AICD **Policy & Advocacy**

Submission

to

Corporate and Markets Advisory Committee

on

Long-Tail Personal Injury Claims

22 December 2006

Australian Institute of Company Directors

Australian Institute of Company Directors (AICD) is the peak organisation representing the interests of company directors in Australia. Current membership is over 21,000, drawn from large and small organisations, across all industries, and from private, public and the not-for-profit sectors. Membership is on an individual, as opposed to a corporate basis.

AICD has seven State divisions, each of which is represented on the AICD Board. Overall governance of the AICD is in the hands of its Board which is comprised of the seven Division Representatives, the Chair, three National Directors and the CEO.

AICD has several national policy committees, focusing on issues such as law, accounting and reporting and corporate governance.

The key functions of AICD are:

- to promote excellence in director's performance through education and professional development
- to initiate research and formulate policies that facilitate improved director performance
- to provide timely, relevant and targeted information and support services to members and, where appropriate, Government and the community
- to maintain a member's code of professional and ethical conduct
- to uphold the free enterprise system
- to represent the views and interests of directors to Government, regulatory bodies and the community
- to develop strategic alliances with relevant organisations domestically and internationally to further the objectives of the AICD.

Long-Tail Personal Injury Claims

1. Overview

1.1 This submission is provided by the Australian Institute of Company Directors (AIDC) in relation to a reference on the treatment of future unascertained person injury claims from the Parliamentary Secretary to the Treasure to the Corporations and Markets Advisory Committee dated 12 October 2005 (Reference).

1.2 Regulation of corporations which are required to account for provisions in respect of actuarially certain future mass claims exposures to take account of those provisions may be appropriate in some specifically defined circumstances. However, the legislation should provide genuine guidance and certainty to directors in terms of its application and what must be done to comply with it. The currently proposed threshold test is too uncertain and onerous to be applied.

1.3 Corporations which may be subject to the mass future claims regime should still be able to reasonably and responsibly manage their capital consistently with modern market expectations.

1.4 The proposed prohibition on intentional avoidance is too broad and would not be appropriate in respect of a threshold test as proposed. Any such provision must be very clear in its operation and be based on a demonstrated need to specific legislative provision.

1.5 Whilst the inclusion of future creditors to participate in formal insolvency situations is consistent with notions of basic fairness, the inclusion has significant consequences for insolvency administrators and creditors. The potentially very significant costs and delays that will be occasioned must be considered carefully, together with how the inclusion of such a class will affect the ability of a company to undertake a reasonable and responsible restructuring of its affairs.

2. Would the proposed reforms unduly compromise current corporate law and insolvency principles?

2.1 The key proposed reforms would significantly alter the policy of the Corporations Act 2001 (Act) towards the assessment of the solvency of corporations in particular circumstances and for particular purposes. The alterations are proposed

to affect the general creditor protections provisions identified in the reference (i.e. ss. 256B, 257A and s 563A) and for the purposes of external administration. Persons having no present right of action against a company for damages are not creditors (actual, prospective or contingent), though actuarial opinion is that claims will emerge in the future.[1] It is clear that the Reference does not propose a definition of creditor for the purpose of the whole of the Act which would include a potential future claimant in circumstances where actuarial opinion is that such claims will emerge.

2.2 The proposed reforms would have a very significant effect on both liquidations and administrations, altering the long standing position that only creditors may participate in either. The legislation would create an unknown and unspecified class of person who would be entitled to participate through a nominated person.

3. The preliminary test – "mass future claim"

3.1 If a reform proposal of the nature contemplated by the Reference were to be put into effect, it is most desirable that it provides genuine guidance and certainty to a board both in determining whether the provisions apply to any particular company and, if so, what must be done to comply with the legislation.

3.2 The test for "mass future claim" proposed in the Reference is very complicated. It would potentially require a company to make extensive enquiries which may not provide reliable information on which to form an opinion as to whether a "future mass claim" situation exists.

3.3 The key concepts from the proposed threshold test include an "*unusually high number of claims for payment*" in respect of personal injury against the company or more than one company of a "*similar industry*" or with "*similar business operations*" to the company and a "*strong likelihood of numerous future claims*" of that type.

