

Shareholder Liability For Postdissolution Claims In California: *Pacific Scene, Inc. v. Penasquitos, Inc.*

I. INTRODUCTION

The “trust fund” doctrine¹ traditionally has been applied to allow satisfaction of predissolution claims out of the distribution of corporate assets to shareholders.² Many courts and commentators have suggested that such an equitable remedy should likewise be applied to those claims arising after the dissolution³ of a corporation.⁴

1. The “trust fund” doctrine is defined as:

[W]here [a] corporation transfers all its assets with a view to going out of business and nothing is left with which to pay debts, [the] transferee is charged with notice of the circumstances of the transaction, and takes the assets subject to an equitable lien for the unpaid debts of the transferring company.

BLACK’S LAW DICTIONARY 1356 (5th ed. 1979).

2. See Henn & Alexander, *Effect of Corporate Dissolution on Products Liability Claims*, 56 CORNELL L. REV. 865, 909 (1971). This viewpoint was also discussed in *Pacific Scene, Inc. v. Penasquitos, Inc.*, 46 Cal. 3d 407, 758 P.2d 1182, 250 Cal. Rptr. 651 (1988).

3. “The dissolution of a corporation is the termination of its existence as a body politic.” BLACK’S LAW DICTIONARY 425 (5th ed. 1979). In California, a corporation may be dissolved involuntarily by: 1.) a limited number of people by the filing of a verified complaint in a county superior court, provided certain criteria are met (CAL. CORP. CODE § 1800 (West 1977)); or 2.) attorney general on certain grounds (CAL. CORP. CODE § 1801 (West 1977)). The grounds for involuntary dissolution are drastic since the legislative intent was to restrict involuntary dissolution to limited instances. CAL. CORP. CODE § 1800, Leg. Comm. Comment (1975) - Assembly (West Supp. 1988). Once the corporation has been involuntarily dissolved by “order, decree or judgment of a court, a copy of the order, decree or judgment, certified by the clerk of court, shall forthwith be filed in the office of the Secretary of State.” CAL. CORP. CODE § 1809 (West 1977).

A corporation may also close its doors voluntarily. A majority of shareholders may vote to dissolve the corporation. CAL. CORP. CODE § 1900 (West 1977 & Supp. 1989). Once a corporation has completed the process of closing down, a certificate of dissolution, signed and verified by a majority of directors, is filed with the Secretary of State. CAL. CORP. CODE § 1905 (West 1977 & Supp. 1989). All shareholders and known creditors are notified of the voluntary dissolution pursuant to CAL. CORP. CODE § 1903 (West 1977).

CAL. CORP. CODE §§ 2000-11 cover the dissolution process, other than the procedural requirements of filing a certificate of dissolution. This Note will deal with topics covered generally by § 2009 and § 2011. See *infra* notes 23-24 and accompanying text. Section 2010 also is relevant, although not mentioned in the California Supreme Court’s decision in *Pacific Scene, Inc. v. Penasquitos, Inc.*, 46 Cal. 3d 403, 758 P.2d 1182, 250 Cal. Rptr.

However, a recent California Supreme Court case, *Pacific Scene, Inc. v. Penasquitos, Inc.*,⁵ concluded that the California Legislature had precluded the availability of that equitable remedy when it amended the California Corporations Code in 1975.

This Note will review the equitable remedy traditionally allowed under the "trust fund" theory and the statutory corporate scheme now in place in California. In addition, California case law, before the 1975 amendment to the Corporations Code and after, will be reviewed. This Note will then discuss the policy reasons behind the California Supreme Court's decision in *Pacific Scene* disallowing the equitable remedy of holding shareholders liable on predissolution claims. Ultimately, this Note will conclude that, in light of the decision in *Pacific Scene*, there is a need for the legislature to address the issue. The legislature should allow a limited period of time, after dissolution, in which creditors can recover from the dissolved corporation on claims which have arisen after the dissolution of the corporation.

II. DEVELOPMENT OF THE TRUST FUND THEORY

A. *The Common-Law Trust Fund Theory*

The "trust fund" theory began as a common-law doctrine which was applied in courts of equity. Before its adoption, a creditor whose claim arose before the corporation was dissolved had no recourse if the corporation had dissolved before the claim was satisfied.⁶

The trust fund theory, articulated in *Wood v. Dummer*⁷ and again in *Mumma v. The Potomac Co.*,⁸ was based on constitutional contract clause principles.⁹ The idea behind this doctrine is that share-

651 (1988). Section 2010 allows a corporation to continue for certain limited purposes during the winding-up period: litigation; conveyance of property and other assets; and any other action which is included in winding up the affairs of the corporation. CAL. CORP. CODE § 2010 (West 1977). See also C. FRIEDMAN, CALIFORNIA PRACTICE GUIDE CORPORATIONS § 8(1)590-94 (student ed. 1988).

4. Henn & Alexander, *supra* note 2, at 909 n.5.

5. 46 Cal. 3d 407, 758 P.2d 1182, 250 Cal. Rptr. 651 (1988).

6. A bona fide creditor might find that there was no recovery possible. Courts of equity applied the "trust fund" theory to get around this potentially harsh result by holding shareholders liable to those creditors for any amounts received on dissolution. Wal-lach, *Products Liability: A Remedy in Search of a Defendant - The Effect of a Sale of Assets and Subsequent Dissolution on Products Dissatisfaction Claims*, 41 Mo. L. REV. 321, 328 (1976). Dissolution of a corporation traditionally put an end to all claims against the corporation. *Id.* at 329.

7. 30 F. Cas. 435 (C.C.D. Me. 1824) (No. 17,944) (Story, C.J.).

8. 33 U.S. (8 Pet.) 281 (1834).

