

REPORT
OF THE
SPECIAL COMMISSION OF INQUIRY
INTO THE
MEDICAL RESEARCH AND
COMPENSATION FOUNDATION

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Commissioner

September 2004

This is the second printing of the Report and incorporates the
corrigenda that was released with the Report on 21 September 2004.

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P R E F A C E

The Report which follows is in response to Letters Patent issued to me on 12 February 2004 under the *Special Commission of Inquiry Act 1983*.

The subject matter of the Inquiry attracted a great deal of public attention. Many members of the public attended. Much of the evidence was reported on by media representatives who followed the course of the Inquiry. Many of the issues were the subject of public discussion.

The range of matters involved was such that it was necessary to hear oral evidence for many days and to receive voluminous quantities of documentary evidence, and oral and written submissions.

It would not have been possible to conduct the Inquiry effectively without the assistance of others. I have been fortunate to have as Senior Counsel Assisting Mr John Sheahan SC, whose intelligent, rigorous and fearless dedication to the task has been of the highest order. I thank too his junior counsel, initially Robert Kelly and later in addition Dominique Hogan-Doran and Matthew Darke, and the Solicitor Assisting the Inquiry, Mimi Barbaro, for the skilled and dedicated work they performed, often for long hours.

The Inquiry proceeded at a rapid pace. To do that effectively required an administrative head of considerable skill and expertise. I was fortunate to have Margaret Lennan to perform that task. She was able to ensure that the Inquiry proceeded expeditiously and economically. I thank her and her deputy Anthony Tarleton. Mr Michael Armitage of the Premier's Department was of great assistance also in ensuring that arrangements proceeded smoothly.

Finally I would like to thank my secretary Karen Bassant and my assistant Sally Sanders for their cheerful assistance.

21 September 2004.

D.F. Jackson QC

Abbreviations and Acronyms

ABN 60 Foundation	The foundation established on the separation of ABN 60 from the JHI NV. Also referred to as Foundation II.
Allens	Allen Allen & Hemsley (up to 1 July 2001) Allens Arthur Robinson (post 1 July 2001)
Amaba / Jsekarb	Jsekarb Pty Limited (up to 23 February 2001) Amaba Pty Limited (post 23 February 2001)
Amaca / Coy / JH & Coy Pty Ltd	James Hardie & Coy Pty Limited (up to 23 February 2001) Amaca Pty Ltd (post 23 February 2001)
ASIC	Australian Securities and Investment Commission
ASX	Australian Stock Exchange
AUS GAAP	Australian Generally Accepted Accounting Principles
Corrs	Corrs Chambers Westgarth
Coy	James Hardie & Coy Pty Ltd
DDB	Dust Disease Board
DDT	Dust Diseases Tribunal of New South Wales
EBIT	Earnings before interest and tax
EBITA	Earnings before interest, tax and amortisation
ED 88	Exposure Draft for a new Australian accounting standard
FY	Financial Year
Grant Samuel	Grant Samuels & Associates Pty Limited
IPO	Initial Public Offering
JH NV	James Hardie NV
JH Research	James Hardie Research Pty Limited
JHA	James Hardie Australia Pty Limited
JHFC	James Hardie Fibre Cement Pty Limited
JHFL	James Hardie Finance Limited
JHI Finance BV	James Hardie Finance BV
JHI NV	James Hardie Industries NV

JHIL or ABN 60	ABN 60 Pty Limited (formerly James Hardie Industries Limited)
JHR	James Hardie Research Pty Limited
JLT	Jardine Lloyd Thompson
JLW Advisory	JLW Advisory became Jones Lang LaSalle
Mallesons	Mallesons Stephen Jaques
MRCF	Medical Research and Compensation Foundation
MRCF Investments	MRCF Investments Pty Limited
NPV	Net Present Value
PricewaterhouseCoopers / PwC	PricewaterhouseCoopers Securities Limited
QBE	QBE Insurance Limited
1996 Trowbridge Report	Trowbridge's report of 10 October 1996
1998 Trowbridge Report	Trowbridge report of 10 September 1998
2000 Trowbridge Report	Trowbridge's Report dated 16 June 2000
2002 Trowbridge Report	Trowbridge's report of 28 October 2002
2003 Trowbridge Report	Trowbridge's report of September 2003
February 2001 Trowbridge Report	Trowbridge Report of 13 February 2001
August 2001 Trowbridge Report	Trowbridge Report of 16 August 2001
Watson & Hurst	Presentation prepared by Bruce Watson and Mark Hurst, Trowbridge Actuaries for the Accident and Compensation seminar at the Institute of Actuaries of Australia dated November 2000.
Trowbridge	Trowbridge Deloitte Limited (post May 2000) John Trowbridge Consulting Pty Limited (prior to May 2000)
US GAAP	US accounting principle requiring disclosure of full extent of the James Haride Group's asbestos liabilities

Relevant Persons Mentioned in the Evidence

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Barrett, The Hon Justice Reginald Ian	Judge of Supreme Court of NSW.
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Stevens, Malcom	Allens Arthur Robinson, Solicitor.
Stevenson, Andrew Wentworth	Corrs Chambers Westgarth, Solicitor.
Stockdale, Peter	Mallesons Stephen Jaques, Solicitor.
Strassburg, Mathew	Chief of Staff in the office of the NSW Special Minister of State, John Della Bosca.
Sweetman, Anthony John	UBS Warburg, Australia, Investment Manager.
Terry, Greg	James Hardie Industries Limited, Board member.
Trebeck, David Bruce	ABN 60 Pty Limited, Director.
Van Olffen, Martin	De Brauw Blackstone Westbroek Amsterdam, Dutch Attorney.
Velez, Peter	Watson Mangioni, Solicitor.

Wait, Stephan	Heath Lambert Group, the London Insurance group.
Waterman, Ewen Leith	Tenix Defence Pty Limited, Adviser.
Watson, Bruce Allan	Trowbridge Deloitte Consulting, Actuary.
Wedderburn, Graeme	Chief of Staff to the Premier of NSW, the Hon. Bob Carr.
Whitehead, Guy	Taylor Fry Consulting, Actuary.
Wilcox, Peter	James Hardie Industries Limited, Non-executive Director.
Wylie, Mark	Trowbridge Deloitte Consulting, Actuary.
Wilkinson, Richard	KPMG Actuaries.
Williams, Roy	Allens Arthur Robinson, Solicitor.
Wilson, David	UBS Warburg.
Wilson, Ian	SBC Warburg Dillon Reed, London.
Wilson, Stephen	Grant Samuel & Associates, Director.
Winters, John	James Hardie Industries Limited, Occupational Health and Safety Officer.

INTRODUCTION

A. Appointment and Terms of Reference

1. By Letters Patent issued on 27 February 2004¹ by Her Excellency the Governor in Council under s 4(1) of the *Special Commissions of Inquiry Act 1983*, I was appointed to inquire into and report on the following matters:

- “1. the current financial position of the Medical Research and Compensation Foundation (“the MRCF”), and whether it is likely to meet its future asbestos-related liabilities in the medium to long term;
2. the circumstances in which MRCF was separated from the James Hardie Group and whether this may have resulted in or contributed to a possible insufficiency of assets to meet its future asbestos-related liabilities;
3. the circumstances in which any corporate reconstructions or asset transfers occurred within or in relation to the James Hardie Group prior to the separation of MRCF from the James Hardie Group to the extent that this may have affected the ability of MRCF to meet its current and future asbestos-related liabilities; and
4. the adequacy of current arrangements available to MRCF under the Corporations Act to assist MRCF to manage its liabilities, and whether reform is desirable to those arrangements to assist MRCF to manage its obligations to current and future claimants.”

2. The Letters Patent required me to report by 30 June 2004. The number of issues to which the Terms of Reference gave rise, together with the volume of evidence received, made it necessary to seek an extension of the time within which to report, and by further Letters Patent issued on 30 June 2004² the time for reporting was extended until 21 September 2004.

¹ The Letters Patent are contained in Annexure A.

² Also contained in Annexure A.

B. Conduct of the Inquiry

3. The steps taken in conducting the Inquiry are set out in Annexure B. The professional and administrative staff who provided so much assistance in the conduct of the Inquiry are identified in Annexure C. My thanks to them are recorded in the Preface.

C. Conclusions on Terms of Reference

4. Chapter 1 contains conclusions on Terms of Reference 1 and 3 and my views on the matters most directly answering Terms of Reference 2. It is difficult to express views on Terms of Reference 4 in a short form, and it is necessary to refer readers to Part 5 of the Report in that regard.

5. The body of the Report, in addition to the matters mentioned in Chapter 1, deals (and sometimes declines to deal) with a large number of matters sought to be raised by the persons and bodies appearing at the Inquiry.

D. Arrangement of the Report

6. The Report has five Parts. Part 1 contains Chapter 1 which I have already described, and Chapter 2 which sets out a short version of the asbestos activities of members of the James Hardie Group, and the events which led to the establishment of the Inquiry. Part 2 deals with Term of Reference 1, the financial position of the former James Hardie companies which are now subsidiaries of the Medical Research and Compensation Foundation. Part 3 deals with Term of Reference 3. I deal with Term of Reference 3 before Term of Reference 2 because the events to which Term of Reference 3 relates are earlier in time than those with which Term of Reference 2 is concerned.

7. Parts 4 and 5 deal with Terms of Reference 2 and 4 respectively.

E. Publication of the Report

8. By s 10(3) of the *Special Commissions of Inquiry Act*, a Commissioner may make such recommendations relating to the publication of the whole or any part of the Report as the Commissioner thinks proper. I recommend that the whole of the Report be published.

9. I take that view because:

- (a) The Inquiry has attracted great, and legitimate, public interest.
- (b) The reputations of a number of persons have been put in issue. It is desirable that the allegations be dealt with.
- (c) The future of the Foundation is of importance to many people.
- (d) The position of the James Hardie companies needs to be clarified.

Part 1 – Introductory Matters

Chapter 1 - Principal Conclusions

A. Term of Reference 1 – “The current financial position of the Medical Research and Compensation Foundation (“the MRCF”), and whether it is likely to meet its future asbestos-related liabilities in the medium to long term.”

1.1 Although referring to the financial position of the Medical Research and Compensation Foundation (which I shall call “the Foundation”), it is not in doubt that the Terms of Reference are directed to the financial position of the two former James Hardie companies now controlled by the Foundation, those companies now being named Amaca Pty Limited (“Amaca”) and Amaba Pty Limited (“Amaba”).

1.2 The net assets of Amaca and Amaba total approximately \$179.2m as at 30 June 2004. Against that, however, must be set the amounts which are the present provision for meeting currently notified asbestos-related claims, some \$63.01m. Against that also should be put the estimate of likely asbestos-related claims in future years, a sum the net present value of which is about \$1.5 billion. I do not think it will be less. If a lump sum were to be set aside to make more certain that those liabilities could be paid, it would be much higher.

1.3 Amaca and Amaba have entitlements to recover from insurers some amounts in respect of the present and future claims. I estimate that the amounts recoverable have a net present value of about \$160m. The possible insurance recoveries have a somewhat theoretical aspect because most of the amounts involved would not be payable before, as I mention in the next paragraph, the Foundation’s funds were exhausted.

1.4 The Foundation’s funds are being quickly used up in the payment of current claims against Amaca and Amaba. In my opinion, they will be exhausted in the first half of 2007 and it has no prospect of meeting the liabilities of Amaca and Amaba in either the medium or the long term.

1.5 Submissions have been made that the conduct of members of the James Hardie Group, their officers, their actuaries, and various firms of solicitors, may give rise to causes of action which might augment the funds of Amaca, Amaba or the

Foundation. I deal with these contentions in various Chapters in Parts 3 and 4. I regard some of these causes of action as speculative, others perhaps not, but I regard them all as unlikely to result in any significant increase in the funds of Amaca, Amaba or the Foundation.

B. Term of Reference 2 – “The circumstances in which MRCF was separated from the James Hardie Group and whether this may have resulted in or contributed to a possible insufficiency of assets to meet its future asbestos-related liabilities.”

1.6 Amaca (formerly James Hardie & Coy Pty Ltd) and Amaba (formerly Jsekarb Pty Ltd) had been subsidiaries of James Hardie Industries Limited (“JHIL”). They ceased to be so, and were separated from the James Hardie Group, on 15 February 2001. Amaca and Amaba had previously been manufacturers of products made from asbestos. They have had, have, and will acquire, legal liabilities to many persons affected by asbestos and asbestos products. My estimate of the present value of such liabilities, as I have said, is that they will be not less than \$1.5 billion. The James Hardie Group had moved its senior management to the United States. That country was seen as the focus of the Group’s business for the future. The principal purpose of separation was to enable the Group thereafter to obtain capital or loan funding or to use its own share capital for future acquisitions without the stigma of possible future asbestos liabilities.

1.7 Amaca and Amaba were acquired by the Foundation for no monetary consideration. Their net assets amounted to about \$214m. JHIL agreed to provide additional sums, over time, in return for the execution of a Deed of Covenant and Indemnity by Amaca and Amaba so that the stated present value of the total assets acquired by the Foundation was \$293m. The public announcements made by JHIL at the time of separation emphasised that JHIL had provided for a Foundation which had sufficient funds to satisfy all future legitimate asbestos-related claims.

1.8 There was no *legal* obligation for JHIL to provide greater funding to the Foundation, but it was aware – indeed, very aware because it had made extensive efforts to identify and target those who might be “stakeholders”, or were regarded as having influence with “stakeholders” – that if it were perceived as not having made adequate provision for the future asbestos liabilities of its former subsidiaries there

would be a wave of adverse public opinion which might well result in action being taken by the Commonwealth or State governments (on whom much of the cost of such asbestos victims would be thrown) to legislate to make other companies in the Group liable in addition to Amaca or Amaba.

1.9 The dominant purpose of supplementing the assets available to the Foundation from \$214m to \$293m was to enable the Group to say that the assets available to the Foundation exceeded the “Best Estimate” contained in an actuarial report of Amaca/Amaba’s asbestos liabilities as at 13 February 2001. That estimate was that the liabilities had a net present value of \$286m.

1.10 The actuarial report had been produced by Trowbridge Deloitte Limited (“Trowbridge”). Trowbridge’s report (“the February 2001 Trowbridge Report”) in my opinion provided no satisfactory basis for an assertion that the Foundation would have sufficient funds to meet all future claims. Amongst other reasons the Report was not directed to the issue of separation. The Report, it was also known, did not take into account the most recent James Hardie asbestos litigation figures, which showed a significant increase in outgoings for asbestos claims. The Trowbridge assessments were also subject to many qualifications not stated in that Report.

1.11 The assertion that the Foundation would have sufficient funding to meet all legitimate future asbestos claims, based on Trowbridge’s Best Estimate was also based on a financial model prepared by JHIL, and described as the Twelfth Cash Flow Model. It reflected the fact that the assets of Amaca and Amaba at separation were not cash or its equivalent. They consisted of real estate the subject of leases to James Hardie operating companies, loans to James Hardie companies repayable over time at 8.13 per cent per annum, and the additional amount made available in return for giving the Deed of Covenant and Indemnity. That amount was itself payable over time. To demonstrate that the funds being provided were sufficient a constant earnings rate of 11.7 per cent per annum for 50 years was adopted on that part of the Foundation’s funds available for investment from time to time. Such a rate was in my opinion selected simply to achieve the result that the model showed significant surpluses of funds over its life. Warnings from independent experts as to the assumptions in the model were not followed up.

1.12 The James Hardie Group management, in my opinion, had taken the view that the resolution of the problems occasioned by the Group's asbestos associations had gone on for too long, that a trust of the nature established in connection with the Foundation was a solution, that the Board of JHIL should be urged to adopt that course, and to do so quickly. A reason for urgency was thought to be the impending introduction in Australia of an Accounting Standard which would have required JHIL to state in its group financial statements and the net present value of all likely future asbestos liabilities. This would involve attributing to them a far higher figure than it had been thought necessary to indicate in such documents in previous years.

