CHARTERED SECRETARIES AUSTRALIA

Leaders in governance

24 September 2007

Mr John Kluver
Executive Director
CAMAC
Level 16
60 Margaret Street
SYDNEY NSW 2000

By mail
and by email: john.kluver@camac.gov.au

Dear Mr Kluver

Long-tail liabilities: the treatment of unascertained personal injury claims

Chartered Secretaries Australia (CSA) welcomes the opportunity to comment on the discussion paper, *Long-tail liabilities: the treatment of unascertained personal injury claims*, which deals with proposals for the treatment of long-tail liabilities for solvent companies and companies in external administration.

CSA is the peak professional body delivering accredited education and the most practical and authoritative training and information on governance, as well as thought leadership in the field. We are an independent, widely-respected influencer of governance thinking and behaviour in Australia. We represent over 8,000 governance professionals working in public and private companies, a number of whom have been involved in class actions or who have had to consider the impact of 'dangerous products', which at this point in time refers to asbestos. We have drawn on their experience in the formulation of this submission.

General comments

CSA notes that the rationale for both the referral of a proposal to extend existing statutory creditor protections to unidentified future personal injury claimants (UFCs) against companies where a mass future claim is afoot (Referred Proposal) and the discussion paper issued by the Corporations and Markets Advisory Committee (CAMAC) came from the *Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation* (the James Hardie Inquiry). The James Hardie Inquiry found that the current external administration mechanisms do not give adequate recognition to the existence of long-tail liabilities arising in the case of unascertained future creditors, including persons who have suffered injury through exposure to products where the injury does not manifest itself until after the time of the external administration.

In its initial submission, dated 17 February 2006, a copy of which is attached, CSA highlighted a number of concerns focused on the damage that could follow any undue delays in the winding up of companies.

At the time of the Referred Proposal, the situation with James Hardie was unfolding, and it was unclear if the current law was able to deal with long-tail liabilities and the treatment of unascertained personal injury claims. However, CSA notes that the current law did not fail in dealing with this issue, and that the passage of time since the Referred Proposal was formulated has clarified the capacity of the current law to achieve a solution.

CSA therefore strongly recommends that any amendment to the law in relation to long-tail liabilities and the treatment of unascertained personal injury claims should be limited to extreme cases only, where there are prescribed 'dangerous products' that have become publicly identified with the risk of UFC claims. CSA notes that, at the current time, the only 'dangerous product' that has been so identified is asbestos.

Any reform of the law on this issue should clearly not apply where there is only a chance of future claims or where claims only become apparent with hindsight and could not have been reasonably foreseen at the time.

Any amendment of the law beyond extreme cases has the potential to introduce profound uncertainty in relation to the decision-making of directors and the existing protections for creditors and shareholders. Such uncertainty would cause considerable paralysis in decision-making, which in turn would have a profound impact on the regular ongoing management of companies and the value of shares.

CSA also notes that the discussion paper states that it does not address taxation matters. CSA, however, firmly believes that CAMAC cannot make a final recommendation to the government on the issue of long-tail liabilities and the treatment of unascertained personal injury claims without reference to the taxation impact on shareholders. This would particularly be the case if the rights of shareholders to claim a capital loss upon liquidation of a company were to be deferred indefinitely while claims of UFCs were being tested.

CSA recommends that there be no determination in this area that disadvantages shareholders, including on taxation issues.

Definition of mass future claim

CSA does not believe that it is appropriate to have a 'mass future claim' threshold test for the application of additional protections for UFCs.

CSA recommends that definition by regulation be the approach that is taken, with the Corporations Regulations prescribing 'dangerous products' that have become publicly identified with the risk of UFC claims (including asbestos products). Any definition should be limited to dangerous industries and extreme cases.

Any other approach has the potential to introduce uncertainty and paralysis. The introduction of a 'mass future claim' threshold would invite speculative claims that would significantly impair the day-to-day operations of companies. The uncertainty of application would paralyse the process, no matter how valid the claim.

Solvent companies

CSA believes that a complete prohibition on capital management for companies with UFC claims would severely affect them and is not appropriate.

CSA recommends that solvent companies subject to claims by UFCs should only have to take into account the interests of UFCs in situations of significant capital reconstruction or insolvency. In these limited circumstances, directors should have to take all reasonable steps to take the interests of UFCs into account. CSA notes that a scheme of arrangement is a capital reconstruction.

CSA strongly opposes any requirement for solvent companies (whether or not facing a mass future claim) to disclose the existence of UFCs, as such disclosure would invite speculative claims, regardless of their validity.

CSA can see the merit of such disclosure in very limited circumstances where regulation has prescribed a 'dangerous product'.

CSA also strongly opposes any extension of UFC provisions to dividends, for the reasons outlined in the discussion paper on page 51. CSA notes that the Referred Proposal did not refer to dividends and CSA believes this was correct, given the interference with the regular ongoing management of companies and their operations that such a proposal would introduce.

CSA also notes that any extension of UFC provisions to dividends would cause loss of value to shareholders, and reiterates that any determination on the issue of long-tail liabilities and the treatment of unascertained personal injury claims should not disadvantage shareholders.

CSA does not support a new provision or possible new procedure to be utilised by companies that anticipate the likelihood of becoming insolvent in the future as UFC claims crystallise through the development of injury-related symptoms.

Liquidation

CSA opposes UFCs being categorised as preferred creditors.

CSA recommends the establishment of a contingency fund where a mass future claim is afoot and, in the context of a liquidation, that:

- while there is always a risk that the contingency funding will be underestimated, it is neither practicable nor desirable for the legislation to regulate such a risk. Moreover, this risk is balanced by the certainty granted to unsecured creditors who are not mass future claimants and shareholders that they need not wait many years for payment
- the distribution of any surplus from the contingency fund after UFCs have been paid should also be left to the determination of the fund administrator at the appropriate time
- the judge dealing with a class action involving mass personal injury claims should be granted the power to take into account the amount to be set aside in a contingency fund, which could be administered by the court or by a court-approved body, such as an insurance company or an external fund administrator, long after the winding up is completed
- any reform to introduce a contingency fund should ensure that it does not create any undue delay in the winding up of a company, which would disadvantage creditors and shareholders, for instance, by interfering with the liquidator's decision about how to deal with assets. There should be suitable mechanisms to allow the early crystallisation and assessment of UFC claims to permit liquidation to be completed within a reasonable time.

CSA supports the procedure set out in the discussion paper under 8.4 on page 89.

Anti-avoidance provision

While CSA had noted in its earlier submission of February 2006 that, in principle, it had no objections to the inclusion of an anti-avoidance provision in the Referred Proposal, the intervening months have clarified that the current law did not fail in relation to the James Hardie situation.

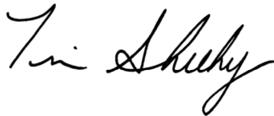
Within this context, CSA opposes the introduction of an anti-avoidance provision. CSA notes that the current law relating to capital reconstruction and insolvency already deals with creditor protection. Directors have a positive obligation to protect creditors' interests, which would include UFCs. If they do not protect creditors' interests, directors should be exposed to liability.

Conclusion

CSA continues to recommend that any reform in relation to long-tail liabilities and the treatment of unascertained personal injury claims should not interfere with existing creditors' or shareholders' rights, including taxation issues for shareholders.

CSA would welcome further contact during the consultation process and the opportunity to be involved in further deliberations.

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE

Submission to the Corporations and Markets Advisory Committee

Long Tail Liabilities: The Treatment of Unascertained future personal injury claims

Discussion Paper

Marina Nehme
School of Law, University of Western Sydney
Locked Bag 1797
Penrith South DC NSW 1797
Email: m.nehme@uws.edu.au

Claudia Koon Ghee Wee
Faculty of Business and Informatics
Central Queensland University
333 Kent Street
Sydney NSW 2000
Email: weec@syd.cqu.edu.au

Introduction

This submission addresses the release of the CAMAC Discussion Paper on *Long Tail Liabilities: The treatment of Unascertained Future Personal Injury Claims* (June 2007). Some of the suggestions that have been provided in this submission are of a policy nature and question the need to take into consideration UFCs in case of voluntary administration or scheme of arrangements.

If any of the responses require further explanation please contact Marina Nehme at the UWS School of Law at M.Nehme@uws.edu.au or Claudia Koon Ghee Wee at CQU Faculty of Business and Informatics at weec@syd.cqu.edu.au

Academics involved in producing this response

NEHME; Marina is an Associate Lecturer in Law at the University of Western Sydney. She is a researcher in corporate law issues. Previously, she was a part time Lecturer in Corporate Law at the University of Technology, Sydney and a member of UTS Corporate Group.

WEE; Claudia Koon Ghee is a Lecturer in Finance and Economics at Central Queensland University. She is a researcher in corporate finance issues and she is currently completing a PhD in finance at the University of New South Wales.

General Observations:

The discussion paper, *The Long Tail Liabilities: The treatment of Unascertained Future Personal Injury Claims* (June 2007), analyses the need for the introduction of new rules to protect the interest of UFCs.

The observation made in this submission can be summarised in the following manner:

- UFC liabilities should be treated as contingent liabilities for accounting purposes; instead of provisions in the balance sheets.

- The provisions in relation to share capital reduction, share buy-back and financial assistance should take into consideration Unascertained Future personal injury Claimants (UFCs).
- The directors' duties should not be amended but should be left as they are since directors do not owe a duty to creditors when the company is solvent. Accordingly, they should not owe a duty to UFCs in case of solvency.
- Section 588G of the *Corporations Act* should not be changed to take UFCs into consideration.
- Adopting a process similar to the US system in relation to UFCs needs to be conducted with extreme care.
- Voluntary administration should not take into consideration UFCs as the system is designed to maximise return to creditors and allow the company to be saved. If the company remains in existence after the voluntary administration is completed, then the UFCs still have the opportunity to recover their money in the future. Additionally, the procedure in relation to voluntary administration is very well balanced and any introduction of new rules in relation to UFCs might complicate an effective system.
- Scheme of arrangement should not take UFCs into consideration.
- Liquidation should take UFCs into consideration.
- Anti avoidance provisions should be introduced in the *Corporations Act.*

Consideration Issue in Chapter 2: Current position

Whether, in principle, UFC liabilities should be treated as provisions or contingent liabilities? What are the practical implications for companies, and others, if UFC liabilities were provisions or contingent liabilities

UFC liabilities should be treated as contingent liabilities for accounting purposes; instead of provisions in the balance sheets.

AASB 137 para 14 requires that 'a reliable estimate can be made of the amount of the obligation', which in the case of the potential liability to UFCs, is extremely difficult. Though liability estimation is a common practice in the insurance industry, it is difficult for companies that are not of this nature to come up with a reliable estimate of their expected value of liabilities if the companies are not even aware of any existing potential risk in their operations. As to the 'Directors' central estimate' referred to in *In the matter of Stork ICM Australia Pty Ltd* [2006] FCA 1849,

estimates that are 'subject to considerable uncertainty and actual liabilities for such claims could vary, perhaps materially, from the Directors' central estimate' can hardly qualify as a 'reliable estimate' required by AASB 137.

UFC liabilities should be treated as contingent liabilities. Companies have the obligation to inform current and potential stakeholders regarding any contingent liability involved for two main reasons: (1) to assist the decision-making process of current and potential shareholders; and (2) to be socially responsible towards all stakeholders. Any aspect of uncertainty regarding the contingent liabilities should be indicated clearly. With global pressure pushing towards Corporate Social Responsibility, reporting UFC liabilities as contingent liabilities can be considered a step in the right direction.

Consideration Issue in Chapter 4: Threshold of mass future claims

Whether it is appropriate to have a 'mass future claim' threshold test for the application of the additional protection for UFCs?

Mass future claims can have an enormous impact on otherwise viable organisations and can cause a dilemma for the people working for these organisations in relation to how and when to deal with such claims. Additionally, there is a need to take into consideration mass claims due to the fact that parties have traditionally found individual tort action in relation to mass claims unwieldy and too expensive for all parties. Accordingly, defining mass future claims through the setting of a threshold test can be of vital importance. A threshold test will enhance the awareness of companies in relation to situations where mass future claims may appear and will give companies the opportunity to remedy any liability that may appear in the future.

Additionally, the directors of companies will be aware of situations where their companies will be facing mass future claims. This will allow them to manage such claims in accordance with the duties imposed on them under common law, the equity and the *Corporations Act*. Having a definition for mass future claims will be of help to companies, their directors and any person injured or involved in the organisation.

Some have argued against the incorporation of a threshold test in relation to mass future claims as such a test may have an arbitrary benefit due to the fact that some UFCs will receive protection while other will not. Such an argument is contestable as if the number of claims is minimal (and is not within the definition of mass future claims), then at that time the individuals suffering injury may act by themselves and should not be provided with any specific protection by the *Corporations Act*. However, they will still be protected by the general laws.

A threshold test for mass future claim is welcomed. Such a test will not only establish how mass claims will be dealt with and protected under the *Corporations Act,* but will also provide guidance in identifying such claims. Additionally, the threshold will perform a **gate keeping** function and limit mass future claims to significant cases. It is not supposed to deal with scenarios where the future liability is so unforeseeable or speculative. However, to ensure that criticism in 4.1.2 does not have any real basis,

there is a need to establish a clear threshold (in relation to mass future claims) that is not subject to uncertainty.

