

**TERM OF REFERENCE NO 1 — THE CURRENT FINANCIAL
POSITION OF THE MRCF**

DISTRIBUTION OF ASSETS WITHIN THE FOUNDATION GROUP OF COMPANIES

1. The Medical Research & Compensation Foundation (**MRCF**) is a public company limited by guarantee which owns (i) all shares in MRCF (Investments) Pty Ltd (**MRCFI**); and (ii) 50% of the issued shares in Amaca Pty Ltd (**Amaca**).
2. MRCFI holds the other 50% of shares issued in Amaca. Amaba Pty Ltd (**Amaba**) is a wholly owned subsidiary company of Amaca.
3. The MRCF is the trustee of a trust for charitable purposes established under a deed executed on 16 February 2001: Ex 3, vol 1, tab 6.
4. The corporate relationships described in paragraphs 1 and 2 above allow the entities MRCF, MRCFI, Amaca and Amaba to be described as a corporate group. In evidence before the Commission this corporate group was described as “**the Foundation**”. The main assets and liabilities of the Foundation reside with Amaca, and to a lesser extent, with Amaba and MRCF. The relationship between MRCF and Amaca and Amaba may be described as follows:
 - (a) MRCF either directly, or indirectly through its wholly owned subsidiary MRCFI, is the owner of all shares in Amaca; and
 - (b) MRCF, through the interposed entities of Amaca and MRCFI, is the indirect owner of all shares in Amaba.
5. The MRCF was set up with a gift of \$3 million from JHIL. Its role is to provide grants for medical research into asbestos related diseases. Other than its shares in Amaca and Amaba, the MRCF currently has assets of \$2.2 million. As at 5 April 2004, it was about to provide grants of \$100,000 per year for the next three years: Ex 6, [11]. Its assets and liabilities appear to be relatively static.

6. Evidence before the Commission on the current financial position of entities within the corporate group was sometimes given by loose reference to “the Foundation” and at other times, by specific reference to the assets and liabilities of Amaca and Amaba. Wherever possible, these submissions will address the assets and liabilities of Amaca and Amaba. However, where evidence was given by general reference to “the Foundation”, that practice will also be followed here.

CURRENT ASSETS OF AMACA AND AMABA

7. The best sources of evidence on the assets of Amaca and Amaba are (i) Mr Dennis Cooper’s supplementary statement of 5 April 2004 which provided figures till the end of February 2004 (Ex 6); and (ii) Mr Cooper’s statutory declaration dated 9 July 2004 which provides figures till the end of May 2004. Mr Cooper is the Managing Director of the four companies within the Foundation: Ex 5, [7].
8. Table 1 presents the balance sheets of Amaca and Amaba as at February 2004 and May 2004. These figures are based on Ex 6, [29] & [34] and Mr Cooper’s statutory declaration of 9 July 2004, [6], [8]. Based on Table 1, the combined total assets Amaca and Amaba at the end of May 2004 were \$188,057,000. The combined net assets were \$125,078,000.
9. The bulk of Amaca and Amaba’s assets are represented by the income streams for the receivables from the Deed of Covenant and Indemnity (**DOCI**) and QBE. At 5 April 2004, Mr Cooper estimated these to represent a net present value (**NPV**) of some \$110m: Ex 6, [25].
10. Table 2 presents a summary of the income statements of Amaca and Amaba as at June 2003, the year to February 2004 and the year to May 2004. These figures are based on Ex 6, [30] & [35] and Mr Cooper’s statutory declaration of 9 July 2004, [7] & [9]. Based on Table 2, the combined income of Amaca and Amaba in the year to May 2004 was \$11,726,200.

Table 1 — Recent Balance Sheets of Amaca and Amaba

<i>Figures in \$million</i>	AMACA Feb 2004	AMACA May 2004	AMABA Feb 2004	AMABA May 2004
Cash, Securities and Working Capital ⁽⁵⁾	18.2	23.9	1.75	1.411
Property ⁽⁶⁾	72	0	—	—
Multiplex Receivable ⁽⁷⁾		48.0	—	—
QBE Receivable (net) ⁽²⁾	25.1	25.6	0.991	1.004
DOCI Receivable ⁽²⁾	85.1	84.9	3.247	3.241
TOTAL ASSETS ⁽¹⁾	200.4	182.4	5.998	5.657
Provision for notified claims ⁽⁸⁾	(62.3)	(62.3)	(0.833)	(0.679)
NET ASSETS	138.1	120.1	5.155	4.978

NOTES

These notes follow Ex 6, [29] & [34] and Mr Cooper's statutory declaration of 9 July 2004, [6] & [8].

