

Chapter 14 – The 15 February 2001 JHIL Board Meeting

A. Events prior to the Board Meeting

14.1 Very considerable activity took place in the period between the Board meetings of 17 January and 15 February 2001. Hardly surprisingly, there appears to have been some informal consultation with directors before that meeting and by 30 January at a meeting of executives of JHIL and advisers, Mr Baxter reported¹ that the directors:

- “• want certainty
- subject to comfort on numbers, moral reservations are softening.”

14.2 I have referred earlier to a Deed of Covenant and Indemnity being given by Coy and Jsekarb to JHIL in consideration of the additional funding. Its genesis appears to have been Mr Shafron’s email of 1 February 2001 to Mr Peter Cameron and Mr Robb in which he said:²

“Confidential and Privileged

I want to revisit this.

If we are being generous with Coy (and arguably we are, particularly if we hand across the 57) then that should support a waiver/indemnity in respect of Coy manufacture. If its a private document, then I wonder about disclosure – initially any way.

I could be that we ask the existing Coy directors to sign the docs (I guess with the benefit of some Allens/Allsop advice, if needed) and present it to the prospective directors as a fait accompli. With more cash than they thought they had, they shouldn’t complain (I doubt Bancroft would).

Obtaining the indemnity overcomes possibly the biggest question mark I have over this transaction (risk to JHIL). I would very much like to make it work.”

14.3 On the same day Mr Shafron advised Mr Attrill by email:³

¹ Ex 189, Vol 1, p. 187.

² Ex 148, Vol 1, Tab 13. “The 57” is a reference to the then current value of an assumed reversal of the \$43.5m dividend.

³ Ex 57, Vol 4, p. 974.

"A February 15 execution and announcement for the trust (stand alone) is firming very strongly in the betting. Please assess all aspects of work remaining. I will call you tomorrow to confirm definitively. In the meantime, not a moment to lose."

14.4 On the same day Mr Attrill emailed to Mr Shafron his draft of the regular Asbestos report to be included in the Board Papers for the February Board meeting.⁴ The draft contained no grounds for optimism as to the future. In relation to the Third Quarter results, it noted:

"Third Quarter 2001 Results

In the three months to 31 December 2000, settlement payments were \$7.6M which is a substantial increase over the second quarter's figure of \$4.7M, and is above the previous 12 months' quarterly average of \$6.3M. ...

Legal and consultancy costs in this quarter were \$1.3M, less than the second quarter at \$1.8M and lower than the previous 12 months' quarterly average of \$1.5M.

Insurance recoveries were \$0.4M (compared to \$3M for the previous quarter) and were below the 12 months' quarterly average of \$2.1M. The low recovery rate largely reflected the fact that a high proportion of the quarter's settlements fell within the QBE and earlier (uninsured) periods. ...

Overall, the total litigation-related costs for the quarter were disappointingly high at \$9.3M, and were substantially higher than the previous quarter (\$4.6M). This was due to much higher settlements and lower recoveries.

James Hardie received 51 new product and public liability claims (in line with the previous 12 months' quarterly average of 52 new claims) and 9 new workers claims (above the 12 months' quarterly average of 7 new claims). The monthly graphs, indicating trends in claims received, expenditures and disease type of new claims incorporating the three months to 31 December 2000 are attached."

It is perfectly apparent from the monthly graphs to which Mr Attrill referred, that the position in the *calendar* year 2000 had been significantly more than in previous years in each of the three respects dealt with by those graphs.

14.5 Mr Attrill noted⁵ in relation to the cost of resolution of claims:

⁴ Ex 57, Vol 4, p 976.

⁵ Ex 57, Vol 4, pp. 976–977.

“Case Issues

The third quarter saw a significant increase in very expensive settlements. In the second quarter of this year, James Hardie paid 56 claims, of which all but 2 cost less than \$300K each (and over half cost less than \$100K each). In the current quarter, James Hardie paid 46 claims, 10 of which cost more than \$300K each with 4 mesothelioma claims alone having a combined cost of \$2.7M. These four claims, which are reported in the table below, largely account for the increase in asbestos costs over the previous quarter.

Major asbestos-related settlements in 3Q01				
<i>Plaintiff</i>	<i>Age</i>	<i>State</i>	<i>Settlement / Award</i>	<i>Remarks</i>
Hope	51	Vic	\$500,000	<i>Claimed exposure to JHC AC products only in 1964–1970 while a builder in Victoria. ... Plaintiff sought \$1.3M plus costs. Case settled after first day of trial.</i>
Weller	48	WA	\$559,000	<i>School teacher in WA, claimed exposure to JHC AC sheet in 1964–1974 and 1979 while a builder’s labourer. Sought \$625,000.</i>
Edwards	57	NSW	\$803,000 plus costs	<i>Nurse in SA ... exposed to AC products in 1970–1980 while assisting father with home renovation work. Could not settle ...</i>
Turner	52	NSW	\$850,000	<i>Exposure to JHC AC as carpenter in 1965–1970. Sought \$1.3M plus costs.</i>

Unfortunately, it would appear that this year James Hardie can expect to receive a number of major claims in the final quarter, particularly mesothelioma claims brought by people who have not retired. As at 1 February 2001, we had notice of 15 claims, each of which could potentially settle for more than \$400,000. We would expect to settle many of these claims in the next three months.”

B. The Board Papers

14.6 The proposal to establish the Trust was the subject of detailed consideration in the Board Papers circulated for the meeting, to take place on 15 February 2001 at 9:00 am at PricewaterhouseCoopers in Sydney. Discussion on Project Green, according to the Agenda, was to commence at 11:00 am.

14.7 The Board Papers, as might be expected included a Project Green Board Paper dealing with the proposal.⁶ There was a covering document dated 5 February 2001 by Mr Macdonald which recommended the adoption of the proposal at that point. He commenced with a Summary which said:⁷

“We have developed a comprehensive solution to critical issues that James Hardie has been facing for over five years. The solution should be implemented now to

⁶ The document is set out in full in Annexure K.

⁷ Ex 75, Vol 8, Tab 119, p. 2735.

maximize potential improvements in shareholder value. Although the plan is not risk free, it is recommended as providing the best outcome from the alternatives that are possible.

The objective is to position James Hardie for future growth and to eliminate legacy issues that would otherwise continue to detract from value creation. Once fully implemented, a focused fiber cement growth company, with an appropriate financial structure, will be in place and legacy issues will have been removed.”

14.8 In the “Background” Mr Macdonald noted that James Hardie had been rationalizing its business portfolio over the last 7 years and that once it had disposed of its Australian window business it would be left with two business streams. He observed:⁸

“James Hardie has two ongoing businesses with significantly different investment characteristics leading to differing value perceptions by investors. James Hardie also has significant legacy issues surrounding asbestos product manufacturing activities of some subsidiary companies. To date, the company has not succeeded in implementing a combined solution to these issues.”

14.9 The proposal then advanced had three elements:

- (a) the establishment of the trust – “Separation from Legacy Issues”
- (b) the ongoing fibre cement business, and a proposal to dispose of the gypsum business – “Portfolio”
- (c) a Netherlands company to be the principal company of the Group, with a Netherlands finance subsidiary to be the financier of all the operating companies – “Financial Restructuring”.

14.10 In relation to the trust proposal, the paper said:⁹

“i. **Implement Separation by creating a Foundation now.** Attachments A & B detail the proposal to separate JHIL from JH & Coy and Jsekarb. Providing that the prospective Foundation directors agree to take up director positions at a final review meeting on Tuesday 13 February, it is recommended that the JHIL Board agree to the creation of the Foundation at its Thursday, 15 February meeting for announcement, together with JHIL’s Q3 results, on Friday, 16 February.”

⁸ Ex 75, Vol 8, Tab 119, p. 2735.

⁹ Ex 75, Vol 8, Tab 119, p. 2737.

14.11 The paper's Conclusion was that:¹⁰

“James Hardie needs to act now. Delaying creation of a Foundation past financial year end significantly increases the risk of ED 88 complications. Latest intelligence is that ED 88 will be promulgated before the end of this financial year and that CSR will significantly increase its asbestos provisioning by early adopting ED 88 and disclosing details at its full year results announcement in May. While it is possible to delay exploration of a Gypsum exit, this is not recommended. The proposed timing is suitable and a Gypsum exit would provide a compelling commercial justification for a financial restructuring as a significant portion of James Hardie's assets would be being sold and debt would need to be re-financed.”

14.12 The passages to which I have referred clearly were intended to create the impression of a need for urgency in deciding upon the proposal. They reflect my overall impression of the evidence of and relating to Mr Macdonald and Mr Shafron, namely that the issue had gone unresolved for too long, that the newer management team under Mr Macdonald had found a way to resolve it, that that way should be agreed to by the Board and that the impending implementation of ED 88 made it highly desirable to do so sooner rather than later.

14.13 There was nothing inherently wrong in the presentation of these views by management to the Board. Management, in my opinion, is entitled, sometimes obliged, to put its views to the Board in strong, or persuasive, terms and management is entitled to have the Board consider those views. Mr Macdonald too was a member of the Board and the Chief Executive Officer. What is striking, however, is the absence of any substantive discussion in the Paper on the actual amount of the asbestos liabilities. In Mr Macdonald's covering observations the only reference to the adequacy of the funding of the Foundation is in the following passage:¹¹

“ ... James Hardie and Coy Pty Ltd and Jsekarb Pty Ltd, two subsidiaries which formerly produced asbestos bearing products and are currently subject to plaintiffs actions on account of injuries caused by asbestos, have current and potential liabilities that have the potential to exceed their net worth. This does not create an obligation for JHIL to meet any shortfall. It is recommended that the shares of these two companies be vested to a Foundation to manage the companies' assets in the interests of current and future creditors. It is also proposed that an additional sum be paid over time (NPV \$70M) to JH & Coy in return for an indemnity and covenant not to sue JHIL and an agreement to take JHIL if it is put to it in the future with no subsidiary companies.”

¹⁰ Ex 75, Vol 8, Tab 119, p. 2738.

¹¹ Ex 75, Vol 8, Tab 119, p. 2735.

14.14 Attachment A to Mr Macdonald's paper dealt with "Separation Issues". The paper, in dealing with "Payment to JH & Coy/Jsekarb and Obtaining Indemnity", dealt only with whether the directors of JHIL had "a sound basis to be comfortable with the decision"¹², to receive the indemnity from Coy/Jsekarb in return for the additional funding. The only discussion in Attachment A of the actual *adequacy* of the Foundation's funds is again in relation to directors' duties and protections:¹³

"Director Risk and Protections

The decision to create the Foundation is not harmful to existing or future creditors' interests – in fact, it is beneficial. This is because of:

- additional capital being injected;
- funds committed to medical research;
- the entrenchment of Coy assets for the benefit of future claimants; and
- no change to the JHIL capital structure.

As a result, there is no valid basis for attack on directors from claimants.

The decision to create the Foundation does involve writing down a substantial JHIL investment, and the incurring of an additional liability to JH & Coy. These decisions require careful consideration of shareholder interests – discussed above. In addition, the balance sheet and cash flow impact on JHIL of creating the Foundation will not prejudice the interests of JHIL's creditors.

It follows that individual directors need not feel dependent on the protective mechanisms available to them. However for completeness, those protections include:

- deeds of indemnity from JHIL (recently revised and reissued);
- D & O insurance that protect directors against such issues if decisions are made in good faith; and
- Legal advice.

The Australian advice consists primarily of the Allsop opinion. US advice (... from Shea and Gardner in Washington DC), has also been received to the effect that:

- The Foundation concept is a good one.

¹² Ex 75, Vol 8, Tab 119, p. 2739.

¹³ Ex 75, Vol 8, Tab 119, pp. 2740–2741.

- JHIL is being generous, by the standards of the law.
- With a potential life of at least around 15 years, JHIL should have no reason for concern.
- There are no issues for US based directors.
- Because JHIL is being generous, it should give more thought to getting a private contractual undertaking from JH & Coy not to sue and to indemnify JHIL (done).
- The main problems with US trusts have been that plaintiffs control the creditors committee, and pay out way too much, too soon – not the position here.
- Other kinds of US “solutions” invariably involve rump companies being left with insufficient assets even to cover the filed claims (e.g. GAF) – not the position here.
- North American companies, that pay creditors for a long time, then go into liquidation quietly, often do not cause a ripple (e.g. Cassiar).
- What JH is proposing is “much safer” than the approach taken by US companies seeking to separate from their asbestos liabilities.
- If JH & Coy runs out of money one day, and there are unsatisfied US claims, then suits against the US subsidiaries are possible. There is no need for concern however (except for legal costs) because such claims would have no basis in law.”

14.15 The Attachment referred also to two additional proposals for insurance which had been received.¹⁴ Neither was recommended.

14.16 In addition the Attachment noted:¹⁵

“Risk

The main risks to the creation of the Foundation are political and legislative. The exposure to JHIL post separation, e.g. break through suits, or nuisance suits by JH & Coy or third parties, is substantially reduced by the JH & Coy covenant not to sue and the indemnity. A further discussion of political and legislative risk and the communication strategy is set out in Attachment A & B.

While the creation of the Foundation does not trigger any positive requirement for Trowbridge disclosure in the accounts or elsewhere nor create any issues for the directors of the impact on JHIL’s creditors, pressure to disclose may arise as a result of political/market pressure and both issues will be of concern in the Court scheme meeting if and when stage 2 progresses.”

¹⁴ Ex 75, Vol 8, Tab 119, p. 2745.

¹⁵ Ex 75, Vol 8, Tab 119, p. 2745.

14.17 Attachment B was the “Communications Strategy”. Its “Recommendation” was expressed as follows:¹⁶

“Recommendation

We believe that our communication strategy will deal effectively with the numerous risks involved in executing the separation proposal and that therefore the separation proposal can be implemented as recommended. We have formed this view because:

- there is a strong legal and business case for separation
- there are clear benefits for shareholders
- the position of creditors is significantly enhanced
- there is no valid basis for government intervention
- we have identified and understand the major stakeholder risks
- we have developed a comprehensive plan to neutralize those risks

Our analysis of risk includes ‘worst case’ scenarios. We have strategies to deal with them and believe these strategies will be effective.”

In the event, of course, the adoption of these strategies had some limited success. Nothing happened to disturb the effects of separation for the first few years after it occurred.

14.18 The “Recommendation” part of the Communications Strategy then, correctly in my view, identified the “central communications conundrum” as being that¹⁷

“... we will not be able to provide key external stakeholders with any certainty that the funds set aside to compensate victims of asbestos diseases will be sufficient to meet all future claims.”

It was also noted in the same part that:¹⁸

“In short, we believe opposition from stakeholders could be significant and that their major questions will be:

- will the funds set aside be sufficient to meet all future claims?

¹⁶ Ex 75, Vol 8, Tab 119, p 2747.

¹⁷ Ex 75, Vol 8, Tab 119, p. 2745.

¹⁸ Ex 75, Vol 8, Tab 119, p. 2745.

- what will JHIL do if those funds are insufficient?
- what will be the fate of victims if the funds are insufficient?"

14.19 The Communications Strategy then dealt in very considerable detail with the “Key Working Assumptions” (Section 1), “Risk Analysis” (Section 2), “The Communications Strategy” (Section 3), “Key Messages” (Section 4), “Draft Questions and Answers” (Section 5), a “Communications Strategy for the Medical Research and Compensation Foundation” (Section 6), “Key Messages for the Foundation” (Section 7) and “Foundation – Questions and Answers” (Section 8).

14.20 I will not discuss these Sections in detail, but I would simply draw attention to the following features:-

- (a) Direct intervention by government was recognised as the most significant risk: Section 2.1. A great deal of the implementation of the Strategy was directed to avoiding that possibility: Sections 2.1.3, 3.5.
- (b) The timing of the separation announcement was to coincide with the announcement of JHIL’s third quarter results, so that the establishment of the Foundation would be a “business” story: Section 3.1. The aim was “to confine the story to its business context”: Section 3.4.
- (c) The question of “uncertainty” could be used to advantage by treating separation as meaning “there will be greater certainty than has ever before ... we can argue that it is uncertain that JH will exist in 5, 10 or 20 years but that separation provides much greater certainty that funds will be available to compensate victims past these time periods than if JH was merged into another company”: Section 3.0. See too the eighth and ninth of the Key Messages in Section 4.0.
- (d) Mr McGregor and Mr Macdonald, it was suggested, should undergo intensive media training in the week prior to the announcement, to

“rehearse our agreed key messages and the Q&A in simulated interview situations”: Section 3.4.

- (e) The “Q&A” were the draft Questions and Answers in Section 5.0. Perhaps not too much emphasis should be put on them, because they were a work in progress, but it is clear that they recognise that the issue which would attract particular interest would be whether the Foundation’s assets could meet all future claims: see Questions 1, 2, 3, 4, 5, 9, 12, 13, 15, 21.
- (f) The Foundation’s communications strategy should be the same as that of JHIL, “i.e. shut the story down as quickly and effectively as possible”: Section 6.4.

14.21 What is obvious from the proposals in Attachment B was that the implementation of it from the JHIL point of view was then to avoid any statement to the effect that the Foundation would have sufficient funds to meet legitimate asbestos claims against Coy or Jsekarb. To the extent to which any statements along those lines might be made, they would derive from the Foundation: see Questions 5, 6, 7, 8, 9, 10, 11, 13, 19. In the event, the JHIL Media Release of 16 February 2001 did make statements to this effect.

14.22 Attachment C to the Board Papers dealt with the sale of the gypsum business, and Attachment D with “Financial Restructuring”. Attachment D was expressed to be a summary of the paper presented to the November 2000 Board meeting. Attachment E was headed “Alternatives Considered”. It referred, in the “Introduction”¹⁹, to the fact that:

- “ • JHIL has a number of issues it has been considering over a number of years, including:
 - ⇒ structural inefficiencies
 - ⇒ asbestos-related liabilities
 - ⇒ portfolio initiatives, the latest being the ongoing relevance of James Hardie Gypsum

¹⁹ Ex 75, Vol 8, Tab 120, p 2797.

- Numerous alternatives to address these issues have been investigated in detail but no alternative has provided an ideal solution with an acceptably low level of execution risk.”

14.23 The paper then proceeded to identify the recommended solution as follows:²⁰

- “ • The recommended solution, which is detailed in the Board paper to which this discussion paper is attached includes:
 - ⇒ achieving separation from asbestos liabilities through the creation of the Foundation which would hold JH & Coy and Jsekarb for the benefit of asbestos-related claimants;
 - ⇒ testing the value implications of the sale of James Hardie Gypsum;
 - ⇒ restructuring, subsequent to the separation, to achieve a more efficient corporate structure, involving a Dutch ultimate holding company that would be ASX and NYSE listed.”

14.24 It referred to other possibilities as being:²¹

- “ • The next best alternative is considered to be combining separation and the restructure. This alternative is considered in detail in this paper but has a number of issues. While each of these issues can be addressed separately by different implementation methods and features, all variables have unattractive aspects
 - ⇒ the most attractive variable is to implement the separation and restructure (sic) by a scheme of arrangement but delaying the NYSE listing of the new holding company
- Other alternatives that have been considered in the past and have been revisited briefly in this paper for completeness are:
 - ⇒ business as usual (“BAU”)
 - ⇒ restructure but no separation
 - ⇒ other alternatives to separation
 - ⇒ sale of James Hardie through a takeover by a third party or an LBO / MBO.”

and said that the purpose of the paper was “to review these alternatives prior to making a decision whether to proceed with the preferred alternative (separation only initially).”

²⁰ Ex 75, Vol 8, Tab 119, p. 2797.

²¹ Ex 75, Vol 8, Tab 119, p. 2797.

14.25 It is unnecessary to deal in detail with the discussion of all the alternatives. I would mention, however, that the discussion of “Business as Usual”²² emphasised that that state of affairs should not continue:

“2. Business As Usual

- Inefficient capital structure
 - ⇒ average tax rate will continue to rise
 - ⇒ significant withholding tax to maintain dividends
 - ⇒ could consider cutting dividends and reinvesting earnings
- Ongoing uncertainty relating to asbestos
 - ⇒ certain parties will not invest (e.g. some US funds)
 - ⇒ management distraction managing and explaining to other parties (e.g. debt providers)
 - ⇒ issue exacerbated by the introduction of ED88 (effective by 30 September 2002 balance date)
 - ⇒ poison pill for potential corporate acquirers
 - ⇒ further growth may reduce extent of the issue (unlikely should the issue grow)
- Significant ongoing management distraction
- This is not an acceptable outcome.”

14.26 A similar theme appears in the discussion of “Alternative to Separation”:²³

“4. Alternatives To Separation

- There are several alternatives that may be employed to address the asbestos issue other than separation:
 - ⇒ aim to stop the noise
 - possible independent Board/management to reduce JHIL/NV board involvement
 - careful program to address the issues – educate investors
 - unlikely to be successful
 - ⇒ insurance takeout
 - loss portfolio transfer
 - stop loss cover (e.g. Turner & Newall)

²² Ex 75, Vol 8, Tab 119, p. 2803.

²³ Ex 75, Vol 8, Tab 119, p. 2805.

very expensive (with figure expected to continue to increase)

- ⇒ provision to actuarial figure
 - expected to be required by ED88 by September 2002 balance date (allows for discounting)
 - also required under US GAAP (does not allow for discounting – i.e. larger number)
 - expected negative market reaction (may not be in proportion to the figure disclosed)
- ⇒ continue to grow the business and “dilute” the issue
 - separation funds used to accelerate growth?
 - unlikely to hide the issue – investors are aware of it and paranoid given worsening US experience
- None of these solutions successfully addresses the asbestos issues, or is considered a viable alternative
 - ⇒ business will continue to have to report asbestos numbers
 - ⇒ investors will continue to discount the share price
 - ⇒ poison pill will remain – preventing or severely hindering corporate activity.”

14.27 The Board Papers also included a letter of advice from Allens in which the advantages and disadvantages of the preferred option were discussed. Mr Cameron and Mr Robb, who gave the advice, preferred the second option (separation and restructuring combined), and concluded:²⁴

“In summary, we believe the preferred option can be effected lawfully. To do this, the directors of both JHIL and JH & Coy will need to properly view the transaction as being in the interests of each respective company. The two sets of directors should be considering these issues at arm’s length and with the benefit of advice. You have asked us to confirm whether we support management in its approach, noting that this proposal has the support of each management team member and your financial advisers. We acknowledge the key commercial drivers against a business as usual approach and against the execution risk and the direct disclosure versus delay decision that arise under the other option. We agree that management and the board have grounds to support the view that the commercial benefits of the preferred approach, with its staggered separation and the disadvantages discussed above, outweigh the costs of delay and heightened execution risk of the second alternative. That said, as lawyers, we consider that the cleaner and more concrete legal result (and that effects both separation and restructuring) is achieved through the second option, albeit at a higher risk of achieving the Foundation alone (at stage one of the preferred option). Finally, we suggest that, for the benefit of all concerned, we seek James Allsop’s views on this proposal in light of all current information.”

²⁴ Ex 75, Vol 8, Tab 119, p. 2809.

14.28 The material before the Board also included the “Asbestos” summary prepared by Mr Shafron and Mr Attrill. It was in relevant respects in the same form as Mr Attrill’s draft to which I have earlier referred.

14.29 What is noteworthy about all the material contained in the Board Papers is that it was recognised that the principal challenge to the implementation of the proposed scheme would come if there was a public perception that the money being made available to the Foundation was insufficient to meet future claims, and elaborate steps were proposed to avoid that perception being adopted. Yet nothing was contained in the Board Papers which would provide any satisfactory basis for identifying what those liabilities might be. One gains the clear impression from the Board Papers that the Board was being urged to go ahead with separation, to bite the bullet and get it over with, whatever might be the likely true level of such liabilities.

C. The Meeting

14.30 The PowerPoint presentation to the Board²⁵ at the 15 February 2001 meeting contained five sections:

- Section 1 Introduction
- Section 2 Separation
- Section 3 Portfolio – Gypsum
- Section 4 Financial Restructuring
- Section 5 Recommendation and Timing

14.31 Section 1 identified the “Actions being sought” as follows:²⁶

“Actions being sought

- ◆ Approve the immediate establishment of the Foundation
- ◆ Approve commencement of the sale process to test value of gypsum (sale subject to Board approval if acceptable bids are received)
- ◆ Continue to progress restructuring preparation for Board approval in May”

²⁵ Ex 75, Vol 8, Tab 123, p. 2841.

²⁶ Ex 75, Vol 8, Tab 123, p. 2843.

14.32 The “Background” was described in by now familiar terms as:²⁷

“Background

JHIL has a number of significant issues that it has been considering over a number of years, including:

- ◆ Financial structure
 - current structure is inappropriate and inefficient
 - failure to address this issue will result in an increasing average global tax rate (from approximately 30% in 2001 to approximately 40% in 2004) and lower returns to shareholders
- ◆ Asbestos issues
 - lack of transparency – earnings and balance sheet distortion
 - management distraction
 - investor uncertainty (associated with US experience)
 - difficulty in raising new equity to fund growth initiatives
 - barriers to participating in corporate activity (poison pill)
- ◆ Market’s perception of JH as a cyclical building materials company
 - due to gypsum
 - ratings benefit from high growth focussed fibre cement business not fully received”

14.33 A comment made on the Recommended Solution was:²⁸

- “ • Provides a comprehensive solution to critical issues that have been confronting JHIL for over 5 years.”

14.34 In Section 2, under the heading “Foundation Update” a question was posed “What has changed since the last Board meeting?”, the answer given being:

- “ ◆ Increased funding available to JH&Coy in exchange for indemnity and waiver to JHIL
- \$112m over time / \$72m NPV of additional funding
- ◆ Foundation directors have signed on
- ◆ Detailed review of funding indicates that it is manageable
- ◆ Additional \$1m to support proposed Asbestos Diseases Research Institute (ADRI)
- emphasises that JHIL is not walking away
 - provides a seat at the table to keep abreast of developments
- ◆ Gross assets should be sufficient for future claims.”

²⁷ Ex 75, Vol 8, Tab 123, p. 2844.

²⁸ Ex 75, Vol 8, Tab 123, p 2846.

14.35 The last point there mentioned seems the first *positive* suggestion that the funds of the Foundation, augmented by the additional funding proposed to be made available, “should be sufficient for future claims” in the sense that the total of the assets of Coy and Jsekarb, with the money to be payable under the Deed of Covenant and Indemnity, could cover the amount of future claims.

14.36 In Section 2, the “Summary of key issues for consideration”²⁹ said that they included:

- “ ♦ Foundation establishment
- ♦ Quantum of funds contributed
 - foundation life expectancy
- ♦ JHIL and JH & Coy / Jsekarb relationship post-separation
- ♦ JHIL Directors’ decisions
- ♦ JH & Coy and Jsekarb Directors’ decisions
- ♦ Financial effects of separation
- ♦ Positioning / key stakeholder messages
- ♦ Market reaction.”

14.37 When dealing with “Fund life expectancy/sensitivity”, it was said:³⁰

- “ ♦ Trowbridge analysis revised:
 - same basic assumptions as previously
 - higher claim numbers predicted
 - predicted future cashflows
- ♦ Future funds availability depends on:
 - Trowbridge cashflows (“most likely”)
 - asset classes (land, debt, and invested cash)
 - assets earnings (some known and some predicted)

JH modelling³¹

- ♦ Key assumptions
 - Trowbridge actuarial data
 - earnings on investment portfolio 11.7%
 - JHIL loan 8.13% p.a. return
 - running costs of \$2.4m p.a.
 - inflation
 - 3% p.a. rent, running costs
 - 4% p.a. litigation costs

²⁹ Ex 75, Vol 8, Tab 123, p. 2851.

³⁰ Ex 75, Vol 8, Tab 123, p. 2854.

³¹ Ex 75, Vol 8, Tab 123, p. 2855.

- no tax paid (no realisation of investment earnings in early periods)
- land increases in value by 3% p.a., buildings not depreciated, though \$1m p.a. sinking fund
- properties disposed of in 2025 at carrying value
- ◆ Surplus most likely outcome
- ◆ Analysis reviewed by PWC and Access Economics.”

This material derives from the February 2001 Trowbridge Report and the financial model described as the “Twelfth Cash Flow Model”.

14.38 The presentation also included a lengthy “Update on Board paper”,³² which was summarised as follows:³³

“Update on Board paper

- ◆ Since we issued the Board paper, we have continued to investigate and analyse the key risks and fine-tune our key messages and strategy
- ◆ This analysis has included further discussions with communication advisors and new discussions with advisors brought on board in the past 10 days (see over)
- ◆ As the details of the separation model have evolved, we and our advisors have become much more confident in our ability to ‘sell’ the proposal to external stakeholders
- ◆ We have also been able to strengthen and simplify our key messages and believe that we now have powerful arguments in support of our case
- ◆ We have undertaken intensive media training to road test our Q&A and are confident we have credible selling messages which are reinforced by an array of supporting facts and figures.”

14.39 The “advisors brought on board in the past 10 days” appear to have been Mr Loosley, Mr Gary Gray and Mr John Denton. Mr Loosley’s advice was said to have included:

- “ • Counseled us to strengthen the adequacy of funding so that we could argue that the most likely outcome was that all claims would be met.”³⁴

Mr Gray:

- “ • Strongly suggested that independent third party endorsements were needed, such as supporting actuarial advice.”³⁵

³² Ex 75, Vol 8, Tab 123, pp. 2863–2881.

³³ Ex 75, Vol 8, Tab 123, pp. 2863.

³⁴ Ex 75, Vol 8, p. 2864.

³⁵ Ex 75, Vol 8, p. 2865.

Mr Denton's advice does not appear to have dealt with the level of funding.

14.40 It was said that there had been on the Tuesday, i.e. 13 February, a briefing of the chiefs of staff of the New South Wales Premier and Industrial Relations Minister.

14.41 The presentation then listed the Key Messages to be presented to the public:³⁶

“Key messages

- ◆ JH has effectively resolved its asbestos liability for the benefit of shareholders and claimants
- ◆ A new, independent Foundation has been established to manage JH's liabilities, compensate people injured by asbestos and fund medical research
- ◆ The Foundation's assets will be used solely for compensating people with asbestos diseases
- ◆ The Foundation expects to have enough funds to pay all claims
- ◆ The position of claimants is substantially improved because the Foundation provides much greater certainty that compensation will be available to meet all future claims
- ◆ The position of shareholders is also substantially improved because the company's results and financial strength will no longer be affected by asbestos costs.”

14.42 The fourth and fifth of those “Key Messages” were, in fairly clear terms, assertions which were to be made to the public that there was an expectation that the Foundation was expected to have enough funds to pay all claims.

14.43 The Board minutes record that at the meeting of directors:³⁷

“The Chairman tabled a Board Paper explaining the proposed transaction and the Board discussed this paper along with the Board Paper for January's meeting (which discussed in greater detail the objectives and rationale for effecting the Coy and Jsekarb Separation). The Chairman tabled legal advice from Mr JLB Allsop SC dated 14 February 2001.

The Chairman tabled a financial model (incorporating certain legally privileged materials) which set out forecast Coy and Jsekarb assets and cashflows and which indicated that there was likely to be a surplus of funds in the Foundation group when available assets, likely earnings rate, and likely future claims and costs were considered (Financial Model).

³⁶ Ex 75, Vol 8, Tab 123, p. 2869.

³⁷ See Ex 75, Vol 8, Tab 118, p. 2719. The minutes are set out in Annexure L.

The Chairman then tabled a draft valuation report from Grant Samuel and Associates Pty Ltd (Valuation Report) which valued the Company's holding in Coy at zero (prior to payments to be made under the Indemnity).

The Meeting discussed the legal and financial issues concerning the amount being paid under the Indemnity, based on actuarial assessments carried out, the Financial Model, and legal advice received."

14.44 It will be seen that the discussion, to the extent to which it is recorded, is said to have referred to:

- (a) the Trowbridge actuarial assessments (described in the Minutes as "certain legally privileged materials" incorporated in the financial model and "actuarial assessments");
- (b) the financial model; and
- (c) the amount being paid under the Deed of Covenant and Indemnity.

14.45 Mr McGregor's³⁸ recollection of the Meeting and relevant issues arising in his cross-examination included:

- (a) Mr Morley addressed the Board on funding and the expected life of the Foundation and spoke to the Project Green Board Presentation – February 2001³⁹. Mr Morley explained that the model was based on actuarial estimates provided Trowbridge and the Board was informed (by either Morley or Mr Shafron) that a revised report had been obtained from Trowbridge, which took account of recent data published by Trowbridge. Graphs were shown, high, middle and low, representing different estimates by Trowbridge and the Board

³⁸ According to Mr McGregor, the JHIL/JHI NV Board typically operates by reaching a consensus in which all directors agree and he does not recall any occasion on which a matter had been put to a formal vote. In a typical meeting, management will present papers or proposals, which the Board then discusses. Directors will ask questions of management and consider the views of different directors. "A consensus normally develops during the course of the Board's discussion and towards the end of the discussion, I will sometimes state what I understand to be the consensus reached by the Board" McGregor, Ex 80, pp. 3–4, para. 20. I note that Mr McGregor resigned as Chairman of JHI NV on 11 August 2004.

³⁹ Ex 80, Tab 7, pp. 153–208 at p. 168.

was advised that Trowbridge considered the middle curve was the most likely projection.⁴⁰

- (b) During the presentation either Mr Shafron or Mr Morley was asked whether Trowbridge had taken into account the December quarter claims figures, which showed a higher than expected claims expenditure and the answer was given that the question had been raised with Trowbridge and Trowbridge had said that one quarter's figures would not disturb a trend based on years of data.⁴¹ No report from Trowbridge was tabled.⁴² Mr Morley said that he had obtained information about earnings rates from Towers Perrin and Mercers⁴³ and "had obtained advice from PricewaterhouseCoopers and Access Economics on the structure of the model".⁴⁴
- (c) The essence of Mr Morley's presentation was that when the Trowbridge numbers represented by the low curve Trowbridge were used, the model suggested a large surplus; when the Trowbridge numbers representing the middle curve were used, the model suggested a small surplus, and when the Trowbridge numbers representing the high curve were used the model had sufficient funds to meet claims for around 20 years.⁴⁵
- (d) Mr Peter Cameron, who was in attendance at the meeting, emphasised that the directors needed to be conscious of their responsibilities as directors under the Corporations Law, and that directors could not provide the trust "with more than that for which JHIL was legally responsible, without honestly believing that ... what we were doing was of benefit to JHIL's shareholders."⁴⁶

⁴⁰ McGregor, Ex 80, p. 5, para. 28.

⁴¹ McGregor, Ex 80, p. 5, para. 29.

⁴² McGregor, Ex 80, pp. 5-6, para. 30.

⁴³ Mr McGregor said he had no reason to doubt that the information represented an appropriate basis for determining a reasonable rate of return, namely 11.7%; McGregor, Ex 80, p. 6, para. 31.

⁴⁴ McGregor, Ex 80, p. 6, para 32.

⁴⁵ McGregor, Ex 80, p. 6, para 33.

⁴⁶ McGregor, Ex 80, p. 7, para. 42.

- (e) Mr Morley justified the 11.7% earnings rate to the Board by explaining “ ... that he had sought records of results for funds from different organisations that recorded these things – I think InTech was one, and Mercers, and ... also sought advice on earnings rates from Towers Perrin, I think, advice on something from UBS for what the indices had been over various periods of years and the rate he took at 11.7% was lower than most, if not all, on those rates.”⁴⁷
- (f) In cross-examination Mr McGregor stated that Mr Morley had not told him that Access Economics had been asked to omit any comments on the high nature of the earnings rate.⁴⁸ Mr McGregor was not aware of the request to PricewaterhouseCoopers to omit a reference in their advice as to whether the earnings rate should be the subject of independent advice.⁴⁹
- (g) Mr McGregor said that he was not aware of Access Economics and PricewaterhouseCoopers being specifically asked not to examine assumptions such as the earnings rate.⁵⁰
- (h) Previous Trowbridge reports had not been given to the JHIL Board.⁵¹ Rather, “summary findings” were given by the relevant responsible officer.⁵²

14.46 Mr Macdonald’s recollection of the discussions during the meeting included the following:⁵³

⁴⁷ McGregor, T 1573.29–39.

⁴⁸ McGregor, T 1573.41–45.

⁴⁹ McGregor, T 1573.47–52.

⁵⁰ McGregor, T 1574.16–21.

⁵¹ McGregor, T 1442.6–10.

⁵² McGregor, T 1442.10–15.

⁵³ Macdonald, Ex 148, p. 11-12, para. 47. Mr Macdonald stated that he did not see the PricewaterhouseCoopers letter or the Access Economics letter on or before 16 February 2001. However, he “... was aware that PricewaterhouseCoopers and Access were not providing advice on future earnings rates”. He was “not aware of any other limitation to the scope of their advice and understood that they had advised that the model was suitable for its purpose for which it was being used” and did not believe that the advice was limited to checking the arithmetic accuracy of the model”; Ex 308, p. 8, paras 43–44. Mr Macdonald said at all times he believed that “the cash flow model was suitable for use in assessing what level of funding would be appropriate to fund future

- (a) Sir Llew Edwards's contribution to the meeting before withdrawing was to the following effect:

"We think James Hardie has been generous in its funding to the Foundation. My fellow directors and I are happy for the fact to be known."⁵⁴
- (b) Mr Morley gave a presentation, which demonstrated that JHIL could not afford to repay its existing debt to Coy and "purchase the indemnity in a lump sum". He presented a proposal which included a series of indemnity payments and a staged repayment of JHIL's debt to Coy;
- (c) Mr Morley discussed ("at considerable length") the rationale for selection of the earnings rate used in the model. Mr Morley said that he and Mr Harman had selected equity market earnings rates as being the most appropriate for the funding model as the model showed that cash flow from such earnings together with the other sources of income would "provide all the cash required by the Foundation" for "around 25 years".
- (d) The earnings rate selected was discussed by Mr Morley at "significant length" with a number of directors who were, according to Mr Macdonald, more experienced than he was in relation to "financial matters". There was also discussion of lower earnings rates, such as "the risk free rate and the rates that might be selected by actuaries."⁵⁵
- (e) "Mr Morley explained how he and Mr Harman had selected a rate of 11.7% pa as being a reasonable rate that was a 20% or so discount to

anticipated claims". He did not "... hear either Mr Morley or Mr Harman express any view to the contrary"; Macdonald, Ex 308, p. 8, para. 43. See also para. 24.23 above.

⁵⁴ Macdonald, Ex 148, p. 11, para. 44.

⁵⁵ Macdonald, Ex 308, p. 9, para. 47. Mr Macdonald could not recall whether he saw the Mercer Investment Consulting Survey (Ex 121, Vol 7, Tab 121, pp. 2925–2928) at that time but if he did he would have considered the disclaimer to be of a standard form. "They (sic) would not have caused me to doubt the reasonableness of the cash flow model and the earnings rate used in the model"; Macdonald, Ex 308, p. 9, para. 48.

the equity market rate being reviewed. It was explained that this was equivalent to a 7.6% pa after tax return for most tax payers.”⁵⁶

- (f) “Ultimately, the Board accepted the logic of the cash flow model and the reasonableness of the earnings rates.”

14.47 Mr Macdonald stated that as at 15 February 2001 he had not read any of the Trowbridge reports.⁵⁷ Mr Macdonald’s evidence in relation to the meeting tended to be self-serving, especially his statement (Exhibit 308) of 12 July 2003. This was a statement admitted into evidence after Mr Macdonald had completed his oral evidence.

14.48 In cross-examination, Mr Peter Cameron recalled that there was no indication given to the Board before the 15 February 2001 meeting that experience could vary considerably from actuarial estimates.⁵⁸

14.49 Mr Harman, who was also in attendance at the meeting, could not recall drawing the Board’s attention to the limitations of the model or the issues raised by Access Economics and PricewaterhouseCoopers.⁵⁹ Mr Harman had discussed PricewaterhouseCoopers’s recommendation that the earnings rate be subject to independent assessment with Mr Morley but he did not know whether Mr Morley discussed this matter with others.⁶⁰

D. Board Resolutions

14.50 The Board in the event resolved:

- “ (a) in order to achieve the benefits to the Company as outlined in the Board Paper and the January Board Paper and discussed at the Meeting;
- (b) given the detailed consideration of management and the Board proposal and to the alternatives;
- (c) on the basis of the various advices received from legal, actuarial, accounting, taxation, public relations and strategy advisers; and

⁵⁶ Macdonald, Ex 308, pp. 8–9 para. 46.

⁵⁷ Macdonald, T 2466.28–30.

⁵⁸ P Cameron, T 3047.21–41.

⁵⁹ Harman, T 1305.6–23.

⁶⁰ Harman, T 1305.25–36.

- (d) having regard to the profit and loss, balance sheet and cash flow position of the Company following the Coy and Jsekarb Separation,

The Board considers that it is in the best interests of the Company to effect the Coy and Jsekarb Separation.”

14.51 The meeting also approved the ASX announcement to be made by JHIL.

Chapter 15 – The 1996, 1998 and 2000 Trowbridge Reports

A. Introduction

15.1 The actuarial assessments carried out by Trowbridge before separation have been the subject of a great deal of evidence and contention. These are four such reports, namely:

- (a) that dated 10 October 1996
- (b) that dated 10 September 1998
- (c) that dated 16 June 2000. (This report is described as a “draft” but, as I find below, it was for all practical purposes, complete. It suited JHIL to treat it as a draft—it could be disavowed if JHIL wished to do so.¹)
- (d) that dated 13 February 2001. (There are two versions, the later identifiable by its specific reference to the 2000 Trowbridge Report.)

15.2 In this Chapter I discuss the first three.

15.3 So far as it appears from the evidence, whilst the JHIL Board had received extracts from Trowbridge Reports, no member of the Board (Mr Macdonald included) had, as at February 2001, ever read the 1996 Trowbridge Report, the 1998 Trowbridge Report or the 2000 Trowbridge Report.² Nor does any member of the JHIL Board (again including Mr Macdonald) appear to have seen, prior to separation, a copy of either version of the February 2001 Trowbridge Report.

15.4 This seems extraordinary. Of course a company director is not required to read the base material for every decision coming before the Board, but separation was regarded as a highly important matter, one thought vital to the future of the Group.

¹ T 1729.44–1730.17

² Macdonald, T 2466.28–.30, T 2495.38–2496.9, T 2583.13–.22 and T 2584.7–.41 and McGregor T 1475.29–.33.

15.5 How to effect it satisfactorily had been a question discussed by the Board, and by management, for years. Surely at least one director might have actually read the Report which was said to indicate the level of the asbestos liabilities. It was one of the two core inputs into the Twelfth Cash Flow Model.³ It is not that in dealing with separation, the Board did not condescend to matters of detail. That is clear from looking at the material which was before the Board – in what frankly seems inordinate detail – on the public relations aspect of separation.

B. First attempt at assessment

15.6 The first professional actuarial assessment of present and future asbestos liabilities was not obtained by JHIL or Coy until 1996. There had been an earlier attempt at an assessment of those liabilities, prepared in April 1992 by JHIL's then solicitor, Mr M J Knight⁴. The calculation prepared by Mr Knight was aptly described by him as a "conjecture". It appears to have assumed an average mesothelioma latency period of 20 years and a peak of claims in 1992–1995. His "best intuitive guess" of James Hardie's future total exposure was \$40–45m (in 1992 dollars), before insurance. His report is perhaps of most interest because he noted the very different view of CSR, which predicted a litigation peak in 2000–2010.

C. 1996 Trowbridge Report

15.7 The first report from Trowbridge was an "Initial Review" dated 5 June 1996, addressed to Mr Michael Rose at Allens. It said that it provided a "first cut" at estimating liability.⁵ It estimated present and future liabilities, after insurance, at a net present value ("NPV") of \$175 m, discounted at 8 per cent per annum.⁶

15.8 The report was evidently prepared with a view to making accounting provision for the liabilities.⁷ Mr Gellert, JHIL's General Counsel, instructed Trowbridge to proceed to Stage 2 of the actuarial review, again with a view to proper accounting provision. Trowbridge wrote to Mr Gellert on 11 July 1996 setting out a

³ Morely T 2245.22–24, Harman T 1302.42–50.

⁴ Ex 179.

⁵ Ex 2, Vol 3, Tab 11, p. 559.

⁶ Ex 2, Vol 3, Tab 11, p. 560.

⁷ Ex 2, Vol 3, Tab 11, pp. 560, 563.

proposal for the scope of the Stage 2 work. Trowbridge's proposal concluded with mention of uncertainty.⁸

“There is considerable uncertainty over the future cost of asbestos-related disease claims. While we can make our best estimate of the liability according to the principles described above, significant deviations from our estimates are to be expected.

A question for JHI to consider is whether, in view of the uncertainty, a “best estimate” approach to setting the provision is appropriate, or whether a more conservative estimate should be made.

In any event, the provision should be reviewed on a regular basis and updated based on changes in the experience and the environment.”

15.9 The suggestion in the second paragraph appears not to have been taken up. Dr Barton could not recall the basis on which the actuarial report was prepared being discussed.⁹

15.10 An initial presentation of the results to the JHIL Board appears to have taken place on 1 October 1996 by Mr McFadden, a director of Coy.¹⁰ The presentation (based, it seems, on Ex 178) emphasised the “great uncertainty” attaching to the estimates, due to:

- “ • epidemiological work that is the basis of claim number projections is uncertain
- potential behaviour of claimants (including likelihood of suing) is unpredictable
- future legal decisions cannot be predicted
- incomplete data particularly for recoveries on individual cases”

15.11 Only the last of these four factors had reduced in significance by February 2001). The presentation estimated the NPV of the liabilities at \$193m,¹¹ and noted that the estimate “represents a high cost relative to the company’s profitability” (p.4).

15.12 The ultimate report (“The 1996 Trowbridge Report”) was dated 10 October 1996, and addressed to Mr Michael Rose at Allens.¹² Unlike the initial review it is

⁸ Ex 176, p. 6.

⁹ T 2730.50–2731.8.

¹⁰ Ex 57, Vol 4, p. 960.

