

Long Tail Liability: Current Issues and Future Reforms

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A long tail liability arises where the conduct of a company causes its workers and members of the general public to suffer personal injury that only manifests itself at some indefinite future time. A striking recent example of such liability is the James Hardie case. Although this issue may affect thousands of people, Australia's corporations legislation does not really take it into consideration. Nor does it treat the unascertained future personal injury claims that may arise from long tail liability as debts owed by a company. The law, in fact, does not even recognise the existence of such a liability. This paper considers the current position under Australian law and compares it with overseas legal systems such as that of the United States. The paper also discusses the Corporations and Markets Advisory Committee's recommendations in relation to the treatment of long tail liability claims.

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I INTRODUCTION

Long tail liability claims usually arise when the conduct of a company causes individuals to suffer a personal injury that only manifests itself at an indefinite future time; there is an interval between the exposure to harm and the manifestation of the injury.¹ Such claims raise a number of dilemmas.

Given the above-mentioned latent period, one such dilemma is how to determine which conduct of the company caused the harm. In such claims, an injury may manifest itself ten, twenty or thirty years after the initial cause, presenting companies with unexpected liabilities. An example is offered by the asbestos industry. There is evidence that asbestos has been used since the time of Christ. The modern asbestos industry started in the nineteenth century. However, it was only in the 1930s that a report was published in England detailing the possible damage caused by asbestos dust to the lungs of workers. The extent of harm caused by the product was discovered some considerable time after its initial use.² Further, a ban on asbestos use was not immediately put in place. France, for example, prohibited the use of the product only in 1996, some sixty years after it became apparent that asbestos could seriously harm people.³

¹ Corporations and Markets Advisory Committee, *Long Tail Liabilities: The Treatment of unascertained future personal Injury Claims*, Report (May 2008), 4. This definition does not take into consideration environmental liability that does not cause personal injury. The reason behind this limitation in the definition is due to the fact that the CAMAC report did not take into account such type of liability.

² Brian R Maguire, "Mesothelioma and Bedside Litigation" (1995) 27 *Australian Journal of Forensic Sciences* 19, 19.

³ From the 1970s until the ban on asbestos was put into place, France imported 80 kilos per inhabitant. Laurent Vogel, "The WTO Asbestos Dispute: Workplace Health Dictated b trade Rules?" <http://www.btinternet.com/~ibas/vogel_wto.htm> at 12 January 2009; Laurie Kazan-Allen, 'French Asbestos Legacy' <http://www.btinternet.com/~ibas/lka_fr_asb_legacy_05.htm> at 12 January 2009; Senat, "Le Drame de l'Amiante en France: Comprendre, Mieux Reparer, en Tirer des Lecons pour l'Avenir" <<http://www.senat.fr/rap/r05-037-1/r05-037-16.html#toc24>> at 12 January 2009.

Another dilemma is that long tail liability claims can arise after the company has stopped producing the dangerous product. For example, individuals who demolish a house that was built with asbestos may suffer an injury as a result of their exposure to the product. This would entitle them to a claim against the company that constructed the house, even if these people did not have any direct dealings with it. Clearly, long tail liability is difficult to assess and predict.

Given the uncertainty that surrounds such claims, the term ‘unascertained future claimants’ is used throughout this paper to refer to individuals whose personal injury claims against a company will be made at some indefinite time in the future. When assessing the position of these claimants, there is a need to consider the protection that the law provides them with. In 2008, the Corporations and Markets Advisory Committee (CAMAC) issued a discussion paper⁴ which was followed by a report⁵ in relation to long tail liabilities. This raised awareness of the plight of unascertained future claimants, and paved the way for future reforms in this area. The CAMAC report does not consider long tail environmental liability (which does not always result in personal injury).⁶

Part 2 of this paper looks at the manner in which unascertained future claimants are treated in Australia; specifically, what protection the *Corporations Act 2001* (Cth)

⁴ CAMAC, *Long Tail Liabilities: The Treatment of unascertained future personal Injury Claims*, Discussion Paper (June 2007).

⁵ CAMAC, *Long Tail Liabilities: The Treatment of unascertained future personal Injury Claims*, Report (May 2008).

⁶ Such a long tail environmental liability may take the form of ‘large remediation costs that burden public authorities and/or private landholders.’ Australian Conservation Foundation, *Submission to the Corporations and Markets Advisory Committee on Long Tail Personal Injury Claims* (17 February 2006), 1, <www.camac.gov.au> at 10 January 2009.

(*Corporations Act*) provides them with. Part 3 considers the CAMAC's proposals and possible reforms to protect the interests of unascertained future claimants.

II TREATMENT OF UNASCERTAINED FUTURE CLAIMANTS UNDER THE *CORPORATIONS ACT*

The *Corporations Act* does not contain provisions that deal specifically with long tail liabilities. Accordingly, to assess the treatment of unascertained future claimants under the Act, it is crucial to determine if this category of claimants falls under the definition of 'creditor' of a company. If this is the case, it means that all the protections available to creditors under the *Corporations Act* are also available to protect the interests of unascertained future claimants. For example, if these claimants are treated as creditors, then, in the case of insolvency of a company, they are entitled under s 553 to an equal share in the company's assets.

The first section below attempts to define the word 'creditor'. The second section applies the definition to determine if unascertained future claimants are creditors for the purposes of the *Corporations Act*. The third section notes the existence of some protections to unascertained future claimants. The last section considers the need for change.

A Definition of 'Creditor'

The term ‘creditor’ is defined in the *Macquarie Dictionary*⁷ as ‘someone to whom money is due’. This definition does not shed light on whether unascertained future claimants are creditors, because it does not mention people whose debt may arise in the future. Further, a definition of this term cannot be found under s 9 of the *Corporations Act*, or elsewhere in the Act.

However, the concept of debts or claims that are admissible to proof in winding up may help in establishing a definition for the term ‘creditor’.⁸ Section 553 of the *Corporations Act* states:⁹

‘Subject to this Division and Division 8, in every winding up, all debts payable by, and all claims against, the company (present or future, certain or contingent, ascertained or sounding only in damages), being debts or claims the circumstances giving rise to which occurred before the relevant date, are admissible to proof against the company.’

Based on this section, Brooking, Phillips and Hansen JJ have observed that, for the purpose of external administration:

‘the word “creditors” should not be so confined, but should be read as extending to all those who had a claim against the company arising on or before that day, whether the

⁷ The online version of the *Macquarie Dictionary*.

⁸ R P Austin and Ian Ramsay, *Ford’s Principles of Corporations Law* (13ed, 2007), 1381.

⁹ This section relates to Part 5.3 of the *Corporations Act*. However, for the purpose of this article we are generalising the content of this section due to the lack of definition and guidance in relation to the term ‘creditor’.

claim be “present or future, certain or contingent, ascertained or sounding only in damages”.¹⁰

Consequently, the term ‘creditor’ may refer to several categories of claims, namely:

- present claims;
- certain claims;
- ascertained claims;
- future claims; and
- contingent claims.

Such claims constitute different categories of creditors. However, it is important to note an inconsistency in the *Corporations Act* in relation to the use of the term ‘creditor’.¹¹ Section 256B requires a company to consider the interests of ‘its creditors’ when initiating a reduction of capital. But s 462 states that ‘a creditor (including a contingent or prospective creditor) of the company’ may apply for winding up of the company based on s 461.