9. The rationale was that state laws governing the dissolution of a corporation could not impair the obligation of the contract between the corporation and the creditor; that obligation would survive the dissolution of the corporation. Mr. Justice Story, delivering the court's opinion in *Mumma*, analogized a dead corporation's contractual obligations to those of a dead person's. "The obligation of those contracts survives; and the

holders are acting as trustees over a fund to which creditors have a superior claim. The shareholders are liable for any claims which a creditor might have against the dissolved corporation to the extent they received corporate assets. This is true whether or not the shareholders knew of the claims when they received the distribution.¹⁰

B. *The Trust Fund Theory and California Case Law*

California courts have recognized the viability of the "trust fund" theory for more than eighty years. The first California case which recognized the validity of this equitable theory was *Crossman v. Vivienda Water Co.*¹¹ The California Supreme Court stated "[t]he universally accepted modern doctrine is that the debts of the corporation are not vacated by its dissolution. In the absence of statute, equity treats the surviving assets as a trust fund for the creditors and stockholders, and enables beneficiaries to reach the same by appropriate procedure."¹²

In *Trubowitch v. Riverbank Canning Co.*,¹³ the California Supreme Court looked at whether a contract could be enforced by the assignee after the dissolution of the contracting corporation. The court did not specifically base its holding on the "trust fund" theory, but reiterated in dicta the importance of the "trust fund" theory in California law.¹⁴

More recent cases have also allowed recovery under the equitable "trust fund" theory. In 1970, the Fourth District Court of Appeal held, in *Zinn v. Bright*,¹⁵ that a creditor's sole means of recovering from a dissolved corporation was under this theory. However, at the time *Zinn* was decided, there was a slightly different version of the corporations code in place.¹⁶ That version gave a creditor no legal

creditors may enforce their claims against any property belonging to the corporation, which has not passed into the hands of bona fide purchasers. . . ." *Id.* at 285.

10. See H. HENN, HANDBOOK FOR THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 171 (2d ed. 1970) for a discussion of the development of the "trust fund" theory.

11. 150 Cal. 575, 89 P. 335 (1907).

12. *Id.* at 579, 89 P. at 336.

13. 30 Cal. 2d 335, 182 P.2d 182 (1947).

14. "Since the assets of a dissolved corporation can only be distributed to the shareholders subject to the rights of creditors of the corporation, the assets of the corporation remained subject to an equitable charge for all debts owed by the corporation . . ." *Id.* at 345, 182 P.2d at 188-89.

15. 9 Cal. App. 3d 188, 87 Cal. Rptr. 736 (1970).

16. 1947 Cal. Stat. 2396 (current version at CAL. CORP. CODE § 2009 (West 1977)). See *infra* notes 22-23.

right of action and imposed no duty on the corporation to bring an action against its shareholders.¹⁷ Therefore, the court held there was no statutory limit on a creditor's equitable right to pursue recovery¹⁸ under the "trust fund" theory.¹⁹ The corporation was the only party which could bring an action against a shareholder under the old section 5012; creditors had no statutory remedy.²⁰

C. The Current Statutory Scheme

In 1975, the California Corporations Code was amended to provide specific procedures for making claims against dissolved corporations.²¹ This was a distinct change from the previous section 5012, which allowed only the corporation, or its representative in bankruptcy, to sue shareholders for assets improperly distributed. Creditors had no statutory right to directly sue shareholders to recover assets the shareholders might have received improperly. In addition, the corporation had no duty to bring an action against the shareholders to satisfy any outstanding creditor liability.²² Thus, under the old section 5012, creditors could potentially be left without a statutory remedy to recover on any claims after dissolution of the corporation.

The amended statutory scheme added a statutory right of creditors to sue the shareholders for any improper distribution of corporate assets. That right can be found in California Corporation Code section 2009 which replaces the former section 5012.²³

17. Cf. CAL. CORP. CODE § 2009 (West 1977). See *infra* note 23.

18. *Zinn*, 9 Cal. App. 3d at 192, 87 Cal. Rptr. at 739.

19. *Id.* The court based its holding on the rule that if there is no statute which specifically excludes the equitable remedy, the court will allow that equitable remedy to be pursued. The Ninth Circuit, in *United States v. Oil Resources, Inc.*, 817 F.2d 1429 (9th Cir. 1987), applied the converse of this rule to deny recovery under the "trust fund" theory. The *Oil Resources* court felt that the legislature had enacted an appropriate statutory remedy in CAL. CORP. CODE § 2009. See *infra* notes 34-38 and accompanying text.

20. Cf. CAL. CORP. CODE § 2009 (West 1977). See *infra* note 23.

21. See 1975 Cal. Stat. 1609. The changes were effective January 1977.

22. 1947 Cal. Stat. 2396. Section 5012 provided in relevant part:

Whenever in the process of winding up a corporation any distribution of assets has been made . . . without prior payment or adequate provision for payment of any of the debts and liabilities of the corporation, any amount so improperly distributed to any shareholder or owner of shares may be recovered by the corporation or by its receiver, liquidator, or trustee in bankruptcy. Any of such shareholders or owners may be joined as defendants in the same action or brought in on the motion of any other defendant.

Id.

23. CAL. CORP. CODE § 2009 (West 1977). Section 2009 provides in relevant part:

(a) Whenever in the process of winding up a corporation any distribution of assets has been made . . . without prior payment or adequate provision for payment of any of the debts and liabilities of the corporation, any amount so improperly distributed to any shareholder may be recovered by the corporation (b) Suit may be brought in the name of the corporation to enforce the liability under subdivision (a) against any or all shareholders receiving the dis-

In addition, Section 2011 sets up the procedural go ahead for creditors to sue in the name of the corporation, after the corporation has been dissolved.²⁴

Subsequent courts had a difficult time determining if sections 2009 and 2011 were meant to negate the equitable "trust fund" remedy historically available in California.