If so, whether, and for what reasons, you prefer the approach in the Referred Proposal or any other alternative approaches to the definition of mass future claim

The referred proposal states the following:

- *Either*
- *the company has been subject to an unusually high number of claims for payment arising from particular acts or omissions leading to personal injury; or*
- *more than one company of a similar industry, or other companies with similar business operations to the company in question, have been subject to such claims;*

and

- *there is a strong likelihood of numerous future claims of this type*
- *unless it is not reasonably possible to:*
- *identify the circumstances giving rise to the future personal injury claims and the class of persons who will bring the claims; or*
- *reasonably estimate the extent of the company's liability under such claims*

Is such a definition of mass future claims acceptable? Let's look at the proposed elements of the definition:

> *The company has been subject to an unusually high number of claims for payment arising from particular acts or omissions leading to personal injury*

Such a requirement seems reasonable. For a mass future claim to exist there needs to be an unusually high number of claims. However there is a need to define what is meant by a 'high number of claims'. There is a need to quantify such a number. Maybe the manner in which we can assess whether or not the company is subject to an unusually high number of claims can be specified through regulation.

> *More than one company of a similar industry, or other companies with similar business operations to the company in question, have been subject to such claims*

At first glance, such a requirement seems acceptable. However, it is difficult to apply in certain situations because, in some cases, the company, or its directors, administrators or liquidators will not necessarily be aware of what is happening in other companies in a the same industry. If the companies in the industry are dealing with mass claims through private settlements then, at that time, the public and other companies in that industry may not be aware of any mass claims and this may hinder the application of such an element. The broadening of the application of s 596B of the *Corporations Act* to ensure the disclosure of confidential mass claim settlement in different industry to external administrators may solve the problem. Additionally, since the matter will be in the hands of the court, the court may assess every request and limit any possible abuse to such an addition.

Another solution to the problem was proposed by the IPAA in the discussion paper in paragraph 4.3.3: This element should only apply to companies that have dealt with certain products or industries specified by the regulation. Such a proposal has its appeal since it will save external administrators the trouble of going to court and spending the resources of the company to discover if they are dealing with a mass claim or not through the use of s 596B. Additionally, the regulation may easily be updated to include any new industries with potential mass future claims. However, the only problem that may appear here is that, with modern technology and a global marketplace, there is an unlimited list of products that might cause massive liability. Accordingly, keeping the list up to date is crucial and may be challenging in certain instances.

There is a strong likelihood of numerous future claims of this type

Such an element is desirable however there is a need to clearly define what is meant by 'strong likelihood' and how to quantify 'numerous claims'.

Unless it is not reasonably possible to:

- *identify the circumstances giving rise to the future personal injury claims and the class of persons who will bring the claims; or*
- *reasonably estimate the extent of the company's liability under such claims*

This element will considerably limit the number of mass future claim that may be protected by the Act. However, it may also raise certain problems. For example, with UFCs it can be hard in certain instances to determine the class of people that may have a claim because the effect of the injury may be too broad - especially with globalisation. For instance, Johns-Manville did not only cause injury to people in the US but also in Japan. Mass future claim may have a geographic widespread effect. Additionally, assessing the extent of the company's liability may be achievable but the accuracy of such an estimate is not very reliable since the company is dealing with future claims. For example, in the Johns-Manville case, the original estimate of the company's liability was not close to the ultimate liability paid by the company.

As for the possible alternative proposed in paragraph 4.5, it has its appeal because it is very broad and the mass future claim threshold will kick in the minute that one personal claim injury is started. This is tempered by requirement 2 and 3. These last two requirements will have a gate keeping role to keep certain farfetched claims at bay. However, a number of words such as 'significant number' and 'numerous future claims' should be defined in the legislation or through regulation.

As for the US reform proposal in relation to mass future threshold:

1. *the act/omission has occurred*
2. *the act/ omission may be sufficient to establish some legal liability if injuries are later manifested*
3. *the debtor has been subject to numerous claims on similar grounds and is likely to be subject to more claims in the future*
4. *the holder of these claims are known, or can be identified or described with reasonable certainty; and*
5. *the amount of such liability is reasonably capable of estimation*

Elements 1 and 2 of this definition determine whether liability meets the definition of a claim. Elements 3, 4 and 5 play a gate keeping role to limit the number of claim that may appear. They will limit the claim to significant mass tort liability and play the role of a filter to inappropriate claims. Requiring the presence of element 3 captures those cases which are most easily recognised as mass claim. Requiring that the liability be reasonably capable of estimation targets those debtors dealing with real and not incidental threats of massive liability when debtors already have dealt with sufficient number of claims to be able to estimate or predict their value.[1]

The proposed definition in the US may be appealing but it suffers similar criticism to the first proposed definition in Australia.[2]

Consideration Issue in Chapter 5: Solvent Companies

The possible amendments to the share capital reduction, share buy-back and financial assistance

Today, the possibility to register limited liability companies may create an adverse effect on creditors. Accordingly, the principle of capital maintenance is of some importance. Under the capital maintenance doctrine, creditors in a limited liability company are 'entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business'.[3] However, over the decades, the principle of capital maintenance has been relaxed and companies were allowed to reduce their capital in compliance with the statute. But is there a need to tighten the rules in relation to reduction of capital to take into consideration UFCs or are the current provision in relation to reduction of capital acceptable?

The share capital reduction:

Share reduction of capital should not be banned all together since such reduction can bring to the company a number of benefits.

Section 256B of the Corporations Act:

A company may reduce its share capital in a way that is not otherwise authorised by law if the reduction:

(a) is fair and reasonable to the company's shareholders as a whole; and

(b) does not materially prejudice the company's ability to pay its creditors; and

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[1] National Bankruptcy Review Commission, 'Treatment of Mass Future Claims in Bankruptcy', ,http://govinfo.library.unt.edu/nbrc/report/09bmass.html> viewed on 1 October 2007.

[2] See above comments in relation to the first threshold test proposed in Australia.

[3] *Trevor v Whitworth* (1887) 12 App Cas 409 at 423-424.

(c) is approved by shareholders under section 256C.

A look at s 256B shows that for a reduction of capital to be allowed, the reduction should take into consideration the interest of shareholders and creditors. However, UFCs are not considered as creditors under the corporations laws based on the analysis in the CAMAC discussion paper on Chapter 2. As a result, it will not be taken into consideration when deciding on whether a company is complying company with the share capital provisions.

Such a problem appeared in the James Hardie cancellation of partly paid shares. In October 2001, the Supreme Court of New South Wales approved a scheme of arrangement under which shares in JHIL were exchanged for shares in JHI NV. As a result of the scheme, JHI NV became the only shareholder in JHIL and held partly paid shares (the uncalled liability was of $1.9billion). However in 2003, a resolution was passed to cancel the partly paid shares, thereby releasing JHI NV from any liability. This was made in a time when there was a prospective shortfall in the capacity of the company to pay all mass future claims.

The question that may arise from this situation is the following: Was there a breach of s 256B of the *Corporations Act?* The Commissioner made no finding of a breach of s 256B in this case.[4] However the answer to the question raised above will depend on the way we interpret the word 'creditor' in s 256B. The commissioner seemed to be in favour of a broad interpretation of the word 'creditor'. Such a broad interpretation will lead to the inclusion of UFCs.[5]

Accordingly, this submission supports the following amendment to s 256B:

(b) does not materially prejudice the company's ability to pay its creditors ***nor its ability to pay mass future claims****;*

Whether a prejudice is material will be a question of judgement to be determined in light of all relevant circumstances, including the particular characteristics of the company and the situation of the company's creditors and the UFCs. It will also take into consideration scenarios where the reduction of capital would strengthen the position of the company and will increase rather than reduce the funds available to cover claims by UFCs.

Such an inclusion will not drastically affect the way the provision works. It will only add a burden on companies that are subject to mass future claims in situation where the reduction will endanger the chances of the UFCs from getting their money back.

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[4] Special Commission Inquiry, *Report Of The Special Commission Of Inquiry Into The Medical Research And Compensation Foundation*, 517, <http://www.ir.jameshardie.com.au/default.jsp?xcid=643> viewed on 2 October 2007.

[5] Special Commission Inquiry, *Report Of The Special Commission Of Inquiry Into The Medical Research And Compensation Foundation*, 515. <http://www.ir.jameshardie.com.au/default.jsp?xcid=643> viewed on 2 October 2007.

As for the concern that directors in companies may refuse to reduce the capital due to concerns about UFCs, such fears need to be substantiated with evidence which is not currently available.

Share Buy Back

Share buy backs should not be forbidden as long as such a share buy back complies with s 257A of the *Corporations Act.* Share buy backs such as reduction of capital has its advantages. For instance, Stewart observed an improved long term performance for companies after share buy backs.[6] In another study, Dann focused on tender offers by listed US corporations and formed the same conclusions with regard to immediate future performance.[7] Vermaelen found evidence of a permanent increase in share performance.[8]

Section 257A of the Corporations Act:

> *A company may buy back its own shares if:*
>
> *(a) the buy-back does not materially prejudice the company's ability to pay its creditors; and*
>
> *(b) the company follows the procedures laid down in this Division*

Based on the reasoning followed in relation to reduction of capital, this submission supports the following amendment to s 257A:

> *(c) the share buy-back does not materially prejudice the company's ability to pay its creditors* ***nor its ability to pay mass future claims****;*

Whether a prejudice is material will be a question of judgement to be determined in light of all relevant circumstances, including the particular characteristics of the company and the situation of the company's creditors and the UFCs. It will also take into consideration scenarios where the share buy back would strengthen the position of the company and will increase rather than reduce the funds available to cover claims by UFCs.

Financial Assistance

Financial assistance is prohibited unless it complies with s 260A of the *Corporations Act*. Such a prohibition performs a useful function in deterring a range of undesirable transactions having the potential to prejudice a company's financial position.

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[6] Stewart, S S, "Should a Corporation Repurchase its own Stock?" (June 1976) *Journal of Finance.*

[7] Dann, L Y, "Common Stock Repurchases" An Analysis of Returns to Stock Holders and Bond Holders", (June 1981) *Journal of Financial Economics.*

[8] Vermaelen, T, "Common Stock Repurchases and Market Signalling" (June 1981) *Journal of Financial Economics.*

Section 260A(1) of the Corporations Act:

A company may financially assist a person to acquire shares (or units of shares) in the company or a holding company of the company only if:

(a) giving the assistance does not materially prejudice:

(i) the interests of the company or its shareholders; or

(ii) the company's ability to pay its creditors; or

(b) the assistance is approved by shareholders under section 260B (that section also requires advance notice to ASIC); or

(c) the assistance is exempted under section 260C.

The requirement (a (ii)) takes into consideration the interest of creditors. However if we apply the definition of creditors illustrated in Chapter 2 of the discussion paper, it will not take into consideration the interest of UFCs.

The section should be changed to take into consideration the interest of UFCs and the new formulation will state the following:

A company may financially assist a person to acquire shares (or units of shares) in the company or a holding company of the company only if:

(a) giving the assistance does not materially prejudice:

(i) the interests of the company or its shareholders; or

(ii) the company's ability to pay its creditors ***and mass future claims****; or*

(b) the assistance is approved by shareholders under section 260B (that section also requires advance notice to ASIC); or

(c) the assistance is exempted under section 260C.

Section 260(A)(1)(b) and (c) should stay because they minimise the difficulties the rule currently causes for ordinary commercial transactions.

The possible disclosure only approach

This submission does not agree with the disclosure only approach because any additional disclosure requirement is unnecessary given the reporting requirement under AASB 137. Additionally, a disclosure only approach will not guarantee in any

way that companies will take into consideration the information before conducting a reduction of capital, share buy-back or financial assistance.

The discussion of dividends, insolvent trading, s 1324 and directors' duties

Dividends

This submission does not support the need to change the laws in relation to payment of dividends. Any extension may be seen as unduly impending the regular management of companies and will add a burden on directors when deciding on the payment of dividend.

Section 254T notes that dividends can be paid out of profit. Such a section is a consequence of the principle of capital maintenance and provides protection to creditors and members of a company. The word 'profit' is not defined by statute and the courts have been reluctant to give a clear definition on the matter. Lord Macnaghten said in *Dovey v Corby*:[9] '… I do not think it is desirable for any tribunal to do that which parliament has abstained from doing- that is, to formulate precise rules for the guidance or embarrassment of businessmen in the conduct of business affairs.'

Accordingly, there is not one set of definition in relation to profit. Making companies take into consideration UFCs might cause more uncertainty in an already fragile system and might make the establishment of a definition in relation to 'profit' even harder.

Insolvent Trading

This submission agrees with the fact that the UFCs should not extend to insolvent trading because such UFCs will add a huge burden on directors and will cause the problems pointed out in paragraph 5.8.

S 1324

This submission agrees with the proposal in paragraph 5.9. Section 1324 of the *Corporations Act* applies in relation to 'a person whose interests have been, are or would be affected by the conduct'. This will probably include UFCs.

Directors' duties

This submission opposes any change to directors' duties. If a company is solvent, directors do not owe a duty to creditors[10] and accordingly should not owe a duty to UFCs. They should manage the company in good faith and with care by acting for the best interest of all present and future shareholders in a company.

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[9] *Dovey v Cory* [1901] AC 477 at 488.
[10] Walker v Wimborne (1976) 137 CLR 1.

The possible new procedure for companies that anticipate future insolvency as claims by UFCs mature

As noted in the discussion paper, the US has an established procedure in relation to companies that anticipate the likelihood of becoming insolvent in the distant future due to UFCs (companies can apply to it even if they are not insolvent. That was the case for example in Johns Manville case). Such an organisation will be able to apply to the court for an order enabling its affairs to be conducted pursuant to the establishment of a trust set up to meet UFC claims.

Such a procedure has its benefits since it will protect the interest of creditors and will quarantine the liability of UFCs by limiting their rights in relation to funds held by the trust. However it is interesting to look at the US experience to decide on the merit of such a system.