1. These extracts from Amaca and Amaba's balance sheet at these various dates have been adjusted to clearly reveal the net present value ("NPV") of the DOCI and QBE income streams. To comply with accounting standards, the balance sheets in Amaca and Amaba's audited financial statements accrue a liability for deferred income equivalent to the NPV of these income streams. In order to make the NPV of these income streams visible at each relevant balance date, the liabilities for deferred income have been excluded.
2. The payment streams for QBE and the DOCI are discounted at the then prevailing bond rate to calculate an NPV for the accounts.
5. A settlement receivable for \$3m has been included in Amaca's securities for 2004.
6. From 2002, properties were no longer depreciated.
7. Deferred settlement of property sale to Multiplex.
8. Provision for notified claims to be updated for June 30 financial year end.

Table 2 — Summary of Amaba and Amaca's Recent Income Statements

<i>Figures in \$ million</i>	AMACA			AMABA		
	June 2003	YTD Feb 2004	YTD May 2004	June 2003	YTD Feb 2004	YTD May 2004
Investment	(2.3)	1.8	2.7	0.082	0.054	0.077
Property	5.6	3.9	4.1	—	—	—
C & I	5.3	3.5	4.9	0.0202	0.0135	0.0185
TOTAL INCOME	8.6	9.2	11.7	0.0284	0.0189	0.0262
Settlements	38.0	28.6	43.7	—	—	—
Legals	10.2	6.1	8.6	—	—	—
QBE Income ⁽²⁾	(3.0)	(2.0)	(2.8)	—	—	—
Insurance Recovery	(3.1)	(1.0)	(1.2)	—	—	—
NET LITIGATION COST ⁽⁵⁾	53.1	31.7	48.3	0.0187	0.0118	0.0262
Operational Costs ⁽⁴⁾	2.4	2.7	4.7	0.0102	0.067	0.094
OPERATING LOSS	(46.9)	(25.2)	(41.3)	(0.05)	0.04	(0.0255)
Movement in Provisions ⁽³⁾	7.0	7.6	7.6	0.0182	(0.0121)	0.033
NET LOSS	(39.9)	(17.6)	(33.7)	0.0177	(0.0117)	(0.0222)

NOTES

These notes follow Ex 6, [30] & [35] and Mr Cooper's statutory declaration of 9 July 2004, [7] & [9].

2. QBE receipts were originally based on income recognition over a 30 year period commencing in 1995. From 2003 these receipts have been recognised as cash is received.
3. From 2003, the provision for notified claims was reduced following an internal analysis of actual settlement costs compared with existing settlement reserves.
4. Commission costs which are subject to an insurance claim for recovery are included in this figure.
5. In the case of Amaba, each open claim is valued and provisioned; and the net litigation cost reflects the difference between actuals and provisions.

AVAILABLE INSURANCE COVER

11. Mr Hutchinson gave evidence about the Foundation's insurance position. He is currently a director of each of the four entities in the Foundation: Ex 26, [2]. Mr Hutchinson made five statements to the Commission: Exhibits 26, 27, 218, 219 and 294. Of particular relevance in this context are Ex 218 (statement of 31 May 2004) and Ex 294 (statement of 23 June 2004).
12. In his oral evidence, Mr Hutchinson qualified many of the statements contained in Ex 218, and conceded that he was not able to give a precise picture of the Foundation's likely level of recovery pursuant to the insurance policies: T2990.42.
13. Taken as a whole, Mr Hutchinson's evidence indicates that the Foundation's knowledge of its actual insurance cover is still very limited; and that there is no adequate basis for the claim that the Foundation's likely level of recovery for any given period of insurance is either zero or 7%.

Mr Hutchinson's original evidence

14. In his 31 May 2004 statement, Mr Hutchinson stated that there is uncertainty as to the actual insurance cover available to Amaca and Amaba and the likely level of recovery under such policies. The sources of this uncertainty are: (i) incompleteness in the records received by the Foundation from the relevant assured entity within the James Hardie group of companies; (ii) uncertainty as to the financial status of some insurers, most notably by entities in the HIH group of companies; (iii) the inherent complexity of the insurance program in the 1981 to 1997 period; and (iv) uncertainty as to whether some cover was in fact ever placed: Ex 218, [8]; see also T2990. 23.
15. The insurance policies available to entities in the Foundation are summarised at Ex 218, [11], [34]-[39], [44]-[60]. This summary is based on schedules which appear at Ex 218, vol 1, tabs 2-7, these schedules being, in turn, "spreadsheets which summarise the Foundation's insurance policies such as they are presently known to the Foundation": Ex 218, [10]. Mr Hutchinson was unable to consider the contents of the original documents in any detail: Ex 218, [3].