D. Case law Since the 1975 California Corporations Code Revision

In 1977, the California Supreme Court heard the case of *Ray v. Alad Corp.*²⁵ The main thrust of the case was the overlap between the remedies provided under the California Corporations Code and the remedies promulgated by the California Supreme Court in the field of products liability recovery.²⁶ The general rule was that a successor corporation was not responsible for a predecessor's liabilities, however, this court made an exception to that rule based on the policies behind strict products liability in California.²⁷ While this case dealt with the liability which would be attributed to a successor corporation, it can be analogized to the liability of shareholders after the dissolution of the corporation.²⁸ In both situations, courts have

tribution by any one or more creditors of the corporation, whether or not they have reduced their claims to judgment.

Id.

24. CAL. CORP. CODE § 2011 (West 1977). Section 2011 provides in relevant part: "(a) In all cases where a corporation has been dissolved, the shareholders may be sued in the corporate name of such corporation upon any cause of action against the corporation arising prior to its dissolution. This section is procedural in nature and is not intended to determine liability." *Id.*

25. 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977).

26. The plaintiff brought a strict liability tort action for injuries which he sustained in a fall from a defective ladder six months after the defendant corporation had acquired the assets of the manufacturing corporation. *Id.* at 25-28, 560 P.2d at 5-7, 136 Cal. Rptr. at 576-78.

27. *Id.* at 34, 560 P.2d at 11, 136 Cal. Rptr. at 582. The court found that the successor corporation was producing essentially the same product (the ladder), was relying on the predecessor corporation's goodwill in selling the product, and was not differentiating itself in the public's mind from the predecessor corporation. All of these factors led the court to hold the successor corporation liable for a defective product manufactured by the predecessor corporation. The court found that the successor corporation was enjoying substantial benefits from the acquisition of the predecessor corporation and should therefore shoulder the accompanying burdens. *Id.* at 34, 560 P.2d at 10-11, 136 Cal. Rptr. at 581-82.

28. Shareholders are also benefitting from the predecessor corporation's goodwill and ability to produce a beneficial product when they cash out their equity position in the corporation. Traditionally, however, shareholders have been held liable for a corporation's liabilities under the equitable "trust fund" theory, while successor corporations

given plaintiffs an equitable way to recover for their injuries even though the corporation has been dissolved.

In *Levin Metals Corp. v. Parr-Richmond Terminal Co.*,²⁹ the United States District Court of the Northern District of California, applying California law, barred equitable recovery from the shareholders of a dissolved corporation on a predissolution claim. The court stated that there were no other reported California cases at the time which had decided the question of shareholder liability. All of the previous cases had been decided under the older California corporate statutory scheme.³⁰

In reaching its decision, the court analogized to the results reached in two federal district court cases: one decided under Iowa law³¹ and the other decided under Massachusetts law.³² However, this analogy was flawed for a basic reason. The two corporation codes relied on in these cases were significantly different from the California corporation provisions, despite the contrary statement by the *Levin Metals* court. Both Iowa and Massachusetts put time limitations on causes of action filed after the dissolution of the corporation.³³ California does not have a statute of limitations on recovery of predissolution claims against a dissolved corporation.

In 1987 *United States v. Oil Resources, Inc.*³⁴ came before the Ninth Circuit. This case involved a claim of shareholder liability for the taxes of a dissolved corporation. The IRS had sued the successor corporation, the predecessor corporation, Oil Resources, and Oil Resources' shareholders. The IRS sought to recover back taxes owed by Oil Resources.³⁵ The district court held that the shareholders of Oil

often have not been held liable.

29. 631 F. Supp. 303 (N.D. Cal. 1986).

30. *Id.* at 304. See *supra* notes 11-20 and accompanying text.

31. *Bishop v. Schield Bantam Co.*, 293 F.Supp. 94 (N.D. Iowa 1968). See *infra* note 33 for an analysis of the Iowa statute.

32. *Gonzalez v. Progressive Tool & Die Co.*, 455 F. Supp. 363 (E.D.N.Y. 1978). See *infra* note 33 for an analysis of the Massachusetts statute.

33. The *Bishop* court limited the time for recovery on predissolution claims to the two year statute of limitations set out in the IOWA CODE ANN. § 496A.102 (West 1962 & Supp. 1988). The *Gonzalez* court declined to allow recovery under the "trust fund" theory because Massachusetts law provided for the existence of a dissolved corporation for three years after dissolution "for the purpose of prosecuting and defending suits . . ." MASS. GEN. LAWS ANN. ch. 156B, § 102 (West 1970 & Supp. 1988). The legislature had placed a statute of limitations on recovery but in the process impliedly allowed recovery for postdissolution claims. See *also infra* note 80 and accompanying text.

34. 817 F.2d 1429 (9th Cir. 1987).

35. The predecessor corporation was Oil Resources, Inc. It had "transferred all of its assets and liabilities to Capital Energy Corporation [the successor corporation] in exchange for Capital stock." *Id.* at 1430. The Capital stock was distributed to all Oil Resources shareholders and Oil Resources was dissolved. Capital had assumed Oil Resources' unpaid tax liabilities as part of the exchange. *Id.* at 1430-31. The federal circuit court held there was a de facto merger of the two corporations. *Id.* at 1434, 1484 n.6.

Resources were liable under the "trust fund" theory.³⁶

The court of appeals reversed, closing off the possibility of recovering from Oil Resources' shareholders. However, this court left open the possibility that shareholders would be held liable if adequate provision for predissolution liabilities had not been made.³⁷ The court based its decision on the presence of section 2009 which specifically deals with predissolution claims.³⁸ The court did not discuss post-dissolution claims.

