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

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]

---

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:

---

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.

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.

---

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.

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