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Not Dead Yet — Calif. Corporate Liability In The Afterlife

Law360, New York (February 14, 2013, 1:12 PM ET) -- For any company involved in litigation, California is a "big" state: It is our most populated state, our third largest state and home to two of the nation's 10 most populous metropolitan areas. If California were a country, its economy would rank eighth among all nations, between Italy and Brazil.

But to companies that have sold products in California, California also is big in a not-so-positive way. In 2012, the American Tort Reform Association awarded California the dubious honor of being the nation's number one "judicial hellhole" for, among many litigation abuses, its runaway asbestos litigation. For these reasons, a rather dry choice-of-law/statutory interpretation case pending before the Supreme Court of California could have serious financial ramifications for manufacturers and their insurers.

A corporation is a legal fiction that is purely a creature of state law. At common law, the "dissolution" of that state-created entity extinguished corporate existence and was thus considered the equivalent to the death of a natural person. As such, upon dissolution, creditors and claimants of the corporation were left without recourse.

Modern state laws altered the common law to address this inequitable result while continuing to ensure that shareholder liability was limited for the acts of the now-dissolved corporation. So-called "survival" and "wind-up" statutes enable the dissolved corporation to exist as a legal entity for a period of time after dissolution (continuance period) for the limited purposes of prosecuting and defending claims.

Generally, no action may be brought by or against the corporation after the conclusion of the continuance period, regardless of whether the applicable statute of limitations has run. 16A Fletcher Cyclopedia of the Law of Corporations § 8144 (2012). Survival and wind-up statutes thus balance the interests of creditors and claimants of dissolved corporations against the interests of dissolving corporations and their shareholders for finality.

In contrast to most jurisdictions, California has no statutory deadline by which a creditor or claimant must sue a dissolved corporation. California Corporations Code § 2010 permits a dissolved corporation to be sued at any time, forever.

This fundamental difference between the California corporate code and the survival and wind-up statutes of many other states has created an interesting legal issue with serious practical consequences. May an out-of-state state-dissolved corporation continue to be subject to suit in the courts of California after the expiration of the continuance period established by the state law that created that corporation?

This question will soon be resolved by the Supreme Court of California when it reviews the case of Greb v. Diamond Int'l, 108 Cal. Rptr. 3d 741 (Cal. Ct. App.), rev. granted, 237 P.3d 530 (Cal. 2010). The plaintiffs in Greb sued Diamond International Corporation for asbestos-related injuries.

Diamond, a Delaware corporation, was dissolved on July 1, 2005. Delaware has a three-year survival period from the date of dissolution. Del. Code Corp. § 278. The plaintiffs filed suit against Diamond on Dec. 22, 2008, five months after the continuance period expired in Delaware. Diamond moved to dismiss, arguing that it legally did not exist and thus lacked the capacity to be sued.

The plaintiffs opposed the motion, relying on N. Am. Asbestos Corp. v. Superior Ct., 225 Cal. Rptr. 822 (Cal. App. Ct. 1986) (North American II), in which, in a 2-1 decision, California's Court of Appeals of California, First Appellate District, Division 3, reversed its prior opinion in N. Am. Asbestos Corp. v. Superior Ct., 179 Cal. Rptr. 889 (Cal. App. Ct. 1982) (North American I) and held that California Corporations Code § 2010 applies to non-California corporations.

In this case, a dissolved Illinois corporation appealed the denial of its motion for summary judgment in a personal injury asbestos case filed after the Illinois survival period expired. The North American II majority observed that when § 2010's predecessor was originally drafted in 1929, the California Constitution included a provision mandating that the law treat foreign corporations no more favorably than domestic corporations.

Although the constitutional provision was repealed by referendum in 1972, the majority concluded that the electorate did not intend § 2010 to apply exclusively to domestic corporations, thereby bestowing more favorable treatment on dissolved foreign corporations. Having resolved that § 2010 applied to Illinois corporations and was therefore in conflict with Illinois law, the majority engaged in a choice-of-law analysis and concluded that California's interest in applying § 2010 outweighed Illinois's interest in applying Illinois law.

As such, the majority held that § 2010 was applicable to the dissolved Illinois corporate defendant and affirmed the trial court's judgment.

Notwithstanding North American II, the trial court in Greb agreed with Diamond that it lacked legal capacity to be sued and dismissed the suit. The California Court of Appeals, First District, Division 1, agreed, declining to follow North American II and holding that § 2010 does not apply to non-California corporations.

In arriving at its decision, the appellate court first noted that the legal existence of a corporation and its capacity to be sued is usually determined by the laws of the state in which it is incorporated. Under Delaware authority, a suit may not be instituted against a Delaware corporation after the expiration of Delaware's continuance period.