III. EXPOSITION OF THE CASE

A. *The Facts*

Pacific Scene, Inc. (Pacific) is a California corporation which mass produces tract homes. Penasquitos, Inc. (Penasquitos) was a California corporation which developed, finished, and sold residential lots which were used for tract homes. In 1974, Penasquitos sold a number of graded lots to Pacific. Pacific built homes on those lots and a year later sold those homes to the public. In 1979, Penasquitos was dissolved.³⁹ In 1982, nine homes sustained damage resulting from soil subsidence of lots which Penasquitos sold to Pacific. The homeowners sued Pacific on theories of strict products liability, negligence, and breach of warranty.⁴⁰

Pacific cross-claimed against Penasquitos, which demurred.⁴¹ The trial court sustained the demurrer without leave to amend and dismissed the cross-complaint.⁴² The trial court concluded that Califor-

36. *Id.* at 1432, 1434. The only time the equitable remedy would not be available would be when the common-law remedy under the "trust fund" theory specifically conflicted with the statutory remedies. *Id.* at 1432-33. Yet, the court effectively foreclosed the availability of the "trust fund" theory to creditors looking for relief in a de facto merger situation. *Id.* at 1434.

37. The analysis revolved around the Uniform Fraudulent Transfer Act (UFTA), CAL. CIV. CODE §§ 3439-3439.12 (West Supp. 1989). *See infra* notes 81-89 and accompanying text. The court held that there had been adequate provision for the debts of the predecessor corporation and sufficient consideration had been paid when Capital exchanged stock for the assets of Oil Resources. *Oil Resources*, 817 F.2d at 1432-33.

38. *See supra* note 23. "Common law rules must yield when they conflict with a statute's logic and intention Insofar as the theories may conflict, permitting relief under the *Trubowitch* 'trust fund' theory would undermine legislative intent." *Oil Resources*, 817 F.2d at 1432-33. (citations omitted).

39. It is unclear from the facts whether the dissolution was voluntary or involuntary. *See supra* note 3 for a detailed discussion of dissolution procedures in California.

40. *Pacific Scene, Inc. v. Penasquitos, Inc.*, 46 Cal. 3d 407, 409, 758 P.2d 1182, 1182, 250 Cal. Rptr. 651, 652 (1988).

41. *Id.*

42. *Id.* at 409, 758 P.2d at 1182-83, 250 Cal. Rptr. at 652. There would be no

nia Corporations Code section 2011 barred a suit against a dissolved corporation on claims arising after the dissolution.⁴³ The court of appeal agreed that the corporation itself could not be sued. However, it reversed with directions to grant Pacific leave to cross-complain against the former shareholders of Penasquitos under the equitable “trust fund” theory.⁴⁴ The California Supreme Court granted the shareholders’ petition for review⁴⁵ and reversed the court of appeal, concluding that Pacific’s postdissolution claim against the shareholders of Penasquitos under the “trust fund” theory was barred.⁴⁶

B. *The Court of Appeal’s Opinion*

The Fourth District Court of Appeal, Division One, looked at the history of the California Corporation Codes dealing with dissolution, yet came up with a result opposed to the California Supreme Court’s final decision.⁴⁷ The court of appeal concluded that the equitable means of recovery was still available to creditors. The court found that plaintiffs would suffer an unjust hardship if there were no equitable “trust fund” recovery. The dissolved corporation was no longer in existence and the shareholders who had received distributions from the dissolved corporation would be free from any claims arising out of postdissolution injuries, absent fraud or consideration

question of Penasquitos’ liability if it had been a “living” corporation. California courts had recognized the liability of both builder-sellers of mass-produced homes and developers of residential lots under the strict products liability rule outlined in *Greenman v. Yuba Power Products, Inc.*, 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963). See *infra* notes 90-98 and accompanying text for a discussion of the products liability concerns raised in *Pacific Scene*. The two cases which established the liability of developers and builders were *Kriegler v. Eichler Homes*, 269 Cal. App. 2d 224, 74 Cal. Rptr. 749 (1969) and *Avner v. Longridge Estates*, 272 Cal. App. 2d 607, 77 Cal. Rptr. 633 (1969). See *infra* notes 92-93 and accompanying text.

43. *Pacific Scene, Inc. v. Penasquitos, Inc.*, 195 Cal. App. 3d 533, 536, 240 Cal. Rptr. 758, 759 (1987). The claims brought before the court “arose” when the homeowners discovered the damage to their homes due to the soil subsidence, three years after Penasquitos had dissolved. “In all cases, the statute of limitations begins to run from the time the cause of action accrues. The general rule is that the cause of action accrues on the date of injury in a negligence action.” 2 M. MADDEN, *PRODUCTS LIABILITY* § 18.1 (2d ed. 1988).

California has an additional statute of limitations on causes of action relating to damage due to development or improvement of real property. CAL. CIV. PROC. CODE § 337.15(a) (West 1982). That statute of limitations limits recovery to 10 years after “the substantial completion of the development or improvement” for any damage due to a latent deficiency. *Id.* The statute defines a latent deficiency as a “deficiency which is not apparent by reasonable inspection.” CAL. CIV. PROC. CODE § 337.15(b) (West 1982). This statute of limitations was not an issue in *Pacific Scene*, although there are many instances where it might be of overwhelming importance.

44. *Pacific Scene*, 195 Cal. App. 3d at 545, 240 Cal. Rptr. at 766.

45. *Pacific Scene, Inc. v. Penasquitos, Inc.*, 747 P.2d 527, 243 Cal. Rptr. 86 (1988) (en banc).

46. *Pacific Scene*, 46 Cal. 3d at 410, 758 P.2d at 1183, 250 Cal. Rptr. at 652.

47. *Pacific Scene*, 195 Cal. App. 3d at 545, 240 Cal. Rptr. at 766.

problems.⁴⁸

The court of appeal was practical in reaching its decision to allow retention of the "trust fund" theory of recovery. It mentioned that, without that theory of recovery, a corporation might purposely plan to limit its lifespan to cut off shareholder's liability, especially in those industries where there is a greater risk of products liability.⁴⁹

The court of appeal also emphasized the history of products liability in California. The court argued that history and the policies behind the products liability theory must be considered in coming to a reasoned decision in this case. Those policy reasons include California's traditional place at the forefront of protection of injured consumers, and the idea that the cost of the injury should be borne by the manufacturer of the defective product.⁵⁰

C. *The California Supreme Court's Opinion*

The California Supreme Court's opinion⁵¹ focused on the shareholders' arguments that the California legislature had prescribed the rights and remedies relating to corporate dissolution in such detail that the equitable "trust fund" remedy was no longer available.⁵² While there is no legislative history available for section 2011,⁵³ the

48. *Id.* at 543-44, 240 Cal. Rptr. at 765. See *infra* notes 81-89 and accompanying text for a discussion of the relationship of fraudulent transfers to dissolution of corporations.