1.13 At first the management of JHIL had endeavoured to persuade the Board of JHIL, at its January 2001 meeting, to establish the Foundation with only the net assets of Amaca and Amaba, the \$214m. The Board had declined to do so, asking management to see if further funds could be found, so that the Trowbridge Best Estimate could be met.

1.14 No doubt management and the Board were entitled to seek to achieve, if they could, separation of JHIL from Amaca and Amaba and thus from the shadow thought to be cast from those companies' emerging asbestos liabilities. But I find it difficult to accept that management could really have believed that the funds of the Foundation would have been sufficient to enable it to pay all future legitimate asbestos-related claims against Amaca and Amaba. Yet that was the message that JHIL propounded on 16 February 2001, the day after separation, to the Australian Stock Exchange ("ASX"), to government, the media, its shareholders, unions, plaintiffs' solicitors, asbestos victims and anybody it felt the need to convince.

1.15 I set out the terms of the Media Release sent to the ASX in Annexure R. In my opinion, its terms conveyed that the Foundation had been provided with sufficient funds to meet all legitimate future asbestos-related claims, and that accordingly there was "certainty" for persons who might suffer from such diseases and for JHIL shareholders. They also conveyed the impression that JHIL's determination of the amount of funding needed for the Foundation had been checked by independent experts. In each of these respects they were seriously misleading.

1.16 Shortly after the establishment of the Foundation, steps were taken which would have the effect of distancing Amaca and Amaba further from the operating arms of the James Hardie Group.

1.17 In October 2001 a Scheme of Arrangement was approved whereby the holding company of the Group became James Hardie Industries NV (“JHI NV”), a Dutch company. Shareholders in JHIL became shareholders in JHI NV; the shares in JHIL were held by JHI NV. Those shares were principally partly paid shares. Under their terms JHIL could call on JHI NV for up to about \$1.9 billion if needed to maintain solvency.

1.18 It became apparent to the Foundation quite rapidly that the level of outgoings of Amaca and Amaba on asbestos claims was far beyond that represented at the time of its establishment, and that the Foundation’s funds would be exhausted well before ten years of its life. Attempts to obtain further funding from the James Hardie Group were rebuffed, except that first \$10m, then \$18m, was proposed to be provided if the Foundation acquired JHIL, in which case the partly paid shares would be cancelled.

1.19 The Foundation would not agree to this course and in March 2003 JHI NV and JHIL (by then known as ABN 60 Pty Limited (“ABN 60”)) agreed to cancel the partly paid shares. A new Foundation (“the ABN 60 Foundation”) was then made the sole shareholder in ABN 60. The only legal connection between ABN 60 and JHI NV is now a Deed of Covenant, Indemnity and Access. The net assets of ABN 60 at the time of separation of ABN 60 from the Group were about \$20m.

1.20 The preceding paragraphs dealing with this Term of Reference have dealt with its first part, “the circumstances in which MRCF was separated from the James Hardie Group”. The Term of Reference also asks whether the circumstances of separation “may have resulted in or contributed to a possible insufficiency of assets to meet its future asbestos-related liabilities”.

1.21 As I have mentioned there was no legal obligation on JHIL to provide Amaca or Amaba, on separation, with any funds in addition to the assets of those companies. Amaca and Amaba were not stripped of assets; they retained them. Indeed they obtained more than those assets by reason of the additional periodical

payments. It is thus not possible, in money terms, to say that separation directly resulted in or contributed to a possible insufficiency of assets to meet the future asbestos-related liabilities of Amaca and Amaba. But in practical terms separation was, in my opinion, likely to have an effect of that kind. If separation had not taken place in February 2001 it seems likely that, for the indefinite future, the asbestos liabilities would have been treated, as they had been for years, as one of the annual expenses of the Group. It may well have been that consideration would be given to different schemes for dealing with the emerging asbestos liabilities, but whatever was done would have been likely to involve significantly greater funding from the Group.

1.22 I have mentioned that after the establishment of the Foundation, the James Hardie Group was adamant that no further substantial funds would be made available to the Foundation, and that it had taken all proper steps at the establishment of the Foundation. In July 2004, after the Inquiry had been in progress for some months, JHI NV accepted that the Foundation had been underfunded, and to a very significant degree. In my opinion it was correct in accepting that that was the position. The evidence demonstrated that the February 2001 estimates of future liabilities were far too low and that the results of the financial modelling were wildly optimistic.

1.23 The James Hardie Group has also indicated, subject to various matters dealt with in discussing Term of Reference 4 (including that it is under no legal obligation to do so), that it is prepared to fund the future asbestos liabilities of Amaca, Amaba and JHIL. In my opinion it is right that it should do so. There may have been no legal obligation on JHIL to fund the liabilities of Amaca and Amaba simply because they were its subsidiaries, but if it were thought, in the interests of JHIL, for it to be separated from those subsidiaries because of the shadow of asbestos liabilities they brought with them, it is hard to see why it would not have been in the interests of JHIL to provide the funding which was necessary to enable that to be done effectively. To do it effectively meant to do it in a way which would not result in the issue rearing its head again, as has happened here, with very adverse results to the public standing of James Hardie. If the interests of JHIL's shareholders were thought to lie in cutting loose the asbestos liabilities, what seems to have been

overlooked,³ is what Mr Peter Shafron (the Group's Chief General Counsel) had said to the Board some twelve months before in his paper "Asbestos":⁴

"The overall US experience on reorganisations, as described by JH's US attorneys, has some admittedly fairly obvious lessons for us:

In sum, the US experience has shown thus far that a carefully planned reorganisation that makes fair provision for the asbestos claims has some chance of succeeding. But any attempt at reorganisation that does not leave significant assets for the asbestos claims will, at a minimum, spawn lengthy and costly litigation with the plaintiffs' bar, and may ultimately be unsuccessful."

1.24 I add two observations.

1.25 The first is that I can understand how, the manufacture of asbestos products having ceased in the 1980s (finally in 1987), asbestos liabilities came to be described within the James Hardie Group as "legacy issues" or part of the "rump". That mode of thought, however, tends to obscure the true legal situation. The negligence of the James Hardie companies occurred in the past, but the liabilities flowing from that negligence only arise day by day, now and in the future, as the diseases are acquired or manifest themselves. The exposure to asbestos may not even yet have occurred. The position in February 2001 was, as it remains, that members of the public will contract asbestos-related diseases over many years because of the negligence of Amaca and Amaba. The notion that the holding company would make the cheapest provision thought "marketable" in respect of those liabilities so that it could go off to pursue its other more lucrative interests insulated from those liabilities is singularly unattractive. Why should the victims and the public bear the cost not provided for?

1.26 The second observation concerns the quite misleading statements made on behalf of JHIL at the time of separation, and the culture of denial adopted as the shortcomings in the Foundation's funding began to emerge. For nearly thirty years in this country we have had standards for business communications. Such communications are not to be misleading or deceptive. Those standards appear in the *Trade Practices Act 1974* (Cth) and in its State equivalents, in the *Corporations Laws* and in the *Corporations Act 2001*. They have been maintained by governments of all political colours. In my opinion they were not here observed.

³ Including by Mr Shafron.

C. Term of Reference 3 – “The circumstances in which any corporate reconstruction or asset transfers occurred within or in relation to the James Hardie Group prior to the separation of MRCF from the James Hardie Group to the extent that this may have affected the ability of MRCF to meet its current and future asbestos-related liabilities.”

1.27 No question arises in relation to Amaba. Its business was sold to interests outside the James Hardie Group in 1987. Amaca, however, was the principal operating company until 1998. It ceased to be so in 1998 when the new operating company became James Hardie Australia Pty Ltd (“JHA”).

1.28 The “corporate reconstructions” and “asset transfers” which have been considered in the Inquiry are:

- (a) the 1995 sales of Amaca’s “core technology” and of some other businesses which it controlled;
- (b) the declaration of dividends of \$100.9m in 1995–1996 and of \$43.5m in 1996–1997;
- (c) the levels of management fees paid by Amaca to JHIL in the years 1990–1998;
- (d) the transfers of assets by Amaba in 1998 and the rental levels at which Coy leased its premises to this new operating company.

These are the only transactions to which Term of Reference 3 would appear to apply.

1.29 The 1995 sale of the core technology occurred for perfectly sensible business reasons. The 1995 sales of the other businesses are in a similar category.

1.30 There are arguments that the two dividends should not have been paid, in the light of the emerging asbestos liabilities. The argument is stronger in the case of the \$43.5m dividend, but in the end I am not satisfied that the declaration of either dividend would be impugned successfully.

⁴ Ex 283, Vol 5, Feb 00 Tab, p. 15.

1.31 The management fees charged in the years 1995–1998 were high, and in some respects arbitrarily set. The evidence did not allow for me to form a concluded view as to the levels of a “proper” management fee.

1.32 I am not satisfied that the sale of Amaca’s assets in 1998 occurred at other than fair value.

1.33 One of the terms of the sale of Amaca’s non-Queensland assets was to the effect that Amaca would lease to JHA five premises formerly used by Amaca. A criticism made in the Inquiry was that the rentals fixed for the leases were too low. There may have been some substance in this criticism, but I was unable to be satisfied that in the events which had happened, both before and after the establishment of the Foundation, it would have made any significant difference to Amaca’s financial position.

1.34 I have also considered the effect of those transactions as a whole. The effect of them was that Amaca moved from being an operating company carrying on a substantial business to a company which owned land, lent money within the Group, had some other investments and carried the asbestos liabilities. The suggestion made was this was done so that the business assets would not be available to asbestos claimants. The 1998 transactions in particular were said to have that quality, and it was contended that there was a breach of duty by JHIL’s directors in so doing.

1.35 That the operating assets of the Group would not be available to asbestos claimants was a purpose of these changes, but not their only purpose. At the same time, however, a holding company is not obliged to keep a particular subsidiary operating a particular business. Amaca had quite adequate funds to pay its creditors as their debts fell due, and was doing so. There was nothing to suggest it would not continue to do so. I do not consider that there was any breach of director’s duties in this regard.

1.36 The transfers of assets which took place within the James Hardie Group prior to February 2001 have not so far affected the ability of the Foundation to pay asbestos-related liabilities.

D. Term of Reference 4 – “The adequacy of current arrangements available to MRCF under the Corporations Act to assist MRCF to manage its liabilities, and whether reform is desirable to those arrangements to assist MRCF to manage its obligations to current and future claimants.”

1.37 It seems clear that current arrangements available to the Foundation under the Corporations Act will not assist the Foundation to manage its liabilities.

1.38 A consideration of the future position has been overtaken to a significant degree, by the events to which I have referred to in paragraph 1.23. The best long-term solution for satisfying the asbestos liabilities of Amaca, Amaba and ABN 60 would be a scheme, for which that proposed by JHI NV might be a starting point. The proposal, however, is presently in an embryo, and sometimes contradictory, form. More clarification is required. So too is much detailed consideration.

Chapter 2 – Background To The Inquiry

A. Asbestos and the James Hardie Group

Asbestos: Uses and Consequences

2.1 Asbestos was used in Australia during a large part of the last century in the manufacture of building products (particularly sheeting and roofing), pipes, insulation materials, brake linings and other friction products, and other materials. Asbestos, however, carries with it problems. Its fibres can give rise to asbestosis, lung cancer, asbestos-related pleural diseases and mesothelioma. Asbestos-related diseases may take many years after exposure to manifest themselves. Mesothelioma is especially insidious: very slight exposure to asbestos fibre may cause it, the disease may not manifest itself until 40 or more years after the exposure but when it does the course of the disease is most often short, very painful and fatal.

The James Hardie Group: “JHIL”, “Coy” and “Jsekarb”

2.2 Companies in the James Hardie Group were major participants in the manufacture and distribution of asbestos products. For a time the Group also mined asbestos ore. There have been many changes in the identity and names of the James Hardie companies,¹ but three companies are principally involved.

2.3 The first is James Hardie Industries Ltd, now ABN 60 Pty Limited. I describe it either as “JHIL” or as “ABN 60”.

2.4 At first JHIL was an importer of asbestos products, but it became a manufacturer in the 1920s. It continued as such until 1937 when manufacture was carried on instead by the second principal company, its new subsidiary James Hardie & Coy Pty Ltd (“Coy”). Coy was a very substantial producer. It had plants in New South Wales, Victoria, Queensland, South Australia and Western Australia. In the 1980s, however, it ceased manufacturing asbestos products, the last production being

¹ Re Amaca see Ex 276, Tab 2; re Amaba see Ex 276, Tab 3; re JHIL see Ex 284, Tab 1, pp. 1–2 and Ex 276, Tab 6.

at Welshpool in Western Australia and Meeandah in Queensland in March 1987.² Coy's name changed to Amaca Pty Limited on 23 February 2001. I describe it either as "Coy" or as "Amaca".

2.5 Coy had earlier manufactured brake and friction products, but in 1963 the James Hardie Group entered into a joint venture to produce brake linings and friction products. The joint venture company was Hardie Ferodo Pty Ltd. The Ferodo interest sold out, however, in 1978 and the company was thus wholly owned by the James Hardie Group. It later became James Hardie Brakes Pty Ltd, Jsekarb Pty Ltd, and Amaba Pty Limited. I describe it as "Jsekarb" or as "Amaba". Its business was sold to interests outside the James Hardie Group in 1987 for \$12m. It is the third company. It was a relatively minor player in events.

2.6 Australia was a very heavy consumer of asbestos products and their production appears to have reached its peak in the 1970s.³ The propensity of asbestos to cause diseases had been well known for years⁴, however, and there was a search to develop satisfactory products which could be substitutes. A discussion of asbestos in Australia and the James Hardie involvement is in Annexure D.

B. Separating the asbestos liabilities from the "core businesses"

2.7 The substitutes developed, and new products, proved commercially very successful for the James Hardie Group, especially in the United States market. More and more the focus of the Group's activities became the United States.⁵ A difficulty in that country, however, was that companies with asbestos liabilities had been in dire straits because of litigation for such claims and the existence (and possible extent) of the potential asbestos liabilities of companies in the Group was perceived as likely to impede attempts to obtain capital, or funding, there, or to use shares for the purposes of acquisitions.

² See Ex 61, Vol 1, Tab 1.

³ See Mr Wilkinson's report, Ex 252, p 18, Figure 3.1, and his oral evidence T3284.36–38.

⁴ Asbestosis was common in the 1920s and 1930s. The connection between asbestos exposure and mesothelioma was established in 1960: see the briefing paper "James Hardie and Asbestos", Ex 2, Vol 3, pp. 456, 457, prepared by Wayne Attrill, JHIL's Litigation Counsel, for the meeting of proposed directors of the Foundation (its proposed name then being Claimsure Nominees Pty Limited) Coy and Jsekarb on 15 January 2001.

⁵ Dr Barton, JHIL's Managing Director from 1993–1999, regarded the Australian market as "very mature. There wasn't much in the way of new ventures for Coy" T2737.27–28.

2.8 With the passage of time after the Group finally stopped manufacturing asbestos products, with changes in personnel and with the focus on the newer and profitable businesses, the Group's liabilities in respect of asbestos came to be regarded as something reflecting the past. They came to be described, and regarded, as "non-core issues", "part of the rump", "legacy issues". They were issues which were a source of "management distraction", which it would be desirable to "separate".⁶

2.9 "Separating" the asbestos liabilities, however, was a problem. Attempts to do so in the United States and the United Kingdom had a poor success record.⁷ One difficulty was the likely amount of such liabilities. Another was how separation might be effected and effective.

2.10 In relation to the likely amount of the liabilities, descriptions such as "legacy issues" tended to obscure the fact that although the Group's negligence in the manufacture or distribution of the asbestos products⁸ had ceased years before, the *liabilities* consequent upon such negligence were accruing, and would continue to accrue, for many years.⁹ Nor could the persons to whom the companies might be liable be identified, other than in very generalised terms.