¹¹ Ex 178, p. 7.

stated to be “for use solely in relation to current or pending asbestos litigation of [JHIL]”. The 1996 Trowbridge Report estimated present and future liabilities at \$230 million, discounted at 8 per cent¹³, and emphasised the uncertainty of the results.¹⁴

D. 1998 Trowbridge Report

15.13 The 1998 Trowbridge Report¹⁵ appears to have been requested in the context of Project Chelsea. According to the Project Chelsea Board Report,¹⁶ the principal purpose of the updated asbestos advice to Allens:

“is to satisfy directors that the proposed Stage 1 capital return will not in any way compromise the interests of creditors.”

15.14 The Report stated, however, that it was prepared for the sole purpose of use in relation to litigation and legal advice.¹⁷

15.15 The 1998 Trowbridge Report estimated the net present value of the liabilities at \$254 million, discounted at 7 per cent.¹⁸ The undiscounted estimate, \$501,456,621,¹⁹ was less than the 1996 estimate (\$523,542,565),²⁰ a result broadly consistent with the estimated payments for the intervening two years. Adjusting for the change in the discount rate, the net present value increased by only \$5 million between 1996 and 1998.²¹ An increase of that order would be expected in any event simply as a result of the reducing effect of the discount as time moved on.²²

¹² Ex 2, Vol 3, p. 586.

¹³ Ex 2, Vol 3, p. 589.

¹⁴ Ex 2, Vol 3, pp. 589 – 590, 637.

¹⁵ Ex 2, Vol3, Tab 13, 10 September 1998.

¹⁶ Ex 61, Vol 3, Tab 11 at p. 117. The preference to keep the report confidential is stated specifically at p. 121.

¹⁷ Ex 2, Vol 3, Tab 13, p. 696.

¹⁸ Ex 2, Vol 3, Tab 13, p. 702.

¹⁹ Ex 2, Vol 3, Tab 13, p. 834.

²⁰ Ex 2, Vol 3, Tab 12, p. 687.

²¹ Ex 121, Vol 6, Tab 62, p. 2310

²² Ex 2, Vol 3, p. 765.

E. 2000 Trowbridge Report

15.16 According to Trowbridge, the February 2001 Trowbridge Report should be treated as no more than an update of the 2000 Trowbridge Report.²³ It is necessary to deal with the 2000 Trowbridge Report in some detail.

Request for the Report

15.17 On about 7 March 2000 Mr Shafron sent Mr Attrill a draft of a letter of instructions from Allens to go to Mr Minty at Trowbridge.²⁴ Mr Minty had assisted with the previous Trowbridge Reports and Mr Shafron considered him to have “a good knowledge” of the relevant data and claims experience.²⁵ On 9 March 2000 Mr Shafron telephoned Mr Attrill and instructed him to make contact with Mr Minty²⁶ and to procure a “fresh” Trowbridge Report valuing the asbestos liabilities of Coy and Jsekarb as at 31 March 2000.²⁷ Mr Shafron also requested that Mr Attrill seek a preliminary indication of Trowbridge’s likely valuation before the JHIL Board Meeting²⁸ to be held on 15–16 April 2000, and said that QBE recoveries should be assumed to be zero.

15.18 On 10 March 2000 Trowbridge received by facsimile a letter of instructions from Mr Martin of Allens requesting an update of Trowbridge’s 1998 advice, and in particular²⁹:

- “
- (a) an actuarial estimate of potential exposure for known asbestos-related claims as at 31 March 2000;
 - (b) projection of potential exposure for known and unknown asbestos-related claims as at 31 March 2000; and
 - (c) an analysis on any significant developments in claims experience or new trends since your 1998 review.”

²³ Ex 2, Vol 4, Tab 14.

²⁴ Ex 56, p10, para. 30; Ex 57, Vol 1, pp. 39–40.

²⁵ Ex 17, p11, para. 64.

²⁶ Ex 56, p10, para. 31.

²⁷ The scope of the instruction given to Mr Minty came into sharper focus in June 2000 when a degree of tension developed between Mr Minty and JHIL management (Mr Shafron, Mr Macdonald and Mr Attrill) regarding Trowbridge’s request for an indemnity when the draft Trowbridge Report was to be given to insurers for the purpose of insurance defeasance. See, for example, Ex 50, Tab 11, p. 106–107.

²⁸ Ex 57, Vol 1, p. 39. Mr Shafron did not recall being ‘let down’ by the preliminary estimate not being available for the JHIL Board Meeting in April 2000. Shafron, T 1754.30–49.

²⁹ Ex 50, Tab 2, p. 8.

Reasons for the Report

15.19 Mr Shafron sought to characterise the request to Trowbridge for an updated report in March 2000 as part of a “pattern” to obtain an actuarial valuation of the “prospective asbestos related liabilities” of Coy and Jsekarb every two years.³⁰ It is more likely that the initial motivation for, and timing of the request was related to the commercial objectives of separation underlying Project Green together with the proposed introduction of ED88 in December 2000.³¹ By February 2000³² Mr Shafron and other members of JHIL’s corporate management were also aware of the proposed introduction.³³ Further, as early as 14 December 1999, Mr Shafron had sent an email to Mr Macdonald reporting on the “Allens” view of the legal aspects of separation.³⁴ Mr Shafron noted that “going forward” they (Allens), amongst other things, would:

get Trowbridge in the slot to be able to produce a report as close to YEM00 as possible.”³⁵

15.20 The timing of the request to Trowbridge is also consistent with other initiatives being undertaken at that time by Mr Shafron in the context of Project Green. Thus on 8 March 2000 Mr Shafron forwarded to Mr Martin and Mr Peter Cameron at Allens a “rough note”³⁶. The subject heading was “Green/Asbestos”.

The note had been prepared by Mr Shafron with the assistance of Mr Sweetman of UBS Warburg with the title “Project Green Contingent Liabilities”, and in the text of

³⁰ Ex 17, p.11, paras 63–64.

³¹ Ex 121, p. 22, para. 140. If adopted, ED88 would have required provisions to be established in JHIL’s financial accounts for the contingent liabilities of controlled entities: Ex 121, p. 22, paras 140–141.

³² Ex 17, p. 14, para 78. For his part, Mr Macdonald acknowledged that he was aware of ED88 “from at least August 2000”: Ex 148, p. 3–4, para. 11. It would be surprising if Mr Macdonald was not also aware of the ED88 issues in February 2000.

³³ See Mr McClintock of PwC’s email of 4 November 1999 and attached letter dated 5 November 1999: Ex 61, Vol 4, Tab 5, pp. 18–33. The advice eventually given to the JHIL Board in August 2000 was:

“(a) ED88 was expected to be promulgated as a mandatory Australian Accounting Standard in December 2000;
(b) JHIL would be likely to have to comply with ED88 in the preparation of its accounts for the year ended 31 March 2002;
(c) the then existing provision for asbestos claims in JHIL’s consolidated accounts was approximately \$43 million;
(d) if implemented, ED88 would require JHIL to include a provision of \$263 million (that amount being the latest Trowbridge estimate of the present value of Amaca (Coy’s) and Amaba’s (Jsekarb’s) asbestos liabilities, less the present value of amounts to be received from QBE under a settlement).” Ex 148, p. 4, para. 11.

³⁴ Namely, the views of Mr Martin and Mr Peter Cameron, both Allens partners at the time.

³⁵ Ex 61, Vol 4, Tab 11, p. 99.

³⁶ Ex 224, Vol 1, Tab 7, pp. 49–53.

his covering email Mr Shafron requested "... concrete advice behind the alternatives discussed in time for the April Board...".

15.21 During the first half of 2000, as part of Project Green, JHIL's senior management and advisors were also actively considering a "share swap and buy back proposal". Mr Shafron noted:

"One question, if that proposal proceeded, would be the level of funds which could be left in JHIL and whether the report by Trowbridge could be released publicly to support, in a public debate, any amount chosen".³⁷

On that approach an actuarial estimate which was up to date would seem essential to a proper consideration of key issues traversed in the paper.³⁸ Mr Shafron "...also had in mind that JHIL might use the work done by Mr Minty to explore the possibility of purchasing insurance against the risk of future claims exceeding certain amounts."³⁹

15.22 Reinsurance or insurance defeasance of asbestos related liabilities had been raised in the context of Project Scully⁴⁰ and Mr Shafron re-canvassed this issue in the paper he presented to the JHIL Board Meeting in February 2000.⁴¹ Reinsurance was also identified by him as one of the "Takeout Options" in a paper he presented to the JHIL Board Meeting in April 2000.⁴²

³⁷ Ex 17, para. 70, p. 12.

³⁸ See, for example, "D. Combination of reinsurance and separation/trust", Ex 224, Vol 1, Tab 7, p. 52.

³⁹ Ex 17, p.11, para. 65.

⁴⁰ Ex 61, Vol 4, Tab 9, pp. 63–65.

⁴¹ Ex 22, p. 13–14.

⁴² Ex 23, Section 4.2. Mr Shafron subsequently engaged Jardine Lloyd Thompson to contact insurers and ascertain whether an insurance option could remove future asbestos costs from the JHIL group. The potential use of the Trowbridge Report for such purposes was not raised with Mr Minty until June 2000 when Mr Shafron instructed Mr Attrill to "*appraise Trowbridge that we intend to give the report to brokers and insurers*". Ex 57, Vol 1, p. 144; T 946.7–20; Ex 50, p. 4, para. 25.

Additional Information Provided to Trowbridge

15.23 In the period 16 March 2000 to 12 April 2000 Mr Attrill forwarded various data, records and accounting information to Trowbridge in accordance with Mr Minty's requests.⁴³ He provided written and oral briefings to Mr Minty in relation to US Claims, wharf claims,⁴⁴ developments in New Zealand⁴⁵ and the Dust Diseases Board reimbursement scheme⁴⁶ and the possibility of heads of damages expanding.⁴⁷ In addition, Mr Attrill arranged an oral briefing for Mr Minty by Mr Russel Adams, a partner at Phillips Fox, one of the panel of solicitors servicing JHIL's asbestos litigation.⁴⁸

15.24 Two comments may be made in relation to the provision of further data and the briefings. First, Mr Attrill was able to service Trowbridge's requests within a relatively short period. Secondly, the nature of the information provided was consistent with increasing cost of claims and increasing claims numbers.⁴⁹

Initial Estimate and Reaction

15.25 On 13 April 2000 Mr Minty advised Mr Shafron by email that Trowbridge's "first draft" conclusion was that the discounted present value of liability "lies between AUD300 and AUD350 million at 31 March 2000, compared to our estimate of \$254 million at March 1998."⁵⁰ Mr Minty identified "major drivers" for the change as being:

"a 10% to 15% increase in the average size of m-claims [mesothelioma] due to the impact of new heads of damage..."

⁴³ Ex 56, pp. 10–11, paras 34–39.

⁴⁴ The impact of *Crimmins v Stevedoring Industry Finance Committee* (1999) 200 CLR. 1.

⁴⁵ Possible liability to remediate contaminated land in New Zealand and adverse change in the national accident compensation system which would reinstate the right to sue for work related injuries.

⁴⁶ Mr Attrill considered that DDB reimbursement was likely to become an issue, and Mr Adams, a partner at Phillips Fox, anticipated significant litigation with regard to how "DDB recovery can be calculated in settlement". Ex 57, Vol 1, p. 99.

⁴⁷ Ex 56, p. 11, para. 37.

⁴⁸ Ex 56, p. 11, para. 38. See also Mr Attrill's notes of 6 April 2000, Ex 57, Vol 1, pp. 97–99.

⁴⁹ See, for example, *Review of James Hardie's Asbestos-Related Liabilities*, 5 April 2000, Ex 57, Vol 1, pp. 93–96; Mr Attrill's file note of 16 April 2000.

⁵⁰ Ex 57, Vol 1, p. 101.

allowance for higher net cost of cross-claims against the company...

\$8 million liability for around 300 w-claims [waterside workers]”

15.26 On receiving the estimate on 14 April 2000, Mr Shafron emailed Mr Attrill: “Wow. That’s much more than I was expecting.”⁵¹ Mr Shafron promptly advised Mr Macdonald and Mr Morley of this estimate.⁵²

15.27 Completion of the Trowbridge report was seen as a high priority by both Mr Shafron and Mr Macdonald, the latter describing the priority as follows⁵³:

“As we discussed, the next step will be to work through the whole thing thoroughly and test all the assumptions to make sure we think the basis is fair.

When do you think we might be able to get a final report in a fully reviewed and agreed state? (We really do need to have it well before the May Board meeting so that our resolution discussions can have as much certainty as possible).”

15.28 On 16 April 2000 Mr Shafron instructed Mr Attrill to “stay close to Minty”.⁵⁴ Although not attributing fault to anyone, Mr Shafron expressed his disappointment with the estimate being \$100m or 40per cent more than the increase he had expected. He informed Mr Attrill that he was “appalled” the number was so high and instructed him to “test” Mr Minty’s logic in relation to the estimate. Mr Attrill’s understanding of Mr Shafron’s reaction at that time was that Mr Shafron was concerned to keep the numbers down because a low number would advance the prospects of a restructuring.⁵⁵ Pursuant to Mr Shafron’s request, Mr Attrill telephoned Mr Minty on 18 April 2000⁵⁶ and was advised by Mr Minty that the figure “may end up at 310 million”.⁵⁷ Mr Minty acknowledged that he had built a safety margin into the original estimate.⁵⁸ Mr Attrill subsequently informed Mr Shafron that Mr Minty expected the figure to be in the “\$300–310m range”.⁵⁹

⁵¹ Ex 57, Vol 1, p. 101; see also Ex 17, para. 66.

⁵² Ex 57, Vol 1, p. 111.

⁵³ Ex 57, Vol 1, p. 103.

⁵⁴ Ex 57, Vol 1, p. 106.

⁵⁵ T 932.43–933.27.

⁵⁶ Ex 56, pp. 11–12, para. 41.

⁵⁷ Ex 57, Vol 1, p. 103; T 933.36–43.

⁵⁸ Ex 57, Vol 1, p. 106.

⁵⁹ Ex 57, Vol 1, p. 106.

15.29 Although Mr Attrill expected the estimate to increase due to “the wharf claims and JHL’s increasing settlement share”, he too had not expected the extent of the increase.⁶⁰ Mr Shafron, in an email dated 20 April 2000, responding to Mr Attrill’s email of 17 April 2000 advising that the final figure for the estimate would be in the \$300–310m range, commented⁶¹:

“Thanks Wayne – still not a great story. If it went up 25% over the last 2 years, why wouldn’t it go up 25% over the next 2 years, so the argument could go.”

15.30 Mr Attrill agreed that this was “definitely” a problem and noted that “JH’s investment with Allens’ working up the test cases” had not yielded dividends in the form of lower settlements.⁶² He also observed that:

“The Legislature intervened to nullify some of our key advances, the plaintiffs’ lawyers improved their own performance, and the courts did their bit by expanding and increasing the level of damages, (a quite common, but unhelpful, feature of the tort system) as well as our share of them. What we have told QBE⁶³ – that the litigation always gets worse – is quite correct. And, unfortunately, there is more potential downside in the system yet.

Part of the problem is that Trowbridge do not cost the liabilities on an insurance basis – i.e. allow a contingency for potential adverse developments. So when a new wave of claims hits, like the wharf claims, they have no choice but to increase their number. The higher estimate may also be due to better quality input data from us.”⁶⁴

15.31 Further data was provided to Trowbridge during the following period.⁶⁵ Mr Attrill also met with Mr Minty and Mr Marshall⁶⁶ on 4 May 2000 for the purpose of obtaining an explanation of “... the status of, and assumptions underlying, the report being prepared by”⁶⁷ Trowbridge.⁶⁸ Mr Minty and Mr Marshall informed Mr Attrill that:

“(a) an increase in claim numbers, especially mesothelioma claims, had led to the increase in the projected liabilities compared to the report to 31 March 1998;

⁶⁰ Ex 57, Vol 1, p. 106.

⁶¹ Ex 57, Vol 1, p. 109–110.

⁶² Ex 57, Vol 1, p. 109.

⁶³ JHIL was in negotiation with QBE in relation to disputed insurance cover for asbestos liabilities for various periods.

⁶⁴ Ex 57, Vol 1, p. 109.

⁶⁵ Ex 57, Vol 1, p. 113.

⁶⁶ Mr Marshall was an actuary at Trowbridge assisting Mr Minty.

⁶⁷ Ex 56, p. 12, para. 45.

⁶⁸ Mr Attrill’s notes of the meeting are reproduced in Ex 57, Vol 1, p. 115–188.

- (b) they had extended the time during which James Hardie could expect to receive mesothelioma claims from 2021 to 2025;
- (c) their feeling was that the number of new mesothelioma claims had, however, stabilised and would drop off over the next five years;
- (d) they accepted that our legal costs had fallen since the 1998 report, but noted that this had to be offset against an increase in average settlement payments;
- (e) the Andrews and Atkins study (which for some time had formed the basis of modelling the emergence of asbestos related disease in Australia) was to be reviewed by Trowbridge and a new study was to be produced for presentation at a seminar in November; and
- (f) the projected liabilities were \$284.5 million plus \$10 million for wharf claims.”⁶⁹

15.32 Mr Attrill advised Mr Shafron of the results of the meeting by email dated 4 May 2000.⁷⁰ Mr Attrill noted “I went through the individual figures Trowbridge propose to use in their model, and they appeared reasonable to me based on my experience with the claims.”

Drafting Process

15.33 Mr Marshall of Trowbridge forwarded the first draft of a Management Summary to form part of the report to Mr Attrill by facsimile on 9 May 2000.⁷¹ After Mr Attrill clarified GST and other issues with Mr Marshall, a revised draft “Management Summary” was emailed by Mr Marshall to Mr Attrill on 10 May 2000.⁷² A process then commenced of further developing the draft Trowbridge Report.⁷³ According to Mr Attrill that process proceeded in the following manner:

- “
- (a) I would provide copies of the draft Trowbridge reports to Peter Shafron who would provide his comments on the drafts. On occasion I would also comment;
 - (b) I would then pass on Mr Shafron’s comments (and, where relevant, my comments) to Trowbridge and further drafts would be prepared;

⁶⁹ Ex 56, pp. 12–13, para. 46.

⁷⁰ Ex 57, Vol 1, p. 120.

⁷¹ Ex 57, Vol 1, pp. 121–130.

⁷² Ex 57, Vol 1, pp. 133–143.

⁷³ Various iterations of the draft report together with associated emails, faxes, notes of meetings and telephone conversations involving Mr Attrill, Mr Shafron and Trowbridge are to be found in Ex 57, Vols 1 and 2, pp. 145–751.

- (c) During the course of the process I received a telephone call from Peter Shafron on 1 June 2000 during which he essentially explained to me his requirements for the Trowbridge report. His requirements were that he wanted:
- (i) the report kept in draft;
 - (ii) the report to be amended to provide more certainty;
 - (iii) to maintain privilege and confidentiality over the report and to that end he wanted the report to be prepared for the asbestos litigation partner at Allens (Roy Williams);
 - (iv) the report was to stand alone and not refer to earlier reports;
 - (v) me to notify Trowbridge that the report was intended to be provided to brokers and insurers.⁷⁴

15.34 Mr Shafron was insistent that the report not be provided in final form as evidenced by his request to Mr Attrill on 12 May 2000, “Don’t let them go final whatever you do”.⁷⁵

15.35 The first full draft of the report was dated 16 May 2000.⁷⁶ The projected potential expense for both known and potential asbestos-related claims as at 31 March 2000 was \$294m.⁷⁷ The amount was described as the “discounted present value of payments projected to arise in *all future years*” and represented the Trowbridge projection “of the most likely outcome of the cost of settlement of claims based on current legislative and judicial trends and ignoring the potential for new sources of exposure to emerge.”⁷⁸

15.36 Mr Shafron, through Mr Attrill, sought to exercise very great influence over the contents of Trowbridge’s report. His views are recorded in Mr Attrill’s note of the telephone conversation with Mr Shafron on 1 June 2000.⁷⁹ These views were then reinforced by Mr Shafron in a facsimile forwarding a copy of the first five sections of the draft report, with manuscript comments and amendments, to Mr

⁷⁴ Ex 56, pp. 14–15, para. 54. See also Mr Attrill’s File Note of the telephone conversation with Mr Shafron, Ex 57, Vol 1, p. 144.

⁷⁵ Ex 57, Vol 1, p. 150.

⁷⁶ With a footer “<DRAFT> Tues 16 May 2000 2:16 pm”. Ex 57, Vol 1, pp. 152–258.

⁷⁷ Ex 57, Vol 1, p. 160.

⁷⁸ Ex 57, Vol 1, p. 161.

⁷⁹ Ex 57, Vol 1, p. 144.

Attrill on 1 June 2000.⁸⁰ Mr Shafron’s “main points”, noted on the cover page of the facsimile, were:

- “ 1. no ref. (reference) to previous review
2. draft/privileged everywhere
3. Roy Williams the recipient
4. Tone down speculative risks”⁸¹.

15.37 Mr Shafron’s manuscript comments indicate that he required that the words “Draft”⁸² and “confidential and legally privileged prepared for purposes of litigation” be included in the “footer” on each page of the report.⁸³ The commentary and heading “Developments Since Our Previous Review” were deleted.⁸⁴ Comments which emphasised the uncertainty of estimates were to be softened.⁸⁵ A reference to ED88 was deleted, as was a reference to the fact that the estimate had increased by \$40m since the last review,⁸⁶ and also the fact that the number of mesothelioma cases was higher than the previous review. The word “considerably” was deleted from the phrase “future experience could vary considerably from our estimates”.⁸⁷ The sentence “Wide variations are normal and are to be expected” was deleted.⁸⁸

15.38 Mr Shafron, an obviously intelligent man, was clearly very familiar with the issues raised in the draft report and understood the report’s limitations. The amendments sought by him, to a significant extent, were incorporated in the final Trowbridge draft.

15.39 The use of Trowbridge’s report for the purpose of obtaining insurance defeasance for Coy and Jsekarb’s asbestos-related liability became relevant in late May 2000 during a teleconference involving Mr Shafron, Mr Morley, Mr Attrill, and

⁸⁰ Ex 57, Vol 1, pp. 229–255.

⁸¹ Ex 57, Vol 1, p. 229.

⁸² Mr Shafron’s view was that by keeping the report in draft somehow “*helped to protect against the adverse consequences of loss of confidentiality*”. Ex 17, p. 13, para. 75.

⁸³ Ex 57, Vol 1, p. 230.

⁸⁴ See also T 942.49–943.3.

⁸⁵ Ex 57, Vol 1, p. 233–4. Although this is to some extent at odds with Mr Shafron’s later request for more certainty in the context of using the draft report for insurance defeasance purposes.

⁸⁶ Ex 57, Vol 1, p. 237.

⁸⁷ Ex 57, Vol 1, p. 239.

⁸⁸ Ex 57, Vol 1, p. 239.

Ms James, a London based representative of JHIL's insurance brokers, Jardine Lloyd Thompson.⁸⁹ Mr Attrill's notes of the conversation record Mr Shafron saying that his "CEO" wished to proceed with "deliberate speed" and that the draft actuarial report would be sent the following week.⁹⁰ He also sought insurance cover for environmental liability.⁹¹ Mr Minty was informed of the proposed use of the report by Mr Attrill on 2 June 2000.⁹²

15.40 The final version of the 2000 Trowbridge Report was dated 16 June 2000.⁹³ It is the version which incorporates a disclaimer concerning use of the report by "insurance houses or insurers". It was unsigned, and still marked "Draft", but was, for practical purposes a final report, and that was understood by Mr Shafron.⁹⁴

Structure of the Report

15.41 The Report's pattern is generally consistent with that of the 1998 Trowbridge Report. Part I is a "Management Summary". Part II sets out the detailed analysis. An introductory chapter describes the retainer, the background to James Hardie's exposure, the categories of claims (general liability and workers compensation)⁹⁵ and the scope of the review. Chapter 2 describes the approach to the "valuation", that is the methodology employed in broad outline. Chapter 3 describes the information on which the review was based (primarily, James Hardie's individual claims register and the relevant accounting data base). Trowbridge concluded that the quality of the data supplied by James Hardie was reasonably good, and that their results were not materially affected by the discrepancies that were observed.⁹⁶

15.42 Chapters 4 to 8 examine the various elements of the measurement of exposure, in five categories:

⁸⁹ Ex 61, Vol 4, Tab 12, p. 100; see also T 1163.40–1164.10.

⁹⁰ Mr Shafron remained concerned to maintain privilege.

⁹¹ Ex 61, Vol 4, Tab 12, at 101.

⁹² Ex 57, Vol 1, p. 229.

⁹³ Ex 2, Vol 4, Tab 14.

⁹⁴ Shafron, T 1728.46–1729.2.

⁹⁵ "Workers Compensation" in this context refers to claims by former employees, not simply claims for statutory workers compensation.

⁹⁶ Ex 2, Vol 4, Tab 14, p. 861.

- Ch 4: Numbers of general liability mesothelioma claims.
- Ch 5: Numbers of general liability non-mesothelioma claims.
- Ch 6: Cost of settling general liability claims.
- Ch 7: Insurance recoveries for general liability claims.
- Ch 8: Cost of workers compensation claims.

15.43 Chapter 9 summarises the results of the analysis as follows:

Table 2 – Projection of Potential Exposure for both Known and Potential Asbestos-Related Claims at 31 March 2000

	\$m	\$m
General liability claims		
- arising from mesothelioma	190	
- arising from other asbestos-related diseases	49	
- legal costs incurred by James Hardie ¹	<u>73</u>	312
Workers' compensation claims		7
Additional claims involving waterside workers		10
Amounts recoverable from insurers		<u>(35)</u>
		294

¹ These amounts exclude legal payments already made for unsettled claims.⁹⁷

15.44 It then goes on to describe a series of sensitivity analyses,⁹⁸ the results of which are presented in Table 9.4:

Table 9.4 – Results of Sensitivity Analysis

Scenario	Estimate \$m	Change from Base \$m	Differences from Base %
Base Case	294		
1. High Claim Numbers	420	126	43
2. Low Claim Numbers	167	(126)	(43)
3. Change in Meso 'peak'	264	(30)	(10)
4. High Average Claim Size	337	43	15
5. High Claim Inflation	424	130	44
6. Higher Legal Costs	328	34	12
7. Low Discount Rate	344	51	17
8. High Discount Rate	229	(64)	(22)
9. No Discounting	559	266	90

Trowbridge said in relation to Table 9.4 that the degree of variation gave "some indication of the limited knowledge and history of asbestos-related claims and the uncertainty that exists in respect of the potential impact of their emergence on Hardies' exposure."⁹⁹

⁹⁷ Ex 2, Vol 4, p. 886.

⁹⁸ Ex 2, Vol 4, pp. 888–9.

⁹⁹ Ex 2, Vol 4, p. 892.

15.45 Chapter 10 deals briefly with the limitations of the report, and Part III is a series of Appendices settings set out in more detail the data and analysis reported on in Chapter 2.

Methodology

15.46 Mr Whitehead, an actuary retained to assist the Commission, summarised the Trowbridge methodology as involving the following steps (for each of the mesothelioma claims and the other claims):

- “ • based on Australia-wide data, a model of the expected emergence pattern of the number of future asbestos related disease cases diagnosed is selected. Trowbridge refers to the number of asbestos related disease cases as the number of “events”, since it is the incidence of an asbestos related disease that give rise to the possibility of one or more claims being made;
- the historical JHG claims reported experience is analysed to derive an assumed base number of reported claims for the current experience period;
- the assumed reporting pattern is applied to the assumed base number of claims to project the expected number of claims that will be reported in each future year;
- after allowing for the delay between reporting and settling claims, the number of claims expected to be settled in each future year is calculated. This calculation includes the settlement of pending claims that had been reported before the valuation date but which remained unsettled at that time;
- multiplying the expected number of claims settled in each future year by the assumed average claims cost produces the estimated claim payments for each future year, measured in current dollars. Similarly, multiplying by the assumed average legal expense per claim provides an estimate of the legal expenses in each future year in current values;
- the current value cash flows are converted to nominal cash flows by increasing the projected payments for assumed future claims and legal expense inflation;
- the nominal projected cash flows are discounted to produce estimates of the present value of the projected future claim and legal expense payments. This is the estimated liability.”¹⁰⁰

¹⁰⁰ Ex 251, para. 4.3.3.

15.47 He also noted an important difference between the methodology adopted in the 1998 and 2000, (and February 2001) Trowbridge Reports and that adopted in 1996 and post-separation reports. In 1998 and 2000 the second step identified above was broken into two:

- “ • An event (a disease case) can give rise to more than one claim. Trowbridge analysed the JHG claim database to determine the number of events underlying the reported claims. They then applied the assumed event emergence pattern to a selected base number of events to project the number of events expected to occur during each future report year;
- They then introduced a new parameter that is intended to convert the number of events to the number of claims. Having analysed the ratio of claims to events in the database, they determined an appropriate value to scale the projected number of JHG events up to the projected number of JHG claims.”¹⁰¹

15.48 In the 2000 Trowbridge Report the critical data as to this aspect was set out in Table 4.2.

“Table 4.2 – Comparison of Events and Claims

Report Year	Events	Claims	Claims per Event
Earlier	67	72	1.07
1991/92	25	29	1.16
1992/93	38	45	1.18
1993/94	51	59	1.16
1994/95	68	78	1.15
1995/96	62	75	1.21
1996/97	63	79	1.25
1997/98	73	101	1.38
1998/99	78	102	1.31
1999/00	85	90	1.06
Total	610	730	1.20 ¹⁰²ⁿ

15.49 The first step in the methodology is the adoption of models for the expected emergence of asbestos-related diseases. It is not in dispute that the most important is the model for mesothelioma. Trowbridge said they paid particular regard to the Atkins, Smith and Watson presentation to the Institute of Actuaries 6th Accident

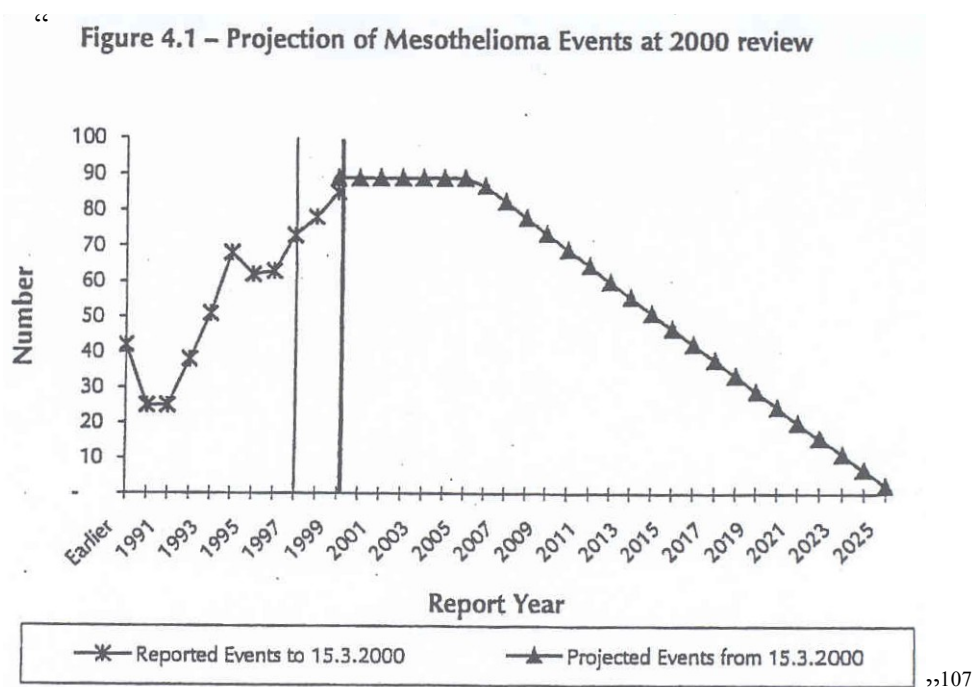
¹⁰¹ Ex 251, para. 4.3.6

¹⁰² Ex 2, Vol 4, Tab 14, p. 864

Compensation Seminar in December 1996.¹⁰³ That paper did not advance a new model for the incidence of mesothelioma in Australia. Rather, it referred back to the “low” and “high” models described by Andrews and Atkins in their 1993 paper,¹⁰⁴ and expressed the view that the “high” model was more appropriate than the “low”. The “high” model (without the derivation being explained, as Mr Whitehead observed¹⁰⁵) predicted a peak incidence of mesothelioma in Australia in 2001 declining to nil in 2021.

15.50 Mr Minty explained in his evidence that the 2000 Trowbridge Report did not simply adopt the Andrews and Atkins “high” model; rather the peak was extended so as to plateau for five years, to 2006.¹⁰⁶

15.51 In the result, Trowbridge’s projection of James Hardie mesothelioma claims was as follows:



¹⁰³ Ex 2, Vol 3, Tab 13, pp. 777–8036

¹⁰⁴ See Ex 2, Vol 3, Tab 12, pp. 640–664 and esp 663.

¹⁰⁵ Ex 251, para. 4.4.17

¹⁰⁶ Minty, Ex 257, para. 9 – although query whether the reference to “Low” in the first line is correct.

¹⁰⁷ Ex 2, Vol 4, Tab 14, p. 865.

15.52 It will be observed that mesothelioma claims were thought to have plateaued in 2000. Trowbridge also expressed the view that James Hardie mesothelioma events had levelled.¹⁰⁸

15.53 Two other aspects of the Trowbridge report require elaboration. The first is the use of “nil claims”. This became the cause of some confusion during the course of the Inquiry, but the explanation seems to be as follows. The James Hardie claims database recorded cross-claims by other defendants against James Hardies as separate claims. When such a claim was resolved by a payment by James Hardie to the plaintiff, however, the database recorded that payment only in respect of the claim brought by the plaintiff, and the cross-claim was recorded as settled without contribution by James Hardie.¹⁰⁹ But it was not possible to ignore these claims completely as they involved some legal costs.¹¹⁰ Further, the model used by Trowbridge projected claim numbers, and these would include nil claims.

15.54 It followed that projected claim costs had to be adjusted for the proportion of nil claims likely to be included in the total. Accordingly, the assumed average non-nil mesothelioma claim cost (before legal costs and insurance recoveries) of \$180,000 had to be reduced by the anticipated percentage (25 per cent) of claims that would be nil claims, producing an average claim cost (nil and non-nil) of \$135,000.¹¹¹

15.55 The second aspect of their valuation which needs mention is the derivation of the estimated non-nil claim costs of \$180,000. Trowbridge selected a number considerably higher than the average of claim costs over the previous ten years (\$139,000),¹¹² but not materially different from the average cost in the last complete year (\$177,000). The estimate cannot easily be reconciled, however, with James Hardie’s internal discussions of its claim costs. Mr Attrill’s figures suggested average costs in YEM 2000 of \$228,000, not \$177,000.¹¹³ On the other hand,

¹⁰⁸ Ex 2, Vol 4, p. 864.

¹⁰⁹ Minty, Ex 257, para. 34; T 3271.12–3273.24.

¹¹⁰ Ex 2, Vol 4, pp. 878–9. Non-nil mesothelioma costs were estimated at \$40,000. All claim mesothelioma costs were estimated at \$15,000.

¹¹¹ Ex 2, Vol 4, pp. 875–6; Minty, Ex 257, paras 26 to 38.

¹¹² Ex 2, Vol 4, p. 875.

¹¹³ Ex 63 at p. 13.

Ms Burtmanis' summary of the YEM 2000 results indicates an average mesothelioma pay out of \$168,398.00.¹¹⁴

15.56 It is not necessary, fortunately, to reconcile these figures. The James Hardie data and the Trowbridge analysis were independently reviewed by Mr Whitehead and Mr Wilkinson for the purposes of the Inquiry. Neither suggested that Trowbridge's estimate did not reflect the data.¹¹⁵ Mr Wilkinson's ultimate projection was only marginally higher (\$185,000).¹¹⁶

Key Assumptions and Conclusions

15.57 The key assumptions and conclusions of the 2000 Trowbridge Report may be summarised as follows:

Number of current and projected mesothelioma claims	1,638
Average non-nil mesothelioma claim costs	\$180,000
Proportion of nil mesothelioma claims	25%
Average non-nil mesothelioma claims legal costs	\$40,000
Average nil mesothelioma claim legal costs	\$15,000
Inflation	4%
Super-Imposed Inflation	nil
Gross liability, net of Insurance	\$557,000,000
NPV, discounted at 7% (including \$10m for wharf claims)	\$294,000,000

15.58 This estimate was described as Trowbridge's "most likely" estimate of the ultimate cost to Hardies.¹¹⁷ The explanation of this expression was somewhat less than illuminating:

"In principle, all our assumptions have been selected to yield estimates which are not intentionally above or below the ultimate cost of Hardie's asbestos-related exposure within the scope defined, although as noted earlier there is considerable potential for future experience to differ from our assumptions."¹¹⁸

¹¹⁴ Ex 65.

¹¹⁵ Whitehead, Ex 251, section 4.5; Wilkinson, Ex 252, pp. 42–44.

¹¹⁶ Ex 252, pp. 54–5.

¹¹⁷ Ex 2, Vol 4, Tab 14, p. 888.

¹¹⁸ Ex 2, Vol 4, Tab 14, p. 888.

15.59 What it did not make clear was that the estimate was “most likely” in a particular sense. In fact it was a “median” or “central” estimate, i.e. an estimate that falls centrally in the range of possible outcomes, so that half the possible outcomes are higher, and half lower. This meant that a fund set at the level of the “most likely” estimate would have only a 50/50 chance of paying all claims.¹¹⁹

Qualifications

15.60 Part 1 of the 2000 Trowbridge Report emphasised its limitations. The estimates only covered areas of exposure that were “well established”.¹²⁰ This meant that claims originating outside Australia, claims relating to non-disabling conditions, stress or psychological trauma, and environmental, property or land remediation, or similar “clean up” claims were not considered.¹²¹ It was assumed that there would be a continuation of the current legal environment, and therefore a continuation of the current basis of compensation for lung cancer and asbestosis cases and the current real quantum of damages.¹²² It was assumed that there would be no major landmark or precedent setting cases which would materially change the pattern of claims or average settlements.¹²³ The uncertainty of the projections was emphasised:

“It should be noted that of their very nature our estimates are subject to considerable uncertainty and significant deviations from our estimates are to be expected. While there is uncertainty with any projection of future claim experience, this uncertainty is heightened in the case of asbestos-related claims because:

- the projections are based on epidemiological work which itself is subject to great uncertainty (as evidenced by the range of professional opinions held by medical and other experts)
- the behaviour of potential claimants (including their propensity to claim) is uncertain
- the potential exposure will be heavily influenced by the outcome of court decisions and legislative processes that are impossible to predict. Such

¹¹⁹ Marshall, T 915.29–38; Minty, T 821.10–17; Wilkinson, T 3383.28–47.

¹²⁰ Ex 2, Vol 4, Tab 14, p. 842.

¹²¹ Ex 2, Vol 4, Tab 14, pp. 842–3, 851–2.

¹²² Ex 2, Vol 4, Tab 14, p. 843.

¹²³ Ex 2, Vol 4, Tab 14, p. 853.

decisions may impact the tendency for people to pursue claims as well as affecting the quantum of damages awarded in particular circumstances.”¹²⁴

15.61 In its original form Section 10 of Part 2 of the Report was a detailed discussion of areas of potential exposure not encompassed by Trowbridge’s assessment.¹²⁵ This discussion was omitted by Trowbridge from the “final” report at the request of Mr Shafron.¹²⁶ I discuss this further below.

Mr Shafron’s approach to the 2000 Trowbridge Report

15.62 It is perhaps understandable, in the context of insurance defeasance, that Mr Shafron sought a report which conveyed “more certainty”¹²⁷ but more difficult to justify an approach whereby he instructed Mr Attrill to “tone down the speculative risks”¹²⁸ and remove the reference to “wide variations” being normal.¹²⁹

15.63 Mr Shafron’s responses in cross-examination to questions going to the issue of good faith and a duty of disclosure to prospective insurers suggested to me that he had been endeavouring to avoid making full disclosure.¹³⁰ Whilst he acknowledged in cross examination that he knew about “the duty of full disclosure” to insurers,¹³¹ he attempted to justify any failure to discharge such a duty by recourse to the need to maintain confidentiality.¹³² He was aware that “in view of the very short timescale an insurer may choose to rely on your actuary’s numbers in order to provide a price”.¹³³ This approach, in my view, reflects poorly on a senior office holder of a publicly listed company.

15.64 Mr Attrill carried out Mr Shafron’s direction to ensure that Mr Williams of Allen Allen & Hemsley was to be the source of instruction for Trowbridge in

¹²⁴ Ex 2, Vol 4, Tab 14, pp. 843–4. As indicated earlier, the topic of uncertainty was referred to again in the discussion of the sensitivity of the results.

¹²⁵ Ex 57, Vol 2, pp. 321–324.

¹²⁶ Ex 57, Vol 2, p. 332, 336.

¹²⁷ Ex 57, Vol 1, p. 144.

¹²⁸ Ex 57, Vol 1, p. 229

¹²⁹ Ex 57, Vol 1, p. 239.

¹³⁰ Shafron, T 1735.34–1736.7.

¹³¹ Shafron, T 1770.41–1771.2.

¹³² Shafron, T 1735.34–1736.7.

¹³³ Ex 57, Vol 2, p. 337.

continuing the preparation of the report.¹³⁴ Mr Attrill also informed Mr Williams that “he may be called upon to advise on some of the “emerging areas” (such as land remediation) so as to tighten up Minty’s instructions and reduce the uncertainty in the report”.¹³⁵ Mr Williams proceeded to fax a letter of instruction to Trowbridge.¹³⁶ In the light of the proposed use of the report, the claim for legal professional privilege did not appear to be soundly based.¹³⁷

15.65 Various aspects of the changes to the draft report sought by Mr Shafron raise issues as to his motivation and candour. His endeavours to remove all references to previous Trowbridge Reports, no doubt to avoid identification of possible trends, do not appear to be appropriate (or in the circumstances, perhaps even achievable).¹³⁸ Mr Shafron’s desire to achieve certainty¹³⁹ in the context of insurance did not sit well with his internal memorandum to Mr Macdonald dated 11 October 2000. In that memorandum his reasons for not disclosing the estimate contained in the 2000 Trowbridge Report to the ASX included:

“4. The Trowbridge work is very uncertain. It is based on very imperfect epidemiological models and very uncertain predictions of future claim numbers and claim costs. On the basis of its sensitivity analysis the liability could be up to \$384M higher or \$220 (sic) lower (at net present values). (The sensitivity analysis that was used in the draft report is not based on any particular level of probability.)”¹⁴⁰

15.66 Mr Shafron also obtained Trowbridge’s agreement to deletion of Section 10 of the draft which had been headed “Other Elements of Potential Exposure”¹⁴¹ because its contents were “too speculative”. The elements included:

- “
 - the possible reversal of the generally accepted condition that evidence of asbestosis is required before lung cancer will be attributable (at least in part) to asbestos exposure
 - non-disabling diseases, such as pleural plaques

¹³⁴ Ex 57, Vol 2, p. 326.

¹³⁵ Ex 57, Vol 2, p. 256.

¹³⁶ Ex 50, Tab 8, pp. 22–23.

¹³⁷ See, for example, Mr Attrill’s concessions as to the purpose of the report, T 942.17–47.

¹³⁸ Attrill, T 948.30–58.

¹³⁹ Ex 57, Vol 1, p. 144.

¹⁴⁰ Ex 189, Vol 1, p. 3.

¹⁴¹ Ex 57, Vol 2, p. 307.

- claims arising from mental anguish associated with asbestos exposure and/or disease
- cross claims by Hardies
- environmental, land remediation or clean-up claims
- general emergence of new sources of claim not currently represented in the Hardies database
- claims arising outside of Australia and New Zealand”¹⁴²

15.67 Although Mr Minty agreed to “take out” Section 10, he informed Mr Attrill that the report would still indicate that there were areas of uncertainty.¹⁴³

15.68 Mr Shafron wanted the ultimate maximum sensitivity figures to be below \$400m.¹⁴⁴ He explained his approach in seeking to change the draft report in the following terms:

“You know I didn’t really have anything in mind other than I knew this report was going to be sent to some third parties, and I wanted to test it by reference to a number of things including, you know, what if it became public, and so I was making some rather broad brush and I would say even rapid comments in relation to this to improve the look of it in the event that it did become public, and so the reason it escaped me now when I saw the sensitivity analysis, I thought it wasn’t, you know, based on anything – there didn’t seem to be any logic behind it so it seemed to me that a cosmetic change that I could make which I suggested was let’s keep this under 400. I believe there was no more to it than that.”¹⁴⁵

15.69 The assertion that the changes sought were “cosmetic” does not accord with Mr Minty’s response in relation to the sensitivity analysis. Mr Attrill’s recollection was that Trowbridge considered the sensitivity analysis to be “an integral part of their report”.¹⁴⁶ To that end Trowbridge persisted in refusing to change Scenario 5 in the Table setting out Sensitivity Analysis for Alternate Scenarios.¹⁴⁷ Mr Shafron continued with his endeavours to seek deletion of the sensitivity analysis. Mr Shafron accepted in cross-examination that he did not want Mr Minty to know that

¹⁴² Ex 57, Vol 2, pp. 307–309. These “elements” had been explicitly raised by Allens and commented on the ‘Project Chelsea’ review prepared by Mr Roy Williams of Allens. Environmental, land remediation and clean-up claims were not treated as “speculative” in the Asbestos Liabilities Management Plan. YEM01–YEM03: Ex 57, Vol 1, pp. 14–16

¹⁴³ Ex 57, Vol 2, p. 336.

¹⁴⁴ Shafron, T 1411.32–40.

¹⁴⁵ Shafron, T 1414.14–26.

¹⁴⁶ Attrill, T 960.12–17.