In the US, a number of companies faced with UFCs have used the system. UNR Industries Inc was the first asbestos defendant to file for bankruptcy protection under Chapter 11 in 1982. As of 31 December 2000, the trust had received more than 360,000 claims. Accordingly, issues concerning the UNR trust continue to arise. In March 2001, two claimants filed an adversary complaint in the bankruptcy court, challenging a $100 per claim filing fee. This fee was imposed by the trust to fight law firms from supposedly becoming careless in their filing practices.[11] Accordingly, if such a system is to be introduced in Australia, a question may arise in relation to claim filing fees. Should such fees be allowed? For purpose of fairness and equity such fees should not be permitted due to the fact that the individuals filing the claim are exercising their inherent right.

The most known example of asbestos related bankruptcy filing was the Johns Manville case when the company applied for Chapter 11 relief in August 1982. This case illustrates an example where the trust fund is not enough to cover all UFCs. At the time when the Manville trust was established, the trust was expected to receive between 83,000 to 100,000 asbestos claims over the expected 49 year life of the trust. However, such a figure was incorrect. Since the establishment of the trust in 1989, the Manville trust has paid over $2.5billion to nearly 360 000 beneficiaries. This is a problem that is faced when dealing with UFCs. It is impossible to find an exact or even an approximate amount for UFCs claims. Such a reality might make it hard for companies to decide on the necessary funds that need to be put in the trust to cover future UFCs. The bankruptcy reorganisation plan in the case of Johns Manville stated that claimants will receive payment from the Trust of 100% full value. However, the claim lodged exceeded the value of the available assets of the trust which made the trust consider lower payments to as low as 5-6.5¢ on the dollar. As the trust was out of funds, the company had to restructure again and this time it used a class action device by declaring the fund allocated under the Chapter 11 reorganised as a limited fund. It required that trust assets should be distributed on a pro rata share basis.[12]

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[11] Mark D Plevin and Paul W Kalish, "Where Are They Now? A History Of the Companies That Have Sought Bankruptcy Protection Due to Asbestos Claims", Mealey's Asbestos Bankruptcy Report, <http://www.crowell.com/pdf/Asbestos.pdf> viewed at 2 October 2007.

[12] <http://www.mantrust.org> viewed 2 October 2007.

Certain reasons why the US system should not be adopted in Australia:

- The system is subject to abuse: The organisations may attempt to curtail the claims of UFCs.
- Involvement of the court: The court will approve the scheme. However the disadvantage is that it may lead to an expensive, lengthy and complex process.
- The funds in the trust may not be enough to cover all UFCs.
- The current UFCs will probably receive bigger amounts than the future UFCs in situations where the funds of the trust are not enough to cover all mass future claim liabilities.
- Introducing such a trust system means that there is a need to do several amendments in our current laws in different field. Such an introduction will affect taxation laws, the external administration regime, securities, contracts, fiduciary responsibilities and civil procedure that need to be complied with when applying for the trust. Such a system cannot be easily slid in the Corporations Act. The Tax implication by themselves need to be seriously considered. In the US, the Internal Revenue Service introduced the 'Manville Rule' to deal with the Trust unique tax implication.

For all the reason above, this submission does not support the introduction of a system similar to the US system in Australia. There should be a close evaluation of the US system dealing with bankruptcy before considering introducing it into the Australian system.

Consideration Issue in Chapter 6: Voluntary Administration

The process of voluntary administration in Australia is a very effective system. Accordingly, the system of voluntary administration does not need to be changed. However, if a change should occur to accommodate UFCs, there should be serious consideration taken to ensure that the process of voluntary administration remains as fast and effective as it is now.

Comments on option 1: the alternative possibilities under the referred Proposal (Monetary Provision with or without further recourse for UFCs)

This submission does not support such an option due to the fact that it can cause a number of problems in the voluntary administration process. Some of these problems are stated below:

- One of the requirements in this option is to set aside an amount for UFCs. However the question that will be raised is how much should be set aside? This is impossible to determine since the claims are unknown. As it can be seen in the Johns Manville example, the estimates were very different from what actually happened. Accordingly, it will be hard for anyone to assess the amount that should be set aside.

- Having an independent expert's report prepared on the impact of the proposed DOCA on the UFCs may prolong the period of voluntary administration and this may remove the speed of the process. Additionally, if the period of voluntary administration is lengthened than consideration needs to be taken in relation to extending the period of moratorium. Such an extension may make substantial secured creditors uneasy because they will have to wait for a longer time to receive their moneys.

- Secured and unsecured creditors may not be tempted to approve any DOCA especially if it will affect their rights of getting paid. Unsecured creditors may discover that the amount that they will receive under winding up is higher than the amount received under voluntary administration (due to the amount set up for UFCs). As a consequence, they may oppose any DOCA. Accordingly, a company that may have been saved under the current system may end up being liquidated for claims that have not happened yet (the danger of this occurring will depend on how broad the threshold test of mass future claim is).

- Paragraph 6.3.2 proposes a solution to make the process more appealing: 'any financial provision for UFCs in a voluntary administration constitutes the full amount of corporate funds available to them in the future.' However this process may be unfair for UFCs. If an amount is set aside and the amount is not enough, than at that time what will happen? The old UFCs might have gotten all the money, leaving new UFCs victim with nothing. This may make the voluntary administration process subject to abuse. If a company wants to get rid of its UFCs than it can put the company under voluntary administration and put a sum of money on the side to cover the long tail liability claims. This will release the company from any future liability. The proposed safeguard requires court intervention which will make the process of voluntary administration lengthy and expensive.

Comments on option 2: No Provision for UFCs in a Voluntary Administration

This is the option that this submission supports. The voluntary administration process allows a company in financial difficulty to remain in existence. Accordingly, if the company can be saved, the legislation needs to ensure that this happens and it should not hinder such a recovery. If the company cannot be saved than it should go under liquidation and than UFCs liabilities should be taken into consideration.

It is true that such an option will not consider the interests of UFCs. However, it will allow the company to remain in existence and it will maximise the chance of solvency of the company in the future allowing UFCs to get their money though private lawsuit when their claims appear.

Comments on option 3: Certificate by directors

This submission opposes this option because this proposal will add a burden on directors and it may lead them to unintentionally breach their duties. Additionally,

imposing a similar requirement to the one proposed for capital reduction, buy back and financial assistance is not desirable because the purposes of the principle of capital maintenance and the voluntary administration have different goals and purposes. The first protects the creditors by ensuring that there will be enough money to pay them in case of reduction of capital while the latter attempts to save the company and maximise return for creditors.

Comments on option 4: Right of legal representative of UFCs to challenge a DOCA

This proposal may be of interest since it gives some protection to UFCs without adding an unnecessary burden on the voluntary administration process. However, certain problem may appear such as:

- Who may appoint a UFCs representative? Involving the court in the appointment of a UFCs representative is not desirable due to the fact that this may complicate the voluntary administration process through court intervention and may make the process of voluntary administration more expensive.

- How will the administrator know about UFCs liability? Will such consideration add an extra burden on the administrator?

Consideration Issue in Chapter 7: Scheme of arrangement

The scheme of arrangement allows a company facing the prospect of insolvency to restructure its debts typically through a compromise of creditors' claim. Such a scheme requires the court's intervention. A creditors' scheme of arrangement was never common in the past and has now been eclipsed by the voluntary administration process. The complexity, formality, expense and delays inherent in the procedure explain why the scheme of arrangement is unpopular. Accordingly, adding a new dimension to an already unpopular system might not be beneficial and will make the system even more complex and the chances that anyone will use it (in situations where the company is in financial difficulty) will be next to nil.

Accordingly, this submission does not support the referred proposal in 7.2. UFCs should not be taken into consideration in the scheme of arrangement. Allowing UFCs to have a voting right will even worsen the situation since this may result in them having a veto right (since they will be considered as a separate class from other creditors) and this will make the process even less appealing.

As for the options in paragraph 7.3:

- Requirement for directors to issue a certificate: We do not support this proposal since it will add a burden on directors.[13]

[13] See remarks put above in relation to option 3 in Chapter 6.

- Right to legal representation: Even through this might be acceptable, it may cause procedural problems as noted in 7.3 and this may make the system even more complex.

- No provision for UFCs in the scheme: Desired solution because it will leave the scheme as it is and will not add any burden to the existing system.

- Another proposal is the following: Add a provision in the legislation to allow the court to consider UFCs interest when determining whether the scheme should be approved. If the court finds that the scheme is affecting or endangering the interests of UFCs it will reject it. If the court finds that the interest of the UFCs are not affected it will allow the scheme. If the scheme may affect the interest of UFCs, the court might make provisional orders to ensure that the interests of these UFCs are protected. For example, in the James Hardie case noted above, the scheme of arrangement led to the issue of partly paid shares. Additionally there was a risk that these shares might be cancelled leaving the UFCs with a very limited amount of money if the unpaid shares are cancelled. Accordingly since the interest of UFCs may be affected the court may issue an order approving the scheme on the condition that the company changes its constitution for example to restrict its powers in relation to cancelling unpaid shares. Such a provision would have protected UFCs in the James Hardie case because the partly paid shares would not have been able to be cancelled.

Consideration Issue in Chapter 8: Liquidation

Comments on the referred proposal

This submission supports in principle the referred proposal. However it is important to note that such an inclusion will add a significant cost to creditors. Additionally, there is a problem in relation to distribution of assets when dealing with UFCs:

- How can we determine the value of the amount that should be put aside for UFCs? We are again dealing with future claims that are not yet known and as noted in Johns Manville case, it is very hard to determine a correct figure.

- If a figure is determined, in what order should creditors (including UFCs) be paid? Based on the current system, secured creditors get paid first, than preferential unsecured creditors (s 556 of the *Corporations Act*) and lastly the rest of the unsecured creditors (pro rata if there is not enough money left. If there is money left than preferential shareholder will get paid followed by ordinary shareholders). If we introduce UFCs to this equation, what will be the order of priority? Will the amount that is left for them put aside before or after preferential creditors get paid for example? If preferential creditors are paid and than an amount of money are taken for UFCs and nothing is left toward the rest of the unsecured creditors, what will happen than? These questions need to be addressed.

Comments on possible procedure to implement Referred Proposal

Any procedure that needs to be implemented in relation to the referred proposal need to be done with care since the new procedure need to ensure that the winding up process will not become lengthier.

Comments on Payment of membership-type debts

This point deals with the priority of payment. Who should get paid first? What should happen is that an expert assesses the approximate amount (again there is no way that anyone can be sure that this will be the correct amount), than the secured creditors are paid, preferential creditor are paid, followed by unsecured creditors. After that, the UFCs assessed liability will be withdrawn from the assets of the company. However the UFCs should not be put at the same or below the level of members.

Comments on Corporate group

Section 588V of the *Corporations Act* should have a role in lifting the corporate veil in case of UFCs. The veil may be lifted to hold the holding company liable if the holding company did not take into consideration UFCs liability of a subsidiary. This may make holding companies more responsible when dealing with UFCs.

Consideration Issue in Chapter 9: Anti Avoidance

We agree in principle to the introduction of anti avoidance provision in the *Corporations Act.*

We believe that Option 3 should apply, because it ensures that misplaced funds are put in the trust while still protecting the interest of unsecured preferential creditors such as employees.

Conclusion

The discussion paper provided by the Corporations and Markets Advisory Committee (CAMAC) is an important discussion point on the various issues relating to long-tail liabilities. If any amendments to the law were to be made, it is important to balance the enforcement aspects and practical business considerations with corporate social responsibility. Aligning these three priorities would be a step in the right direction for the Australian business environment.

The Insolvency Practitioners Association (IPA) submission

Our ref: mhm

10 October 2007

Long-tail liabilities - The treatment of unascertained future personal injury claims Insolvency Practitioners Association submission to the Corporations and Markets Advisory Committee

Introduction

1. This submission is made by the Insolvency Practitioners Association (IPA) on behalf of its members, who are insolvency practitioners who, relevantly, are appointed as liquidators, administrators and receivers under the Corporations Act to insolvent companies.

2. The submission responds to aspects of the discussion paper of the Committee - Long–tail liabilities: The treatment of unascertained future personal injury claims. The IPA notes that it made an earlier submission dated 14 March 2006 and it relies on the views expressed there for this submission.

Defining the issues

3. The circumstances of such claims require some clear description, in particular as to their timing in relation to the occurrence of the formal insolvency. For the purposes of this submission, we have found it useful to assume three standard fact and party scenarios, to which we refer throughout.

Scenario one	
1970	company B manufactures asbestos
1980	B goes into insolvency
1990	X is exposed to the asbestos and suffers illness as a result.
X is a person to whom the discussion paper refers as an unascertained future claimant (UFC) as at the time of the insolvency in 1980.	

Scenario two	
1970	Company B manufactures asbestos
1980	X is exposed to asbestos
1990	B goes into insolvency
2000	X suffers illness as a result
In this scenario, X may also come within the Committee's definition of a UFC, although this is debatable.	
Scenario three	
1970	Company B manufactures asbestos
1980	X is exposed to asbestos by company B

Insolvency Practitioners Association of Australia ABN 28 002 472 362
33 Erskine Street, GPO Box 3921, Sydney NSW 2001 P+61 2 9290 5700 F +61 2 9290 2820 **www.ipaa.com.au**

1990	X suffers illness as a result
1990	B goes into insolvency
	X is quite clearly a claimant in the insolvency of B

32. In summary, we do not think that scenario one presents any provable claim by X in the insolvency of B. Scenario two may result in X's claim being a provable claim. In scenario three X has a provable claim. We refer to these claims generally as long-tail liabilities.

Insolvency principles

33. The IPA says that there are certain insolvency principles which claims in scenarios one and two have the potential to disturb.

34. The Harmer Report[1] identified the generally accepted principles that should guide the development of a modern insolvency law. These include that there be a fair and orderly process for dealing with the financial affairs of insolvents; that there be the least possible delay and expense; that an insolvency administration should be efficient and expeditious; and that the principle of equal sharing between creditors should remain. There should generally be a release from the financial liabilities of the insolvent, in particular in a voluntary administration of a company.