49. *Id.*

50. *Id.* The traditional policy reasons behind applying strict liability in tort, articulated by leading commentators in the field, are:

(1) The costs of damaging events due to defectively dangerous products can be borne by the enterprisers who make and sell these products (2) The cause of accident prevention can be promoted by the adoption of strict liability and the elimination of the necessity for proving negligence (3) . . . for institutional reasons and because of the costs of litigation, proof of the existence of fault of negligence in the sale of a defective products should no longer be required

W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS 692-93 (5th ed. 1984).

51. The opinion was written by J. Mosk, with six other justices concurring. There was no dissenting opinion.

52. *Pacific Scene*, 46 Cal. 3d at 409-10, 758 P.2d at 1183, 250 Cal. Rptr. at 652. The court focused on § 2009 and § 2011(a) of the California Corporations Code. See *supra* notes 23-24 and accompanying text.

53. The court of appeal specifically mentioned its attempt to track down the legislative history of § 2011. "We unsuccessfully attempted to obtain legislative history materials from both the Legislature and the State Bar. We were able to locate more than 200 pages of materials concerning the bill [the amendment to the Corporations Code] through the State Archives, but section 2011 is never mentioned." *Pacific Scene*, 195 Cal. App. 3d at 538, 240 Cal. Rptr. at 761.

California Supreme Court discussed in detail a legislative intent to create finality and certainty in corporate dissolution.⁵⁴ It was that interpretation of the legislative intent that led the court to conclude that the equitable remedy which Pacific sought would frustrate the general purpose of the Corporations Code.⁵⁵

In addition, the court looked at the history of the two Corporate Code sections⁵⁶ and how they had been amended over the years. Because amendments had substantially altered the statutes after the earlier cases had been decided, the court distinguished those cases from the case before it.⁵⁷ The court argued that the equitable remedy was barred by the statutory scheme, foreclosing the possibility of Pacific recovering from Penasquitos, or its shareholders, in a cross-complaint.⁵⁸

IV. ANALYSIS

The California Supreme Court and the lower court of appeal emphasized four areas of analysis: the applicability of sections 2009 and 2011 to postdissolution claims; the need for finality for both the corporation and its shareholders; products liability and latent defect⁵⁹ concerns; and the applicability of the Uniform Fraudulent Transfer Act (UFTA)⁶⁰ to the dissolution of a corporation and distribution of its assets to shareholders. While the final result of not holding the

54. *Pacific Scene*, 46 Cal. 3d at 417, 758 P.2d at 1188, 250 Cal. Rptr. at 657-58. Arguably, the California legislature was not overly concerned with the need for finality. Many states have statutorily provided certainty to corporations with regard to predissolution claims by only allowing actions against a dissolved corporation, its officers, directors or shareholders within two years of the dissolution. See *infra* note 79 and accompanying text. California, however, has declined to place a time limitation on predissolution claims. See CAL. CORP. CODE § 2009 (West 1977).

55. Arguably, the need for finality is more important to the corporation itself. It has a need to wind up its affairs; dissolution has essentially rendered it dead. See *supra* note 3.

56. Sections 2009 and 2011. Section 2009 was previously known as § 5012. See *supra* note 22. Section 2011 was previously known as §§ 3305, 3305.1, 3305.2, and 3306. CAL. CORP. CODE xxi-xxii (West 1977).

57. The court specifically looked at the previous § 5012 and the *Zinn* case, stating that two commentators had concluded that § 2009 effectively overruled *Zinn* and its reliance on the equitable "trust fund" theory. *Pacific Scene*, 46 Cal. 3d at 412, 758 P.2d at 1185, 250 Cal. Rptr. at 654. The commentary by Ballantine and Sterling opined that the "trust fund" recoveries were barred after the passage of § 2009. The source for this statement was the *Oil Resources* decision. 1A BALLANTINE & STERLING, CALIFORNIA CORPORATION LAWS § 317.04 (4th ed. 1988). See also *supra* notes 34-38 and accompanying text.

58. See *infra* notes 61-76 and accompanying text.

59. "Latent defect" is defined as a defect "which could not be discovered by reasonable and customary inspection." BLACK'S LAW DICTIONARY 794 (5th ed. 1979).

60. CAL. CIV. CODE §§ 3439-3439.12 (West Supp. 1988). "Fraudulent conveyance law is a set of remedial principles designed to protect creditors from debtors who transfer their assets in a form detrimental to creditors' claims." *Fraudulent Conveyances*, 5 Debtor-Creditor Law (MB) ¶ 22.01[A] (Dec. 1988). This is generally applied in bankruptcy and insolvency cases.

shareholders liable eight years after the lots were graded and three years after the dissolution of the corporation has its merits, the analysis which the California Supreme Court used was flawed.