¹⁴⁷ Attrill, T 963.6–29.

he had an agenda in relation to the amendments.¹⁴⁸ Mr Shafron considered the “exercise” in relation to the sensitivity analysis was “arbitrary”.¹⁴⁹

15.70 The issue of the sensitivity analysis continued unresolved and the analysis remained in the report.¹⁵⁰ Mr Shafron instructed Mr Attrill that the Trowbridge report was to remain in draft form.¹⁵¹ As I have earlier noted the draft June 2000 report was for all practical purposes completed although not signed. An admission to this effect was made by Mr Shafron in cross-examination.¹⁵²

Accuracy of the Trowbridge Estimate

15.71 Questions were raised about the accuracy of the 2000 Trowbridge Report at an early point. Mr Roy Williams, a partner at Allens closely involved with Coy and Jsekarb’s asbestos litigation, sent Mr Attrill a letter by facsimile on 23 June commenting on the Report.¹⁵³ Mr William’s comments addressed a number of assumptions “which are said to have founded the draft report and certain legal issues” which occurred to him in reading the report. These included:

- (a) No allowance being made “for major landmark or precedent-setting cases”. The Trowbridge draft report assumed a continuation of the current legal environment;
- (b) No allowance for increased claims costs payable to the DDB under the “claw back” provisions of the 1998 legislation;¹⁵⁴
- (c) No allowance for “superimposed inflation”. He considered this to be an excessively optimistic assumption, and one which ran contrary to the then current legal environment. In his view, unless a successful test case was mounted by “James Hardie” additional damage would

¹⁴⁸ Shafron, T 1774.26–39.

¹⁴⁹ Shafron, T 1774.41–48.

¹⁵⁰ Minty, T 693.43–45; Attrill, T 959.52–960.26.

¹⁵¹ Attrill, T 964.12–21. The unresolved issues surrounding the sensitivity analysis were also given as a reason for not asking for finalisation of the draft report by Mr Williams of Allens in a letter he sent to Mr Minty on 30 January 2001 seeking a further report. Ex 50, Tab 12, pp. 110–111.

¹⁵² Shafron T 1728.46–52.

¹⁵³ Ex 61, Vol 4, Tab 13, pp. 103–105.

¹⁵⁴ Mr Attrill’s concerns with regard to the draft DDB reimbursement regulation in July 2000 are to be found in Ex 61, Vol 4, Tab 25, pp. 134–135.

be payable in most claims under the principle enunciated in *Sullivan v Gordon*,¹⁵⁵

- (d) The assumptions in relation to mesothelioma claims settlements were “somewhat optimistic”;
- (e) The possibility of lung cancer claims becoming more prevalent remained of concern;
- (f) At the time he was also concerned about a successful appeal by Rolls Royce seeking indemnity from “James Hardie” in the *Hay* case;¹⁵⁶
- (g) He was more optimistic than Trowbridge in relation to waterside workers’ claims;
- (h) He saw some possibility that lung cancer and mesothelioma would be established as “divisible” conditions which would result in lowering the average claims costs in mesothelioma and lung cancer matters;
- (i) The final outcome of the QBE settlement would need to be “factored in appropriately”;
- (j) The fact that “environmental, property or land remediation” or similar “clean up” claims were not taken account of was considered to be reasonable.

15.72 Mr Attrill forwarded Mr William’s comments to Mr Shafron by facsimile on 11 July 2000.¹⁵⁷ Mr Attrill had a telephone discussion on 10 August 2000 with Mr Robb of Allens in which Mr William’s comments were discussed. He said that Mr Williams “shouldn’t be too pessimistic.”¹⁵⁸ Mr Attrill also recalled that Mr Shafron’s view on the subject was that “... Roy was always looking on the sort of doom and gloom side”, and he would be “happy” if that view was conveyed to Allen

¹⁵⁵ (1999) 47 NSWLR 319.

¹⁵⁶ The matter was subsequently determined in Coy’s favour by the NSW Court of Appeal in *Rolls Royce Industrial Power (Pacific) Ltd v James Hardie & Coy Pty Ltd* (2001) 53 NSWLR 626.

¹⁵⁷ Ex 75, Vol 5, Tab 54, p. 1784.

¹⁵⁸ Ex 61, Vol 4, Tab 35, p. 184.

Allen and Hemsley.¹⁵⁹ In cross-examination Mr Attrill conceded that most of Mr William's comments were soundly based.¹⁶⁰ I would add that Mr Williams, whose evidence I accept, said that he had been told by Mr Robb that on four occasions he had asked for Mr William's comments to be given to Trowbridge to be "factored in" but had received no satisfactory answer.¹⁶¹

The 2000 Trowbridge Report and Public Relations

15.73 It was recognised within James Hardie that the funding aspects of restructuring required reliable actuarial information; separation would be a public process. That issue was highlighted in the advice given in conference on 18 July 2000 by Mr Gill when he said:

"The pressure point will be – if the funds prove to be inadequate, will JHNV#2 put in more money?"

15.74 Mr Shafron said that the answer was "no".¹⁶² The subsequent written advice from Mr Gill and Mr Adams dated 4 August 2000 concluded:

"Another risk with this overall strategy is that it necessarily involves the making of a public statement about the aggregate sum of money which the company considers is the value of its future liability. That may have a number of consequences, not the least of them being to excite the interest of potential Claimants and those who represent them."¹⁶³

15.75 Restructuring was also discussed by Mr Attrill with Mr Forrest QC on 25 July 2000. Mr Attrill reported to Mr Shafron, by email the same day that "Jack's 'gut reaction' to the scheme is that "it sounds OK", but that one of the key points which emerged during the discussions was:

"JH should retain an expert epidemiologist to review the basis of the Trowbridge projections. The plaintiffs will probably use Jim Leigh. We may need to counter with our own expert (WJA: Alan Rogers, Geoffrey Berry, Joe McLaughlin?)"¹⁶⁴

¹⁵⁹ Attrill, T 1192.6–20.

¹⁶⁰ Attrill, T 1165.28–1169.21.

¹⁶¹ Ex 332, para. 20. Mr Robb is rather vague in his recollection stating that he had twice so advised Mr Shafron: Ex 61, Vol 4, Tab 13; T 2903.48–2905.22.

¹⁶² Ex 100, Vol 1, Tabs 4, 6 and 7. See also Ex 100, Tab 6.

¹⁶³ Ex 61, Vol 4, Tab 31, p. 154 at 155.

¹⁶⁴ Ex 61, Vol 4, Tab 20, p. 126; see also Ex 61, Vol 4, Tab 22, pp. 127–129.

15.76 That advice was not followed.¹⁶⁵

15.77 Mr Shafron said that one of the questions which arose out of the share “buy back” proposal considered in the first half of 2000 as part of Project Green “would be the level of funds which could be left in JHIL and whether the report by Trowbridge could be released publicly to support, in a public debate, any amount chosen.”¹⁶⁶ A decision was made to engage in an exercise of “reverse due diligence”. The “exercise was expected to assist JHIL’s public relations advisers determine if the report would be able to be defended in what might be a hotly contested public debate.”¹⁶⁷

15.78 To that end Mr Ashe,¹⁶⁸ a senior manager in JHIL’s Corporate Affairs Department, produced a document dated 8 August 2000.¹⁶⁹ His review did not reflect favourably on the 2000 Trowbridge Report.¹⁷⁰ It identified a number of comments arising from the stakeholders’ perspective:

“The extensive qualifications provided by Trowbridge throughout the report suggest that in relation to estimating future asbestos related liabilities reliance on the actuarial assessment provides questionable benefit. The report does not leave the reader with confidence that the amount of \$294m is sufficient. In fact, one could easily be left with the impression that the amount is insufficient.”

15.79 That view was expressed to be based on:

- “ • The report is very heavily qualified – more than usual. Trowbridge notes that uncertainties associated with an actuarial assessment are heightened in the case of asbestos related claims.
- The limited scope of the review. Although the scope includes emerging experience and developments into medical and legal arenas and all areas of potential exposure, they have effectively excluded these areas by requiring there be “sufficient data”. The Report notes “there are a considerable number of areas of potential claim development from known sources, and those yet to be recognised.” Yet, with a couple of exceptions, they were not considered due to their speculative nature.

¹⁶⁵ Attrill, T1184.28–T1185.19.

¹⁶⁶ Ex 17, p. 12, para. 70.

¹⁶⁷ Ex 17, p. 12, para. 71.

¹⁶⁸ Mr Ashe reported to Mr Baxter, JHIL’s Senior Vice President Corporate Affairs and Planning.

¹⁶⁹ “*Review of the Draft Trowbridge Report in the Context of Stakeholder Management*”. Ex 75, Vol 5, Tab 53, pp. 1771–1783.

¹⁷⁰ Appended to the report was a document in the form of a table, which itemised 50 qualifications and disclaimers in the report which, in the author’s view, required legal advice: Ex 75, Vol 5, Tab 53, pp. 1774–1783.

While this decision might be sound from an actuarial perspective, stakeholders would suggest that with a minimum of 20 years of claims left, an allowance should be made to cover the risk of claims eventuating from “the considerable number of areas of potential claim development” – particularly as there appears to be an emerging trend by the courts and Government to make suppliers like JH more accountable for their past.

- The (what appeared to be) tendency for Trowbridge to lean on the low side in relation to key data such as number of claims and average settlement sizes.
- The sensitivity analysis. First impression of the sensitivity analysis is that the \$294m appears to be on the low side. The variation in amounts range from \$169m to \$559m with the average being \$337m. Although averaging is unlikely to be a sound basis for considering the reasonableness of the \$294m, the spread of amounts in the sensitivity analysis does leave the impression that \$294m is on the low side.
- What attracts more attention to this analysis and highlights the potential for stakeholders to use it for arguing a much higher amount, is their accompanying comment:

“This degree of variation gives some indication of the limited knowledge and history of asbestos related claims and the uncertainty that exists in respect of the potential impact of their emergence on Hardie’s exposure.”

One could easily contemplate a reader quickly making adjustments (such as the ones shown below) to argue for a larger amount:

- If the legal and other costs were more in line with 1998 rather than 1999 – add \$34m;
- If claim numbers increased, not by 50% as per the “high claim number” projection, but say by 20% - add \$50m;
- If the average claim size increased by 20% - add \$43m;
- The required amount of \$294m becomes \$421m, and this doesn’t account for other risks such as potential environmental related claims.

It would appear reasonable to expect that adjustments such as the above will be argued as necessary by some stakeholders. Hence, the issue of a “buffer”, its size and our ability to convince and/or influence stakeholders will be key matters for success.

Areas of Potential Attack

Potential attack is likely to centre around three areas:

- The extensive qualifications and disclaimers placed on the report by Trowbridge. Trowbridge seems to be warning against the use of their assessment for anything other than internal matters – certainly not as the basis for calculating separation costs.

- The failure to adequately provide for “a considerable number of areas of potential claim development” in estimating future liabilities.
- The data and assumptions used in applying the methodology.”¹⁷¹

15.80 According to Mr Shafron, in the light of Mr Ashe’s analysis, “it was decided that the Trowbridge actuarial report, possibly like other actuarial reports involving long latency period events and future uncertainties, would be difficult to defend in a public debate.”¹⁷² In cross-examination Mr Shafron did not accept that it was his opinion (or indeed he had an opinion) on the issue of “defensibility” of the Report. Rather, he sought to characterise the review as “an assessment made by the PR people about defensibility”.¹⁷³

15.81 In any event, a decision was made not to make the report public.¹⁷⁴ However, the 2000 Trowbridge Report was given on “a confidential basis for various insurers”.¹⁷⁵

Use of the Report for Insurance Purposes

15.82 Following the advice to Mr Minty that the Report was required for insurance purposes, Mr Shafron was anxious to obtain a report from JHIL’s insurance brokers Jardine Lloyd Thompson prior to the JHIL Board meeting in August 2000 containing “costed options, mechanics, and likely third parties, necessary to take out or defray its asbestos liabilities”.¹⁷⁶ Mr Shafron advised Mr Steve Forrest of Jardine Lloyd Thompson that “we would move heaven and earth to send him a draft of Trow.”¹⁷⁷

15.83 An issue which gave rise to tension between Mr Shafron and Mr Minty was Trowbridge’s request for an indemnity if the Report was used for any insurance purposes. On 16 June 2000 Mr Shafron emailed Mr Minty:

¹⁷¹ Ex 75, Vol 5, Tab 53, pp. 1772–1773.

¹⁷² Ex 17, p.13, para. 71. On 10 August 2000, in an email to Mr Attrill, Mr Shafron expressed the issue that the 2000 Trowbridge Report “is not suitable for public release”: see Ex 61, Vol 4, Tab 39.

¹⁷³ Shafron, T 1722.5–21.

¹⁷⁴ Shafron, T 1580.40–43; T 1580.49–51.

¹⁷⁵ Shafron, T 1580.45–47.

¹⁷⁶ Ex 57, Vol 2, p. 334.

¹⁷⁷ Nevertheless, Mr Shafron still was intent on seeing the draft first. Ex 57, Vol 2, p. 334.

“I have just finished talking to our CEO and wanted to convey how unhappy we are with the position you have taken in demanding an indemnity in return for us being able to use your report for the purposes that I outlined to you in February.

The reason I outlined the possible use of the report (subsidiary and incidental to the main purpose of using it in our litigation strategy) in February was to flush out any special requirements that you may have. I suspect that you didn’t raise any issues then because you were still operating as Trowbridge and had not merged with Deloitte. The position you took then was consistent with your general approach to our work – nothing was too much trouble. For that I was very grateful.

The position you have now taken is a surprise and likely in breach of your original contract of engagement where no such requirement was discussed or agreed.”¹⁷⁸

15.84 Mr Minty replied on 15 June 2000:

“As I have discussed with Wayne, we do not expect to have any issue with giving permission if you choose to release our current or previous reports in conjunction with any restructuring of the JH group, as we discussed in February, since the purpose of the report is to assist JH’s advisers in respect of the litigation of the claims and in advising the Board. Such a release therefore would be, in my opinion, consistent with the original purpose for which the report was prepared given the restructuring is in part a means of dealing with the emerging liability.”¹⁷⁹

15.85 JHIL provided Trowbridge with a limited indemnity by letter dated 16 June 2000.¹⁸⁰

15.86 Some insight in relation to both Mr Shafron’s and Mr Macdonald’s understanding of the limitations of the 2000 Trowbridge Report can be seen in an email dated 15 June 2000 from Mr Shafron to Mr Macdonald complaining about the “unexpected” request for an indemnity by Trowbridge. He said that the risk in JHIL providing an indemnity to Trowbridge:

“... is that a UK insurer relies on it, it turns out to be flawed, and sues Trowbridge. T sues JHIL and JHIL pays. This risk is reduced because we will provide the underlying data, and insurers are expert at making these kind of assessments with actuaries on staff etc. And actuarial reports are by their nature guesses, and this report states clearly that there are no guarantees. The model itself is fairly simple and explained in the report. We can further reduce the risk by making it clear that they cannot rely on the report but must rely on the underlying data etc.”¹⁸¹

¹⁷⁸ Ex 50, Tab 10, p. 107.

¹⁷⁹ Ex 50, Tab 10, p. 106.

¹⁸⁰ Ex 57, Vol 3, pp. 750–751.

¹⁸¹ Ex 57, Vol 2, p. 435.

Tillinghast

15.87 Consideration was given to engaging actuaries other than Trowbridge. A catalyst may have been the views attributed to Mr Gill in a teleconference on 25 July 2000 involving Mr Shafron, Mr Gill and Mr Adams and Mr Attrill.¹⁸² The notes taken by Mr Gill¹⁸³ and Mr Attrill suggest that Mr Gill raised the issue of utilising other actuarial reports and “critiquing Trowbridge”. Mr Shafron is recorded as saying: “Will get another actuary (sic) report from Towers Perrin”.¹⁸⁴

15.88 Mr Shafron made contact with Mr Verne Baker of Tillinghast (a firm of actuaries associated with Towers Perrin) in late July 2000.¹⁸⁵ Mr Shafron informed Mr Attrill “I plan to get these guys to help us handle Minty (an actuary in our corner).”¹⁸⁶ A copy of the 2000 Trowbridge Report was forwarded to Mr Baker at Tillinghast–Towers Perrin on 2 August 2000.¹⁸⁷

15.89 In a subsequent teleconference on 10 August 2000 involving Mr Shafron, Mr Baxter, Mr Ashe and himself, Mr Attrill recorded the following exchange:

- “ • PJS (Mr Shafron) – T (Trowbridge) were asked in the past to highlight areas of uncertainty for litigation.
- Do we go to another actuary and start again?
- SB (Mr Baxter) – would like to have a report which we can make public including the data and the methodology.
- PJS – next action point – conference with Verne – sensitivity analysis – DM (Mr Minty) has agreed to take out numbers.”¹⁸⁸

15.90 The rationale for opening the dialogue with Tillinghast is canvassed by Mr Shafron in his email on 10 August 2000 to Mr Attrill¹⁸⁹:

“It is possible that we would ask Verne for the actuarial advice that we need to support the separation. The more I think about the Trowbridge report the more I

¹⁸² Mr Attrill’s notes are in Ex 61, Vol 4, Tab 19, pp. 122–125, and Mr Gill’s notes are in Ex 100, Tab 9.

¹⁸³ Mr Gill is also recorded as observing: “*Absent total restructuring, no insurance arrangements can give complete resolution. Insurance always sits behind a corporate liability. Worthwhile getting stop loss insurance.*” Ex 61, Vol 4, Tab 19, p. 123; see also Ex 100, Tab 11, p. 115.

¹⁸⁴ Ex 61, Vol 4, Tabs 19, p. 122 at p. 124.

¹⁸⁵ Ex 61, Vol 4, Tab 28, pp. 148–149 at 149.

¹⁸⁶ Ex 61, Vol 1, Tab 28, p. 148.

¹⁸⁷ Ex 61, Vol 4, Tab 30, p. 152.

¹⁸⁸ Ex 61, Vol 4, Tab 38, pp. 242–245 at 244.

¹⁸⁹ Ex 61, Vol 4, Tab 39, p. 246.

think that it is not suitable for public release, prepared as it was to assist us in our litigation strategies.

One possible scenario is that we conclude the Trowbridge report (i.e. finalise comments and ask Minty to sign) and let it take its place on the litigation shelf with reports 1 and 2. We separately brief Verne to produce the kind of report that Allens advise us would be appropriate for public release in the context of the takeover.

I would like to proceed this way:

1. David Robb and Wayne Attrill meet Verne (me participating by phone) next week to take his comments and assess Verne as the possible takeover actuary.
2. Allens (Robb) prepares a draft outline of actuarial report (i.e. topics, length) that would be appropriate for public release to support the takeover. JH comments.
3. Depending on our assessment of Verne and other factors we discuss the outline with Minty or Verne. Wayne will set up the meeting with Verne, and liaise with David and me (Wed or Thurs afternoon next week is OK for me).

OK?”

15.91 The use of Tillinghast’s actuarial services for the purpose of Project Green was also discussed between Mr Robb and Mr Attrill on 10 August 2000.¹⁹⁰ The matters discussed included the use of Allens to brief Tillinghast to maintain privilege, and Allens’ desire to maintain Mr Williams’ involvement notwithstanding his criticism of the Trowbridge report. Whilst acknowledging this desire on the part of Allens, Mr Shafron cautioned that “they (Allens) should be careful that a balanced picture of the litigation is presented to the actuary.”¹⁹¹ Mr Robb is also noted as saying “that Tillinghast would derive some comfort from the fact that a buffer is proposed over and above the amount the actuary may advise and that we will obtain QC sign-off”.¹⁹²

15.92 Mr Shafron’s approach to retaining Tillinghast was cautious, however: “we mustn’t assume that we have changed or will change horses”.¹⁹³ Mr Attrill interpreted this approach as representing a change on Mr Shafron’s part:

¹⁹⁰ Ex 61, Vol 4, Tab 42, p. 249.

¹⁹¹ Mr Attrill noted that Mr Williams was mainly involved in the most difficult cases and had less knowledge of the “run of the mill cases”. Ex 61, Vol 4, Tab 42, p. 249.

¹⁹² Ex 61, Vol 4, Tab 42, p. 249.

¹⁹³ Ex 61, Vol 4, Tab 42, p. 249.

“Peter (Mr Shafron) said that he only wants us to obtain Verne’s initial impressions of the Trowbridge draft. I think he wants us to try and find out from Verne what his likely attitude would be before we commit to formally briefing him.”¹⁹⁴

15.93 This appears to have occurred at the low point in the commitment to Project Green. As earlier mentioned in a conference call on 10 August 2000 with Mr Baxter, Mr Ashe and Mr Attrill, Mr Shafron had provided an overview on the prospects of separation,¹⁹⁵ in which it was said that the “mood in the camp” was “very negative”. Mr Macdonald was said to be “strongly influenced” by a note from Mr Ashe and Mr Baxter which “highlighted likely strong government opposition”.

15.94 Jardine Lloyd Thompson had also come back with a number of reinsurance options. Relevantly, “AIG” was said not to “accept Trowbridge” and their “base case” was “\$650m”¹⁹⁶ undiscounted (some \$120m more than the Trowbridge figure). Mr Attrill’s understanding was that AIG had also reworked the Trowbridge figure and for cover of \$1bn the premium would be \$400m, on the basis that JHIL was liable for the first \$75m.¹⁹⁷ None of the insurers consulted indicated that they expected that the stream of liabilities would be less than the Trowbridge estimate.¹⁹⁸ Mr Shafron acknowledged in cross-examination that JHIL was not in a position to fund these options.¹⁹⁹

15.95 JHIL senior management duly reported on insurance to the JHIL Board on 18 August 2000 as part of the comprehensive presentation dealing with key aspects of Project Green.²⁰⁰ Put simply, the report concluded that there was “(i) insufficient cash to fund premiums”.²⁰¹ Mr Macdonald’s recollection was that the “premiums quoted significantly exceeded the net assets of Amaca and Amaba” and were “at similar levels to the costs expected by Trowbridge”.²⁰² In those circumstances

¹⁹⁴ Ex 61, Vol 4, Tab 43, p. 250.

¹⁹⁵ Ex 61, Vol 4, Tab 38, pp. 242–245.

¹⁹⁶ Shafron, T 1586.34–37.

¹⁹⁷ Shafron, T 1585.19–53.

¹⁹⁸ Shafron, T 1586.15–37.

¹⁹⁹ Shafron, T 1587.11–22.

²⁰⁰ Ex 148, Vol 1, Tab 1, pp. 1–52 at pp. 12–17.

²⁰¹ Ex 148, Vol 1, Tab 1, pp. 1–52 at p. 15.

²⁰² Ex 148, p.4, para. 13.

“management did not recommend nor did the Board request that any of the proposals be accepted. JLT continued to work on the insurance defeasance concept”.²⁰³

15.96 A meeting was held with Tillinghast on 23 August 2000²⁰⁴ the purpose being to explore with Tillinghast whether JHIL would instruct Tillinghast to prepare another report for the directors to assess asbestos liabilities for the purpose of “corporate reconstruction”.²⁰⁵ It was also intended that such a report would be made public. The report was to address “JH’s present and future liability for compensatory damages for personal injury for asbestos-related claims and associated legal costs”.²⁰⁶

15.97 The notes taken of the meeting by Mr Attrill provide some insight with regard to other actuaries’ views of aspects of the existing draft Trowbridge report.²⁰⁷ The key inputs (epidemiological data and court settlements) lacked certainty. Tillinghast could “only give (JHIL) a range, not an actuarial number. That is as far as you can go. Otherwise it’s spurious accuracy”. Mr Finnis indicated that Tillinghast would “strongly go for scenario modelling”. It seems such an approach would have taken account of “a lot of potential developments” excluded by the Trowbridge report. Mr Finnis is recorded as saying he was more comfortable with a “range” rather than a number: “I’d be very edgy about picking a best estimate. That is not within actuarial capabilities”. The notes then record an exchange between Mr Baker and Mr Finnis to the effect that the Australian Actuarial Standard usually requires a “central estimate” and this study would “go outside the actuarial standard”. “DF: This is not an appropriate context to produce a central estimate”.²⁰⁸ Mr Shafron wanted a “short report” and for privilege to be maintained.²⁰⁹

15.98 One of the reasons given by Mr Shafron why he was actively exploring the use of another firm of actuaries was that Trowbridge “... used to have fairly detailed

²⁰³ Ex 17, p.14, para. 76.

²⁰⁴ Attended by Messrs Baker and Finnis from Tillinghast, Mr Robb from Allens, Mr Attrill and Mr Ashe with Mr Shafron participating by telephone. Ex 61, Vol 4, Tab 50, pp. 324–326. See also Shafron, T 1734.12–1735.32; Attrill, T 1202.41–1204.22.

²⁰⁵ Attrill, T 1203.5–11; T 1203.21–24.

²⁰⁶ Ex 61, Vol 4, Tab 50, p. 325.

²⁰⁷ Ex 61, Vol 4, Tab 50, pp. 324–326.

²⁰⁸ Ex 61, Vol 4, Tab 50, p. 325.

²⁰⁹ Ex 61, Vol 4, Tab 50, p. 325.

discussion of legal developments and often times those legal developments related to ongoing cases or current cases and that isn't something that I would expect to see in a public report".²¹⁰ Mr Shafron accepted that he could have asked Trowbridge to delete such references, as he had done with other aspects of the draft report.²¹¹ I found Mr Shafron's stated reasons for his discussions with Tillinghast not entirely convincing. I think it more likely he was exploring, as he was entitled to do, whether a further actuarial report might be more favourable, in the sense of giving a lower estimate of the asbestos liabilities, than the 2000 Trowbridge Report. In the end, however, Tillinghast was not subsequently engaged to prepare an actuarial report for JHIL.

15.99 The fate of the insurance proposal was outlined by Mr Shafron in an email to Mr Adams of Phillips Fox on 8 September 2000:

"In relation to the insurance option, we got some quotes for loss portfolio transfer that were frankly too rich for us. The problem was that the reinsurers were factoring in an earnings rate on the premium of around 7%, but if we keep the money we earn around 20% investing it in our own business. They are currently looking at stop loss options."²¹²

15.100 It seems, however, that the 2000 Trowbridge Report may have still been under "active consideration" by prospective insurers in December 2000.²¹³

Continuous Disclosure Requirements

15.101 The final matter concerning the 2000 Trowbridge Report related to a query raised at the August 2000 Board Meeting by Mr Brown,²¹⁴ a director of JHIL. Mr Brown appears to have asked whether the 2000 Trowbridge Report gave rise to any issues with regard to Continuous Disclosure requirements under the ASX Listing Rules.²¹⁵

15.102 Mr Shafron's view was that JHIL was not compelled to make any such disclosure. He prepared a draft memorandum for Mr Macdonald and forwarded the

²¹⁰ Shafron, T 1735.5–9.

²¹¹ Shafron, T 1735.11–20.

²¹² Ex 100, Tab 15, p. 1.

²¹³ Ex 17, p.24, para. 134.

²¹⁴ Ex 224, Vol 1, Tab 13, p. 183.

draft for comment to Mr Peter Cameron at Allens.²¹⁶ Mr Shafron's draft included the following:

"I have raised the issue with Peter Cameron/David Robb at Allens. In his view (and mine) the draft Trowbridge work does not compel us to make any additional disclosure to the market in relation to asbestos liability in the Group. In brief, the reasons are as generally follows:

....The Trowbridge work is very uncertain. It is based on very imperfect epidemiological models and very uncertain predictions of future claim numbers and claim costs. On the basis of its sensitivity analysis the liability could be up to \$384M higher or \$220 lower (at net present values). (The sensitivity analysis that was used in the draft report is not based on any particular level of probability.)

... The Trowbridge work is still in draft, partly because of certain unresolved issues in its preparation and presentation. One of those issues is the sensitivity analysis.

In short, given the uncertainty of the level of the future liability and the difficulty in making an accurate prediction; given that whatever the eventual liability, on the current state of the law the maximum extent of the Group's legal obligation is around \$170M (Coy's net assets); given our current disclosures and the information currently in the market, we do not seem to have any additional concrete or specific information that we are compelled to disclose under the ASX Listing Rules."

15.103 Mr Cameron, who had not read the 2000 Trowbridge Report²¹⁷ commented that he was "broadly²¹⁸ comfortable" with Mr Shafron's conclusions in his draft, including in his reasons:

"2. The Report seems to me to fall within several possible heads of ASX LR 3.1.3: It was generated for internal management purposes (in connection with managing the litigation and so that the Board would have an understanding of the potential parameters of exposure in order to manage the Group), it is incomplete in that it is a draft (although not a "proposal or negotiation") but *in particular, it seems to me that as a measure of the company's exposure it is insufficiently definite to warrant disclosure, at least in part due to the sensitivities to which you refer.*

In this last regard, I am reminded of some of the more sensible decisions in relation to prospects statements in connection with prospectuses and takeover documents (where there are no carveouts), where the courts have held that *information which is so speculative as to be potentially misleading* should not be disclosed." (Emphasis added)

²¹⁵ Ex 156 and Ex 157.

²¹⁶ Ex 224, Vol 1, Tab 13, p. 184.

²¹⁷ Or any of the Trowbridge Reports: P. Cameron, T 3046.16–23.

²¹⁸ Ex 224, Vol 1, Tab 14, p. 186.

15.104 The memorandum in final form dated 16 October was circulated with the October 2000 Board Papers.²¹⁹ Mr Shafron said in regard to the 2000 Trowbridge Report that:

“... It is based on imperfect epidemiological models and a range of predictions of future claim numbers and claim costs.”

15.105 And:

“The Trowbridge consulting work may not progress to a definite report, partly because of certain unresolved issues about which there is significant uncertainty.”

15.106 It is surprising, in the light of those views about the 2000 Trowbridge Report, that it could have been regarded as a satisfactory base which Trowbridge could update for the purpose of separation. The short fact seems to be that the 2000 Trowbridge Report was used by James Hardie when it suited it to do so, but was denigrated when it did not.

The new Study

15.107 In Chapter 11, I have discussed the emergence in November 2000 of the Trust as the most promising separation concept within James Hardie management. Late in November, however, there emerged an unpleasantness which had the potential to increase significantly the calculation of the Group’s asbestos liabilities. It was a presentation by two Trowbridge actuaries to the 8th Accident Compensation Seminar. I discuss it in the next Chapter.

²¹⁹ Ex 25.

Chapter 16 – Watson and Hurst

A. Background

16.1 Actuaries from Trowbridge had been prominent in publishing studies on the likely impact of asbestos related diseases, in particular for insurers. This work included the Andrews and Atkins study in 1993¹ (a presentation to the Institute of Actuaries), and the Atkins, Smith, Watson paper on “Recent Trends in Asbestos-Related Diseases”, presented at the 6th Accident Compensation Seminar in December 1996.²

16.2 On 29 November 2000 the pattern continued with a presentation by Watson and Hurst to the 8th Accident Compensation Seminar. So far as it was documentary, the presentation consisted of a PowerPoint presentation.³ The presentation addressed “asbestos liabilities” and became known as the “Watson and Hurst Model”. This was later published on the internet.⁴ A copy is Annexure “N”.

B. Structure of the Presentation

16.3 The study commenced with some information about the incidence of mesothelioma and the scope of liabilities in the United States, Europe and Australia. The aims of the presentation were then stated:

“Understand implications of a number of significant legal and other developments.

Review recent projections of future claims experience and current methods for estimating asbestos-related disease liabilities.

Update method for the estimation of future asbestos reserves.”

As to the first point, data from various sources (Mesothelioma Register, Dust Diseases Board and Dust Diseases Tribunal) indicated that mesothelioma numbers continued to rise, that product liability claims in particular were increasing, reflecting later exposure, and suggesting a later “peak” than had previously been expected. As

¹ Ex 2, vol 3, Tab 12, p. 639.

² Ex 2, Vol 3, Tab 13, p. 777.

³ Ex 3, Vol 3, Tab 1.

⁴ Ex 7, MRCF 3, Tab 8, pp. 83–109.

to the second point, the presentation noted the possible impact of the decision in *Crimmins*,⁵ and the increasing activity of plaintiffs' lawyers.

16.4 The central part of the presentation was a comparison of the Australian mesothelioma experience with expectations based on earlier studies, specifically, Andrews and Atkins's Low and High, and a projection called "Expected - Berry High". This showed actual experience being significantly worse than even the most pessimistic forecasts.

16.5 The reference to a "Berry" projection or curve requires explanation. Dr G Berry of the University of Sydney published a paper in 1991 entitled "Prediction of mesothelioma, lung cancer and asbestosis in former Wittenoom asbestos workers".⁶ The paper proposed a range of models or curves based on different assumption as to the time "lag" between exposure to asbestos and the commencement of development of mesothelioma and differing rates of elimination of asbestos from the body.⁷ The "Expected-Berry High" curve discussed in this part of the Watson and Hurst presentation was based on the first of the models in Dr Berry's report (nil lag, nil elimination).

16.6 The presentation then turned to a consideration of an updated reserving approach which would allow for the fact that old models were based on now outdated data (to 1990), and had been shown to be inadequate. The new models were called "Berry Medium" and "Berry High" and the total number of projected future claims under the various models was as follows:

Model	Future Meso Claims	Increase from A & A High (1993)
A & A High (1993)	4,500	-
A & A High (rescaled)	6,300	40%
Berry Medium	9,400	109%
Berry High	11,400	153%

⁵ *Crimmins v Stevedoring Industry Finance Committee* (1999) 2000 CLR 1.

⁶ Br. J. Ind. Med. 1991; 48: 793-802; Ex 257, pp. 20-29.

⁷ Ex 257, p. 25.

Mr Minty explained that these two “Berry” models were based on the second and third models in Dr Berry’s 1991 paper, rescaled⁸ to take into account the actual experience for the 1990’s, and then extended out to 2040 (from 2020).⁹

C. Watson and Hurst’s Data

16.7 The presentation was based on mesothelioma incidence data to 1996,¹⁰ claims made to the New South Wales Dust Diseases Board and Dust Diseases Tribunal, and the data of twelve insurers.

D. Trowbridge – JHIL discussions concerning Watson and Hurst

16.8 On 1 December 2000 Mr Minty advised Mr Attrill by email of the presentation and of its publication on the Trowbridge website.¹¹ In a subsequent telephone conversation on 4 December 2000 Mr Minty explained the material in the presentation to Mr Attrill in “general terms”.¹² Mr Minty’s recollection of the conversation was that Mr Attrill asked whether “James Hardie’s ARD claims data” was included in the presentation. Mr Minty indicated that James Hardie’s data had been kept confidential and only publicly available data was used. When asked by Mr Attrill to undertake “some projections” as to the likely effect on Trowbridge’s liability projections for JHIL, Mr Minty responded to the following effect:

- “(a) the Watson and Hurst study did not rely upon any James Hardie specific data;
- (b) accordingly, it was not appropriate to simply overlay the Watson and Hurst study’s conclusions onto Trowbridge’s actuarial reports for James Hardie;

⁸ “Rescaling” or recalibration essentially involves shifting the curve up the vertical axis so that it intersects with the most recent data point.

⁹ Ex 257, paras 11–13; Ex 258, paras 14–17.

¹⁰ As Mr Whitehead explained, data for the register took two years to be checked and reconciled, and was unreliable until then (T 3203.25–3207.30, Ex 254).

¹¹ Ex 57, Vol 4, p. 76; Ex 50, p. 5, para. 28; Ex 56, p. 16, para. 62.

¹² Although Mr Shafron and Mr Attrill responded indignantly, Mr Attrill, at least, had some forewarning that a presentation would take place in November. It would seem that Mr Attrill was informed by Mr Marshall, Ex 50, Tab 12, p. 109, at the briefing conference on 4 June 2000 that Trowbridge had set up a “*project team to update the Andrews and Atkins paper for a seminar in November* (2000). Ex 57, Vol 1, p. 115. This appears to be confirmed by Mr Attrill’s file note of 4 December 2000, Ex 57, Vol 4, p. 799, and Mr Minty’s email to Mr Marshall of 4 December 2000, Ex 50, Tab 11, p. 109.

- (c) a further detailed analysis would need to be undertaken to ascertain the relevance of the conclusions in the Watson and Hurst study to James Hardie”.¹³

Mr Attrill is said by Mr Minty to have replied:

“OK. There’s no need for you to do any of these projections now. I’ll speak to my colleagues in the US and get back to you.”¹⁴

16.9 On 1 December 2000 Mr Shafron reported to Mr Macdonald on November asbestos developments.¹⁵ He said that “November has been a poor month on the asbestos front”, that an “upcoming epidemic in asbestos disease in NZ, particularly among building workers” had been predicted and that “November has been a very busy month” with “settlements and judgments for the month \$4.65m”. He went on to deal with Watson and Hurst:

“Two actuaries from Trowbridge have gone on the public record (a conference of actuaries and the Trowbridge web site) predicting a sharp increase in the rates of asbestos disease and indicating that most existing provisions will be inadequate (see attached). If the Trowbridge numbers for Coy were reworked on the basis of the new material, then there could be an increase in the predicted cash out flows by around 40%, although we will know more when we speak to David Minty on Monday.

The information contained in the report broadly accords with our own experience, although was based on information from insurers, the DDB and possibly other public information. To that extent its broad message is no surprise, either to us or participants in this area. However, the specificity of the findings and their broad public release could well attract wider attention. The report is based on a more detailed study, which is not yet complete.

We were very surprised to hear of the report, given that we have Trowbridge on retainer on this very subject. I suspect that they will say that it is part of their ongoing published work in this area (one of the authors – Watson – has authored work in this area previously). We will get to the bottom of that Monday, and intend to request Trowbridge to remove the document from its website, at least on a pro tem basis pending the finalisation of the detailed study.”

¹³ Ex 56, pp. 16–17, para. 68.

¹⁴ Ex 50, p. 5, para. 28.

¹⁵ Ex 57, Vol 4, p. 795.

16.10 Mr Shafron forwarded the Watson and Hurst presentation to Mr Macdonald, Mr Morley and Mr Baxter with the following observations:

“... In short, the report says that future claims experience is likely to be worse than originally predicted by Andrews, Smith and Atkins. Existing reports based on the Andrews study (eg Trowbridge reports) are now out of date and would seem to require an up tick factor of at least 40%.”¹⁶

According to Mr Shafron, Mr Macdonald “hit the roof” when he saw the report, especially given the lack of prior notice¹⁷ and Mr Macdonald thought that the Chairman (Mr McGregor) would react in the same way. Hardly surprisingly, one might think. The prospect that estimates of liabilities had increased by 40 per cent, and might well get higher, was likely to have two effects. It might increase the amount of money to be left in Coy/Jsekarb if separation were to take place. The fact that estimates of asbestos liabilities were increasing continually might also make separation more urgent.

16.11 Although concerned, Mr Shafron pondered whether the presentation was part of “... an ongoing program of some sort” but still instructed Mr Attrill to prevail upon Mr Minty to suspend the publication from the Trowbridge website on the basis that it was an incomplete report.¹⁸ Mr Attrill spoke to Mr Minty but Trowbridge did not remove the report from their website.¹⁹

16.12 The experience of James Hardie itself also was to the effect that asbestos liabilities overall in Australia were increasing. That experience was dealt with in some detail in Mr Attrill’s December 2000 Operating Plan Review, the subject of Chapter 17.

¹⁶ Ex 57, Vol 4, p. 767.

¹⁷ Mr Macdonald said his reaction was concern rather than anger. Macdonald, T 232.25–27.

¹⁸ Ex 57, Vol 4, p. 795; Ex 57, Vol 4, p. 798.

¹⁹ Ex 57, Vol 4, p. 800; Ex 57, Vol 4, p. 801.

Chapter 17 – Operating Plan Review

A. JHIL's Business Plans

17.1 JHIL operated a rolling 3-year Business Plan for its business units. The Business Plan incorporated a one year Operating (or “Management”) Plan.¹ The Operating Plan was reviewed approximately six-monthly by relevant members of the Group Management Team² (“GMT”). In accordance with these arrangements Mr Attrill was required to prepare, on an annual basis, an Asbestos Liabilities Management Plan for his Section. Actual performance was then compared against the plan. Mr Attrill was required to explain any variance to the plan to the GMT and, “in conjunction with the GMT, develop a revised strategy”.³

B. December 2000 Operating Plan Review

17.2 On 12 December 2000 the Operating Plan Review for the six months ending 30 September 2000 was circulated to Mr Macdonald, Mr Morley, Mr Shafron, Mr Baxter and Mr Ashe⁴ in anticipation of a telephone conference the following day.

17.3 The Operating Plan Review records a number of observations relating to significant developments during the preceding six months.⁵ While the first observation stated “Overall our performance in HY01 exceeded our expectations”,⁶ a number of significant developments were identified, including:

- (a) Cost of settlements and damages awards was 25 per cent higher than forecast and 56 per cent higher than the same period YEM99.
- (b) This was due to a 58 per cent increase in the number of claims settled.
- (c) New claim numbers, (126) were up 70 per cent on the previous period, and 116 of these were product or public liability claims.

¹ Macdonald, T 2329.50–56.

² Attrill, Ex 56, para. 23–25. There is some confusion in the evidence about the nomenclature of the Plans. The sense, however, is as I have described it in the text of this paragraph.

³ Ex 56, p. 9, para. 25 in Attrill, T 974.10–19.

⁴ A copy of the Watson and Hurst presentation was attached Ex 57, Vol 4, p. 815. A forecast in asbestos related costs for YEM01 (Appendix 3) Ex 57, Vol 4, p. 817 was also provided pursuant to “*the request of Mission Viejo*” (JHIL’s Corporate Head Office).

⁵ These observations were, in effect, a high level summary of significant changes since the last report: Attrill, T 974.22–29.

⁶ Ex 57, Vol 4, p. 808.

- (d) The greater majority of claims settled were mesothelioma claims.
- (e) An increasing proportion of new claims were for mesothelioma contracted by end users (59 out of 64 per HY01, as opposed to 36 out of 41 in HY001)."

17.4 And, as Mr Attrill also said in that document:

"The increase in claims may be a temporary phenomenon. However, if it continues it may necessitate a re-rating upwards of James Hardie's long-term expected claim numbers and liabilities because: (a) the number of people who used or were exposed to James Hardie's [Asbestos Cement] products is very large; (b) lighter exposure to asbestos appears to be sufficient to cause mesothelioma; (c) lighter exposure is known to increase to disease latency which in turn may limit insurance recoveries and may extend the peak in claims received."

C. Additional information in the Operating Plan Review

17.5 The Operating Plan Review was of particular significance because it also contained information relating to the period after September 2000. Appendix 3⁷ recorded that in November 2000:

"...we were asked to review the YEM01 asbestos forecasts at the request of Mission Viejo.

We concluded, on the basis of our performance to date and having regard to currently notified claims which we expect to resolve in the next quarter, that the estimates should be increased. The end result was:

To 31.12.00

Settlements:	\$19.3m
Legal costs:	\$4.5m
Recoveries:	(\$3.0m)- excluding QBE
Total:	\$20.8m

To 31.3.01

Settlements:	\$27.7m
Legal costs:	\$6.5m
Recoveries	(\$4.0m)
Total:	\$30.2m
QBE provision	(\$6.1m)
Grand total	\$24.1m

⁷ Ex 7, MRCF 1, Tab 5, p. 103.

These figures exclude the corporate costs. It is clear from the number of current mesothelioma claims we presently have that the next few months will be busy. It is unlikely that JHC will enjoy the traditional January lull next year.”

17.6 The \$6.1m QBE provision for the year to 31 March 2001 reflects the receipt in one year of two years of the QBE settlement amount. If one leaves the QBE figure out of account, it appears that the net outgoings for the YEM 2001 were now expected to be \$30.2m. This was at a level much above that used in the 2000 Trowbridge Report, and to be used in the February 2001 Trowbridge Report.

17.7 Appendix 3 went on to say that the principal reasons for the increase in estimated costs include:

- “1. More claims – mainly end users with meso from lighter exposure. (Trowbridge projected 102 GL meso claims for FY01. In HY01 JHC received 64 meso claims).
2. End user claimants are typically younger than WC claimants. This has increased the number of “significant” claims (\$0.5–1.0m+) we have received and settled this year. As at 13 November 2000, we had on our books about 11 such claims (some of which have now settled).
3. Turner Freeman’s marketing operation in SA is having its impact (7 claims received since 1/9/00, more to come); wharf claims are increasing claim numbers but not yet impacting on settlements; increased claim activity in WA since Slaters enlarged their Perth office.
4. The increase is not due to increases in average settlement payments by JHC – we are holding the line.
5. Non-QBE insurance cover has temporarily fallen off, and will not increase until we receive more claims with exposure in the 1980s.”

17.8 The November request for a review of the YEM01 asbestos forecasts had come from “Mission Viejo”, i.e. JHIL’s head office, where Messrs Macdonald, Shafron and Morley were located. This suggests an interest in the figures going beyond the position normally obtaining at periodic reviews.

D. 13 December 2000 Conference concerning the Operating Plan Review

17.9 A telephone conference took place on 13 December 2000 between Mr Macdonald, Mr Shafron and Mr Morley (in the US) and Mr Attrill, Mr Baxter and

Mr Ashe (in Australia). Mr Attrill's note of the conversation⁸ makes it clear that the deterioration over the YEM 1999 to YEM 2000 period was discussed in some detail, with specific input from Mr Morley and Mr Macdonald. Mr Macdonald referred to the aim of achieving \$20m for a full year. There was also a discussion of the proposal for a trust and its funding, Mr Shafron observing that: "We're on our best behaviour because of Project Green" and Mr Baxter saying that they should "aim for no media coverage for a month or so."

17.10 Mr Attrill's oral evidence that was "he took the GMT through the key points from my OPR, and there certainly was concern expressed" (by the GMT members and Mr Attrill) "about the increase in claim numbers, and the amounts that the litigation was costing".⁹

17.11 The trust then proposed was also mentioned. It was to be simply the shares in Coy and Jsekarb, and an additional sum from JHIL "to spend on medical projects". It was mentioned that they had "3-4 weeks to find Trustees".