16. The exact identity of these policies, and the likely level of recovery is still unknown. These matters are currently the subject of investigation by the Insurance Recovery Project (**IRP**) set up by the Foundation: Ex 218, [9], [12], [27]–[28], [77]; T289.37; T2991.3. The members of the IRP are Mr Cooper, Mr Sutherland and Mr Phillips. The activities of the IRP are described at Ex 218, [14]–[28].
17. On 31 May 2004, Mr Hutchinson stated that the IRP had reached the following views:
- (a) Disregarding the annual commutation payment from QBE, recoveries under the insurance policies held by the Foundation in relation to its asbestos liabilities will only meet a small percentage of future claims. Such recoveries “will not exceed 12% of claims paid and may well be less”: Ex 218, [12(a)].
 - (b) Policies placed in London from 1981 to 1988 will only yield a fraction of the face cover value of A\$450 million (rather than \$750m, as suggested): Ex 218, [83]–[87]. There are also impediments to the recovery of even these smaller amounts: Ex 218, [12(b)].
 - (c) There are difficulties in forming a view as to the proper commutation value of the London policies. Commutation of these policies may be unlikely or inappropriate. If commutation occurs, it may be for only a fraction of face value of the policies: Ex 218, [12(c)], [88], [90]–[92].
18. Mr Hutchinson also made statements about the likely insurance recoveries where a plaintiff had been exposed to asbestos from the 1930s to date. These statements were based on his reading of the Trowbridge “Review of Potential Exposure to Asbestos Claims to end June 2003” (Ex 3, vol 3, tab 10) and what he understood about the IRP’s knowledge of the solvency of insurers. In relation to the five discrete period of insurance coverage, Mr Hutchinson said:
- (a) **1930s to 1976**: No recovery other than what is offered through the annual \$3.1m QBE commutation payment. It is doubtful whether the amount received from QBE will be adequate to compensate future claims which involve exposure during this period: Ex 218, [13], [43];
 - (b) **1976 to 1981**: Recovery of 5%. This period was covered by insurance placed with various Lloyds syndicates and companies on an “occurrence” basis.

Approximately A\$28 million of cover still exists with ACE, but recovery will be limited by the “time on risk” practice regarding claims where the exposure period spanned two or more insurance policies (this practice is described at Ex 218, [61]-[68]). Other insurance covers have been exhausted: Ex 218, [13], [44]-[49]; T2991.44. This statement was based on the twin assumption that HIH was the insurer on many of these policies, and that claims cannot be recovered under these policies.

- (c) **1981 to 1986**. Recovery of 7%. This period was covered by CE Heath policies with various Lloyds syndicates and companies on an “occurrence” basis. Some 50% of this cover is now underwritten by Equitas, a company which may become insolvent due to its asbestos liabilities. Work still needs to be undertaken to identify policies and policy documents for this period. Based on the Foundation’s claims history and the “time on risk” practice there is doubt whether full recovery will be made under these policies: Ex 218, [13], [50]-[59].
- (d) **1986 to 1997**. No recovery. The obstacles cited were: (i) that subject to the *Insurance Contracts Act 1984* (Cth), s 54, these policies only respond to claims made during the insurance period, and may be subject to a “retroactive clause”; (ii) the insolvency of HIH may impede recovery, the liquidator of HIH apparently denied the Foundation access to the “cut-through provisions” of *Corporations Act*, s 562A; (iii) the Foundation is experiencing difficulties in accessing policy documents from the HIH liquidator: Ex 218, [13], [69]-[73].
- (e) **1997 to date**. No recovery, due to the presence of express exclusion clauses for asbestos related injuries in the insurance policies: Ex 218, [13], [74]-[78]; see also Ex 218, vol 2, tab 16, p365.