35. In relation to many issues raised in the discussion paper, the IPA considers there is a potential for long-tail liabilities to disturb the application of these principles, in particular as to the need for certainty of resolution of claims and their efficient and prompt assessment and the payment of dividend returns to creditors.

Outline of the IPA submission

36. The discussion paper identifies particular and general problems and issues that arise in a corporate insolvency in relation to long-tail liability claims. Many of these are policy issues that the IPA does not directly address. The IPA accepts that long-tail claims may require particular legislative and court attention in an insolvency, in particular, from our members' perspective, to assist them in dealing with the difficulties described in the discussion paper.

37. This submission therefore seeks to:

- explain what the IPA sees as the nature of provable claims under the current law, with a view to contrasting that law with UFCs whose claims may not be provable; in fact to more clearly identify the legal status of UFCs. This responds to the initial question in 2.5 of the discussion paper as to the nature of long-tail liabilities as provable claims;
- if UFCs do not in fact have provable claims under current law, how UFCs should be dealt with. In that regard, the IPA does not offer submissions as to whether such claims should or

1 General Insolvency Inquiry ALRC 45, 1988, at [33].

should not be dealt with in insolvency law,[2] or dealt with in some other way by addressing what can be seen as a long-term social and medical problem. If there is a view that insolvency law should address these claims, and if the prospect of further such claims is real, we offer comment on the features of a regime that might assist that process, involving clear initial identification of UFCs, with specific legislative provisions, and close court involvement. This should be tempered by the cost and time required to deal with such claims in light of available funds. The IPA is concerned to have a regime that provides its members clear and ready assistance in dealing with what are difficult issues in a difficult commercial environment.

Current law

Who are creditors?

38. A major focus of insolvency law is on who is a creditor because only a creditor is entitled to share in the assets of the insolvent. The legal impact of insolvency is dramatic and significant in that a creditor's claim is determined at the date of the insolvency, in the case of a liquidation, the 'relevant date'.[3] At whatever stage that claim has reached in its progress at the time of the formal insolvency, the task of insolvency law is to make an assessment of whether it is a valid claim and if so, the monetary amount involved.

39. Debts can be 'cleanly' determined; for example all debts of an insolvent may be judgment debts about which no contest as to liability or quantum is raised. On the other hand, the claims may be vague, factually and legally, potentially subject to complex litigation, difficult to quantify, and sometimes unknown to the insolvent, and even the creditor. Given the immediate legal effect of an insolvency, in effect transforming the rights of creditors, the full range of these scenarios is not uncommon in any given insolvency.

40. Hence insolvency law is not unused to dealing with difficult claims, as to whether they are provable debts and in what quantum. The IPA alerts the Committee to certain issues in the existing law, not only in relation to personal injury claims but also in relation to other 'difficult' claims with which insolvency law deals. We consider these issues and cases in relation to the existing law should be fully understood in the context of assessing the legal status of UFCs and before any consideration is given to reform of that law.

41. In particular, we list the following examples of recent cases where insolvency law has addressed the question of difficult provable claims.

2 Some of the difficult legal and policy issues of dealing with these claims in an insolvency are addressed in 'James Hardie and insolvency', (2005) 6(2) INSLB 21, Cowling D and Magee S

3 *Corporations Act* s 9; under Part 5.3A, see s 444D

- Trade practices or other such claims, which can be 'unascertained' at the time of formal insolvency, for example for misleading conduct, or for defective goods, or breach of competition law, in some cases necessitating reinstatement of the liquidated company.[4]
- Environmental claims, for example where a company contaminates land that is later bought and built on by X and then X contracts an illness arising from the contamination, or suffers remediation costs;[5]
- Litigation costs claims may be provable debts even before the court makes any order for costs;[6]
- Insurance claims, for example where a policyholder takes up a policy with an insurer, which thereupon assumes a contingent liability. The policyholder is a contingent creditor of the insolvent insurer at the point in time that the policy is taken out even if, at the time of the insurer's insolvency, no insurable loss has been suffered or any claim made. That affects the present insolvency of the insurer.[7]
- Warranty creditors, for example in respect of a car sold with an extended warranty as to defects that extends beyond the relevant date in respect of a deed of company arrangement;[8]
- Damages claims for post-appointment breaches of contract, for example future breaches of a lease, as discussed in *Brash Holdings v Katile*[9] and *Lam Soon v Molit*[10] and further discussed by Finkelstein J in *Theiss Infraco*[11] and later cases.

42. As well, insolvency law is used to dealing with a large number of claimants who require assessment and quantification of their claims – see for example the case law in relation to Ansett Airlines, One.Tel and HIH Insurance.

43. We also mention that bankruptcy law addresses many of these fundamental issues, albeit under different wording, and policy, in s 82 *Bankruptcy Act*.

44. As to the existing law, and as the discussion paper says, although the *Corporations Act* uses the term 'creditor' throughout, there is no definition of the term and this has been the subject of comment in various court cases.[12]

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4 See for example *ACCC v ASIC* (2000) 34 ACSR 232

5 *Joyce Rural v Harris* [2001] WASC 14

6 *McDonald v Commissioner of Taxation* (2005) 187 FLR 461; *Environmental & Earth Sciences Pty Ltd v Vouris* (2006) 152 FCR 510.

7 See 'The assessment of the insolvency of a general insurance company', Background paper no 15, HIH Royal Commission Report.

8 *Motor Group Australia Pty Limited (Administrators Appointed) (ACN 101 051 101)* [2005] FCA 985.

9 (1994) 12 ACLC 472

10 *Lam Soon Australia Pty Ltd (Administrator Appointed) Pty Ltd v Molit (No 55) Pty Ltd* (1996) 70 FCR 34.

11 *Thiess Infraco (Swanston) Pty Ltd v Smith* (2004) 50 ASCR 434; and on appeal, *Wallace-Smith v Thiess Infraco (Swanston) Pty Ltd* (2005) 218 ALR 1. Whereas in Lam Soon the Full Federal Court, speaking of future breaches of a covenant to keep leased premises in repair said it was "not even a contingent claim" because the right to sue before breach was a mere expectation. That proposition not accepted by Finkelstein J in *Thiess Infraco*, at 440.

45. The need to determine who is a 'creditor' in an insolvency can arises in several instances, including:

- at the very beginning, when a determination of the solvency of company B must be made. Solvency is determined by the ability of an entity to pay all its creditors (who are owed debts or who make claims) as and when they fall due. This necessarily requires determination of the extent of these debts;
- on company B entering liquidation, at the point of the liquidator's determination of who the creditors are, both for the purpose of assessing the company's financial position, and notifying those creditors of the insolvency;
- for the purpose of convening and holding creditors' meetings, in determining rights to vote and to participate in such meetings;
- in the case of a Part 5.3A administration, in deciding upon a deed; and
- at the point when proofs of debt are lodged and then assessed and dividends paid.

46. The issue is inherently difficult in insolvency because of the breadth of the claims that are to be assessed for the purposes of s 553, and under s 444D in relation to Part 5.3A administrations. It is also inherently important. It is one of the policies of insolvency law that a broad scope be given to the definition of a creditor both so as to ensure that all persons with claims can share in the assets of the company; and that if the company is to survive, that it be released from all its liabilities in order to facilitate its on-going financial position.[13]

47. The fact that claims are difficult to assess does not diminish the fact that they may nevertheless be clearly provable claims. The law does acknowledge that some such claims need particular legislative attention, and there are provisions that give assistance to administrators in computing debts and claims, under Part 5.6 Division 6 Subdivision 6 of the *Corporations Act*, in particular in relation to claims of 'uncertain value': s 554A. A provable claim may, in terms of that section, be a debt that is of uncertain value. The fact that claims are numerous, in the thousands, is also not a relevant issue in determining provability.

48. In the context of this submission, the meaning of the words "claims the circumstances giving rise to which occurred before the relevant date" in s 553 are central to deciding the status of many long-tail claims. The High Court has recently noted the lack of judicial examination of those words.[14]

49. In the context of this submission, and referring back to our three scenarios, we consider that there are good arguments that:

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12 *Motor Group Australia Pty Limited (Administrators Appointed) (ACN 101 051 101)* [2005] FCA 985 at [7]

13 Harmer Report Ch 16

14 *Sons of Gwalia Ltd v Margaretic* [2007] HCA 1; (2007) 232 ALR 232; (2007) 81 ALJR 525 at [171]

- X in *scenario one* is a UFC and has no provable claim in B's insolvency. Whilst the asbestos as a harmful product exists, we do not think the fact of the circumstance of the unsafe product having been manufactured by B, absent any exposure of that product to X, is of itself a relevant fact or circumstance within s 553.[15]

- X in *scenario two* may well have a provable claim in that the exposure occurs before the relevant date, even if the illness is not manifested until later. We appreciate that a different view was taken in *Edwards v Attorney-General*, as cited in the discussion paper.[16] In light of the case law on contingent claims, referred to above, we do not think it is the case that the relevant facts and circumstances must include the person falling ill, nor that section 553 requires a completed cause of action to exist at the relevant date. We note the differing views in *T&N Limited and Others*, and in *Re Stork ICM Australia.*

- X in *scenario three* has a provable claim, all facts and circumstances having occurred before the relevant date.

50. We point out that the term 'unascertained future claimants' is perhaps not accurate. 'Future' claims clearly fall within s 553. The fact that they are 'unascertained' (suggesting they are not yet known about) is not to the point. A future claim may be unascertained at the relevant date, for example, if the claimant is not yet aware that they are ill, or that the land they purchased is contaminated. They nevertheless have a provable claim. UFC is only an accurate term if 'unascertained' means that the claim, and its circumstances, are yet to exist at the relevant date, which may be the case if the exposure to asbestos occurs after that date (scenario one).[17]

51. The real question is what happens if the claim arises after the relevant date. That is, if it is a *post insolvency claim*, albeit based upon a fact or circumstance occurring before the relevant date. In the normal course, insolvency law tries to avoid that situation arising, by giving a broad definition of a creditor and provable debts under s 553. Beyond that cut-off date no claims can be considered largely because they would not be claims arising from the company's conduct.

Proposals for dealing with UFCs

52. The discussion paper acknowledges that insolvency practitioners are:

> 'understandably concerned about the cost to other creditors of the increased costs of administration of an estate, delay in the distribution of any dividend and decreased dividends. Further, there are presently concerns that insolvency practitioners often have inadequate funds and company information with which to carry out the investigation of any mass future claim by UFCs'.

53. The IPA agrees with that summary of some of our members' concerns.

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15 We note the view in footnote 13 of the discussion paper

16 pp 18-19

17 Also, the opposite of 'ascertained' in s 553 is 'sounding only in damages', ie unliquidated.

Generally

54. We emphasise what the IPA sees as some requirements of any reform proposals. Assuming that UFCs do represent a class of claimants that do not fall within the existing law, and assuming that it is considered that they should be accorded recognition in an insolvency, there should be:

- a clear definition of a UFC, with a clear differentiation, or 'carving out', from the existing broad range of claims that come within s 553. We anticipate that the 'mass future claim' definition will be defined at a high threshold level; such that the whole issue involved in this discussion paper will only arise in exceptional circumstances and perhaps in relation to particular industries;
- a regime that allows any such claims to be dealt with according to particular legislative provisions, court rules and guidelines;
- rules that should apply to UFCs irrespective of the type of administration that the directors choose. It should not be open to directors to be able to choose an administration that does not allow for the particular regime, or to seek to avoid the attention that such a regime would give to UFCs;
- Court involvement in the insolvency administration with directions available throughout at the request of the administrator. In such a case, court appointed representatives of the claimants may be needed as there would be difficulties for the court in dealing with such claimants on an individual basis. There would also be difficulties for an administrator in dealing with other than an appointed representative/s of such claimants.
- Even if company B is small, or has only traded for a comparatively limited time, there may be mass claims and court involvement is required to allow proper assessment of the circumstances of the claim (assuming for example it is of the nature of an asbestos type claim) to be made.
- A purpose of court involvement would be to offer protection to administrators handing what are difficult issues. The IPA is concerned to suggest that the process needs to be clearly set down in the legislation and rules that provide guidelines to administrators which, if followed, will avoid the potential for future claimants to make a claim against the administrator personally. In particular, careful consideration will need to be given to the nature and extent of the inquiries which are expected of the administrator to ascertain whether a mass future claim situation exists; and the extent to which the administrator can, or should, rely on independent (eg expert) assessment of the likelihood and extent of such claims. We point out the obvious difficulties which would confront administrators in situations where there are limited funds available. Also, over the course of the administration, there may be new or further expert evidence emerging which suggests, or more strongly suggests, the likelihood

of mass future claims. Recourse to the court for assessment of these issues is necessary.[18] Formal court approval of any deed or other arrangement is desirable.

- The IPA also emphasises, to the extent in any case that this can be achieved, that an insolvent entity should be better able to deal with UFCs if the entity can be reconstructed. Simply put, a company with UFCs may be able to deal with them, as a reconstructed entity that trades on, where future claims can be paid out into the future. That will necessarily raise commercial tensions between existing creditors of the entity and the UFCs, and the company itself;
- How to assess the impact of UFCs on a company's present financial position is raised in the discussion paper. The position of directors, who are obliged to monitor the solvency of their company, for example to maintain accurate books and records, and prevent the company trading whilst insolvent, should be considered in terms of how UFCs are quantified;
- if UFCs are to be confined to personal injury claims, then the inequity of a person suffering a long-tail loss other than through personal injury should be assessed from a policy viewpoint.[19] Corporate insolvency law makes no real definition between claims on such policy issues, the only real exception being in relation to fines and penalties, under s 553B. The claim is reduced to a dollar amount, paid *pari passu*, no matter what the relative needs or moral rights of the individual creditors. It is a matter for the law to address any such inequity and beyond that the IPA makes no comment.