C. The first actuarial assessments

2.11 Until 1996 the Group's asbestos liabilities – judgments, settlements and legal costs – had been met as they became due.¹⁰ The amounts had been (excluding recoveries):¹¹

⁶ These phrases can be seen in, for example the Project Chelsea Board Presentation, Ex 61, Vol 3, Tab 11, pp. 101–102, 125; SBC Warburg Dillon Read re "Project Chelsea Rump Strategy", Ex 61, Vol 1, Tab 23, the Project Green Board Paper prepared for the JHIL Board meeting on 15 February 2001, Ex 75, Vol 8, Tab 120, pp. 2735, 2740, Project Green Board Presentation, February 2001, Ex 75, Vol 8, Tab 123, pp. 2844, 2845, 2858. JHIL Board Papers, February 2000, Ex 283, Vol 5, Feb 00 Tab, pp. 13–15; Ex 175, para. [12] and Annexure C; Ex 61, Vol 3, Tab 24, p. 245 – James Hardie Media Release of 2/7/98 re: Corporate Restructure; Ex 1, Vol 3, Tab 35, p. 716 – Information Memorandum re: New York Stock Exchange Listing.

⁷ Ex 283, Vol 5, Feb 00 Tab, pp. 11–15.

⁸ An essential element in there being any liability.

⁹ Liability in tort does not arise until the occurrence of "damage", relevantly the suffering of the asbestos-related disease.

¹⁰ Ex 57, Vol 1, p. 35.

¹¹ Ex 2, Vol 3, Tab 12, p. 667.

- (a) pre-1991/1992¹² \$7.167m;
- (b) 1991/1992 \$3.815m;
- (c) 1992/1993 \$4.244m;
- (d) 1993/1994 \$9.774m;
- (e) 1994/1995 \$12.208m.

and in a business of Coy's size, amounts of this order of magnitude might be regarded as manageable. The amounts were increasing, however, and it also must have been obvious that the lead time with mesothelioma was such that much greater liabilities would exist.

2.12 The first step to obtain a professional actuarial assessment of the total asbestos-related exposure to liability of the James Hardie companies was taken in 1996, when John Trowbridge Consulting Pty Ltd was engaged by Mr Stephen Gellert, then JHIL's General Counsel. (Trowbridge Consulting became Trowbridge Deloitte Limited in May 2000. I refer to each as "Trowbridge".) Trowbridge produced its report (the "1996 Trowbridge Report") on 10 October 1996. The Report¹³ "an actuarial assessment of the potential liability of the company and its subsidiaries for personal injury claims arising from asbestos-related diseases" – assessed those liabilities at a net present value, discounted at 8 per cent per annum of \$230m¹⁴ as at 31 March 1996.

2.13 Two years later Trowbridge carried out a review of the same question as at 31 March 1998, its report of 10 September 1998 (the "1998 Trowbridge Report")¹⁵ assessing the liabilities at a net present value, discounted this time at 7 per cent per annum of \$254m.¹⁶

¹² For years commencing 1 April.

¹³ Ex 2, Vol 3, Tab 12.

¹⁴ Gross present value was \$258m; the figure of \$230m assumed insurance recoveries of \$28m: Ex 2, Vol 3, Tab 12, p. 589.

¹⁵ Ex 2, Vol 3, Tab 13.

¹⁶ Gross present value was \$281m; the figure of \$254m assumed insurance recoveries of \$27m: Ex 2, Vol 3, Tab 13, p. 702.

2.14 There are difficulties in endeavouring to compare, directly, the estimates of liability in the 1996 and 1998 Trowbridge Reports. Table 4.7 in Mr Whitehead's Report¹⁷ provides a comparison of the liabilities estimated in the various Trowbridge Reports on a like-for-like basis:

“Table 4.7: Comparison of Calculated Discounted Values of Projects 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	65.6	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.”

2.15 There were later Trowbridge actuarial reports. They are discussed below.

A. Coy disposes of its business. The 1998 IPO.

Introduction

2.16 Coy itself underwent dramatic change in the period 1995–1998. Its assets, apart from land, were sold. It was no longer a manufacturer and producer; rather its activities were limited to being a landlord and lender to other James Hardie companies, and a company defending and settling the asbestos-related claims. This came about in the following way.

¹⁷ Ex 251, pp. 4–33.

Sale of core technology and other businesses

2.17 In the year ended 31 March 1995 Coy's "core technology" was sold to a new member of the Group, James Hardie Research Pty Ltd (JH Research), for \$75m. This was in implementation, it is said, of a policy that the Group's core technology and other industrial property, and research and development activities, should be conducted by one entity only in the Group. Thereafter Coy would pay JH Research a royalty in order to use the technology.

2.18 In 1995 Coy also sold a number of companies which it controlled for a net profit of \$38.255m.

1995–96 and 1996–97 dividends

2.19 The sales referred to in paragraphs 2.17 and 2.18 were included in "Abnormal Items" in Coy's financial statements for the year ended 31 March 1996. Dividends totalling \$100,900,000 were paid during that year, a large part of which effectively came from the proceeds of these sales.¹⁸

2.20 A further half-yearly dividend of \$43.5m was declared from retained profits the next year, on 2 October 1996. During that financial year Coy made an operating loss after income tax of \$33,597,000. This was Coy's last dividend. It was declared a short time before the 1996 Trowbridge Report was received, but at a time when a draft of that Report¹⁹ may have been received.

¹⁸ The sales produced a total of \$113,255,000. After deductions totalling \$13,442,000 for "rationalisation costs" and "provision for product liability costs", the figure for abnormal items was \$97,813,000. Coy's operating profit before income tax was \$109,369m. After adjustments for income tax, the total operating profit (taking into account the two sales) was \$110,195,000. Retained profits at the beginning of the financial year had been \$57,775,000 and, after an adjustment for a change in accounting policy, the "Total available for appropriation" was \$166,734,000. (See Ex 1, Vol 1, Tab 7, pp. 104 and 108).

¹⁹ Showing an estimate of asbestos liabilities for the year ending March 1996 as \$12.468m: Ex 2, Vol 3, Tab 12, p. 667.

Transfer of other Coy assets

2.21 In 1998 a number of transactions occurred involving the transfer of assets from Coy to other companies in the James Hardie Group:²⁰

- (a) In March, a considerable quantity of Coy's plant and equipment was sold to James Hardie Fibre Cement Pty Ltd for \$37,065,498.
- (b) In June, Coy transferred trademarks used by it to JH Research Pty Ltd for \$139,500,000.
- (c) In October, the remaining assets used to carry on the fibre cement business in Australia were sold to a new operating entity, JHA. Those sales resulted in a total purchase price in favour of Coy of \$30,130,675 including \$16.5m for goodwill.

The proceeds of the sales were used to repay loans due from Coy to other members of the Group and to make loans to other members of the Group.

JHA and the IPO

2.22 The new operating entity, JHA, was not a subsidiary of JHIL. Rather it was a subsidiary of a new Dutch company, James Hardie NV ("JH NV"). At that point there was in contemplation an initial public offering ("the IPO") of 15 per cent of the shares of JH NV on the New York Stock Exchange. Despite considerable marketing efforts in the United States, that offering did not meet expectations, and was aborted.²¹ I would note that a significant difficulty which would have existed if it were attempted to make JHIL (rather than JH NV) a US-based company was that generally accepted accounting principles in the United States ("US GAAP") may well have required JHIL to indicate the full extent of the Group's asbestos liabilities, in an undiscounted amount.

2.23 The attempted 15 per cent IPO in the United States reflected the fact that in the period 1997 until 2000, much consideration was given to proposals for

²⁰ Morley, Ex 121, paras 24–34, 52–63 and 75–83.

restructuring the Group to make it US-based “to fully realise the value of JHIL, and for its growth prospects to be realised”.²² This was done by a number of proposals which were investigated under various project names: Project Blue Sky, Project X²³, Project Scully, which became Project Chelsea, Project Monica and Son of Chelsea, which appears to have become known as Project Green.²⁴

E. 2000: Movement towards the Foundation

Introduction

2.24 The situation which obtained in 2000, following the unsuccessful attempt to sell the 15 per cent interest in JH NV in the United States, was:

- (a) Coy and Jsekarb, owned by JHIL, bore the asbestos liabilities;
- (b) JHA, owned by JH NV, carried on the current business.

Consideration of ways in which the affairs of the Group might be restructured continued and in the period 2000–2001 the issue was dealt with as Project Green.

The 2000 Trowbridge Report

2.25 Whilst these issues were under consideration, Trowbridge had been engaged to prepare a further actuarial report on the Group’s asbestos liabilities, this time as at 31 March 2000. A reason for the report was an endeavour by the Group to ascertain the cost of insurance to cover the outstanding asbestos liabilities.

2.26 The resulting Trowbridge Report remained in draft form because, it is said, of differences of view between officers of James Hardie and Trowbridge as to aspects of it, particularly the “Sensitivities”.²⁵ Subject to the Sensitivities, Trowbridge’s estimate of the net present value of the Group’s asbestos liabilities

²¹ Barton, Ex 175, para. 14.

²² Project Chelsea Board Sub-Committee meeting 3 February 1998 (Ex 61, Vol 1, Tab 21, p. 139) under the heading “2. Review of Rationale for Project Chelsea”.

²³ Ex 61, Vol 1, Tab 5.

²⁴ Barton, T 2745.39–52, P. Cameron Ex 224, paras 14–15.

²⁵ The Sensitivities indicated the extent to which the estimate might vary with changes in assumptions and conditions: see Ex 2, Vol 4, Tab 14, Section 9.3 and Table 9.4.

discounted at 7 per cent pa, was \$294m.²⁶ The Report (“the 2000 Trowbridge Report”) was produced in June 2000.

2.27 In late 2000 those involved in Project Green became interested in a trust structure as the means of separating the asbestos liabilities from those of the Group as a whole. Soundings took place of prospective directors of the trust, including those who ultimately became its directors (Sir Llew Edwards, Mr Peter Jollie, Mr Michael Gill and Mr Dennis Cooper). The concept of the trust was that Coy and Jsekarb would remain responsible to claimants in respect of asbestos-related liabilities, to the extent of their existing assets, but ownership of Coy and Jsekarb would pass from JHIL to a new company unrelated to JHIL, which would operate as a trust, the principal purpose of which was to compensate victims of asbestos-related diseases.

2.28 A difficulty was that the net assets of Coy and Jsekarb appeared to be only \$214m, insufficient by \$80m to meet the estimate of liabilities in the 2000 Trowbridge Report. That was ameliorated to a degree by the fact that the 2000 Trowbridge Report estimate did not take into account the settlement of an insurance dispute which the Group had with QBE Insurance Ltd, which would produce payments by QBE totalling \$47.5m.²⁷ It was exacerbated, however, by the publication in late November 2000 at an Accident Compensation Seminar of the Institute of Actuaries of Australia of a presentation which suggested that the methods currently used to estimate the numbers of persons likely to form asbestos-related diseases were likely to result in significant underestimation. The presentation (“Watson and Hurst”²⁸) was prepared by Bruce Watson and Mark Hurst, Trowbridge actuaries.

2.29 Two further factors came into play. One was that there was in being an Exposure Draft (“ED 88”) for a new Australian Accounting Standard. ED 88 was likely to come into force at the end of October 2001.²⁹ It would require that the total of the Group’s estimated asbestos liabilities, discounted to present value, would have

²⁶ Gross present value was \$329m; insurance recoveries were \$35m.

²⁷ Hutchinson, Ex 218, Vol 1, para. 42. The \$47.5m was by way of 15 annual payments of \$3.1m. Its net present value at February 2001 was \$29.8m – Ex 339.

²⁸ Ex 3, Vol 3, Tab 1.

to be disclosed in its accounts.³⁰ This gave a degree of urgency to the need to separate out the asbestos liabilities from the Group. The second factor was a public relations aspect: if the separation could be effected at the same time as the announcement of the Group's Third Quarter results, the inclusion of information about the Group's cutting loose its asbestos liabilities – a matter which might otherwise attract undesirable publicity – would be muted by its mingling with “business news”.

February 2001 Trowbridge Report

2.30 Discussions took place with proposed directors of the trust – ultimately named the Foundation – in December 2000 and in January 2001. The proposed directors of the Foundation had sought access to the 2000 Trowbridge Report, a request to which James Hardie was unwilling to accede. Instead Trowbridge was engaged to provide an update based on applying to the figures in the 2000 Trowbridge Report the approach taken by Watson and Hurst.³¹ In the result Trowbridge produced the February 2001 Trowbridge Report in which it assessed total asbestos liabilities over periods of 10, 15 and 20 years, discounted at 7 per cent p.a., as follows:³²

	Current	Medium	High
10 years	\$181,398,631	\$184,111,303	\$191,901,891
15 years	\$237,442,862	\$246,377,538	\$264,658,133
20 years	\$269,678,188	\$286,523,135	\$317,528,334

²⁹ Ex 264.

³⁰ As at 1999 the position that JHIL had adopted in their statutory accounts in respect of asbestos liabilities was summarised in the letter from PricewaterhouseCoopers to Allen Allen & Hemsley dated 5 November 1999 (Ex 61, Vol 4, Tab 5, pp. 19–21) as follows:

“ . subsidiaries of JHIL have a liability for known asbestos related claims which results from past events and that such subsidiaries recognise that they will be named as defendants in litigation in Australia as a result of past manufacturing and marketing of products containing asbestos.
. it is probably that, in future, sacrifice of economic benefits will be required
. a provision for known claims has been recognised
. a note has been included in the statutory accounts with respect to future asbestos claims which states that a contingent liability exists in respect of the ultimate cost of any claims yet to be made which cannot reliably be measured at the present time.” (Also see Ex 277, Vol 2, Tab 1999, pp. 49, 57 and 64).

The provision made in the 1999 accounts was \$43m (see Ex 61, Vol 4, Tab 5, p. 19)

³¹ There is a serious dispute as to the manner in which this came about. It is dealt with in Chapter 24.

The estimates for 50 years were significantly higher³³:

(a) best [i.e. median] estimate - \$322,630,453

(b) high estimate - \$378,408,816

Additional funding

2.31 The proposal came before JHIL's Audit Committee on 16 January 2001³⁴ and Board of Directors on 17 January 2001.³⁵ The proposal from management at that time was for the Foundation's funding to be limited to the net assets of Coy and Jsekarb, a total of approximately \$214m.³⁶ Some directors thought that more funding should be made available. In the end the Board's resolution was that:³⁷

“The Chairman noted that the concept appeared to have some merit, but that the question of funding for the Company required more work. He requested management to continue to developing the concept and to report progress, particularly in relation to funding, at the February meeting.”

2.32 Both before and after that decision considerable effort had been expended in considering whether any of the past dealings between Coy and Jsekarb on the one hand, and JHIL on the other, might thereafter be susceptible to challenge. One reason was that Coy and Jsekarb would no longer be under the control of JHIL after the separation. Another reason had point after the January Board meeting. It was that, to the extent to which it might be found that any payment made in the past was improperly or doubtfully made, that might provide a reason to justify the payment to the Foundation of money, in addition to the value of Coy and Jsekarb's assets. The only one thought possibly so susceptible was the 1996 \$43.5m dividend, the reason being its declaration at a time when the likely results of the 1996 Trowbridge Report may have been known. The value of the \$43.5m, with compound interest to 2001, would be \$57m. It would increase the fund to \$271m.

³³ Ex 50, Tab 18, p. 163.

³⁴ Ex 121, Vol 5, Tab 60, p. 2235 and Tab 85 and Ex 123 p. 4.

³⁵ Ex 75, Vol 7, Tabs 95 and 95A.

³⁶ Ex 75, Vol 7, Tab 95A, p. 2511.

³⁷ The discussion at the Board is referred to in the evidence of Mr McGregor, Ex 80, para. 22 and at T1533.13–52 and T1576.54–58. The Board's resolution is at Ex 75, Vol 7, Tab 95, p. 069.

2.33 In the event, but without explicit reference to the \$43.5m dividend, the figure announced as the funding for the Foundation was \$293m.