17.12 Mr Shafron rather endeavoured, I thought, to distance himself from any specific knowledge of the adverse aspects of this report.¹⁰ For example, one issue of particular significance related to whether there was a "levelling off" of claims for mesothelioma. In cross examination on this aspect of the Operating Plan Review he accepted that if he had "thought about them" he would have agreed that the current experience at the time did not show a levelling off of mesothelioma experience.¹¹ He acknowledged that the number of "downstream users" exposed was very large¹² and that Mr Attrill was reporting that an increasing proportion of mesothelioma claims was being made by "downstream users".¹³ Mr Shafron agreed that having read Mr Attrill's memorandum and discussed it during the performance review he would have understood that on the basis of the figures JHIL had been experiencing over the previous six months, there was a "real risk" that the exposure to asbestos claims in

⁸ Ex 61, Vol 5, Tab 13.

⁹ Attrill, T 976.46-57.

¹⁰ Nonetheless, he accepted it was one of his areas of responsibility and one in respect of which he reported to the JHIL Board. Shafron T 1742.46-52.

¹¹ Shafron, T 1739.50-54.

¹² Shafron, T 1740.36-41.

¹³ Shafron, T 1740.43-47.

the future would be re-rated upwards.¹⁴ Mr Shafron also agreed that with the exception of workers compensation claims the “current experience” in the review period was inconsistent with a levelling off in claims experience or damages in relation to product liability claims and mesothelioma claims.¹⁵

17.13 For his part Mr Macdonald in his oral evidence attempted to disavow any specific knowledge of the details of Mr Attrill’s report or any adverse developments outlined by Mr Attrill in his observations.¹⁶ His oral evidence was that his primary focus was “cost management”.¹⁷ Mr Macdonald also accepted that he did not know at the time whether the adverse changes were temporary or permanent. Mr Macdonald did accept that “if long term trends were interrupted then it would cause change in the actuarial assessment”.¹⁸ Further, Mr Macdonald acknowledged that the adverse trends identified by Mr Attrill had in fact become worse. His evidence on this issue was “I was concerned when I heard the current trends were adverse, and I raised that I think appropriately with the chairman and the board and with executives in the company.”¹⁹

17.14 Mr Macdonald conceded that Trowbridge was not given any indication of any of the opinions expressed in the Review; in particular of any fear that a continuation of the trends shown in the data might necessitate an upward rating of JHIL’s long term expected claim numbers and liabilities.²⁰ In his evidence on this issue Mr Macdonald embarked on a somewhat circular justification that only Trowbridge was in a position to “take into account claims data” and “form forward

¹⁴ Shafron, T 1741.55–1742.4.

¹⁵ Shafron, T 1742.6–21.

¹⁶ Mr Macdonald, in a supplementary statement provided after conclusion of his oral evidence, acknowledged that he had received the document and reviewed it prior to or during a telephone conference on 12 December 2000 (California time). He said that he was involved in reviewing approximately 10 other operating plans for the group’s business unit, “*all of which were more important than Mr Attrill’s operating plan*”. Mr Macdonald disavowed any familiarity with the figures or claims information in the operating plan. Further, he did not recall “*anything*” from Mr Attrill’s Operating Plan Review which made him “*think that Trowbridge’s February 2001 report was unsuitable for assessing likely future claims because it had been prepared using data as at 31 March 2000*”. Ex 308, pp. 6–7, para. 36.

¹⁷ Macdonald, T 2330.8–16; Mr Macdonald’s evidence was that he would rely on the managers who were presenting to him to understand the importance of the material. Macdonald, T 2588.7–9.

¹⁸ Macdonald, T 2330.18–25.

¹⁹ Macdonald, T 2331.27–34. There appears to be some tension between this evidence and Mr Macdonald’s supplementary statement. Ex 308, pp. 6–7, para. 36.

²⁰ Macdonald, T 2332.37–43.

projections: and that the company did not have such expertise”.²¹ His endeavours to distance himself and JHIL from any responsibilities failed to address the threshold issue, failure to raise the issue directly with Trowbridge.

17.15 Mr Macdonald also acknowledged that he understood from Mr Attrill’s email of 4 December 2000 to Mr Shafron (copied to Mr Macdonald) that as a result of the Watson and Hurst analysis that Mr Minty/Trowbridge would “want to look at the proportion of claims JHC actually receive (updated from 31 March 2000) as compared to the new claim projections”.²² Mr Macdonald accepted that the information provided in Mr Attrill’s report did not reflect an increase in average settlement payments, but rather an increase in the number of claims.²³ He said that he had been told several times “to expect volatility and that volatility wouldn’t change the long term trend”.²⁴

17.16 I should also note Mr Macdonald’s own perception of the situation on 31 January 2001 when he emailed Mr Shafron and Mr Morley, copying the email to Mr Peter Cameron and Mr Robb:²⁵

“**Asbestos.** We have reviewed the graph below and had harboured some hope that Q4 would be significantly lower in cost, demonstrating what an outlier Q3 was. An early look at January shows costs of \$3m – and we should presume that February and March (in the absence of other information) will be at a similar level. Should we proceed with the Foundation, costs in the JHIL accounts would cease as of the date that the Foundation was formed.”

²¹ Macdonald, T 2333.17–23.

²² Ex 57, Vol 4, p. 801.

²³ Macdonald, T 2592.6–28.

²⁴ Macdonald, T 2592.38–46.

²⁵ Ex 150, p. 103.

Chapter 18 – February 2001 Trowbridge Report

A. Two Reports

Content

18.1 There are two relevant versions of the February 2001 Trowbridge Report, each dated 13 February 2001. The earlier version¹ does not, and the later version² does, have the date '31 March 2001' in the first paragraph³.

18.2 There appear to be two reasons why a second version of the February 2001 Trowbridge Report came into existence. Each derives from events at a presentation by Mr Minty to the incoming directors of the Foundation on 13 February 2001.

18.3 The first reason was that Mr Jollie said at the meeting that the incoming directors would require a copy of the Report, to be addressed to them. The version they had been given was addressed to Allens, JHIL's solicitors.

18.4 The second reason appears from Mr Minty's supplementary statement⁴ where he said:

"12 In relation to paragraph 187, Mr Marshall and I left the 13 February 2001 meeting shortly after I concluded my presentation. I was not present during any presentation by Mr Ashe or during any advice provided by Mr Bancroft to the Proposed Directors in the absence of Mr Morley, Mr Ashe, Mr Robb, Mr Attrill and Mr Shafron.

13 On the way back to Trowbridge's office, after the 13 February meeting at PwC, Mr Marshall and I had a brief discussion concerning finalisation of the Report and I said words to the effect:

"Some of the people there didn't seem to have been aware before we made out presentation that our report is based on James Hardie's data up to 31 March 2000. We should add some words to our final report confirming what we told them at the meeting to ensure that it is clear."

Mr Marshall said words to the effect:

"I agree, I think that's a good idea."

¹ Ex 7, MRCF 1, Tab 16. A copy is Annexure P1.

² Ex 50, Tab 23. A copy is Annexure P2.

³ Annexure P3, shows the changes made to arrive at the later version.

⁴ Ex 51.

18.5 The second version was sent to Mr Williams and Mr Shafron at 9.18am on 14 February 2001⁵. There were interim versions of the Reports. It is unnecessary to discuss them.

B. Content of the Report

18.6 The February 2001 Trowbridge Report was brief – three pages of text and ten pages of tables and graphs. It describes its purpose as being to revisit the claim number assumptions adopted in the 2000 Report in view of recent work conducted by Trowbridge to estimate the impact of such claims on the insurance industry (a reference to Watson and Hurst). The brevity of the report was a product of Mr Shafron’s explicit instructions, as was the fact that the projections were confined to a 20-year period,⁶ even though Trowbridge prepared projections to “infinity”, and had given them to James Hardie.⁷

18.7 The brevity of the February Report was such that it could not properly be understood without reference to the detailed statements of method, data and sensitivity of results in the 2000 Trowbridge Report. Looked at from the point of view of Trowbridge, it is appropriately characterised as merely an addendum to that report.⁸ Unfortunately, however, the terms of the February Report do not make that clear to other readers.

⁵ Minty, Ex 51, para 16.

⁶ Ex 50, Tab 12, p.110; Ex 75, Vol 7, Tab 99; Tab 103 at p.2585. An exception should be noted – the second February Report disclosed the anticipated number of claims beyond 20 years, but not the associated cash flows, or the present value of those liabilities. See Ex 50, Tab 23, pp. 208, 209.

⁷ Ex 50, Tab 16, 17.

⁸ Trowbridge Initial Submissions, para. 21.

C. Methodology

18.8 Mr Minty explained the approach adopted in relation to the February Report in his statement of 4 June 2004.⁹ The method was simple. The number of James Hardie’s “events”¹⁰ for YEM 2000 (89) was grossed up by Trowbridge’s projected claim/event ratio (1.15) to give an assumed number of claims (102.35). The ratio of that number to the Watson and Hurst Berry Medium projection for Australian mesothelioma cases in the 1999 year (454.30, giving a ratio of .2253 or 22.53 per cent)) could then be applied to each succeeding year in the Watson and Hurst projection, and to the total number of claims forecast by Watson and Hurst. This was the “calibration” of the model to the James Hardie experience. A similar process was then undertaken with the “Berry High” model from Watson and Hurst.

18.9 The assumptions critical to this process were that the exposure patterns giving rise to the claims against James Hardie were sufficiently similar to the exposure patterns of the community as a whole to make the Watson and Hurst models useful and that the number of “events” recorded by James Hardie in YEM 2000 was likely to be reflective of long run James Hardie experience. The latter assumption had two aspects. One was that the YEM 2000 experience was not “off the trend”, i.e., unusually better or worse than was expected. The other was that there was no significant scope for the proportion of mesothelioma cases that were James Hardie “events” to increase, (as would be the case, for example, if there were any significant risk of an increase in the propensity to sue). To put it another way, since the Berry Medium model projected a plateau of mesothelioma cases through 2000–2004, Trowbridge must have expected that James Hardie events and claims had also levelled. It will be necessary to return to these matters.

18.10 The third model described in the February Report was called the “Current” model, and it was simply the projection which had been adopted in the 2000 Report. It was not a “low” estimate in contradistinction to the “high” estimate. Rather, it was merely an outdated median estimate that no longer reflected the available data or current actuarial opinion.

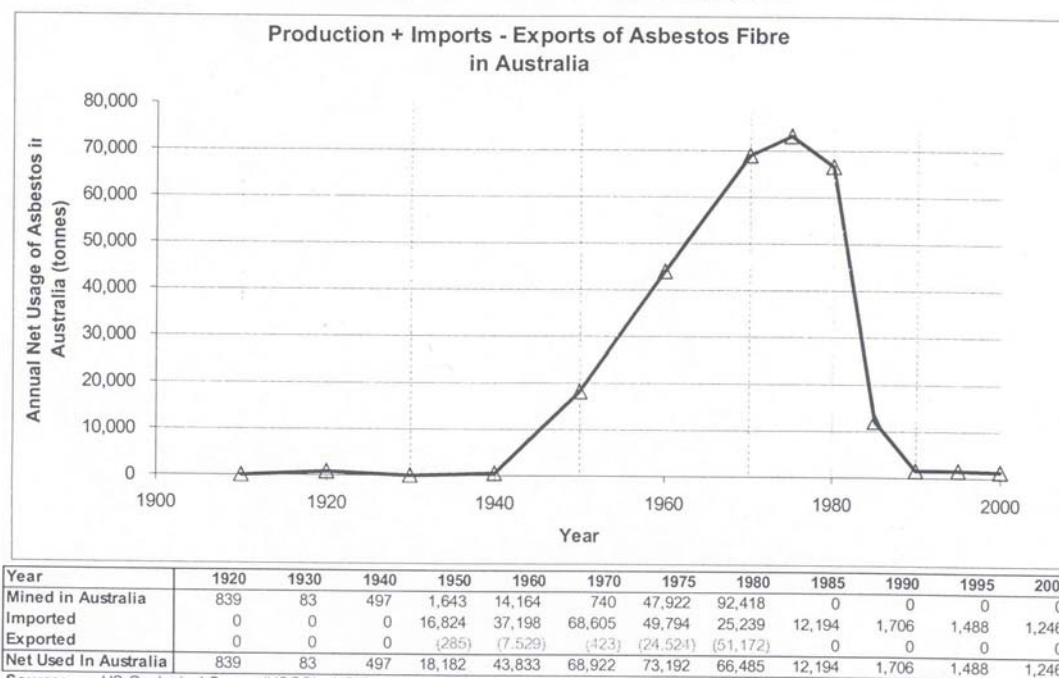
⁹ Ex 257, paras 19–22. See also T 3275.28–3280.15; 3282.26–36.

¹⁰ That is, mesothelioma cases giving rise to a claim.

18.11 The final critical step in the methodology of the February 2001 Trowbridge Report was the selection of a preferred “Best Estimate” model for James Hardie, as between Berry Medium and Berry High. The Report suggests that Berry High best fits the likely national experience;¹¹ Trowbridge, however, adopted the more optimistic “Berry Medium” curve for the James Hardie Best Estimate.

18.12 This choice was not explained in the report. According to Mr Minty the choice was based on a perception that James Hardie’s claims experience for the three years to March 2000 had been relatively stable (at about 100 mesothelioma claims per year).¹² He also referred to an indication by Mr Shafron that the experience to December 2000 was in line with what Trowbridge had already seen,¹³ a statement Mr Shafron denies. He also referred to some aspects of the relevant exposure history,¹⁴ a subject on which Mr Marshall expanded. He explained that while asbestos production and consumption increased gradually, it fell away quite rapidly or steeply in the 1980s. Mr Whitehead showed this in a graph: ¹⁵

Figure 3.1: Annual Usage of Asbestos Fibre in Australia



Source: US Geological Survey (USGS); US Department of the Interior; US Geological Survey - Worldwide Asbestos Supply and Consumption Trends from 1900 to 2000 by Robert Virta

¹¹ Ex 50, Tab 23, pp. 197, 198.

¹² Ex 258, para. 20; T 3288.25–55.

¹³ Ex 258, para. 20.

¹⁴ T 3288.25–55.

¹⁵ Ex 251, p. 3-15.

18.13 Two features of the graph suggested that the exposure peak was earlier than the consumption peak. One was that during the upward curve, with production increasing, there was more time for people to be exposed, and length of exposure was relevant to the likelihood of disease. The other was that in the earlier phase production was dominated by blue and brown asbestos, and these were regarded as more toxic than white asbestos.¹⁶ Mr Whitehead referred to a further consideration, namely, that in later periods work safety practices are likely to have improved so that production or consumption of a given quantity of asbestos produced less exposure.¹⁷

D. The results and their significance

18.14 Trowbridge projected the following undiscounted and discounted (at 7%) liabilities.¹⁸

<u>Period</u>	<u>Discounted (\$ m)</u>			<u>Undiscounted (\$ m)</u>		
	Current	Medium	High	Current	Medium	High
10 yrs	181.4	181.4	191	288.3	293.4	307.6
15 yrs	237.4	246.4	264.7	435.9	457.7	500.3
20 yrs	269.7	286.5	317.5	554.2	605.7	694.5
50 yrs	284.7	324.4	380.2	557.1	753.7	990.5

The data in the last line was not in the February 2001 Trowbridge Report, but was given to James Hardie.¹⁹

18.15 What the discounted data conveyed was that a fund of the size indicated by one of the discounted numbers, on the assumption that it would earn a long term average return of 7 per cent per annum, and on the further assumption that the model in which column it appears was borne out by experience, would last the period indicated for its line. For example, a fund of \$286.5m, would last 20 years, but no longer, if the Berry Medium projections were correct. The Fund would require an additional \$37.98m (i.e. \$324.4m – 286.5m) to last for 50 years.

18.16 Although the February Report did not take the cash flows past 20 years it did make clear that significant numbers of claims were expected after a 20-year period.²⁰ It also noted, briefly, the limitations of the report:

¹⁶ T 3446.47–3447.37.

¹⁷ T 3216.56–3217.15.

¹⁸ Ex 50, Tab 23, p. 205.

¹⁹ Ex 50, Tab 16, p.136.

“The projections of future asbestos-related disease cases are based on epidemiological work that is subject to inherent uncertainty. In addition, the behaviour of potential claimants (the propensity to sue) is uncertain and the potential exposure will be heavily influenced by legal decisions that are impossible to predict. Our estimates are based on a continuation of the current environment regarding legal principles and settlement practices. We have also taken into account our understanding of insurance arrangements with various insurers and reinsurers in assessing the net liability for outstanding claims, and the eventual extent of these recoveries is also subject to uncertainty. Our estimates do not allow for the agreement that has been reached with QBE Insurance in relation to commutation of various covers, and so any such amounts can be deducted from our estimates in this letter.”²¹

E. Comparison of the Trowbridge Reports 1996–2003

18.17 In comparing assessments made at different times, three things must be taken into account: first, an allowance for claims paid between the two periods (the earlier assessment includes these, the later does not); secondly, the increasing significance of discounting as time moves on; and thirdly, any change in the discount rate itself. The second and third of these can be ignored if undiscounted figures are compared. Using discounted figures, the first two factors substantially cancelled each other out in this case.

The evidence discloses the following assessments:

Report	Undiscounted	5%	6%	7%	8%
1996	517			249 ²²	230
1998	498			254	238
2000	552		304	289	
Feb. 01 ²³	734		355	322	
Aug. 01	1,270		574	516	
2002	1,641		752		
2003	2,208	1,089			

18.18 Another basis of comparison is to focus on the mesothelioma claims that are the major part of the liability. Mr Whitehead has produced a table which shows the

²⁰ See Ex 50, Tab 23, pp. 208, 209.

²¹ Ex 50, Tab 23, p.199.

²² Ex 2, Vol 3, Tab 13, p.60.

²³ Note that the figures in this line, taken from Ex 3, Vol 3, Tab 7, p.479 are slightly different from those in Ex 50, Tab 16. The figures in the line above and below have the same source.

value of the claims after 31 March 2003, as projected by each reported, discounted to the date at 5 per cent per annum.²⁴

Table 4.7: Comparison of Calculated Discounted Values of Projected Payments after 31 March 2003 as at 31 March 2003, Discounted at 5% pa

	Calculated Discounted Value of Projected Payments - Mesothelioma only Valued at 31 March 2003 at 5% pa						
	Oct-96	Sep-98	Jun-00	Feb-01	Aug-01	Oct-02	Sep-03
	% pa	% pa	% pa	% pa	% pa	% pa	% pa
Discount Rate	5%	5%	5%	5%	5%	5%	5%
	\$ mns	\$ mns	\$ mns	\$ mns	\$ mns	\$ mns	\$ mns
Calculated Discounted Values at 31 March 2003							
Settlement Payments	153.2	150.7	211.0	266.4	525.5	688.8	877.1
Legal Expenses	51.1	71.5	52.7	66.6	67.4	73.1	93.1
Total	204.2	222.2	263.7	333.0	592.9	761.9	970.2
% Change from previous		9%	19%	26%	78%	29%	27%
Cum % Change since Oct 1996 Report		9%	29%	63%	190%	273%	375%
Cumul % Change since Feb 2001 Letter					78%	129%	191%

Note:

The projected cash flows for later reports are for year ending 30 June rather than 31 March. For the purposes of this comparison, we have treated all projected cash flows as being for years ending 31 March. We do not expect this approach to create any material distortions in the results presented.

18.19 What the previous Table suggests, and this Table confirms, is that the 2000 and February 2001 Trowbridge Reports showed significant increases above the preceding reports (which had been quite close), but that the first report after separation revealed a substantial step up in the assessments. Less substantial, but nevertheless significant, increases followed in the two following years. This invites the question, “Why was the assessment in February 2001 so low?”

18.20 KPMG’s retrospective central estimate as at February 2001 (without hindsight) was of an NPV of \$694.2m (discounted at 7 per cent), with undiscounted net liabilities of \$2,179m. Mr Wilkinson’s report explains the differences.²⁵

²⁴ Ex 251, p.4–33.

²⁵ Ex 252, p.73.

“ **Table 6.6 – Analysis of variation of liabilities**

Assumption	Contribution \$m	Liability \$m
Trowbridges’ calculation		286.5
Additional Cash flows	36.1	
Trowbridge’s calculation using all future cash flows		322.6
Inclusion of Wharf Claims	9.4	
US Claims	3.6	
Average Costs	10.9	
Numbers*	156.0	
Superimposed inflation*	156.4	
Nil Settlement Rate*	35.3	
Total Contribution	371.6	
KPMG Assessment		694.2

”

*The three key assumptions contribute \$347.7m of the total variation of \$407.7m.

18.21 The major differences require some explanation.

18.22 **Numbers** This item refers to KPMG’s adoption of a curve for future mesothelioma claims that peaked in around 2010, at about 140 claims per annum, as opposed to the Berry Medium curve, which peaked in 2001 at 102 claims per annum.²⁶ The KPMG projection was much more pessimistic than the Berry High curve, which would peak around 2005–2007 at 110 claims per annum.²⁷

18.23 **Superimposed Inflation** The February 2001 Trowbridge Report noted that it assumed a continuation of the “current environment regarding legal principles and settlement practices”. Superimposed inflation, however, may derive not only from changes in laws or their administration by judges and lawyers, but also from the impact of medical developments.²⁸ Improvements in medical care, short of a cure, tend to increase damages beyond ordinary inflation by increasing the cost of medical care and extending life expectancy.²⁹

18.24 On the other hand, as the ages of claimants increase, damages tend to fall, as the lost earnings component can shrink.³⁰ While this factor tends to cancel out the others to some extent, Mr Whitehead and Mr Wilkinson were agreed that it was

²⁶ See Ex 252, p.130.

²⁷ Ex 50, Tab 23, p. 208.

²⁸ See, eg, Ex 252, para. 3.3.2.

²⁹ Attrill, T 1207.30 – 1208.7.

³⁰ Ex 253, para. 3.3.2.

appropriate to make an allowance for superimposed inflation, Mr Minty agreed that if he had been preparing a report with a wider scope, he would have made some allowance for it. And Mr Marshall, though he saw little evidence of superimposed inflation in James Hardie's costs to 2000, did not form a view that the correct estimate for it was nil, but rather that given that history and the limited scope of the report, it was appropriate to deal with the matter by way of a 4 per cent sensitivity, that figure being a plausible scenario at the high end of the range of possible outcomes.³¹ Assuming superimposed inflation at 4 per cent, as Mr Whitehead suggested and as Trowbridge provided for in its sensitivities, would have increased Trowbridge's assessment by more than 50 per cent.³²

18.25 Nil Settlement Rate In the 2000 Trowbridge Report a nil settlement rate of 25 per cent was assumed. I was not satisfied with the explanations given on behalf of Trowbridge for adopting this figure. Mr Wilkinson's view, which should be accepted, is that a figure of 20 per cent should have been adopted, having regard to the recent history.³³

18.26 Other Matters The matters so far mentioned, however, do not provide a complete explanation for the discrepancy between the assessment in the February 2001 Trowbridge Report and later assessments. There are two other matters. The first is the discount rate. The February Report employed a range of rates (7, 8 and 9 per cent). This was a departure from earlier reports in that none of these rates was the then current rate for high quality corporate bonds, which was the benchmark previously and subsequently adopted by Trowbridge. The change was due to a request by Mr Shafron that Trowbridge use more "commercial" rates of return. Mr Shafron was anxious to see if the discount rate could be improved so that the assessed NPV of the liabilities would be lower.³⁴ Mr Minty agreed that without such an instruction from Trowbridge, the appropriate discount rate would have been 6 per cent, not 7–9 per cent. Mr Wilkinson would have used a rate of about 5.7–5.8 per

³¹ Whitehead, T3210.42–3211.40; Wilkinson, Ex 252 p.48, T3391.35–3397.34; Minty, T 3313.30–3314.10; Marshall, T3428.4–59, 3429.55–3430.32, 3435.25–3438.6.

³² See, Ex 3, vol 3, Tab 8, p.528. Whitehead at % 3211.5–40; Minty at T 3316.50–3317.31.

³³ See Ex 252, paras 5.2.4, 5.4.2(4); and JHI NV Initial Submissions on Terms of Reference 2 and 3, paras 13.1.51 – 13.1.55, which may be accepted.

³⁴ Shafron, Ex 17, para 142; T 1710.41 – 1711.28; 1759.50–1760.37; Minty, T 819.29–820.19.

cent.³⁵ A one-percentage point reduction in the discount rate would increase the assessment by more than 10 per cent.

18.27 The second factor is that Trowbridge's February 2001 Report was prepared without reference to James Hardie's claim data from April to December 2000 (inclusive) ("the Current Data"). It showed a marked deterioration in James Hardie's exposure. This was made clear by Mr Attrill's "Operating Plan Review" document discussed in the previous Chapter.

18.28 There can be no real doubt that access to the Current Data would have had a significant impact on the Trowbridge assessment. Trowbridge's view, expressed in September 2001, was that access to the Current Data would have been likely to cause them to adopt higher claim number assumptions (up around 30 per cent using Berry High) and higher mesothelioma claim cost assumptions (up from \$180,000 to \$230,000), among other changes.³⁶

18.29 Overall, the impact of the changes would have been, according to Trowbridge, to increase the 20-year assessment from \$286m to \$373m and the total assessment from \$322m to \$437m.³⁷ Increasing that figure to allow for a lower discount rate (6 per cent, producing \$486m³⁸) and superimposed inflation (at 4 per cent - a 58 per cent increase) would produce an outcome of the order of \$767m.³⁹

18.30 This number can be seen to be the estimate Trowbridge would have been likely to have given if the Current Data had been made available, if it had not been constrained as to the choice of a discount rate, and it had not regarded the nature of the task it was undertaking as requiring it to leave superimposed inflation out of account.⁴⁰ It is still a central estimate and thus not an estimate of sufficient probability to permit confidence that a fund of that size would be sufficient to pay all claims.

18.31 The evidence of Mr Wilkinson confirmed that the Current Data would have been of significance. On the strength of it, he would have increased his assessment

³⁵ Wilkinson, T 3408.40–3409.14.

³⁶ Ex 3, Vol 3, Tab 6, p.470.

³⁷ Ibi, p. 472.

³⁸ Ibid, p. 472.

³⁹ Minty, T 3301.19–3305.44; 3313.10–3314.10.

of the liabilities as at February 2001 by about 50 per cent, from \$694.2m to \$1044.5m.⁴¹ A further adjustment to reduce the discount rate to 5.9 per cent would increase the amount by a further 15 per cent⁴² to produce a total of \$1,210m.

18.32 That figure may be compared with the figure of \$767m for Trowbridge. It represents the figure KPMG would have adopted in February 2001, unconstrained by instructions as to the discount rate, and with access to the Current Data. Again it is a central estimate, inappropriate for establishing a separate or closed fund like the MRCF.

18.33 The difference between the KPMG figure (\$1,210m) and the Trowbridge figure (\$767m) is largely attributable to their different estimates of future claim numbers, that is, the use of different “curves” to project the likely claims. In my opinion, and with the benefit of hindsight, it is clear that KPMG’s retrospective assessment of claim numbers is more accurate, though still conservative.

⁴⁰ Minty, T 3301.19–3305.44; 3313.10–3314.10.

⁴¹ Ex 252, p. 86.

⁴² T 3408.45–3409.14; cf Ex 252, p. 72.

Chapter 19 – The "Twelfth Cash Flow Model"

A. Structure of the Model

19.1 The Twelfth Cash Flow Model was the latest in a series of such exercises which Mr Steven Harman, the James Hardie Financial Controller, had begun developing in August 2000 to assist in the restructure planning for Project Green.¹ His analysis underwent further development and iterations as the Trust proposal gathered pace.² A copy of the Twelfth Cash Flow Model is Annexure M.

19.2 The Twelfth Cash Flow Model, as drawn by Mr Harman, consisted of five pages:

- (a) The first lists the "Assumptions" used in the preparation of the calculations in the models on the fourth and fifth pages.
- (b) The fourth page shows the assumed inflows and outflows of funds to the Foundation during a period of a little over 50 years using:
 - (i) Trowbridge's "Most Likely Scenario"; and
 - (ii) an earnings rate of 11.7 per cent per annum on the Foundation's funds from time to time available for investment.
- (c) The fifth page performs a task similar to that of the fourth page, but uses:
 - (iii) Trowbridge's "High Scenario"; and
 - (iv) an earnings rate of 14.55 per cent per annum rather than 11.7.
- (d) The second page showed the assets that would be left in the Foundation at the end of periods of 10, 15, 20, 25, 30, 40, 50 and 51 years:

¹ Ex 68, para. 14.

² Harman, Ex 68, para. 19.

- (v) assuming Trowbridge's Most Likely Scenario; but
 - (vi) in addition to the 11.7 per cent, at rates of 9.7, 10.7, 12.7 and 13.7 per cent.
- (e) The third page used both the 11.7 and 14.55 per cent earnings rates, and showed the assets remaining in the Fund after 15, 20, 30, 40 and 51 years at each such earnings rate, assuming both the Most Likely Scenario and the High Scenario.
- (f) When presented to the JHIL February 2001 Board Meeting the fifth page appears not to have been included, although results flowing from the fifth page were included.

19.3 Notable features of the Twelfth Cash Flow Model were:

- (a) The second page appeared to indicate that using the Most Likely Scenario but taking a pre-tax rate earnings rate on investments as low as 9.7 per cent, the Foundation would still have in excess of \$48m funds after 20 years.
- (b) At 11.7 per cent, there would be nearly \$159m still left after 20 years and more than \$38m left after 51 years: second and fourth pages.
- (c) Even on the High Scenario, and using an earnings rate of 11.7 per cent, the fund would still have nearly \$149m at the end of 15 years, although by the end of 20 years it would be in debt to the tune of \$5.47m: third page.

19.4 These predictions, of course, have proved to be wildly optimistic. To take the principally used prediction by way of example, it is absolutely extraordinary that a body which, on the "most likely scenario" and using an earnings rate of 11.7 per cent, should have had \$38,586,000 after 51 years, is now facing the prospect that its funds will be exhausted after about six years.

19.5 To see how this might happen one needs to understand the Model. The starting point is found in its fourth and fifth pages.

19.6 The terms “Most Likely Scenario” and “High Scenario” reflect some of the figures which were supplied to Mr Harman by Mr Marshall of Trowbridge on 9 February 2001 (Sydney time). Mr Marshall had sent what he described in his covering email³ as:

“... three claim number projection scenarios as follows:

Current Scenario: the current projected claim numbers for all claim types

Best Estimate Scenario: a best estimate projection which takes the Berry Medium for meso, a basis which is discussed in more detail below for non-meso and the current basis for Workers’ Compensation

High Scenario: Berry High for meso, Berry Medium for non-meso and current basis for Workers’ Compensation”

19.7 The figures supplied by Mr Marshall were given as both discounted figures and undiscounted figures. They reflected the outgoings that Trowbridge estimated Coy and Jsekarb would expend each year on asbestos claims by way of court awards, settlements and legal costs. They were the net figures after taking into account insurance recoveries, but they did not take into account amounts to be received pursuant to the settlement with QBE.⁴

19.8 Mr Harman used Trowbridge’s undiscounted figures for the years 2001 to 2050. The figures can be seen in the three right columns on each of the fourth and fifth pages of the Twelfth Cash Flow Model under the headings “Current”, “Best Estimate” and “High Estimate”. On the fourth page, the “Most Likely Scenario and earnings rate of 11.70%”, the Trowbridge “Best Estimate” is used. The figures appear in Column j, the column headed “Cash depletion asbestos litigation”. On the fifth page, the “High Scenario and earnings rate of 14.55%” the Trowbridge High Scenario figures appear in Column j, again under the heading “Cash depletion asbestos litigation”.

19.9 Perhaps it does not matter much in the end, but the Trowbridge figures have been “postponed” by a year in the two Scenarios. For example, the Trowbridge undiscounted figures for 2001 were:

(a) Best estimate \$22,308,311

³ Harman, T 1260.49–.55.

⁴ Ex 68, Tab “I”.

(b) High estimate \$22,406,154

but in Mr Harman's calculations they are shown as the figures for the 2002 year, the postponement being repeated for succeeding years. For the six months to 31 March 2001, Mr Harman worked on a figure of \$16.3m. That appears to be a figure assumed by him from information conveyed by management accounts⁵ and indirectly by Mr Shafron or Mr Attrill.⁶ Mr Harman said he had been concerned that \$16.3m for a half year did not sit well with the estimate of \$22.306m he used for the year ending March 2002. As I have said \$22.3m was actually Trowbridge's "Best Estimate" figure for the preceding year, and it sat even less well with an actual half-yearly outgoing of \$16.3m. However, Mr Harman said that it had been explained to him by Mr Morley that the \$16.3m was the result of some large cases⁷ and that "it wouldn't be anticipated that that sort of figure would be represented in the 2002 financial year, in other words the \$16m was a one-off".⁸

19.10 Mr Harman's evidence that it was his belief that the \$16.3m was a one-off does not sit well with his email of 23 February 2001 to two members of his staff, Greg Evans and Beverly Cooper, the email being copied to another member of his staff Lyndal Hoare, and to Mr Macdonald, Mr Shafron and Mr Morley. The subject of the email⁹ was the closing accounts for Coy and Jsekarb, i.e. the accounts as at 15 February 2001. The email dealt with four particular matters and then concluded:

"Can you please ensure that I review the Coy and Jsekarb accounts before they are passed to anyone external (which of course includes the Foundation). Obviously we want to ensure that they show assets which, when added to the \$78.9m off balance sheet receivable for the indemnity, arrives to at least \$293m. Also, we want to accurately reflect (re: minimise) JHIL's asbestos costs for the 10.5 months."

19.11 When Mr Harman was asked about this document in his oral evidence, he said:¹⁰

RUSH: "Q. You go on to say "also we want to accurately reflect (re: minimise) JHIL's asbestos costs for the 10.5 months". What is that meant to indicate to the people you sent the email to?"

⁵ T 1260.38–44, T 1261.3–34.

⁶ T 1261.36–47.

⁷ T 1273.53–1274.19.

⁸ T 1274.49–54.

⁹ Ex 75, Vol 8, Tab 135, p. 2990.

¹⁰ T 1281.38–49.

- A. It was intending to indicate, we wanted to make sure we had an accurate recording of the asbestos costs.
- Q. Why wouldn't you say you wanted an accurate recording then? Why put in "re: minimise", that would lead to an inaccurate recording, wouldn't it?
- A. No, accurately reflect is the sense I was trying to convey."

I found the manner in which Mr Harman gave evidence on this point unsatisfactory, and said:¹¹

- "COMMISSIONER: Q. I have great difficulty with that, Mr Harman. Why do you say "read: minimise" as meaning "accurately reflect"? I expect a rather better answer than the one you last gave.
- A. I was conscious that the asbestos costs for the 10.5 months would appear in the James Hardie Industries' accounts whilst it's under control of the James Hardie Industries. I was anxious to have a correct cut-off, a correct accounting, but erring on the side of not minimisation, it is an unfortunate word, but trying to accurately reflect the costs of the cut-off.
- Q. Is that the best answer you can give?
- A. I think so, yes Sir.
- RUSH: Q. I just want to put it to you directly, Mr Harman, that you were directing your staff to inaccurately go about their work in relation to the accounts?
- A. No Sir, I was directing them to accurately reflect."

19.12 I am not prepared to accept Mr Harman's explanation on this aspect. I formed the impression that he was conscious that the "asbestos costs for the 10.5 months" had been at a rate much higher than those used in the materials at separation and was seeking to ensure that as much as possible of those costs would be attributed to the period after 15 February. As the short history of the Foundation has demonstrated, the level of asbestos outgoings was, of course, a critical assumption in determining the life of the Fund.

19.13 Returning to the fourth and fifth pages in the Twelfth Cash Flow Model, in addition to the outgoings for asbestos litigation, Mr Harman's model took account of the future running costs of Coy and Jsekarb, which were estimated under the heading "Cash depletion running costs" in Column i. These were the same in each Scenario.

19.14 As to incoming funds there were several sources. One was rent from the properties leased to James Hardie operating companies. It was set out in Column f, the

¹¹ T 1281.55–T 1282.14

figures being the same in each Scenario. Mr Harman worked on the assumption that the properties would be sold at March 2025 and the proceeds invested.¹² That is why the rental receipts cease at that point, and why a capital receipt of \$99.307m is at the same time recorded in Column l.

19.15 The payments to be made as interest on the intercompany loans made by Coy to JHIL were a second source of incoming funds. The interest was recorded in Column g. The payments were to be made until 2007, and were diminishing in the years preceding 2007 because of repayments of the principal of the loan. The repayments appear in Column n. Again, as one might expect, the figures in Columns g and n are the same in each Scenario.

19.16 The third source of incoming funds was the QBE settlement. The amounts to be received were a little in excess of \$3m per year until the year 2015. They are in Column h2, again for the same amounts in each Scenario.

19.17 The fourth source consisted of the amounts to be received pursuant to the Deed of Covenant and Indemnity. Those amounts were a total of \$5.575m per year for seven years, with a balloon payment of \$73m in 2008. Again these figures were the same in each Scenario: see Column h3.

19.18 Finally there was the income on investments, worked out at earnings rates of 11.7 per cent and 14.55 per cent respectively. The results appear in Column k.

19.19 In summary, the model forecasted various cash inflows and outflows associated with the assumed assets and liabilities of Coy and Jsekarb,¹³ the anticipated cash inflows to be generated by:

- (d) repayments by JHIL of principal on an existing loan made to JHIL and interest on that loan;
- (e) rent on properties occupied by James Hardie Australia and other companies under long-term leases;

¹² Ex 68, Tab “H”.

¹³ Ex 68, paras 25–26.

- (f) a series of payments by JHIL in consideration for an indemnity in favour of JHIL;
- (g) the QBE annuity stream;
- (h) interest on assumed investment balances;

and the anticipated cash outflows to be generated by:

- (i) administrative running costs of Coy and Jsekarb;
- (j) asbestos-related outlays as forecast by Trowbridge; and
- (k) a matter not earlier mentioned, a \$1m per year (inflated) sinking fund for refurbishment and renewal of buildings.

B. The key assumptions underlying the Model

19.20 It will be appreciated that the integers used in the Model were almost all fixed. The amounts being repayments of principal on the loan, interest on the loan, rent on the leased properties and the QBE annuity stream were all fixed (or within defined parameters). So too were the assumed running costs and the sinking fund. That left two variable features: the Trowbridge projections and a prediction as to future earnings.¹⁴ The prediction as to future earnings depended on the amount available for that purpose, and on the earnings rate applicable. The amount available would itself be dependent, of course, upon the amount of additional funding which JHIL was prepared to provide. Once that was determined, however, the figures for future earnings on investments would depend on the earnings rate, or rates, selected.

19.21 There has been a substantial challenge on the appropriateness of the selection of 11.7 per cent earnings rate in the Model, and to whether that selection was made bona fide. I deal with these matters below, but it needs to be remembered the 11.7 per cent rate did not apply to all the assets of the Foundation, but only to the portion available for investment at any time. So used in the Model, those amounts were:

¹⁴ Harman T 1297.8, Morley T 2245.20; JHI NV Initial Submissions para. 8.2.2.

	(\$000)
YEM 02	51,180
YEM 03	50,668
YEM 04	64,597

19.22 It has been submitted on behalf of JHI NV/ABN 60 that¹⁵ the table below compares the interest which would be earned on those amounts at 11.7 per cent per annum and 7 per cent per annum (the lowest rate mentioned by Mr Minty):

“	Funds invested (\$000)	Interest earned at 11.7% pa	Interest earned at 7.0% pa
YEM02	51,180	5,988	3,583
YEM03	50,668	5,928	3,547
YEM04	64,597	7,558	4,522
		19,474	11,651”

No allowance is made for the compounding of interest in the above table, however, it is clear that the difference of \$7.8m does not explain the shortfall currently faced by the Foundation.

19.23 I agree with that submission, in the sense that the selection of the 11.7 per cent could not, by itself, have been the cause of the present state of the Foundation’s finances. That does not prevent it, however, from being a possible contributing cause.¹⁶

C. Reliance on Trowbridge

19.24 As noted above, the Model was based on two key assumptions: the Trowbridge projections and a prediction of future earnings.¹⁷

19.25 In relation to the Trowbridge projections, the Model assumed that the Trowbridge numbers were reliable and comprehensive¹⁸ and that the Trowbridge “best estimate” indicated the most likely outcome involving a substantial probability or

¹⁵ JHI NV Initial Submissions paras 8.2.6, 8.2.7.

¹⁶ On any view, the Foundation would require a lot of cash in its early years to pay out claims and costs.

¹⁷ Harman T 1296.33–1297.10, Morley T 2245.20; JHI NV Submissions para. 8.2.2.

¹⁸ Harman T 1297.

likelihood.¹⁹ In his evidence to the Commission, Mr Harman accepted that he was aware that the Trowbridge estimates in earlier years had been considered by JHIL insufficiently reliable to be used for the purposes of JHIL's accounts;²⁰ he was unable to point to any very credible reason why there was any sudden change to their reliability in February 2001.²¹ Mr Morley was also aware of the uncertainty attached to the Trowbridge estimates.²²

D. Use of the 11.7 per cent per annum earnings rate for a period of 51 years

19.26 To assume an earnings rate of 11.7 per cent per annum for a short period may, or may not, be appropriate. To assume such a rate year by year for 51 years in respect of a fund which is to have no additional infusions of capital (other than those already taken into account in the Model) seems, at first blush, a large assumption. Even larger would be the assumption of a rate of 14.55 per cent.

19.27 The assumption as to the estimated future earnings rate itself came from James Hardie.

19.28 I note that an early model produced on 4 January 2001 by Mr Harman and sent to Mr Shafron (copied to Mr Morley, Mr Cooper and Mr Sweetman) used an earnings rate equivalent to the overdraft rate of 8.1 per cent²³ and that on 19 January 2001, Mr Minty of Trowbridge suggested to Mr Shafron and Mr Morley that commercial rates of return would be 7, 8 or 9 per cent.²⁴ It is suggested by JHI NV/ABN 60 that Mr Minty's observations were "apparently casual remarks" on which I should not place any weight²⁵, but Mr Shafron asked Mr Minty to express a view on these topics in a professional capacity, and was asking him for the purpose of the exercise which ended

¹⁹ Harman T 1298.46–.50.

²⁰ T 1301.22–25.

²¹ Harman T 1301.27–31.

²² Morley T 2248.51–55.

²³ Ex 121, para. 175, Tab 75.

²⁴ Shafron Ex 17, para. 142, T 1710–1711; Minty T 819; Initial Submissions of Counsel Assisting, Section 2, paras 32–36, para. 142.

²⁵ JHI NV Initial Submissions para. 8.6.1.

as the Model.²⁶ Mr Minty was present at the discussion. I do not see why Mr Minty's views on the topic may not be taken into account.²⁷

19.29 When the first Model using the Trowbridge data was prepared on 7 February 2001 and sent by Mr Harman to Mr Morley,²⁸ it used earnings rate of 10 per cent, 12.5 per cent and 15 per cent.

19.30 The Model itself provides one comparator: the loan from Coy to JHIL. It was being regularised – in the sense that its terms were being settled and documented – at the time of separation. The rate chosen was 8.13 per cent per annum. A rather obvious question was why 8.13 per cent would be chosen for the loan from Coy to JHIL, but 11.7 per cent should be assumed for other investments Coy might thereafter make.

19.31 Mr Shafron said that he did not think he had a view at the time,²⁹ and that he was not able to shed light on why different rates were chosen for the interest on the loan to JHIL and as the earnings rate assumed on the Foundation's investments.³⁰

19.32 Mr Donald Cameron, an outgoing director of Coy and Jsekarb, could also offer no very satisfactory explanation for the difference, other than a suggestion that the interest rate for the loan approximated the bank overdraft rate James Hardie would have had to pay for funds. His evidence was:

“Q. The loan that Coy had with formerly related companies with the group attracted interest at the rates of 8 per cent, a little bit more, 8.1 or thereabouts?

A. Approximately that, yes.

Q. It was an unsecured loan to a corporate?

A. Yes.

Q. Repayable by instalments over five years?

A. Yes.

Q. I think I am right in saying, no provisions for it to be accelerated in the event of a material adverse event in the life of the corporate?

A. I'd need to check that.

²⁶ Shafron T 1710.30–1711.27.

²⁷ The JHI NV Initial Submissions, (at para. 8.6.1) suggested that it is not apparent whether Mr Minty's figures were pre-or post tax. My understanding of both his and Mr Shafron's evidence was that Mr Minty's earnings rates were pre-tax.

²⁸ Ex 121, Tab 98.

²⁹ T 1762.16–25.

³⁰ T 1762.42–58.

- Q. I'll come back to that. At any rate, an unsecured loan to a corporate, even James Hardie, in 2001 was not a gilt-edged investment, was it?
- A. No, it approximated the overdraft rate that James Hardie would have had to have paid for funds.
- Q. But James Hardies' overdraft presumably was secured, wasn't it?
- A. No, not secured.
- Q. If you had reasonable confidence as a director of Coy that by investing in the fashion implied by Mercer and Investech and so on in the reports that you could get an 11.7 per cent year in/year out average return, why would you as a director of Coy think it appropriate to lend money at 8.13 per cent to James Hardie?
- A. I really can't recall what my thinking was in that regard."

He went on to say:³¹

- "Q. The truth is, Mr Cameron, that the loan as far as you were concerned was a given, wasn't it?
- A. It was, and that was built into the model at the rates that were there.
- Q. But there was no question that you were going to execute the deed of loan on behalf of Coy, was there? Mr Shafron or Mr Morley asked you to do it and you were going to sign?
- A. Well, it would have been in any event inappropriate to have a third party have a loan without a loan agreement, so whether they'd said it or not, it was the right thing to do.
- Q. No –
- A. – to formulate a loan agreement.
- Q. This might be difficult and I am sure my questions aren't putting it as clearly as they might, Mr Cameron, but if you try to think about the position from the perspective of James Hardie and Coy Proprietary Limited, just before you signed the deed of loan, it could have immediately demanded repayment of all the monies then advanced to other companies in the James Hardie Group, isn't that right?
- A. I understand that to be the position as I recall.
- Q. And having done so, could have invested the money, on your view of things, at 11.7 per cent in the investment market, is that right?
- A. That's what I said.
- Q. And that would have been, on your view of things, clearly a much better option for James Hardie, Coy Proprietary Limited, correct?
- A. Had they received the money and invested it, yes.
- Q. And the only reason that didn't happen was that as far as you were concerned, it was a matter for James Hardie Industries Limited to decide how much would

³¹ T 647.52–648.44.

be left owing by it or its subsidiaries to Coy, and once it had made that decision, that loan would be documented, isn't that right?