Qualification — Mr Hutchinson’s oral evidence and the 23 June 2004 Statement

19. In his testimony before the Commission, Mr Hutchinson re-affirmed the complexity and the uncertainty of the insurance situation: T2990.54. He also qualified important aspects of the evidence summarised at paragraphs 17 and 18 above. Of particular significance are the following statements:

- (a) The 2003 Trowbridge Report (Ex 3, vol 3, tab 10) upon which Mr Hutchinson relied in making the observations did not consider the more recent work undertaken by the IRP: T2998.4.
- (b) The work of the IRP was “not yet complete”; there was “still quite a lot of work to be done”: T2991.10. Work was still to be performed on all of the IRP’s projects: T2998.6. These projects include the identification of all existing and responsive policies, a review of the most effective system of insurance recovery, an investigation of whether any of the claims fall into the HIH Claims Support Scheme. The projects are detailed at Ex 218, [28].
- (c) The Foundation had not yet received the report of Mr Phillips who recently travelled with Mr Sutherland to London to explore Amaca and Amaba’s insurance provision on the 1976 to 1981 and 1981 to 1986 policies: T3000.26-T3000.54.
- (d) Mr Hutchinson (and, presumably, the IRP) had still not adequately inspected the insurance documents which are summarised in the schedules at Ex 218, vol 1, tabs 2-7: T3001.12. Mr Hutchinson was unable to contradict the proposition that the Foundation was never refused access to insurance related documents held by ABN60: T3002.22, referring to Ex 218, vol 1, tab 1, pp1&2.
- (e) Mr Hutchinson (and, presumably, the IRP) had not yet inspected documents relating to insurance which were produced to the Commission by various parties, including the liquidators of FAI and HIH: T3001.24.
- (f) The Foundation had not yet received legal advice about the more favourable insurance recoveries that would flow to the Foundation if it sought full indemnity for a claim up to the available limit of indemnity notwithstanding that the relevant period covered only part of the period of exposure: T2998.40 cf Ex 218, [68]. Such an advice would address some of the recovery problems caused by the “time on risk” practice affecting claims in the three insurance periods covering the years 1976 to 1986.
- (g) Mr Hutchinson conceded that he had erroneously understated the amount of excess cover provided by (an entity which he assumed to be) HIH: T2991.58 -

T2992.49; see also Ex 294, [18]. He also conceded that it was possible that the insurance provided in this layer was provided as to 27.99% by Lloyds and as to remainder by some unknown insurer: T2993.5.

(h) No advice had yet been obtained as to the application of the section 54 of the *Insurance Contracts Act* which might enable the late notification of certain claims: T3000.9.

(i) Mr Hutchinson was unable, in oral evidence, to support his claim that the HIH liquidator had denied the Foundation access to the provisions of *Corporations Act* s 526A: T2999.35. The highest this evidence went was to say that the liquidator did not support such access but was holding any reinsurance recoveries in trust awaiting legal advice: Ex 218, vol 2, tab 14, p 345; T2999.10.

20. When Mr Hutchinson appeared before the Commission he was unaware of Amaca and Amaba's applications lodged under the HIH Claims Support Scheme ("**HCS**") (Ex 200 and 202): T2993.35-T2996.31. That is a remarkable thing given that he was the person put forward by the Foundation as a person able to give evidence on the question of the Foundation's insurance position. Subsequently, Mr Hutchinson lodged a further statement (Ex 294) in which he acknowledged:

- (a) That Amaca and Amaba had been advised by Eakin, McCaffery Cox that they may be eligible to make a claim: Ex 294, [12]
- (b) That Amaca and Amaba had lodged applications to HCS: Ex 294, [14];
- (c) That Amaca and Amaba satisfied the criteria of eligibility under the HCS: Ex 294, [13];
- (d) That if the HIH policies responded to Amaca and Amaba's claims, the HCS would operate so that the insured (HCS applicant) would be paid 90% or 100% of the amount which the insurer would have been obliged to pay under the relevant policy: Ex 294, [10], [16].

21. Exhibits 200 and 202 identify 13 policies of insurance issued by HIH covering the periods from 1979 to 1981 and 1986 to 1997. The total face value of these policies (the

total of upper limits) is \$1.105 billion: Ex 202, p 101.

