17 February 2006

Submission to the Corporations and Markets Advisory Committee on Long-tail personal injury claims

The Australian Conservation Foundation (ACF) welcomes the opportunity to comment on the proposal by the Parliamentary Secretary to the Treasurer to strengthen protection of certain unascertained future creditors of corporations.

The proposed changes, while offering some protection to those who are personally injured by corporate misconduct in a narrow set of circumstances, are a solution neither to the more general problem of long-tail liabilities in insolvency, nor to the larger issue of the ability of corporations to externalise costs on to unwilling and innocent third parties through structures of limited liability.

In particular, the proposal does not address the pervasive problem of long-tail environmental liabilities, which do not always result in personal injury claims but more typically take the form of very large remediation costs that burden public authorities and/or private landholders. Further, the limitations and qualifications on the proposed protections for unascertained personal injury claimants would seriously limit the practical ability of victims of corporate misconduct to recover for their injuries.

1. Environmental long-tail liabilities and limitation of the reforms to the personal injury context.

In the report of the *Special Commission of Inquiry into James Hardie*, David Jackson QC observed that "current laws do not make adequate provision for commercial insolvency where there are substantial long-tail liabilities, that is liabilities that arise may years after the events or transactions that give rise to them."

The problem identified here is a general defect in the current laws regarding the treatment of long-tail liabilities in the insolvency context, whether those liabilities happen to relate to future personal injury claims or other possible claims. The general defect requires a general solution, not a partial solution that remedies the situation of personal injury claimants only.

The shifting of long-term environmental liabilities from private companies on to the public or other private parties is a serious and recurrent problem in Australia. One of

the more recent and egregious cases is that of the Mt Todd gold mine in the Northern Territory. Following only three years of operation, a decrease in world gold prices led to the cessation of operations by U.S.-based Pegasus Mining at Mt Todd, and ultimately the Australian operating subsidiary went into receivership. Pegasus left behind a toxic mess, including cyanide stored on site and a tailings pile leaching heavy metals and acidic water. The estimated total remediation costs of at least $20 million will fall heavily on the government of the Northern Territory.

The Mt Todd site is but one instance of a wider problem. Australia is pockmarked by similar sites, including Brukunga in South Australia, Captains Flat in New South Wales, Mt Lyell in Tasmania, Mt Morgan in Queensland and Rum Jungle in the Northern Territory. At many of the sites, the environmental damage has caused great costs to be incurred long after the original site operators have extracted their profits from the land and been wound up.

If unremediated by governments, such orphaned sites would cause more extensive contamination and could give rise to widespread personal injuries. However, while the proposed reforms would allow consideration of future personal injury claims in winding up procedures, they would not appear to allow similar consideration of costs incurred to prevent such personal injuries.

This is a perverse effect. If personal injury costs are cognisable and worthy of compensation, then what can be the justification for denying recognition of costs incurred by governments or even claimants themselves to mitigate what would otherwise result in such compensable personal injuries? Surely avoidance of injury is better than compensation. Therefore, compensation funds should be set up not only to cover personal injuries as they occur, but also to fund preventative measures (such as safe removal of asbestos, or environmental remediation) that lower costs and avoid injuries in the first place.

Recommendation: The proposed reforms should encompass all long-tail liabilities, including environmental liabilities, and not be limited to personal injury claims.

2. Limitations in the proposed test for “mass future claims”.

The proposal contains a number of significant limitations on the scope for consideration of possible future claims. In particular, the protections are triggered only in the event of an “unusually high number of claims for payment arising from particular acts or omissions leading to personal injury” against the company or other similar companies, and only where there is a “strong likelihood of numerous future claims of this type.” Furthermore, the protections do not apply if it is not “reasonably possible” to identify the circumstances giving rise to the claims and the class of persons who will bring the claims, and most importantly if it is not possible to “reasonably estimate the extent of the company’s liability”.

Taken cumulatively, these qualifications impose very high hurdles on future claimants and render it most unlikely that the proposed protections will be applicable in most long-tail liability circumstances.

The exemption where it is not possible to "reasonably estimate" the extent of a company's liability would unreasonably limit protection. Consider, for example, a case where future claims are almost certain, but the range of estimates of possible aggregate liability is from $20 million to $200 million. In that situation, it could be open to the company to argue that there is no "reasonable estimate" of total liability, with the consequence that the future creditor provisions do not apply at all. As a result, no amount would have to be set aside for future claimants – not even the lowest estimate of liability of $20 million.

The focus on the number of claims is similarly perplexing. If there is a strong likelihood of future claims, it is not clear why claimants should have to meet the additional requirement that there be "numerous" future claims. It would be unjust and again perverse to deny compensation to a small class of unascertained future claimants merely because the corporation's misconduct does not injure a larger group of individuals. Consider a case where a company's conduct has a 50% chance of causing cancer in each of 20 residents of a remote community. There will be on average only 10 claims, which may not fulfil the "numerous claims" requirement – yet why in principle should the interests of those future claimants be disregarded?

A better approach would be to establish a structure through which an external administrator is required to make provision for future liabilities whenever such liabilities are reasonably likely. The amount of provision should be set according to the entirely of the circumstances. Factors such as the number of claims and the range and certainty of estimates of total liability would be relevant to the determination of the required provision.

Recommendation: Provision for unascertained future claims should be required whenever such claims are reasonably likely. Factors such as the estimated or possible number of claims and the certainty of estimated liability should be relevant to the amount of the financial provision, but should not operate to exclude consideration of likely long-tail liabilities.

3. Other reforms suggested by the James Hardie inquiry.

Special Counsel assisting the James Hardie inquiry noted that "the existing exceptions to limited liability do not provide adequate protection for victims of torts committed by insolvent subsidiaries of wealthy holding companies." This is true both for unascertained future claimants and for current involuntary creditors of a company.

This deeper issue is not addressed by the proposed reforms, which are designed only to grant future unascertained creditors some form of standing as creditors under existing processes, not to allow recourse to the assets of wealthy parent companies.

It is regrettable that the proposals put forth for CAMAC's consideration have not addressed the principles of limited liability as they operate to deny compensation for involuntary creditors of corporate subsidiaries. One solution advanced in CASAC's May 2000 *Final Report on Corporate Groups* would be to impose direct liability on holding companies for the negligent acts of their subsidiaries where it would be in the public interest to do so.

The James Hardie case and other ongoing abuses of limited liability (eg, the protection of Eurogold's assets from potentially massive environmental liabilities incurred by its subsidiary Transgold, operator of the disastrous Baia Mare gold mine in Romania) continue to highlight the imperative for such a reform if our *Corporations Act* is to maintain some claim to be a just system of economic organisation.

Recommendation: In response to the Parliamentary Secretary to the Treasurer's question whether the proposed reforms would "protect the interests of future, unascertained creditors", the Committee should consider:

(1) noting that the proposal at most places unascertained creditors in the position of ascertained creditors, but fails to protect the interests of involuntary creditors insofar as it gives them no remedy if the assets of a company are insufficient to cover its liabilities; and

(2) reaffirming the need for direct liability of corporate parents for negligent acts of its subsidiaries, along the lines of the recommendations in the 2000 CASAC Report.

ACF would be pleased to provide any additional information that would assist the Committee in its inquiry into these matters.

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