F. Establishing the Foundation

2.34 On 15 February 2001 the JHIL Board resolved to proceed with separation. The formal steps necessary to establish the Foundation commenced late on that day and concluded on the morning of the next. A great deal of prior preparation had occurred. The events which took place were in essence:

- (a) Medical Research and Compensation Foundation Ltd (“MRCF”), a company limited by guarantee, became the trustee of the MRCF Trust.
- (b) MRCF held 50 per cent of the shares in Coy, with another new company MRCF Investments Pty Ltd holding the other 50 per cent. MRCF Investments was a wholly owned subsidiary of MRCF.
- (c) Coy owned all the shares in Jsekarb.
- (d) In return for payments to be made over time by JHIL to each of Coy and Jsekarb, JHIL was to be indemnified by Coy and Jsekarb against any asbestos-related liabilities which JHIL might have, and Coy and Jsekarb could make no claim against JHIL arising from any past dealings with it (including payment of dividends or management fees).
- (e) Inter-company loans from Coy to JHIL were formalised.
- (f) New directors were appointed to the trust, Coy and Jsekarb.

Announcement of the separation

2.35 This was done on 16 February 2001 at the time of the announcement of JHIL's third quarter results. JHIL's Media Release,³⁸ a copy of which was sent to the ASX, included the following:

"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."

...

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.

...

³⁸ Ex 1, Vol 7, Tab 66, pp. 2119–2120.

When all future claims have been concluded, surplus funds will be used to support further scientific and medical research on lung diseases.

...”

2.36 Other statements about the effect of separation were made in accompanying documents,³⁹ and in the oral presentation to the media by Mr Macdonald, JHIL’s Chief Executive Officer⁴⁰ and a member of the Board of Directors.

G. The increase in the asbestos liabilities

2.37 The confidence expressed in the Media Release was shortlived. Trowbridge was engaged by the Foundation to provide actuarial services to Amaca and Amaba. Its first report to the Foundation was given to the Foundation in draft form⁴¹ on 5 August 2001. On 16 August 2001, the final version of this report was sent to the Foundation (“the August 2001 Trowbridge Report”).⁴² The final report valued the asbestos related disease liabilities of Amaca, as at 30 June 2001, at a net present value of \$574.3m at a discount rate of 6 per cent per annum.

2.38 This was an enormous increase from the figures contemplated in the February 2001 Trowbridge Report. If they are compared on the basis of the same discount rate, the value of all future payments increased by 65 per cent.⁴³ Trowbridge, when asked why there was such a difference, said that if it had been provided by JHIL with its claims data for the 9 months to December 2000, the figures would have been much higher. In particular, at a 6 per cent per annum discount rate the figure for all future payments would have been \$486,035,000 rather than \$355,267,000.⁴⁴

³⁹ Ex 1, Vol 7, Tab 66, pp. 2124–2125 and 2162–2168.

⁴⁰ Ex 300 and 301.

⁴¹ Ex 50, Tab 31, p. 257. The total liabilities were assessed at \$640.9m; \$574.3m was arrived at after deducting \$66.6m for insurance recoveries. The insurance recoveries did not include the QBE settlement amounts.

⁴² Ex 3, Vol 3, Tab 8.

⁴³ Ex 3, Vol 3, Tab 4, p. 466.

⁴⁴ Ex 3, Vol 3, Tab 6, p. 472.

2.39 A further deterioration in the actuarial estimation of the prospects of the Foundation was seen in Trowbridge's report of 28 October 2002 ("the 2002 Trowbridge Report"⁴⁵). It estimated the potential liabilities of the Foundation at \$751.8m discounted at 6 per cent per annum.⁴⁶

2.40 Trowbridge's next report was made in September 2003 ("the 2003 Trowbridge Report"⁴⁷). It dealt with the situation as at 30 June 2003, and estimated the potential liabilities at \$1,089.8m discounted at 5 per cent per annum.⁴⁸

H. Foundation's actual outgoings

2.41 In addition to actuarial assessments predicting the long term future, the net litigation costs of the Foundation – its actual outgoings – have much exceeded the figures estimated. The Foundation's financial year now ends on 30 June, and its net litigation costs for Amaca have been:⁴⁹

YE 30.6.2002	\$42.5m
YE 30.6.2003	\$53.1m
YE 30.6.2004	\$53.0m

It is obvious that if the Fund continues to pay out at that rate, it will be exhausted in a few years, even taking into account the income which it might earn on the diminishing assets.⁵⁰

2.42 It should be borne in mind that the funds of Amaca/Amaba were not \$293m in money in hand. About a sixth was in that category, the remainder being the value of the leased properties and of the loan to JHIL, together with the present value of the QBE settlement and the amounts payable under the Deed of Covenant and Indemnity. There was also some insurance but its true value has proved difficult to assess.

⁴⁵ Ex 3, Vol 3, Tab 9.

⁴⁶ A total of \$838m less \$86.1m recoverable from insurers: Ex 3, Vol 3, Tab 9, p. 552.

⁴⁷ Ex 3, Vol 3, Tab 9.

⁴⁸ A total of \$1,205m, amounts recoverable from insurers being assessed at \$115.2m. Ex 3, Vol 3, Tab 10, p. 613.

⁴⁹ Ex 339.

⁵⁰ Towers Perrin letter of 17 February 2004 to Mr Cooper, Ex 9, p. 3.

I. The move to the Netherlands: JHI NV replaces JHIL

Introduction

2.43 During 2001, but after the establishment of the Foundation and the separation of Amaca/Amaba from JHIL, steps were taken to substitute a new Dutch company JHI NV for JHIL as the holding company in the Group. This was effected pursuant to a scheme of arrangement under s 411 of the *Corporations Act 2001*(Cth).⁵¹

The scheme of arrangement

2.44 The main features of the scheme of arrangement and related reduction of capital were summarised in the materials before the Supreme Court⁵² as being:-

- (a) All members of JHIL whose address in the register of members was Australia, New Zealand, the United Kingdom or the United States of America were to receive an interest in shares in JHI NV in exchange for their shares in JHIL. The interest in JHI NV was to be held in the form of CHESS Units of Foreign Securities (CUFS) to allow trading on the ASX.
- (b) All other members of JHIL would receive the cash proceeds from the sale of their entitlement to interests in JHI NV. There were said to be approximately 100 such members with a combined holding of approximately 0.1 per cent of JHIL's issued capital.
- (c) JHIL would become a wholly owned subsidiary of JHI NV;
- (d) JHIL would transfer all its shares in JH NV, the owner of the operating businesses and assets of JHIL and its controlled entities, to JHI NV at market value (based on the market value of the James Hardie Group).

⁵¹ The *Corporations Act 2001* had come into force on 15 July 2001.

⁵² See affidavit of Donald Ewen Cameron sworn 9 August 2001, para. 14: Ex 278, Vol 1, Tab 2, p. 5.

- (e) JHIL would declare and pay a dividend to JHI NV and would effect a reduction of capital in respect of all its shares then held by its new parent, JHI NV, under which \$775,326,261.04 (\$1.72 per share) was distributed to JHI NV. The reduction was conditional on JHI NV subscribing for partly paid shares, and would be effected without cancelling any shares.
- (f) JHI NV would subscribe for partly paid shares in JHIL. Under the terms of issue of the partly paid shares, JHIL could call on JHI NV to pay any or all of the remainder of the issue price of the partly paid shares at any time in the future and from time to time. The callable amount under the partly paid shares would be equal to the market value of the James Hardie Group less the subscription monies already paid up.

2.45 The purposes of the scheme were said to be to position the Group for further international growth and to improve the after tax returns to shareholders. Grant Samuel & Associates Pty Limited (“Grant Samuel”) had been retained to provide an independent expert’s report on the proposed restructure and its view, in summary, was⁵³:

“In Grant Samuel’s opinion, the proposed restructure is, on balance, in the best interests of James Hardie Industries’ shareholders as a whole. The transaction is essentially neutral insofar as shareholders will have the same underlying economic interest in the business of James Hardie Group before and after the proposed restructure. The primary benefit of the proposed restructure is an increase in after tax returns to shareholders. This benefit is a tangible and material gain relative to the status quo. IN the absence of some form of restructuring, James Hardie Industries faces an increasing corporate tax rate that could reach almost 50% in the near future. A “do nothing” approach would ultimately have negative consequences on shareholder value.

There are other benefits such as a more attractive “currency” for scrip acquisitions but these are not regarded as substantial. There are a number of costs, disadvantages and risks arising from the proposed restructure. Key issues for shareholders will be impacts on corporate governance and liquidity. While these factors are not inconsequential, and some may be significant for some shareholders, they do not, in Grant Samuel’s opinion, outweigh the benefits for shareholders as a whole.”

⁵³ Ex 278, Vol 1, Tab 3, p. 261.

The proceedings in the Supreme Court of New South Wales

2.46 On 23 August 2001 Justice Santow ordered the convening of a meeting of members of JHIL, to be held in Sydney on 28 September 2001. The resolution was passed on that day by a very substantial majority, notwithstanding that much of the apparent justification for it had gone because of the announcement, on the evening before the meeting, of proposed changes reducing to zero the withholding tax on dividends paid from the United States to Australia.

2.47 The application was finally approved by Justice Santow on 11 October 2001. The result was that the shares in JHIL were all held by JHI NV, and consisted of⁵⁴:

- (a) 270 fully paid ordinary shares
- (b) 100,000 ordinary shares paid to \$50, but on each of which JHIL was liable to pay a sum to be calculated as:

$$\frac{\text{JHI NV Share Price} \times 450,771,082}{100,000}$$

This sum was likely to be in the order of \$1.9 billion.

2.48 During the hearing Justice Santow had raised the question of JHIL's ability to satisfy any asbestos-related liabilities, and had been assured that JHIL's ability to call on the partly paid shares would satisfy that liability.

Matters not drawn to Justice Santow's attention

2.49 There are matters which were not drawn to Justice Santow's attention but which it is said should have been. Three are of some importance.

2.50 The first concerns the communications from the Foundation about the inadequacy of its initial funding, culminating in the Foundation's letter dated 24 September 2001. That letter, from Sir Llew Edwards to Mr Macdonald, contended that the Foundation, in light of the August 2001 Trowbridge Report, was not "fully

⁵⁴ See Ex 276, Tab 6, p. 8 and Ex 278, Vol 2, Tab 11, p. 89 and Ex 17, p 40, para. 221(c).

funded” and that it would not be able to meet the claims of all asbestos victims. There is a dispute about the date the letter was sent, and received, and in particular whether it had been received well before the time when the order approving the scheme of arrangement was made on 11 October 2001.

2.51 The second matter was the existence of the Deed of Covenant and Indemnity executed on 16 February 2001 and the existence in that document of a “put” option, i.e. an arrangement whereby Amaca could be required to acquire for a nominal consideration all the issued shares in JHIL. There was no way, of course, that Amaca would ever have the funds to satisfy the amount which might become payable on the partly paid shares in JHIL.

2.52 The third matter was whether JHIL then had in mind, either as a formed intention or as a real possibility, the intention to cancel the partly-paid shares.

J. The attempts to resolve matters between the Foundation and JHI NV/JHIL

2.53 In the period after the implementation of the scheme of arrangement in late 1991 until March 2003, the Foundation made a number of endeavours to persuade the James Hardie Group to recognise an obligation to provide further funds to it, and to pay a substantial amount. James Hardie was unwilling to pay anything, but was prepared to offer sums, variously described, effectively reaching \$20m, in order to arrive at a “negotiated settlement” of the claims by the Foundation.

2.54 During that period JHI NV came under pressure to separate itself even more from the Foundation, and asbestos claims. In a paper prepared for the JHI NV Board meeting of 11 March 2003, Mr Shafron said:⁵⁵

“... recent experience (June to October 2002) in renegotiating the terms of the Company’s long term notes indicates that the mere existence of arrangements with the Foundation causes anxiety among certain lenders at least and prejudices the position of and the terms available to the Company.”

⁵⁵ Ex 148, Vol 2, Tab 24, p. 531.

2.55 There was a sense of urgency to resolve the position before the end of JHI NV's financial year on 31 March 2003. Two proposals were considered:

- (a) An agreement with the Foundation whereby it (via Amaca/Amaba) would acquire the shares in ABN 60, and indemnify JHI NV in respect of any asbestos liabilities of ABN 60, in return for an increase in the funds of ABN 60 of the order of \$20m.
- (b) If necessary, an exercise of the put option in the February 2001 Deed of Covenant and Indemnity.

2.56 Whilst the negotiations with the Foundation were proceeding, JHI NV and ABN 60 agreed to cancel the partly paid shares. Notification was given to the ASIC. It would take effect on 31 March 2003,⁵⁶ but JHI NV and ABN 60 did not otherwise make it public.

2.57 JHI NV's desire to hand control of ABN 60 over to the Foundation foundered on 17 March 2003 when the Foundation's solicitors advised⁵⁷ that the Foundation was not prepared to accept the proposal then in mind, and would very carefully scrutinise "any earlier actions taken by ABN 60 if the put option were exercised".

2.58 A flurry of activity followed to seek an alternative course. In the event a new Foundation was established on 31 March 2003 to acquire the shares in ABN 60, and to use that company's funds to pay the amounts due to Amaca/Amaba under the Deed of Covenant and Indemnity. The funds of ABN 60 were augmented by JHI NV to the extent of about \$18.5m. Mr Morley, JHI NV's Chief Financial Officer, calculated that on a "worst case scenario" the possible liability for asbestos-related claims by former employees of ABN 60, not covered by insurance, was approximately \$10.76m, "leaving a surplus" of approximately \$7.73m.⁵⁸ This calculation makes no allowance for any liability to the Foundation or Amaca/Amaba.

⁵⁶ *Corporations Act*, s 256C(3).

⁵⁷ Ex 187, Vol 3, Tab 70.

⁵⁸ Morley, Ex 121, p. 49, para. 323.

2.59 The result was that ABN 60 was now completely removed from the James Hardie Group. Its parent, its only corporate relative, was the ABN 60 Foundation.

K. Deed of Rectification

2.60 During the remainder of 2003 the relationship between the Foundation and JHI NV soured further. An examination of the documentation executed at the time of the creation of the ABN 60 Foundation indicated that JHI NV might be liable to indemnify ABN 60 for claims made by Amaca/Amaba. In the result a Deed of Rectification⁵⁹ was entered into between JHI NV and ABN 60 on 3 February 2004 to cure supposed errors in the drafting of a Deed of Covenant, Indemnity and Access between those parties entered into at the establishment of the ABN 60 Foundation.

L. The Inquiry

2.61 The very large discrepancy between the initial funding of the Foundation and the actuarial assessments of its liabilities, gave rise to controversy resulting in the establishment of this Inquiry.

2.62 As I have noted, although the contention of inadequacy in the initial funding was much in contest at the commencement of the Inquiry, it is now accepted that there is a very significant inadequacy, although the legal obligation to provide for it is not accepted.

⁵⁹ Ex 42, Tab 39, p. 254.

Part 2 – Term Of Reference 1

Chapter 3 – The Foundation’s Present Financial Position

A. Issues

3.1 This Chapter discusses Term of Reference 1:

“The current financial position of the Medical Research and Compensation Foundation (“MRCF”), and whether it is likely to meet its future asbestos related liabilities in the medium to long term;”

There are five aspects to which it is necessary to direct attention:

- (a) the present assets of Amaca and Amaba, leaving out of account potential recoveries under, or in respect of, insurance policies;
- (b) the amount which may be expected to be recovered under, or in respect of, insurance policies;
- (c) the extent of the liabilities of Amaca/Amaba;
- (d) the likely life of the Foundation;
- (e) additional assets, if any.

B. Amaca and Amaba’s assets

3.2 At the establishment of the Foundation the assets of Amaca totalled \$293.5m and consisted of cash, securities and working capital (\$47.9m), property (\$66.8m), the discounted values of the settlement amount from QBE Insurance (\$29.8m) and the amount payable under the Deed of Covenant and Indemnity (\$80.3m)¹ and the amount of the loan to JHIL (\$68.7m).

3.3 Since then the properties have been sold to Multiplex Limited, the sale being completed on 24 March 2004 for \$70m.² The price was payable in

¹ This was the estimate on 16 February 2001. On 23 February Mr Harman raised the NPV of the payments to \$84.5m, but nothing turns on this : see Ex 69.