After acknowledging the "convoluted reasoning" applied by the North American II majority, the appeals court noted that the intentions of the original drafters of § 2010 and the 1972 electorate need not be considered in construing the meaning of § 2010 because the language of the statute is plain on its face. The court was also critical of North American II's failure to acknowledge Riley v. Fitzgerald, 223 Cal. Rptr. 889 (Cal. App. Ct. 1986), an opinion from the intermediate appeals court issued two months before North American II, which held that § 2010 does not apply to foreign corporations.

In construing § 2010, the court in Greb observed that California's Corporations Code generally applied to "corporations organized under this division and to domestic corporations." Cal. Corp. Code § 102(a).

The court also ruled that the language of § 102 generally limited the application of the code to domestic corporations. This reasoning was confirmed by other sections of the code that explicitly provide for application to foreign corporations.

Because similar language is absent from § 2010, the Greb court concluded that the statute is inapplicable to non-California corporations and that Delaware law controls whether Diamond has legal capacity to be sued following dissolution. Accordingly, the court affirmed the trial court's dismissal of the suit on the basis that Diamond's legal existence had ceased, and it thus lacked capacity to be sued.

Notably, the appellate court's conclusion obviated a choice-of-law analysis. Because the court determined that, on its face, § 2010 is inapplicable to a Delaware corporation, the court concluded that the laws of California and Delaware were not in conflict with regard to Diamond's legal capacity to be sued.

The California Supreme Court is now set to rule on both Greb and Robinson v. SSW Inc., 147 Cal. Rptr. 3d 230 (Cal. Ct. App.), rev. granted 288 P.3d 1288 (Cal. 2012), a factually similar case, in which the intermediate appeals court also ruled that § 2010 does not apply to a non-California corporation.

Corporate boards, insurers and shareholders should keep a watchful eye on the high court's disposition of both cases. Should the Supreme Court hold that § 2010 allows non-California corporations to be resurrected in California courtrooms, the corporate afterlife will become a far scarier place for those with liability exposure and subject to personal jurisdiction in the Golden State.

Assuming such a ruling, new and costly liability pitfalls could arise under numerous scenarios. California law permits claimants to sue a dissolved corporation for its undistributed assets, including any available insurance assets held by the corporation. Cal. Corp. Code § 2111(a)(1)(A).

Because corporate assets are often depleted to satisfy creditors and thereafter liquidated to shareholders of dissolved corporations during the wind-up phase, claimants may sue with an eye toward tapping historic insurance policies. But if the dissolved corporation was but one of several companies that might claim rights under the policies, it may be unclear who owns such historical insurance business assets: the dissolved corporation, the surviving corporation or even another successor.

This uncertainty could force insurers into a dilemma: either fund the dissolved corporation's defense or risk an enforceable and expensive default judgment against the insurer. Should the insurer refuse to defend the suit, it may also be faced with a bad faith and breach of contract lawsuit.

Successor and parent corporations who have legally dissolved certain subsidiaries could also stare down similarly unpleasant scenarios. Such surviving corporations that allow a default judgment to be entered against the dissolved corporation may risk a significant liability judgment if the claimant is able to pierce the corporate veil. This possibility may lead to further costly litigation between the surviving corporation and insurers of the dissolved corporation over the insurers' legal obligation to indemnify the dissolved and/or the surviving.

Shareholders of the dissolved corporation may also have reason to fear a reversal of Greb and Robinson. For corporations dissolved on or after Jan. 1, 1992, in addition to pursuing the remaining assets of the dissolved corporation, claimants may also pursue shareholders personally.

Shareholder exposure is limited to the lesser of the shareholder's pro rata share of the claim or their pro rata share of assets distributed upon dissolution. Cal. Corp. Code § 2111(a)(1)(B). Claimants pursuing shareholders, however, must sue within four years after the date of dissolution or before the expiration of the applicable statute of limitations — whichever is earlier. Cal. Corp. Code § 2111(a)(2).

Thus, if § 2010 applies to a Delaware corporation dissolved on Jan. 1, 2010, the shareholders likely would be immune from liability in Delaware after Jan. 1, 2013, but could remain subject to liability in California until Jan. 1, 2014.

Of course, the California Supreme Court may affirm Greb and Robinson, adopting the intermediate appeals courts' sound interpretation of § 2010 and holding that it applies to California corporations exclusively. Even if the court were to find that § 2010 applies to foreign corporations, the issue may not be conclusively resolved.

With conflicting state laws, the court could address, or remand to the intermediate court to address, which state's law would apply to the issue. Although North American II found that California law would apply, the majority of jurisdictions hold that the home state's law generally determines whether a corporation has legal capacity to be sued.

As such, there are two plausible and well-reasoned paths the California Supreme Court could go down to reach a result in which non-California corporations and their shareholders and insurers could rest in peace in the corporate afterlife. Many interested eyes will be watching to see which, if any, the court takes.

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