Court Sets Aside Years of Shareholder Distributions Due to Contamination at Dissolved Company's Former Site

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In the ongoing saga of what is known as the "Ashley II Litigation," the United States District Court of South Carolina recently set aside several years of distributions to the shareholders of a dissolved, closely-held family corporation because the payments were intended to avoid liability for environmental contamination of property the company had not owned in 40 years. *PCS Nitrogen, Inc. v. Ross Development Corp.*, 2015 BL 36539, D.S.C., No. 09-cv-03171, 2/12/15. This latest decision follows a prior case where PCS Nitrogen, Inc. successfully sued Ross Development Corporation's Board of Directors for breach of fiduciary duty for authorizing the same payments. The distributions were considered fraudulent conveyances because the corporation did not set aside any funds following dissolution to address the contamination if necessary.

Ross operated a fertilizer plant from 1906 to 1966, then sold the property to PCS. In 2005, a subsequent purchaser sued PCS who later filed a cross claim against Ross, for recovery of approximately $8 million in costs to clean up significant lead and arsenic contamination on the site. PCS' claim was based both on the theory of strict liability under environmental law for past owners and operators of contaminated property and on an indemnity contained in the purchase agreement. The court found PCS and Ross liable in the underlying trial, but Ross had already dissolved and liquidated all of its assets.

Although Ross had begun the dissolution process in 1982, it was still disposing of its assets when the Directors learned by 1998 that the company might be held liable for contamination at the property. Distributions upon the sale of various properties continued through 2006 and the corporation was dissolved in September 2006. PCS filed its cross claim in November 2006 and Ross authorized a final liquidating distribution to shareholders the next day, depleting the corporate accounts despite the fact that the dissolution plan called for a reasonable reserve for payment of debts and expenses.

Notwithstanding that the plan of liquidation was initially adopted in 1982, the company ceased all active operations and had no employees by 1983, distributions began in 1992, Ross had no real notice of potential liability for the property until 1998, and that no cost recovery suit was filed until 2005, the court found it significant that:

1. At least one Director wanted to "completely drain all the accounts" in 1999 in response to the potential lawsuit.
2. Although the dissolution plan provided that the distributions would be made in exchange for outstanding shares, no such redemption occurred, resulting instead in a distribution of income.
3. Ross failed to prove that the transfers were not designed to defeat the known potential claims of its subsequent creditors.

As a result, the court declared that all distributions made to the shareholders between 1998 and 2006 totaling over $5 million were void and subject to a constructive trust until its debt to PCS could be established. Interestingly, the court noted that PCS would have to pursue satisfaction from the Directors, the shareholders or a combination of both groups in such a way to avoid double recovery. Otherwise, the Directors could be required to pay twice since each one is also a shareholder.

The Ashley II litigation has also produced several other significant decisions in environmental law, including the scope of the bona fide prospective purchaser affirmative defense, the definition of disposal, the extent of operator liability, and the allocation of responsibility among various responsible parties. Because many of these issues were a matter of first impression, the courts' opinions will have a significant influence on future cases.

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