A. That's right.

Q. And you exercised no independent judgment about that?

A. About the amount or –

Q. About the amount.

A. No, no, I – there was an amount repaid and there was an amount still outstanding.”

19.33 It seems really very clear that the 8.13 per cent rate was selected when documenting the JHIL borrowing from Coy because it was the rate at which it suited JHIL to pay. The 11.7 per cent was selected as the earnings rate for other reasons.

19.34 The credibility of the selection of 11.7 per cent as the earnings rate is also affected, rather adversely in my opinion, by the fact that it was not selected because it was an appropriate rate. Rather it was selected because it was the earnings rate necessary to be applied to arrive at a fund which would still have some assets at the end of 50 years. That rate having been identified, it was then sought to justify it. The submissions on behalf of JHI NV/ABN 60 urge against that view. They point to the fact that other earnings rates, both above and below 11.7 per cent, had been used and that whilst 11.7 per cent was in fact the earnings rate necessary to assure a fund which would last for 50 years on the Trowbridge projections, it is too narrow a view to treat it as selected for that purpose.³²

19.35 In this regard, Mr Harman's statement³³ said:

“48 On Wednesday 14 February 2001, I was requested to run the Model to ascertain the lowest rate of return that would still keep the trust solvent for 50 years, at the Best Estimate Trowbridge projections. I do not recall who made the request. I ascertained from the Model that such a rate of return was 11.7%, which was within the range calculated by Mr Morley and myself.”

Wednesday, 14 February 2001 was the day before the JHIL Board meeting approving separation.

19.36 In his oral evidence Mr Harman expanded upon this part of his statement:³⁴

³² JHI NV Initial Submissions para. 8.3.1–8.3.3; Reply Submissions para. C3.1, 3.2.

³³ Ex 68, para. 48.

³⁴ T1268.30–1269.18. See too Mr Morley's evidence at T 2246.22.

- “Q. How many different figures did you try before you found that gave the answer of 11.7?
- A. There were many iterations of the model.
- Q. So when we look then at the page that's got 9.7 through to 13.7 as the investment earnings rate, is the position that by using a number of different rates at 11.7 as being the closest one, that would leave a figure after 51 years which was a positive figure?
- A. That's correct.
- Q. And then the other figures, the other columns, are they there to indicate what the position would be if you went 1 or 2 per cent either side of 11.7?
- A. That's right, so we could assess the sensitivity of the interest rates.
- Q. Now if you had gone to say 11.6 rather than 11.7, would that have had the result that it would show a negative figure at the end of that period?
- A. I expect it would been negative at the end of 50 years, yes.
- Q. So is it right to say that 11.7 was the figure that was the first per cent, to the first 10 per cent of 1 per cent that put you with a positive figure at the end of that period?
- A. That's correct.
- Q. Why was it that you were looking for a positive figure at the end of that period?
- A. Because I was being asked to demonstrate what the earnings rate would have to be given the assets in the fund and the proposed, and the expected outgoings, what the earnings rate were to be.
- Q. So is it right to say then that the 11.7 figure was a rate that was selected not because of its inherently appropriateness to anything else other than to arrive at the figure which was positive at the end of the 51 years?
- A. That's correct, but it was then compared to other historical earnings rates to assess whether it was reasonable.
- Q. But the initial selection of it was to arrive at a positive figure?
- A. Yes.”

19.37 As that evidence implied, the adoption of this course gave rise to a need to justify – after it had been selected for other reasons – the earnings rate of 11.7 per cent. This was later referred to by Mr Harman in his evidence:³⁵

- “Q. Your method of procedure in relation to the model was to work out the earnings rate that had to be achieved in order for the fund to pay all its liabilities, that was the first step?
- A. Yes.

³⁵ T 1308.46–1309.47.

- Q. And the second step, having established that that number was 11.7 per cent as an average forever, was to see if there was some support for the conclusion that that was a plausible earnings rate, on average, forever, is that right?
- A. That's what I was asked to do, yes.
- Q. ... Now let's just go back a little bit. The second stage of your process was to try and see if the 11.7 per cent future earnings rate on average fifty years was a plausible assumption, isn't that right?
- A. That was reasonable, yes.
- Q. What evidence did you use to form the conclusion that it was a reasonable assumption?
- A. It was the materials which Mr Morley obtained which I showed in my witness statement.
- Q. So it all comes down to tab K, is that right, is that it?
- A. Yes, it's Mr Morley who was looking after the investment earnings side of things.
- Q. Well we need to be clear about this. Did you form a view yourself about the plausibility of 11.7 per cent, or did you simply put it in there because the model required it and Mr Morley said "yes we'll run it with that"?
- A. I formed a view that it was within a reasonable range because it actually had occurred historically.
- Q. All right, so you had a view. If you had a different view, you wouldn't have been happy with the model going out in that form would you?
- A. No I wouldn't.
- Q. In forming your view, you relied on tab K, is that it?
- A. Yes."

19.38 "Tab K" - Annexure K to Mr Harman's statement - was a Towers Perrin "Superannuation Pooled Funds Survey for the period ended 31 December 2000". The document shows the after tax returns, over periods of 3, 5 and 10 years for Capital Stable, Below Average Volatility, Average Volatility and Above Average Volatility Funds. Mr Harman in his statement described the course which he took in relation to justifying the 11.7 per cent.³⁶

- "44 So that the modelling could advance whilst awaiting the outcome of the UBS Warburg research, and at Mr Morley's direction, Mr Morley and I undertook the exercise of calculating the weighted average rate of after tax index returns for 3 year, 5 year and 10 year periods, using data from attachment K. The exercise is summarised in attachment M. It was assumed for this exercise that an appropriate asset allocation to adopt for JH&Coy's investment portfolio was 25% Australian fixed interest, 35% overseas shares and 40% Australian shares. No further investment allocation to property was assumed, given JH&Coy's

³⁶ Ex 68, paras 44-47.

already substantial land and buildings portfolio, which was the subject of specific rental income projections in the Model. These calculations resulted in after-tax average rates of return of 11.3%, 12.8% and 13.2% over 3 year, 5 year and 10 year periods respectively.

- 45 Separately, the asset weighted after tax earnings rate for average volatility superannuation pooled funds surveyed by Towers Perrin was reviewed. As shown in attachment K, this shows after-tax average rates of return of 10.0%, 11.2% and 11.6% over 3 year, 5 year and 10 year periods respectively.
- 46 As these average rates of return were after tax returns, the effect of the 15% rate of tax applicable to superannuation funds had to be reversed by dividing by 0.85 to arrive at a before tax rate of return, consistent with the logic used in the Model. Taking the after tax average volatility data (the arithmetically lowest set of numbers), this resulted in before tax rates of return from 11.7% to 13.6%. over the 3 year to 10 year periods respectively.
- 47 I consulted with PwC Sydney Tax Services to establish whether the relevant companies would be in a tax paying position, in order to determine whether an allowance for tax outflows should be included in the Model. PwC Sydney Tax Services calculated that, based on the Model:
- a. during the early years, when there are significant cash inflows through a combination of loan principal receipts and indemnity receipts, there would be no need to realise investment earnings and thereby create a tax liability; and
 - b. in subsequent years, when the deferred investment earnings are realised, there would be sufficient accumulated losses from litigation and other outgoings to shelter the taxable investment earnings.

This conclusion, that no tax payment outflows need be included, was listed as one of the Model's underlying assumptions in the cover sheet attached to the Model."

19.39 The primary responsibility for selection of the 11.7 per cent earnings rate was borne by Mr Morley. He sought to judge the rate for plausibility on the basis of historical information he had consisting of Towers Perrin figures referred to above.³⁷ As matters unfolded it emerged that James Hardie did not obtain any independent expert to estimate future earnings rates for a fund of this kind. Although Mr Morley asked UBS Warburg to do so,³⁸ they ultimately declined to do so,³⁹ only providing data about historical rates of return. When UBS Warburg declined, Mr Morley formed the view that his analysis of the historical rates was sufficient. Mr Harman did not disagree.

³⁷ Ex 121, Vol 7, pp 2925–6.

³⁸ Sweetman T 1325.29–.56; Morley T 2249.16.

³⁹ Sweetman T 1326.8–26; Morley T 2249.16–18, T 2249.39–.41. Mr Sweetman's explanation was that it was outside the scope of their business.

19.40 Whilst I accept that various earnings rates had been used in earlier versions of the Model, I formed the clear impression from the evidence of Mr Harman and Mr Morley that the 11.7 per cent earnings rate was a result of an assumption as to the amount and timing of the additional funding to be provided to the Foundation. I am sceptical of the view that it was regarded bona fide as an, or the, appropriate rate, to be used in the calculations.

19.41 However, whatever might have been Mr Harman's views in February 2001, he agreed that the data which was available was an insufficient basis to adopt an earnings rate of 11.7 per cent per annum for the Foundation for 50 years.⁴⁰

“SHEAHAN: Q. ... As you sit there now, you know that this data is an insufficient basis for forming a conclusion that it is reasonable to expect the Foundation to earn 11.7 per cent per annum on average for fifty years from its investments, isn't that right?

A. That is right.”

19.42 Mr Harman went on⁴¹ to seek to justify the adoption of the 11.7 per cent figure by comparing the Foundation to a superannuation fund. He expressed the view⁴² that the exercise “was done with the best data we could get and ... the expectation was UBS Warburg would write a report”.

19.43 This was one of a number of occasions in which Mr Harman stated that he understood that expert advice was being obtained from UBS Warburg in relation to the appropriate investment earnings rate⁴³. That had been perfectly true but by the date of the Board meeting of 15 February 2001 Mr Harman knew that UBS Warburg was not going to give a report on that topic.⁴⁴

“Q. And you understood at that time, 15 February, that UBS Warburgh (sic) was declining to do a report about future earnings rates because it wasn't within their professional expertise to give such an opinion, isn't that right?

A. I was aware they were not going to give a report, I wasn't aware of the reasons they were being unwilling.”

⁴⁰ T 1310.21–27.

⁴¹ At T 1310.29–1312.29.

⁴² T 1312.30–39.

⁴³ T 1306.34–.42, T 1308.10–.14, T 1310.10–.16, T 1316.40–.42.

⁴⁴ T1308.25–.32.

19.44 A further feature was that Mr Harman's models made no allowance for volatility in relation to claims or investment returns, the only allowances in that regard being simply to use Trowbridge's High Estimate as well as the Best Estimate, and to risk the Model at different interest rates, the rate remaining the same for the whole period. These were matters which both Access Economics and PricewaterhouseCoopers – to whose reports I shall come – had regarded as significant weaknesses in the model. Mr Harman said:⁴⁵

“SHEAHAN: Q. And volatility in relation to claims and returns, they were areas of inevitable uncertainty, were they not?

A. Yes they are.

Q. And you had been specifically warned of the relevance of these considerations by both Access Economics and PricewaterhouseCoopers hadn't you?

A. Yes, that's contained in the reports, yes.

Q. What did you do to deal with or cater for the warnings that they made in respect of those matters?

A. I discussed them with Mr Morley when we had the draft report, and he advised me that management was satisfied with the model as it was, I didn't need to take no further action.

Q. But you couldn't have been satisfied with the model as it was Mr Harman, could you?

A. A more sophisticated model could have been prepared.

Q. If you had been asked to wager your money on the survival of the Foundation, you would have wanted a more sophisticated model wouldn't you?

A. It's possible, yes.

Q. You would have wanted a model that answered the criticisms of your model that were made by PricewaterhouseCoopers and Access Economics, isn't that right?

A. It's possible.

Q. It's true isn't it?

A. Yes it is.

Q. Your model also didn't allow for risks, did it?

A. What sort of risks?

Q. Well it didn't allow for the risk that claims history might be worse than anticipated, save to the extent that in a column of numbers on the right-hand side, you had the figures for the Trowbridge high estimate, that was the only respect in which it allowed for that particular risk, isn't that right?

A. Not quite accurate Sir. The model, one of the iterations of the model, the attachments to the model, it showed the impact of using those higher--

⁴⁵ T 1300.1–51.

Q. I stand corrected, you're quite right.

COMMISSIONER: Q. Just so that it's clear, the higher what?

A. The high scenario as is described in Trowbridge.”

19.45 Mr Harman also agreed that his model was not capable of justifying a conclusion that the Foundation would be able to pay all its liabilities. This appears from several passages in his oral evidence. First:⁴⁶

“Q. Given its limitations, it was incapable of supporting a conclusion that the most likely outcome would be that the Foundation would pay all its liabilities, isn't that right?

A. It was based on assumptions which were clearly stated. A more sophisticated model could have been prepared, I was not asked to prepare a more detailed model.

Q. ... Given the limitations of your work, I understand you did what you were told to do, given the limitations of what you did, your model was not capable of justifying a conclusion that the most likely outcome was that the Foundation would be able to pay all its liabilities. You would need more, wouldn't you Mr Harman, to justify such a conclusion?

A. Indeed a more sophisticated model?

Q. You would need to do a more sophisticated model and you would need allowance for volatility and risk, for the inevitable uncertainties that your model did not cater for before you could be satisfied that the most likely outcome was that the fund would satisfy all its liabilities, isn't that right?

A. The model was dependent on a series of assumptions which were, I believe, transparently laid out.

Q. Assuming the assumptions to be right, the problem was, I suggest Mr Harman, that the model intrinsically was capable only of identifying for the board a possible outcome, that is it say, an outcome that would occur if all those assumptions were realised in practice, isn't that right?

A. That's correct.

Q. In order to demonstrate what was most likely to happen, in addition to having a degree of satisfaction about the assumptions as such, you would need to have a degree of satisfaction about whether the funding in the model was enough to cater for the volatility, the inevitable volatility of investment returns and claim incidences, isn't that right?

A. In a more sophisticated model, yes.

Q. And your model didn't do that, isn't that right?

A. Yes, and that can be clearly seen from the model.

Q. But only someone who was cognisant of the limitations of financial modelling of this kind, who had read perhaps the warnings contained in the PricewaterhouseCoopers' report and the Access Economics' report and

⁴⁶ T 1303.7–1304.55.

appreciated that your model did nothing in respect of them, would realise that your model didn't cater for those matters, isn't that right?

A. That's correct.

Q. Did you know whether the board was going to be put in that position?

A. No I didn't.

Q. You knew that the board was going to be told that your model established, or justified a conclusion I should say, that the most likely outcome was that the Foundation would pay all its liabilities, didn't you?

A. My model showed on the assumptions made, that that would occur, yes.

Q. You knew that the board was going to be told that the model supported a conclusion that the most likely outcome was that the Foundation would pay all its liabilities, didn't you?

A. On assumptions made, yes.

Q. You knew the board was going to be told that, that was the most likely outcome?

A. I knew the board was going to be provided with a copy of the model.

Q. You saw the Project Green presentation for the board didn't you?

A. Which one is that sorry?

Q. (Exhibit 42, Mr Cameron's statement handed to witness.) If you go behind tab number 12 please?

A. I have it.

Q. You saw this before it went to the board didn't you?

A. Yes I believe I did.

Q. Go to page 77 in the bottom right-hand corner, you see it has a heading "funds life expectancy/sensitivity" and then "James Hardie modelling" a heading "key assumptions" which is then set out and then the next point "surplus, most likely outcome"?

A. I see that.

Q. Given the limitations of your model, that was a somewhat misleading proposition to put to the board wasn't it?

A. On those key assumptions, it was a valid outcome, but I take the point about sensitivities.

Q. The point about sensitivities, you understand, is that even on those assumptions, the question about whether a surplus is the most likely outcome is unanswerable without dealing with the sensitivities and the volatilities, isn't that right?

A. I'd agree."

19.46 There was a real risk in basing expectations of future returns on past returns unless one had regard to the extent to which recent history was typical of the past, or likely to be repeated. That was made explicit in warnings stated in the Mercer survey

itself,⁴⁷ and Towers Perrin's survey material provided by UBS Warburg (subsequently confirmed by UBS Warburg in their letter of 19 February 2001, after the February Board meeting).⁴⁸

19.47 The reason was explained by Associate Professor Geoffrey Kingston, an expert retained by the Commission. He said that the figure of 11.7 per cent, derived as it was from average performance between 1985 and 2000, was "substantially too high, partly because it reflects the high price earnings ratios that emerged in the equity markets of the 1980s and 1990s, and partly because it inherits five years of the high expected and actual inflation that characterised the 1970s and 1980s".⁴⁹

19.48 In Dr Kingston's opinion, the period 1986–2000 was "exceptional" and using returns based on that 15 years experience was subject to serious deficiencies. The period was too short a span for a projection based on past average returns. It disregarded the forward-looking information about prospective returns. It also disregarded the longer-term outlook for inflation.

19.49 Dr Kingston's opinion was, to a degree, challenged in the JHI NV submissions⁵⁰ on grounds which I thought a little insubstantial, but those submissions⁵¹ also noted:

"On the other hand, it is important to remember that he considered the rate of 11.7% used in the model as equivalent to an after tax rate of 7.6%, which is not greatly different to the 6.4% identified by Dr Kingston and very close to a rate that could be identified by the use of assumptions that could reasonably have been adopted."

19.50 My view that whilst 11.7 per cent may have been capable of justification as an appropriate earnings applicable in February 2001, its unvarying use for a term of 50 years was not justified.

19.51 Speaking a little more generally about the Model, it was capable only of identifying an outcome that would occur if all the assumptions were realised in

⁴⁷ Ex 121, Vol 7, Tab 121, p. 2925; Initial Submissions of Counsel Assisting, Section 2, paras 38–39.

⁴⁸ Ex 1, Vol 8, Tab 85, Sweetman T 1327.3–15.

⁴⁹ Ex 237, p. 11.

⁵⁰ JH INV Initial Submissions paras 8.7.1–8.7.11.

⁵¹ JHIN Initial Submissions paras. 8.7.10.

practice.⁵² The Model did not allow for probabilities, only interest variability.⁵³ Mr Morley acknowledged that where future liabilities could not be reliably measured, the only way to be reasonably confident that they would be met, would be by allowing for a “buffer”.⁵⁴

E. Expert review of the Twelfth Cash Flow Model

19.52 Mr Ashe and Mr Loosley had met on 7 February 2001.⁵⁵ On 9 February 2001 at about 2.30 pm Mr Macdonald and Mr Loosley met in Sydney.⁵⁶ Mr Loosley’s advice dealt with a number of topics, all concerned with the best way of presenting the proposal to interested parties.

19.53 On the next day Mr Macdonald emailed to Mr Baxter, with copies to, amongst others, Mr Shafron and Mr Morley, some observations about the meeting with Mr Loosley. The notes⁵⁷ included the following:

“Just reviewing my meeting notes.

Overall, Stephen felt our strategy was sound.

1. **Media Strategy.** In terms of creation of the Foundation Stephen was most concerned that we positioned it properly to the broad media – a very deliberate and consistent media strategy was important. We needed to be available and get to the key people in the first 48 hours – when the issue would likely be won or lost. We should work hard to identify the key catch phrases we would want to repeat and have every stakeholder understand and accept. Some examples were:

- James Hardie is not running away – it is actually committing to solving this problem.
- James Hardie has produced an outcome that is fair to all parties.
- James Hardie has greatly improved the position of future victims of asbestos disease.

⁵² Harman T 1303.33–.39.

⁵³ Harman T 1298.53–.56.

⁵⁴ Morley T 2248.41–49.

⁵⁵ Ex 135, para 7.

⁵⁶ Loosley Ex 135, para. 10 and Tab 5. Present also were Mr Baxter, Mr Ashe and Mr Pigott, a PwC employee.

⁵⁷ Ex 145.

- James Hardie has provided \$284M in funding for future asbestos victims – this will support \$750M of future payments (based on payout projections from most likely models).
- James Hardie has structured the Foundation so that the money will be there.
- James Hardie is not **the** asbestos problem – it was a small part of the problem (less than 20 per cent).
- etc, etc...

4. **Funding – will it be enough ? and independent verification.** Stephen felt the new numbers put us in a very powerful position. We should attempt to get independent verification of the funding outcomes we had modelled (Access Economics, Grant Samuel, PwC were suggestions) so that funding outcomes were not solely on our say so. For example, we should be ready to say “James Hardie’s Board has taken a very responsible and fair approach. They have provided for future victims. Two independent reviews have agreed with James Hardie’s calculations – that in all probability there will be sufficient money for victims.”⁵⁸

19.54 I shall come to the detail below, but I would note at this point that it was sought to commission three “independent reviews”. They were:

- (a) UBS Warburg in relation to the earnings rate. As noted earlier, WBS Warburg declined to provide the information requested;
- (b) Access Economics;
- (b) PricewaterhouseCoopers.

19.55 It is clear, however, that the two independent reviews which were in fact commissioned or contemplated constituted anything remotely approaching an “independent verification of the funding outcomes”. Nor could any have provided a basis for saying that “independent reviews have agreed with James Hardie’s calculations – that in all probability there will be sufficient money for victims”. Instead what was done was to obtain expert opinion on limited aspects (in the case of Access Economics and PricewaterhouseCoopers on whether the Model was technically sound

⁵⁸ An argument was put that the idea originated within JHIL (JHI NV Submissions, paras 8.5.2.–8.5.3. JHI NV and ABN 60 Submissions in Reply on Terms of Reference 1 to 3, para. C4.1) but the evidence is inconclusive. I shall rely on Mr Macdonald’s contemporaneous email.

and correct) as distinct from whether the outcomes in the Model were probable. Why such a narrow scope of review was determined upon is perhaps a matter of some conjecture. Time pressure may have played a factor; the idea only emerged in the week prior to separation. But whatever time pressure there may have been was self-imposed and took on significance only because it was chosen to best suit the James Hardie timing for separation.⁵⁹ The detailed steps taken in relation to Access Economics and PricewaterhouseCoopers indicate, it seems to me, that the principal reason was that the management of James Hardie preferred not to have either of those firms express a view on whether 11.7 per cent was an appropriate earnings rate over the 50-year term, or on the ultimate results of the Model.

19.56 After receiving Mr Macdonald's email – para. 10.48 – Mr Ashe contacted Access Economics and PricewaterhouseCoopers and emailed Messrs Shafron, Macdonald, Morley and Baxter with the following information:⁶⁰

“Subject: PwC / Access Economics

Both PwC and Access are willing to do the work and can commence Monday morning.

The PwC person is David Brett (8266 8761) – his (sic) is based in Sydney and will be waiting for our call. The Access people are Marnie Griffiths and James Ollnutt (sic) (02 6273 1222). They will also be waiting for our call.”

19.57 Mr Shafron forwarded the message, a minute later, to Mr Harman, with a copy to Mr Morley, adding:

“Subject: FW: PwC / Access Economics

A job for you on Monday – get these guys to bless your model. Thought I better give you fair warning.”

19.58 On Monday, 12 February 2001, Mr Ashe apparently spoke to Ms Griffith of Access Economics and asked Access Economics to undertake “a technical review of the model”. Before further information could be given, however, he required that these

⁵⁹ Morley T 2254, p. 14-19.

⁶⁰ Ex 61, Vol 6, Tab 3. The email bears the notation: “Sent: Thursday, February 08, 2001 10:36 PM”, but it seems likely that Ashe's computer was on California time, the Sydney equivalent being Friday 5:31 PM.

confidentiality agreements be executed by Ms Griffith, Mr Allnutt and Mr Waterman.⁶¹ This was done, and the model was then emailed to Mr Waterman by Mr Harman.⁶² Mr Waterman was the Access Economics's officer responsible for carrying out the task, Ms Griffith and Mr Allnutt working under him.

19.59 On 13 February 2001, Mr Ashe emailed Mr Waterman indicating the type of report that was being sought. His email⁶³ referred to "the type of report we are seeking which will give you a good idea of the type and extent of work required":

"This report comments on a model for estimating future costs in asbestos litigation involving James Hardie & Coy Pty Limited and Jsekarb Pty Limited. Specifically, we are asked to comment on the reasonableness of the model in projecting future cashflows.

Access Economics has reviewed the "forecast JH & Coy Pty Limited and Jsekarb Pty Limited assets and future cash flow" model and finds it to be logically sound and technically correct. The model works effectively by inputting classes of assets, generating predetermined returns on those assets, and deducting management and claims related costs and settlements.

Given the assumptions used in the model and the "most likely estimate" future claims cost scenario as provided by the actuarial firm Trowbridge, the model shows that a surplus of funds will exist after all claims have been paid.

Key variables in the model which we have not checked and on which we express no opinion are:

- investment earnings rates
- litigation and management costs
- future claim costs"

19.60 Late on 13 February 2001 Mr Allnutt emailed Mr Ashe with the views so far arrived at. He said⁶⁴ they had reviewed the model as presented to us in the email, and:

"First, we have made some alterations to the model

1) We have taken the Trowbridge results and turned them into 'real' figures (i.e. remove the inflation component). We can then apply a consistent inflation assumption to these 'real' figures.

⁶¹ Ex 41, Mr Waterman's Statement, paras 8 and 9, Tabs 1 and 2.

⁶² Ex 41, para. 10 and Tab 2, Ex 41.

⁶³ Ex 41, Tab 4.

⁶⁴ Ex 41, Tab 6.

This is necessary because it ensures consistency throughout the model. The original figures had an assumed inflation rate of 4% in the litigation figures, but 3% elsewhere. This significantly alters the results.

2) We have made the 'return on investment' figure a 'real rate of return'. We set the real rate of return to 10.7%, giving a nominal rate of return of 13.7% under the 3% inflation scenario (this then gives consistent results to what we originally had).

The structure of the model itself appears sound, with the possible exception of the two equations that Marnie discussed with you. They probably warrant some further discussion tomorrow."

and then continued:-

"However, the model results are highly sensitive to changes in assumptions. This underlines the importance of sensitivity analysis, and ensuring that the assumptions used are realistic. The management of James Hardie needs to be comfortable with these assumptions.

It should also be noted that small changes in inflation/rates of returns at the start of the forecast period can also be highly significant to the results. For example, a poor return in an early year can jeopardise the viability of the entire scheme over the forecast horizon.

The adjustment to the Trowbridge figures means that a nominal return of around 11.2% is required in the 'worst case scenario' (8.2% per annum in real terms) to keep assets in the fund. This is still a high figure, especially over such a long period of time. We remain cautious about assuming a relatively high return on assets invested and believe that this is something that James Hardie will need to test more fully."

19.61 The next day a draft report was sent to Mr Ashe by email. It said:⁶⁵

"We have reviewed the model as presented to us in your email, and made alterations to the Trowbridge data to maintain consistency in the application of inflation assumptions on future cash flows. The initial data obtained included an assumption of 4% inflation per annum across the forecast period. The model has been adjusted so that the assumed rate of inflation is uniform for all variables. Unless a consistent rate of inflation is used across all relevant variables, the results of the model would be distorted.

The structure of the model itself appears sound for the analytical work for which it has been designed.

As with any modelling of this nature, the results depend importantly on the underlying assumptions, which the management of James Hardie needs to be comfortable with. We have not been asked to provide an opinion on some of the key assumptions, particularly:

- The investment earnings rate;
- The inflation rate;

⁶⁵ Ex 41, Tab 7.

- Litigation and management costs; and
- Future claim costs.

You have indicated that you are obtaining independent, expert advice on those assumptions. We would like to note, however, some points about the results generated by the model.

It should also be noted that small changes in inflation/rates of returns at the start of the forecast period can also be highly significant to the results. For example, a poor return in an early year can jeopardise the viability of the entire scheme over the forecast horizon. This effect illustrates the importance of performing sensitivity analysis on the results. While returns may average a particular rate over the forecast horizon, the dispersion of returns in individual years can be of critical importance to the final result.

The results depend importantly on the assumption concerning the investment earnings rate. The adjustment to the Trowbridge figures means that a nominal return of around 11.6% is required in the ‘worst case scenario’ (8.6% per annum in real terms) to keep assets in the fund. This is still a high figure, especially over such a long period of time. We remain cautious about assuming a relatively high return on assets invested and believe that this is something that James Hardie will need to test more fully. We understand that James Hardie is seeking separate advice on this issue.”

19.62 Seeing the draft resulted in Mr Harman and Mr Waterman speaking by telephone, the effect of the conversation being that Mr Harman said that James Hardie:⁶⁶

“did not see the role of Access Economics as including any detailed comments on the assumptions for the model and that was not part of our remit as this was being dealt with by other experts.”

19.63 The consequence of the conversation was that Mr Waterman changed the last paragraph of the draft so that in the final report, emailed to Mr Harman on 15 February 2001, it read:⁶⁷

“The results depend importantly on the assumption concerning the investment earnings rate. We have not been asked to comment on the specific assumption employed, but it is something that warrants detailed consideration by James Hardie.”

19.64 As Mr Waterman said in evidence,⁶⁸ notwithstanding the conversation with Mr Harman, he:

⁶⁶ Waterman, Ex 41, para. 18; T499–503.

⁶⁷ Ex 1, Vol 8, Tab 84, p. 2295.

⁶⁸ Ex 41, para. 19 and Tab 3.

“still felt professionally obliged to make the point in principle that the earnings rate was very important and the impact of volatility in that rate in the early years pointed to the need for sensitivity analysis”.

19.65 At PricewaterhouseCoopers, the person principally concerned was Mr David Brett.⁶⁹ He was contacted by Mr Harman on 11 February 2001,⁷⁰ and met Mr Harman and Mr Ashe on the afternoon of 12 February 2001 at James Hardie’s Sydney office. Mr Brett has deposed, and I accept, that the following took place:⁷¹

“16. During the course of the meeting, Mr Harman said to me words to the following effect in relation to the report that he wanted PricewaterhouseCoopers to prepare:

“I have prepared a model which is designed to represent cashflows in relation to the proposed MRCF. The purpose of the model is to demonstrate that there is a surplus of funds available to the MRCF when all claims against it have been paid and it has funded research. We want you to bless the model. We need you to comment on the reasonableness of the model in terms of checking it for logical and technical correctness. We do not want you to make any comments on the key assumptions we just want you to review the model to check it’s arithmetically correct. We don’t need you to come up with a new model.”

17. What is recorded at paragraph 16 does not necessarily represent what was said by Mr Harman at the one time, but it reflects the effect of what he told me during the course of the meeting as to the report that he was seeking from PricewaterhouseCoopers.

18. At some point during that meeting I asked them a question to the following effect about the assumptions used in the model:

“What is the source of the assumptions about expected claims liabilities?”

Mr Harman replied words to the following effect:

“The expected claims liability assumptions are provided by Trowbridge and those figures are already in our spreadsheet.”

I also asked Mr Harman a question to the following effect:

“What about the other key assumptions?”

To that question he replied words to the following effect:

⁶⁹ Ex 67, para 27.

⁷⁰ Mr Brett in his oral evidence at T1227 expressed the view that 9 February may have been the correct date, but I have doubts about that.

⁷¹ Ex 67.

“They will be provided by James Hardie. You’re not being asked to review these assumptions. The key assumptions are James Hardies, but we have other professional advisors such as Access Economics.”⁷²

19.66 He also deposed, and again I accept, that what was conveyed to him on the occasion of that meeting was to the effect stated in the first and fourth paragraphs of his report,⁷³ namely:

“I refer to a request from Mr Stephen Harman (Financial Controller) and Mr Steve Ashe (Vice President, Public Affairs) to comment on the reasonableness of a model prepared by Mr Harman which is designed to project cashflows in relation to the proposed Medical Research and Compensation Foundation (MRCF). ‘Reasonableness’ in this context refers to logic and technical correctness given the purpose for which the model has been designed.

We understand that the purpose of the model is to demonstrate to you, the Directors of James Hardie Industries Limited, that there is a surplus of funds available to MRCF when all claims against it have been paid. We understand that the assets and liabilities in question are assets and liabilities held by both JH & Coy and Jsekarb, and that the new entity MRCF will hold an interest in both of these companies. We understand that the plan is to fully fund the outstanding liabilities of the MRCF entity over a period of five years so that once fully funded it will be able to meet all liabilities on its own account.”

19.67 During the course of that meeting Mr Brett was shown an email which dealt with “suggested report wording” and in which it was said:⁷⁴

“A couple of suggestions:

In particular – I think the use of most likely is better than “best estimate” which can be interpreted as “best case” which it clearly isn’t.

OK?

Peter M

-----Original Message-----

From: Steve Ashe
Sent: Sunday, February 11, 2001 7:00 PM
To: Peter Shafron USA; Peter Macdonald; Phillip Morley
Subject: suggested report wording

⁷² Access Economics, of course, was being asked **not** to look at the assumptions.

⁷³ Ex 67, Tab 18.

⁷⁴ Ex 67, Tab 2.

Executive Summary

This report comments on a model for estimating future costs in asbestos litigation involving JH&Coy P/L and Jsekarb P/L. Specifically, we are asked to comment on the reasonableness of the model in projecting future cashflows.

... has reviewed the “forecast JH & Coy Pty Limited and Jsekarb Pty Limited assets and future cash flow” model and finds it to be logically sound and technically correct. The model works effectively by inputting classes of assets, generating predetermined returns on those assets, and deducting management and claims related costs and settlements.

Given the assumptions used in the model and the “most likely estimate” future claims cost scenario as provided by the actuarial firm Trowbridge, the model shows that a surplus of funds will exist after all claims have been paid.

Key variables in the model which we have not checked and on which we express no opinion are:

- investment earnings rates
- litigation and management costs
- future claim costs”

19.68 Confidentiality agreements were executed by Mr Brett and by the other PricewaterhouseCoopers staff to be engaged in the exercise, Mr Oakey and Mr Rabindranath.⁷⁵

19.69 The model was emailed to Mr Brett by Mr Harman and then worked on by PricewaterhouseCoopers. In the event at 6:30 pm on 15 February 2001 – the JHIL Board meeting had concluded – Mr Brett emailed to Mr Harman the PricewaterhouseCoopers report.⁷⁶ A draft report had been sent to James Hardie on 14 February.

19.70 The report, in its principal text, said:

“We have reviewed the model referred to above and find that it is logically sound and technically correct, within the limitations imposed by this kind of model. Further on the question of ‘reasonableness’, we have noted below the limitations of the type of model used for the purpose described. Some detailed comment on the components of the model are attached (See **Appendix – model components**). The model has been verified by reproducing the results provided by JHIL in a spreadsheet we have built ourselves, using your starting balances and assumptions (See **Appendix – model results**).

⁷⁵ Ex 67, Tabs 5, 6 and 7.

⁷⁶ Ex 67, Tab 18. The report was dated 14 February 2001.

The model generates cash in flows and outflows associated with the assumed assets and liabilities of the companies (referred to in the model as JH & Coy). In general terms, cash in flows are generated by:

- repayment of a loan made to JHIL and still outstanding
- interest on that outstanding loan
- rent on properties occupied by James Hardie Australia and other companies
- a payout by JHIL that provides an indemnity to JHIL
- a payout by QBE
- interest on outstanding investment balances

Cash out flows are generated by:

- running costs of JH & Coy and JSEKARB
- costs associated with forecast asbestos litigation
- \$1M per year (inflated) sinking fund for refurbishment and renewal of buildings

The model generates a net cash flow amount at the end of each period (the model uses intervals of one year), which is carried over to determine the investment value of cash and other financial assets at the beginning of the following year. The MRCF entity enjoys positive cash flows in the early years (to 2007), mainly because of repayments of principal by JHIL and payments of interest on the outstanding balance of that loan. In the middle years, say years 2008 to 2042, net cash flows are negative because the expected compensation payouts exceed the income of the entity. The exceptional year in the middle period is 2024, in which the model generates a large positive cash flow because it is assumed that the entire property portfolio is sold. In the final years of the model, annual net cash flows return to positive, as the expected compensation payouts decline and the costs associated with claims administration also decline. Investments in financial assets remain positive for the entire period of the model.

We have not independently verified any of the inputs to the model and model assumptions. In particular, key values and parameters used in the model that we have not checked and on which we express no opinion are:

- investment earnings rate over the period to 31 March 2053
- future claims costs (subject of actuary's report)
- costs associated with litigation (eg. preparation of defence)
- other cost of ongoing operations (eg. costs of company directors)
- interest rate earned on proceeds of loan from JH & Coy to JHIL
- inflation rate over the period to 31 March 2053 (used for inflating running costs, rent, and property asset values)

The model results are sensitive to these values and assumptions, and we urge the directors to JHIL to satisfy themselves, as to whether the values and assumptions used in the model are reasonable.

We note here some limitations in relation to the type of model used here for the stated purpose, as follows:

- While the chosen model may demonstrate a surplus of funds available to MRCF when all claims against it have been paid (given the input assumptions), it

contains no decision rules on the question of whether the level of funds available at any point in time is prudent or necessary. An alternative model could determine an optimum level of support for MRCF in view of the expected claims against it, consistent with assumptions on say the level of overdraft, liquidity, or net assets as a proportion of forecast claims liability.

- The chosen model does not systematically explore the risks inherent in the forecast cash flows and therefore asset values. This could be addressed by discounting or by various forms of dynamic modelling (see the following two points below).
- The chosen model does not recognise the risk-adjusted time value of money, so that distant cash flows effectively carry the same weight in the outcome as near cash flows. In reality, near cash flows (expected claims, rent, etc.) should be attributed more weight in the model than distant cash flows. A discounted cash flow approach would compare the present value of cash in flows against the present value of cash out flows.
- The chosen model does not deal with the possibility that interest rates, asset values and expenses vary over time and the possible impact various trends might have on the result. The model locks in current rates and values for all time; uncertainty is managed solely by the availability of three scenarios in relation to the cost of claims, and the possibility that different interest rates can apply, but then remain fixed for all time. For example, while a certain class of investment funds might earn a rate of return of say 12% pa on average over a long period of time, it is a characteristic of all except risk-free investment funds that returns vary markedly from year to year – in some years returns may be negative. This concern could be addressed by running a variety of scenarios with possible trends in interest rates, asset values, and expenses. There is a possibility that the worst case scenario in relation to the cost of claims is combined with the most optimistic assumption on earnings. As there is no necessary correlation between the cost of claims scenario and investment earnings, it is reasonable to investigate the possibility that the worst case eventuates in respect of both the cost of claims and investment returns.”

19.71 The Appendix to the report, which dealt with “model components”, noted the following:⁷⁷

“Item	Value / percentage
Interest rate (paid by JHIL to JH & Coy)	8.13% pa
Earning rate for investment	11.70% pa
Interest on overdraft	11.70% pa
Inflation rate for expenses, rent, land value	3.00% pa
Initial running costs	\$2,400,000 pa
Terminal running costs	\$100,000 pa
Rent (beyond the term of current leases)	Current rent indexed for inflation (currently at about 7.9% of market value)

We make no comment on the level of assumptions. However, we suggest that the Directors satisfy themselves of the appropriateness of having the earning rate for investment at the same level as the interest on overdraft. The rate forecasts should depend on a range of factors (type and term of investment securities, whether the borrowings are secured, etc.).”

19.72 It is absolutely clear, of course, that neither Access Economics nor PricewaterhouseCoopers was engaged to do more than determine whether the model developed by Mr Harman was satisfactory as a mathematical tool, and that although both Access Economics and PricewaterhouseCoopers were capable of reviewing the assumptions,⁷⁸ neither firm was engaged to determine whether the underlying assumptions, the critical matter, were justified.

19.73 The evidence of Mr Morley and Mr Harman made it apparent that the work of Access Economics and PricewaterhouseCoopers was not of great significance. As Mr Morley said⁷⁹:

“Q. Just taking it a step at a time, you agree with me, do you not, Mr Morley, that when you read this, you appreciated that Mr Loosley’s advice was that there should be external, independent, professional verification of the outcome of your model, not merely its logic?

A. I can see that reading this, yeah.

Q. What happened after 10 February to bring about the situation that all you asked PricewaterhouseCoopers and Access to do was verify its logic?

⁷⁷ Ex 67, Tab 18, p83.

⁷⁸ Ex 41, para. 15; Ex 67, para. 25.

⁷⁹ T2252.37–T 2254.19.

- A. I can't recall the exact conversations, but that was clearly the impression I got that they were going to review the calculations.
- Q. What you got PricewaterhouseCoopers and Access Economics to do was certainly an arid exercise, wasn't it?
- A. When you say "arid" you mean just looking at the calculations?
- Q. By "arid" I mean pointless. You knew, with complete certitude, before you sent the model to them, that it was logically correct; isn't that right?
- A. Well, yes.
- Q. You didn't need their blessing to give you any increase in your confidence on that subject, did you?
- A. No, because the person building the model was an expert in that area.
- Q. Mr Harman was an expert and it was in truth a simple model as financial models go?
- A. Yes.
- Q. So what you asked Access Economics and PricewaterhouseCoopers to do was certainly arid and pointless, was it not?
- A. Well, I didn't brief them, but that was the - I understand what you're saying. I agree with what you're saying.
- Q. If they had been asked to do what Mr Loosley suggested they had been asked to do, their exercises would have had some point; you agree?
- A. I agree.
- Q. They would have had assisted to give you, if they approved of what you were doing, reasonable confidence that all asbestos victims would be paid, correct?
- A. Yes.
- Q. There was also a risk though that they would not approve of the assumptions in your model; isn't that right?
- A. I can't say I thought of it like that at the time.
- Q. Is that why they were asked to confine themselves to the logic of the model and to leave aside its assumptions - that you were concerned, at this late stage, that things might come unstuck just as it looked like they were getting to closure?
- A. No, I can't draw that conclusion.
- Q. Can you think of any other reason why PricewaterhouseCoopers and Access Economics would be invited to indulge in this arid exercise rather than the exercise of substance that Mr Loosely suggested?
- A. Well, the comment - this was all about how we're going to go to the media and both Mr Macdonald and Baxter wanted to be able to say that at least the work we'd done had been checked out by Access and PwC.
- Q. Mr Macdonald and Mr Baxter weren't proposing to tell the media that PwC and Access had engaged in an arid pointless exercise of checking logic you were confident was correct; that wasn't what was being discussed, was it?
- A. Not that I can recall, no.
- Q. Can you suggest any consideration, other than a concern that views sought about the substance of the assumptions might disrupt the progress of the

transaction, to explain why PricewaterhouseCoopers and Access were given the limited brief they were?

A. Well, other than - we wanted to announce this transaction on 16 February.

Q. Even if that meant that you couldn't get the benefit of their views to assist you as to your confidence that all victims would be paid?

A. Yes, I agree with what you say.

COMMISSIONER: Q. Sorry, I didn't hear what you said?

A. I agree with what he's saying.

SHEAHAN: Q. You understand, don't you, that the 16 February date was significant only because it suited James Hardie public relations strategies in respect of this announcement; isn't that right?

A. Yes, because that was the reporting date for our third quarter results."

19.74 JHI NV/ABN 60 have submitted, in relation to Mr Morley's agreement that the exercises performed by PricewaterhouseCoopers and Access Economics was "arid and pointless", that:

"C4.3 Not much should be made of Mr Morley's agreement that the exercise which had been undertaken by PwC and Access Economics was "arid and pointless": cf. CA, Section 2, [11]. The concession was understandable from his perspective. He was entitled to believe that the model was sound. Moreover, the Commission should be cautious in judging these events with hindsight; no one other than Mr Harman had reviewed the detail of the model (Harman T1263.48) and it is inherently likely that Mr Harman would have seen some benefit in having PwC and Access Economics Reports confirm that the model was logically sound and technically correct (T1263.2)."

I do not accept these submissions. Mr Morley was Mr Harman's superior. Both men were very interested in the modelling exercise. I thought also that Mr Morley's oral evidence just quoted was a distinct admission by him that the principal purpose of engaging PricewaterhouseCoopers and Access Economics was cosmetic.

19.75 Mr Harman's oral evidence also suggested that there was no desire to bring to the Board's attention any question about the soundness of the use of the 11.7 per cent rate.⁸⁰

"COMMISSIONER: Q. I think you're being asked about the observation that it was a high figure, 11.6 per cent, especially over such a long period of time, and the question is, was it your suggestion that that observation be deleted from the final report?

⁸⁰ T 1316 23-58.

A. It may have been, yes.

SHEAHAN: Q. You told Mr Waterman that Access should keep away from commenting on assumptions because it wasn't part of their retainer, something to that effect?

A. My understanding perhaps of their review was to test the logical soundness of the model.

Q. You told him, having seen this draft, to omit material which involved a commentary on the assumptions because you only wanted him to talk about the logic of the model, is that right?

A. That is correct, because the earnings rates were being covered by a separate report from UBS Warburgh (sic). That is my understanding at the time.

Q. Why do you think the board wouldn't be assisted by knowing Access Economics' reaction to the assumption as to earnings rates in addition to UBS Warburgh's? (sic)

A. I can't answer that.

Q. It was information that was clearly of potential value to a person assessing the utility of your model, wasn't it?

A. Yes it is.

Q. Why did you want it suppressed?

A. Because Access had been asked just to assess the logical soundness of the model and the earnings rate assumptions were being reviewed separately by UBS Warburgh." (sic)

19.76 As I have foreshadowed, my view of the realities is that it was the desire of JHIL to be able to use the names of Access Economics and PricewaterhouseCoopers in support of the view that the question of funding of the Foundation had been checked by independent experts, sparked by Mr Loosley's recommendation, which led to the engagement of those firms⁸¹. It went nowhere near Mr Loosley's suggestion that there be "independent verification of the funding outcomes".

19.77 This view is supported, I think, by the fact that James Hardie's Corporate Affairs Department, on the afternoon of 15 February 2001, sought from Mr Brett agreement to the terms of a draft of its proposed media release in relation to the establishment of the Foundation⁸².

⁸¹ Mr Morley's evidence at T2251 was to that effect:

"Q. Do you recall that the PricewaterhouseCoopers and Access Economic reports came about because of a suggestion that James Hardie should be in a position publicly to say that it had provided for future victims and two independent reviews had agreed with James Hardie calculations that, in all probability, there would be sufficient money for the victims?