The question that arises is: Does the use of the term ‘creditors’ in s 256B include contingent or prospective creditors (as is stated explicitly in s 462)? We can assume that it does if we take into account the reason for the establishment of the principle of capital maintenance, and the exceptions to the principle, which can be linked to

¹⁰ *Brash Holdings Ltd v Katile Pty Ltd* (1994) 13 ACSR 504, 509, 514-515. In *Re Glendale Land Development Ltd (in liq)* [1982] 2 NSWLR 563 at 565, McLelland J defined creditors (for the purpose of a scheme of arrangement) as including ‘any person with a pecuniary claim against the company whether present, prospective or contingent and whether present, prospective or contingent and whether contractual or otherwise.’

¹¹ William J Koeck and Ian M Ramsay, “The Importance of Distinguishing Between Different Categories of Creditors for the Purposes of Company Law” (1994) 12 *Company and Securities Law Journal* 105.

limited liability. To protect the interests of creditors, a reduction of capital is allowed if the company remains solvent.¹² Since contingent creditors are taken into consideration when determining the solvency of the company, the term ‘creditor’ for the purpose of reduction of capital would include these creditors.¹³ This hypothesis generalises the application of s 553 to all parts of the Act that may be linked, even indirectly, to its insolvency provisions.¹⁴

Further, the *Corporations Act* treats different classes of creditors differently in certain cases. For example, s 459P(1) states that ‘a creditor (even if the creditor is a secured creditor or is only a contingent or prospective creditor)’ may apply for winding up of the company for insolvency. However, under s 459P(2), ‘a person who is a creditor only because of a contingent or prospective debt’ may only apply for winding up of the company for insolvency if they have leave from the court. This limitation does not apply to creditors whose debts are due.

We also find references to these categories of claims in case law. For example, in *Jeffree v National Companies and Securities Commission*,¹⁵ Wanup Pty Ltd, as a corporate trustee of a family trust, carried on a swimming pool business. A dispute arose between Wanup Pty Ltd and Leighton Contractors Pty Ltd and the matter was sent to arbitration. The director, Mr Jeffree, feared that the company might not be able

¹² *Wright v Mansell* (2001) 187 ALR 508, 514.

¹³ *New Cap Reinsurance Corporation Ltd (in liq) and Another v A E Grant and others* (2008) 68 ACSR 176, 194.

¹⁴ On one hand, Commissioner Jackson noted that ‘the word “creditor” for the purpose of s 256B of the *Corporations Act 2001* (Cth) is a matter of some complexity.’ He seemed to favor a broad interpretation of the term creditor which may include unascertained future claimants. David Jackson, "NSW Special Commission of Inquiry into Medical research and Compensation Foundation Final Report" at [27.82], <http://www.dpc.nsw.gov.au/_data/assets/pdf_file/0018/11385/PartC.pdf> at 6 January 2009. On the other hand, CAMAC report did not seem to agree with such an interpretation of s 256B. CAMAC, above n 1, 46.

¹⁵ *Jeffree v National Companies and Securities Commission* [1990] WAR 183; (1989) 15 ACLR 217.

to satisfy an award made against it, so he incorporated a new company and transferred to it the assets of Wanup Pty Ltd. The Full Court of the Supreme Court of Western Australia found that Mr Jeffree had breached his duty to the present, future and contingent creditors of the company.

B Are Unascertained Future Claimants ‘Creditors’ for the Purposes of the Corporations Act?

Categories such as ‘present claims’, ‘certain claims’ and ‘ascertained claims’ are clearly inapplicable to unascertained future claims. However, it is harder to determine if unascertained future claims fall under the categories of ‘future claims’ or ‘contingent claims’. The difficulty arises because the legislation does not define these two categories.

A ‘contingent creditor’ is defined by Pennycuik J in *Re William Hockley Ltd*¹⁶ as:

‘a person toward whom, under an existing obligation, the company may or will become subject to a present liability upon the happening of some future event or at some future date.’¹⁷

Kitto J adopted this definition and applied it in *Community Development Pty Ltd v Engwirda Construction*:¹⁸

¹⁶ *Re William Hockley Ltd* [1962] 2 All ER 111.

¹⁷ *Re William Hockley Ltd* [1962] 2 All ER 111, 113.

¹⁸ *Community development Pty Ltd v Engwirda Construction* (1969) 120 CLR 455. This definition was adopted in a number of Australian cases such as *Re William Hockley Ltd* [1962] 1 WLR 555, 558; *Re International Harvester Australia Ltd* (1983) 7 ACLR 415 at 416 and *FAI Workers’ Compensation (NSW) Ltd v Philkor Builders Pty Ltd* (1996) 20 ASCR 592, 597.

‘The importance of these words for present purposes lies in their insistence that there must be an existing obligation and that out of that obligation a liability on the part of the company to pay a sum of money will arise in a future event, whether it be an event that must happen or only an event that may happen.’¹⁹

However, do unascertained future claims fall under such a category? In Australia, they do not. In *Edwards v Attorney General*,²⁰ Young CJ observed that unascertained future claims ‘do not have a completed cause of action until damage is suffered and that usually involves manifestation of the disease’.²¹ Further, his Honour noted:²²

‘No one can currently know the identity of the future claimant. This type of liability must be distinguished from the case of a contingent creditor. [...] The distinction is vital because while contingent [...] creditors are taken into account in assessing solvency, possible future claims that might crystallise are not.’

Since unascertained future claims are not considered as contingent claims, the next step is to check if they fall under the category of ‘future claims’. Barrett J noted that a future claim is a claim ‘which will become due and owing at a future time, if a present state of affairs continues until then’.²³ For example, as noted in *Molit (No 55) Pty Ltd v Lam Soon Australia Pty Ltd*,²⁴ rent which is going to be owed in the future under a lease that exists when a company goes into liquidation is considered a future claim.²⁵

¹⁹ *Community development Pty Ltd v Engwirda Construction* (1969) 120 CLR 455.

²⁰ *Edwards v Attorney General*, (2004) 208 ALR 605.

²¹ *Edwards v Attorney General*, (2004) 208 ALR 605, 614.

²² *Edwards v Attorney General*, (2004) 208 ALR 605, 614.

²³ *Heesh and Another v Baker and Others* (2008) 67 ACSR 192, 204.

²⁴ *Molit (No 55) Pty Ltd v Lam Soon Australia Pty Ltd* (1996) 19 ACSR 160.

²⁵ *Molit (No 55) Pty Ltd v Lam Soon Australia Pty Ltd* (1996) 19 ACSR 160, 167.

Such a claim is different from a ‘contingent claim’. Palmer J observed that:

‘[A] future claim is distinguishable from a contingent claim in that, while both are founded on an obligation existing as at the commencement of the winding up or the deed of company arrangement, a future claim will arise at some time thereafter while a contingent claim may arise.’²⁶

In the case of unascertained future claims, it is not possible to know which individuals may suffer an injury in the future. Further, it is hard to determine the number of claims that will arise in the future.²⁷ Accordingly, it may be argued that unascertained future claims do not fall under the category of ‘future claims’.²⁸

In summary, unascertained future claimants are not considered as creditors; as a consequence, the protection given to creditors under the *Corporations Act* does not apply to them.

C Any Protection for Unascertained Future Claimants?

Even though unascertained future claimants are not provided protection as creditors under the *Corporations Act*, the court may use its discretion to take into consideration the interests of unascertained future claimants in certain instances. For example, in *Re Stork ICM Australia Pty Ltd*,²⁹ the Federal Court examined whether the interests of unascertained future claimants were protected by the proposed scheme of arrangement

²⁶ *Expile Pty Ltd v Jabb’s Excavations Pty Ltd* [2004] NSWSC 284, at [37].