Summary and effect of Hutchinson evidence

22. When Mr Hutchinson's oral evidence and his 23 June 2004 statement (Ex 294) are read against the 31 May 2004 statement (Ex 218), it becomes apparent that the Foundation has not yet fully ascertained what insurance policies it can access. The conclusions expressed in Ex 218 on the likely level of recovery pursuant to those policies cannot be sustained, as the later evidence casts doubt on the most important assumptions regarding the ability to recover.
23. It is clear that the Foundation's IRP still has much work to perform. This is particularly so in the case of the London policies in the periods 1981 to 1986 and 1986 to 1987. In respect of these policies:
- (a) The identity of many insurers is still unknown. Mr Phillips' report is still outstanding.
 - (b) The ability to recover under section 54 of the *Insurance Contracts Act* has not been determined.
 - (c) Amaca and Amaba may recover on HIH policies through the HCS scheme.
 - (d) Many of the entities identified as potential insurers are solvent and may be *direct* insurers on the policies held by the Foundation. The Foundation appears to have assumed, without knowing, that these insurers are *reinsurers* against whom the Foundation could only proceed under section 562A of the *Corporations Act*. Recovery possibilities under a section 562A claim are much more limited than recovery under a claim against a direct insurer.
24. Finally, it should be noted that the insurance position reported by the Foundation is contradicted by the witness statement of Mr Richard Wilkinson of 12 July 2004 (**RCW1**). After reviewing the available evidence on the level of cover available to MRCF in the 1977 to 1985 period of exposure, Mr Wilkinson has valued this cover at a discounted

value of \$160.8m and an undiscounted value of \$333.6m: RCW1, [48]-[50]; see also Ex 252, App N, p 133 and Table 9.15. In the absence of other evidence, the Commission should find that the insurance recovery conclusions reached by KPMG Wilkinson (RCW1, [48]-[50]; Ex 252, App N, p 133 & Table 9.15) are reasonable and that they should be adopted.

ASBESTOS LIABILITIES OF THE FOUNDATION

25. The Commission received the statement of Mr Guy Whitehead (of Taylor Fry Actuaries) signed 23 May 2004 (Ex 251) and the statement of Mr Richard Wilkinson (of KPMG Actuaries Pty Ltd) signed 7 June 2004 (Ex 252) (***KPMG 2004 Report***) which was updated by RCW1 on 12 July 2004. Both the Whitehead and the KPMG 2004 reports review the Trowbridge Deloitte reports of the 1996-2003 period on the asbestos related liabilities of the Foundation.
26. The KPMG 2004 report provides an up to date actuarial assessment of Amaca and Amaba's asbestos liabilities. The assessment provided by KPMG was based on an exposure based model which was specific to the James Hardie exposure. Mr Whitehead agreed that the exposure based model was "preferable " to the approach adopted by Trowbridge (Ex 251, para 4.4.36). Mr Whitehead himself did not prepare a model. Nor does he purport to provide an actuarial assessment of Amaca and Amaba's liabilities. Rather, his report only provides comments on the approach taken by Trowbridge. The only issue of substance between Mr Whitehead and Mr Wilkinson is that Mr Whitehead appears to assert that it would be reasonable, when valuing the asbestos liabilities of Amaca and Amaba, to use an assumption of either 0% or 4% superimposed inflation, depending on what assumption is made about "a continuation of the existing legal environment": Ex 251 para 4.5.13.
27. The KPMG 2004 report assumed the future inflation of claims to be 6% per annum, comprising 4% per annum base inflation and 2% per annum superimposed inflation weighted over all future years: [9.3.6].

28. The Commissioner should prefer the approach adopted in the KPMG 2004 report. The selection of the superimposed inflation rate of 2% is justified in RCW1, [4]-[20]. First, the justification is offered by reference to the specific circumstances of the Foundation — age of claimants, historical levels of superimposed inflation, average cost of a mesothelioma claim, trends in MRCF’s share of liability in co-defendant cases: RCW1 [6]-[16]. Second, the justification is offered by reference to broader economic assumptions, such as the relationship between the superimposed rate of inflation and the discount rate (yield curve): RCW1, [17]-[18]. There was no corresponding justification or analysis for Whitehead’s assumption of an inflation rate of either 0% or 4%: cf Ex 251, [4.6].

Suggested “future asbestos related liability” figure

29. The overall result of the KPMG 2004 report’s valuation of the Foundation’s liabilities as at 30 June 2003 was for a discounted central estimate of \$1,573.4 million: Ex 252, [9.4.1]. These results were sensitivity tested at Ex 252, [9.4.2]. Mr Wilkinson would not change that central estimate having regard to the additional data to the end of May 2004: RCW1 [62]. The Commission should accept this amount to be the “future asbestos related liabilities” of Amaca and Amaba for the purposes of Term of Reference 1.