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[California Court Of Appeal Holds That Shareholders Have Standing To Pursue Derivative Actions After Dissolution Of A Corporation](#)

In *Favila v. Katten Muchin Rosenman LLP*, 188 Cal. App. 4th 189 (2d Dist. 2010), the [California Court of Appeal](#) reversed the trial court's denial of plaintiff's motion for leave to amend its complaint and dismissal of plaintiff's derivative action, holding, in part, that a shareholder's estate may maintain a derivative action on behalf of a corporation even after the corporation has been dissolved. The holding clarifies that although a corporation is dissolved, it continues to exist for the purpose of winding up its affairs, and its shareholders retain the right to bring shareholder derivative actions.

Richard Corrales was the founder of Motion Graphix. He originally owned 51 percent of its shares, while another individual, Raleigh Souther, owned 49 percent. Following a dispute between Corrales and Souther, Corrales agreed to sell 80 percent of his shares to Motion Graphix and resign from his positions with the company. After Corrales's death, Souther, with the help of Motion Graphix's attorneys, arranged for the assets of Motion Graphix to be sold to Get Flipped, a company fully owned by Souther. Motion Graphix was subsequently dissolved.

After Motion Graphix's dissolution, Corrales' Estate filed a complaint against Souther, Get Flipped and Motion Graphix' attorneys for conversion, breach of fiduciary duty, fraud and breach of contract. The trial court sustained defendants' demurrer on the grounds that the Estate failed to obtain a court order before filing a complaint for conspiracy between an attorney and its client as required by [Section 1714.10\(a\) of the California Civil Code](#). The trial court also denied the Estate's petition to file an amended complaint. Ultimately, the Court of Appeal reversed the trial court's denial of the Estate's petition.

Significantly, the Estate also filed a separate derivative action purportedly on behalf of Motion Graphix against its attorneys, alleging malpractice, breach of fiduciary duty and unjust enrichment in connection with purportedly aiding Souther with the sale of Motion Graphix's assets to Get Flipped. The trial court sustained the attorneys' demurrer to the derivative action, ruling the Estate lacked standing to bring a derivative action on behalf of a dissolved corporation. The court held that because Motion Graphix was dissolved, it no longer had any shareholders, thus the Estate lacked standing to bring a derivative action. The trial court further ruled the Estate was precluded from pursuing its derivative action against outside corporate counsel in the absence of a waiver of attorney-client privilege by Motion Graphix.

The Court of Appeal reversed, holding that despite Motion Graphix's dissolution, the Estate had standing to

maintain its derivative action. The Court held that “[t]he shareholders of a dissolved corporation do not cease to exist as shareholders, nor do they lose all interest in, or responsibility for, the affairs of the corporation upon dissolution.” The Court looked to [Section 2010 of the California Corporations Code](#), which provides that a dissolved corporation continues to exist for purposes unrelated to continuing business. Despite the fact that the corporation no longer exists for purposes of continuing business (see [Section 1905\(b\) of the California Corporations Code](#)), “the shareholders continue to exist and to have rights and potential liabilities with respect to the dissolved corporation.” This, the Court reasoned, support the view that shareholders retain standing for a derivative action. The Court of Appeal noted that this was a case of first impression in California, but that the New York Court of Appeals reached the same conclusion thirty years ago in [Independent Investor Protective League v. Time, Inc.](#), 50 N.Y.2d 259 (1980). The California Court remanded the matter for further consideration on whether a waiver of attorney-client privilege by Motion Graphix was required.

This decision clarifies an open question in California by confirming shareholders’ rights with respect to maintaining a derivative action after the dissolution of a corporation.

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