²⁷ The number of claims can only be an estimate.

²⁸ CAMAC, above n 1, 14.

²⁹ *Re Stork ICM Australia Pty Ltd; Stork ICM Australia Pty Ltd v Storck Food Systems Australasia Pty Ltd* [2006] FCA 1849.

under s 411 of the *Corporations Act*. The Court observed that the term ‘liabilities’ as used in s 413(4) should have ‘an expansive interpretation’ which would encompass long tail liabilities.³⁰ Lindgren J noted that ‘potential or contingent liabilities’ of a company that is subject to a scheme of arrangement toward ‘potential claimants, are capable of being made subject of an order under s 413(1)’.³¹

Additionally, there is State legislation that deals with certain types of long tail liability. For example, in New South Wales, the *Dust Diseases Tribunal Act 1989* (NSW) established the Dust Diseases Tribunal to deal with claims in tort for negligence relating to death or personal injury caused from specified dust diseases (such as asbestos) and other dust related conditions.³² One case heard by the tribunal is *Giuseppe Zappia v Amaca Pty Ltd*.³³ The plaintiff, Mr Zappia, was employed by James Hardie and Co between 1958 and 1960. During his employment, he was exposed to and inhaled asbestos dust and fibre, and as a result contracted the disease mesothelioma. The tribunal awarded him \$313,200. However, such a tribunal only deals with claimants after the damage manifests itself, not before. This leaves unascertained future claimants without any clear protection if the company that caused their injury becomes insolvent.

Another instance where long tail liability is taken into account is in the annual financial reporting of reporting entities. Accounting standard AASB 137 *Provisions*,

³⁰ *Re Stork ICM Australia Pty Ltd; Stork ICM Australia Pty Ltd v Storck Food Systems Australasia Pty Ltd* [2006] FCA 1849, at [91].

³¹ *Re Stork ICM Australia Pty Ltd; Stork ICM Australia Pty Ltd v Storck Food Systems Australasia Pty Ltd* [2006] FCA 1849, at [92].

³² The Dust Disease Tribunal, <http://www.lawlink.nsw.gov.au/lawlink/ddt/ll_ddt.nsf/pages/DDT_ddtfirst> at 8 January 2009; John Lawrence O’Meally, “Asbestos Litigation in New South Wales” (2007) 15 *Journal of Law and Policy*, 1209.

³³ *Giuseppe Zappia v Amaca Pty Ltd* [2008] NSWDDT 2.

Contingent Liabilities and Contingent Assets requires such entities to include in their balance sheet a ‘provision’³⁴ if two criteria are met:³⁵

- It is probable that the company will have a long tail liability.
- The amount of that liability can be readily estimated.

In *Re Stork ICM Australia Pty Ltd*,³⁶ the balance sheet of Stork ICM showed, as of 31 December 2005, a ‘provision’ of \$5.8 million. This provision was a director’s central estimate, based on independent actuarial expert advice, in relation to ‘non-pending asbestos related disease claims’.³⁷

However, assessing the potential liability of unascertained future claimants is extremely difficult. Although liability estimation is a common practice in the insurance industry, it is hard for companies that are not insurers to derive a reliable estimate of the expected value of their liability. It was admitted in *Re Stork ICM Australia Pty Ltd*³⁸ that ‘estimates of asbestos related disease claims are subject to considerable uncertainty and actual liabilities for such claims could vary, perhaps materially, from the Director’s central estimate’.³⁹ Accordingly, certain companies may not consider such estimates as reliable for the purpose of AASB 137.⁴⁰ This may

³⁴ A provision is considered under the accounting standard as a liability of uncertain timing or amount.

³⁵ The Accounting Standard AASB 137, *Provisions, Contingent Liability and Contingent Assets* at [14]; CAMAC, above n 1, 22.

³⁶ *Re Stork ICM Australia Pty Ltd; Stork ICM Australia Pty Ltd v Storck Food Systems Australasia Pty Ltd* [2006] FCA 1849.

³⁷ *Re Stork ICM Australia Pty Ltd; Stork ICM Australia Pty Ltd v Storck Food Systems Australasia Pty Ltd* [2006] FCA 1849, at [22].

³⁸ *Re Stork ICM Australia Pty Ltd; Stork ICM Australia Pty Ltd v Storck Food Systems Australasia Pty Ltd* [2006] FCA 1849.

³⁹ *Re Stork ICM Australia Pty Ltd; Stork ICM Australia Pty Ltd v Storck Food Systems Australasia Pty Ltd* [2006] FCA 1849, at [22].

⁴⁰ The Accounting Standard AASB 137, *Provisions, Contingent Liability and Contingent Assets* at [14] which require that disclosure if a ‘reliable estimate’ can be made.

open the way for them to avoid disclosing a long tail liability without breaching the standard.

Another possible protection under current laws is the court's discretion to lift the corporate veil to hold a parent company liable for its subsidiary's tort. In *Briggs v James Hardie and Co Pty Ltd*,⁴¹ Mr Briggs suffered from asbestosis, which he allegedly contracted while in the employment of Marlew Mining Pty Ltd, a subsidiary of James Hardie and Co Pty Ltd. In a negligence action against both his employer and the holding company, Mr Briggs argued that the corporate veil between the two companies should be lifted to make James Hardie and Co Pty Ltd liable for its subsidiary's conduct. The New South Wales Court of Appeal held that, while the rules in relation to lifting the corporate veil are not clear, it is possible for this doctrine to apply in the law of tort, especially in the law of employer's negligence.⁴² However, Australian courts are reluctant to lift the corporate veil in cases of long tail liability, as illustrated by the subsequent James Hardie litigation.⁴³

D A Need for Change

The James Hardie case led to a Special Commission of Inquiry into James Hardie's restructure and establishment of a charitable fund to deal with future liabilities from

⁴¹ *Briggs v James Hardie and Co Pty Ltd* (1989) 16 NSWLR 549.

⁴² *Briggs v James Hardie and Co Pty Ltd* (1989) 16 NSWLR 549, 556.

⁴³ Jason Harris, "Lifting the Corporate Veil on the Basis of an Implies Agency: A Re-evaluation of Smith, Stone and Knight" (2005) 23 *Company and Securities Law Journal* 7; Edwina Dunn, "James Hardie: No Soul to be Damned and No Body to be Kicked" (2005) 27 *Sydney Law Review* 339; Peta Spender, "Blue Asbestos and Golden Eggs: Evaluating Bankruptcy and Class Actions as Just Responses to Mass Tort Liability" (2003) 25 *Sydney Law Review* 223; Lee Moerman and Sandra Van Der Laan, "Pursuing Shareholder Value: The Rhetoric of James Hardie" (2007) 31 *Accounting Forum* 354.