Different types of insolvency administration

55. The discussion paper examines the various forms of procedure to deal with mass future claims by UFCs in the context of voluntary administration, schemes of arrangement and liquidation. We address each of these in light of the issues just raised.

Voluntary administration

56. We note that there are four options that CAMAC considers might apply in a voluntary administration.

Option 1: monetary provision with or without further recourse for UFCs

57. This would require the administrator to admit and make provision in a voluntary administration for a UFC in circumstances where what the discussion paper refers to as a 'mass future claim' test is satisfied. A Deed of Company Arrangement (DOCA) would need to include some financial provision for UFCs, for example, a separate trust fund into which the funds are placed for these 'creditors', separate to funds made available to deed creditors.

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18 We draw the Committee's attention to a comment in the Harmer Report as to processes for the quantification of uncertain claims by a 'specialist tribunal' or other court [786].

19 The Harmer Report [782] recommended that inequities arising from the then distinction between tort and contract claims in insolvencies be removed. See *Coventry v Charter Pacific Corporation Limited* [2005] HCA 67; (2005) 222 ALR 202 at [7].

58. Generally, the IPA emphasises that, given the inherent future component of UFCs, any regime that assists in a company surviving, with UFCs to be paid out of a separate fund, or future profits, or through some shareholding of UFCs in the company, is preferable to a liquidation scenario where the finality of a winding up and deregistration can limit the ability to deal with UFCs.

59. The discussion paper also contemplates an appointed representative for such creditors who would have standing to challenge the proposed DOCA; and the preparation of an independent expert's report on the impact of the proposed DOCA on the UFCs. That of course would necessarily have an impact upon the expected speed of resolution under a DOCA, which would be a significant departure from the essential nature and purpose of Part 5.3A administration. However we accept that mass future claims matters would of themselves be exceptional.

60. The IPA considers such a proposal as feasible but refers the Committee to the considerations above that we suggest be taken into account in developing any such proposal.

Option 2: no provision for UFCs

61. This option provides that no provision should be made for UFCs in a voluntary administration and simply retains the current law under which such 'creditors' are not bound by the DOCA. They would simply be post-deed creditors of the company, nevertheless ones that can be anticipated into the future and therefore ones with the potential to presently impact on the company's continued viability.

62. Given the limited circumstances in which UFCs will arise in any given insolvency administration, this option is valid. The creation of a whole new regime in insolvency to address a particular type of claim that arises infrequently should in our view be critically assessed.[20]

Option 3: a certificate by directors

63. The third option is to permit a vote by ascertained creditors on a DOCA which provides for a partial repayment to creditors only if the directors have provided a relevant certification that the company has no UFCs or that the DOCA would not prejudice the interests of such creditors. The IPA doubts it is useful to rely on director certification for such a significant issue.

Option 4: allowing a representative for UFCs to challenge a DOCA in court

64. The fourth option is to require the administrator to appoint a legal representative for UFCs before a vote on any DOCA. The representative would be unable to vote in relation to the proposal but would have standing to apply to the court to challenge it. This does not explain the criteria by which a challenge would be made and seems only to defer the issue. Nevertheless, in terms of our earlier comments, the IPA supports any proposal where an independent person is appointed to represents UFCs and any proposal involving court involvement.

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20 Particular insolvency regimes have been created for particular industries and entities – for example, life insurance, banking, Aboriginal corporations.

Schemes of Arrangement

65. The discussion paper proposes that the scheme of arrangement provisions in respect of UFCs where there is a mass future claim would be similar to those under a voluntary administration. As to insolvent schemes, the IPA relies on its comments in relation to voluntary administrations.

Liquidation

66. The discussion paper proposes that a mandatory requirement in liquidation would be the obtaining of a court order for the establishment of a trust fund for UFCs. This would deal with matters such as the amount of the fund, who can act as the trustee of the fund and the remuneration of the trustee. Any claims on the trust fund would cease to be claims in the liquidation. It is further proposed that, to assist the liquidator in reaching a decision as to whether or not to apply for such an order, the directors of the company in liquidation should be required to disclose whether the company has any ascertained future personal injury claimants. By the making of the court order referred to above, the company's obligations and rights in relation to such creditors would be assigned to the separate trust fund, which would allow the liquidation to be completed.

67. In principle, the IPA raises no objection to this proposal, as long as the guidance to a liquidator is clear and consideration we have raised are taken into account.

Limited funds

68. We do point out that all these proposals assume a liquidation or DOCA with some substantial return expected for creditors, and money for the trust fund, or assume a future viability for the company. The reality may be different. For example, if company B is one that operates unethically or unlawfully and produces products that will cause harm, it is likely to be an entity that will be transient in the commercial world. Many such companies that act in breach of trade practices and fair trading legislation and that are pursued by aggrieved existing creditors, or consumers who have suffered personal harm from use of the products, or the regulators, will end up with no or limited assets. The company from which this issue arose – James Hardie – was at the other end of the commercial spectrum, as was the T&N company in the UK. There needs to be some commercial reality in-built into any regime for UFCs, such as setting a monetary threshold of available funds, or anticipated future profits, and hence expected dividend return to creditors.

Anti- avoidance

69. The discussion paper considers whether an anti-avoidance provision should be included in any legislation dealing with long-tail liabilities and, if so, what form it should take.

70. The IPA supports this in principle but points out that the *T&N* case in the UK in fact involved a transfer of the liabilities to a separate entity, for a proper purpose. The IPA therefore says that caution is required in imposing liability, including on advisers, lest it serve to deter any legitimate restructuring proposal for the benefit of UFCs.

71. We also note that the concept described appears to be based on the regime under Part 5.8A of the *Corporations Act* in relation to the 'entering into agreements or transactions to avoid employee entitlements' (s 596AB).[21] That regime appears to have been little used (at least in so far as reported decisions are concerned) and it has been criticised as being of limited utility.[22]

72. The IPA is grateful for the opportunity to make this submission and would be pleased to clarify or explain these issues further. Please contact our legal director, Michael Murray, should you wish to do so.

Insolvency Practitioners Association

Paul Cook
President

21 See 'James Hardie and insolvency', (2005) 6(2) INSLB 21, Cowling D and Magee S

22 'Will there ever be a prosecution under Part 5.8A?', (2002) 3(1) INSLB 17, Symes C

Law Council
OF AUSTRALIA

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
Via email: john.kluver@camac.gov.au

12 October 2007

Dear Mr Kluver

Response to the Corporations and Markets Advisory Committee Discussion Paper on Long-Tail Liabilities ("Discussion Paper")

1 Introductory Comments

1.1 This letter sets out submissions of the Corporations Committee of the Business Law Section of the Law Council of Australia (the "**Committee**") in response to the Discussion Paper. Please note that whilst the submissions have been approved by the Business Law Section, owing to time constraints they have not been considered by the Council of the Law Council of Australia.

1.2 The Committee's primary approach in this letter is to respond to the "Referred Proposal" described in the Discussion Paper at a high policy level. The Committee does not support a specific regulatory regime to regulate a concept as ambiguous as a "UFC".

1.3 In the Committee's view, a "one size fits all" legislative response, designed around the Australian experience in the circumstances surrounding asbestos related diseases, is unlikely to be the most efficient means of improving the position of unascertainable future personal injury claimants in all other situations, in light of the potential costs and business uncertainties which would be imposed on other stakeholders by the proposed UFC regime.

~~1.4 The Committee believes that if implemented the Referred Proposal (and specifically,~~ those parts of the Referred Proposal outlined in section 3.5 of the Discussion Paper relating to recognition of unascertainable future claimants ("**UFCs**") as creditors) and is likely to:

(a) result in more complex voluntary administrations and liquidations for affected companies;

GPO Box 1989, Canberra, ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612 | Telephone **+61 2 6246 3788** Facsimile +61 2 6248 0639 | Law Council of Australia Limited ABN 85 005 260 622 www.lawcouncil.asn.au

(b) increase the costs and time associated with those processes;

(c) increase uncertainty for creditors and shareholders as to their return in an external administration; and

(d) arguably heighten the prospect that affected companies will become insolvent before satisfying UFCs.

1.5 More fundamentally, the Committee does not believe that implementation of the Referred Proposals discussed in 3.3 and 3.5 of the Discussion Paper can address the fundamental problem associated with long tail liabilities- namely, the need for a defendant to remain profitable for a sufficiently long period to satisfy all liabilities.

1.6 However, the Committee considers that there is merit in some of the proposals in the Discussion Paper and comments on these in paragraph 6 of this letter.

2 Impact of different circumstances

2.1 The Referred Proposal was a response to the Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation ("**MRCF**"). As such, its focus was driven by the particular circumstances surrounding asbestos related diseases, the James Hardie Inquiry and the MRCF.

2.2 The issues created by asbestos related diseases are not likely to be repeated in precisely the same way for all future cases which may give rise to long tail liabilities. A number of the circumstances surrounding MRCF which may not be present in future cases are:

(a) the nature of the diseases caused by exposure to asbestos, both in terms of the nature of the pain and suffering associated with those diseases and the absence of any cure;

(b) the time of life at which the diseases tended to manifest themselves;

(c) the means by which persons became exposed to the disease; and

(d) the relatively long period during which products containing asbestos were used after a scientific link had been established between asbestos and the diseases.

2.3 The purpose of mentioning these issues is to highlight that each future instance of products which give rise to long tail liabilities is likely to have peculiar features, which may affect the nature of the community response. A general ex ante legislative response appropriate and effective in all instances is unlikely to be possible.

2.4 Some of the factors which the Committee considers may be relevant to formulating a legislative response to the problems posed by a particular product giving rise to long tail liabilities are set out below:

- *Community impact*

The positive impact which a product has had on the community, as well as the scale of the negative impact which the product has had on the community, may result in a community reaction far different to that created by asbestos. For example, the community may react differently if a successful drug is found to have negative side effects with a long latency period for a particular class of consumers.

- *Timing of realisation of negative side effects*

The time it takes for the scientific and broader community to recognise that a product is unsafe may effect the community's reaction, and also be relevant to how companies respond.

- *Financial position of industry participants*

A fundamental factor shaping the settlement between James Hardie, the NSW Government and others was the need, acknowledged by all parties, to ensure James Hardie remained a viable and profitable business over the long term, to be in a position to satisfy claims by UFCs over a long period. The financial condition of the affected companies and industry as a whole may be relevant to the response.

- *Government reaction*

The reaction and conduct of governments at the time it becomes clear that a product could give rise to latent injuries may be a factor in shaping the ultimate reaction to the long tail liabilities associated with the product. For example, whether governments respond early with legislation which bans products and requires their withdrawal once there is scientific evidence of a risk, or fail to take steps for a long period, may bear on the magnitude of the ultimate liability exposure.

- *Potential changes to legal regime*

While many asbestos related claims have been based on tort law, it is possible that product liability claims involving future types of long tail liabilities will be brought under other statutes. New forms of legislative causes of action may ultimately have some impact on the practical ability of unascertainable future claimants to make claims.

2.5 The widely differing experience and response of various jurisdictions to asbestos related diseases clearly illustrates the proposition that one size does not fit all and that regulatory issues surrounding regulation of UFCs are very fact specific:

- In Australia it has been estimated that State and Federal governments collectively have the largest uninsured liability exposure to asbestos UFCs, with a net present value of approximately $2.5 billion. The remaining primary liability exposure of the corporate sector is spread across companies, but is concentrated in two companies.

- Many of the companies in the United States bearing primary responsibility for producing and distributing products containing asbestos have gone into bankruptcy, or are undergoing some form of bankruptcy proceedings. The current level of recovery of UFCs for asbestos claims is generally significantly less than 100 cents in the dollar.

- In the United Kingdom, there have been a number of significant bankruptcies of companies facing asbestos claims. However, there has not been a broad based legislative response to the issues created by UFCs.

- In New Zealand, there is a general no fault statutory compensation scheme, which also applies to claims by UFCs.

3 A hypothetical case study

3.1 To try to assess the potential impact of those aspects of the Referred Proposal discussed in section 3 of the Discussion Paper on one industry, the Committee discussed their potential impact in the following hypothetical scenario.

3.2 The hypothetical scenario considered by the Committee assumes that scientific studies emerged suggesting that there could be a causal connection between usage of a particular product and cancer, while other scientific studies suggest there was no causal link. Later scientific studies produce different results, with scientific evidence beginning to more frequently demonstrate that there could be some statistical connection correlation between heavy usage of certain types of this product, by particular members of the community, and cancer. Plaintiffs start commencing actions alleging they suffered injury as a result of using the product, and a number of defendants were held liable at common law for negligence. At some point a plaintiff is successful in obtaining a court ruling linking the product to the personal injury. Ultimately, significant class actions are brought on behalf of thousands of alleged victims against producers and suppliers of the product.

3.3 The question the Committee asked after posing this hypothetical scenario is how legislation of the type suggested by the Referred Proposal will benefit the class of potential victims, and at what potential cost to shareholders, creditors and other stakeholders in the affected companies, such as employees and the community at large.

3.4 The first and obvious point to make about the hypothetical scenario is that if implemented the Referred Proposal would be unlikely to initially have any immediate impact on the industry in this hypothetical example or consumer behaviour, so that it is unlikely to prevent diseases which are ultimately linked to the use of the product, at least until there was some scientific certainty around the causal link.

3.5 At some point in time, possibly where the preponderance of scientific evidence suggests there may be a statistical connection, the legislation may have some impact on the behaviour of participants in the industry (and potentially consumers).

3.6 Depending on a number of factors, including the nature of the scientific evidence, the success of plaintiffs in bringing claims and the potential exposures involved, the industry response may be to withdraw particular types of products, or sell them with health warnings attached. (It should be noted that the industry could be expected to respond in some way, once scientific evidence was clear, regardless of whether the Referred Proposal was implemented.)