² Cooper Ex 6 para. 23; T 19.40–20.3.

instalments, those remaining being payable in December 2004 and March 2005³ with interest payable in the interim.⁴

3.4 The loan to JHIL was repaid in mid-2001.⁵

3.5 The assets of Amaca at various dates since the establishment of the Foundation appear from a summary extracted from the unaudited balance sheets for Amaca and Amaba as at 30 June 2004, prepared by Mr Cooper.⁶

[Figures in \$ million]	Feb	June	June	June
[Rounding may affect summations]	2001	2002	2003	2004
Cash, Securities and Working Capital (5)	47.9	87.4	43.6	22.2
Property (6)	66.8	72	72	0
Multiplex Receivable (7)				48.0
QBE Receivable (net) (2)	29.8	26.2	25	22.3
C&I Receivable (2) & (4)	80.3		91.6	81.6
Loan (JHIL) (3)	68.7			
Total Assets (1)	293.5	185.6	232.2	174.1
Provision for notified claims (8)	(43)	(73.9)	(69.9)	(62.3)
Net Assets	250.5	111.7	162.3	111.8

Notes:

1. These extracts from Amaca's balance sheet at each of these various dates have been adjusted to clearly reveal the net present value of the C&I Deed and QBE income streams. To comply with accounting standards, the balance sheets in Amaca's audited financial statement accrue a liability for deferred income equivalent to the NPV of these income streams. In order to make the NPV of these income streams visible at each relevant balance date, the liabilities for deferred income have been excluded.
2. The payment streams for QBE and C&I are discounted at the then prevailing bond rate to calculate an NPV for the accounts.
3. JHIL paid back the loan in 2001.
4. In the 2001/2 financial year, accounting advice was received that the C&I payment stream could not be booked as an asset; this was reversed in 2003 following legal advice.
5. A settlement receivable for \$3m has been included in Securities for 2003 and 2004.
6. From 2002, properties were no longer depreciated.
7. Deferred settlement of property sale to Multiplex.
8. Provisions for notified claims to be updated for June 30, 2004 financial year end however preliminary figure is \$69m.”

³ T 19.53–55.

⁴ T 19.57–58.

⁵ Cooper Ex 6, para. 23.

⁶ Ex 339.

3.6 Amaba's summarised Balance Sheet for the same period is:⁷

“

[Figures in \$ '000] [Rounding may affect summations]	Feb 2001	June 2002	June 2003	June 2004
Cash and Working Capital	(293)	1,752	1,759	1,516
QBE Receivable (net) (2)			982	876
C&I Receivable	3,947		2,841	2,706
Loan (JHIL)	2,204			
Total Assets	5,858	1,752	5,582	5,098
Provision for notified claims:		(889)	(712)	(710)
Net Assets	5,858	863	4,870	4,388

Notes:

1. Accounting treatments are as for Amaca.
2. Amaba's entitlement to QBE receipts was formalized and implemented in financial year 2002.”

3.7 In the result my view is that, as at the end of June 2004:-

(a) the total assets of Amaca and Amaba were:

Amaca	174.100
Amaba	<u>5.098</u>
	\$179.200m

(b) provision by each company for claims already notified was:

Amaca	62.300
Amaba	<u>0.710</u>
	\$63.010m

(c) the net assets of the companies, after taking into account the provisions for claims already notified, were:

Amaca	111.800
Amaba	<u>4.388</u>
	\$116.19m

3.8 This is, of course, a disastrous position for the Fund. It means that almost 40 per cent of the Fund's net assets have been used up in 3½ years of the Fund's life. Another 20 per cent is provision for claims already notified. The consequences for the life of the Fund are very serious.

⁷ Ex 339. The total of Amaca and Amaba's assets at February 2001, according to the figures in paragraphs 3.5 and 3.6, exceeds \$293m, but the manner of arriving at that figure did not even entirely satisfactorily appear.

C. Insurance recoveries

Background

3.9 In February 2001 the MRCF “inherited” the extant insurance arrangements pertaining to Coy and Jsekarb.⁸ The Group’s insurance program was “run and controlled” by JHIL. Subsidiaries did not obtain separate insurance cover and “Insurance for asbestos risks was part of the Group’s general liability cover”.⁹ The documentary records available to the Foundation in relation to these arrangements remain incomplete.¹⁰

3.10 On 19 January 2001, prior to the separation of Coy and Jsekarb from JHIL, Mr Attrill retained Phillips Fox to “undertake a process of identifying, collating and advising on the non-QBE insurance policies”.¹¹ Phillips Fox continued with that project after the establishment of the Foundation¹² and in subsequent advice dated 1 March 2001 alerted the Foundation to a number of “gaps” in JHIL’s insurance arrangements, including:

- “(a) gaps in insurance records: the underwriters were not identified or were not clearly identified for every period of insurance;
- (b) the structure of the insurance program was not clear from the available documents;
- (c) only limited information was available on policy coverage in the 1981–1982 and 1985–1986 policy periods and relevant wordings were missing; and
- (d) in some years (particularly, the 1986/87 policy period) there were significant doubts as to whether the contracts were ever fully placed.”¹³

⁸ Hutchinson, Ex 218, p. 6, para. 17.

⁹ Hutchinson, Ex 218, p. 6, para. 15.

¹⁰ Hutchinson, Ex 218, p. 6, para. 17. There is a difference of view between JHI NV/ABN 60 and the Foundation on why this has occurred. It is unnecessary to resolve it.

¹¹ Attrill, Ex 56, p. 39, para. 156.

¹² Attrill, Ex 56, p. 39, para. 158.

¹³ Hutchinson, Ex 218, p. 7, para. 21; Ex 218, Tab 8, pp. 77–189 at p. 79. See also letter of instructions: Hutchinson, Ex 218, Vol 1, Tab 9, pp. 72–76.

3.11 Mr Gill resigned as a director of the Foundation on 26 February 2003 and Mr Hutchinson was appointed a director on that date.¹⁴ Mr Hutchinson made a suggestion prior to joining the Foundation that a review of the Foundation's insurance portfolio be undertaken. Mr Marshall Phillips (an experienced former insurance broker) was appointed to assist with this task.¹⁵ Since his appointment Mr Phillips has been co-ordinating the reconstruction of the Foundation's insurance records and other aspects of its Insurance Recovery Project.¹⁶

3.12 For present purposes, the insurance policies relevant to the Foundation date from 1930, and fall into five periods:

- “(a) from the early 1930s to 1976, when the James Hardie companies were predominantly insured by QBE and its predecessor, the Queensland Insurance Co Ltd.;
- (b) from 1976 to 1981 when insurance was placed with various insurers being VACC, AIU (now AIG), GRE (now Zurich), Preservatrice (now HIH, in liquidation), Cigna (now ACE), INA (now ACE) and HIH (in liquidation);
- (c) from 1981 to 1986, when insurance was placed with various Lloyds syndicates and companies in the London market from time to time on an occurrence basis;
- (d) from 1986 to 1997 when insurance was apparently placed [with] various Lloyds syndicates and companies in the London market on a claims made basis; and
- (e) post-1997 when no insurance cover for asbestos claim made against James Hardie exists.”¹⁷

3.13 In relation to these periods:

- (a) From 1930 to 1976, “James Hardie” companies were insured “mainly under various policies issued by QBE” (and its predecessor the Queensland Insurance Co Ltd). JHIL's rights under these

¹⁴ Mr Hutchinson is a solicitor with an extensive background in advising on corporate transactions, mergers and acquisitions. He is a former managing partner of Freehill, Hollingdale and Page. He holds or has held numerous board appointments including a number as chairman. He was the counsel for Lloyds from 1981 to 1998 and Lloyd's Australia representative: Hutchinson, Ex 26, p. 1, paras 1–8.

¹⁵ Hutchinson, Ex 26, p. 3, para. 19; Hutchinson, Ex 218, p. 8, para. 26.

¹⁶ The MRCF established an Insurance Recovery Project team in mid-2003 to investigate systematically the provenance of various insurance arrangements, with a view to optimising insurance recoveries. Cooper, Ex 6, para. 22, Hutchinson, Ex 218, p. 2, para. 9, pp. 8–10, paras 26–28. The activities undertaken by the Insurance Recovery Project team are outlined in some detail in Mr Hutchinson's statement of 31 May 2004: Ex 218, pp. 8–10, paras 26–28.

¹⁷ Hutchinson, Ex 218, p. 13, para. 34.

policies were the subject of a commutation in June 2000 with QBE¹⁸ for a sum of \$47.5m which will continue to be payable to the Foundation in annual instalments of \$3.1m until 2014.¹⁹

- (b) From 1976 to 1981, insurance was placed with “various Lloyds syndicates and companies in the London market”. These policies are on “an occurrence” basis and are more complex than the previous arrangements with different “layers” of cover with different insurers accepting different percentages of risk.

The prima facie consequence of having “occurrence-based” policies is that only claims by persons who were exposed to (in the sense of inhaled) asbestos fibres during the period of insurance would fall within the policies. The investigation carried out by the Insurance Recovery Project team indicates that only \$28m of available cover exists and this is limited by a “time on risk” practice.²⁰ The Foundation does not have any knowledge of how this “time on risk” practice developed and the extent to which it is legally obliged to accept the practice, and is seeking legal advice on the matter.²¹ The balance of cover is either exhausted or with insolvent insurers such as HIH.²²

- (c) From 1981 to 1986, cover was placed with CE Heath and various Lloyds syndicates and companies in London on “an occurrence” basis. According to Mr Hutchinson it appears that the aggregate

¹⁸ The documentation is to be found in Ex 75, Vol 5, Tabs 43–44, pp. 1380–1415.

¹⁹ Hutchinson, Ex 218, p. 15, paras 40–43.

²⁰ Hutchinson, Ex 218, p. 16, paras 44–48. This approach to settling claims is described by Mr Hutchinson: Ex 218, pp. 20–21, paras 61–68. The practice arises in respect of claimants who may have been exposed to asbestos over a long period of time in circumstances where the “*occurrence-based*” policies only cover exposure between 1976 to 1981 and 1981 to 1986. Plaintiffs may have suffered exposure outside these periods and the policies would not respond to such exposure. A practice developed between JHIL and its insurers whereby each insurer was asked to contribute on a proportional basis based on the plaintiff’s period of exposure to asbestos. This is described as a “*time on risk*” basis. Mr Hutchinson described the implications of this “*time on risk*” approach as being two-fold:

“ (a) *only a percentage of each claim will be compensated under each policy. If a plaintiff has been exposed to asbestos over many years, possibly decades, the percentage paid out under each policy will be small; and*
(b) *the number of claims which will need to be indemnified will need to be very large to exhaust the available indemnity under a policy.*” See Ex 218, pp. 2–21, para. 64.

²¹ Hutchinson, Ex 218, p. 20, para. 63; p. 21, para. 68.

²² Hutchinson, Ex 218, p. 17, para. 49.

value of cover for this period is \$475m.²³ Approximately 50% of this cover is underwritten by Equitas.²⁴ Additional factors of concern relate to identification of insurers, inability to locate policy documents and indeed whether insurance was actually placed. The “time on risk” practice is also a limiting factor.

- (d) From 1986 to 1997, the policies are “claims made” policies which only respond to claims made by asbestos victims during the period of insurance. Accordingly, the time to notify any claims expired well before the establishment of the Foundation. It is suggested that there may be some relief available to “out of time” claimants by virtue of *Insurance Contracts Act 1984* (Cth) s 54. This view is untested. In addition, insurers adopted a further protective measure of introducing retroactive clause into policies requiring both an occurrence after the retroactive date and a claim within the currency of the policy.²⁵

There is a further issue as to whether the insolvency of HIIH presents difficulties with regard to “claims made” policies, namely, the application of s 562A of the *Corporations Act 2001* (Cth).²⁶ It is suggested also that there are difficulties in gaining access to the relevant policies from the joint liquidator of HIIH.²⁷

In any event, Trowbridge has estimated the total expected settlement costs for all claims reported in this period at \$64.8m and total expected legal costs for the period at \$22.37m.²⁸

- (e) Post-1997. The Foundation has been advised by its brokers that there are no policies which respond to asbestos related claims due to

²³ Hutchinson, Ex 218, p. 17, para. 51.

²⁴ Hutchinson, Ex 218, pp. 17–19, paras 52–55.

²⁵ Hutchinson, Ex 218, p. 21, para. 70–71; MRCF Initial Submissions: Chapter III, pp. 75–76, paras 3.51–3.52.

²⁶ Hutchinson, Ex 218, p. 22, para. 72; see also MRCF Initial Submissions: Chapter III, pp. 76–77, paras 3.53–3.60.

²⁷ Hutchinson, Ex 218, p. 22, para. 73.

²⁸ Cooper, Ex 295, p. 5, para. 10 and Annexure C, pp. 16–19 at pp. 18–19.

the express exclusion of asbestos liability in the policy wording from 1997. It is investigating this matter further.²⁹

Recoveries going forward

3.14 It is against that background that the prospect of future insurance recoveries falls for consideration. In this regard, there are three views to be considered, namely those of Trowbridge, KPMG (Mr Wilkinson), and the Foundation (Mr Hutchinson).

3.15 **Trowbridge** - The Trowbridge estimate is to be found in the 2003 Trowbridge Report³⁰. This provided a projected “potential exposure for both known and potential asbestos-related claims at 30 June 2003 as being \$1,089.8m”. The estimate was arrived at after deducting \$115.2m,³¹ as amounts recoverable from insurers.³² That is the discounted present value of payments projected to arise in all future years, using a discount rate of 5% per annum. The estimate represents the net present value of future recoveries for general liability claims. It does not include claims by former employees.³³

3.16 The analysis supporting Trowbridge’s estimate is in Section 6 of the 2003 Trowbridge Report³⁴ and was summarised in Trowbridge’s Submissions as follows:³⁵

“In estimating Amaca’s and Amaba’s future insurance recoveries for the June 2003 Report, Trowbridge took into account the following:

- (a) the type of insurance policies held by Amaca and Amaba;

²⁹ Hutchinson, Ex 218, pp. 22–23, paras 74–78.

³⁰ Ex 3, Vol 3, Tab 10, pp. 607–672.

³¹ This estimate makes no allowance for future recoveries arising out of the settlement with QBE Insurance Limited: Ex 3, Vol 3, Tab 10, p. 614, for the period of cover 1965–1976 (QBE had agreed to pay a total of \$46m over 15 years at the rate of approximately \$3.1m per year).

³² Ex 3, Vol 3, Tab 10, p. 613, Table 2.

³³ See Ex 3, Vol 3, Tab 10, p. 620 (Bullet point 3), p.613, Table 2. According to Mr Hutchinson most workers compensation claims are met by policies issued by MMI (now Allianz): Ex 218, pp. 30–31, paras 106–110. Allianz either accept risk or act as agent for WorkCover although there are some residual costs not covered by these policies such as “*ex-gratia*” payments. Trowbridge evaluated this residual exposure but noted that it is “*relatively small*”: Ex 3, Vol 3, Tab 10, p. 621. There was some concern regarding the NSW Court of Appeal decision in *Orica Limited & Anor v CGU Insurance Limited* [2003] NSWCA 331, namely, “*that common law liability for an injury (in that case a dust disease) that occurred after the period for which the policy of insurance was in force was not covered by the terms of the policy ...*”. – see the Explanatory Note relating to the Workers Compensation Legislation Amendments Bill 2004, p. 2, para. (d). This issue has now been addressed by the amendments contained in the *Workers Compensation Legislation Amendment Act 2004* No 56 which inserted s151AAA into the *Workers Compensation Act 1987* No 70.

³⁴ Ex 3, Vol 3, Tab 10, pp. 644–646.

³⁵ Trowbridge Initial Submissions, pp. 42–44, paras 119–129. This is a plausible explanation of the methodology but I doubt that the actual evidence in the Inquiry goes so far.

- (b) the periods of exposure for which Amaca and Amaba had insurance coverage and with which insurer;
- (c) the limits of indemnity on those insurance policies and whether those limits had been reached; and
- (d) the details of ARD claims settled by James Hardie between 1993 to 2002, including the period of exposure to asbestos reported in each settled claim and the existence and extent of insurance coverage during those periods of reported exposure.”