James Hardie's use of asbestos. While Commissioner Jackson did not expressly state in his final report that there is a need for law reform,⁴⁴ he noted:

‘[T]he circumstances that have been considered by this inquiry suggest there are significant deficiencies in Australian Corporate Law. In particular, it has been made clear that current laws do not make adequate provisions for commercial insolvency where there are substantial long-tail liabilities.’⁴⁵

Further, regulated corporate entities are usually rational actors who will decide whether to comply with regulation by appraising the expenditure and benefits which compliance produces for them at a particular time.⁴⁶ They may assess the reaction of the government to strategies they plan to implement. For instance, in an attempt to avoid long tail liability claims, James Hardie Industries Ltd decided to establish another company, the Medical Research and Compensation Foundation. The company's board paper noted that ‘the risk of government intervention [in the matter] is low on legal and commercial grounds’.⁴⁷ However, such risk could not be ‘ruled out on political grounds’.⁴⁸ The company assessed the possible outcomes of its conduct and concluded that ‘the NSW Government will be sensitive to stakeholder opposition but will also be quite pragmatic in assessing separation. The risk of legislative intervention is regarded as low.’⁴⁹

⁴⁴ David Jackson, "NSW Special Commission of Inquiry into Medical research and Compensation Foundation Final Report" at [30.66], <<http://www.cabinet.nsw.gov.au/hardie/Volume1.pdf>> at 6 January 2009.

⁴⁵ Ibid, at [30.67].

⁴⁶ George Gilligan, Helen Bird and Ian Ramsay, *Regulating Directors' Duties: How Effective are the Civil Penalty Sanctions in the Australian Corporations Law* (Centre for Corporate Law and Securities Regulation, 1999) 9.

⁴⁷ James Hardie Industries Ltd, "Board Paper Project Green Board Paper", 16, <<http://www.asx.com.au/asxpdf/20040921/pdf/3mxi19v12s88s.pdf>> at 7 January 2009.

⁴⁸ Ibid.

⁴⁹ Ibid, 19.

Additionally, the fact that there are no clear federal laws protecting the interests of unascertained future claimants is being used by companies when deciding if they can avoid long tail liabilities. James Hardie Industries Ltd seems to have done so when assessing its position. It observed that:

‘the easiest practical option for the NSW Government would be to “flick-pass” the issue to the Federal Government and ask that they deal with it as an issue of Corporations Law’.⁵⁰

Commissioner Jackson also believed that long tail liability reforms should be made at the Commonwealth, not State, level.⁵¹

In summary, the Australian position in relation to long tail liability is not acceptable. This is especially so in view of the growing importance of corporate social responsibility. If Lord Chancellor Thurlow were to ask today whether ‘you ever expect a corporation to have a conscience, when it has no soul to be damned and no body to be kicked’, the answer might be ‘yes’, given society’s current expectation that companies should be socially and environmentally responsible. For a company to ignore a category of stakeholders that may be affected by its past conduct may be viewed as unethical and immoral. It may drastically affect the company’s image and thus – at a time when social responsible investment is on the rise – its bottom line.⁵²

⁵⁰ Ibid, 19.

⁵¹ Jackson, above n 44, [30.66].

⁵² According to the Social Investment Forum, in the U.S. socially responsible investment assets rose more than 324% from 639 billion in 1995 to \$2.71 trillion in 2007; while during the same period, non-socially responsible assets under professional management only increased for less than 260 percent from \$7 trillion to \$25.1 trillion. Social Investment Forum, “2007 Report on Socially Responsible

Furthermore, as a globalised nation, Australia cannot ignore the fact that overseas legal systems do take long tail liability into consideration.

For instance, the United States (US) has an established procedure in relation to companies that anticipate the likelihood of becoming insolvent in the distant future due to long tail liability.⁵³ Such companies can apply to the court for an order enabling their affairs to be conducted pursuant to the establishment of a trust set up to meet unascertained future claims. This procedure protects the interests of creditors and quarantines the liability of unascertained future claimants by limiting their rights in relation to funds held by the trust.⁵⁴

In the United Kingdom, future unascertained claimants are considered to be contingent creditors for the purpose of liquidation or administration. In *Re T&N Ltd*,⁵⁵ T&N Ltd and a number of related companies (T&N group) were involved in the mining of asbestos and the manufacture and distribution of asbestos products. As a consequence, the company became one of the largest asbestos defendants in the United Kingdom and was faced with liabilities on a massive scale. A scheme of arrangement was proposed to deal with the matter. The Court granted leave for a creditors' meeting and Richards J noted that:

'T&N is subject to contingent liabilities in respect of future asbestos claims, as defined in the administrators' application and the future asbestos claimants, being

Investing Trends in the United States", (2007)

<http://www.socialinvest.org/pdf/SRI_Trends_ExecSummary_2007.pdf>, at 6 January 2009.

⁵³ Companies can use such a system even if they are not insolvent. 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. A trust was created to deal with the long tail liability claims.

⁵⁴ *Bankruptcy Code* 11 USC, s 524(g).

⁵⁵ *Re T&N Ltd and others* [2005] EWHC 2870 (Ch, [2006] 3 All ER 697.

those persons who have been exposed to asbestos and who will have claims in negligence against T&N if they develop asbestos-related diseases, are “creditors” of T&N for the purpose [of the scheme of arrangement provisions].⁵⁶

As a result of this decision, the United Kingdom Rules were amended to consider that long tail liabilities are provable debts in liquidation or under a scheme of arrangement.⁵⁷ The explanatory note observes:⁵⁸

‘Rule 13.12(2) is amended to extend the interpretation of debt to include claims founded in tort where all of the elements required to bring an action against the company exist at the time the company goes into liquidation or enters administration, except that the claimant has not yet suffered any damage and does not therefore, at that time, have a cause of action against the company. When read with Rule 12.3 of the Rules, this interpretation has the effect of extending the category of debts provable in a winding up or administration.’

Additionally, the principle of fairness requires the interests of unascertained future claimants to be taken into account, especially when the company goes under external administration.⁵⁹ The ‘hypothetical contract’ analysis has been used by a number of theorists to resolve issues of fairness.⁶⁰ Applying the hypothesis in this context raises the following question: Would unascertained future claimants agree to the manner in

⁵⁶ *Re T&N Ltd and others* [2005] EWHC 2870 (Ch, [2006] 3 All ER 697 at [66].

⁵⁷ *Statutory Instrument 2006 No 1272* (UK), Rule 13.12.

⁵⁸ Explanatory Note to *Statutory Instrument 2006 No 1272* (UK), < <http://www.opsi.gov.uk/si/si2006/20061272.htm> > 6 January 2009.

⁵⁹ Unascertained future claimants are at a disadvantage in the process of external administration. They have little bargaining powers. The court may protect their interest at its discretion. Creditors would usually lean toward maximising their payments. This ultimately would undervalue unascertained future claims causing unfairness.

⁶⁰ John Rawls, *A theory of Justice* (1971) 11-17; Thomas Scanlon, “Contractualism and Utilitarianism” in Amartya Sen and Bernard Williams (eds) *Utilitarianism and Beyond* (1982), 103.

which their claims were considered under the current laws if their agreement had been asked for, and if they were free from morally arbitrary influences, and if there had been full disclosure about their exposure, the injury they may suffer and their rights?⁶¹

Faced with such a question, unascertained future claimants would most likely select a process for distribution of the company's assets that was consistent with their interests. In a hypothetical contract setting, while the claimants might know that they had been exposed to the harmful substance, they could not be certain whether their claim would be present or future, if the company went under external administration. Assuming that they were risk averse,⁶² unascertained future claimants would be unlikely to agree to a system that ignored their interests. They would demand equal treatment with present claimants. Accordingly, the hypothetical contract analysis indicates that fairness requires consideration of the interests of unascertained future claimants, regardless of the timing of their claim.