3.7 Secondly, once on notice that it was likely to face "mass future claims", an affected company in this industry would need to consider whether to disclose either a contingent liability or make a provision for the liability in its balance sheet, in accordance with the accounting standards. Over time, as both the likelihood of successful claims, expected timing and the anticipated size of those claims becomes clearer to companies, the amount disclosed, and type of disclosure required by the accounting standards, may change. The fact that the company is exposed to future claims is likely to have an immediate impact on the way shareholders and unsecured creditors assess the company, regardless of the introduction of the Referred Proposal.

3.8 If that part of the Referred Proposal described in section 3.3 of the Discussion Paper (the requirement to restrict company transactions which adversely affect share capital) is implemented, affected companies would be restricted from engaging in some forms of

capital management such as share buy-backs and reductions of share capital, as they would need to consider the potential impact on future unascertained claimants. This restriction could indirectly increase the company's cost of equity capital, if it resulted in the company being unable to implement capital management strategies which it otherwise would have implemented.

3.9 If the part of the Referred Proposal described in section 3.4 of the Discussion Paper (the prohibition on intentional avoidance) is implemented, directors may be reluctant to undertake restructuring initiatives designed to increase a company's ability to maintain profitability and ultimately satisfy all creditors and unascertainable future claimants. Whether directors are overly cautious would depend on how clearly defined the prohibition on intentional avoidance is- if there was a clearly defined safe harbour for directors, this may not be a practical problem.

3.10 Assuming that part of the Referred Proposal described in section 3.5 of the Discussion Paper is implemented (allowing UFCs to prove in external administrations), other unsecured creditors may also take into account the risk that, upon liquidation:

(a) the amount distributed on winding up will be reduced as a result of the requirement to include unascertainable future claimants as creditors; and

(b) the time at which distributions will be payable may be later than it otherwise would have been, due to the need for a liquidator to quantify and set aside amounts for unascertainable future claimants.

These factors could indirectly increase the cost of an affected company's debt, in turn reducing the ability of the affected company to maintain profitability and ultimately solvency.

3.11 If an affected company did go into external administration or liquidation after the Referred Proposal was implemented, a number of issues arise. Firstly, current personal injury claimants (along with other unsecured creditors), may face a delay in receiving a distribution while the external administrator or liquidator determines the amount to be set aside for future claimants.

3.12 Secondly, the liquidator may be required to ration the amount to which unsecured creditors are entitled, to ensure there are sufficient funds to pay UFCs. Rationing of current claims may in effect mean that currently afflicted individuals (and other creditors) receive very little of their liquidated claim, so that the capital can be preserved to allow anticipated future claimants to be compensated.

3.13 UFCs may however have an advantage over currently affected personal injury claimants. While they may suffer compensable injury, given that by their nature the injuries will only be realised at some time in the future, a medical cure may have been found by the time they are diagnosed. Accordingly, the compensable amount to which they would be entitled, which is necessarily uncertain, may fall over time due to medical progress.

3.14 If the nature of the exposure of participants in the affected industry is sufficiently widespread, affected community interest groups (e.g. consumer protection lobbies or unions) may demand a tailored legislative solution, aimed at ensuring that all potential claimants are adequately compensated. Some circumstances which could encourage this type of community reaction are:

(a) if one or more industry participants have been wound up even before the claims fall within the scope of the legislation, leaving large numbers of potential claimants without recourse;

(b) if the potential number of claimants is so great, and the potential costs and time associated with pursuing a range of class actions so significant;

(c) if the nature of the injuries inflicted by the products is such that victims, once diagnosed, have a need to access compensation quickly; or

(d) if the size of the potential claims is such as to seriously endanger the ability of one or more significant industry participants to continue operate, which could have broader economic implications for the community.

3.15 There are a range of industries which could conceivably be confronted with "mass future claims" in the future, including the telecommunications industry and genetically modified food industry (if scientific evidence established a causal connection between the industry's behaviour and a particular disease), to which this hypothetical example might possibly be relevant. The giving of these examples is not to suggest any likelihood of liability but to highlight the key concerns identified in paragraph 1.4 above.

4 Support for the introduction of an "*Edwards*" type power

4.1 The Committee proposes the introduction of an additional discretionary power into section 1318 of the Corporations Act, along the lines argued for by the plaintiffs in *Edwards v Attorney-General* (NSW) [2004] NSWCA 272, to permit the Court to grant relief to directors who may face future liability to UFCs. In the *Edwards* case, the directors of the Medical Research and Compensation Foundation sought relief from future liability arising from their actions in paying out the full entitlement of presently existing asbestos claimants, instead of rationing the amounts. The provable claims against the subsidiaries of MRCF in a winding up were minor, but the potential future claims were significant.

4.2 In *Edwards*, the Court held that it did not have power to grant relief under the section 1318 of the Corporations Act in its current form in respect of potential future claims against directors. The Committee believes it is important for the courts to be able to provide certainty to directors that they will not be faced with future personal claims arising out of decisions taken in good faith in this type of scenario.

5 Application of accounting standards

5.1 Companies are under an obligation to consider disclosing and quantifying unascertainable future claims under AASB 137, either as a contingent liability or a provision. This disclosure obligation ensures that companies and their directors do not ignore the interests of unascertainable future claimants, notwithstanding that they are not treated as creditors on a winding up.

5.2 The Committee considers that the accounting standards provide an adequate and certain (to the extent possible, given the need for estimates of contingent liabilities and provisions and the inherent uncertainties around such estimates) means for company's measuring and disclosing unascertainable future claims.

5.3

6 Specific responses to questions raised in the Discussion Paper

6.1 Brief responses to some of the specific requests for submissions raised in the Discussion Paper are set out below.

Comments on Chapter 3 of the Discussion Paper

(a) For the reasons outlined further above, the Committee does not support the reforms discussed in sections 3.3 or 3.5.

(b) The Committee broadly supports the introduction of a prohibition on intentional avoidance of a company's obligations, as proposed in section 3.4, providing it is very clear in its operation and scope.

Comments on Chapter 4 of the Discussion Paper

(c) Assuming the Referred Proposal is adopted (which the Committee does not support), the Committee considers that it would be appropriate to adopt a high threshold for the definition of "mass future claim", and accordingly considers that the approach proposed in section 4.2 is preferable to that in section 4.4 and 4.5.

Comments on Chapter 5 of the Discussion Paper

(d) The Committee does not support changes to the share capital reduction, share buyback, or financial assistance provisions as discussed in sections 5.2 to 5.5, as it considers there is a risk of perverse consequences associated with introducing such changes.

(e) The Committee considers that the disclosure proposal in section 5.6 has merit. If a disclosure requirement is introduced, the Committee submits that it should be consistent with accounting standards.

(f) The Committee queries the implicit suggestion in section 5.7 that share buy-backs (in particular) are discretionary in a way which relevantly distinguishes them from dividends. Both actions are discretionary and in many instances economically equivalent.

(g) The Committee would not support an extension of the Referred Proposal to insolvent trading due to potentially perverse outcomes that could give rise to.

(h) The Committee agrees that it is not necessary to introduce a provision permitting directors of solvent companies to set aside a portion of the company's assets in trust to meet anticipated claims by UFCs, as discussed in section 5.10.

(i) The Committee broadly supports the introduction of either Chapter 11 style procedures, or procedures to enable schemes of arrangement between a company and an identified class of UFCs, which are designed to provide a framework which solvent companies can elect to use to address the issues associated with UFCs. One alternative to either of these approaches would be to provide a discretionary power in the court to enable it to provide protection to companies seeking to implement these types of arrangements. Any of the above proposals (although unlikely to be a general panacea to the issues created by long tail liabilities) would at least increase the prospect that affected companies would

survive to satisfy claims by UFCs, without introducing the undesirable effects of allowing UFCs to participate in voluntary administrations and liquidations.

Comments on Chapter 6

6.2 The Committee does not support the ability of UFCs to prove in voluntary administrations, due to the increased cost, complexity and uncertainty such a reform would create for unsecured creditors, shareholders and other stakeholders in administrations. However, the Committee considers that, of the options proposed in sections 6.3 and 6.4, the best one would be to require the administrator to appoint a legal representative of UFCs, and to amend section 445D to provide the legal personal representative a basis for challenging a proposed deed of company arrangement on behalf of UFCs (as proposed in section 6.6), so that the court can protect the interests of UFCs in appropriate circumstances.

Comments on Chapter 7

6.3 The Committee considers that it would be practically difficult to permit UFCs to participate in schemes, except in limited situations such as those in *Re T&N Ltd (No 2)* [2005] EWHC 2870 (Ch). However, the possibility of appointing a legal personal representative, as outlined in section 7.3, who would have the right to challenge any proposed scheme on behalf of UFCs, would provide UFCs some protection against company's seeking court approval of schemes which would endanger their ability to ultimately satisfy UFCs.

Comments on Chapter 8

6.4 As discussed above, the Committee does not support the Referred Proposal discussed in section 8.2, as it believes that allowing UFCs to prove in a liquidation will create uncertainty, increase costs and result in delays to liquidations, without providing any assurance that UFCs will be able to recover their loss.

Comments on Chapter 9

6.5 The Committee supports the introduction of anti avoidance measures modelled on Part 5.8A of the Corporations Act. These provisions should be sufficiently narrow so that they do not limit the ability of affected companies to conduct capital management initiatives or enter other transactions for the company's benefit, which in turn may ultimately benefit UFCs by contributing to the survival of the company.

Comments on Chapter 10

6.6 The Committee agrees that it would not be appropriate to seek to amend limitation periods for the benefit of UFCs. As noted in Chapter 10, the courts retain discretion in any event in relation to limitation periods.

Miscellaneous comment on the Discussion Paper

6.7 The Referred Proposal only suggests reforms to permit unascertainable future personal injury claimants to prove as creditors in an external administration. The Committee does not appreciate why, in principle, economic loss or environmental liabilities should be treated differently (although it does recognise that there may be added complexity in estimating UFCs for economic loss).

7 Conclusion

The Members of the Committee involved in the preparation of this submission would be pleased to discuss with representatives of the Advisory Committee some of the difficult, broader philosophical issues which the Referred Proposal give rise to, which are likely to be more easily communicated verbally than in written submissions. Please contact the Committee Chair,Greg Golding, on (02) 9296 2164 if you would like to arrange a meeting of members of the Committee and representatives of the Advisory Committee.

Yours sincerely,

Peter Webb
Secretary-General

16 October 2007

ASIC

Australian Securities & Investments Commission

Corporations and Markets Advisory Committee

Long-tail liabilities: The treatment of unascertained future personal injury claims

Submission by the Australian Securities and Investments Commission

October 2007

Introduction

The Australian Securities and Investments Commission (ASIC) welcomes the opportunity to provide this submission to CAMAC's review of long-tail liabilities and the treatment of unascertained future personal injury claims.

ASIC supports the Government's aims of strengthening protection for unascertained future personal injury claimants ('UFCs'), and deterring the misuse of company structures to avoid making compensation.

ASIC also supports the stated aim of the Parliamentary Secretary to the Treasurer's Referred Proposal, which is to strengthen protections for personal injury claimants, particularly where there is a long latency period for an injury, which hinders them from taking any action to protect their rights.

At the same time, ASIC recognises the need for any law reform process to minimise disruption to business certainty.

ASIC is generally supportive of CAMAC's proposed measures for the implementation of these aims, as set out in its paper *Long-tail liabilities: The treatment of unascertained future personal injury claims* (Discussion Paper). ASIC's submission comments on various aspects of the proposals that relate to ASIC's functions and responsibilities, in the interests of assisting the further development of these proposals. This includes comment on the impact of the proposals on the conduct of companies and external administrations, and the practical operation of the proposals in general.

The issue of long-tail liabilities and UFCs also encompasses two particular aspects of public policy, that is:

- whether the cost of compensating UFCs should be borne by companies responsible for the injuries suffered, or by the community through a public fund, or other means; and
- whether increased protection for UFCs should extend beyond personal injury claims to all long-tail liabilities, for example, those resulting from environmental harm.

ASIC does not consider that it is part of its role to comment on these high-level public policy issues, which are properly to be determined by the Government. ASIC's submission does not discuss these matters.

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Issue 1: Threshold Test

Relevant Proposals

1.1 The model referred to CAMAC by the Parliamentary Secretary to the Treasurer (Referred Proposal) envisages that UFC protections will only be triggered once a threshold test is satisfied (Referred Proposal test, set out at section 3.2 of the Discussion Paper).

1.2 The Discussion Paper proposes an alternative threshold test (CAMAC test, set out at section 4.5 of the Discussion Paper).

ASIC Comment

1.3 It is crucial to define a threshold test with sufficient certainty to make it reasonably clear when it will be satisfied. This is particularly so for directors and external administrators, who will be subject to additional obligations once the threshold is met. These parties need to be able to make decisions about how to deal with company funds with confidence.

Referred Proposal Test

1.4 ASIC has some reservations about the Referred Proposal test. In particular, we are concerned that certain aspects of the wording might lead to uncertainty.

1.5 Concepts such as an ‘unusually high number of claims’, a ‘strong likelihood’ and ‘numerous’ appear to incorporate a range of different standards of probability and need more precise definition, and might mean different things to companies of different sizes.

1.6 We are also concerned that the carve-out might represent an additional significant obstacle to triggering the threshold and impose an unnecessarily high evidentiary burden at this preliminary stage. There is also some risk that including such a carve-out might encourage wilful blindness in companies, in deliberately not investigating the potential for UFC liabilities to arise or not quantifying the likely costs involved.