3.17 The various Trowbridge estimates are summarised in the following Tables from that Report:

“ **Table 2 – Projection of potential exposure for both known and potential asbestos-related claims at 30 June 2003** ³⁶

	\$m	\$m
General Liability Claims (including legal costs)		
- arising from mesothelioma	968.3	
- arising from other asbestos-related diseases	218.9	1,187.2
Workers' compensation claims		16.3
Additional claims involving Waterside Workers		1.5
Amounts recoverable from insurers		(115.2)
Total		1,089.8

Table 6.1 - Insurance limits¹ (\$ 000) ³⁷

	QBE	AIG	Various	CIGNA	Heath
Exposure Years	1965 - 76	1976 - 79	1979 - 80	1980 - 81	1981 - 86
Amaca Pty Ltd	13,500	6,000	15,000	50,000	Unlimited
Amaba Pty Ltd	11,400	4,000	2,000	50,000	Unlimited

¹ CIGNA and Heath limits apply across all companies in the group

Table 6.2 - Estimated past recoveries from insurers (\$000) ³⁸

	Harflex	QBE	AIG	Various	CIGNA	Heath
Claimed against insurer ¹	92,233	40,932	26,020	7,470	5,551	16,235
Amount of Cover Used	n/a	33,336	26,020	7,470	5,551	16,235

¹ Estimated amounts from claim database ”

³⁶ Ex 3, Vol 3, p. 613.

³⁷ Ex 3, Vol 3, p. 644.

³⁸ Ex 3, Vol 3, p. 645.

3.18 **KPMG–Wilkinson** - In his evidence, Mr Wilkinson of KPMG Actuaries Pty Ltd made several observations relevant to insurance recoveries, including:

- (a) “... contracts written on a claims made basis will provide little by way of future recoveries”.³⁹
- (b) “... the failure of HIH and the uncertainty surrounding the availability and applicability of cut-through arrangements make recoveries under the period 1990–1997 uncertain and possibly unlikely, depending on the interpretation of s562A” of the Corporations Act 2001 (Cth).
- (c) “The discounted value of open claims, using my assessment, is \$78m and it is also perhaps worth reflecting that total gross payments ever made, up to June 2003, were of the order of \$190m. These two figures should be compared with cover of in excess of \$1bn placed in the period 1986–1997. All in all, I find it difficult to conceive how this extra cover can be made use of in the future, given that most of the outstanding claims provisions relate to IBNR claims.”
- (d) “As such the claims made policies, in my opinion, have very limited potential for further recovery and protection to the liabilities, particularly in relation to IBNR claims.”⁴⁰

3.19 Mr Wilkinson, in focusing his analysis on contracts written on a loss occurring basis, concluded that the discounted value of his central estimate of insurance recoveries was \$160.8m (undiscounted value \$336.6m).⁴¹ Mr Wilkinson noted:

“The extent to which this is actually recoverable will depend greatly on how the actual exposures of the individual claimants is allocated to occurrence years”.⁴²

3.20 **Foundation/Hutchinson** - Mr Hutchinson’s evidence was based on his understanding of the work of the Insurance Recovery Project Team with regard to expected future insurance recoveries. It is to the following effect:

- “ (a) recoveries under the insurance policies held by the Foundation in relation to its asbestos liabilities will meet only a small percentage of future claims. It is impossible to quantify likely future recoveries. However, it is the present view of the Insurance Recovery Project team that such recoveries will not exceed 12% of claims paid and may well be less. The basis for that view is:
 - (i) 12% is the percentage projected by Trowbridge for recoveries in Table 6.3 of the 2003 Trowbridge Report (at Ex 2, Folder 3, Tab 10)

³⁹ Ex 312, p. 7, para. 35.

⁴⁰ Ex 312, p. 7, paras 36–38.

⁴¹ Ex 312, p. 9, para. 50 and see Wilkinson, Ex 252, p. 133, Appendix N.

⁴² Ex 312, p. 9, para. 50.

in respect of those policies which the Insurance Recovery Project team considers are still available to the Foundation. The relevant policies are described as “various”, “Cigna” and “Heath” by Trowbridge and correspond to the 1976 to 1981 and 1981 to 1986 policy periods;

- (ii) the Foundation’s experience since its inception is that it is not quite recovering 12% of claims paid...;
- (iii) there is no basis for the Foundation to think over the long term that those recoveries will increase although recoveries on an annual basis may fluctuate; and
- (iv) indeed, there are reasons to be concerned that recoveries under the Heath policies may be more limited in the future.

This view does not include the payments from QBE.”⁴³

3.21 It is obvious that the views expressed in relation to insurance recoveries are estimates, incorporating value judgements. The passage of time since the inception of the policies must affect, as a practical matter, the prospects of successful recoveries. Recognising that Mr Hutchinson’s estimate that insurance recoveries will not exceed 12 per cent of claims has significant elements of uncertainty, it is yet in the same range as Mr Wilkinson’s estimate of \$160.6m as the net present value of insurance recovery. In my opinion an estimate in line with that of Mr Hutchinson is appropriate, based as it is on the experience of the Foundation and the work so far of the Insurance Recovery Project Team.

3.22 Resolution of this issue has a somewhat academic air, because insurance recoveries would not come all at once but only at or after payments out to claimants by Amaca and Amaba as claims were settled in future years. The level of payments out in the short term is so high - see below - that the funds of those companies would be exhausted before the insurers would be called on to pay.

HIH Claims Support Scheme

3.23 I should mention also the HIH Claims Support Scheme.⁴⁴ This Scheme was introduced in May 2001 by the Commonwealth to provide assistance to policy holders experiencing hardship as a result of the HIH collapse. Details of the Scheme

⁴³ Hutchinson, Ex 218, pp. 4–5, paras 12–13.

⁴⁴ See Ex 294.

are outlined in Mr Hutchinson's statement of 23 June 2004⁴⁵. A sum of \$640m has been appropriated to provide financial assistance to eligible persons.⁴⁶

3.24 Amaca and Amaba have lodged applications under the Scheme but there has been no formal response from HIH Claims Support Limited, (the entity administering the scheme on behalf of the Commonwealth).⁴⁷ I am not in a position to reach any concluded view as to the likely success of any claims by Amaca or Amaba. The HIH Claims Support Scheme, however, is discretionary and in any event the aggregate maximum funds available to all successful claims is \$640m.⁴⁸ As noted by Mr Meagher SC in oral submissions, it would seem an "unintended consequence if the scheme was able to produce significant funds in relation to this Foundation".⁴⁹

Commutation of Existing Insurance Policies

3.25 Mr Attrill raised the issue of the commutation of various policies in the London insurance market,⁵⁰ suggesting that the "full aggregate value of the policies placed in London from 1981 to 1988 equates to in excess of \$700m".⁵¹

3.26 Mr Hutchinson's evidence with regard to this issue was that "the insurance policies during period 1981 to 1988 comprised:

- "(a) occurrence-based cover for the period 1981–1986 which have an aggregate face value of \$475 million ...; and
- (b) claims-made cover for the 1986/1987 and 1987/1988 policy period are \$85 million in any one year of insurance (subject to there being a \$1 million deductible during the 1987/88 policy period) or a total of \$169 million...however, this amount of \$169 million should not be included in any calculation".⁵²

⁴⁵ Hutchinson, Ex 294.

⁴⁶ *Appropriation (HIH) Assistance Act 2001* (Cth).

⁴⁷ Hutchinson, Ex 294, p. 3, para. 15.

⁴⁸ Outline of the MRCF's Oral Reply, para. 5.2(d).

⁴⁹ T 3714.41–43.

⁵⁰ Attrill, Ex 56, pp. 39–40, para. 161.

⁵¹ Attrill, Ex 56, p. 40, para. 161(d).

⁵² Hutchinson, Ex 218, p. 24, para. 85.

and he responded to Mr Attrill's suggestion in the following terms:

- “ (a) in respect of the suggestion (discussed below) that policies placed in London from 1981 to 1988 offer cover in excess of \$A700,000,000, that is not the case. The amount likely to be available to the Foundation under those policies is likely to be only a fraction of the aggregate cover on the face of those policies. Further, there are impediments to recovering under those policies which are discussed below; and
- (b) in respect of the suggestion that the London policies might be commuted, that suggestion has been considered and is still being investigated by the Insurance Project Recovery team. A difficulty is that, in light of the uncertainty surrounding the cover, it is difficult to form a view as to the proper commutation value of the policies. The “time on risk” practice also very significantly impacts upon the amount the Foundation would be likely to receive in a commutation, likely being only a fraction of the face value of the policies. The Insurance Project Recovery team's present view is that it is doubtful whether the policies will be able to be commuted at all. Assuming they are, and it were proper to do so, it seems unlikely that the commutation will be for an amount which would significantly improve the Foundation's ability to meet its future claims liabilities.”⁵³

3.27 Mr Hutchinson also concluded:⁵⁴

“... assuming the time on risk approach is correct, the possible commutation value of the policies is likely to be a fraction of the face or aggregate value of the policies. This would appear to be the case even if the time on risk profile changes in the future such that the 7% recovery under the Heath policies may vary based on a variation in exposure periods over time.”⁵⁵

3.28 The JHI NV Submissions contend that Mr Hutchinson did not take account of the most recent work undertaken by the Insurance Recovery Project team and in particular the visit to London during the Inquiry by Mr Sutherland and Mr Phillips in May 2004 as part of the project.⁵⁶ The report by Mr Sutherland and Mr Phillips is now in evidence.⁵⁷ It records some progress but does not provide any material assistance towards achieving a more accurate basis for estimating future insurance recoveries. I found nothing in the evidence on this question which would lead me to change the views on likely insurance recoveries expressed above.

⁵³ Hutchinson, Ex 218, pp. 4–5, para. 12.

⁵⁴ Hutchinson, Ex 218, pp. 23–27, paras 79–92.

⁵⁵ Hutchinson, Ex 218, p. 27, para. 92.

⁵⁶ JHI NV Initial Submissions on Term of Reference 1, pp. 5–11 at p. 8.

⁵⁷ Ex 318. The report is undated.

QBE Commutation in June 2000

3.29 An issue, which I note in passing, is that the Foundation contends that the QBE policies for the “period from the early 1930s to 1976” were commuted in June 2000 for an amount less than Amaca and Amaba might have recovered in future had the policies remained on foot.⁵⁸ This issue was not explored in evidence before the Commission and I decline to express a view on the topic.

D. Extent of the asbestos-related liabilities

Make no finding?

3.30 There is an initial question raised by the Submissions of UASG and MRCF. They urge me not to make a finding as to the future asbestos-related liabilities of Coy and Jsekarb. They submit that the areas of uncertainty involved are so numerous and so potentially significant that an attempt to settle on a figure is inappropriate, particularly given the history of continual increases in the actuarial estimates of Coy and Jsekarb’s liabilities.⁵⁹

3.31 There is some force in this submission but I do not accept it. In my opinion the proper course is to make such findings as are possible on the evidence before me, whilst recognising the presence of uncertainty. I am required by the Terms of Reference to report on the current financial position of the Foundation, and I would not be doing so if I did not attempt to estimate the current and future asbestos liabilities of Coy and Jsekarb.

Central estimate

3.32 The most current detailed actuarial assessments in evidence estimate the present and future liabilities of Amaca and Amaba as at 20 June 2003. Mr Wilkinson has also reviewed claims data to February 2004 and after analysis, concluded that his valuation assessment as at June 2003 remained reasonable in light of the emerging experience.⁶⁰ It is convenient then to focus on the 30 June 2003 assessments.

⁵⁸ MRCF Initial Submissions, p. 61, para. 3.13; see also Shankland, Ex 315.

⁵⁹ MRCF Initial Submissions, pp. 8–58; UASG Initial Submissions, paras 3.38–3.44.

⁶⁰ Ex 312, para 62.

3.33 The key points of difference between the Trowbridge and KPMG assessments may be summarised as follows:

	Trowbridge	KPMG
Future Meso reports	4,149	4374
Average non-nil cost (Meso)	\$280,000	\$301,750 ⁶¹
Nil claims (Meso)	20%	17.5%
Expected Peak (Meso)	2011/12	2011
Discount Rate	5%	4.49–5.56%
Superimposed Inflation	Nil	2%
NPV	\$1,089.8m	\$1,573.4m

3.34 The financial impact of these points of difference was outlined in the KPMG report as follows:⁶²

“Table E.5 – Analysis of variation of liabilities at June 2003

	Contribution \$m	Liability \$m
Trowbridges’ Recommendation		1,089.8
Average Costs	89.1	
Numbers	47.5	
Nil Settlement Rate	44.2	
Superimposed Inflation	356.5	
Discount Rate	(53.7)	
Total Contribution	483.6	
KPMG Assessment		1,573.4

”

It will be seen that the major contribution to the difference is superimposed inflation. Adding an allowance for it at 2% to Trowbridge’s estimate would increase the estimate by about \$360m giving a new total of \$1,449m. That figure is not, in the scale of things, greatly removed from KPMG’s estimate.

⁶¹ Includes a “large claim” allowance of \$41,750: Ex 252, p.105.

⁶² Ex 252, p. ix.

3.35 In the circumstances I regard it as appropriate to accept a figure of \$1.5 billion as a reasonable *central* estimate of the present and future liabilities of Amaca and Amaba, within the limitations of the work done by Trowbridge and KPMG.⁶³ These conclusions are supported by Mr Whitehead's view that the Trowbridge 2003 estimate satisfied his "reasonableness" tests.⁶⁴

Qualifications concerning central estimate

3.36 It is necessary, however, to emphasise several matters.

3.37 One is that this is a central estimate, produced by a deterministic, rather than stochastic, model. A deterministic model produces a single result from a given set of input assumptions. It may be contrasted with a stochastic model which attempts to give more information about the probability of different outcomes. Mr Whitehead explained:⁶⁵

“3.4.59 - A stochastic or probabilistic model is one which produces a complete estimated probability distribution of the value of the liability. A probability distribution provides a measure of the relative likelihood of a particular value eventuating out of the total range of possible values identified by the model.

3.4.60 - In order to produce a stochastic model, at least one, and usually more than one, of the input assumptions or intermediate processes must be in the form of a probability distribution. For example, the number of claims reported in each future year might be represented by a probability distribution.

3.4.61 - The deterministic model might assume that say 100 claims will be reported next year. In the stochastic model, the model might assume that **on average**, 100 claims will be reported, but that the actual number reported could be as low as 50 or as high as 200. The input assumptions would list all the possible values for the number of reported claims for that year and the associated probability that each outcome will eventuate.

3.4.62 - A stochastic model provides much more information about the value of the liabilities than a deterministic model. For example, in addition to the mean or average of the liability (which is what the deterministic model would usually be attempting to value), the stochastic model will provide an estimate of the standard deviation of the value of the liability, and the percentiles of that value.

3.4.63 - As an example, the mean liability could be \$1.0 billion, while the 75th percentile is \$1.3 billion. This means that if we were to consider all the possible values of the liability that could emerge in future, then 75% of the time the value of

⁶³ A finding to this effect is supported by the submission of JHI NV (Initial Submissions on Term of Reference 1, para. 29); Counsel Assisting (T3902.26–33) and Trowbridge (Initial Submissions, paras 98–100).

⁶⁴ Ex 251, p. 4–37 ff.

⁶⁵ Ex 251, para 4.9.1–4.9.23.

those liabilities would be less than \$1.3 billion (or conversely, 25% of the time the actual liabilities will exceed \$1.3 billion).

3.4.64 - APRA, the prudential regulator for general insurance companies in Australia, requires general insurers to set their outstanding claims provisions at a level that at least meets the 75th percentile value. The intention of holding a provision that exceeds the mean or average value is to provide a buffer against the possible (and not improbable) emergence of liabilities that exceed the mean.”

3.38 In a deterministic model, as employed by Trowbridge and KPMG, the sensitivity analysis does some of the work of a stochastic analysis by indicating a range of plausible scenarios that would result in larger or smaller liability outcomes. Hence the importance of these analyses. They give useful content to the almost conventional statements that actuarial projections are uncertain.