A. Applicability of Sections 2009 and 2011 to Postdissolution Claims

Pacific Scene involves a conflict between section 2009, a rather specific all-encompassing statute covering debts and liabilities of the corporation when it dissolves,⁶¹ and section 2011, a procedural statute regarding predissolution claims.⁶² The problem arises in determining if section 2009 applies solely to predissolution claims, thus leaving open equitable recovery under the "trust fund" theory. The California Supreme Court found that the California legislature had set out "detailed statutory remedies now encompassing virtually all claims previously asserted in equity against former shareholders of dissolved corporations."⁶³ However, there is no direct evidence that the legislature intended section 2009 to apply to postdissolution claims.⁶⁴

Under section 2009, a predissolution creditor of a dissolved corporation may bring a suit, in the name of the corporation, to recover assets distributed to shareholders without adequate provision for that creditor's claim.⁶⁵ It doesn't matter whether the creditor's claim has been reduced to judgment; the predissolution creditor retains the right to bring both a predissolution and a postdissolution suit.⁶⁶

In *Oil Resources*,⁶⁷ the Ninth Circuit interpreted this section in a manner consistent with the California Supreme Court's decision in *Pacific Scene*. Their interpretations bar equitable recovery for claims arising after dissolution, even though the language of section 2009 taken with section 2011 speaks only to predissolution claims. Thus, despite the lack of legislative history clearly requiring such an inter-

61. CAL. CORP. CODE § 2009 (West 1977). See *supra* note 23 for the text of this code section.

62. CAL. CORP. CODE § 2011 (West 1977). See *supra* note 24 for the text of this code section.

63. *Pacific Scene*, 46 Cal. 3d at 413, 758 P.2d at 1185, 250 Cal. Rptr. at 655.

64. If the legislature had intended that result, they simply had to add language to the text of the statute, limiting the equitable remedy. By leaving it out, arguably, they were allowing for the equitable "trust fund" remedy which had an 80-year history in the state of California. See *supra* notes 11-20 and accompanying text.

65. CAL. CORP. CODE § 2009(a), (b) (West 1977).

66. CAL. CORP. CODE § 2009(b) (West 1977).

67. 817 F.2d 1429 (9th Cir. 1987). See *supra* notes 34-38 and accompanying text.

pretation,⁶⁸ the California Supreme Court was willing to find that section 2009 precludes equitable recovery. Arguably, section 2009 fails to distinguish between pre and postdissolution claims due to the legislature's recognition of California's long history of allowing recovery under the "trust fund" theory.⁶⁹

Section 2011 is solely a procedural statute.⁷⁰ It allows shareholders to be sued on any cause of action "arising prior to [the corporation's] dissolution."⁷¹ Shareholders of Penasquitos argued that since there was no provision within section 2011 for postdissolution claims, the legislature had declined to give postdissolution claimants any means of recovery.⁷² The California Supreme Court declined to base its denial of equitable recovery to postdissolution claimants on this "negative implication."⁷³

However, the court rejected the court of appeal's finding that since section 2011 only spoke of predissolution claims, postdissolution claims were "relegat[ed] . . . to . . . equity."⁷⁴ The court applied a legislative history analysis of the underlying rationales for the dissolution sections of the corporations code.⁷⁵ That purpose was to provide finality and certainty to the dissolution process.⁷⁶ In doing so, the court precluded equitable recovery. Arguably, section 2011 is subject to the same analysis applied to section 2009 above.

B. Need for Finality

There is legitimate need for finality when winding up the affairs of a corporation. The corporation and its shareholders share that need, although they have different motivations. The corporation has a need for certainty in its winding up process so that it can close its books, provide for its debts and liabilities, and distribute the remaining assets to the shareholders.⁷⁷

Likewise, the shareholders have a need for certainty. When they receive their share of the corporate assets, they should not be re-

68. See *supra* note 53.

69. See *supra* notes 11-20 and accompanying text for a brief overview of decisions which have allowed shareholder liability under the "trust fund" theory.

70. See C. FRIEDMAN, *supra* note 3, § 8 at ¶597.

71. CAL. CORP. CODE § 2011(a). Section 2011, however, "does not authorize suits against a dissolved corporation's shareholders for causes of action *arising after* dissolution." C. FRIEDMAN, *supra* note 3, § 8 at ¶600 (emphasis original).

72. *Pacific Scene*, 46 Cal. 3d at 414, 758 P.2d at 1186, 250 Cal. Rptr. at 655.

73. *Id.*

74. *Id.*, at 415, 758 P.2d at 1186, 250 Cal. Rptr. at 656.

75. The court merely cited to §§ 2009-11 for its finding of legislative purpose. *Id.*, 758 P.2d at 1186, 250 Cal. Rptr. at 655.

76. *Id.*

77. The need has its basis in the idea that a dissolved corporation is a dead corporation. See *supra* note 9. The need can best be understood by analogy to the need for winding up the estate of a dead person in a timely fashion.

quired to hold the money in "trust" on the remote possibility of a postdissolution claim. They will want to spend or reinvest that money, not keep it tied up.⁷⁸

These needs for finality on the parts of the shareholders and the corporation are in direct conflict with the interests of the creditors of the corporation, both known and unknown. A creditor has a right to recover any debt owed to him or her by the dissolved corporation. If the debt arises prior to dissolution of the corporation, as it would in a normal general business creditor case, the creditor has a statutory cause of action.⁷⁹ However, if it is a claim arising after dissolution of the corporation, it is barred by the California Supreme Court's decision in *Pacific Scene*.

Is there a resolution to this conflict between the corporation's and its shareholders' needs for finality and the legitimate interest of creditors in recovering their claims? The ideal resolution does not lie in the decision of the *Pacific Scene* court to bar postdissolution claims completely.

If the courts are concerned about the unlimited liability which would attach to the shareholder's distribution under the "trust fund" theory, another possible solution would be to allow postdissolution claims for a limited period of time after the dissolution of the corporation, such as three years.⁸⁰ That would allow creditor's claims which might arise after dissolution of the corporation to be pursued. It would also address both the corporation's and its shareholders' fi-

78. Contrast the ability of a shareholder to continue using the assets after distribution with the limited ability of a corporation to continue its existence after it has been declared legally dead in the course of dissolution. See CAL. CORP. CODE § 2010(a) (West 1977) (which provides for a corporation to continue to exist only for "the purpose of winding up its affairs, prosecuting and defending actions by or against it and enabling it to collect and divide its assets . . ."). See also *supra* note 3.