CAMAC Test

1.7 ASIC supports the alternative test proposed by CAMAC. We feel that it avoids some of the problems of the Referred Proposal test discussed above, as it is more precise and certain and is not undermined by the carve-outs in the Referred Proposal, which, in combination, might have the tendency to promote lengthy legal disputes.

1.8 We note that this test would not cover the situation where UFC liabilities of one company were at some point in the past isolated in a

subsidiary, which was then sold off. However, we consider that this kind of scenario relates properly to the issue of anti-avoidance, and should be dealt with through the proposed anti-avoidance provision, as discussed further in section 4.

1.9 While, as stated, we support this test, we make the following comments:

Application of Test — Corporate Groups

1.10 We consider that this test should apply to corporate groups. That is, the test should be satisfied if:

- at least one personal injury claim against the company or related body corporate, or against another company or related body corporate in a similar industry to the company, has successfully been made or currently exists with a reasonable likelihood of success; and
- the company knows or ought reasonably to know of the exposure of a significant number of persons to the factors that have given rise to the claim; and
- there is a reasonable likelihood that future claims against the company or a related body corporate would arise form that exposure.

1.11 Companies in corporate groups often have formal or informal arrangements that ensure that their financial viability is interrelated, and it is essential that these structures not be misused to defeat the interests of UFCs.

Issue 2: Solvent Companies

Relevant Proposals

2.1 The Referred Proposal suggests that, once the threshold standard is met, existing creditor protection provisions in relation to share capital reduction and share buy-backs would be triggered. It proposes an amendment to the *Corporations Act 2001* (the Act) along these lines.

2.2 The Discussion Paper sets out various alternative policy options in relation to solvent company UFC obligations, including extending the Referred Proposal model to financial assistance transactions and dividends, and introducing a specific directors' duty in relation to UFCs.

ASIC Comment

2.3 ASIC agrees, as a basic principle, that solvent companies should not be able to act in such a way as to jeopardise their ability to compensate UFCs.

Capital Returns

2.4 ASIC supports the proposal that the Act should be amended to make it clear that solvent companies that meet the threshold standard should take into account the interests of UFCs in various corporate transactions that return capital to shareholders. That is, for the avoidance of doubt, the Act should be amended so that it is clear that UFCs cannot be materially prejudiced in the following circumstances:

- in relation to share capital reductions (ie, an extension of the condition in s256B(1)(b) that share capital reductions only be made by a company where the reduction would not materially prejudice the company's ability to pay its creditors); and
- in relation to share buy-backs (ie, an extension of the condition in s257A(a) that share buy-backs only be completed by a company where the buy-back would not materially prejudice the company's ability to pay its creditors).

Financial assistance

2.5 ASIC notes that the Discussion Paper does not express a strong view on whether the proposals should extend to financial assistance for acquiring shares, that is, whether the condition in s260A(1)(a)(ii) of the Act, that a company only give financial assistance for acquiring shares where it would not materially prejudice the company's ability to pay its creditors, should extend to UFCs.

2.6 ASIC supports this extension, being a logical extrapolation of the principle that a company's funds should not be transferred to shareholders if this would prejudice UFCs.

2.7 We note, however, that s260A(1)(a)(ii) operates differently from ss256B(1)(b) and 257A(a), in that shareholders may approve such assistance under s260A(1)(b) of the Act, even where this would be materially prejudicial to creditors. Thus, an extension of this provision would not necessarily provide entire protection for UFCs from prejudicial transactions, especially given that UFCs are unlikely to be members of the relevant company, or even realise at the time that they have a claim against it.

2.8 Nevertheless, ASIC still believes this extension is necessary in order to provide some requirement to consider UFCs in these circumstances.

Dividends

2.9 ASIC notes that the Discussion Paper considers various arguments for and against the extension of UFC protection to the payment of dividends, that is, extending the implicit creditor protection in s254T of the Act, without making an explicit recommendation.

2.10 ASIC feels that, while there are arguments for extending UFC protections in relation to all transactions that reduce company funds, dividend payments can be distinguished from capital reduction transactions in that they are part of a company's regular capital management activity, and are less discretionary in nature.

2.11 We are concerned that requiring companies to take UFCs into account before declaring a dividend might prove to be an unnecessary restraint on this market activity.

Preferred Approach — 'Red Light' Directors' Duties

2.12 While we support the Referred Proposal and CAMAC proposals as discussed above, ASIC feels that CAMAC should consider a broad duty for directors to take UFCs into account as necessary.

2.13 ASIC notes CAMAC's conclusion that the law currently permits directors to take into account the interests of UFCs in carrying out their duties (Discussion Paper, section 5.10). However, we consider that, while a permissive provision might not be necessary, the Act should be amended in order to introduce a positive obligation on directors to act in such a way that will not materially prejudice UFCs when carrying out their duties.

2.14 This could be done via a 'red light' model, so that the positive obligation is triggered once the threshold test is met. At this point, directors would be required to take UFCs into account in any

transaction the company undertakes, including capital reductions and share buy-backs. This would replace the need to introduce specific obligations into the Act in relation to particular activities discussed above.

2.15 ASIC feels that a 'red light' director's duty could be an important way of providing global protection for UFCs in all of a company's transactions. While the standard of the duty would be high, this duty would only be engaged once the threshold test was satisfied. ASIC prefers this approach because it is cleaner, and does not clutter up the capital reduction, buy-backs and other provisions with rules that will only very rarely be relevant.

Alternative Approach — Court Approval of Transactions

2.16 Another alternative is to incorporate an additional protective measure into the capital reduction and buy-back procedures, so that:

- where a company has UFCs, and meets the threshold test; and
- the directors of the company consider that a capital reduction or buy-back would not materially prejudice UFCs, and that the company should proceed;
- a court should first approve such a transaction on such terms as it thinks appropriate.

2.17 A court might be better placed to consider the interests of UFCs and how they might be affected by the proposed transaction than directors. In order to obtain court approval, the company would need to put before the court evidence that the interests of UFCs would not be materially prejudiced, and its methodology for reaching this conclusion. This would expose the decision-making process to external scrutiny, and potentially to publicity. These factors would act as a deterrent in circumstances where the decision to enter into the transaction was not reasonably based.

2.18 Nevertheless, ASIC recognises that such a step would involve additional cost to companies, and might have the effect of discouraging companies from undertaking these transaction. This is not our preferred option.

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Issue 3: Insolvent Companies

Relevant Proposals

3.1 The Referred Proposal contains a number of options for making provision for UFCs in the course of voluntary administrations, schemes of arrangement and liquidations (Discussion Paper, Chapters 6–8).

ASIC Comment

Preferred Policy Options

Voluntary administrations

3.2 ASIC supports Option 4, as set out at section 6.6 of the Discussion Paper, requiring administrators to appoint a legal representative for UFCs, who would play no other role than to have standing to apply to the court to challenge a deed of company arrangement (DOCA) prejudicial to UFCs. We consider that this option achieves the best balance between protecting the rights of UFCs and avoiding excessive disruption of the voluntary administration process.

Schemes of arrangement

3.3 ASIC supports the third alternative proposal, as set out at bullet point three of section 7.3 of the Discussion Paper, again requiring the appointment of a legal representative for UFCs, who would play no other role than to have standing to apply to the court to challenge a scheme where prejudicial to UFCs.

3.4 We feel that this proposal would fit well with the existing regulatory framework for schemes of arrangement, which are already subject to court supervision.

Liquidations

3.5 ASIC supports the Referred Proposal, with the implementation procedure as set out in section 8.4 of the Discussion Paper, involving a trust fund for UFCs, with all matters to be determined by a court on the basis of expert actuarial evidence.

3.6 ASIC feels that this proposal has merit in making provision for UFCs without unreasonably delaying the course of the liquidation and payment to other unsecured creditors.

3.7 While we support this policy option, we feel it is important to note the following:

- The proposals will result in some delays and reduction of returns for ordinary unsecured creditors.

- The reduction in returns for ordinary unsecured creditors will be greater than the return to UFCs because of the expense of the process. Trustee fees, legal costs, and fees for actuarial advice will all erode the amount available to pay both unsecured creditors and UFCs.
- UFCs will only receive minimum compensation through this process:
  - Reports by liquidators lodged with ASIC under s533 indicate that, for the period 1 July 2004 to 30 June 2007, the amount payable to unsecured creditors was 10 cents in the dollar or less in approximately 96% of these liquidations. In the same period, approximately 63% of unsecured creditors received nothing.[1]
  - ASIC conducted a review of 275 reports from administrations that commenced between 1 July 2006 and 15 March 2007. Based on the reports in this sample, administrators estimated that creditors would receive between zero and 10 cents in the dollar in 38% of these administrations.
  - We would expect an insolvency involving UFCs to return significantly less than other insolvencies because of the additional class of creditors, and the expense of the UFC process.

3.8 ASIC suggests that, given the problems outlined above, CAMAC might wish to consider proposing a threshold amount of net assets remaining in the insolvent company, below which the UFC process will not be worthwhile. For example, if the possible return to UFCs is calculated to be less than one cent in the dollar, the process might only end up transferring the limited assets of the company to the external administrator, trustee, lawyers, and actuaries.

[1] These figures do not reflect all liquidations and generally reflect the position for small to medium-sized enterprises only.

Issue 4: Anti-avoidance

Relevant Proposals

4.1 The Referred Proposal includes an anti-avoidance provision, whereby a person would be prohibited from entering into agreements detrimental to UFCs where certain conditions are met (Discussion Paper 9.2).

4.2 The Referred Proposal also suggests giving a special priority for amounts awarded as compensation under the new provision, so that these would rank behind employee entitlements, but before other unsecured creditors (Discussion Paper 9.2.4)

ASIC Comment

4.3 The proposed provision would be difficult to enforce, as it would be hard to obtain the evidence necessary to prove the intention elements of the offence. This would be especially so where the relevant event is remote in time from the crystallisation of the offence. In addition, evidence of a different intention might be used as a defence.

4.4 Nevertheless, ASIC feels that an anti-avoidance provision might have a deterrent effect, particularly with a criminal sanction attached. It is also important that the Referred Proposal envisages that persons knowingly involved in the contravention of the provision would also be liable to prosecution, including non-corporate parties such as lawyers.

4.5 As discussed in section 1 at para 1.8, above, we feel that it is important that the provision should cover situations where a company no longer operates in the industry in question, having been sold in an attempt to quarantine and avoid UFC liability.

Priority

4.6 ASIC has some reservations about the Referred Proposal's suggestion of a special priority for compensation awarded to UFCs above other creditors, so that they would rank only behind employees.

4.7 An effect of this would be that all existing creditors, including those existing personal injuries claimants with an unexecuted judgment debt against the company, would rank behind future personal injury claimants. This seems an unjustified intrusion into the *pari passu* principle.

4.8 That, in turn, creates a potential disincentive to foreign investors in Australian domiciled companies, as foreign investors will be aware that the special priority afforded to potential personal injury claimants would demote the investor's ranking in a distribution in the event of

insolvency. There is also the potential for the complication of multiple jurisdiction insolvencies.[2]

4.9 ASIC feels that a better outcome is to rely on the trust fund model for payments to UFCs, discussed in relation to Issue 3, above.

[2] See *Re HIH* [2006] EWCA Civ 732. Assets could not be repatriated to Australia for distribution because of a different order of priority from that under the English statutory scheme.

The Institute of Chartered Accountants in Australia

11 February 2008

John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Email: camac@camac.gov.au

Dear Sir

Submission on Long-tail Liabilities Discussion Paper

The Institute of Chartered Accountants and the National Institute of Accountants (the professional bodies) welcome the opportunity to make a submission on the Long-tail Liabilities Discussion Paper. This submission focuses solely on the accounting issues raised in Chapter 2. We understand that CPA Australia are commenting on the paper separately on a wider range of issues and will include the same comments as below on Chapter 2 accounting issues.

This area of accounting is regulated by an accounting standard known as AASB 137 *Provisions, Contingent Liabilities and Contingent Assets.* We expect this standard to be replaced in the first half of 2009. The International Accounting Standards Board (IASB) is of the view that the amendments clarify as opposed to change the operation of AASB 137. Other commentators have opined that the quantum of disclosure will be reduced. The IASB are still in the process of redeliberating the exposure draft in light of several roundtables that were held subsequent to the issue of the Exposure Draft. A complete summary of the project report can be obtained from the IASB website.

This submission is framed in the context of existing accounting guidance. It should be remembered, however, this discussion focuses on accounting in circumstances where an entity is a going concern. The underlying accounting assumptions change when an entity is insolvent. It is assumed an entity will have sufficient assets to cover liabilities over time. This may not always be the case.

Does AASB 137 have the effect that UFC liabilities are provisions or alternatively, contingent liabilities?

A provision is defined as a "liability of uncertain timing or amount" in the current accounting standard. A contingent liability is a possible obligation or a present obligation that is not recognised (either because it is not probable that an outflow of resources will be required to settle the obligation or because the amount of the obligation cannot be measured reliably). A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

An unascertained future personal injury claimant (UFC) is a long-tail liability - whether it is a liability for the purpose of the accounting framework will depend on the extent it satisfies the definitions above.

A long-tail liability requires an act or omission that will give rise to a claim to have occurred and the persons who in due course will have a claim against the company do not yet have a completed cause of action either because their injury has not yet become manifest or because an intervening event that will give them a completed cause of action has yet to occur.

The professional bodies' thoughts regarding the application of current standard are that it is the past action of the entity that is one factor relevant to the existence of an accounting liability. The other necessary factor is the expectation of an outflow.

The professional bodies believe that a UFC meets the existence factor for an accounting liability; however it may not be recognised due to there being a lack of evidence to support the expectation of an outflow of resources from the entity.

Whether or not a UFC is a contingent liability as opposed to a liability of uncertain timing and/or amount (i.e., a provision) is problematic. It is dependent on whether the liability is probable and/or can be measured reliably, and this will often depend on the extent and quality of information both within the entity and outside of the entity.