3.4 The most immediately noticeable feature of the suggested key concepts is that they involve the determination of a number of differently described opinions (eg. "*Unusually high*", "*similar*", "*strong likelihood*"), which could be the subject of different views and potential dispute, rather than an easily determinable objective criteria. Further, to form a view about whether the proposed definition might be met would potentially require significant investigations to be made of matters not within the knowledge of any particular company as to the nature of claims against other companies and the nature of the "*industry*" or "*operations*" of other companies.

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[1] See *Edwards v The Attorney-General* [2004] NSWCA 272 – though the position in the United Kingdom is a little more generous, at least for some purposes : see *In the matter of T&N Ltd* [2005] EWHC 2870

3.5 It is further proposed that the threshold test will not be met in cases where 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*". In basic conceptual terms, these provisos do appear to identify the type of situation in which a company should not be subject to the regulation of the kind proposed. But these qualifications illustrate the inefficiency of the principal key concepts suggested for the threshold determination, and involve further matters of opinion. They do not reduce the inquiries that would be required to be made in an attempt to determine whether the preliminary test might apply in any particular case.

3.6 It will be quite difficult, and potentially onerous or oppressive, for directors to determine whether the preliminary test is met on the conceptual basis proposed. In short, the proposed preliminary test appears be too complicated and difficult to apply.

3.7 This lack of certainty will add to the inherent difficulties for directors and officers in determining whether a company is trading solvent or otherwise. It makes a strong case for the extension of the business judgement rule in the form of s180(2) of the Act to the insolvency provisions applying to directors and officers in that Act. The introduction of a 'safe harbour' will not excuse directors and officers from liability where they are clearly in breach. However, it provides a framework against which sensible business decisions can be made if directors and officers comply with the criteria. We understand that the Federal Treasurer will release in early 2007 a discussion paper on penalties for breach of directors' duties. We intend to recommend an extension of the business judgement rule to the relevant solvency provisions of the Act.

3.8 The question then is whether (assuming that reform intended to provide regulation in the situation of a company with significant prospects of future claims is considered appropriate) a clear and simple definition could be formulated which could be applied without undue difficulty and incurring significant costs.

3.9 In this context, Accounting Standard AASB 137[2] presently requires disclosure of provisions in respect of a "contingent liability".[3] Paragraph 86 provides:

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[2] Accounting Standard AASB 137 July 2004 Provisions, Contingent Liabilities and Contingent Assets.

[3] For the purpose of the standard the term "contingent liability" is wider than the recognised legal operation of that term: cf. *Edwards v Attorney-General {2004} NSWCA 272 [check reference]*

"*Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the reporting date a brief description of the nature of the contingent liability and, where practicable:*

(a) an estimate of its financial effect, measured under paragraphs 36-52;

(b) an indication of the uncertainties relating to the amount or timing of any outflow; and

(c) the possibility of any reimbursement."

3.10 In this regard a "*contingent liability*" is defined by clause 10 as:

"a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more future events not wholly within the control of the entity".

3.11 Hence, a review of AASB 137 discloses that companies subject to the Accounting Standards are already required to consider and make provisions for the best estimate of the present amount required to settle future personal injury claims.

3.12 If there is to be a definition of "future mass claim" which requires an opinion to be formed on the basis of a specified test or formula, then it is desirable that the test should be consonant with the relevant accounting standards. At present, the requirements contained in AASB 137 to disclose the company's best estimate of the amount required to make a current financial settlement of the "possible obligations" may provide a better framework than a complicated and legalistic notion of "mass future claim". The test is simpler, and can be made on the basis of the information available to the company at the relevant time.

3.13 However, the reform proposal is intended to deal with the limited circumstances of mass future claims. It is most likely that companies which are subject to those circumstances will operate in industries which have become publicly identified with the risk of mass future claims (eg the sale of asbestos products). A far more appropriate way of regulating particular industries at risk of mass future claims would be through the formal identification of those particular industries: i.e. by prescription through regulation which clearly and specifically identifies industries or products which the government considers are appropriate to be subjected to such regulation.