3.39 The significance of a central estimate is that it represents an amount that, if invested for the return implied by the discount rate, would have a 50/50 chance of being adequate to meet the projected claims.⁶⁶

3.40 The proposition in the preceding paragraph, however, must be further qualified. It is untrue if the fund is a closed fund (ie, a fund which has no prospect of accretions to its capital, save by return on its investments), as opposed merely to a provision in the accounts of an entity that has other resources able to be called on in need. This is because a deterministic model such as this does not allow for the volatility of claim payments and investment returns. This consideration was highlighted by both PricewaterhouseCoopers⁶⁷ and Access Economics.⁶⁸ The latter made the point quite graphically:

“It should also be noted that small changes in inflations/rates or 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 important to the final result.”

This consideration would be of particular significance if, as occurred in February 2001, it were proposed to attempt to achieve higher rates of return than the “risk free” discount rate adopted by Trowbridge and KPMG for their 2003 estimates.

⁶⁶ Minty, T 821.10–17; Marshall, T 915.29–38; Wilkinson, T 3383.28–47.

⁶⁷ Ex 1, Vol 8, Tab 83, pp. 2286–7.

⁶⁸ Ex 1, Vol 8, Tab 84, p. 2295.

3.41 Again, the \$1.5bn central estimate is subject to the limitations of the particular reports. They do not allow for some areas of potential liability such as exemplary damages and they specifically exclude certain factors, almost all potential liabilities. The 2003 Trowbridge Report referred to them as:⁶⁹

- “
- a lowering in the standard of causation in a number of lung cancer claims, reversing the generally accepted condition that evidence of asbestos is required before lung cancer will be attributable to asbestos exposure
 - claims arising from mental anguish associated with asbestos exposure and/or disease
 - cross-claims by Amaca
 - environmental, land remediation or clean-up claims
 - general emergence of new sources of claims not currently represented in the Amaca database
 - claims arising outside of Australia
 - costs incurred due to the charge-back from NSW Dust Diseases Board (DDB) of amounts paid by it before the settlement of a claim at common law.”

3.42 Two other areas where claims may increase have been largely omitted from consideration by Trowbridge and KPMG. They are “*third wave claims*” and increases in “*propensity to sue*”.

3.43 Mr Whitehead described third wave claims in this way:⁷⁰

“...the first wave of claims are generally linked to the mining and milling of asbestos and the production of the people producing it involved in asbestos products, so those would be people working in mines or the mills or working in the plants where asbestos was used to produce, for example, asbestos sheets. The second wave of claims would arise from the people who make use of those products. In the case of asbestos it was largely people in the construction industry for example and ship building and the workers were exposed and others were exposed to the asbestos in using and installing the asbestos containing product. We then have the situation where that asbestos remains in the environment until it is

⁶⁹ Ex 3, Vol 3, Tab10, p. 655. As Counsel Assisting’s Initial Submissions, Section 1, para. 18 note, some indication of the magnitude of the risks associated with some of these potential liabilities (in particular, remediation, DDB reimbursements, and exemplary damages) appears from James Hardie’s own records (see Ex 57, Vol 1, pp. 14–16; the Forrest QC and Watson Opinion on exemplary damages (Ex 61, Vol 4, pp. 294–295, 305–319); and Attrill’s evidence (T1165.40–1166.1; 1217.47–1220.5). The likelihood of the risk occurring and the magnitude of such impact if it does, both need to be considered. Some of the documents in which these matters are discussed are subject to non-publication orders. It is sufficient to say that the risks appear to be significant, and that in some cases (remediation in particular) the potential liabilities may be very large.

⁷⁰ T 3211–12

ultimately removed and there is on-going exposure, sometimes call secondary exposure, which could potentially lead to further claims in the future. That exposure is on-going and is based on the fact that, as I say, there's a significant amount of asbestos in the Australian building environment which would lead to people being exposed to asbestos and having mesothelioma cases and those are in the third wave claims."

3.44 Mr Minty accepted that Trowbridge's model did not fully allow for such claims and, in particular, did not make full allowance for exposure to asbestos being an ongoing matter.⁷¹ Mr Wilkinson agreed that the exposure data that underlay his model made no allowance for third wave claims.⁷²

3.45 The removal of asbestos which is now in situ is likely to involve much lower levels of exposure than the original mining, milling, manufacturing and installation of asbestos.⁷³ On the other hand, while standards of practice and risk awareness in relation to occupational asbestos exposure may be relatively high, it is doubtful if that is so for the large number of "do-it-yourself" home renovators and repairers in the Australian community. Identifying that asbestos has been encountered may itself be a problem. James Hardie had been responsible for 70 per cent of Australian asbestos consumption.⁷⁴

3.46 Mesothelioma claims against James Hardie have increased at a much higher rate than the incidence of mesothelioma in the community and increases in propensity to claim are likely to be the main explanation.⁷⁵ The fact that:

- (a) mesothelioma claims against Amaca have been continuing to increase (rather than peak or plateau), and
- (b) while James Hardie accounts for 70% of Australian asbestos consumption, it has claims made against it in a significantly smaller proportion of the total number of cases;

⁷¹ T 3320.17–3321.50.

⁷² T 3389.53–57.

⁷³ This view is reflected in some American literature (see Ex 274, B Price, "Analysis of Current Trends in United States Mesothelioma Incidence", (1997) 145 American Journal of Epidemiology 211 at 217).

⁷⁴ Ex 251, p. 3–21; Figure 3.5 and see T 3391.20–24. There is no evidence that it had ever conducted or been responsible for a public education campaign designed to educate the public about the risks of the huge volumes of James Hardie asbestos products still in homes and workplaces in Australia. It was invited to adduce such evidence: T 2598.33–47

⁷⁵ See Whitehead at T 3208.51–3209.2; Minty at T 3326.47–55; Marshall at T 3444.35–40, Ex 262 at p. 7.

together suggest that there remains potential for further increase in the rate of claims against Amaca.⁷⁶ While Mr Wilkinson’s impression was that propensity to claim was not likely further to increase, he acknowledged that it may be necessary to do more research into the question⁷⁷.

3.47 A consequence of the views above is that it is only appropriate to adopt \$1.5bn as a minimum central estimate of the liabilities of the Foundation.

How much would be necessary for a closed fund?

3.48 A further consequence of those views is that it would not be appropriate to treat \$1.5bn as the amount which, if invested in a closed fund, would give a high degree of assurance that all claims would be met. The actuaries were agreed that they would approach the task of determining the quantum for such a fund differently from the way in which the reports in respect of Amaca and Amaba were prepared. In particular, the evidence indicates that in carrying out such a task, it would be necessary or appropriate:

- (a) to make allowance for the risks which were identified as “excluded” in Section 8 of the 2003 Trowbridge Report;
- (b) to make allowance for “third wave” claims, to the extent that the existing model did not make adequate allowance for them;
- (c) to make allowance for the possibility of further increases in the propensity to claim against Amaca and Amaba;
- (d) possibly, to provide for a “buffer” or prudential margin.⁷⁸

⁷⁶ Whitehead at T 3209.33–3210.14; Minty at T 3328.3–3329.20).

⁷⁷ T 3401.53 – 3402.33.

⁷⁸ Minty at T 3319.54–3320.15; 3321.35–50; 3329.11–34; 821.5–823.57; Wilkinson at T 3397.48–3398.27; 3399.26–3400.49; 3402.20–33; Marshall at T 913.6–915.3; 3444.35–3445.44.

3.49 To some – perhaps a large – extent these considerations are allowed for in Mr Wilkinson’s sensitivity analysis, which is as follows:⁷⁹

“Table 9.16: Sensitivity testing KPMG’s 2003 valuation results

		Discounted Net Liabilities \$m	Difference to Central Estimate** \$m
Central Estimate Basis		1573.4	
Scenario 1	Discount rate at 0% per annum	3,403.1	1,829.6
Scenario 2	Nil settlement rates increase: mesothelioma up by 2.5%, non-mesothelioma & workers compensation up by 5%	1,516.1	-57.3
Scenario 3	Superimposed inflation – 6% for 5 years, then linearly decrease over the next 5 years and remain at 2% long term	1,709.9	384.6
Scenario 4	Average claim size – increased by 10% for all claim types	1,709.9	136.5
Scenario 5	Notification curve – increased by 10% at all future periods	1,722.7	149.3

**If one were to wish to combine two or more scenarios together, adding the monetary changes indicated above would not necessarily reflect the true combined effect of the revised scenarios but would provide a broad indication of the financial impact.”

3.50 On Mr Wilkinson’s evidence, it seems that if he were defining a fund which would have a reasonable chance of meeting all claims he would have adopted more conservative estimates for the main aspects of liability (superimposed inflation, claims size and claim numbers).⁸⁰ In their submissions Counsel Assisting have suggested that having regard to Mr Wilkinson’s evidence, a rough guide to an amount that might, in a separate fund, give reasonable confidence that all claims would be paid would be \$2.24 billion, a sum derived by adding to the KPMG central estimate each of the sensitivity amounts for those matters.⁸¹

⁷⁹ Ex 252, p. 109.

⁸⁰ T 3397.48–3398.29, 3399.26–3400.50.

⁸¹ Initial Submissions, Section 1, para. 25.

3.51 The burden of this submission is not that \$2.24 billion is a reliable estimate of such an amount, but rather that it is an indication of the significantly greater sums beyond the actuaries' central estimates that might have to be provided if a fund were to be estimated *on a once and for all basis* to cover all Amaca and Amaba claims.

3.52 I agree with that view.

E. Life of the Fund

3.53 Since the establishment of the Foundation, Amaca has sustained very substantial operating losses. They may be seen in the following summary of Amaca's Income Statements for the period to June 2004.⁸²

“

[Figures in \$ million] [Rounding may affect summations]	June 2001 (1)	June 2002	June 2003	June 2004
Investment:	9.5	5.4	(2.3)	3.1
Property:	6.6	5.4	5.6	4.1
C&I:	2.0	5.3	5.3	5.3
Total Income:	18.1	16.1	8.6	12.5
Settlements	40.2	38.0	49.0	48.1
Legals	8.2	8.7	10.2	9.3
QBE Income (2)	(6.8)	(2.2)	(3.0)	(3.0)
Insurance Recovery	(9.8)	(2.0)	(3.1)	(1.4)
Net Litigation Cost	31.8	42.5	53.1	53.0
Operational Costs (4)	0.9	2.0	2.4	4.8
Operating Loss	(14.6)	(28.4)	(46.9)	(45.3)
Movement in Provisions (3)	(6.0)	(24.9)	7.0	7.6
Net Loss	(20.6)	(53.3)	(39.9)	(37.7)

Notes:

1. The June 2001 period is 15 months covering 10.5 months under JHIL management and 4.5 months under the Foundation management.
2. The QBE receipts were originally based on income recognition over a 30 year period commencing in 1995. From 2003 these receipts have been recognized as cash is received.
3. From 2003, the provision for notified claims was reduced following an internal analysis of actual settlement costs compared with existing settlement reserves.
4. Commission costs which are subject to an insurance claim for recovery are included in this figure. For June 2004, a credit of \$1m has been accrued based on estimated recovery.”

⁸² Ex 339.

3.54 Amaba's summarised Income Statements for the same period are:⁸³

“

[Figures in \$'000] [Rounding may affect summations]	June 2001	June 2002	June 2003	June 2004
Investment:	139	70	82	84
C&I:	105	1,250	202	202
Total Income	244	1,320	284	286
Net Litigation Cost	452	1,489	187	413
Operational	30	102	102	115
Operating Profit (Loss)	(238)	(271)	(5)	(242)
Movement in Provisions	(1,850)	(961)	182	2
Net Profit (Loss)	(2,088)	690	177	(240)

Notes:

1. The June 2001 period is 15 months covering 10.5 months under JHIL management and 4.5 months under the Foundation management.
2. The accounting treatments are as for Amaca except that each open claim is valued and provisioned. The net litigation cost reflects the difference between actuals and provisions.”

3.55 The total amounts which have been paid out each year as a net litigation cost are thus very large, totalling in the period since 1 July 2001:

Year ended 30 June 2002	\$43.989m
Year ended 30 June 2003	\$53.2187
Year ended 30 June 2004	\$45.540m

3.56 The Foundation could not continue to pay out at that rate. If it did it would be exhausted in about three years, even taking into account the income which it might earn on the diminishing assets, and Towers Perrin, the investment advisers to the Foundation, have expressed the view,⁸⁴ based on the actual cash outflows of the Foundation, that all its assets will be exhausted by March 2007.⁸⁵ That view has not been seriously challenged. Mr Cooper's evidence was to generally similar effect.⁸⁶ I accept that the life of the Foundation is about three years, perhaps a little less.

⁸³ Ex 339.

⁸⁴ Towers Perrin advice of 17 February 2004, Ex 9, p. 3.

⁸⁵ I would note that the cash outflows have brought about a situation where the Foundation has had to adopt a low-risk strategy in its investments in order to have cash to meet its commitments: see Ex 9, p. 3.

⁸⁶ T172.15–35.

F. Additional assets

3.57 Contentions have been advanced on behalf of the Foundation, and other parties, that the Foundation, Amaca or Amaba has causes of action against James Hardie companies, various individuals, actuaries, solicitors and others, and that the assets may be augmented by the proceeds of any litigation in respect of such causes of action. To the extent necessary I have dealt with such claims in other Chapters of this Report.

Part 3 – Term of Reference 3

Chapter 4 – Introduction

4.1 The Chapters in Part 3 deal with Term of Reference 3:

- “3. The circumstances in which any corporate reconstruction or asset transfers occurred within or in relation to the James Hardie Group prior to the separation of MRCF from the James Hardie Group to the extent that this may have affected the ability of MRCF to meet its current and future asbestos related liabilities.”

4.2 The “asset transfers” to which Term of Reference 3 is applicable commence in 1995 with the sale of Coy’s technology to another company in the Group for \$75m. I discuss that in **Chapter 5**. In 1995 Coy also sold a number of its controlled entities for a net profit of \$38.255m. That too is discussed in Chapter 5.

4.3 The proceeds of the sales to which I have referred in paragraph 4.2, together with some retained profits, were effectively paid out as dividends during the YEM 1996. The propriety of the declaration of the dividends (totalling \$100.9m) is discussed in **Chapter 6**. So too is the propriety of the declaration of a dividend of \$43.5m in the following year. During relevant years Coy paid JHIL substantial management fees. A consideration of the propriety of charging management fees at that level is also in Chapter 6.

4.4 There was no “corporate reconstruction” in the strict sense which affected Coy in the period prior to February 2001. In 1998, however, it ceased to be an operating company, its business being sold to JHA, a subsidiary of the Dutch company JHNV. **Chapter 7** examines these sales.

4.5 The operating company JHA was to use premises owned and previously used by Coy. Leases were entered into between Coy and JHA. The appropriateness of the rental levels for those leases has been investigated. It is discussed in **Chapter 8**.

4.6 Some larger questions have been raised, namely whether there was any impropriety in causing Coy to cease to be the operating company. Was it done in order to prevent the operating assets becoming available to asbestos litigation creditors? Term of Reference 3 is not concerned simply with whether transfers of property were at full value. It is looking also at their commercial position. This, and some related aspects, are discussed in **Chapter 9**.

Chapter 5 – 1995: Disposal of Coy’s Research and Development Interests; Sale of Controlled Entities

A. Research and development interests

5.1 The first group of assets divested by Coy was its “core technology”. The sale took place as at 1 April 1995¹, with the sale price being \$75m. The price was arrived at by reference to an assessment by Coopers & Lybrand of the “fair market value” of the core technology. That assessment was that the value was “in the order of \$70 million to \$82.5 million”, with Coopers & Lybrand considering “the most likely valuation point estimate would be \$75 million”.²

5.2 Dr Barton had become Managing Director of JHIL in March 1993³. He had come from outside the James Hardie Group.⁴ His evidence, which I accept, was that soon after joining JHIL, he:

“... conducted a world-wide review of the operations of the comparison in the James Hardie group of companies with a view to improving the Group’s productivity and general performance which I felt was substantively below its potential at that time.”⁵

5.3 In his oral evidence he said:⁶

“If you look at the research and development, I – when I came on board, I had spent a fair bit of time on the money we were spending on R and D and nobody could tell me how much we were indeed spending. We agreed to gather it together in its own group and sold it out of Coy at an arm’s length value.”