Does AASB 137 need to be clarified in relation to these matters?

The accounting standard already exists and deals with these types of liabilities, albeit through a principles approach rather than specific application to a UFC.

Existence and Recognition
We would expect that entities complying with accounting standards are already making an assessment of the existence and recognition any potential claims relating to asbestos manufacture (or the like) – whether they are solvent, restructuring or subject to external administration.

Measurement
The current standard adopts a 'best estimate' approach (the amount that an entity would rationally pay to settle or transfer the obligation at the reporting date) for the measurement of such UFC liabilities as well as providing some minimal guidance on measurement where probabilities are involved. In the actuarial industry a number of formal standards would apply to these types of liabilities. Corporations often engage actuaries to perform estimates for self insurance purposes. The measurement principles involved are likely to change when the new standard is released.

The professional bodies would not support the inclusion in the existing standard of any specific reference to UFC liabilities. Doing so would introduce material not found in the international standard. We support the adoption of international accounting standards and as such additions would contradict that objective.

We also note that the standards have been recently amended to remove the majority of Australian specific paragraphs or guidance. This was a result of the Financial Reporting Council's directive to the AASB that the audited financial reports for-profit entities be able to comply with international accounting standards. Accordingly, AASB 137 is the Australian equivalent to the IASB's IAS 37.

We would support an approach by the AASB to lobby for an example of a UFC to be included in the implementation guidance in respect of the new IAS 37 to be issued in 2009. This would be supported on the basis that the guidance contains a number of other examples and these are not included in the main body of the standard.

What are, if any, the practical implications for companies and others, if UFC liabilities were provisions or contingent liabilities?

The practical implications of these types of liabilities are associated with the ability to obtain a reliable measurement of any probable exposure.

The issues involved are complex, largely because of the uncertainty inherent in liability estimates of this type. Establishing a practical framework which can accommodate this uncertainty will be a key challenge and is being reviewed by the IASB as part of the project to update this standard.

It is unlikely that an entity will be able to determine the probability of settlement along with a reliable measurement without some expert advice, usually by an appropriately qualified actuary.

If UFC liabilities were not to be treated as provisions or contingent liabilities, should there be some other disclosure requirement?

The extent of disclosure for provisions or contingencies varies in the current standard, as follows:

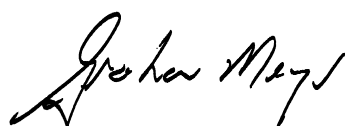
- The nature of material provisions are required to be disclosed and the uncertainties about the amount or timing of outflows to be indicated.
- Contingent liabilities, unless they are considered to be remote, are required to be described and where practicable estimates provided along with indications of uncertainties relating to the amount or timing of any outflow.

Therefore where UFC are assessed as provisions or contingent liabilities that are not determined to be remote, they are already subject to disclosures under the current standard. It should be noted that these disclosure requirements specify a minimum set of disclosures and the professional accounting bodies support entities providing greater disclosure to users of financial statements. We do not support commentators that recommend no form of disclosure of liabilities of the kind contemplated by this inquiry appears in the financial statements of solvent companies.

If UFC liabilities did not meet the criteria as provisions or contingent liabilities we do not support any other form of disclosure requirements.

Please feel free to contact Kerry Hicks (the Institute of Chartered Accountants in Australia) on 02 9290 5703 or Tom Ravlic (NIA) on 03 8665 3143 should you wish to discuss any issues further.

Yours faithfully



Graham Meyer
Chief Executive Officer
The Institute of Chartered
Accountants in Australia

Roger Cotton
Chief Executive Officer
National Institute of
Accountants

19 February 2008

Office of the Chief Executive
Geoff Rankin, FCPA
CPA Australia Ltd
ABN 64 008 392 452
CPA Centre
Level 28, 385 Bourke Street
Melbourne VIC 3000 Australia
GPO Box 2820
Melbourne VIC 3001 Australia
T +61 3 9606 9689
F +61 3 9602 1163
W www.cpaaustralia.com.au
E geoff.rankin@cpaaustralia.com.au

John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Email: camac@camac.gov.au

Dear Sir

Submission on Long-tail Liabilities Discussion Paper

CPA Australia welcomes the opportunity to make a submission on the Long-tail Liabilities Discussion Paper. This submission responds to most of the issues raised. The submission of the Institute of Chartered Accountants in Australia and the National Institute of Accountants was confined to commenting on the accounting issues raised in Chapter 2 and is the same (as below) on Chapter 2 accounting issues.

Chapter 2 Current position (accounting issues)

This area of accounting is regulated by an accounting standard known as AASB 137 *Provisions, Contingent Liabilities and Contingent Assets.* We expect this standard to be replaced in the first half of 2009. The International Accounting Standards Board (IASB) is of the view that the amendments clarify as opposed to change the operation of AASB 137. Other commentators have opined that the quantum of disclosure will be reduced. The IASB are still in the process of redeliberating the exposure draft in light of several roundtables that were held subsequent to the issue of the Exposure Draft. A complete summary of the project report can be obtained from the IASB website.

Our submission on Chapter 2 accounting issues is framed in the context of existing accounting guidance. It should be remembered, however, this discussion focuses on accounting in circumstances where an entity is a going concern. The underlying accounting assumptions change when an entity is insolvent. It is assumed an entity will have sufficient assets to cover liabilities over time. This may not always be the case.

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We also note that the standards have been recently amended to remove the majority of Australian specific paragraphs or guidance. This was a result of the Financial Reporting Council's directive to the AASB that the audited financial reports for-profit entities be able to comply with international accounting standards. Accordingly, AASB 137 is the Australian equivalent to the IASB's IAS 37.

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The issues involved are complex, largely because of the uncertainty inherent in liability estimates of this type. Establishing a practical framework which can accommodate this uncertainty will be a key challenge and is being reviewed by the IASB as part of the project to update this standard.

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If UFC liabilities were not to be treated as provisions or contingent liabilities, should there be some other disclosure requirement?

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If UFC liabilities did not meet the criteria as provisions or contingent liabilities we do not support any other form of disclosure requirements.

Chapter 3 The Referred Proposal

CPA Australia acknowledges and supports the general thrust of the Referred Proposal, but would like to express some reservations particularly with respect to the potential uncertainty and scope for wide interpretation within some of the test key terms.

Chapter 4 Threshold test of ‘mass future claims’

4.1.1 Arguments for this test

CPA Australia agrees that it is necessary to have within the legislation an appropriate threshold which limits the operation of any scheme for dealing with mass long-tail liabilities only to those companies with a significant level of unfunded claims, specific identification of which will emerge well into the future. In addition to confining claimant protection in a practical and predictable manner, we believe that within such a test there ought additionally be acknowledged the need to:

- adequately recognise and facilitate the meeting of significant personal injury claims of a particular character, and
- facilitate the better conduct of the interface between corporate legal personality and the tort of negligence.

4.3.1 General comments

CPA Australia disagrees with the submission referred to (the Australian Conservation Foundation) which suggests that the Referred Proposal test is too narrowly based. The addressing of long-term economic and environmental harm through the Proposal mechanism potentially confuses both the recognition and remedial treatment of tortuous or wrongs based obligations with positive duties which are typically embodied in statute. Similarly, with regards the various categories of tort and equitable wrong, the scope of definition needs to be at least as narrow as contemplated to ensure that the variety of harms which can be give rise to are treated in a predictable and consistent manner.

4.4.1 Definition by regulation

CPA Australia rejects this alternative to the Referred Proposal. Such a regulatory prescribed approach runs the risk of being contradictory to the nature of emergent mass-tort liability by placing a regulator in the position of declaring which products or industries are going to be regarded as giving rise to long-tail liabilities. This potentially shifts the onus for identification of possible liability away from the tortfeasor with whom the duty of care correctly sits. Additionally, this form of regulatory declaration without any apparent court intervention or approval, may be seen as inferring an admission of liability for which the affect company may wish to challenge.

4.4.2 Application of accounting standards

CPA Australia recognises some merit in seeking consistency in the definitions of 'mass future claims' and 'contingent liability' as it is important to avoid, or at least minimize, disharmony between definitions and tests contained respectively in the Corporations Act and accounting standards. It is emphasised however that the Act and accounting standards serve differing purposes such that the latter whilst driven by considerations of disclosure utility, should not be excessively relied upon as a basis for managing complex legal obligations.

4.5 Possible alternative test of 'mass future claim'

CPA Australia acknowledges the potential value in this lower threshold test. The very nature of long-tail tort liability is such that the obligations arise over an extended period of time making quantification highly problematic. There is some likelihood that the carve-out contained in the Referred Proposal could preclude in some complex instances the warranted orderly management of emergent liability.

Chapter 5 Solvent companies

5.2 to 5.5 share capital reduction, share buy-back and financial assistance provisions

Whilst recognising the need for companies to manage their capital structure in the most economic efficient manner, CPA Australia agrees that the existing creditor protection principle embodied in s 256B(1)(b) should be extended to protect the interests of UFCs. Similarly, it is arguable that the financial assistance rule should be amended in a similar manner, though with regards dividend declaring rules, the situation is less certain given the more routine nature of providing financial returns to members.

5.8 Insolvent trading and 5.10 Directors' duties

We provide no specific comment on these matters other than to point to possible wider consideration of these matters being given as an outcome of Treasury's 2007 Review of Sanctions in Corporate Law.

Chapter 6 Voluntary administration

The Discussion Paper's reference to solvent companies supports incremental development in the law to give appropriate recognition to the interests of unascertained future tort claimants. As such, CPA Australia suggests that the voluntary administration provisions should likewise appropriately accommodate this type of claimant. Complexities nonetheless arise, particularly with regards the balancing of UFC claims with the underlying business recovery objective of the voluntary administration regime. However, we do not believe that it is acceptable to proceed with Option 2, which largely represents the status quo position.

Whilst Option 1 reflecting the Referred Proposal is viewed by CPA Australia as containing merit, the following observations are made. To enable ongoing management of emerging liabilities to work within the structure of a deed of company arrangement (DOCA), there is likely to be greater demands on the supervisory and review functions of the courts involving such matters as the appointment of a UFC representative and defining what rights such representatives have in relation to voting on the DOCA. On this rationale, we likewise support Option 4 as being the least intrusive on the widely accepted and supported rationale of the voluntary administration regime. Similarly, the continuity of representation envisioned in Option 4 avoids the inflexibility potentially given rise to in the suggested variation (6.3.2) to Option 1 that would see the establishment of a fixed monetary provision.

Concerning Option 3, this likewise presents its own practical difficulties. The expectation that directors would be in the position to give the type of certification described, and thus render themselves personally liable for misstatements, is possibly contradictory to the objective of the voluntary administration procedure which seeks to provide a relatively quick and certain resolution to a company's financial difficulties. Further, potential uncertainty around the development of joint tortfeasors in the specific context of long-tail liability, would seem to act against the practicality of this option.

Chapter 7 Schemes of arrangement

We make no specific comment in relation to this chapter of the Discussion Paper.

Chapter 8 Liquidations

CPA Australia supports the Referred Proposal in its dealing with insolvent companies and in particular sees merit in the more certain basis for quantifying the emergent liability through actuarial assessment along with court involvement in approving the establishment of a trust fund, as outlined in section 8.4 of the Discussion Paper. The proposed level of court supervision is potentially significant in the handling of those instances where the return to unascertained future claimant is potentially miniscule and, as a matter of efficiency, the liquidation should be allowed to run its course.

Additionally we support the discussion at 8.1.2 concerning the determining of insolvency in the context of s 459D(1) and acknowledge that the description of contingent liability as outlined in AASB 137 as possibly extending beyond that described by Young CJ in *Edwards v Attorney General (NSW)* ([2004] NSWCA 272 at paras 59 – 60) where a distinction is drawn between contingent and prospective creditors, on the one hand, and possible future claims that might crystallise, on the other. In CPA Australia's view, the conclusion in the Discussion Paper (page 80) that this may facilitate a court's discretion in making an insolvency assessment, does not of itself amount a clear basis of proving a UFC claim.

Notwithstanding the widely acknowledged difficulty of both quantifying and managing the ongoing emergent nature of UFC claims, there seems little to be added by adopting the more formalised recognition of claim applying in the UK as described in 8.1.3 of the Discussion Paper.

Chapter 9 Anti-avoidance

9.1 Anti-avoidance provision

We give broad support to the development of a statutory avoidance provision modelled on the existing Part 5.8A of the Corporations Act. Whilst acknowledging the presence of only limited judicial consideration having been given to Part 5.8A, the inclusion in statute of such schemes can function as a deterrent to opportunistic abuse of the corporate form.

9.6.3 Policy options in relation to priority

Whilst *Option 4* may be seen as adding further complexity to the final resolution of a corporate insolvency, it does however in our view have the advantage of reflecting and preserving the current order of statutory priorities. If, as would seem the case with *Option 1*, UFC claimants were through the trust arrangement to be the sole beneficiaries of a recovery under an anti-avoidance regime, this would create a disharmony with the current structure of priorities as set out in s 556.

If there is considered merit in granting a priority to non-adjusting tort claimants, this should be approached via amendment of s 556 itself. Such development is acknowledged as contentious and likely beyond the scope of CAMAC's present deliberations. We however mention in passing that greater clarity could be given to the scope and nature of the injury compensation priority provided in s 556(1)(f) and that this specific provision might be applied in those circumstances where the UFC claimant is also an employee or former employee.

Please feel free to contact Dr Mark Shying on 03 9606 3903 (Chapter 2 accounting issues) or John Purcell (all other issues) on 03 9606 9826 should you wish to discuss any issues further.

Yours sincerely

Geoff Rankin FCPA
Chief Executive Officer

Copy: M Shying
J Purcell