We may conclude from this that a change to the *Corporations Act* is needed to hold companies accountable when faced with long tail liabilities. Following the *Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation* (also known as the James Hardie Inquiry), the then Parliamentary Secretary to the Treasurer, the Hon. Chris Pearce, MP, observed the importance of

⁶¹ Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (1986) 7-19; Jackson noted that, applying the hypothetical contract to bankruptcy law, the system for payments of creditors in cases of bankruptcy can be seen as a solution to creditors because with such a system they would get paid a certain amount of money because the transaction cost is lower. The application of the hypothetical contract in cases of external administration has been criticised. Barry E Adler, "Financial and Political Theories of American Corporate Bankruptcy" (1993) 45 *Stanford Law Review* 311. Roe noted that 'First-come, first served distribution has great appeal where the claimants have little control over when to assert their claims.' Fairness would not be a reason for which the society would be willing to lessen the pay out of identifiable victims over prospective ones; Mark J Roe, "Bankruptcy and Mass Tort" (1984) 84 *Columbia Law Review* 846, 855.

⁶² Thomas A Smith, "A Capital Markets Approach to Mass Tort Bankruptcy" (1994) 104(2) *Yale Law Journal* 367, 378-382.

initiating reforms in the area of long tail liability. He asked the CAMAC to examine whether the protections available to creditors should be extended to unascertained future claimants. The CAMAC issued a discussion paper⁶³ followed by a report⁶⁴ considering different approaches to remedying the lack of protection available to unascertained future claimants under the *Corporations Act*.

III PROPOSED REFORMS

When assessing which reforms are suitable to deal with unascertained future claimants, we need to balance competing policy objectives. On one hand, unascertained future claimants are in a vulnerable position as a result of the long interval between their exposure to the harm and the manifestation of their injury. Their interests need to be protected. On the other hand, by its nature, long tail liability is hard to assess. Accordingly, a company may have little information about the likelihood or magnitude of the future claims that may result from its conduct. Requiring companies to take into account such liabilities would introduce a high level of uncertainty for business.⁶⁵ Most likely, businesses would prefer to ignore such types of liabilities.⁶⁶

The CAMAC report canvassed a range of reforms, some of which are discussed in the section following.

⁶³ CAMAC, above n 4.

⁶⁴ CAMAC, above n 1.

⁶⁵ CAMAC, “Reference in relation to the Treatment of Future Unascertained Personal Claims” (12 October 2005)

<<http://www.camac.gov.au/CAMAC/camac.nsf/byHeadline/Whats+NewTreatment+of+future+unascertained+personal+injury+claims?openDocument>> at 9 January 2009.

⁶⁶ This has been the case in the past for a number of long tail liabilities such as asbestos.

A Mass Future Claims

In his referral to the CAMAC, the Parliamentary Secretary to the Treasury proposed ‘that the existing creditor protections should be extended to future unascertained creditors, where a mass future claim is afoot’.⁶⁷ Mass future claims can have an enormous impact on otherwise viable organisations and create dilemmas for the people working in them regarding how and when to deal with long tail liability. Accordingly, defining mass future claims through the setting of a threshold test can be vital. A threshold test would enhance companies’ awareness of situations in which mass future claims may appear, and give them the opportunity to address any liability that may appear in the future.

Such a threshold test would lessen the regulatory burden that would otherwise be imposed on companies if they had to take into consideration long tail liability, by limiting the protection provided to unascertained claimants. Additionally, such a test would make company directors aware of situations where their companies would be facing mass future claims. This would permit them to manage such claims in accordance with the duties imposed on them under common law, equity and the *Corporations Act*.

However, the inclusion of a mass future claim threshold test in the legislation has a number of drawbacks, which include the following:⁶⁸

⁶⁷ CAMAC, above n 65, 53.

⁶⁸ CAMAC, above n 1, 33-34.

- The threshold test might have an arbitrary benefit due to the fact that some unascertained future claimants would receive protection, while others would not, and victims might only be protected if the total number of victims was sufficient to kick into place the protection provided by the legislation.
- The test might create uncertainty, especially if the criteria were unclear and open to different interpretations.
- A company might not be willing to acknowledge that it was subject to mass future claims, because of the effect such a disclosure could have on its reputation. The company may therefore downplay the numbers of victims that could be affected in the future, to avoid the application of mass future claims. This would especially be the case if the company anticipated that the long tail liability provisions were manageable for the time being.

To overcome these drawbacks, a clear threshold test (in relation to mass future claims) that is not subject to uncertainty has to be established. It should not only establish how unascertained future claims would be dealt with and protected under the *Corporations Act*, but also provide guidance in identifying such claims. Additionally, it should perform a ‘gatekeeping’ function and limit mass future claims to significant cases. It is not intended to deal with scenarios where the future liability is unforeseeable or speculative.

It is useful to examine the threshold test that was proposed by the Parliamentary Secretary. The test stated that protection for long tail liability would only apply where:

‘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 either:

- 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.’

At first glance, this threshold test may seem appealing. However, we need to study the proposed criteria of the test more closely.

The first requirement is that, for a mass future claim to exist, there needs to be an unusually high number of claims. Such a criterion seems reasonable from the point of view of the company, as it ensures that the proposed change to the legislation will have a minimal effect on it. However, this criterion suffers from the drawbacks noted above, such as the arbitrary benefit that such a test might provide.

The Australian Conservation Foundation considered this requirement to be too narrow and that the denial of compensation for a small class of unascertained future claimants

may be viewed as unjust. If a company's conduct affected only a small group of people, it would escape liability.⁶⁹ Even if this criticism is ignored, the criterion is still vague. There is still the need to define what is meant by a 'high number of claims'. Is 1,000 considered to be enough? Or should the number be 10,000 or 100,000? What is the basis for justifying the number ultimately used?

If the first criterion is not met, the test sets out an alternative: '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 may be difficult to apply because, in many cases, appointed administrators or liquidators dealing with the company may not be aware of what is happening in other companies in the same industry. For example, if other companies in the industry are dealing with mass claims through private settlements, no-one will be aware of any mass claims taking place. This possibility hinders the successful application of this criterion.⁷⁰

One way to address this problem would be to amend s 596B of the *Corporations Act*. This section allows the court to summon a person for examination about the affairs of a company. To help administrators and liquidators with their job, s 596B may need to be broadened to allow the disclosure of confidential mass claim settlements to external administrators. However, this is not an ideal way to deal with the problem. In

⁶⁹ Australian Conservation Foundation, *Submission to the Corporations and Markets Advisory Committee on Long Tail Personal Injury Claims* (17 February 2006) 2-3, <www.camac.gov.au> at 10 January 2009.

⁷⁰ Marina Nehme and Claudia Wee, *Submission to the Corporations and Markets Advisory Committee on Long Tail Personal Injury Claims*, 6, <www.camac.gov.au> at 10 January 2009.

Deputy Commissioner of Taxation v Pddam Pty Ltd,⁷¹ Heerey J noted that it would be unrealistic to require an administrator to use the power under s 596B to investigate the affairs of the company.⁷²

Another option to manage the potential uncertainty faced by administrators and liquidators would be to limit the application of this criterion to companies that manufacture a product or operate in an industry prescribed by regulation.⁷³ This would save external administrators and liquidators the trouble of going to court and spending the resources of the company to discover if they are dealing with a mass claim. Additionally, the regulation could be updated easily to include any new industries with potential mass future claims. However, 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 would be crucial and could be challenging in certain instances.

If either of the above two criteria is met, the next criterion is that there is a strong likelihood that numerous claims would arise in the future. The Business Council of Australia supports such a requirement.⁷⁴ However, we need to define what is meant by ‘strong likelihood’ and how to quantify ‘numerous claims’.