A. That was my understanding."

⁸² Ex 67, Tab 15.

19.78 That draft contained the following⁸³:

“In establishing the Foundation, James Hardie sought expert advice from a number of firms, including actuaries Trowbridge, Access Economics and PricewaterhouseCoopers. This advice supplemented the company’s long experience in the area of asbestos and formed the basis of determining the level of funding to meet all future claims.”

19.79 Mr Brett’s response was to ask Mr Harman to change the wording because PricewaterhouseCoopers had not been asked to evaluate the assumptions in the model. Mr Harman “readily acceded to my request”⁸⁴. In the result the final version of the Media Release was relevantly:

“In establishing the Foundation, James Hardie sought expert advice from a number of firms, including PricewaterhouseCoopers, Access Economics and the actuarial firm, Trowbridge. With this advice, supplementing the company’s long experience in the area of asbestos, the directors of JHIL determined the level of funding required by the Foundation.”

19.80 For the reasons I discuss when dealing with the 16 February 2001 Media Release in Chapter 22, whilst Mr Brett may have been content with the extent of change, that part of the Media Release remained misleading.

F. Discussion at February Board meeting

19.81 The copies of the model tabled at the JHIL Board meeting of 15 February 2001 – apparently the first four pages of Mr Harman’s model – contained sensitivity analyses for earnings rates varying between 9.7 per cent per annum and 13.70 per cent per annum.⁸⁵ The February Board papers stated that the cash flow analysis had been “reviewed by PwC and Access Economics”. The Board did not have copies of the reports, and although Mr Harman was present at the Board meeting and had copies with him,⁸⁶ they were not made available to the Board.

19.82 Mr Morley explained the Model to members of the Board at the meeting and I accept that there was some discussion of the appropriateness of the 11.7 per cent rate. I

⁸³ Ex 67, Tab 15.

⁸⁴ Ex 67, paras 35-36.

⁸⁵ Ex 75, Tab 121, p. 2824.

⁸⁶ T 2256.1

accept also that the directors then present at the meeting⁸⁷ were entitled to form the view, on such material as was provided to them and in their brief acquaintance with it, that the Model was an appropriate way of estimating the future position of the Foundation; making the assumption on which the Model was based.

19.83 Mr Morley's evidence was that he had conveyed to the Board the limitations on the retainers of PricewaterhouseCoopers and Access Economics. He said:

“Q. And the next point is analysis reviewed by PWC and Access Economics?

A. Yes.

Q. You spoke to this paper?

A. Yes.

Q. Did you speak to this part of it?

A. Yes.

Q. Did you tell the board that the analysis that had been done by PricewaterhouseCoopers and Access Economics was an arid exercise, it didn't assist your knowledge or confidence about your model at that time?

A. I told the board that Access Economics and PWC had only reviewed, and were only asked to review the calculation of the model, that they made some comments about we should get independent advice or review of the assumptions, and then I took the board back through the assumptions that were used. We supplied the board with the sensitivity on various assumptions, and there was a fair bit of discussions about the earnings rate and how we arrived at the earnings rate”.

19.84 In relation to the question of volatility, Mr Morley said⁸⁸:

“Q. Did you tell the Board PricewaterhouseCoopers and Access Economics had gone to the trouble of warning you that the model that you employed didn't make any allowance for the volatility of investment returns or fund expenses?

A. As I said earlier, yes. My recollection is that I told the Board that PWC and Access Economics were only limited in what they applied, and that we needed to take advice on the earnings rate.

Q. So I take it you did not tell the board that PricewaterhouseCoopers and Access had both gone to the trouble of warning you that the model did not allow for the volatility of investment returns and expenses?

A. Well, we covered that when we showed the board--

COMMISSIONER: You are being asked particular questions, if you could answer the question.

⁸⁷ Directors: Mr McGregor, Mr Macdonald, Sir Llewellyn Edwards, Ms Hellicar, Mr Wilcox, Mr Brown, Mr Terry, Mr O'Brien (alternate for Sir Selwyn Cushing), and Mr Gillfillan and Mr Koffel attending by telephone. Mr Morley, Mr Shafron, Mr Baxter and Mr Harman also attended, as did Mr Ian Wilson and Mr Sweetman (WBS Warburg) and Mr Peter Cameron and Mr Robb (Allens).

⁸⁸ T2256.8–2257.43.

- SHEAHAN: Q. I take it that you did not tell the board that both PricewaterhouseCoopers and Access Economics had gone to the trouble of warning you that the model did not allow for volatility as regards investment returns and expenses?
- A. My recollection is that I did discuss the fact that earnings could be volatile. But I can't exactly be sure as to the exact words I used.
- Q. You understand the significance of the warning that had been made by both the experts to be that, even if the earnings rate assumption was sustained over long periods as an average, adverse outcomes, particularly in the early years of a fund like this, could mean it would be unable to meet all future liabilities?
- A. That was pointed out to the board in the sensitivity table, we showed the rates going up or down 11.7 percent.
- Q. The sensitivity table just gives higher and lower average earnings, correct?
- A. Yes.
- Q. It does not deal at all with the problem of volatility, does it?
- A. That's correct.
- Q. You had been warned by PricewaterhouseCoopers, even on an 11 per cent average, the fund might end up not being able to pay all liabilities, isn't that right?
- A. On volatility, that's correct.
- Q. And you knew without being told that investment returns were volatile?
- A. Yes.
- Q. You knew without being told that the claims experience of James Hardie was volatile?
- A. Yes.
- Q. You could have 20 m dollars a year, or 30 m dollars a year, and then maybe 15 the next, that was your understanding?
- A. Yes.
- Q. You knew that as a consequence of those considerations, even if your assumptions were realised as to averages, the fund might end up being unable to pay the victims, didn't you?
- A. Well, at the time--
- Q. Didn't you know that?
- A. If the earnings rate went down, it wouldn't survive the 50 years we allowed.
- Q. And that would mean some victims would go uncompensated, correct?
- A. Yes.
- Q. Did you point out the significance of the advice that you had received from PricewaterhouseCoopers and Access to the board of James Hardie?
- A. As I said, I can't recall the exact words I used, but I am fairly sure that I discussed the warnings that PWC and Access Economics gave to us as to the volatility, or the input assumptions should be independently verified.
- Q. And the earnings rate assumption was not independently verified, correct?
- A. That's correct.

- Q. And did you tell the board it had not been independently verified?
- A. Yes, because I explained to the board the method we used to arrive at the earnings rate, and there was a discussion about the various historical performances and how we arrived at that earnings rate.”

19.85 I had difficulty in accepting this evidence. I did not think that Mr Morley had any very clear recollection. I did not find any of the evidence about what was conveyed to the Board orally on 15 February 2001 very persuasive. In particular I have much doubt whether the qualifications made by PricewaterhouseCoopers and Access Economics on volatility were conveyed to the Board. Mr Morley, it may be noted, had not seen the (then draft) Access Economics report.⁸⁹

G. Concluding matters

19.86 I have formed the view that the Twelfth Cash Flow Model was inherently an unsatisfactory mode of justifying the conclusions for which it was to be used.

19.87 It was suggested that Mr Morley’s conduct constituted an offence under s. 184(1) of the *Corporations Act*, which provides that:

“(1) A director or other officer of a corporation commits an offence if they:

(a) are reckless; or

(b) are intentionally dishonest;

and fail to exercise their powers and discharge their duties:

(c) in good faith in the best interests of the corporation; or

(d) for a proper purpose.”

19.88 I decline to accept that suggestion. First, in my opinion Mr Morley was acting as an officer of JHIL, not Coy, in relation to the preparation and use *by JHIL* of the Twelfth Cash Flow Model. At all times he was seeking to act in its best interests. He was a loyal employee. I did not think he was intentionally dishonest in his participation in and use of the Twelfth Cash Flow Model, although I regard the inputs to the Model as unsatisfactory. There is an argument that he was “reckless” in the way he assisted in

⁸⁹ T2257.45–2259.4.

preparing and using the Model, but in the light of such “blessing” of the Model as came from Access Economics and PricewaterhouseCoopers, and the inputs as to interest rates he actually used, I do not think it would be found that he was “reckless”, a difficult test to satisfy.

19.89 Various submissions were made that the conduct of JHIL, or its officers in relation to the preparation and use of the Twelfth Cash Flow Model gave rise to causes of action for damages. I think there is little substance in these claims. Establishing any relevant damage would be very difficult.

19.90 I conclude my observations on the Twelfth Cash Flow Model by noting that a measure of the inherent merit of the use of the 11.7 per cent earnings rate over 50 years appears in Mr Harman’s 18 February 2001 e-mail to Messrs Macdonald, Shafron, Morley and Ashe where he said:⁹⁰

“Attached are two spreadsheets, as discussed.

One is our well-loved financial model, trimmed to the bare essentials in what should now be a suitable format for external discussions. I have retained the 11.70% earning rate, being the rate we used when convincing the Board, the Foundation, its insurers and indeed ourselves of the financial outcome ...”

⁹⁰ Ex 72.

Chapter 20 – Incoming Directors

20.1 Several issues arise in connection with the incoming directors of the Foundation. They are:

- (a) whether the incoming directors owed any legal duty to ensure that the Foundation was properly funded; and
- (b) information provided to and the conduct of the incoming directors prior to creation of the Foundation; and
- (c) the steps taken by the incoming directors when it appeared there was likely to be an earlier than anticipated shortfall in the Foundation's funding; and
- (d) the conduct of Mr Bancroft in advising the incoming directors on the creation of the Foundation.

A. Legal Duty

20.2 Only the Unions submit that the incoming directors had a legal duty to ensure that the Foundation was properly funded. In paragraph 2.2 of their submissions they state:

“By accepting the JHIL invitation to consider becoming a director of MRCF, each of the incoming directors accepted the responsibility of ensuring that the MRCF was properly funded ...”

20.3 In my view, that submission is bereft of substance. No legal support for it could be suggested and it seems wrong in principle. At the time to which the submission relates, the incoming directors had not yet been appointed to the Board of the Foundation. They had no duties as directors. Why should they be under a positive duty to ensure the adequate funding of an entity simply because they had been invited to become directors?

B. The information provided to and the conduct of the incoming directors prior to creation of the Foundation

20.4 There was a period of around two months, from mid-December 2000 to mid-February 2001, between the initial approaches to the incoming directors and the creation of the Foundation.

Initial approaches and early meetings

20.5 The initial approaches to the incoming directors were as follows:

- (a) Sir Llew Edwards, who had been a director of JHIL since 2 August 1990,¹ was approached by Mr McGregor on around 15 December 2000,² and by Mr Macdonald on 16 December 2000,³ about chairing the proposed new entity. There was a meeting with him on 19 December 2000.⁴ (Suggestions to similar effect had been made to him earlier in 2000.)
- (b) Dennis Cooper had worked for James Hardie since June 1994. He was the Chief Information Officer for the James Hardie Group, and was based in the United States. He met with Mr Shafron and Mr Morley on 22 December 2000.⁵ At that meeting he received a copy of the James Hardie asbestos liabilities management plan for March 2001–2003,⁶ and a copy of the James Hardie Operating Plan Review as at September 2000.⁷
- (c) Michael Gill met with Mr Morley and Mr Shafron on the afternoon of 20 December 2000.⁸ Prior to this, during 2000, Mr Gill had advised James Hardie on a proposal to split the legal entities carrying the risk of asbestos liabilities from those conducting the ongoing business and

¹ Ex 13, p. 3, para. 19.

² Ex 80, p. 3, paras 16 and 17.

³ Ex 80, Tab 2, p. 3.

⁴ Ex 13, p.12, para. 47.

⁵ Ex 17, p. 19, para. 106.

⁶ Ex 7, MRCF 1, Tab 5, pp. 52–89.

⁷ Ex 7, MRCF 1, Tab 5, pp. 90–103.

⁸ Ex 29, p. 1, para. 3.

holding the assets used in that business.⁹ At the meeting on 20 December 2000, Mr Gill indicated that he would want to receive independent advice before agreeing to become a director.¹⁰

- (d) Peter Jollie was approached by Sir Llew about becoming a director of the proposed new entity on 4 January 2001.¹¹ He was contacted by Mr Macdonald later on the same day.¹² He met with Mr Morley and Mr Shafron on 5 January 2001.¹³ Mr Jollie enquired as to the solvency of Coy and Jsekarb at that meeting, and was told that the companies would be fully solvent, but that there was a possibility of insolvency in the future.¹⁴

20.6 At or shortly after these initial meetings each of the incoming directors received one or more of: a paper prepared by Mr Shafron describing the proposal, the statutory accounts of Coy and Jsekarb, materials regarding medical research into asbestos, and asbestos facts prepared by Mr Attrill.¹⁵ As observed by the Foundation, these materials did not include or refer to any actuarial assessment of the total amount of Coy and Jsekarb's asbestos related liabilities.¹⁶

20.7 Following his initial meeting on 5 January 2001, Mr Jollie met again with Mr Morley on 9 January 2001. Solvency was one of the topics Mr Jollie identified for discussion at that meeting.¹⁷

20.8 On 10 and 11 January 2001, Mr Cooper met with Mr Attrill to understand better the James Hardie Group's asbestos related litigation.¹⁸ On 11 January he asked Mr Attrill to provide him with copies of previous Trowbridge reports, and Mr Attrill

⁹ Ex 100, Tab 5.

¹⁰ Ex 75, Vol 7, Tab 80, p. 2346.

¹¹ Ex 7, MRCF 3, Tab 1 and Ex 36, paras 13–16.

¹² Ex 7, MRCF 3, Tab 2 and Ex 36, para. 17.

¹³ Ex 121, Vol 6, Tab 74, p. 2417.

¹⁴ Ex 36, p. 6, paras 22 and 27.

¹⁵ Ex 5, pp.4–5, paras 22–23; Ex 13, p. 12, para. 49; Ex 29, p. 1, para. 4; Ex 36, para. 34.

¹⁶ Initial Submissions of the MRCF, para. 23.26.

¹⁷ T 463.29–.55.

¹⁸ T 107.46–108.27; Ex 57, Vol 4, p. 889; Ex 5, pp. 9 and 12, paras 41 and 45.

said he would have to ask Mr Shafron.¹⁹ Mr Cooper was not provided with copies of those reports.²⁰

C. 15 January 2001 Meeting

20.9 On 15 January 2001, a significant meeting occurred between the incoming directors, accompanied by Mr Bancroft of Mallesons who had been retained to advise them (see Section D below), and Mr Morley, Mr Shafron and Mr Ashe who were representing JHIL, together with Mr Robb of Allens advising JHIL.²¹

20.10 Following a brief introduction by Sir Llew Edwards²² a number of presentations followed²³:

- (a) Mr Robb outlined “the general structure of the proposal and what legal documentation would be required to implement the proposal”.²⁴
- (b) Mr Morley dealt with the financial aspects of the proposed Trust, Coy and Jsekarb.²⁵
- (c) Mr Attrill dealt with asbestos litigation.²⁶
- (d) Mr Ashe outlined various issues associated with asbestos disease and medical research.²⁷

¹⁹ Ex 5, p. 13, para. 46.

²⁰ Ex 5, p. 13, para. 46.

²¹ Mr Attrill, Ex 57, Vol 4, pp. 937–941 (Mr Attrill’s notes appear to be the most comprehensive contemporaneous record of the meeting); Mr Robb, Ex 187, Vol 1, Tab 15, pp 57-60; Mr Cooper, Ex 7, MRCF 1, Tab 9, pp. 135–142; Mr Gill, Ex 29, pp. 62–67; Mr Jollie, Ex 7, MRCF 3, Tab 5, pp. 9–20; and Mr Bancroft took notes of the meeting, Ex 95, Vol 1, Tab 16, pp. 217–250. These notes are broadly consistent. The Agenda and Materials circulated to proposed directors by Mr Shafron are to be found in Ex 75, Vol 7, Tab 90, pp. 2449–2490. The formal meeting commenced at approximately 1.00pm and lasted approximately 3 hours: Bancroft, Ex 95, p. 4, para. 25.

²² Ex 13, p. 20, para. 74. Sir Llew Edwards regarded himself as being at the meeting to be briefed and had no involvement “in presenting or explaining the Foundation proposal to those present”.

²³ The presentations made by Mr Morley, Mr Attrill and Mr Ashe included Power Point slides: See Ex 95, Vol 1, Tab 16, pp. 223–250.

²⁴ Ex 95, p. 4, para. 26; Cooper, Ex 5, p. 15, para. 54.

²⁵ Ex 5, pp. 15–16, paras 54–58. Mr Morley also made some introductory remarks: Ex 29, p. 66.

²⁶ Ex 5, p. 16, paras 59–60.

²⁷ Ex 5, p. 17, para. 61. Mr Ashe dealt with JHIL’s agreement with the Institute of Respiratory Medicine at the Sir Charles Gardner Hospital in Perth and the possible establishment of a proposed Asbestos Disease Research Institute in NSW: Ex 95, Vol 1, Tab 16, pp. 234–246.

- (e) Mr Cooper dealt with administrative matters relating to the trust, Coy and Jsekarb.²⁸
- (f) Mr Bancroft provided advice to the proposed directors. (Mr Shafron, Mr Morley and Mr Ashe absented themselves from the meeting during these discussions).²⁹

20.11 In his introduction, Sir Llew noted that the concept of the Trust was to be discussed at the JHIL Board meeting on 17 January 2001 with a view to a formal decision being made at the following JHIL Board meeting on 15 February 2001³⁰. Mr Attrill's notes record (although the source was not recorded) that if the JHIL Board, at its meeting on 15 February 2001, made a decision to establish the Trust then the Trust would be in operation the next day.³¹

20.12 Mr Morley summarised the asset position of Coy and Jsekarb by reference to a Power Point presentation.³² That presentation explained that the Foundation would have assets comprising the net worth of both Coy and Jsekarb, and an additional \$2m donated for medical research. The assets of Coy and Jsekarb were said to total \$214m consisting of land and buildings valued at \$68m with an annual income of \$5.25m, QBE recoveries valued at \$28m, with \$3.1m payable per annum for the next 14 years, cash and securities of \$58m, and a receivable from JHIL of \$60m.

20.13 Mr Attrill provided an overview of asbestos litigation with the assistance of a Power Point presentation incorporating a series of charts and graphs illustrating various aspects of asbestos claims made during the first three quarters of the JHIL financial year commencing 1 April 2000.³³

20.14 Mr Bancroft then provided the proposed directors with "some preliminary advice" in the terms set out in his briefing note, which had been prepared for the

²⁸ Ex 5, p. 17, para. 62.

²⁹ Bancroft, Ex 95, p. 5, para. 27.

³⁰ Gill, Ex 29, pp. 62 and 66.

³¹ Ex 57, Vol 4, p. 941.

³² Ex 95, Vol 1, Tab 16, pp. 224–229 and Ex 121, para. 181, Vol 6, Tab 80.

³³ The slides contained an error referring to "Asbestos related claims received 3Q02". Mr Attrill explained to the meeting that the slides headed 3Q02 should in fact have been headed 3Q01 and applied to the nine months ending 31 December 2000. This was the "most up to date monthly data available on James Hardie's asbestos litigation" at the time of the meeting: Attrill, Ex 56, p. 24, para. 100.

meeting.³⁴ The terms of that advice and related matters are addressed at Section D below.

20.15 Following the conclusion Mr Bancroft's discussions with the proposed directors, Mr Shafron, Mr Morley and Mr Ashe re-joined the meeting. They were then informed that Mr Gill and Mr Jollie required more information.³⁵

20.16 In this context, amongst other requests, Mr Gill and Mr Jollie wanted the "Trowbridge" report circulated. Mr Attrill's notes record:

"Want more information before Michael (Mr Gill) and Peter (Mr Jollie) will agree.

– Trowbridge report circulated, want to meet with Trowbridge, want an update on liabilities.

...

Want Trowbridge to give reasonably adequate cover for future claims.

Want the new Co. to get a reputation as a good corporation which will contribute to the better management of the liabilities. Good PR.

Tony (Mr Bancroft) will give a sign-off of comprehensive risk analysis to the new directors.

- MSJ (Mallesons Stephen Jaques) to be the legal advisors to the trust. Would select auditors at an early stage".³⁶

20.17 The next phase of discussions, which occurred towards the end of the meeting, involved Mr Shafron speaking "to prospective directors about actuarial assessments which JHIL had received" in relation to Coy and Jsekarb's prospective asbestos liabilities.³⁷

20.18 Mr Attrill's notes record Mr Shafron's comments:

"Trowbridge

Draft report – current version

Most recent complete report 1998

Seeks to give the ultimate cash flow.

This is not the liability position of the co – rep. by debtors and creditors.

Future cash flow doesn't impact on solvency.

³⁴ Bancroft, Ex 95, p. 5, para. 27, and Tab 15, pp. 215–216.

³⁵ Ex 57, Vol 4, p. 940.

³⁶ Ex 57, Vol 4, p. 940.

³⁷ Shafron, Ex 17, p. 22, para. 120.

On certain assumption, the amt left in JHC will not be sufficient to meet all claims.

Comes out to \$270M on conservative earnings rate.

Good chance on Trowbridge numbers, there won't be enough".³⁸

20.19 Mr Gill also made some comments in relation to the funding of the proposal:

"If funds adequate for 10-15 years, OK

Question if funds less than adequate for 10-15 years.

Want to see trend going forward.

Current draft of T should be circulated tomorrow".³⁹

20.20 Mr Robb's notes⁴⁰ record the following:

"PS (Mr Shafron) Trowbridge – most recent complete is 98
99 is in draft
\$250 mill NPV @ 7%

MG (Mr Gill) : On that basis, not sufficient. How long will funds last – if 10-15 then OK
If way less then an issue".

20.21 Mr Robb also recollected Mr Gill saying words to the effect: "We would not want to be directors of it if the money runs out in 5-7 years".⁴¹

20.22 At the end of the meeting it was agreed that the proposed directors would meet with Trowbridge on 23 January 2001.⁴² Mr Attrill endeavoured to comply with the request, however, the meeting was cancelled on Mr Shafron's instructions.⁴³

D. Communications between Mr Gill and Mr Attrill

20.23 On 6 February 2001, Mr Gill telephoned Mr Attrill to discuss the preparation of the actuarial report on asbestos liabilities which was to be provided to the incoming directors.⁴⁴ In particular, Mr Gill indicated that he wanted to see the assumptions underpinning the actuaries' model and to understand how comprehensive the report

³⁸ Ex 57, Vol 4, p. 941.

³⁹ Ex 57, Vol 4, p. 941.

⁴⁰ Ex 187, Vol 1, Tab 15, p. 59.

⁴¹ Robb, Ex 187, pp. 6–7, para. 47.

⁴² Cooper, T 122.6–.15.

⁴³ Shafron, T 1617.37–.53.

⁴⁴ Ex 57, Vol 4, p. 989.

was.⁴⁵ On 9 February 2001, Mr Gill met with Mr Attrill, Mr Morley and Mr Shafron to discuss what the Trowbridge report would contain.⁴⁶

E. 13 February 2001 Meeting

20.24 There was to be a further meeting with the incoming directors on 13 February 2001. Prior to this meeting, Mr Shafron circulated packages of materials to the incoming directors.⁴⁷ Those packages did not contain the Deed of Covenant And Indemnity or any Trowbridge report.

20.25 The meeting of 13 February 2001 was attended by the incoming directors, Mr Morley, Mr Shafron, Mr Attrill, Mr Ashe, Mr Bancroft, Mr Robb and Ms Hunter.⁴⁸ Mr Minty and Mr Marshall also attended for a time.⁴⁹

20.26 The presentations given at the meeting were summarised by the Foundation in its Submissions as follows:⁵⁰

- “(a) introduction by Sir Llew Edwards;
- (b) trust structure by Mr Robb;
- (c) trust and subsidiary company financials by Mr Morley;
- (d) life of fund by Mr Morley and Mr Minty;
- (e) set up and structural issues by Mr Shafron;
- (f) public relations by Mr Ashe;
- (g) administration update by Mr Cooper;
- (h) independent legal advice by Mr Bancroft.”

20.27 At the start of the meeting, Sir Llew informed the incoming directors that additional funding for the Foundation had been secured,⁵¹ and that all issues they had about the Foundation needed to be raised that day.⁵²

⁴⁵ Ex 57, Vol 4, p. 989.

⁴⁶ T 351.7–26.

⁴⁷ Ex 5, p. 19, para. 72; Ex 13, p. 27, para. 100; Ex 36, p. 15, para. 74(a).

⁴⁸ Ex 17, pp. 33–34, para. 180; Ex 121, para. 226.

⁴⁹ Ex 17, pp. 33–34, para. 180; Ex 121, para. 226.

⁵⁰ Initial Submissions of the MRCF, para. 37.10.

⁵¹ Ex 5, p. 19, para. 77.

⁵² Ex 13, p. 28, para. 103.

20.28 A draft February 2001 Trowbridge report⁵³ was tabled at the meeting, and presented by Mr Minty. I discuss the substance of that report and presentation at paragraphs 20.43–20.45 below.

20.29 Later in the meeting, Mr Morley presented the Cash Flow Analysis to the incoming directors. That analysis showed that, based upon the best estimate and high scenarios presented in the February report, net assets remained positive after 20 years.⁵⁴ At the time, Mr Jollie requested that the model be run at a 7 per cent rate of return (rather than the 11.7 per cent which it used).⁵⁵ A revised analysis, using a rate of 8.7 per cent, was provided to him, it was contended, on 15 February 2001. It showed that after 15 years the Foundation would have available assets of \$124m, and after 20 years available assets of \$9m.⁵⁶

20.30 Following presentation of the Cash Flow Analysis by Mr Morley, and legal advice from Mr Bancroft (see Section D below), the incoming directors discussed alone whether each of them was willing to become a director of the Foundation.⁵⁷ They each indicated a willingness to do this.⁵⁸ Sir Llew indicated this to the representatives of JHIL and external advisers when they re-entered the meeting.⁵⁹

F. 15 February 2001

20.31 The transactions leading to the creation of the Foundation were finalised on the evening of 15 February 2001 and the morning of the next day at the offices of Allens. The incoming directors present were Mr Cooper, Mr Gill and Mr Jollie. Mr Bancroft was also present to advise them.

20.32 During the course of the evening, the incoming directors were provided with a number of documents, including:

⁵³ Ex 7, MRCF 1, Tab 16.

⁵⁴ Ex 7, MRCF 1, Tab 15.

⁵⁵ Ex 5, p. 21, para. 86.

⁵⁶ Ex 5, p. 23, para. 92; Ex 36, p. 18, para. 88. There is a question about whether Mr Jollie actually received the analysis at 7 per cent. I was not satisfied that he did.

⁵⁷ Ex 13, p. 29, para. 110.

⁵⁸ Ex 13, p. 29, para. 110.

⁵⁹ Ex 17, p. 34, para. 187.

- (a) the Deed of Covenant and Indemnity;⁶⁰
- (b) the loan deed;⁶¹
- (c) a revised February 2001 Trowbridge report;⁶²
- (d) the PricewaterhouseCoopers Report;⁶³
- (e) the Access Economics Report; and⁶⁴
- (f) a revised Cash Flow Analysis which used gross earnings rates of 8.7 per cent, 9.7 per cent, 10.7 per cent, 11.7 per cent and 13 per cent.⁶⁵

20.33 The only documents signed by any of the incoming directors were:

- (a) the MRCF Trust Deed, which was signed by Mr Cooper;⁶⁶ and
- (b) the amendment deed to the Deed of Covenant and Indemnity, to ensure that Coy and Jsekarb could receive payment due to them on an accelerated basis, if circumstances required it, which was signed by Mr Gill and Mr Cooper.⁶⁷

⁶⁰ Ex 7, MRCF 4, Tab 23.

⁶¹ Ex 7, MRCF 4, Tab 24.

⁶² Ex 7, MRCF 4, Tab 28.

⁶³ Ex 7, MRCF 1, Tab 18.

⁶⁴ Ex 36, para. 86, and Ex 1, Vol 8, Tab 84, pp. 2294–2295.

⁶⁵ Ex 7, MRCF 1, Tab 19, p. 351.

⁶⁶ Ex 7, MRCF 6, Tab 10.

⁶⁷ Ex 1, Vol 7, Tab 61.

G. Specific issues regarding the information provided to and the conduct of the incoming Directors prior to the creation of the Foundation.

20.34 From this overview, four specific issues arise regarding the information provided to and the conduct of the incoming directors. They are:

- (a) the information provided to the incoming directors about the extent of the asbestos-related liabilities of Amaca and Amaba;
- (b) the significance the incoming directors placed on the level of funding to be provided for the Foundation;
- (c) their independence from JHIL; and
- (d) the effect on the incoming directors of the time pressure which applied to the creation of the Foundation; and
- (e) whether the incoming directors should have done more to ensure the adequacy of the MRCF's funding.

20.35 I consider these in turn.

Information about the extent of the asbestos liabilities

20.36 There is no doubt that the incoming directors sought to obtain an accurate appreciation of the extent of the asbestos related liabilities for Coy and Jsekarb, and that they were unsuccessful in this.

20.37 As already noted, on 11 January 2001, Mr Cooper asked Mr Attrill to provide him with copies of previous Trowbridge reports but this did not happen.⁶⁸

20.38 At the 15 January 2001 meeting, Mr Attrill, as I have said, provided an overview of asbestos litigation with the assistance of a Power Point presentation incorporating a series of charts and graphs illustrating various aspects of asbestos

⁶⁸ Ex 5, p. 13, para 46.

claims made during the first three quarters of the JHIL financial year commencing 1 April 2000.⁶⁹

20.39 The submissions made on behalf of the Foundation are critical of Mr Attrill's presentation.⁷⁰ It is contended that he proposed directors were not provided with any comparison between the data for the nine months to 31 December 2000 and the corresponding period for the previous year.⁷¹ It is further contended that the proposed directors were not given "... any other information which would enable an analysis of the nature, rate and period of change in comparison to previous periods comparable to the detail which was available to the JHIL Board in the form of the Asbestos Litigation Costs Reports".⁷² In cross examination Mr Attrill sought to address this issue, at least in part, by noting that one of the graphs⁷³ produced in the PowerPoint presentation did provide trend information. He said: "... from 1995 up to the end of December 2000, I was disclosing comparative information, I wasn't disclosing as much information as was in the management report, yes, that is correct".⁷⁴

20.40 Relevantly, the management report, namely, the Asbestos Litigation Report as at "Dec 00" had been circulated by email to Mr Attrill, Mr Morley and Mr Shafron on 10 January 2001.⁷⁵ Mr Attrill also accepted in cross examination that comparative analysis of the figures in the management report for the year ending December 1999 indicated a 33 per cent increase in actual litigation expenditure by JHIL and a 50% increase in the claims opened for the year ending December 2000.⁷⁶

20.41 In my view the presentation would have been of more utility to the proposed directors if comparative data was made available and any significant variations explained by Mr Attrill.

⁶⁹ The slides contained an error referring to "Asbestos related claims received 3Q02". Mr Attrill explained to the meeting that the slides headed 3Q02 should in fact have been headed 3Q01 and applied to the nine months ending 31 December 2000. This was the "most up to date monthly data available on James Hardie's asbestos litigation" at the time of the meeting: Attrill, Ex 56, p. 24, para. 100.

⁷⁰ MRCF Submissions: Chapter III, pp. 196–197, para. 27.13.

⁷¹ Attrill, T 1013.36–58.

⁷² MRCF Initial Submissions; pp. 196–197, para. 27.13.

⁷³ Ex 57, Vol 4, p. 951.

⁷⁴ Attrill, T 1014.13–17.

⁷⁵ Ex 57, Vol 4, pp. 904–906.

⁷⁶ Attrill, T 1031.26–1032.21; and further that these increases were not pointed out to the proposed directors: Attrill, T 1031.45–55.

20.42 Also at the 15 January 2001 meeting, Mr Gill and Mr Jollie indicated that they wanted to see a current draft of the Trowbridge report.⁷⁷ Mr Attrill accepted in cross-examination that the relevant “draft” was the 2000 Trowbridge Report. He further accepted that the draft report was readily available as the draft report was in his files.⁷⁸ Notwithstanding that, Mr Attrill did not provide a copy to the proposed directors, because he followed Mr Shafron’s instructions to arrange with Trowbridge the preparation of an updated report.⁷⁹

20.43 It was put to Mr Shafron in cross-examination that the proposed directors wanted a full report from Trowbridge. Mr Shafron described his understanding of the request in the following terms:

“Q. You understood from the meeting of 15 January that the directors wanted a full report from Trowbridge, didn’t you?

A. Well, what I took from the meeting in January was that the directors wanted assurance about the life of the fund and that they didn’t want the life of the fund to end too quickly and that they wanted to see some evidence of that and that was the exercise that I had in mind around that time of the Trowbridge.”⁸⁰

20.44 While this reflects an aspect of what the directors sought at the 15 January meeting, it is plain that they also sought the current draft Trowbridge report and that their request for that report was not limited by reference to whether the fund would last 15–20 (or some smaller number of) years. For his part, Mr Attrill accepted that there was no qualification placed by the proposed directors on their request for the current draft Trowbridge report.⁸¹

20.45 In my view, the failure to give the incoming directors a copy of the 2000 report has some importance. I find that giving the report to the incoming directors would have made them better equipped to analyse and investigate and assess the proposal being put to them. Mr Shafron accepted this in his oral evidence.⁸² It would have disclosed to the incoming directors the extent to which liabilities were likely to extend beyond 20 years, the high degree of uncertainty attached to the estimates of the extent of the asbestos

⁷⁷ Ex 57, Vol 4, pp. 940–941.

⁷⁸ Attrill, T 986.46–987.21.

⁷⁹ Attrill, T 987.53–988.52; Ex 56, p. 25–26, paras 105–106.

⁸⁰ Shafron, T 1600.15–23.

⁸¹ Attrill, T 990.24–35.

⁸² T 1625.41–48.

liabilities, the full scope of the exclusions from and qualifications to the assessment, and the sensitivity analysis contained in the report.

20.46 Further, the draft February 2001 Trowbridge report, and the presentation of it by Mr Minty at the 13 February 2001 meeting, were, in my view, inadequate because they did not make clear that the report only used data up to March 2000.

20.47 Although there was some mention of the use of March 2000 data in Mr Minty's presentation, I find that this was limited to the "current" model contained in the report. This is consistent with Mr Attrill's contemporaneous notes of the 13 February 2000 meeting, which record the following exchange between Mr Gill and Mr Minty.⁸³

"MG: 'Current model' – March 2000?

DM: Yes.

MG: Less than 12 mths old?

DM: Yes.

MG: 9-12 mths out – dramatic move again.

DM: Yes – our information has impacted on the assessment."

20.48 It is also consistent with Mr Cooper's annotation of his copy of the February report where he wrote the words "March 2000" opposite a bar for the current model.⁸⁴ Further, Mr Minty left the 13 February 2001 meeting concerned that the fact that all the scenarios were based on 10½ month old data may not have been made clear.⁸⁵ Mr Robb, who was at the 13 February meeting, was also under the impression that the Trowbridge report was based on current data.⁸⁶

20.49 The terms of the report also suggested that it was based on current data. This is dealt with more fully in Chapter 18; but I would mention the evidence of Mr Cooper,⁸⁷ as significant. He said:

"When I read the Draft February Report I noted the opening paragraphs which stated:

"We refer to your letter dated 30 January 2001 on the above subject. You have asked us to revisit the claim number assumptions that we adopted for our draft advice on the

⁸³ Ex 57, Vol 4, p. 1058.

⁸⁴ Ex 7, MRCF 1, Tab 16, p. 308. The same point can be made about current cash flow projections annotated with the words "March 2004" by Mr Gill on 9 February 2001: Ex 29, pp. 69-72.

⁸⁵ Marshall, Ex 54, p. 4, para. 25.

⁸⁶ Ex 187, p. 9, para. 55.

⁸⁷ Ex 5, para. 82.

future costs of asbestos-related disease claims in view of recent work that Trowbridge Consulting have carried out to estimate the impact of such claims on the insurance industry.” (emphasis added)

I was not shown a copy of the 30 January letter from Allen Allen & Hemsley to Trowbridge and I did not ask to see a copy of that letter. Nor had I seen the previous draft advice referred to, though I had asked Mr Attrill during our 11 January meeting if I could be provided with previous Trowbridge reports. Nevertheless, I placed emphasis on the words I have underlined in forming the view that Trowbridge had relied upon the most update information available in preparing the report that was provided to us during this meeting. Neither the report nor Mr Minty’s briefing gave me reason to believe otherwise.”

20.50 On 15 February 2001 the incoming directors were provided with the final version of the February 2001 report. It amended the portion quoted above as follows:

“We refer to your letter dated 30 January 2001 on the above subject. You have asked us to revisit the claim number assumptions that we adopted for our draft advice on the future cost of asbestos-related disease claims as at 31 March 2000 in view of recent work that Trowbridge Consulting have carried out to estimate the impact of such claims on the insurance industry in Australia.”

20.51 However, this amendment was given to the incoming directors with a large volume of completion documents,⁸⁸ and without the changes marked up. I find that it is unlikely that the incoming directors would have noticed it. Further, I also find that, even if they had noticed the amendment, the incoming directors would have been unlikely to appreciate its significance, given the reference to the “recent work of Trowbridge Consulting”.

20.52 There is not, in my view, sufficient foundation for a finding that the incoming directors would certainly have refused to serve as directors of the Foundation if they had received the 2000 Trowbridge Report or appreciated the limited data on which the February 2001 report was based. It is distinctly possible, however, that if one or both of these things had happened they would have sought a more comprehensive and up to date actuarial report, than the February 2001 Trowbridge Report, and that this would have led to them seeking a greater level of funding for the Foundation.

⁸⁸ Jollie, Ex 36, paras 82–83; Cooper, Ex 5, paras 91 and 109; Gill, Ex 29, para. 13.

H. Significance placed on the level of funding

20.53 The significance attributed to the level of funding to be provided for the Foundation has to be considered separately for each of the incoming directors.

20.54 It is convenient to begin with Mr Gill. There is evidence that at his initial meeting with Mr Morley and Mr Shafron on 20 December 2000 he said that he wanted the funds to last at least 10 years if he was to become a director.⁸⁹ At the 15 January 2001 meeting, Mr Shafron recalls that Mr Gill said he would not be prepared to become a director unless the trust would have sufficient assets to last 10 to 15 years, and that none of the other incoming directors expressed a contrary view.⁹⁰ Mr Attrill's notes corroborate this (see paragraph 20.18 above).⁹¹ In his oral evidence, Mr Gill accepted that what was important to him was that there be funds for 15-20 years.⁹²

20.55 Sir Llew's oral evidence suggests that he did not think that any estimate that the funds would last more than 20 years could be reliable. Sir Llew gave the following evidence:⁹³

“Q. Whilst you were on the Board, you were used, were you not, to getting Trowbridge reports put forward that put forward an estimated liability in relation to James Hardie's asbestos liabilities through to approximately the year 2030 and beyond?

A. Forecasts were considered by the Board from Trowbridge on a number of occasions in that area.

Q. Yet the Trowbridge report of 13 February only went out to twenty years?

A. I do believe that in that the discussions that I had in all my time associated with preparation for this consideration felt that we needed to be assured over a period of twenty years, so I would not be surprised if there was that consideration being made.

Q. But Sir Llewellyn, as I understand it, you brought some experience in relation to asbestos related disease both to the Board of JHIL and to the Foundation, is that correct?

A. That is correct.

Q. You were well aware of the lag period that can exist between exposure to asbestos and the development of mesothelioma?

⁸⁹ Shafron, Ex 17, p. 19, para. 105.

⁹⁰ Shafron, Ex 17, p. 22, paras 121–122.

⁹¹ Ex 75, Vol 7, Tab 92, p. 2499.

⁹² T 299.5–8; T 382.18–22; T 384.45–57.

⁹³ T 202.27–53.

- A. Yes, but I thought at that time and still do that a twenty year forecast is probably the best one can do in scientific matters and the epidemiology of diseases.”

20.56 Mr Jollie gave evidence that it was imperative to him that the Foundation should be able to compensate all asbestos claimants, and that he would not have been satisfied for its funding to last only 15-20 years.⁹⁴ This is in one sense difficult to reconcile with the minutes of the directors of Amaca Pty Ltd of 20 August 2001, which record:⁹⁵

“Directors confirmed during their August 6 meeting that a minimum expected life of some 15 to 20 years was critical to their decision to participate in the Foundation”

but that may well be a statement of the collective view. The materials provided to the incoming directors made it clear that at an earnings rate of 8.7 per cent the Fund would be exhausted in just over 20 years,⁹⁶ and that at rates of 6.5 or 7 per cent the Fund would run out within 20 years.⁹⁷ On balance, I find that Mr Jollie, in deciding to become one of its directors, was concerned about the life of the Foundation, but did not rely on the Foundation having funding for more than 20 years.

20.57 Mr Cooper was satisfied with an actuarial analysis that did not extend beyond a period of 20 years.⁹⁸ He considered 20 years was probably an appropriate benchmark for assessing the life of the Foundation’s funds.⁹⁹ While he seems also to have held out hope that the funds might have been made to last longer by adoption of a more efficient approach to compensation,¹⁰⁰ having regard to the matters referred to in the previous paragraph about Mr Jollie, I do not find that he relied on the Foundation’s funds lasting beyond 20 years in agreeing to become one of its directors.

20.58 Accordingly, I find that none of the incoming directors agreed to become a director of the Foundation because he expected its funds to last for longer than 15-20 years.

⁹⁴ T 416.16–.17.

⁹⁵ Ex 7, MRCF 2, Tab 6, p. 10A.

⁹⁶ Ex 7, MRCF 1, Tab 15, p. 301 and Tab 19, p. 351.

⁹⁷ T 474.25–.42; T 476.1–.16.

⁹⁸ T 131.58–132.13.

⁹⁹ Ex 5, p. 21, para. 86.

¹⁰⁰ Ex 5, p. 21, para. 86.

I. Independence of the incoming directors

20.59 The question of independence from JHIL falls to be considered separately in respect of each of the incoming directors.

20.60 Mr Jollie had no connection with JHIL or the James Hardie Group prior to being approached about being a director of the Foundation. Accordingly, I find that there is no basis for doubting his independence.

20.61 As noted earlier, Sir Llew had been a director of JHIL from 2 August 1990, resigning on 15 February 2001.¹⁰¹ His regard for Mr McGregor and Mr Macdonald as fellow board members is reflected in the following passage from his statement:¹⁰²

“I had served with Mr McGregor and Mr Macdonald as fellow members of the Board of JHIL for 10 years. I had a strong personal regard for them and for their competence and personal integrity. I developed good working relationships and friendships with both of them from the years that we served together on the JHIL Board. I believed that my regard for them was reciprocated. I had great respect for the other members of the JHIL Board.

I believed that by reason of these relationships, what they and Hardies’ employees said to me had a special reliability. I did not believe that they would place me in a position where I would be required to guide a Foundation with shortage of funds in the short or medium term.”

20.62 Also, as noted earlier, Mr Cooper was the James Hardie Group’s Chief Information Officer from June 1994 to February 2001.¹⁰³ As Counsel Assisting submitted, he appeared “to have had warm collegiate regard for Messrs Shafron, Morley and Macdonald”.¹⁰⁴

20.63 Mr Gill was a partner in Phillips Fox which was added to the James Hardie litigation team in 1997 and earned fees in 1998, 1999 and 2000 for that work of \$1-2m per year.¹⁰⁵ Mr Gill had personally given advice to JHIL on the separation of its

¹⁰¹ Edwards, Ex 13, p. 3, para. 19; Ex 276, Tab 6.

¹⁰² Ex 13, p. 30, paras 113–114. Mr Macdonald had not been a member of JHIL’s Board before becoming Chief Executive Officer.

¹⁰³ Cooper, Ex 5, Appendix “A”.

¹⁰⁴ Initial Submissions of Counsel Assisting, Section 2, para. 73.

¹⁰⁵ Attrill, T 1182.43–.56.

asbestos liabilities from its ongoing business and assets.¹⁰⁶ Mr Gill informed the other incoming directors of the first of these matters,¹⁰⁷ but not the second.¹⁰⁸

20.64 It follows that none of Sir Llew, Mr Cooper or Mr Gill can be said to have been completely independent of JHIL.

J. Time pressure

20.65 The issue of time pressure can be considered by reference to the incoming directors as a group.

20.66 The actual reasons for the time pressure placed on the incoming directors are considered elsewhere. It is sufficient to note here that the time pressure was effectively the product of a decision by JHIL, in pursuit of its public relations strategy, to attempt to mute the story of the creation of the Foundation by announcement at the time of announcement of the third quarter results. Even the introduction of ED88, it may be noted, did not give rise to any pressing need for the creation of the Foundation, other than the existence of the apprehension that, if it were not established and the asbestos liabilities separated, JHIL might have to disclose information it would rather not disclose.

20.67 The actual time pressure imposed on the incoming directors was significant. They were left with very little opportunity to consider the Trowbridge report or the Cash Flow Analysis which they received on 13 February 2001. They had even less chance to consider the amended Cash Flow Analysis or the transaction documentation which they received on the evening of 15 February 2001. Had they been given more time to consider the February Trowbridge report and the Cash Flow Analysis, the incoming directors may have been able to identify the deficiencies in them. At a minimum, their conduct needs to be considered in the light of the time pressure under which they were placed.

¹⁰⁶ Gill, Ex 100, pp.2–9, paras 7–33.

¹⁰⁷ Ex 7, MRCF 6, Tab 28, pp. 165–169.

¹⁰⁸ Ex 100, p. 9, para. 36.

