

**Submission to the Corporations and Markets Advisory
Committee**

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

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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

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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

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.

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.

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 impeding 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 creditors¹⁰ 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.

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

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.