HOKE LLC
Corporate Policyholder Recovery

Dissolution for Asbestos Defendants

Under the right circumstances, an asbestos defendant may be able to resolve all of its liability by undergoing voluntary dissolution. This article explains whether dissolution is a viable option for certain companies and, if so, how to successfully navigate the process.

Background: It was commonly assumed that because asbestos was generally banned in the U.S. in the mid-1980's, claims would begin to fall within a few decades. Mesothelioma diagnoses and claims eventually did peak, but only in the last few years. The plaintiffs' bar responded to the decrease in claims by successfully increasing their settlement and verdict demands. As a result, the total asbestos defense and indemnity expenditures still continue to grow year over year. At the same time, as the number of solvent asbestos defendants declined, plaintiffs' counsel have more vigorously pursued ever-smaller or previously unknown defendants to pay the enhanced settlements and verdicts.

There are a surprising number of such companies that, due to corporate reorganizations or simply the passage of time, function largely as litigation shells. Frequently, they have historical insurance that is paying all or most of the companies' asbestos defense and indemnity expense. These companies exist largely or solely to defend cases and collect insurance, but are not insolvent and thus not candidates for bankruptcy. Typically, they have no strategic plan to formally wind-up their affairs including legally and finally resolving their asbestos liabilities. In addition to the ongoing burden and frustration, a company is always one large verdict or insurer insolvency away from a crisis that the passage time will not heal.

Voluntary Dissolution: There are two types of dissolution: voluntary or administrative. Administrative dissolution (a/k/a "involuntary") typically occurs due to the failure of the corporate entity to file its annual report with its state of incorporation and pay the franchise fee. In a voluntary dissolution the business files Articles of Dissolution in the state of its incorporation pursuant to that state's statutory requirements. An important distinction is that in an administrative dissolution the company effectively continues to exist as a legal entity and its obligations continue. Whereas, a voluntary dissolution ends the company's existence, and, in most cases shields the owners and management from any future legal

liability. While a company may successfully legally voluntarily dissolve, certain jurisdictions have recently allowed plaintiffs to revive companies for the sole purpose of collecting its unexhausted liability insurance *(infra)*.

Voluntary Dissolution Procedure: A company undergoes dissolution in the state in which it is incorporated. Each state has its own statutory scheme and requirements. They are typically highly specific, although most share many of the same essential features.

- The Board of Directors and shareholders elect to dissolve;
- The company files Articles of Dissolution in its state of incorporation;
- All outstanding federal, state and local tax obligations must be satisfied;
- All of its creditors must be advised consistent with statutory requirements;
- Notice of the dissolution must be published to potential creditors with instructions as to how to assert a claim;
- All claims must be resolved either through agreement or litigation and satisfied from the company's remaining assets;
- Any remaining assets are then distributed to the shareholders.

During the voluntary statutory dissolution waiting period, pending claims continue to be prosecuted and defended in the jurisdictions in which they were filed. New creditor claims can also be filed during the waiting period. No new claims may be filed after the dissolution waiting period ends. Claims that are filed during the statutory waiting period remain pending until resolution, even after the waiting period has been satisfied. Only when the waiting period has expired, and all claims are finally resolved, is the dissolution process complete. If done properly, shareholders' post-dissolution liability is limited to the company assets. Any assets remaining after all claims are resolved are distributed to the shareholders.

Companies That Are Candidates for Dissolution: Dissolution is only available for companies that are willing to cease operations permanently. If a company is insolvent but intends to stay in business once its liabilities are resolved, it must file bankruptcy. Bankruptcy has the advantage of automatically staying any litigation by creditors. Creditors' claims will be adjudicated within the bankruptcy. If there is substantial risk of breach of fiduciary duty claims against management or shareholders, bankruptcy might be preferable. However, in Chapter Seven, the court-appointed Trustee may utilize the company assets to pursue such claims within the bankruptcy.

Because both bankruptcy and dissolution require notice to existing and potential creditors, a company may fear that it will experience more asbestos claims and liability during the dissolution process than if it continues to function primarily as a run-off entity. Many factors feed into this decision such as how many pending claims it has, the nature of the claims,

and whether any plaintiffs' firms have sufficient incentive to expend the time and effort to challenge the process. Dissolution works best when the company has a declining claim book and there is nothing in its operational or financial history that might make the process difficult or perilous.

***Issues Relevant to Asbestos Defendants Considering Dissolution**:* The specifics of state dissolution requirements vary widely and there can be quite a bit of nuance. Asbestos defendants considering dissolution typically are concerned about how long it takes to successfully complete the dissolution process. The longer the waiting period, the longer asbestos plaintiffs can file new claims. Dissolution waiting periods typically range from two to five years, although Michigan has only a one year waiting period.

As with bankruptcy, dissolving Companies are required to advise their existing creditors, including asbestos plaintiffs who have filed cases against it. Dissolving companies are also required to publish their intent to dissolve with instructions as to how to assert a claim in order to alert potential plaintiffs and other creditors. Publication requirements vary widely among the states. Some states require multiple publications and others, such as Michigan, as few as one. They also vary about where the publication must be made.

It is critical that an asbestos defendant seeking to dissolve carefully adhere to the technical requirements of the applicable state dissolution procedure. The greater the perceived exposure, the more likely that a dissolution may be challenged and the more important that every step of the process be carefully executed. Small deviations, such as publishing before the formal dissolution filing is complete, can invalidate the entire process.

Again, while jurisdictional requirements vary widely, challenges for failure to properly dissolve generally must be asserted before dissolution becomes effective and any remaining assets are distributed. Whether the dissolution was proper is governed by the statutory law of the company's state of incorporation and not the jurisdiction where it is challenged.

***Post-Dissolution "Zombie" Companies**:* Once the dissolution process is complete, those assets that were not paid to creditors are distributed to the shareholders. Insurance is an asset, but any remaining post-dissolution unexhausted insurance is incapable of distribution to the shareholders. Recently, some jurisdictions have allowed plaintiffs to pursue unexhausted insurance even after a company is dissolved. South Carolina liberally allows for plaintiffs to revive dissolved and bankrupt companies for the sole purpose of suing and collecting on unexhausted insurance. Delaware also allows for the appointment of a receiver to defend and administer the remaining insurance assets. These "zombie" companies exist solely to defend and pay asbestos claims. This is a relatively new and

controversial trend which continues to grow in those jurisdictions that have been accepting of the process.

Conclusion: Under the proper circumstances, dissolution can be an effective way for asbestos defendants to legally extinguish their corporate existence. Care must be taken to closely follow applicable statutory requirements. When complete, the company will have successfully resolved its liability for pending and future asbestos claims, although an increasing number of jurisdictions have permitted plaintiffs and others to revive dissolved companies solely for the purpose of collecting unexhausted insurance through court-appointed receivers. However, in these circumstances the insurers and not the dissolved company officers and shareholders are the target of these efforts.

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