section 337.15, all causes of action against a shareholder of such a dissolved corporation are extinguished unless the claimant commences a proceeding to enforce the cause of action against that shareholder of a dissolved corporation prior to the expiration of the ten year statute of limitations applicable to that cause of action; and

(ii) In cases involving a corporation engaged in a business with a high degree of risk of harm to the public, the time period for bringing causes of action against the shareholders of dissolved corporations will be determined under the equitable trust fund theory by the courts reviewing the matter regardless of whether the claim arose prior to or after the dissolution.

(iii) As a matter of procedure only, and not for purposes of determining liability, shareholders of the dissolved corporation may be sued in the corporate name of the corporation upon any cause of action against the corporation. This section does not affect the rights of the corporation or its creditors under Section 2009, or the rights, if any, of creditors under the Uniform Fraudulent Transfer Act, which may arise against the shareholders of a corporation.

(iv) This subdivision applies to corporations dissolved on and after January 1, 1992. Corporations dissolved prior to that date are subject to the law in effect prior to that date.

VI. CONCLUSION

California's current laws concerning continuing corporate and shareholder liability after dissolution are inadequate to equitably balance the competing interests of the involved parties. If a claim is brought against a corporation dissolved prior to January 1, 1992, the claimant can sue the corporation and its shareholders on a pre-dissolution claim, but is limited to only suing the corporation on a post-
dissolution claim. The result is to arbitrarily distinguish among claimants, depending on when the particular claim arose. This state of the law penalizes claimants whose claims arise after a corporation has dissolved.

Recognizing the arbitrariness of this law, the legislature amended California's Corporations Code so that a claim brought against a corporation dissolved after January 1, 1992, can be brought against the shareholders of the dissolved corporations as well as the corporation itself. While the corporation in the latter instance can be sued indefinitely, shareholder liability is limited to a four year period of time and to the extent of the corporation's assets distributed upon dissolution.

For corporations dissolved prior to the statutory revision, the law arbitrarily distinguishes among who can recover. The law effective prior to January 1, 1992, reflects a public policy favoring shareholder's future investments while sacrificing the individual claimant's rights to recovery. Although the statutory amendment applicable to claims against corporations dissolved on or after January 1, 1992, attempts to rectify the situation by holding shareholders liable to some extent, it only does so in a limited number of cases. Under the new law, large classes of claimants are extremely limited in obtaining redress from dissolved corporations. As a result, shareholders continue to have their investments protected under the revised corporate law statute.

The purpose of this comment was to address the current inequitable state of California's doctrine of continuing corporate and shareholder liability. This purpose was accomplished by examining the historical case law development and recent statutory amendment passed to revise prior law. Additionally, this comment illustrated the shortcomings of the doctrine and analyzed the problems of potential claimants who are prevented from recovery. Finally, the comment proposed a solution that more equitably balances the competing interests in such aforementioned cases by providing more claimants with an opportunity to recover for the damages arising from the business activities of dissolved corporations.

The proposed solution amends existing law by adopting many aspects of formerly applicable common law remedies as well as reflecting California's statutes of limitations. Most importantly, the

222. Id.
proposed solution more equitably provides for the interests of claimants as well as shareholders and insures that recoveries will be made. Unlike the current state of the law, the solution offered will achieve the Legislature's intended balance, without disrupting the underlying premises behind corporations law. The proposed solution should be adopted, because it will put an end to the cycle of inequity that traps large classes of seriously injured plaintiff's and will ultimately benefit all society by presenting equitable solutions to remedy the problems involved.

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