⁷¹ *Deputy Commissioner of Taxation v Pddam Pty Ltd* (1996) 19 ACSR 498.

⁷² *Deputy Commissioner of Taxation v Pddam Pty Ltd* (1996) 19 ACSR 498, 510: ‘While it might be theoretically possible, as counsel for the applicant submitted, for an administrator to use the powers of compulsory examination by the court (ss 596A and 596B) that would involve giving notice of an application, waiting for the court to deal with the application for an order and then if an order were made, waiting for an appointment for the examination, conducting the examination and reviewing the transcript thereof. With respect, the suggestion seems to me to be somewhat unrealistic.’

⁷³ Insolvency Practitioners Association of Australia, *Submission to the Corporations and Markets Advisory Committee on Long Tail Personal Injury Claims* (14 March 2006), 2, <www.camac.gov.au> at 10 January 2009.

⁷⁴ Business Council of Australia, *Submission to the Corporations and Markets Advisory Committee on Long Tail Personal Injury Claims* (10 March 2006), 2, <www.camac.gov.au> at 10 January 2009.

The last requirement of the proposed test states that the protections would not apply if it were 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 criterion considerably limits the number of mass future claims that may be protected by the legislation. It may also raise certain problems due to the difficulty of identifying and valuing unascertained future claims. The difficulty in defining eligible claimants is apparent in the asbestos related cases. When compensation claims related to exposure to asbestos first emerged, the injuries that resulted in lawsuits were primarily mesothelioma and asbestosis. With the passage of time, claims for asbestos-related pleural diseases and pleural plaques also appeared. In more recent cases, claims have been made for compensation relating to mental anguish from fear of contracting an asbestos related disease following exposure. This demonstrates the difficulty of foreseeing the outcome of an exposure.

Limiting the outcomes to a category of people is impossible, especially in a global marketplace. For example, Johns-Manville (the case is discussed below) did not only cause injury to people in the US, but also many in Japan. Mass future claims may well have geographically widespread effects.⁷⁵ In the asbestos cases, it was the workers who had been directly exposed to the product who filed the initial claims. But later,

⁷⁵ Naoya Endo, “Reparation Claims Against Johns Manville Corporation” <http://www.livingframemedia.co.uk/cag/gac2004/English/ws_D_01_e.pdf> at 12 January 2009.

new categories of people started being affected, such as children living near asbestos mines or people renovating homes built with asbestos products.⁷⁶

Additionally, assessing the extent of a company's liability may be somewhat achievable, but the accuracy of such an estimate could not be reliable, since the company would be dealing with future claims. For example, the original estimate of the Johns-Manville's liability was not close to the amount ultimately paid by the company. In 1988, when the Manville trust was created to deal with asbestos claims, it was expected that the trust would receive between 83,000 and 100,000 asbestos claims over its expected life (49 years). However, since its first full year of operation in 1989, the trust has paid compensation of over \$2.5 billion to nearly 360,000 beneficiaries.⁷⁷ Clearly, a reasonable estimate can be hard to reach. This opens the way for companies to argue that they have no 'reasonable estimate' and as a consequence unascertained future claimants are not protected because the threshold test is not fulfilled.

We can conclude from this that the proposed threshold test for mass future claims, while desirable, is not suitable for implementation in its current form. The CAMAC declared that the mass future claim threshold test is unnecessary. The purpose for its implementation, namely limiting the regulatory burden on companies, can be achieved otherwise.⁷⁸ The CAMAC concluded that implementing minor changes to

⁷⁶ Institute of Actuaries of Australia, Submission to Corporations and Markets Advisory Committee Treatment of Unascertained Personal Injury Claims (31 January 2006), 3-4, <www.camac.gov.au> at 10 January 2009

⁷⁷ 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, 2, <<http://www.crowell.com/pdf/Asbestos.pdf>> viewed at 12 January 2009.

⁷⁸ CAMAC, above n 1, 41.

the *Corporations Act* might achieve the same purpose, without causing as much confusion as the mass future claim threshold test.

B *Small-Scale Reforms*

Small-scale reforms may be pursued to ensure that the legislative setting takes into account the interests of unascertained future claimants. Such reforms may impact solvent and insolvent companies that have, or will have, dealings with unascertained future claimants.

1 *Solvent Companies*

The limited liability of companies may adversely impact creditors because if the assets of the company are diminished or depleted, the creditors may not receive payment of their debts. Accordingly, the principle of capital maintenance is of some importance.⁷⁹ 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’.⁸⁰ However, over the decades, the principle of capital maintenance has been relaxed and companies have been allowed to reduce their

⁷⁹ The principle of capital maintenance is no longer fully accepted as the most appropriate and efficient way to safeguard creditors’ interests. There is a belief that the doctrine has outlived its usefulness. Further, certain countries, such as the United States, have abolished the principle of capital maintenance. John Armour, ‘Legal Capital: An Outdated Concept’ (2007) 7 *European Business Organization Law Review* 5; John Armour, ‘Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law?’ (2000) 63 *Modern Law Review* 355; Wolfgang Schon, ‘The Future of Legal Capital’ (2004) 5 *European Business Organization Law Review* 429; Fritz Ewang, ‘Regulating Share Capital Transactions and Creditor Protection: A Multi-Faceted Model’ (2007) 21 *Australian Journal of Corporate Law* 1, 3; High Level Group of Company Law Experts, *Report on a Modern Regulatory Framework for Company Law In Europe* (4 November 2002) 86; Andreas Engert, *Life Without Legal Capital: Lessons from American Law* (Working Paper, January 2006), 19.

⁸⁰ *Trevor v Whitworth* (1887) 12 App Cas 409 at 423-424.

capital in compliance with the *Corporations Act*. For instance, a reduction of capital is possible if the requirements of s 256B(1) are met, namely 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
- (c) is approved by shareholders under section 256C.’

Section 256B requires a company to take into consideration the interests of creditors. However, as noted above, unascertained future claimants are not considered to be creditors under the *Corporations Act*. So s 256B does not require directors to consider long tail liabilities when deciding whether a company is complying with the share capital provisions of the Act.

This problem appeared in James Hardie’s cancellation of partly paid shares. In October 2001, the Supreme Court of New South Wales approved a scheme of arrangement under which shares in James Hardie Industries Ltd were exchanged for shares in James Hardie Industries NV. As a result of the scheme, James Hardie Industries NV became the only shareholder in James Hardie Industries Ltd and held partly paid shares (the uncalled liability was \$1.9 billion). However, in 2003, a resolution was passed to cancel the partly paid shares, thereby releasing James Hardie Industries NV from any liability. This was made at a time when there was a prospective shortfall in the capacity of the company to pay all mass future claims.⁸¹

⁸¹ Brendan T O’Connell and Laurie Webb, “Asbestos Victims versus Corporate Power: The Case of James Hardie Industries” < <http://www.afaanz.org/research/AFAANZ%2006145.pdf> > at 12 January 2009.

The question that arises from this situation is: Was there a breach of s 256B of the *Corporations Act*? Commissioner Jackson did not find a breach in this case.⁸² Given that unascertained future claimants are not considered creditors, that finding was not unexpected.

The CAMAC supported the proposal to take into account the interests of unascertained future claimants when a company is reducing its capital.⁸³ One way this could be achieved is by amending paragraph (b) of s 256B(1) to include unascertained future claimants. The new provision would state:

‘(b) does not materially prejudice the company’s ability to pay its creditors **or its ability to pay mass future claims**,’⁸⁴

Such an inclusion would not drastically change the way the provision currently works.⁸⁵ It would only burden companies that are subject to mass future claims in situations where the reduction would endanger the chances of unascertained future claimants obtaining redress.⁸⁶ Similar additions have been suggested for the share buy-back provisions and financial assistance provisions of the *Corporations Act*.⁸⁷

⁸² 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.