K. Should the incoming directors have done more?

20.68 The steps taken by the incoming directors to ensure adequate funding for the Foundation should be seen in context:

- (a) First, the dealings in which they were engaged were not, in my view, comparable with the purchase of a business. The incoming directors were entirely reliant on JHIL and its advisors for any meaningful information in relation to the establishment of the Foundation. They lacked the time and resources to conduct a proper due diligence on their own. They were not, indeed, purchasing anything. They were taking over the management of certain James Hardie Group liabilities, with assets which the Group was to provide.
- (b) Secondly, given the backgrounds of Sir Llew Edwards, Mr Cooper and Mr Gill, the incoming directors quite understandably placed a degree of trust in what they were told by JHIL's management about the funding of the Foundation.
- (c) Thirdly, the incoming directors were misled by JHIL's management as to the likelihood that the Foundation would be able to fund asbestos claims for 15-20 years.
- (d) Fourthly, as I have already observed, the incoming directors were placed under very significant time pressure by JHIL's management, for no purpose other than to meet a public relations strategy.

20.69 It may be unfortunate that some matters were not pursued more vigorously by the incoming directors. They include the provision of the 2000 Trowbridge Report, an early meeting with Mr Minty (which might have given rise to an understanding of the limited data on which the February 2001 Report was prepared), a cash flow model with an earnings rate of 7 per cent, and the deficiencies of the cash flow model made by PricewaterhouseCoopers and Access Economics.

20.70 However, in the circumstances outlined above, I do not consider that the incoming directors could realistically have been expected to do more than in fact they did to ensure that the Foundation was adequately funded.

L. Anticipated shortfall in the Foundation's funding

20.71 The conduct of the Foundation's directors once it became apparent that there would be some shortfall in its funding has been put in issue by the Unions and Asbestos Support Groups.¹⁰⁹ It is dealt with more fully in Chapter 26.

20.72 The first indication of a shortfall in the Foundation's funding appears to have occurred on around 11 April 2001 when Mr Attrill reported to Mr Cooper on Amaca's asbestos-related litigation costs and insurance recoveries, comparing those for the year ending 31 March 2001 against those for the year ending 31 March 2001 against those for the previous year.¹¹⁰ This showed litigation expenses for the year ending 31 March 2001 which were significantly in excess of the level predicted.¹¹¹

20.73 Mr Cooper tested the implications of this result in the cash flow model by increasing litigation costs by \$10 million per annum and reducing the rate of return to 8.7%.¹¹² This showed an expected lifespan for Amaca of around 10-11 years, rather than 20 years.¹¹³

20.74 In the period following this, the Foundation took a number of steps, including those set out below, to raise the shortfall with JHIL:

- (a) in a meeting held on 19 April 2001, Mr Cooper raised the fact that 2001 litigation costs would be significantly higher than expected with Mr Macdonald;¹¹⁴
- (b) Sir Llew arranged a meeting with Mr Macdonald on 15 May 2001, which Mr Cooper also attended, where the increase in claims and costs of settlement was raised;¹¹⁵

¹⁰⁹ Initial Submissions on behalf of Unions and Asbestos Support Groups, paras 2.41–2.42.

¹¹⁰ Ex 7, MRCF 1, Tab 26, pp. 379–381.

¹¹¹ The actual figure was \$31.69m (excluding the QBE receivable) as opposed to the predicted figure of \$22.308m (also excluding the QBE receivable). See Ex 7, MRCF 1, Tab 26, pp. 379–381 and Ex 7, MRCF 1, Tab 16, p. 307.

¹¹² Ex 7, MRCF 1, Vol 2, Tab 32.

¹¹³ Ex 7, MRCF 1, Vol 2, Tab 33.

¹¹⁴ Ex 150, p. 156.

¹¹⁵ Ex 5, pp. 31-32, paras 135 and 138–140.

- (c) there was a further meeting between Mr Cooper and Mr Ashe on 26 June 2001, in which the MRCF's decision to undertake a solvency analysis was discussed;¹¹⁶
- (d) on 21 September 2001, Sir Llew raised the funding shortfall in a telephone conversation with Mr Macdonald;
- (e) on 24 September 2001, Sir Llew wrote to Mr Macdonald about the shortfall.¹¹⁷

20.75 To the extent that it is said that the Foundation ought to have commenced proceedings against JHIL, it should also be recognised that as late as March 2003 it had received legal advice that it had no basis for a claim for damages against JHIL.¹¹⁸

20.76 Overall more rigour could have been applied by the incoming directors, but they were not in breach of any legal obligation by not doing so.

M. Conduct of Mr Bancroft

20.77 Mr Anthony (Tony) Bancroft of Mallesons was first approached on 21 December 2000 to act for the incoming directors by Mr Attrill and Mr Shafron.¹¹⁹ Mr Reg Barrett of Mallesons had previously advised Mr Attrill in December 1998 when he had considered becoming a director of Coy,¹²⁰ and it seems Mr Bancroft was approached when it became apparent that Mr Barrett would be unavailable during January and February 2001.¹²¹

20.78 On 9 January 2001, Mr Shafron sent to Mr Bancroft a letter confirming those instructions.¹²² The letter of instructions was in the following terms:

"I confirm that your advice is now sought in relation to issues of personal risk and liability as well as other matters in connection with the trust proposal that the prospective directors may raise.

Specifically, you are asked to advise the prospective directors on:

¹¹⁶ Ex 150, p. 163.

¹¹⁷ Ex 3, Vol 1, Tab 9.

¹¹⁸ Ex 296, Tab 14.

¹¹⁹ Ex 95, p. 2, para. 10.

¹²⁰ Shafron Ex 75, Vol 7, Tab 86, p. 2429, esp. p. 2436 –2437.

¹²¹ Ex 75, Vol 7, Tab 87, p. 2443.

¹²² Shafron Ex 75, Vol 7, Tab 88, p. 2446; Bancroft Ex 95, p. 3, para. 18 and Vol 1, Tab 9.

- the wording of the D&O policy (provided);
- the wording of the draft indemnity document (provided);
- the protections contained in the constitutions of each of the relevant companies (provided in part);
- the likely independence of the trust company from JHIL; and
- director and trustee duties generally.

As indicated, there may be additional questions that the proposed directors raise.

Primarily, I see your role as addressing any concerns that the proposed directors may have in relation to personal liability issues. Matters of trust structure and set up I see as the role of Allens; except as they may impinge on personal liability issues for prospective directors – either ongoing or arising from a decision that they will be required to take – I do not see that you need to be overly concerned with them. (I envisage at this stage that ‘set up’ decisions that may need to be made by the current Coy and Jsekarb directors will be the subject of advice from Allens).

Technically, your client will be the proposed directors. However, your advice leading up to establishment of the trust will be paid for by JHIL. For convenience, I am happy to be your primary contact. However, feel free to contact Sir Llew Edwards directly if this does not suit for any reason. In relation to your session with the proposed directors on Monday, you may want to think about whether that should be held in the absence of any JHIL representative. I intend to be in Sydney for that meeting, at least for the management presentations.”

20.79 With the letter, Mr Shafron enclosed a draft agenda for the meeting of the prospective directors the following week on 15 January 2001, which envisaged that Mr Bancroft would address the prospective directors following the various management presentations. Mr Shafron anticipated that following this the prospective directors would be in a position “to indicate their willingness or otherwise to accept the board positions”. The letter indicated that JHIL would pay Malleasons’ legal costs of advising the prospective directors.

20.80 At the meeting of 15 January 2001, Mr Bancroft provided the proposed directors with “some preliminary advice” in the terms set out in his briefing note, which had been prepared for the meeting by a junior solicitor within the firm on or about 12 January 2001¹²³ and annotated by him.¹²⁴ Mr Bancroft indicated that he had undertaken a preliminary review of the documents, which included a Directors’ and Officers’ Insurance Policy, a Deed of Access, Insurance and Indemnity, and constitutions of some of the companies. According to Mr Bancroft, he informed¹²⁵ the meeting:

¹²³ Ex 95, Tab 14, p. 210, para. 22.

¹²⁴ Ex 95, Tab 15, pp. 215–216, para. 23; para. 27.

¹²⁵ Bancroft, Ex 95, p. 5, para. 27.

“ ... that these documents were acceptable on the whole but may require some minor amendments that I would take up with Allens and JHIL. I state that my advice was limited to the general matters I addressed in the briefing note.”

20.81 I note that the Deed of Covenant and Indemnity was not part of the relevant documentation at this time.

20.82 Mr Bancroft’s recollection was that, during these discussions, Mr Gill requested a “comprehensive risk analysis as directors of each of the Companies” and further Mr Bancroft should.¹²⁶

“...be satisfied that the legal structure adopted in the proposal did not give rise to any additional personal liability to the directors as a result of the proposed structure”.

20.83 Mr Bancroft described his interpretation of Mr Gill’s request in the following terms:

“ ... I took this to mean that I was requested to consider the legal risks and the personal legal liability which the proposed incoming directors may face on joining the boards of the Companies. Either Mr Gill or Mr Jollie also made a statement that the proposed incoming directors would need to obtain an updated actuarial review by Trowbridge. None of the proposed incoming directors asked me to concern myself with any aspect of the actuarial, financial or cash flow analyses to be provided to them
...¹²⁷

29. I held the view at the meeting, as a result of the questions asked, and the dialogue which ensued, that the proposed incoming directors were pursuing due diligence steps to satisfy themselves of the actuarial basis for the estimates of projected claims.”¹²⁸

20.84 On 7 February 2001, a draft advice to the incoming directors was sent by Mallesons to Mr Shafron.¹²⁹ I do not accept the submission that Mr Bancroft did so for the purposes of Mr Shafron “settling” that advice;¹³⁰ Mr Bancroft simply used Mr Shafron as a point of distribution to the incoming directors, for whom papers were being prepared for their upcoming meeting on 13 February 2001.¹³¹

¹²⁶ Bancroft, Ex 95, pp 5–6, paras 28.

¹²⁷ Other than Mr Jollie, who asked that the February 2001 Trowbridge report be addressed to the proposed directors.
Ex 95, p. 9, para. 53.

¹²⁸ Bancroft, Ex 95, pp. 5–6, paras 28–29.

¹²⁹ Ex 95 at [41], Tab 28.

¹³⁰ Unions & Asbestos Victims Submissions at 2.49(e).

¹³¹ Ex 95 at [41]; T 1847.16; Bancroft Submissions at [26].

20.85 In the course of advising the incoming directors, Mr Bancroft told them that it was inappropriate for them to execute any documents in connection with the proposed transaction.¹³² Mr Bancroft's reasons were:¹³³

“62 From at least 7 February 2001, I held the view that it was inappropriate for the proposed incoming directors to execute any documents in connection with the proposal, other than their consents to act as directors. This was because the proposed incoming directors (other than perhaps Sir Llew Edwards) were not able properly to assess many of the substantive matters dealt with in the Deed of Covenant and the Loan Deed. The commercial terms were being set by JHIL and had not been negotiated with the incoming directors. The proposed incoming directors had no way of assessing whether the best interests of Coy and Jsekarb were served by entering into those transaction documents. In reaching this conclusion I considered that it was a matter for the existing directors to resolve to enter into the relevant documents, including the Deed of Covenant and the Loan Deed, and to execute those documents. The existing directors were in a better position to make an informed judgment as to whether, for example, the Deed of Covenant was in the best interests of Coy and Jsekarb. The proposed incoming directors were not.”

20.86 I am satisfied that Mr Bancroft discharged his obligations to the incoming directors adequately. It is apparent that he took a narrow view of his instructions, being concerned with “the personal legal liability which the proposed incoming directors may face on joining the boards of the [MRCF, Amaca and Amaba]”¹³⁴, rather than with matters such as the adequacy of the Foundation's funding. However, I do not consider that he was obliged to do any more than this. Only the Unions submit that any cause of action arises against Mr Bancroft.¹³⁵ Once the limited scope of his role is understood, it is apparent that this criticism is misconceived.

¹³² Ex 95, p. 10, para. 62.

¹³³ See Ex 95, pp. 11–12, para. 62.

¹³⁴ Ex 95, p. 5, para. 28.

¹³⁵ Initial Submissions on behalf of Unions and Asbestos Support Groups, para. 2.49. I address criticisms of Mr Bancroft advice in relation to the Deed of Covenant and Indemnity in the next chapter.

Chapter 21 – Deed of Covenant and Indemnity of 15 February 2001

A. Introduction

21.1 An important part of the transactions that took place on 15-16 February 2001 was the entry of JHIL, Coy and Jsekarb into a Deed of Covenant and Indemnity.¹ That document was executed in the early hours of the morning of 16 February 2001 on behalf of JHIL by Mr Shafron and on behalf of Coy and on behalf of Jsekarb by their outgoing directors, Mr Morley and Mr Donald Cameron. They resigned later that morning.

21.2 The Deed of Covenant and Indemnity is set out in full in Annexure O. It had three central elements:

- (a) Coy and Jsekarb covenanted that they would not themselves make certain claims² against JHIL;³
- (b) Coy and Jsekarb agreed to indemnify JHIL in respect of certain claims if made by other parties against JHIL;⁴ and
- (c) in return for the covenants and indemnities JHIL agreed to pay Coy and Jsekarb periodical payments.

¹ Ex 1, Vol. 6, Tab 60.

² Defined by cl 1.1 to mean: “... any claim, demand, action, cause of action or proceeding (whether based in contract, tort, statute, at law or otherwise howsoever) whether arising in Australia or in any other part of the world and whether or not substantiated”.

³ Cl. 3.1 provided that the obligation undertaken by the covenant was not to make any “Claim” in respect of two subjects, namely:

- in connection with the marketing, manufacture, processing, purchase, sale, distribution or importation of asbestos or products containing asbestos;
- in connection with ... the payment of moneys by Coy and/or Jsekarb to any JHIL Party whether by way of dividend, distribution, management fees or otherwise.

⁴ *The indemnity given by Coy was described in clause 4.3 (a) in the following terms: “(a) In consideration of the payment by JHIL to Coy of the amounts set out in Schedule 2, subject to clauses 4.3 and 4A1, Coy shall (subject to clauses 4.2, 4.4 and 4.5), to the greatest extent permitted by law, indemnify and hold harmless each JHIL Party in respect of:*

- (i) all Claims which any person may bring or make against such JHIL Party whenever arising and whenever alleged; and
- (ii) all Losses suffered or incurred by such JHIL Party whenever suffered,
- (iii) in each case arising from, in connection with or incidental to, whether directly or indirectly, the marketing, manufacture, processing, purchase, sale, distribution or importation by Coy, at any time before the date of this Deed, of asbestos or products containing asbestos”.

That given by Jsekarb was in similar terms. The Deed, by cl 1.1, defined “JHIL Party” to mean JHIL and each Related Body Corporate of JHIL, other than Coy and Jsekarb.

21.3 The consideration given by JHIL for the covenant was the payment by JHIL:

- (a) to Coy of payments of \$2,648,125 on 15 February in each of the years 2001-2042;⁵
- (b) to Jsekarb of payments of \$139,375 on 15 February in each of the years 2001-2042.⁶

The consideration given by JHIL for the indemnity was the payment by JHIL:

- (a) to Coy of payments of \$2,648,125 on 15 February in each of the years 2001-2042;⁷
- (b) to Jsekarb of payments of \$139,375 on 15 February in each of the years 2001-2042.⁸

The payments to be made by JHIL thus totalled:

- (a) to Coy \$222,442,500; and
- (b) to Jsekarb \$11,707,500.

They are, of course, undiscounted figures.

21.4 The Deed made provision for acceleration of the payments at the instance of JHIL, or of Coy or Jsekarb. In this regard JHIL was given an election to pay Coy and Jsekarb certain lump sums in lieu of the payments due in 2008 and thereafter.⁹ Similar provision was made by in respect of the payments for the indemnity.¹⁰

⁵ See cl 3.1(a) and Schedule 1.

⁶ See cl 3.1(a) and Schedule 3.

⁷ See cl 4.1(a) and Schedule 2.

⁸ See cl 4.2(a) and Schedule 4.

⁹ See cl 3.3 providing:

“3.3 The parties agree that JHIL may elect, by notice in writing to Coy and Jsekarb, instead of making the payments numbered 8 to 42 in each of Schedules 1 and 3, to pay to Coy and Jsekarb the sums of \$34,675,000 and \$1,825,000 respectively by the date specified for payment of payment number 8 in each of Schedules 1 and 3, namely 15 February 2008.”

¹⁰ See cl 4.3.

21.5 Coy and Jsekarb's entitlement to require payment of the net present value of the unpaid balance arose where Coy had paid claims of \$142,500,000 (cl 4A.1);¹¹ Jsekarb had paid claims of \$7,500,000 (cl 4A.2).¹²

21.6 As is apparent from the above, the effect of the Deed of Covenant and Indemnity was that JHIL was immunised from suit by Coy or Jsekarb, not only in respect of asbestos liabilities, but also in respect of claims that Coy or Jsekarb might make in respect of past dividends, distributions, management fees, or any other aspect. The immunity from suit extended not only to JHIL, but also to any JHIL Party, a term that was defined widely. In addition if any "Claim" was brought against a JHIL Party, Coy and Jsekarb were obliged to indemnify the JHIL Party in respect of any such claim.

B. Origin of the Deed of Covenant and Indemnity

Asbestos liabilities of JHIL?

21.7 The concept of the Deed of Covenant and Indemnity seems first to have emerged during the Project Green planning in 2000.¹³ In the Project Green Board papers for the February JHIL Board meeting¹⁴ under the heading "Risk" appears:

"The exposure to JHIL post separation, eg. break through suits or nuisance suits by JH & Coy or third parties is substantially reduced by the JH & Coy covenant not to sue and indemnity."

As part of the "key working assumptions"¹⁵ it was said (ACM and BM referring to Coy and Jsekarb respectively):

¹¹ cl 4A.1 provided in respect of Coy:

"4A.1 The parties agree that if, at any time after the date of this Deed, the total amount (as recorded in the accounting records of Coy) equal to:

- (i) all amounts paid by Coy to any person (including any JHIL Party under this Deed) in respect of asbestos-related Claims (including legal costs and expenses) and which are not recovered by Coy under any insurance contract; less
- (ii) the amount of monies paid under the litigation management contract executed by Coy on or about the date of this Deed (or any similar such contract),

since the date of this Deed, is greater than \$142,500,000, then Coy shall have the right to demand payment from JHIL (to be paid within one month of demand) in one lump sum of the net present value as at the date of payment (calculated by reference to the Discount Factor as at the date of payment) of all amounts referred to in Schedules 1 and 2 which have a date for payment falling after the date of the demand, provided that Coy shall not be entitled to demand such payment if JHIL has previously paid to Coy the amounts of \$34,675,000 and \$34,675,000 in accordance with clauses 3.3 and 4.3."

¹² Clause 4A.2 in respect of Jsekarb was to similar effect.

¹³ Ex 17, at para. 168; JHI NV Initial Submissions on Terms of Reference 2 and 3, para. 5.3.17.

¹⁴ Ex 80, Tab 6, p.88.

“for all practical purposes, asbestos liabilities for the JH group reside in ACM and BM – JHIL has never been found liable and it is not expected it will be found liable in the future, although it is possible that claimants may still attempt to join JHIL in legal actions unsuccessfully as occurs today.”

21.8 On 22 November 2000 Mr Shafron circulated to the Project Green advisers an issues paper prepared by him¹⁶ and posed under the heading “Strategic issues”:

“Coy suing JHIL

- (a) Does creating a trust structure involving Coy increase the changes of Coy suing JHIL? (WJA/PJS)
- (b) Can Newsub be constrained from ever allowing Coy to sue JHIL, e.g. by limitation in the trust deed? (AAH)
- (c) Is it advisable that individuals with knowledge of both Coy and JHIL affairs not be made available to Coy (assuming answer to 3(b) Is no).
- (d) Is JHIL concerned about suits from Coy? (WJA/PJS)”

21.9 On 27 November 2000 Mr Peter Cameron of Allens provided his written outline of advice in response.¹⁷ Mr Cameron advised, inter alia, that JHIL should probably not make a gift of the shares in Coy unless the terms of the proposed trust included a covenant to prevent claims for contribution by Coy against JHIL and an indemnity against breach of that covenant or against third party claims against JHIL where Coy was primarily liable.¹⁸

21.10 Mr Shafron’s Issues Paper, and probably Mr Cameron’s advice, were discussed in a Project Green advisers conference call on 28 November 2000.¹⁹ The evidence suggests that during this meeting Allens was requested to conduct a review of transactions between JHIL and Coy over the previous ten years, and Mr Harman thereafter prepared an analysis of Coy’s financial profile over that decade for that purpose.²⁰

¹⁵ Ex 80, Tab 6, p. 91.

¹⁶ Ex 75 Vol. 7 p. 2248 (“Coy Trust: Issues, Assumptions, Actions”).

¹⁷ Ex 75, Vol. 7, p. 2285.

¹⁸ Ex 75, Vol. 7, p. 2285.

¹⁹ Ex 75, Tab 71; JHI NV Initial Submissions on Terms of Reference 2 and 3, para. 5.3.19.

²⁰ Harman, Ex 68, Tab F.

21.11 On 12 December 2000 a brief to advise in relation to the trust proposal was prepared by Allens and circulated by Mr Blanchard to the Project Green advisers. Mr Shafron sought comments from Mr Morley and Mr Harman.²¹ On 15 December 2000 the brief was sent to Mr James Allsop SC for advice.²² On 20 December 2000 he gave advice in conference on a range of issues, including the following²³:

“A direct covenant from Coy cannot be given by Coy’s directors without valuable consideration paid to Coy. There would be no corporate purpose without valuable consideration. Such consideration would have to be arrived at by an arm’s length mechanism. But in principle there is no reason why JHIL can’t purchase such a covenant from Coy, assuming a reasonable, arms length price can be negotiated”.

21.12 In the same conference Mr Allsop expressed his preliminary views about the susceptibility of JHIL to arguments for the defeat or circumvention of the ‘corporate veil’ applying the reasoning of cases such as *CSR Ltd v Wren*²⁴. In *James Hardie & Coy Pty Ltd v Putt*²⁵ (“Putt”) JHIL had survived a claim for the tortious acts of its New Zealand subsidiary (also known as James Hardie & Company Pty Limited) in relation to its Auckland operations. Mr Allsop observed:²⁶

“the ongoing soundness and applicability of *Putt*’s case turns on the factual findings in that case, those findings being that JHIL was not a defacto employer of Coy’s employees and did not have day to day control of the affairs of Coy”.

21.13 Allens had been conducting a project designed to identify any documents relevant to this question since February 2000. In particular, Allens had been considering the consequences of the transfer of the Industrial Safety Unit from Coy to JHIL in the late 1970s or early 1980s that might suggest that JHIL was more exposed than previously thought to direct claims.²⁷ On 12 January 2001, Allens sent its final report²⁸ on this discovery project to Mr Attrill and Mr Shafron.

²¹ Ex 75 Vol. 7, Tab 73.

²² Cameron, Ex 224, Tab 22.

²³ See note of conference prepared by Allens and settled by Mr Allsop, Ex 121, Vol. 5, p. 2290. On 22 December 2000 Mr Allsop provided a written advice on this issue: Ex 224, Tab 24 (this is subject to a confidentiality direction dated 16.6.04).

²⁴ (1998) Aust Torts R 81,461.

²⁵ (1998) 43 NSWLR 554.

²⁶ Shafron, Ex 75 Vol. 7, Tab 83, p. 2370.

²⁷ T 970.46–54; T 971.8–24; Ex 57, Vol. 4, p. 903.

²⁸ Ex 81.

21.14 On 14 February 2001, Mr Allsop SC provided a further written opinion to JHIL, which dealt, inter alia, with the future possible liability of JHIL in asbestos claims following receipt of the Allens discovery report. Mr Allsop's opinion was tabled at the February Board meeting.²⁹ It is unnecessary to conclude whether or not the assessment that was made by Allens in January 2001 was wrong. It is also not possible to express any definite view on the actual or potential liability of JHIL for asbestos related claims as at the date of separation.³⁰ I simply conclude there was some risk of liability in respect of the claims of the nature assessed in section 10 of Mr Wilkinson's report.³¹ JHIL also had a potential for liability in respect of virtually all claims which could be made against Coy (Amaca) and Jsekarb (Amaba) if tort law developed along lines discussed by Mr Allsop as a possibility.³² JHIL also had potential for liability for such claims on the basis that the decision in *Putt* would not be followed in a case concerning Coy's Australian business, either because a factual inquiry might produce a different outcome, or the law in that regard might change.

Intercompany Payments

21.15 A second unresolved issue, that of intercompany payments, was also taken up following the 28 November 2000 Project Green team meeting. On 3 January 2001, Mr Robb discussed the issue of intercompany payments with Mr Morley and Mr Shafron,³³ stating that the October 1996 dividend payment required further investigation.³⁴ On 13 January 2001, Mr Shafron emailed Mr Robb and Mr Cameron stating that "we need to get the position finalised on dividends and management fees".³⁵

21.16 On 15 January 2001, after the meeting with the prospective directors, Mr Morley spoke to a non-executive director of JHIL and chairman of JHIL's audit committee, Mr Brown, and they discussed the possibility of increasing the assets of

²⁹ Ex 224, Tab 32.

³⁰ Issue 36, see Annexure.

³¹ Ex 252.

³² Ex 224, Tab 24 (subject to confidentiality order dated 16.6.04).

³³ Ex 187, para. 27.

³⁴ Ex 187, Vol. 1, Tab 3.

³⁵ Ex 224, Tab 25.

Coy by a payment of \$59.5m or \$59.9m, representing the amount of the October 1996 dividend (\$43.5m) plus compound interest of \$16m from 1996 to 2001.³⁶

21.17 On 16 January 2001, in a conference telephone call³⁷ prior to a meeting of the Audit Committee, Allens partner Mr Peter Cameron advised that it would be a “big call” to declare that the 1996 dividend payment was bad.³⁸ At the Audit Committee meeting, Mr Morley reported³⁹ that due diligence had been performed on Coy going back 10 years, which had revealed “a single instance where a dividend of \$43.5m had been paid by Coy to JHIL in October 1996 which seemed a little unusual”. Mr Morley further explained that to reverse the dividend to restore Coy’s value in today’s terms for that dividend “an equity contribution of \$57m into the company would be needed” which would increase the asset base of Coy from \$215m to \$272m.

21.18 At the JHIL Board meeting on 17 January 2001 Mr Peter Cameron again advised that it was not clear the 1996 dividend had been unlawful⁴⁰. The Board, however, wanted to investigate the possibility of a separation with an accretion to the assets of Coy. At that stage it seemed that accretion could be achieved by “reversing” the impact of that doubtful dividend.⁴¹ If the “impact” was reversed rather than the dividend itself, a covenant not to sue would be necessary to prevent a later claim. By 1 February 2001, Allens had prepared a first draft of its opinion on the subject of the October 1996 dividend, which continued to be redrafted until 12 February 2001⁴² suggesting there “may be question marks over the prudence of the 1996 dividend, which would need further factual analysis”.⁴³ However, Mr Robb informed Mr Shafron by email dated 7 February 2001 that Allens’ opinion was “unlikely to give a definitive view, as this would require a detailed understanding of what the directors knew and did at the time of making the dividend payment”.⁴⁴ Mr Robb’s opinion was also that it was unlikely that there was any liability in respect

³⁶ Morley T 2003.57.

³⁷ Messrs Morley, Shafron and Macdonald with Mr Peter Cameron and Mr Robb of Allens, and Mr Wilson and Mr Sweetman of UBS Warburg.

³⁸ See Morley, T 2006.12 and Ex 121, Tab 84, p. 2492: JHI NV Initial Submissions on Terms of Reference 2 and 3, para. 5.3.35.

³⁹ Ex 121, para. 193.

⁴⁰ Ex 92, Tab 5; Ex 87, Tab 9 p. 36.

⁴¹ Robb, Ex 189, Vol. 1 p. 149.

⁴² Ex 189 Vol. 1 at 0199; T 2838.35–38, T 2839.10–17.

⁴³ Ex 187, Vol. 1 Tab 12 at 0052.

of management fees.⁴⁵ The draft deed was first circulated by Allens at 7.47 pm on 8 February - a draft which in any event did not refer to dividends or management fees.⁴⁶

21.19 In the upshot, Allens was not required to complete its investigation into the question of whether the October 1996 dividend was improperly paid by Coy. The provision of additional funding would provide the basis for an indemnity, and the indemnity would provide a justification for additional funding sought by the Board. With that justification available, it was not necessary for JHIL to concern itself as to the strength of the dividend claim. Mr Shafron nonetheless instructed reference to be included in the final deed⁴⁷ out of an abundance of caution.⁴⁸

C. Consideration by outgoing directors and their legal advisor

21.20 It will be recalled that Mr Allsop's advice had been that "there is no reason why JHIL can't purchase such a covenant from Coy, assuming a reasonable, arms length price can be negotiated". Of course, given that both Mr Morley and Mr Donald Cameron also held positions within JHIL, the transaction was not, *prima facie*, able to be characterised as "arms length". Indeed, JH INV/ABN 60 do not contend otherwise.⁴⁹ Mr Morley and Mr Cameron were JHIL's appointed directors to its two subsidiaries. How might Coy and Jsekarb's own issues be managed?

21.21 The first draft of the deed was emailed by Allens to Mr Shafron and others on 8 February 2001.⁵⁰ The next day, Mr Robb observed to Mr Shafron that the deed had been "drafted from JHIL's perspective".⁵¹ He accepted that "[c]learly Coy may have its own issues. How will this be managed in terms of advice and instructions".

21.22 Mr Shafron's note indicated that he anticipated any protection of Coy's interests would come through independent advice the outgoing directors would

⁴⁴ Ex 187, Vol. 1 Tab 13.

⁴⁵ Ex 187 para. 28.

⁴⁶ Ex 189, page 303; Ex 98 Tab 4.

⁴⁷ Robb, T 2829.25 –30.

⁴⁸ Robb, T 2829.36–39.

⁴⁹ JHI NV Submissions in reply on Terms of Reference 1 to 3, para. E1.2.

⁵⁰ It was expressed to be between JHIL and Coy, but was later amended to include Jsekarb.

⁵¹ Ex 189, Vol. 1, p. 322.

receive, and “Phil and Don will carry the draft indemnity to the independent lawyer and come back with any changes”.⁵²

21.23 Mr Shafron provided a memorandum to Mr Morley and Mr Cameron (later finalised and dated 15 February 2001)⁵³ in which he set out various general matters in relation to directors duties and the need to “discuss these issues with an independent lawyer”, confirming that he had arranged for them to see Mr Bill Koeck and Mr Jeremy Kriewaldt of Blake Dawson Waldron.⁵⁴

21.24 Mr Cameron and Mr Morley met with Mr Koeck and Mr Kriewaldt on 15 February 2001. Mr Shafron attended.⁵⁵ At the meeting Mr Koeck was given the 8 February 2001 version of the draft deed.⁵⁶ On the basis of what he was told by Mr Morley and Mr Cameron,⁵⁷ and his review of Mr Shafron’s memorandum which they gave him, Mr Koeck understood that the purpose of the indemnity was “to ensure that Coy and Jsekarb can better meet future claims against them”.⁵⁸

21.25 Mr Koeck’s advice went a little way to crafting the Deed to Coy and Jsekarb’s perspective, although it is clear Blake Dawson Waldron was retained by JHIL only to represent the personal interests of the outgoing directors of Coy and Jsekarb. Mr Koeck formed the view that the covenant not to sue was too wide and needed to be confined so that it would identify specifically what was to be the subject matter of the claims given up.⁵⁹ That proposed amendment was taken up by Mr Koeck with Mr Robb and Mr Peter Cameron in a telephone conversation on 15 February 2001.⁶⁰

21.26 I accept that Mr Koeck recognised that the terms of the Deed of Covenant and Indemnity created a need for the directors of Coy and Jsekarb to have a proper and detailed examination of the potential asbestos liability of JHIL. But this was a

⁵² Ex 215.

⁵³ Morley, Ex 121, Tab 125. The memorandum set out matters under various headings “The Proposal”, “Factual Background”, “Directors Duties Generally”, “Protections” and “Independent Advice”. Attached to the memorandum were two annexures, addressing “Asbestos Litigation in the JH Group” and “Piercing the Corporate Veil”.

⁵⁴ See further Ex 98 para 3; Cameron, T 526.11–18.

⁵⁵ Morley, Ex 121, Vol. 8, Tab 126 p. 2957.

⁵⁶ T 1887.22.

⁵⁷ Ex 98, para. 6; Koeck, T 1876.11–16.

⁵⁸ T 1876.49 – T 1877.16.

⁵⁹ T 1889.34; Morley, Ex 121, Vol. 8, Tab 127.

⁶⁰ Koeck, Ex 98, para. 17, Tab 11; T 1887.24–49.

matter that he was specifically requested by JHIL not to advise upon.⁶¹ He understood that Allens was advising Coy and Jsekarb on these matters.⁶² Whilst Mr Koeck urged the directors to “[m]ake an independent judgment of experts assumptions & analysis” and to “[s]eek out support for assumptions”⁶³ the disclaimers expressed in the written advice of 16 February 2001,⁶⁴ are consistent with Mr Koeck’s understanding of his limited function. Consistently with his retainer to advise the directors personally, he recommended that the constitutions of Coy and Jsekarb should be amended to permit the outgoing directors to act in the interests of JHIL, and therefore be afforded the protection of s 187 of the *Corporations Law*.⁶⁵ But his advice specifically excluded matters in relation to legal issues relating to the asbestos claims and other transactions or circumstances, and focussed on the relatively unexceptional matters of the outgoing directors’ general duties and obligations to consider the interests of creditors.⁶⁶

21.27 Of course, Mr Morley had known that the dividend had been the subject of advice. Having learnt of the clause, Mr Morley’s evidence is that he did not inform Mr Donald Cameron, his explanation being that he had relied upon the advice of Peter Cameron that it was paid out of retained earnings at a time when the company was solvent.⁶⁷ Similarly he did not raise the October 1996 dividend with Mr Koeck⁶⁸ and Mr Koeck’s evidence was that he was unaware that an opinion had been formed that there may be a question mark over the prudence of any dividend payment.⁶⁹ Although he was aware that there were covenants in relation to payment of dividends, Mr Donald Cameron did not follow up on Mr Koeck’s recommendations to question assumptions⁷⁰ or discuss this matter with anyone⁷¹.

⁶¹ T 1880.49–57 – T 1881.1–3; T 1891.25–30.

⁶² T 1882.17.

⁶³ D Cameron, Ex 42, para. 13, Tab 3.

⁶⁴ Which formalised the advice outlined by him at the 15 February 2001 meeting: see Koeck, Ex 98 para. 14; D Cameron Ex 42, para. 55.

⁶⁵ Ex 189 Vol. 1 at 357; D Cameron, Ex 42, para. 57, Tab 19. Only Jsekarb’s constitution was amended: Morley T 2155.22–24.

⁶⁶ Koeck, Ex 98 Tab 14.

⁶⁷ Morley, T2126.1–12; T2232.14–19.

⁶⁸ Ex 122 para. 24.

⁶⁹ Morley, T1878.11–24.

⁷⁰ D Cameron, T 533.14–18.

⁷¹ D Cameron, T 534.50–T535.1.

D. Conduct of Mr Morley and Mr Donald Cameron

21.28 No lawyer (whether independent or not) was actually having regard to the interests of Coy and Jsekarb in the separation process.⁷² No advice was sought or obtained by Coy and Jsekarb on the critical matters of either the value of separation to JHIL or the value foregone in giving up causes of action in relation to payments of dividends and management fees by Coy. It is clear that Allens regarded themselves as acting in the interests of JHIL in the separation process.⁷³ The question arises whether it was reasonable for Mr Morley and Mr Cameron to take advantage of such advice as Allens⁷⁴ and Mr Allsop SC had provided to JHIL⁷⁵ or whether they were in breach of duty for failing to identify that Coy and Jsekarb should have received independent advice.⁷⁶

21.29 In my opinion, it was not enough to rely upon the advice of Allens in this transaction. The fact was that Coy and Jsekarb were being separated from the Group. It was to the advantage of JHIL to effect that separation. If Coy and Jsekarb, or their directors, had received independent advice on the merits of the transaction it might have resulted in either separation not proceeding, or arrangements being made for additional funding. As matters stood, the Board of JHIL regarded the consideration as the additional amount to bring the funds available to the estimate requirement to fund the Trowbridge estimates⁷⁷ and Messrs Morley and Cameron accepted that reasoning.⁷⁸ However, from the perspective of the interests of Coy and Jsekarb, the calculation of the consideration for the covenant and indemnity was not the subject of negotiation between JHIL on the one hand and Coy and Jsekarb on the other⁷⁹ - the number was simply provided to the outgoing directors by Mr Shafron.⁸⁰ Notwithstanding Mr Koeck's advice on 13 February to evaluate the indemnity,⁸¹ neither Mr Morley nor Mr Cameron evaluated the deed in money terms, or sought to

⁷² Morley, T 2223.14–35.

⁷³ Robb, Ex 187, para. 6, T 2771.15–24, T 2839.41–49; Ex 141.

⁷⁴ Mr Morley relied on the advice of Roy Williams of Allens in relation to aspects of Mr Shafron's memorandum of 15 February 2001: T 2152.18–33.

⁷⁵ Morley, T 2152.18–33.

⁷⁶ Counsel Assisting's Initial Submissions Section 2, para. 133.

⁷⁷ McGregor, T 1454.16; Shafron, T 1647, 1653.

⁷⁸ Morley, T 2140.25–31; T 2148.2–9; T 2158.51–2159.5.

⁷⁹ McGregor, T 1479–1480.

⁸⁰ D. Cameron, T 538.11 –13.

⁸¹ Morley, Ex 121, Tab 124.

bargain in relation to the quantum of the covenant.⁸² Put simply, to Mr Morley and Mr Cameron \$80m NPV was a “pile of money,”⁸³ and they needed to consider the matter no further.

21.30 Yet, the giving of the indemnity patently facilitated the separation of Coy and Jsekarb from JHIL - indeed, the minutes supporting the resolutions acknowledged this.⁸⁴ Of course, the indemnity may not have been a necessary precondition to separation, but the attitude within JHIL at the time of separation was that elimination of asbestos exposure was of significant commercial value to the James Hardie Group.⁸⁵ Mr McGregor’s evidence to this Inquiry was that he understood separation to not only be “desirable”⁸⁶ but a “practical necessity”.⁸⁷ A listing in the United States was “commercially unrealistic” if JHIL still had asbestos related liabilities on its balance sheet.⁸⁸ Mr Morley and Mr Cameron were aware of the desirability of separation.

21.31 I am conscious, of course, that Coy and Jsekarb were wholly owned subsidiaries of JHIL, but what was being done was not an ordinary transaction. The circumstances were such that the entry into the Deed of Covenant and Indemnity on their part was in fact in consideration for the payments to be made under the Deed, in circumstances where the companies would go their separate ways in the future. The circumstances, in my opinion, gave rise to the need for separate advice to Coy and Jsekarb as to the merits of the transactions.

21.32 Mr Morley sought to explain not thinking about independent investigations or legal advice because the quantum of the indemnity was supported by the financial model.⁸⁹ His explanation was:⁹⁰

“It came up from \$214M which was the gross assets at the time, okay, and we took the view that the put was there so no claims could go against JHIL; reviewing interest rates, management fees and dividends, we took the view there was no

⁸² Morley, T 256.50–53; D Cameron, T 536.21–24.

⁸³ Koeck, Ex 98, Tab 5, T 1876.27–42 (Mr Koeck’s evidence was that the phrase “a pile of money” was either Mr Morley’s or Mr Cameron’s, but he could not recall which one of them).

⁸⁴ Ex 42, Tab 31, p. 213; Ex 42, Tab 32, p. 224.

⁸⁵ McGregor, Ex 80, para 14; Shafron, Ex 17, para. 79; Macdonald, Ex 148, para. 8; Robb, Ex 187, para. 12.

⁸⁶ T 1435.30, T 1497.

⁸⁷ T 1572.

⁸⁸ McGregor, T 1486–T1487; see also Harman, T 1250.

⁸⁹ T 2243.23–52.

⁹⁰ T 2158.51–2159.5.

liability for that then looked at it and said, ‘okay we are getting \$80M extra for what we could perceive no real liabilities flowing to JHIL’ and we thought that was a good amount of money. I guess the other thing that helped us is looking at the model and looking at the projections and the configuration of the assets, we took the view that \$80M on top of the assets would meet the liabilities.”

Mr Cameron said that he believed the company had sufficient funds to meet its liabilities: “I didn’t contemplate that it would run out of money so I didn’t believe that would be a major issue”.⁹¹

21.33 Both these gentlemen in my opinion thought that what they were doing was what was required by their positions as officers of the Group, rather than as directors of Coy or Jsekarb. I think each did consider whether the transactions were in the interests of Coy and Jsekarb, but I do think that the range of matters which they considered was too restricted.

21.34 An argument was raised by Counsel Assisting and the Foundation that JHIL was a de facto director of Coy and Jsekarb at this time for the purposes of contending that JHIL’s conduct was in breach of duty to Coy and Jsekarb.

21.35 In Chapter 6 I expressed the view that, taking certain matters in combination, JHIL was a shadow director of Coy in the period of 1995 - 1998. In my opinion, although some circumstances had changed, that position still pertained at the time of the Deed of Covenant and Indemnity of February 2001.⁹² I accept that there had been no more payments at JHIL’s direction of dividends or management fees since 1999. But that was because the decisions of JHIL about the strategic restructuring of the Group meant that by 2001, the only function that Coy and Jsekarb had was to deal with claims for compensation by asbestos victims. That work was carried out entirely by officers of JHIL. From 1998 Mr Attrill was employed by JHIL as the manager of the asbestos litigation of Coy, Jsekarb and JHIL and reported to management and the board of JHIL.⁹³ The Trowbridge reports, which were said to have been obtained to assist Coy’s litigation and accordingly privileged, were kept confidential from Coy’s directors.⁹⁴ Up until separation, the

⁹¹ T 354–356.5–19.

⁹² Counsel Assisting’s Initial Submissions, Section 2, paras 154 – 157; MRCF Initial Submissions, paras 35.63–35.67; cf JHI NV Submissions in reply on Terms of Reference 1 to 3, section E7.

⁹³ Ex 56. para, 10.

⁹⁴ Cameron, Ex 42 para 21, T 540.50–53, T 541.19–33, T 613.57–58.

JHIL board continued to treat the James Hardie Group as a consolidated group from a financial point of view.

21.36 In relation to the Deed of Covenant and Indemnity itself, there was simply no negotiation in relation to the calculation of the consideration to be given by JHIL for the covenant not to sue and indemnity by Coy and Jsekarb.⁹⁵ The amount was determined by the JHIL board on advice from its executive management. Mr Shafron simply gave the number to Messrs Morley and Cameron,⁹⁶ which they accepted.⁹⁷

21.37 I do not accept the Foundation's submission that JHI NV was also a de facto director of Coy and Jsekarb at the time.⁹⁸ Of course, this was prior to the scheme of arrangement, and the company that later became JHI NV was a subsidiary of JHIL, named RCI Netherlands Holdings BV ("RCINH BV").⁹⁹

21.38 RCINH BV (now JHI NV) would have been a de facto director only if the directors of Coy and Jsekarb acted on its instructions or it otherwise acted as a director. There is simply no evidence that this happened. That there is some overlapping of directors (Mr Don Cameron was also a director of that company) is not enough. As for the suggestion¹⁰⁰ that the new holding company to be put in place pursuant to the restructuring was intended to be recipient of the benefits accruing to the James Hardie Group from the separation, as at February 2001, it was not clear that if Project Green went ahead, the company that is now JHI NV would become the ultimate parent company of the group.

21.39 I would add two further comments:

- (a) Contentions were advanced that Mr Morley and Mr Donald Cameron should have pressed further the propriety of the payment of the \$43.5m dividend. But as a practical matter Coy was to receive more than the amount of that dividend by the payments under that Deed. Whilst the payments did not reflect a reversal of the dividend, the money in substance was paid. In any event even

⁹⁵ McGregor, T 1479–1480.

⁹⁶ Shafron, T 538.11–13.

⁹⁷ Cameron, T526.50–53, T621.43–56.

⁹⁸ MRCF Initial Submissions, paras 35.68–35.74.

⁹⁹ See Annexure I.

today it is not possible to say that the dividend was improperly declared.

- (b) It has been submitted that Messrs Morley and Cameron were required to take into account the interests of future asbestos claimants and that in failing to do so, they were in breach of their duties as directors. I do not agree with that in respect of future asbestos claimants who had not yet suffered damage. There were adequate funds to pay existing claimants.

E. Consideration by incoming directors and their legal advisor

21.40 The position of the incoming directors was considered in Chapter 20. They and Mr Bancroft had a very limited role in the negotiation of the terms of the Deed of Covenant and Indemnity, which was not part of the initial trust proposal put to them in January 2001.¹⁰¹

21.41 Mr Bancroft first became aware of the proposal for the outgoing directors to enter into the Deed from an email from Mr Shafron on 7 February 2001.¹⁰² The package of materials circulated on or about 7 or 8 February 2001 by Mr Shafron for the meeting of incoming directors on 13 February 2001 did not include a draft of the Deed of Covenant and Indemnity¹⁰³ although there was a summary of it in a paper entitled “Set Up and Structural Issues” under the heading “Extra Funding & Hold Harmless”.¹⁰⁴

“The JHIL Board will be asked to approve the injection of additional capital into JH& Coy & Jsekarb so that they will be better able to meet claims that may be made against them, and ultimately fund medical research. The additional amount recommended by management is \$70M - to be paid at \$12.5M p.a. – and allocated primarily to JH & Coy with a portion to Jsekarb. In return, Coy and Jsekarb will agree to hold JHIL harmless and indemnify JHIL against claims that may be made against it in relation to the manufacture of asbestos containing products post 1937 by JH & Coy. No amount will be payable where JHIL has insurance cover. JHIL would remain at risk and unindemnified for the manufacture of asbestos containing products prior to 1937.

¹⁰⁰ MRCF Initial Submissions, para. 35.68.

¹⁰¹ Bancroft, Ex 95, para 26(a) and Vol.1, Tab 16, p.224; T 1836.20.

¹⁰² T 1846.

¹⁰³ Ex 5, para. 72, Ex 13, para. 100, Ex 36, para. 74(a); Ex 7, Vol. 1, Tab 13.