4. Extension of existing creditor protection

4.1 In considering the Reference, it is suggested that regard should be had to the following notions:

(a) It must be regarded as being clearly in the best interests of future personal injury claimants that companies which have potential exposure to such claims continue to trade and have the resources to meet claims as they develop. The regulatory environment should not unduly discourage this

(b) Any regulation should not inappropriately impact on the ability of such a company to manage its capital, consistently with modern expectations of capital management

(c) The need to provide genuine guidance and certainty to companies and their boards in managing the affairs of a company which may be the subject of a regulated future mass claim situation

4.2 It is desirable for such legislation to operate cohesively with the relevant accounting standards (eg AASB 137). In this context we note it is not generally possible to provide a "true" estimate of the likely quantum of such claims, but only a "best estimate" subject to appropriate assumptions and qualifications.[4]

4.3 The proposal contained in the Reference appears to suggest that companies subject to a future mass claim would be restricted from entering into transactions which might adversely affect their share capital such as reductions of share capital (s 256B of the Act) and share buy-backs (s 257A of the Act). A complete prohibition on capital management would severely affect such companies, and is not appropriate.

4.4 Similarly, the proposal may affect the payment of dividends out of profits which is provided for by s 245T of the Act.

4.5 However, some recognition of a provision required by the relevant accounting standards may be appropriate in the consideration by a company of its capital management.

5. Prohibition on Intentional Avoidance

5.1 The existing creditor protection provisions which are proposed to be extended are not the subject of any specific reinforcement by criminal sanction. There does not appear to be a need for a specific provision of the type contemplated.

5.2 A prohibition of this kind should not be imposed unless there is a clear need for it. That is, the other more general provisions of the Act are insufficient. Nor should it be applied unless the threshold test is very clear.

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[4] Cf the Submission to the Corporations and Markets Advisory Committee by the Institute of Actuaries of Australia in relation to the Reference, paragraphs 30-32; AASB 137

5.3 There is potential for routine arrangements to be entered into by a company with a view to ensuring that claims against it are minimised: e.g. for the defence of litigation or the investigation of claims (though the categories are not closed). If such a prohibition is to be implemented it should only catch transactions made with the intent (sole or dominant) of defeating future creditors. It would achieve no more than current legislative provisions such as s 37A of the *Conveyancing Act* (NSW), which sufficiently deals with transactions made with the intention of defeating or delaying creditors (including future creditors).

5.4 The prohibition is suggested to apply to "not just directors or other companies in a group, but also … any person who is a party to the transaction of arrangement". It is important that competent advisers to companies which might be the subject of a mass future claim are not deterred from acting for such companies because of the risk of potential personal liability – it is in the public interest that such companies get good advice. The creation of a low-threshold accessorial liability should be carefully considered, and may not be desirable.

6. External Administration

6.1 The third aspect of the proposal is to extend the definition of creditors for the purposes of administration and liquidation to include a class of mass future claimants (being a class who cannot be specifically identified).

6.2 Such a proposal raises issues which include:

(a) The assessment of the value of the claims of future mass creditors

(b) How to distribute funds when the body of creditors is fluid both as to identity and quantum

(c) The prejudice to non-mass future claims creditors

(d) The delay in finalising insolvency administrations and the costs involved in the administrations

(e) The information and resources available to a liquidator or administrator.

6.3 There is a policy case for the recognition of future creditors in liquidation. If they are not recognised, they will be paid nothing – the funds will be distributed and the company dissolved before many of the claims may mature. However, the inclusion of such creditors within such an administration will potentially involve a very significant (and difficult to quantify) cost to the other creditors in terms of increased costs of administration, delay in distribution and decreased dividends.

6.4 The inclusion of such claimants into the class of creditors who may participate in an administration or liquidation should also provide for suitable mechanisms to allow the early crystallisation and assessment of such claims to permit a liquidation to be completed within a reasonable time and also to facilitate the restructuring of the affairs of financially distressed companies in the interests of all creditors.

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