⁸³ CAMAC, above n 1, 45-46.

⁸⁴ 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 unascertained future claimants. Directors would also be able to 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 unascertained future claimants.

⁸⁵ There may be a concern that directors in companies may refuse to reduce the capital due to the existence of unascertained future claimants. However, such fears need to be substantiated with evidence which is not currently available.

⁸⁶ The new proposal may have protected the interests of unascertained future claimants in the case of James Hardie.

⁸⁷ CAMAC, above n 1, 46.

Another change considered by the CAMAC was in relation to directors' duties. The Australian Securities and Investments Commission supported the adoption of a new general duty that would be imposed on directors; namely, directors would have a duty to act in a way that does not materially prejudice the interests of unascertained future claimants.⁸⁸ However, the CAMAC did not support this proposal, believing that changes to the reduction of capital, share buy-back and financial assistance provisions would sufficiently protect the interests of the claimants. It considered that imposing a new duty on directors would cause confusion because long tail liability is, by its nature, hard to determine and assess. Accordingly, it would be difficult and burdensome for directors to discharge a duty to specifically consider the interests of unascertained future claimants.⁸⁹

Further, under current laws, directors can take into consideration the interests of such claimants if this will benefit the company. This is possible because they are not confined to considering short-term considerations when managing the affairs of the company.⁹⁰ In summary, the CAMAC maintained that discretion should be given to directors in relation to long tail liability.

2 Insolvent Companies

⁸⁸ Such a duty was referred to by the Australian Securities and Investments Commission as the 'red light director's duty'. It would replace the need to introduce changes to the laws relating to reduction of capital, capital maintenance and financial assistance provisions. Australian Securities and Investments Commission, *Submission to the Corporations and Markets Advisory Committee on Long Tail Personal Injury Claims* (October 2007), 2, <www.camac.gov.au> at 10 January 2009.

⁸⁹ CAMAC, above n 1, 48.

⁹⁰ CAMAC, *The Social Responsibility of Corporations Report* (December 2006), Chapter 3.

When a company is made subject to external administration due to insolvency, the current laws do not provide any real protection to unascertained future claimants (as noted in Part 2 of this article). Accordingly, the CAMAC report considered a range of reforms to deal with long tail liability in instances where the company is insolvent. These reforms relate to the *Corporation Act's* provisions governing voluntary administration, schemes of arrangement and liquidation.

In relation to voluntary administration, a number of options have been put forward to protect the interests of unascertained future claimants:⁹¹

- Option 1: The administrator admits, and makes provisions in the deed of company arrangement to protect the interests of unascertained future claimants. Further, these claimants may appoint a representative with the power to challenge a proposed deed of company arrangement in court. An independent expert prepares a report on the impact of the proposed deed of company arrangement on long tail liability claimants.

This option attempts to establish equitable financial treatment between creditors and unascertained future claimants.

While such an aim is commendable, the approach may raise a number of problems that would complicate the process of voluntary administration. For example, one of the requirements of this option is to set aside an amount for unascertained future claimants. As we have discussed, an accurate estimate is

⁹¹ CAMAC, above n 1, 61-68.

very hard to achieve since the claims are, as yet, unknown. As we saw in the Johns-Manville example, the company's estimates were very different from the actual payments.⁹²

Further, if this option were to be adopted, provisions need to be introduced into the *Corporations Act* to determine what voting rights the unascertained future claimants would have. Would they have voting rights? If they did, would it be a nominal vote? Such questions are hard to answer, but are of crucial importance.⁹³ Additionally, requiring an independent expert's report to be prepared on the impact of the proposed deed of company arrangement on the unascertained future claimants could prolong the period of voluntary administration. If the period of voluntary administration were lengthened, the moratorium period would also have to be extended. Such an extension could make substantial secured creditors uneasy because they would have to wait for a longer time to receive their moneys.

Finally, secured and unsecured creditors may be tempted not to approve any deed of company arrangement that took into account long tail liabilities (especially if such a scheme affected their right to be paid). For instance, unsecured creditors might discover that the amount they would receive under winding up was higher than the amount they would receive under voluntary administration (due to the amount set up for unascertained future claimants). As a consequence, they might choose to oppose any deed of company arrangement. Ultimately, a company that may have been saved under the

⁹² Plevin and Kalish, above n 77.

⁹³ CAMAC, above n 1, 62.

current system may end up being liquidated due to unascertained future claims.⁹⁴ This risk may reduce the incentive for directors to put their company under voluntary administration if the company is subject to long tail liabilities.

- Option 2: The current laws in relation to voluntary administration remain the same. No provisions are made in relation to unascertained future claimants.
- Option 3: Directors are required to provide a certificate stating that the company does not have any unascertained future claimants or, if it does, that a deed of company arrangement does not materially prejudice the company's ability to pay such claimants in the future.

This proposal would add a burden on directors and might lead them to unintentionally breach their duties. Further, it could impede the process of voluntary administration.⁹⁵ Arguably, the issue of unascertained future claimants is too significant to leave in the hands of directors.⁹⁶

- Option 4: The administrator is required to appoint a legal representative for unascertained future claimants. This representative, while not entitled to vote

⁹⁴ The danger of this occurring will depend on how broad the threshold test of mass future claim is.

⁹⁵ 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'; CPA Australia, *Submission to the Corporations and Markets Advisory Committee on Long Tail Personal Injury Claims* (19 February 2008), 5, <www.camac.gov.au> at 10 January 2009.

⁹⁶ Insolvency Practitioners Australia, *Submission to the Corporations and Markets Advisory Committee on Long Tail Personal Injury Claims* (10 October 2007), 9, <www.camac.gov.au> at 10 January 2009.

on a deed of company arrangement, has the power to apply to the court to challenge the deed.

This proposal would require amendment of s 445D of the *Corporations Act*. Currently, the section notes the instances under which the court may make an order to terminate a deed of company arrangement. The provision would be modified to allow the court to terminate a deed if the interests of unascertained future claimants had not been taken into consideration.

The CAMAC seems to support Option 4 because it protects the interests of unascertained future claimants while avoiding excessive disruption to the process of voluntary administration.⁹⁷ However, arguably the option needs more consideration to clarify the criteria under which the challenge to the deed of arrangement may be made.⁹⁸

In relation to schemes of arrangement, the CAMAC report recommends that Part 5.1 of the *Corporations Act* should be amended to permit a scheme of arrangement between a company and its unascertained future claimants. However, such claimants would not have a specific right to challenge in court other schemes of arrangements.⁹⁹

Other changes to the Act relate to amendments of Part 5.1 to expressly allow the court to consider the interests of unascertained future claimants when approving a scheme of arrangement or the restructure of the company. Section 413(4) could expressly

⁹⁷ CAMAC, above n 1, 69.

⁹⁸ Insolvency Practitioners Australia, above n 95, 9.

⁹⁹ CAMAC, above n 1, 77.

include such claimants in its definition of liability.¹⁰⁰ If the court found that the scheme was affecting or endangering the interests of unascertained future claimants, it could reject it or make provisional orders to ensure that the interests of these claimants were protected.