79. CAL. CORP. CODE §§ 2009, 2011 (West 1977). See also *supra* notes 23-24.

80. See, e.g., MODEL BUSINESS CORP. ACT § 105 (1979) (allowing predissolution claims to be prosecuted if commenced within two years after dissolution); MASS. GEN. LAWS ANN. ch. 156B, § 102 (West 1970 & Supp. 1988) (allowing the corporation to be continued for three years after dissolution for purpose of prosecuting and defending suits, in addition to other winding-up processes); IOWA CODE ANN. § 496A.102 (West 1962 & Supp. 1988) (allowing predissolution claims to be prosecuted if commenced within two years of dissolution). These statutes allow predissolution claims to be prosecuted for only a limited period of time. In the Comment to the Model Business Corporation Act section 105, the existence of "a body of equity law allowing suits to be brought against directors and shareholders on the principle of tracing the funds of the corporation after dissolution" is clearly recognized. MODEL BUS. CORP. ACT. ANN. § 105 ¶ 2 (2d ed. 1971). So, if the courts refuse to recognize the "trust fund" theory which is recognized in the Model Business Corporation Act itself, they might extend the statute of limitations applied to predissolution claims to postdissolution claims.

nality concerns by providing a cutoff on liability. Such a solution, however, is for the California legislature, not the court system, given the decision in *Pacific Scene*.

C. Applicability of Uniform Fraudulent Transfer Act (UFTA)

Another potential solution to creditors' concerns was provided by Justice Mosk, in his opinion for the California Supreme Court. He made a passing remark at the end of *Pacific Scene* designed to allay fears that consumers and creditors would be left with no remedy:⁸¹ "Thus if a corporation were to mass produce defective products and then dissolve to avoid liability . . . grave questions would be raised under the Uniform Fraudulent Transfer Act."⁸²

The UFTA allows a creditor to recover assets transferred by the debtor if: (a) the debtor actually intended to defraud the creditor; (b) the debtor did not receive sufficient consideration in exchange for the transfer, provided the debtor "reasonably should have believed"⁸³ he or she would incur more debt than they had assets to pay.⁸⁴

The applicability of this statute to intentionally fraudulent transfers is self-evident. However, its application to postdissolution claims is more problematic. To begin with, the language is unclear whether both requirements, (a) and (b), must be satisfied to have a valid claim under section 3439.04. Between (a) and (b) in the statute there is no connector; there is no "and" or "or."⁸⁵

Aside from that ambiguity, proof of actual intent to defraud will revolve around a court's consideration of the so-called "badges of

81. In all likelihood, J. Mosk derived this idea from the Ninth Circuit's discussion of UFTA concerns in *Oil Resources*, 817 F.2d 1429 (9th Cir. 1987). But, *Oil Resources* applied the UFTA to the transfer of assets between corporations in a de facto merger situation. In *Oil Resources*, the court looked to whether the transfer of assets was made with the intention to defraud or was without adequate consideration. *Id.* at 1432. The court found there was no fraudulent transfer of assets and that *Oil Resources* and its shareholders could not be held liable on that ground. *Id.*

82. *Pacific Scene*, 46 Cal. 3d at 418, 758 P.2d at 1189, 250 Cal. Rptr. at 658 (emphasis added). The court specifically relied on CAL. CIV. CODE § 3439.04. Section 3439.04, entitled "Transfers fraudulent as to present and future creditors," provides in part:

A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation as follows: (a) With actual intent to hinder, delay or defraud any creditor of the debtor. (b) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor: . . . (2) Intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they become due.

CAL. CIV. CODE § 3439.04 (West Supp. 1989).

83. CAL. CIV. CODE § 3439.04(b)(2) (West Supp. 1989).

84. *Id.*

85. See *infra* note 82.

fraud”⁸⁶ in light of all the relevant circumstances.⁸⁷ The creditor would have the burden of proving the debtor’s fraudulent intent in transferring corporate assets to shareholders on dissolution.

If the creditor carried her burden of proof, she would be entitled to “avoidance of the transfer” or “an attachment or other provisional remedy against the asset transferred.”⁸⁸ However, this remedy is limited by the provision that a transfer will not be voided against a good-faith transferee who paid sufficient consideration.⁸⁹

Thus, in a situation where the corporation simply decided to voluntarily dissolve, with no motive of fraud, a subsequent creditor would be unlikely to be successful in pressing a claim for recovery under the UFTA. To be successful, the creditor would have to show that the corporation had been dissolved without adequate provision for all known claims or with an intent to defraud the subsequent creditors. Looking at *Pacific Scene*, it is easy to see the difficulty in applying the UFTA to a case involving a voluntarily and nonfraudulently dissolved corporation.

D. Products Liability Concerns

In addition, *Pacific Scene* involves an important twist: a products liability claim. Unfortunately, the California Supreme Court did not address this products liability aspect in their opinion.⁹⁰

A strict liability claim can be made against a whole line of entities, from the producer of the raw materials to the final retailer.⁹¹ In the late 1960s, California recognized a strict liability cause of action as applied to both builders of mass-produced homes⁹² and developers

86. “Recognized ‘badges of fraud’ include fictitious consideration, false statements as to consideration, transactions different from usual course of doing business, transfer of all of a debtor’s property, insolvency, confidential relationship of parties, and transfers in anticipation of suit or execution.” BLACK’S LAW DICTIONARY 127 (5th ed. 1979).

87. The legislature listed a nonexhaustive set of factors which might be relevant. CAL. CIV. CODE § 3439.04 legislative comm. comment ¶ 5-7 (West Supp. 1989).

88. CAL. CIV. CODE § 3439.07 (West Supp. 1989).

89. CAL. CIV. CODE § 3439.08(a) (West Supp. 1989).

90. The importance of the products liability aspect was addressed in more detail in the court of appeal’s decision. *Pacific Scene*, 195 Cal. App. 3d at 543-45, 240 Cal. Rptr. at 765-66.