¹⁰⁴ Ex 2, Vol. 3, Tab 9, pp. 521–522.

In addition, and also in consideration of the additional funding, JH & Coy will agree to acquire all the outstanding shares in JHIL, should JHIL be offered to it at some future time not holding any business operations, delisted, and otherwise non operational.

The current JH & Coy and Jsekarb directors will resolve to enter into these arrangements.

Mr Morley will be covering these funding issues in more detail at the meeting, particularly in light of the most recent thinking.”

21.42 Several features may be noted about this passage. First, the “hold harmless and indemnify” part of it related to “claims that may be made against” JHIL in relation to “the manufacture of asbestos containing products post 1937 by JH & Coy”. The actual Deed of Covenant and Indemnity went beyond that subject matter in that cl 3.1 extended also to a range of other transactions which had taken place.

21.43 The weight of the objective evidence suggests that Mr Bancroft first received a version of the proposed Deed not on 14 February but on 15 February 2001¹⁰⁵ (whether first by email or in the Red Book¹⁰⁶ is unnecessary to decide).¹⁰⁷ His only substantive contribution¹⁰⁸ to the terms of the Deed of Covenant and Indemnity arose in the context of the insertion of cl 4A on the evening of 15 February 2001 with Mr Gill¹⁰⁹ to permit the acceleration of payments under it, should the need arise.¹¹⁰

21.44 Because of this intervention, JHI NV and ABN 60 contend that Mr Bancroft and Mallesons considered and were involved in the finalisation of the terms of the Deed of Covenant and Indemnity¹¹¹ and ultimately submit that:

“[t]he efficacy of the independent advice appears to have failed to some degree, but that is entirely the fault of the incoming directors or Mr Bancroft or both. No blame can properly be levelled at JHIL.”¹¹²

¹⁰⁵ Bancroft Initial Submissions, paras 34 – 41; cf JHI NV Initial Submissions, para. 10.1.6; MRCF Initial Submissions, para. 43.18.

¹⁰⁶ See Cooper, Ex 5, p. 23, para. 91; and also Ex 7, MRCF 4.

¹⁰⁷ A draft was sent by email at 1.56pm on 15 February 2001 from Mr Frangekides, solicitor at Allens: see Bancroft Ex 95, para. 60, Tab 42; the Red Book containing an earlier draft was delivered from Mr Shafron at JHIL that afternoon: Bancroft, Ex 95, para. 61, and Vol. 3, Tab 25; Shafron, Ex 17, para. 204.

¹⁰⁸ cf JHI NV Initial Submissions on Terms of Reference 2 and 3 para. 10.1.6.

¹⁰⁹ T 1873.31–36; T 1841.50–56; T 1873.40–45.

¹¹⁰ Cooper, T 140.25–30; Bancroft, T1841.45, 1848.30–50, 1873.45.

¹¹¹ See JHI NV Initial Submissions on Terms of Reference 2 and 3, para. 10.1.6.

¹¹² JHI NV Initial Submissions on Terms of Reference 2 and 3, para. 10.1.11, see also UASG Initial Submissions, para. 2.49(a).

21.45 I disagree. Mr Bancroft's advice to the incoming directors was that it was appropriate for the outgoing directors of Coy and Jsekarb, to execute documents in connection with the proposal. Mr Bancroft's view, that for the incoming directors to do so was "inappropriate", was because they were not able properly to assess many of the substantive matters dealt with. The existing directors were in a better position to make an informed judgment on whether the Deed of Covenant and Indemnity was in the best interests of Coy and Jsekarb.¹¹³ In my opinion, the amendment to cl 4A he helped craft was one directed simply to the better implementation of that transaction - a matter relevant to the incoming directors in their new roles. That he eschewed the substantive decision whether or not to enter into the transaction as a matter for the outgoing directors is consistent with that approach.

21.46 That said, I note that in his oral evidence, Mr Bancroft ascribed the "principal reason" for not wanting the directors to be appointed prior to the transaction documents being entered to his opinion "that the incoming directors did not have sufficient time to consider the commercial aspects in respect of those documents."¹¹⁴ Evidently Mr Bancroft expressed his concern to the incoming directors regarding the shortness of time within which to consider the transactions documents, including the Deed of Covenant and Indemnity.¹¹⁵ He appears to have accepted as adequate that it would be sufficient for him to provide a written advice on the Deed of Covenant, the Loan Deed and the leases over the real estate held by Coy and Jsekarb to be at a later date¹¹⁶ when they had time to fully consider the documents.¹¹⁷ That advice was eventually provided to them on 14 March 2001.¹¹⁸

21.47 The Foundation submitted that the logical consequence of Mr Bancroft's recognition that "we didn't have time to do a review of the document"¹¹⁹ was to urge the incoming directors not to proceed that night, and that if he had done so, "it is likely that his advice would have been followed".¹²⁰ Mr Bancroft's evidence, which I accept, was that he did point out to the directors that it was possible for the

¹¹³ Ex 95, para. 62.

¹¹⁴ T 1850.18.

¹¹⁵ Bancroft, T 1842.10–15; Bancroft Initial Submissions, para. 16 but cf MRCF Submissions in reply, paras 11.1–11.4.

¹¹⁶ Ex 95 para. 72.

¹¹⁷ T 1841.5.

¹¹⁸ Ex 95, paras 72, 78, Tab 52, p. 696.

¹¹⁹ T 1842.13.

transaction to be delayed so that advice about the Deed of Covenant and Indemnity could be given to them before the transaction was completed. He recollected having discussions with Dennis Cooper before the meeting took place because they were “pretty unhappy”, “personally unhappy” about the fact they had “this large pile of documents so close to the commencement of the meeting”.¹²¹ Mr Bancroft’s explanation was that he did not advise his clients not to enter the transactions if there had not been sufficient time to review the documents because he thought that was “a matter for the directors to make a decision for themselves”.¹²² He believed that “they were making their own enquiries in relation to the commercial aspect of the matter”.¹²³ In my opinion that was approach was reasonably open to him.

¹²⁰ MRCF Submissions in reply, para. 11.4.

¹²¹ T 1941.

¹²² T 1850.34.

¹²³ T 1831.6.

F. The Put Option

21.48 Of course, the Deed of Covenant and Indemnity would not protect JHIL against claims by third parties if Coy and Jsekarb were no longer in a position to indemnify it. Obliging Coy to acquire all the shares in JHIL for a nominal consideration, however, would cater for such a situation.

21.49 On 5 February 2001, Mr Macdonald emailed Mr Robb and instructed him to include an option to “put” JHIL to Coy.¹²⁴ Those instructions were subsequently confirmed by email by Mr Shafron.¹²⁵ Mr Robb’s evidence is that the instructions were written only; that is, at that time he received no oral explanation as to the future intention as to the exercise of the put option.¹²⁶

21.50 The “put” option is in cl 5 of the Deed of Covenant and Indemnity.¹²⁷ Clauses 5.1- 5.3 provided:

“5. Covenant to acquire JHIL Shares

5.1 Covenant to acquire

Coy hereby covenants to the JHIL Shareholder that Coy shall, on receipt of a notice from the JHIL Shareholder in the form of Schedule 3 (Schedule 3 Notice), **acquire the JHIL Shares in whole and in one lot.**

5.2 Exercise

The JHIL Shareholder may require Coy to acquire the JHIL Shares by giving to Coy a Schedule 3 Notice at any time during the Prescribed Period.

5.3 Sale

(a) When the Schedule 3 Notice is given, the JHIL Shareholder shall transfer the JHIL Shares to Coy for a nominal consideration of \$10.00.” [Emphasis added]

21.51 The “JHIL Shares” were all the issued shares in JHIL and the “Prescribed Period” was 15 years from 15 February 2001. A passing curiosity was that the option was given by cl 5.2 to the “JHIL Shareholder” a term defined by cl 1.1 to mean:

“... the person, if any, who is the sole registered holder of the JHIL Shares from time to time.”

¹²⁴ Ex 214.

¹²⁵ Robb, T 2812.14–20.

¹²⁶ Robb, T 2812.42–44.

¹²⁷ Ex 1, Vol. 6, Tab 60, pp. 2045–6.

At the time when the put option was granted, JHIL had multiple shareholders. The identity of the person who might be the sole shareholder was not then known, and the company may not have been in existence. Questions of enforceability of the put option might well have arisen if it were sought to be exercised.

21.52 The put option (if effective) should have operated to permit a future parent company of JHIL to compel Coy to acquire all the shares in JHIL for a nominal sum. The effect of such a transaction would be to turn Coy's former parent into its subsidiary. The consequence would be twofold. First, it would have the effect of removing JHIL from the JHI NV group. This would protect JHNV from any liability (for example, via partly paid shares) to provide funds for asbestos claimants who were able to establish claims against JHIL. Even if such claims were not being made, it would permit JHI NV finally to remove all stigma of asbestos association. The second effect is that exercise of the put option would effectively bring to an end to any claims that Amaca or Amaba had against JHI NV that were for any reason not encompassed by the Deed of Covenant and Indemnity itself (save a claim to set aside or vary the Deed of Covenant and Indemnity).

21.53 In oral submissions, Mr Bathurst QC on behalf of Allens, advanced the proposition that the put option may have been defective.¹²⁸ The difficulty propounded was that there was a real uncertainty as to whether it could be enforced by the JHIL shareholder or on behalf of the JHIL shareholder. In my opinion, assuming JHI NV qualified as the JHIL shareholder at a relevant time, it would have been permitted to call upon the put option's operation for its benefit even though not a party: see *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd*.¹²⁹ Even if it could be enforced, there was no obligation on JHIL to register any transfer of shares as a consequence of the exercise of the put, since it would be a breach of the obligations of the directors of JHIL to register a transfer of shares which had the effect of substituting as the contributory an insolvency for a company which had 1.8 billion dollars.¹³⁰ As it happens, it is not necessary for me to express a concluded view on this.

¹²⁸ T 3848.36 – T 3849.4.

¹²⁹ (1988) 165 CLR 107.

¹³⁰ T 3848.

G. A concluding observation

21.54 I do not think that there was anything inherently inappropriate in a requirement for a Deed of Covenant and Indemnity of the nature in fact entered into. Any “inappropriateness” would only arise in a commercial sense, if the consideration for which it was being given was inadequate.

Chapter 22 – JHIL Media Release of 16 February 2001

A. The Media Release

22.1 As noted in Chapter 4 the JHIL Board meeting of 15 February 2001 approved the ASX announcement to be made by JHIL. The resolution was in the following terms:¹

“ASX Announcement

The Chairman tabled an announcement to the ASX whereby the Company explains the effect of the resolutions passed at this meeting and the terms of the Foundation (ASX Announcement).

Resolved that:

- (a) the Company approved the ASX Announcement; and
- (b) the ASX Announcement be executed by the Company and sent to the ASX.”

22.2 On 16 February 2001 Mr Donald Cameron, on behalf of JHIL, sent to the Company Announcements Office at the Australian Stock Exchange a letter² in which he said:

“Attached for release to the market are the following:

- 1. Media Release – James Hardie resolves its asbestos liability favourably for claimants and shareholders
- 2. Announcement of 3rd quarter results
- 3. ASX Release for the 3rd quarter ended 31 December 2000
- 4. Management Discussion and Analysis for 3rd quarter ended 31 December 2000
- 5. Copies of slides to be presented to media and analysts’ briefings today.”

22.3 The documents reflected the desire of James Hardie to ensure that the announcement of the establishment of the Foundation occurred at the time of the announcement of the Third Quarter results.

¹ Ex 75, Vol 8, Tab 118, p. 2723.

² Ex 1, Vol 7, Tab 66, p. 2118.

22.4 The Media Release – Item 1 in the attachments to Mr Cameron’s letter – was in the following terms:

“16 February 2001

James Hardie Resolves its Asbestos Liability Favourably for Claimants and Shareholders

James Hardie Industries Limited (JHIL) announced today that it had established a foundation to compensate sufferers of asbestos-related diseases with claims against two former James Hardie subsidiaries and fund medical research aimed at finding cures for these diseases.

The Medical Research and Compensation Foundation (MRCF), to be chaired by Sir Llewellyn Edwards, will be completely independent of JHIL and will commence operation with assets of \$293 million.

The foundation has sufficient funds to meet all legitimate compensation claims anticipated from people injured by asbestos products that were manufactured in the past by two former subsidiaries of JHIL.

JHIL CEO Mr Peter Macdonald said that the establishment of a fully-funded Foundation provided certainty for both claimants and shareholders.

‘The establishment of the Medical Research and Compensation Foundation provides certainty for people with a legitimate claim against the former James Hardie companies which manufactured asbestos products,’ Mr Macdonald said.

‘The Foundation will concentrate on managing its substantial assets for the benefit of claimants. Its establishment has effectively resolved James Hardie’s asbestos liability and this will allow management to focus entirely on growing the company for the benefit of all shareholders.’

A separate fund of \$3 million has also been granted to the Foundation for scientific and medical research aimed at finding treatments and cures for asbestos diseases.

The \$293 million assets of the Foundation include a portfolio of long term securities, a substantial cash reserve, properties which earn rent and insurance policies which cover various types of claims, including all workers compensation claims.

Towers Perrin has been appointed to advise the Foundation on its investments, which will generate investment income and capital growth.

In establishing the Foundation, James Hardie sought expert advice from a number of firms, including PricewaterhouseCoopers, Access Economics and the actuarial firm, Trowbridge. With this advice, supplementing the company’s long experience in the area of asbestos, the directors of JHIL determined the level of funding required by the Foundation.

‘James Hardie is satisfied that the Foundation has sufficient funds to meet anticipated future claims,’ Mr Macdonald said.

The initial \$3 million for medical research will enable the Foundation to continue work on existing programs established by James Hardie as well as launch new programs.

When all future claims have been concluded, surplus funds will be used to support further scientific and medical research on lung diseases.

Mr Macdonald said Sir Llewellyn Edwards, who has resigned as a director of James Hardie Industries Limited to take up his new appointment as chairman of the Foundation, has enjoyed a long and distinguished career in medicine, politics and business.

His experience with James Hardie will assist the Foundation to rapidly acquire the knowledge it needs to perform effectively. Sir Llew is a director of a number of organisations including Westpac Banking Corporation and is also Chancellor of the University of Queensland.

The other Foundation directors are Mr Michael Gill, Mr Peter Jollie and Mr Dennis Cooper.

Ends.

For further details contact:

Greg Baxter, Senior Vice President Corporate Affairs ...”

22.5 Item 2, the announcement of James Hardie’s Third Quarter results, contained the following statements in relation to asbestos:³

“Asbestos

The company announced today that it has resolved its future asbestos liability for the mutual benefit of claimants and shareholders.

The company has established the Medical Research and Compensation Foundation (MRCF) which has taken over the management and settlement of the group’s future asbestos liabilities. The foundation will be completely independent of James Hardie.

Assets of A\$293.0 million have been transferred to the Foundation to fund all future claims for compensation and to support medical research.

The transfer of assets means that the James Hardie group will book an extraordinary item of A\$238.0 million in its consolidated profit and loss statement for its fiscal year ended March 31, 2001, to reflect the transfer of assets to the Foundation.

Effective today, the consolidated profit and loss statement of the James Hardie group will not include costs associated with asbestos. From today, these costs will be borne by the new Foundation.

³ Ex 1, Vol 7, Tab 66, pp. 2124–2125.

Additionally, a provision of A\$72.4 million will be removed from the consolidated balance sheet of the James Hardie group to reflect the removal of this contingent liability from the group. No future provisions are expected to be required.

These changes mean that the James Hardie group will be able to concentrate solely on developing its operating businesses and the new Foundation will concentrate solely on managing asbestos related activities.

Further details are contained in a separate announcement also released today.”

Similar statements were contained in Item 4 “Management Discussion and Analysis”.⁴

22.6 Item 5 - the slides - included the following statements:

1. “The Foundation is expected to have sufficient funds to meet all claims relating to James Hardie asbestos”⁵
2. “The assets provide sufficient funds to meet anticipated claims related to James Hardie’s asbestos”⁶
3. “The position of claimants is substantially improved ... future claims fully funded”⁷
4. “Independent advice provided by PwC, Access Economics and actuaries Trowbridge”

B. Meaning of the Media Release

22.7 The terms of the Media Release have been the subject of much analysis in the course of the Inquiry, and it has been contended that they gave rise to contravention of s 995, s 999 and s 1309 of the *Corporations Law*. I deal later with that question; it is convenient to consider first the meanings which the Media Release would convey to the ordinary reader.

22.8 In my opinion the ordinary reader would regard the Media Release as saying that, in fact, the \$293m available to the Foundation, Amaca and Amaba was sufficient:

“to meet all legitimate compensation claims anticipated from people injured by asbestos products that were manufactured in the past”

⁴ Ibid, p. 2139.

⁵ Ibid, p. 2163.

⁶ Ibid, p. 2165.

⁷ Ibid.

by Coy and Jsekarb. It creates, to my mind, the impression that there had been a proper estimation of the number and value of expected claims and that they would be met by the provision of the \$293m. There is no hint of any qualification. Rather, the reverse is conveyed by the reference to “surplus funds” after “all future claims have been concluded, and by the references to “a fully-funded Foundation” which would provide:

“certainly for people with a legitimate claim against the former James Hardie companies which manufactured asbestos products.”

and to there being “sufficient funds to meet all outstanding claims”.

22.9 The only feature of the Media Release which, in terms, might be regarded as militating against regarding the statement as one of fact, is the use of the expression “James Hardie is satisfied” in the eleventh paragraph of the Media Release, it being suggested that it conveys that a state of mind is involved. Certainly that is true as an abstract proposition but, in the sense in which it is used in the Media Release, it appears to be used as an emphatic, that is to emphasize the steps referred to in the preceding paragraph, which steps had been taken to ensure that the “fully funded” statement was true.

22.10 The second aspect of the ordinary meaning of the Media Release concerns the paragraph:

“In establishing the Foundation, James Hardie sought expert advice from a number of firms, including PricewaterhouseCoopers, Access Economics and the actuarial firm, Trowbridge. With this advice, supplementing the company’s long experience in the area of asbestos, the directors of JHIL determined the level of funding required by the Foundation.”

22.11 The ordinary reader of the Media Release, in my opinion, would regard that paragraph as conveying that the “expert advice” from PricewaterhouseCoopers, Access Economics and Trowbridge was advice in relation to the subject matter of the second sentence of that paragraph, namely the determination of the level of funding. What the ordinary reader would not appreciate was the limited function which PricewaterhouseCoopers and Access Economics had actually performed – see Chapter 19 – and in particular that they had been required **not** to deal with “the level of funding required by the Foundation”.

22.12 The third feature of the Media Release, again as looked at by the ordinary reader, was the statement attributed to Mr Macdonald that:

“...the establishment of a fully-funded Foundation provided certainty for both claimants and shareholders.”

22.13 “Certainty” in this context, in relation to claimants, appears to mean that legitimate claimants would have access to a fully-funded Foundation. In relation to shareholders, it would appear to mean that the public could now buy, hold, or sell JHIL shares without the shadow hitherto cast by the asbestos liabilities.

22.14 Each of the three statements – if considered from the point of view of the ordinary reader – is, in my opinion, not true:

- (a) The Foundation was not “fully-funded” in any relevant sense. It was massively under-funded.
- (b) It followed that it did not provide “certainty” for either claimants or shareholders.
- (c) The references to PricewaterhouseCoopers and Access Economics conveyed, by a combination of assertion and omission, a quite incorrect view as to the role of those entities.

22.15 The views which I have just expressed involve the rejection of a number of submissions made on behalf of JHI NV/ABN 60.

22.16 First, in relation to the references to PricewaterhouseCoopers and Access Economics, I accept that the Media Release was accurate in stating that “James Hardie sought expert advice from a number of firms, including PricewaterhouseCoopers, Access Economics and the actuarial firm Trowbridge”. That, however, is to extract those words from their context, and not to give them the meaning which, in that context, they convey.⁸

22.17 Secondly, I do not accept the contention⁹ that “certainty” should be treated as referring, in relation to claimants, to the fact that the funds were no longer held by

⁸ JHI NV Submissions in reply on Terms of Reference 1 to 3, para. F2.10.

⁹ JHI NV Submissions in reply on Terms of Reference 1 to 3, para. F2.11.

subsidiaries of an operating company which, amongst other options, had been considering putting the subsidiaries into liquidation. Instead the assets would never be dedicated to meeting those claims.

22.18 Whilst considerations of this kind may have played a part in the selection of the term “certainty” at this, or earlier points, it is not the meaning conveyed by the use of the term in the Media Release. I would add that, as I have indicated in paragraph 12.24, I accept Mr McGregor’s evidence that options such as winding up or declarations of no support would have been practically unacceptable.

22.19 Thirdly, I would reject the contention¹⁰ that “fully-funded”:

“...does not mean ‘over-funded’ so there is a high degree of assurance for claimants decades in the future. Nor does it mean ‘under-funded’ so that there is a low degree of assurance for such claimants. Fully-funded conveys that there is a reasonable basis for the belief that the funds would be sufficient.”

In my opinion, the term “fully-funded” as used in the Media Release was not intended to have the narrow meaning contemplated in the first two sentences of that submission. Nor, in my view, should it be given the (different) narrow meaning referred to in the third sentence. Why should it have either such meaning? The Media Release was JHIL’s public statement that its difficulties with its subsidiaries’ asbestos liabilities were over, to the benefit of claimants and shareholders. There is no reason why public statements of this kind, which were intended to influence governments, other “stakeholders” and the public generally, should be given any narrow meaning.

22.20 I turn then to a further question which arises in relation to the “fully-funded” assertion (and, in consequence, to the assertion as to certainty). It is that although the statement that the Foundation is fully-funded is presented as a statement of present fact, it is inherently a prediction as to outcomes at a future time. As I have said earlier, that is true in one sense, but to accept that proposition would not be the end of the matter.

22.21 The Media Release, on this assumption, makes it clear that it is conveying that JHIL, in fact, believes that the Foundation is fully-funded (and that Mr Macdonald holds the same view). There are various possibilities as to the state of

belief contemplated, but I would have thought that in the circumstances there would have to be an honest belief based on grounds which did support the asserted belief. This was, for the reasons advanced above, an important matter affecting a wide range of persons and bodies.

C. Public relations over substance

22.22 The Media Release was an integral part of the public relations planning in relation to separation. It was to convey the message that JHIL's asbestos problems had been resolved, to the mutual benefit of all stakeholders. The difficulty with it is that when one looks at its terms, and compares them with the underlying facts, the Media Release seems a pure public relations construct, bereft of substantial truth. In this regard:

- (a) The Foundation did not have sufficient funds to meet all legitimate compensation claims anticipated for people injured by asbestos products manufactured by the Coy and Jsekarb. It was massively under-funded.
- (b) No "certainty" was provided for claimants, or for shareholders.
- (c) James Hardie's asbestos liability was not "effectively resolved".
- (d) The notion that the Foundation would be able to generate investment income and capital growth and would have surplus funds "when all future claims have been concluded" was fanciful. The level of outgoings from the inception of the Foundation has meant it is on the way to being a financial basket case. There will be no surplus.
- (e) The reference to PricewaterhouseCoopers and Access Economics conveyed a quite erroneous impression of the involvement of those entities.

22.23 The evidence on this, and other issues, left me with the distinct impression that public relations played a larger than healthy part in the activities of the James Hardie Group. No doubt the existence of the asbestos liabilities provided a "public

¹⁰ JHI NV Submissions in reply on Terms of Reference 1 to 3, para. F2.6.

relations challenge”,¹¹ that is not a licence to say whatever may best suit the occasion. It was put also that the James Hardie public relations staff was relatively smaller than similar departments in comparable corporate groups.¹² So it may have been, but it was hardly inactive and its influence was pervasive. Of course, public relations questions may be relevant, indeed very relevant to decision-making, but I remain surprised at the degree to which those considerations appear to have been allowed to intrude into the merits of decision-making on these issues.

22.24 I note in this regard Mr McGregor’s oral evidence.¹³

“Commissioner Q. There seemed to be a great deal of time expended by your corporate affairs department and the PR people immediately prior to the events of February 2001. I must say I must express some surprise at the level of the material going to the board. There was so much attention to the public relations aspect of it and to the various spins, if I can use the patois, that might be used. Why was that?

A. James Hardie has a very open management attitude and culture. The material that was sent to the board was, I think, more to demonstrate the preparation, the thought processes and the thinking about the issues that would have to be dealt with and how it was proposed that they would be dealt with in that matter, and the typical way of planning in James Hardie is to take the worst case that you might be faced with and to try and plan how to manage for an effective outcome. The sensitivity of these issues and the adverse publicity that invariably they attract was quite a serious issue for the company, and obviously planning to represent the decisions made in the appropriate manner and openly, as is disclosed in those documents, that preparation I think was sent by the management to inform the board that there was a thorough appreciation of that issues and plans as to how the company would announce and inform people about what it was doing.”

I had some difficulty in accepting that evidence when he gave it; indeed, I formed the impression that he had difficulty in giving it. It seemed an after-the-event rationalisation of what had taken place, rather than an explanation of the underlying reasons.

D. Corporations Law Questions

22.25 There are three provisions of the *Corporations Law* which it is contended have been contravened in the publication of the Media Release. They are s 995,

¹¹ JHI NV/ABN 60 Initial Submissions para. 12.8.1.

¹² Macdonald T2662.14–2663.13.

¹³ T 1527.26–1528.10.

s 999 and s 1309. Contraventions of s 999 and s 1309 were offences by reason of s 1311(1). Contravention of s 995 was not: s 995(3). I shall deal first with s 995.

E. *Corporations Law, section 995*

22.26 The *Corporations Law*, as at 16 February 2001, provided in s 995(2) that:

“A person must not, in or in connection with:

- (a) any dealing in securities; or
- (b) without limiting the generality of paragraph (a):
 - (i) the allotment or issue of securities; or
 - (ii) a notice published in relation to securities; or
 - (iii) the making of, or the making of an evaluation of, or of a recommendation in relation to, offers under a takeover bid; or
 - (iv) the carrying on of any negotiations, the making of any arrangements or the doing of any other act preparatory to or in any other way related to any matter referred to in subparagraph (i), (ii) or (iii);

engage in conduct that is misleading or deceptive or is likely to mislead or deceive.”

22.27 Although a person contravening s 995(2) is not guilty of an offence, the person is liable to anyone suffering loss or damage by reason of the contravention : s 1005(1). For there to be a contravention of s 995(2), it is not necessary for there to be an intention to mislead or deceive : *Wilkinson v Feldworth Financial Services Pty Ltd* (1999) 17 ACLC 220.

22.28 In my opinion the conduct of JHIL in publishing the Media Release in the form in which it did was misleading and deceptive in terms of s 995(2)(b)(ii). The assertion that the Foundation was “fully-funded” was made without qualification. It was not true for the reasons dealt with in Section B of this Chapter. The statements attributed to Mr Macdonald are in the same category. The statements contained in the Media Release as to “certainty” depend on the same matters.

22.29 Again, for the reasons in Section B, the statements made concerning PricewaterhouseCoopers and Access Economics were plainly misleading and deceptive, and in my opinion JHIL contravened s 995(2) in making them. Mr

Macdonald, for reasons which I discuss in relation to s 1309, himself permitted the publication of the Media Release. Again, he is in the same position as JHIL.

22.30 There was thus, in my view, a contravention of s 995(2) by the publication of the Media Release. But what “loss or damage” has been suffered by the Foundation, Amaca or Amaba by reason of *that* contravention?

F. *Corporations Law*, sections 999 and 1309 : A Preliminary Question

22.31 The *Special Commissions of Inquiry Act 1993* provides in s 10(1) that:

“(1) It is the duty of a Commissioner ... to make a report or reports to the Governor in connection with the subject-matter of the commission, and in particular as to whether there is or was any evidence or sufficient evidence warranting the prosecution of a specified person for a specified offence.”

22.32 At the time of publication of the Media Release the *Corporations Law* was a State law. On 15 July 2001, however, the *Corporations Act 2001*, a law of the Commonwealth, came into force. On the same day the *Corporations (Ancillary Provisions) Act 2001*, a New South Wales law, also came into force. The 2001 enactments, in conjunction, have the effect that:

- (a) rights or liabilities (including criminal liabilities) arising under the former State *Corporations Law* are “cancelled”, but a substituted equivalent liability arises under the Commonwealth *Corporations Act*, as if that Act had been in force at the time of the events giving rise to the right or liability; and
- (b) in the case of criminal liability, the offence becomes a Commonwealth, rather than a State, offence.

22.33 The fact that the offences, if any, would now be Commonwealth offences gives rise to a question whether s 10(1) has any application to them, a question I raised during closing arguments of the Inquiry. The response from counsel for JHI NV/ABN 60, with much of which I agree, set out the position under the enactments to which I have referred:

“1. At T3954–5 the Commissioner asked counsel assisting as to the consequences of the conduct said to give rise to contraventions of ss999 and

1309 being conduct prior to the introduction of the *Corporations Act* 2001. The James Hardie parties make the following submissions in response.

2. The conduct said to give rise to contraventions of ss999 and 1309 occurred in February 2001.
3. The *Corporations Act* 2001 (Cth) and the *Corporations (Ancillary Provisions) Act* 2001 (NSW) commenced on 15 July 2001. It is necessary to consider the impact that legislation had upon the scope of this commission.
4. First, as the Commissioner observed, the effect of the legislation is, purportedly, to replace rights and obligations derived from State law to rights and obligations derived from Commonwealth law. In *ASIC v Rich* (2003) 45 ACSR 305 at [2], Austin J said:

‘By virtue of some peculiar transitional provisions in the Corporations Act (especially s1399 and 1400), the proceeding is to be conducted under the Corporations Act rather than the Corporations Law of New South Wales, and the court is required to assume that the Corporations Act was in force at all relevant times, but that its terms were identical with the terms of the Corporations Law applicable at the time of occurrence of the events in contention.’

5. The central provisions are:
 - (a) Section 7(2) of the *Corporations (Ancillary Provisions) Act* 2001, which provides that:

‘if by force of Chapter 10 of the new Corporations Act or Part 16 of the new ASIC Act 2001 a person acquires, accrues or incurs a right or liability in substitution for a pre-commencement right or liability, the pre-commencement right or liability is cancelled at the relevant time and ceases at that time to be a right or liability under a law of the State.’
 - (b) ‘Relevant time’ is defined in s3(1) to mean 15 July 2001.
 - (c) ‘Pre-commencement right or liability’ is expressly defined to include criminal liability under the Corporations Law: s7(5).
 - (d) Section 1400 of the *Corporations Act* is within Chapter 10. It applies in relation to a right or liability (‘the pre-commencement right or liability’) whether civil or criminal, that was acquired under, *inter alia*, the Corporations Law and was in existence immediately before 15 July 2001: s1400(1).
 - (e) Section 1400(2) provides that the person acquires, accrues or incurs a right or liability (‘the substituted right or liability’) equivalent to the pre-commencement right or liability under the corresponding provision of the Corporations Act 2001 ‘(as if that provision applied to the conduct or circumstances that gave rise to the pre-commencement right or liability)’.
 - (f) Section 1400(3) provides that proceedings in respect of the substituted right or liability may be instituted under the Corporations Act 2001 (Cth).

6. *Secondly*, the consequences of those provisions in respect of conduct occurring in February 2001 are that:
- (a) There is no longer any liability for contravention of ss999 and 1309 of the *Corporations Law* – any such liability has been ‘cancelled’ and has ceased to be a liability under a New South Wales law.
 - (b) In particular, there can never be any prosecution for a contravention of ss999 or 1309 of the *Corporations Law* enacted by New South Wales.
 - (c) Only the substituted contraventions of ss999 and 1309 of the *Corporations Act 2001* may be the subject of any prosecution arising out of conduct in February 2001.”¹⁴

The contentions in these paragraphs appear to be correct.

22.34 The Submissions then go on to deal with the extent to which s 10(1) authorises the making of a report in relation to offences. The first point made is that in doing so one should not exceed the authority given by statute:

- “7. *Thirdly*, the obligation imposed by s10 of the *Special Commissions of Inquiry Act 1983* is confined to reporting whether there is or was any evidence or sufficient evidence warranting the prosecution of a specified person for a specified offence. Consistently with *Balog v Independent Commission Against Corruption* (1990) 169 CLR 625, it is inappropriate for the Commissioner to make any finding in relation to criminal conduct beyond that required by the Act.”

I accept that general proposition.

22.35 The Submission then seeks to apply to the present circumstances by saying that “offence” in s 10(1) should be read as meaning offences under a law of New South Wales, and not offences under the laws of the Commonwealth.

- “8. *Fourthly*, the ‘specified offence’ in s10 should be read, on ordinary principles of construction, as confined to an offence against the law of New South Wales. That follows from:
- (a) Section 12 of the *Interpretation Act 1987*, which requires references in legislation to matters and things to be read as references to matters and things ‘in and of New South Wales’.
 - (b) Thus, in *Grannall v C Geo Kellaway & Sons Pty Ltd* (1955) 93 CLR 36 at 52–54, what was decisive was that the New South Wales law prohibiting produce agents from charging excessive commission only applied to produce agents who charged within New South Wales.
 - (c) More directly, in *Solomons v District Court (NSW)* (2002) 211 CLR 119 at [9], Gleeson CJ, Gaudron, Gummow, Hayne and Callinan JJ

¹⁴ JHI NV Submissions in Reply entitled “Further submissions on ss999 and 1309”.

said of s2 of the *Costs in Criminal Cases Act 1967* (NSW) (which authorised a court ‘in any proceedings relating to any offence’ to grant a costs certificate when, *inter alia*, there had been an acquittal), that:

‘The offences in question do not include offences under a law of the Commonwealth. This follows as a matter of construction of s2 of the Costs Act in the light of s12(1) of the *Interpretation Act*.’

McHugh J said at [37]:

“The trial judge and the Court of Appeal correctly held that the Costs Act does not purport to apply to criminal proceedings in federal jurisdiction. It is a long recognised rule of statutory construction that a reference to courts, matters, things and persons in the legislation of a State is a reference to courts, matters, things and persons in that State. In New South Wales, that rule of construction is enshrined in legislation. Consequently, the Costs Act applies of its own force only to offences against the laws of New South Wales.”

Kirby J agreed: at [75]–[76].

9. The reference to “specified offence” in s10 is to be read in the same way.”

Again, I accept that “offence” in s 10(1) should be treated as applying to offences under the laws of New South Wales, and not to offences under the laws of the Commonwealth.

22.36 The Submission then concludes

“10. For those reasons, it is submitted that:

- (a) the Commissioner will be satisfied that there is no possibility of any offence under ss999 or 1309 of the *Corporations Law*; and
- (b) no findings should or indeed *can* be made as to [the] whether there is any evidence, or sufficient evidence, warranting the prosecution of any person for a contravention of ss999 or 1309 of the *Corporations Act*.”

22.37 It is at this point that I disagree. The argument appears to give insufficient attention to the actual wording of s 10(1), i.e. whether there “is *or was*” evidence or sufficient evidence warranting the prosecution of a specific person for a specific offence. It is difficult to see why the words “or was” do not authorise consideration of past events which were, but are not now, the subject of legislative provision by the State. Laws having retrospective operation will often make lawful what had previously been proscribed. In my opinion the submission invokes an unnecessary reading down of s 10(1). Accordingly, I shall discuss s 999 and s 1309.

G. *Corporations Law, Section 1309*

22.38 It is convenient to deal with s 1309 before turning to s 999. There are two provisions of s 1309 which require consideration.

22.39 First, s 1309(1) provided that:

“(1) An officer of a corporation who makes available or gives information, or authorises or permits the making available or giving of information to:

...

- (a) a securities exchange in Australia or elsewhere or an officer of such securities exchange;

being information, whether in documentary or any other form, that relates to the affairs of the corporation and that, to the knowledge of the officer:

- (b) is false or misleading in a material particular; or
- (c) has omitted from it a matter or thing the omission of which renders the information misleading in a material respect;

is guilty of an offence.”

22.40 Secondly, s 1309(2) provided:

“(2) An officer of a corporation who makes available or gives information, or authorises or permits the making available or giving of information, to:

...

- (a) a securities exchange in Australia or elsewhere or an officer of such a securities exchange;

being information, whether in documentary or any other form, relating to the affairs of the corporation that:

- (b) is false or misleading in a material particular; or
- (c) has omitted from it a matter or thing the omission of which renders the information misleading in a material respect;

without having taken reasonable steps to ensure that the information:

- (d) was not false or misleading in a material particular; and
- (e) did not have omitted from it a matter or thing the omission of which rendered the information misleading in a material respect;

is guilty of an offence.”

22.41 The sending of the Media Release and related documents to the ASX was the giving of information to a securities exchange. The information given in the Media Release, I would have thought, plainly related to the affairs of JHIL. The Media Release treated it as doing so by the specific references to JHIL in many of the paragraphs of the Media Release, and the contemporaneous materials sent to the ASX – see paragraph 22.2 – seem a clear indication to the same effect.

22.42 The information provided was, in my opinion, false and misleading in the three respects referred to in Section B. It also omitted matters, the omission of which, in my opinion, rendered the information misleading in a material respect. The omitted material consisted of the qualifications on the role of PricewaterhouseCoopers and Access Economics to which I have referred to in Section B.

22.43 In those circumstances, any officer of JHIL who:

- (a) gave the information to the ASX; or
- (b) authorised the giving of the information to the ASX; or
- (c) permitted the giving of the information to the ASX;

would contravene s 1309(1) if the officer knew that the information suffered from the defect contemplated by paragraph (d) or (e) of s 1309(1). In relation to s 1309(2), such an officer would contravene the provision if the officer had not taken reasonable steps to ensure that the information did not suffer from the cumulative defect contemplated by paragraphs (d) and (e).

22.44 It will be seen that s 1309(1) and s 1309(2) place a liability upon officers of a corporation, rather than upon the corporation itself. (Of course, s 79 may operate to make the corporation liable as a party involved in the contravention).

22.45 The officer who sent the Media Release to the ASX was Mr Don Cameron. He was JHIL's Company Secretary, and I am quite satisfied that he was not aware of the matters falling within paragraphs (d) and (e) of s 1309(1). Again, I think he was entitled to rely on the other officers of JHIL, and the decision of the Board, to say

that he was entitled to assume other all reasonable steps had been taken in terms of s 1309(2).

22.46 The officers of JHIL to whom s 1309(1) and s 1309(2) could have principal application would be Mr Macdonald and Mr Baxter.

22.47 Mr Macdonald is, of course, extensively quoted in the Media Release. The Communications Strategy¹⁵ had indicated that he was to be the person to speak on behalf of JHIL in the presentation of the Third Quarter Results on 16 February 2001, as the case was.¹⁶ It contemplated that he would undergo media training to this end, although it did not appear whether, in fact, he underwent such training. The draft Media Release was in the Board papers from the 15 February 2001 Board Meeting. It is very difficult to believe that he was not familiar with the contents of the Media Release and the “messages” it was seeking to convey and that he did not “permit” the “making available” of the whole of this material to the ASX.

22.48 In my view there was evidence that Mr Macdonald knew that the information provided to the ASX was false and misleading in the respects referred to above. It is referred to in Chapter 24.

22.49 Mr Baxter appears to have had considerable involvement in the public relations aspects of separation; his name is on the Media Release. It has not been possible, however, to investigate whether his conduct was in breach of s 1309, or any other provision. So many issues were raised by the parties at the Inquiry that, in the time available, it was not possible to examine the conduct of every person concerned in every aspect of the events which took place. The relative significance of the Media Release in relation to separation also did not appear as important in the scheme of separation as the evidence later disclosed. Mr Baxter did not give evidence and I make it clear that I make no finding of any contravention against him. I simply have not considered his position.

22.50 I would also note that JHI NV/ABN 60 Final Submissions in Reply, dated 16 August 2004, made the point that:

¹⁵ Ex 75, Vol 8, Tab 119, p. 26.

¹⁶ Ex 301 and 302.

- “29. Sections 999 and 1309, in contrast are criminal provisions. They attach criminal liability not to *conduct* but:
- (a) in the case of s999, to the making of statements or the dissemination of information; or
 - (b) in the case of s1309, to the making available or furnishing of information.
30. While making statements or disseminating information will all amount to conduct, not all conduct which would fall within s995 is capable of falling within ss999 or 1309.
31. The narrowing of language is deliberate. Just as s52 of the *Trade Practices Act* is a broad provision imposing civil liability, followed by more specific criminal provisions, so too s995 of the *Corporations Act* is a broad civil provision followed by specific criminal provisions which deal with, for example, misleading ‘appearances’ (s998), misleading ‘statements’ (s999), misleading ‘statements, promises or forecasts’ (s1000).
32. Conduct which may give rise to a contravention of s52 or s995, namely, implied representations and representations by silence, would not (at least in ordinary circumstances) amount to the ‘making of statements’. Still less would such conduct amount to the dissemination, making available or furnishing of ‘information’.”

22.51 Much of this I would accept, but it means no more than that one must consider each provision according to its own terms. I have tried to do so.

H. *Corporations Law, section 999*

22.52 Section 999 of the *Corporations Law* provided that:

“A person must not make a statement, or disseminate information, that is false in a material particular or materially misleading and:

- (i) is likely to induce other persons to subscribe for securities; or
 - (a) is likely to induce the sale or purchase of securities by other persons; or
 - (b) is likely to have the effect of increasing, reducing, maintaining or stabilising the market price of securities;

if, when the person makes the statement or disseminates the information:

- (c) the person does not care whether the statement or information is true or false; or
- (d) the person knows or ought reasonably to have known that the statement or information is false in a material particular or materially misleading.”

A contravention of s 999 was an offence : s 1311(1).

22.53 In my opinion, the Media Release should be read as a dissemination of information for the purposes of s 999. Its terms, read as a whole, conveyed the message to present and future holders of JHIL’s shares that the perceived dampening effect of the asbestos liabilities had gone and, equally importantly, would not return because the Foundation was “fully-funded”.

22.54 The terms of the Media Release were such that it seems plain enough to have been “likely”, in terms of s 999(b), to have had one of the effects there referred to. See in particular:

- (a) the reference by Mr Macdonald to “certainty for ... shareholders”;
- (b) the statement by Mr Macdonald that the resolution of the asbestos liabilities “will allow management to focus entirely on growing the company for the benefit of all shareholders”.

In fact, the price of JHIL shares on the market rose immediately after the publication of the Media Release.¹⁷

22.55 In my view the Media Release, considered as a whole:

- (a) was likely to induce the sale or purchase of shares in JHIL – s 999(a);
- (b) was likely to have the effect of increasing, or maintaining, the market price of shares in JHIL – s 999(b).

22.56 For the reasons discussed in relation to s 1309, Mr Macdonald, in my opinion, ought reasonably to have known that the information in the Media Release was false in material particulars, and materially misleading. The relevant respects are those discussed in Section B. Again the evidence is referred to in Chapter 24.

22.57 I find it difficult to see why JHIL ought not reasonably to have known the same matters. It had the advantage of the collective knowledge of its various senior officers. I would not have thought that the liability of JHIL would be affected by the fact that not all that information was given to the Board.

I. Evidence in Relation to s 999 and s 1309 Matters

22.58 In considering this question it is necessary to leave out of account two classes of evidence. First s 9(4) of the *Special Commissions of Inquiry Act* provides:

“... the Commissioner is required, when preparing a report in connection with the subject-matter of the Commission, to disregard (in the context of dealing under section 10 with offences that may or may not have been committed) evidence that, in the opinion of the Commissioner, would not be likely to be admissible in evidence in relevant criminal proceedings.”

22.59 I have treated this provision as requiring me to disregard evidence that would be the subject of a claim of privilege.

¹⁷ Ex 135, Tab 8, p. 61 and Ex 279.

22.60 Secondly, s 23 of the *Special Commissions of Inquiry Act* provides:

- “(1) A witness summoned to attend or appearing before a Special Commission shall not be excused from answering any question or producing any book, document or writing on the ground that the answer or production may criminate or tend to criminate the witness, or on the ground of privilege or on any other ground.
- (2) An answer made, or book, document or writing produced, by a witness to or before a Special Commission shall not, except as otherwise provided in this section, be admissible in evidence against that person in any civil or criminal proceedings.
- (3) Nothing in this section shall be deemed to render inadmissible:
 - (a) any answer, book, document or writing in proceedings for an offence against this Act,
 - (b) any answer, book, document or writing in any civil or criminal proceedings if the witness was willing to give the answer or produce the book, document or writing irrespective of the provisions of subsection (1), or
 - (c) any book, document or writing in civil proceedings for or in respect of any right or liability conferred or imposed by the book, document or writing.”

22.61 The enthusiasm for negatives in the second and third subsections makes the provision a little complicated, but in my view it has the following effect:

- (a) By reason of s 23(1), questions must be answered and books, documents or writings produced; no ground for refusal will prevail.
- (b) Answers so given may not later be given in evidence in proceedings against the person in civil or criminal proceedings. Nor may books, documents or writings be so produced. The provision seems intended to have the effect that production to the Inquiry under compulsion of a summons does not have the consequence that an entitlement to non-production, overridden by s 23(1), is not overridden in other proceedings.
- (c) There is an exception to s 23(2) in the circumstances referred to in s 23(3). That of relevance here is s 23(3)(b).

22.62 A number of witnesses, principally those who have been employees of JHIL, have stated specifically that they are not, in terms of s 23(3)(b), “willing to give the answers or produce the book, document or writing irrespective of the

provisions of subsection (1)”. They are perfectly entitled to do so. I have not taken into account the evidence to which that would apply (in accordance with the views expressed above) in dealing with matters under s 10(2) of the *Special Commissions of Inquiry Act*.

J. Conclusions

22.63 It follows from the foregoing that there appears evidence that the publication of the Media Release to the ASX gave rise to contraventions of s 995, s 999 and s 1309.

22.64 It is now a matter for Commonwealth authorities to determine whether any further action should be taken in respect of the contraventions of s 999 and s 1309 and, if so, against whom. As I have said, this is not an area where it has been possible to carry out an exhaustive investigation in relation to these aspects.