For instance, in the James Hardie case (discussed above), a scheme of arrangement led to the issue of partly paid shares at a time when there was a risk that these shares might be cancelled, leaving unascertained future claimants with a very limited amount of money if the unpaid shares were cancelled. If the interests of these claimants had been considered, the court could have issued an order approving the scheme only on condition that the company change its constitution, for example to restrict its powers in relation to cancelling unpaid shares. Such a provision may have protected the interests of unascertained future claimants in the James Hardie case, because the partly paid shares could not have been cancelled.

In cases of liquidation, unascertained future claimants are widely affected because the company no longer exists when they make their claims. The CAMAC report proposes that the court should be given the power in liquidation to order a company to set aside funds in a trust specifically dedicated to unascertained future claimants. While such a proposal has merit, the amount that should be put aside is hard to estimate, as illustrated by the US experience.¹⁰¹ Further, a company, which is being wound up for insolvency, may not have enough money to pay its creditors, let alone put money aside for long tail liabilities. One way to avoid such a problem would be to put aside

¹⁰⁰ The Australian courts have already taken this into account. *Re Stork ICM Australia Pty Ltd; Stork ICM Australia Pty Ltd v Storck Food Systems Australasia Pty Ltd* [2006] FCA 1849, at [91].

¹⁰¹ Plevin and Kalish, above n 76.

funds for the protection for unascertained future claimants while the company is still a going concern.

C Other options

Since long tail liability causes a major problem to certain businesses, Roe argues that companies should deal with such liabilities before they become insolvent. He proposes pooling unascertained future claims in a manner similar to the US annuity funds.¹⁰² Such an early reorganisation would benefit the company because if the company becomes insolvent as a result of mass future claims, its operation would be affected and its value would decline.¹⁰³ Under this approach, the court would order the company to put a certain amount of money in a trust for tort claimants. Based on current estimates of the value of the trust fund and the amount of claims to be paid, the trust administrators would issue shares against the trust fund to compensate tort claimants. If the value of the trust declined, the trustee would adjust downward the redemption value per share.¹⁰⁴

As discussed in Part 2 of this paper, the US has used the trust concept to establish a procedure to deal with companies that anticipate becoming insolvent in the distant future due to unascertained future claims.¹⁰⁵ Such companies can apply to the court for an order enabling the establishment of a trust set up to meet long tail liability claims.

¹⁰² Mark J Roe, "Bankruptcy and Mass Tort" (1984) 84 *Columbia Law Review* 846, 866.

¹⁰³ *Ibid*, 848.

¹⁰⁴ Smith, above n 61, 383.

¹⁰⁵ Companies can apply to it even if they are not insolvent. That was the case for example in Johns Manville case.

Such a method has its benefits – it protects the interest of creditors and quarantines the liability of unascertained future claimants by limiting their rights in relation to funds held by the trust. The CAMAC report is in favour of such a proposal because it deals with long tail liabilities before they become an issue. If a company becomes insolvent in the future, the interests of such claimants are already protected. However, it is useful to examine the US experience to decide on the merits of such a system.

In the US, a number of companies faced with unascertained future claimants have used the system. In 1982, UNR Industries Inc was the first asbestos defendant to file for bankruptcy protection under Chapter 11 of the Bankruptcy Code 1978 (US). At 31 December 2000, the trust had received more than 360,000 claims. 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 discourage law firms from supposedly becoming careless in their filing practices.¹⁰⁶ If such a system were to be introduced in Australia, a question may arise in relation to claim filing fees. Should such fees be allowed? Arguably, for the purposes of fairness and equity such fees should not be permitted since the individuals filing the claims are exercising their inherent rights.

A number of other concerns have been raised:¹⁰⁷

- Establishing a trust can be subject to abuse. Companies may attempt to curtail the claims of unascertained future claimants through the creation of the trust.

¹⁰⁶ Plevin and Kalish, above n 76.

¹⁰⁷ Nehme and Wee, above n 70, 13-14. For more information about the US system: Bruce T Smyth, "Section 524(g) Asbestos Bankruptcy Trusts: Is the Cure Worse than the Disease?" (2003) 15(2) *Environmental Claims Journal* 171.

- The CAMAC report proposes that the court approves the scheme. However, the involvement of the court may lead to an expensive, lengthy and complex process.
- The funds in the trust may not be sufficient to cover all unascertained future claimants. A procedure would be needed to deal with the situation where the funds were depleted but claims were still being made. Further, a lack of funds could lead to unfairness. Current unascertained future claimants would be likely to receive bigger amounts than unascertained future claimants.
- Introducing such a trust system would require several amendments to current laws in different fields including taxation, the external administration regime, securities, contracts, fiduciary responsibilities and civil procedures. Such a system could not be easily incorporated into the *Corporations Act*. The tax implications alone would require significant consideration. In the US, the Internal Revenue Service introduced the ‘Manville Rule’ to deal with the trust’s unique tax implications.¹⁰⁸

For these reasons, the introduction in Australia of a US-style system would need to be evaluated in conjunction with the different laws that already exist.

Other reforms are also possible. One option, not considered by the CAMAC is to include unascertained future claimants in the *Corporations Act*’s definition of ‘contingent creditors’. Such an inclusion would be in line with United Kingdom legislation. It would not be hard to achieve, since the Australian definition of contingent creditors adopted by the courts has its origin in the United Kingdom case,

¹⁰⁸ Marianna S Smith, “Resolving Asbestos Claims: The Manville Personal Injury Settlement Trust” (1990) 53 *Law and Contemporary Problems*, 27.

*Re William Hockley Ltd.*¹⁰⁹ Such an inclusion would allow unascertained future claimants to have provable debts in liquidation or under a scheme of arrangement.

Another protection for unascertained future claimants would be to include a section in the *Corporations Act* specifically allowing the court to lift the corporate veil in cases of insolvency of a company that is subject to unascertained future claimants.¹¹⁰ Section 588V of the *Corporations Act* may play a role in lifting the corporate veil in case of unascertained future claimants. The veil can be lifted to hold the parent company liable for the long tail liabilities of its subsidiary if the holding company did not take into account unascertained future claimants liability of a subsidiary. This may make holding companies more responsible when dealing with unascertained future claimants.

IV CONCLUSION

The topic of long tail liability is of great importance not only because corporations today are being asked to be ethical and, as a consequence, more socially and environmentally responsible, but also because the number of long tail liability claims is on the rise. For instance, it is estimated that cases of mesothelioma resulting from asbestos exposure are expected to peak between 2010 and 2014.¹¹¹

The Australian system needs to be ready to deal with the projected growth in claims. This paper has considered a range of proposals. Two options not considered by the

¹⁰⁹ *Re William Hockley Ltd* [1962] 2 All ER 111, 113.

¹¹⁰ Lifting of the corporate veil was not considered as an option in the CAMAC report.

¹¹¹ O'Meally, above n 32, 1223.

CAMAC are to include unascertained future claimants in the definition of contingent creditors (which would provide protection to this category of claimants when the company goes under insolvency) and to legislate for lifting the corporate veil.

The CAMAC's proposal for the implementation of minor reforms in different areas of the *Corporations Act* to deal with long tail liability claims has merit. However, such reforms must be introduced with care. Although they may be easily incorporated into the legislation, their application may cause a number of problems. Further, they may cause serious gaps in the *Corporations Act*.

While adopting a US-style trust system may be on the cards, such a reform needs to be viewed on a broader scale because of its potential impacts on a wide range of laws, including taxation and consumer protection. Further, financial reporting may also be affected. No matter what, a solution needs to be found to deal with the issue of long tail liability.