91. That line of liability is: producer of the raw material; the maker of the component part; assembler; packager; wholesaler or distributor; one who holds the products out as his or her own; and the retailer. A. WEINSTEIN, A. TWERSKI, H. PIEHLER & W. DONAHER, PRODUCTS LIABILITY AND THE REASONABLY SAFE PRODUCT: A GUIDE FOR MANAGEMENT, DESIGN, AND MARKETING 96-97 (1978).

92. *Kriegler v. Eichler Homes*, 269 Cal. App. 2d 224, 74 Cal. Rptr. 749 (1969). See also *supra* note 42.

of residential lots.⁹³ However, in those cases, the corporations were still in existence when the plaintiffs discovered the latent defects and filed their suits.

Once again, a tension exists between the need for providing for a creditor's claim⁹⁴ and the need for finality in corporate dissolution proceedings. However, the considerations for assessing strict liability claims are slightly skewed by the California courts' leading role in allowing plaintiff recoveries in products liability suits. In these cases, plaintiffs are entitled to recovery since the costs are most efficiently borne by the defendants;⁹⁵ the entity which puts the product on the market should be required to figure the possibility of latent defects into its costs and price its product accordingly. This approach prevents a windfall to shareholders of a corporation that dissolves after taking into account the added costs of strict liability.⁹⁶

One only has to look to the history of California decisions to realize that California courts have been a leader in broadening plaintiff rights in products liability cases.⁹⁷ Yet, in *Pacific Scene* the California Supreme Court turned away from that tradition by relying only on statutory construction of the corporations code to reach its decision. The court denies a number of plaintiffs any recourse, and opens up a way for corporations wishing to protect themselves or their shareholders from liability to insulate themselves in contravention to the acclaimed California products liability doctrine.⁹⁸

V. CONCLUSION

The California Supreme Court's decision in *Pacific Scene*, based on its statutory interpretations, leaves creditors with valid postdissolution claims without any effective remedy. While it is true that the statute can be interpreted in a multitude of ways, it is only by looking at the statute in the environment of products liability that

93. *Avner v. Longridge Estates*, 272 Cal. App. 2d 607, 77 Cal. Rptr. 633 (1969). See also *supra* note 42. In *Avner*, the court "conclude[d] that the manufacturer of a lot may be held strictly liable in tort for damages suffered by the owner as a proximate result of any defects in the manufacturing process." *Id.* at 615, 77 Cal. Rptr. at 639.

94. See *supra* notes 77-80 and accompanying text.

95. See *supra* note 50 and accompanying text.

96. The price of the product will have been raised without a corresponding burden of responding to products liability lawsuits.

97. See, e.g., *Escola v. Coca Cola Bottling Co.*, 24 Cal. 2d 453, 150 P.2d 436 (1944); *Greenman v. Yuba Power Products, Inc.*, 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963).

98. The court of appeal recognized this problem in its decision, foreseeing that "it may become economically prudent for certain corporations to purposefully plan on only limited life spans." *Pacific Scene*, 195 Cal. App. 3d at 544, 240 Cal. Rptr. at 765. The court of appeal felt that this would be especially true in just those industries where the product liability rationale should be applied most strictly, industries such as construction or drug manufacturing. *Id.*

the court could have properly balanced all the factors involved in *Pacific Scene*. The court of appeal had previously produced a decision where all the ramifications were discussed in detail, deciding in favor of shareholder liability under the "trust fund" theory.

The fact that the court of appeal's decision balanced all the factors does not alter its potential for abuse. Shareholders have a need for finality similar to that of the corporation. They should not be held liable ad infinitum for the postdissolution liabilities of their dissolved corporation.

There is a potential for abuse of a different nature in the California Supreme Court's decision. While the court's decision limits the liability of a corporation's shareholder, it does not allow for the possibility of recovery for a postdissolution claimant. By not discussing the products liability aspects, and by making a single remark about the availability of a UFTA remedy, the California Supreme Court decision in *Pacific Scene* is not as well balanced as it could have been.

Arguably, this is not an area where the court should intrude. The California Supreme Court pointedly referred to its unwillingness to engage in judicial lawmaking.⁹⁹ But the history of equitable remedies allows the court to intrude where equity and justice require intrusion. In *Pacific Scene*, the homeowners will not be denied relief since *Pacific Scene* will bear the entire burden of Penasquitos' defective soil compacting. However, it is easy to imagine another case where houses are built by a corporation which also performed the soil compacting. The houses are then sold to home buyers, at which time the corporation is promptly dissolved. Or even more burdensome to a potential plaintiff, one may imagine a drug manufacturer closing down after a limited lifespan to protect itself from possible products liability claims. Should a homeowner later encounter defects in the home or the user of the drug later develop a serious complication, absent evidence of a fraudulent conveyance, there is no remedy left open under the California Supreme Court's decision in *Pacific Scene*.

Given the California Supreme Court's interpretation of sections 2009 and 2011, the legislature now must address the situation. The ideal remedy is for the legislature to allow postdissolution claims for

99. The court specifically denounced judicial lawmaking with regard to providing an equitable remedy for post-dissolution claims. "[T]he matter seems to involve too many imponderables to be susceptible of any satisfactory judicial solution." *Pacific Scene*, 46 Cal. 3d at 413 n.2, 758 P.2d at 1185 n.2, 250 Cal. Rptr. at 655 n.2.

a limited time period following a corporation's dissolution. By doing so, the needs of the corporation and its shareholders for finality would be balanced against the need for recovery by a creditor (be it a plaintiff injured in a strict liability claim or another creditor whose claim did not arise until after dissolution).

The statute of limitations should accommodate different latency periods of injuries by specifying different limitations for various types of conduct. For instance, injuries caused by defective medication are often recognized after a much longer time period than injuries from a defective power tool. Thus, a shorter statute of limitations is appropriate for the tool-caused injury than the drug-related injury.

In the meantime, there will surely be a number of plaintiffs with valid claims left without a remedy due to the California Supreme Court's decision in *Pacific Scene*.

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