5.4 His first statement put the matter more fully:⁷

“3 A part of this group-wide review involved a review of JHIL’s research & development activities (“R&D”). The review, which was concluded in February 1994, identified that:

- (a) the Group’s R&D was haphazard and uncoordinated, resulting in doubtful effectiveness of R&D activities undertaken as:

¹ Ex 174, Tab C, p. 3.

² Ex 174, Tab A, p. 3.

³ Ex 174, para 1.

⁴ T 2694.19–21.

⁵ Ex 174, para 2.

⁶ T 2717.47–55.

⁷ Ex 174.

- (i) technology planning was dependent on individuals rather than being systematic and transparent – there were licences, patents and research initiatives throughout the Group with very little, if any, communication or co-ordination between them; and
 - (ii) information was not available to compare sites, standardise and take the process forward or improve the product; and
 - (b) contrary to the Group's belief, the Group did not have the global technology lead in fibre cement technology, a major operating activity of the Group, as effectively no R&D activities had been undertaken since the development of fibre cement in 1986.
- 4 It was therefore recognised that the Group's activities needed to be integrated and centralised to effectively budget for, control, manage and supervise R&D activities with a market focus, to produce results, including to enable the Group to secure a leading position in fibre cement technology and to improve its research and development capabilities in respect of electronic building access controls, fire fighting equipment and bathroom products, amongst others.
- 5 Following this review of the Group's R&D, JHIL decided to centralise the Group's intellectual property assets. JHIL, in conjunction with JHIL's then auditors, Coopers & Lybrand, then devised a restructure whereby all R&D technology and other industrial property of the Group would be held by one company in the Group. The restructure enabled:
- (a) greater efficiency through focus and improved allocation of resources on agreed priorities world-wide from central planning, coordination and control of R&D;
 - (b) the evaluation of alternative technologies;
 - (c) the control and development of fibre cement operations world-wide; and
 - (d) a project capability to support R&D opportunities worldwide.

Accordingly, on 9 February 1994, the Board of Directors of JHIL approved the incorporation of James Hardie Research ("JH Research") to "co-ordinate the Group's R&D activities".

Apart from the transfer of technology and intellectual property by individual companies in the Group to JH Research, the restructure also involved a management restructure with the appointment of a new R&D manager and other management team members who were given specific roles and measurable goals. A Fibre Cement Technology Network was also formed to plan and coordinate fibre cement R&D and to discuss, priorities and set goals worldwide.

Transfer of technology to JH Research by James Hardie & Coy Pty Limited:

In accordance with the strategic plan to concentrate all of the Group's R& activities in one company, that is, JH Research, all R&D activities and associated technology and industrial property held by individual companies in the Group were transferred to JH Research. The R&D equipment and intellectual property rights in R&D activities were then licensed back to the individual companies, as sub-contractors of JH Research. The sale of the technology associated with building boards held by James Hardie & Coy Pty Limited ("JH & Coy") to JH Research was a part of this restructure."

5.5 This is supported by the Board Paper of 1 February 1994 on the subject (prepared by Mr Morley)⁸ which stated the Background to the proposal and the proposal itself as being:

“Background:

As a result of the work done on quantifying R&D claims going back to 1986, it became evident that there existed a haphazard and unco-ordinated approach to identifying and quantifying R&D expenditure throughout the Group. Appropriate paperwork has since been drawn up along with data collection systems to ensure claimable R&D expenditure is identified and included in tax returns. As a result of this work, a meeting was held with Coopers & Lybrand to explore more fully the identification and collection of claimable R&D expenditure throughout the Group.

A R&D company seemed to fit in with both the current R&D work being undertaken and quantified by the various divisions, and other commercial factors including the benefits to be obtained from having the Group’s core technology and other industrial property contained within the one entity and licensed back to various divisions and having the R&D of the Group (or at least the major R&D projects) contained within the one entity.

Proposal:

To establish a company to co-ordinate all of the Group’s future R&D activities and to increase utilisation of the R&D concession as well as providing other commercial advantages.”

5.6 The OBJECTIVES set out in the Board Paper included:

- “Vendor companies will be able to discharge borrowings or pay dividends using the proceeds of sale of the technology.”

5.7 It was not only Coy’s research and development activities which were sold into the new research company. The same happened to a number of other companies in the Group which had also carried on their own research and development activities.⁹

5.8 I accept the evidence of Dr Barton that the purpose of the sale of the core technology was for the reasons he identified. Mr McGregor’s evidence was to the same effect on this question¹⁰, and I accept it also.

⁸ Ex 61, Vol 1, Tab 2.

⁹ They included James Hardie Plumbing & Pipelines Pty Limited and Hardie Energy Products Pty Limited, as well as Coy.

¹⁰ T1557.42–1558.18.

5.9 I am satisfied that the sale of the core technology was entirely proper. There is nothing to suggest that that sale, taken by itself, had any adverse effect on the assets of the group available to pay its creditors.

B. Sale of Controlled Entities

5.10 In 1995 Coy also sold a number of its “controlled entities”¹¹ for a net profit of \$38,255,000. There is no suggestion that these transactions were in order to insulate Coy’s interest in those companies from asbestos liabilities.

5.11 In the Financial Statements of Coy for the year ending 31 March 1996, after deducting “rationalisation costs” of \$6,638,000 and “provision for product liability costs” of \$8,804,000, the figure for abnormal items was \$97,813,000.¹²

5.12 Coy’s operating profit before income tax was \$109,369,000.¹³ After adjustments for income tax, the total operating profit (taking into account the abnormal items of the two sales referred to above) was \$110,195,000. These were retained profits at the beginning of the financial years of \$57,775,000 and, after an adjustment for a change in accounting policy, the result was that the “Total available for appropriation” was \$166,734,000. Two dividends were paid totalling \$100,900,000 during the year, no doubt effectively from the proceeds of the two sales.

5.13 The first of these dividends (\$60 million) was paid directly, and the second (\$40.9 million) went to Winstone Pty Ltd, a company which was a wholly owned subsidiary of JHIL.¹⁴

C. Conclusion on 1995 transaction

5.14 I find that there was nothing improper in these 1995 transactions. They were undertaken for sensible commercial reasons.

¹¹ Namely James Hardie Building Systems Pty Ltd, Bondor Itex Pty Ltd, Fibre Cement Contracting Pty Ltd, Fibre Cement Technology (Australia) Pty Ltd and Bondor Itex Hungary Kft: Ex 174, Tab G, p. 10.

¹² I.E. (\$75,000,010 + \$38,255,000) – (\$6,638,000 + \$6,804,000): Ex 174, Tab G, p. 7.

¹³ Ex 174, Tab G, p. 3.

¹⁴ Ex 174, para. 18.

Chapter 6 – Dividends And Management Fees

A. Introduction

6.1 In the years 1990–2000, Coy paid dividends and management fees as follows:¹

Year ending March	Dividend \$'000	Management fees \$'000
1990	25,000	19,500
1991	25,825	19,500
1992	20,000	19,500
1993	923	21,500
1994	nil	20,305
1995	nil	20,324
1996	100,900	21,500
1997	43,500	20,279
1998	nil	15,550
1999	nil	8,931
2000	nil	nil

6.2 The payment of dividends and management fees by Coy raises a number of related issues which are conveniently dealt with together. Only the 1996 and 1997 dividends require consideration. Similarly, attention need only be given to the management fees paid between 1995 and 1998 (inclusive).

6.3 The structure of this Chapter is as follows:

- (a) first, the financial position of Coy between 1995 and 1998 (inclusive) is described;
- (b) secondly, details relating to the payment of the 1996 and 1997 dividends are set out, and in particular the question of whether the 1997 dividend was paid other than out of profits is addressed;
- (c) thirdly, Coy's payment of management fees between 1995 and 1998 (inclusive), including the level of those fees, is covered;

¹ Taken from Ex 68, Tab F and Ex 103, Tab 1.

- (d) fourthly, the directors of Coy in the period from 1995 to 1998 are identified, which involves dealing with the question of whether JHIL was a “shadow director” of Coy at those times;
- (e) fifthly, the nature of the director’s duty to act in good faith in the best interests of the company as a whole is discussed;
- (f) sixthly, the question whether the directors of Coy breached their directors’ duties in authorising the payment of any of the dividends or management fees is addressed;
- (g) seventhly, there is a discussion on whether Coy could recover the dividends paid in 1996 and 1997 from JHIL on the basis that they were paid as a result of a mistake as to the extent of Coy’s present and future asbestos related liabilities.

6.4 Before turning to these matters, I note that the Foundation submitted that these payments would be recoverable from JHIL on the footing that:²

- (a) there was a joint venture between JHIL and Coy giving rise to fiduciary duties which JHIL breached in receiving the payments;
- (b) there was an implied contract or estoppel between JHIL and Coy which requires JHIL to meet Coy’s future asbestos liabilities; and/or
- (c) JHIL was Coy’s managing agent.

6.5 In my view, there is no substance in any of these submissions. They are addressed in the Submissions in Reply of JHI NV and ABN 60 at paragraphs K6.1–6.11. Save for the possibility that JHIL was a shadow director of Coy, no basis appears for finding that the relationship between those companies was other than an ordinary relationship between parent and subsidiary unattended by fiduciary duties of the kind the Foundation sought to establish.

² MRCF Initial Submissions, Part B, Chapters III–VI.

B. Financial position of Coy 1995-1998

6.6 Consideration of Coy's payment of the 1996 and 1997 dividends and of management fees between 1995 and 1998 (inclusive) requires an understanding of its general financial position at these times.

Profitability

6.7 Coy's profitability during the 1995, 1996, 1997 and 1998 financial years is set out in the following table:

Year	1995 ³ \$'000	1996 ⁴ \$'000	1997 ⁵ \$'000	1998 ⁶ \$'000
Pre-tax profit	33,227	109,369	(50,504)	41,435
Retained profits	50,860	65,834	16,568	9,783

Net assets

6.8 Adapting an approach taken by Counsel Assisting to the calculation of Coy's net assets, those assets as at 31 March 1995 may be estimated as follows⁷:

Asset	Value (\$000)
Net assets recorded in Coy's 1995 financial statements ⁸	86,068
Plus 1995 management fee ⁹	20,324
Plus amount in excess of book value on sale of plant and equipment ¹⁰	12,500
Plus amount for goodwill on sale of core business ¹¹	16,500
Plus amount on sale of trade marks ¹²	116,500
Total	251,892

6.9 The total of \$251.9m is only a rough figure. In particular, the amount in excess of book value attributed to the sale of Coy's business was calculated in 1998, rather than in 1995. JHI NV and ABN 60 have submitted that, because of the decline

³ Ex 1, Tab 8, p. 124.

⁴ Ex 1, Tab 7, p. 104.

⁵ Ex 1, Tab 6, p. 88A.

⁶ Ex 1, Tab 5, p. 73.

⁷ Counsel Assisting's Initial Submissions, Section 4, para. 27.

⁸ Ex 1, Vol 1, Tab 8, p. 125.

⁹ Ex 103, Vol 1, Tab 1.

¹⁰ Morley, Ex 121, p.4, para. 34.

¹¹ Morley, Ex 121, p.10, para. 64.

in Coy's business between 1996 and 1998, a greater figure than \$16.5m should be used for Coy's goodwill.¹³ Counsel Assisting accepted the correctness of that submission.¹⁴

6.10 The question of how much greater the figure should be is difficult. In my view it should not be as high as \$117.5m at which PwC valued Coy's goodwill as at 20 January 1997.¹⁵ The differences between Grant Samuel's valuation of goodwill of \$16.5m and PwC's valuation cannot be explained solely by reference to the passage of time, and I consider it is preferable to work from the Grant Samuel valuation, since it was used to determine the price at which Coy's business was sold.

6.11 Counsel Assisting have submitted that it is unlikely that Coy's goodwill would have reduced by more than half between 1995 and 1998, which would mean its value in 1995 would have been no more than \$33m. Ultimately, given that, in 1998, Coy's business remained prosperous, despite the fact that it was facing increasing competition, I am inclined to accept this view, at least for the purpose of the present exercise. That would take the value of Coy's net assets to around \$268.3m.

6.12 If the same approach is applied in later years, Coy's net assets between 1995 and 1998 – for each year adding back management fees and dividends paid in that year – can be estimated to have been roughly as follows:¹⁶

Year	1995	1996	1997	1998
	\$m	\$m	\$m	\$m
Net Assets	251.9	385.3	230.0	208.1

6.13 Excluding the amounts Coy paid in dividends and management fees during each of the relevant years, its net asset position can be estimated to have been roughly as follows:¹⁷

Year	1995	1996	1997	1998
	\$m	\$m	\$m	\$m

¹² Morley, Ex 121, p.12, para. 80.

¹³ JHI NV Submissions in reply on Terms of Reference 1 to 3, para. K3.12(c)(v).

¹⁴ Outline of further submissions on 1995 – 1998 transactions, para. 11.

¹⁵ Ex 121, Vol 3, Tab 21.

¹⁶ Based on Ex, Vol 1, Tab 5–8; Ex 103.

¹⁷ Based on Ex, Vol 1, Tab 5–8; Ex 103.

Net Assets	231.5	262.9	166.2	192.5
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Amounts paid for asbestos claims and associated legal costs

6.14 Prior to and during the 1995 to 1998 period, the amount Coy actually paid in respect of its liabilities for asbestos claims and associated legal costs were increasing. Counsel Assisting calculated the amounts paid by Coy as follows:¹⁸

Year	1993	1994	1995	1996	1997	1998
	\$m	\$m	\$m	\$m	\$m	\$m
Amount	4.9	10.6	13.7	13.7	14.2	22.1

These amounts were relatively modest compared with Coy's net assets.

Quantum of Coy's present and future asbestos liabilities

6.15 There is a question about the quantum at which Coy's present and future asbestos liabilities which would have been assessed had an actuarial report, made for the purpose of ascertaining the assets Coy needed to have available in order to be reasonably confident of being able to pay all future creditors, been done.

6.16 The starting point is the Trowbridge report of October 1996.¹⁹ That report assessed JHIL's present and future asbestos liabilities as at 31 March 1996 as being approximately \$230m.²⁰ (The report appears to have been received by JHIL on 1 October 1996, although not presented to the JHIL board until the November 1996 board meeting.)²¹

6.17 Translating that assessment to any other point in time plainly creates some uncertainty. Counsel Assisting have submitted that the figure provides a starting point assessing Coy's present and future asbestos liabilities as at August 1995, because there is no evidence of any dramatic change in the extent of that liability in the intervening period.²² Notwithstanding the lack of precision involved, I am inclined to accept that view, and indeed to adopt Trowbridge's estimate as at March

¹⁸ Counsel Assisting's Initial Submissions, Section 4, para. 45.

¹⁹ Ex 2, Vol 3, Tab 12.

²⁰ Those liabilities were principally liabilities of Coy.

²¹ Barton, T 2705.47–2706.35; Ex 2, Vol 3, Tab 12.

²² Counsel Assisting's Initial Submissions, Section 4, para. 29

1996 as a reasonable (although imperfect) starting point for assessing Coy's asbestos liabilities as at 31 March 1995.

6.18 The 1996 Trowbridge Report was not prepared for the purpose of ascertaining the assets Coy needed to have in order to be reasonably confident of being able to pay all future creditors. The report was to assess "the potential liability of [JHIL] and its subsidiaries for personal injury claims arising from asbestos-related diseases".²³ The assessment was to "provide background for the conduct of asbestos-related litigation".²⁴

6.19 In Chapter 3, I referred to the requirements for an actuarial report to assess asbestos liabilities in such a way as to yield a figure for the net present value of those liabilities which permits a reasonable level of confidence that, if claims provisioning is based on the figure, all future creditors will be able to be paid. The 1996 Trowbridge Report did not take into account either superimposed inflation nor a need for a better than 50/50 chance of being to fund all claims. If those matters had been taken into account, I agree with the submission of Counsel Assisting that it is reasonably likely that Coy's asbestos liabilities would have been assessed at around \$440m.²⁵

6.20 It is unlikely, in my view, that any assessment of Coy's present and future liabilities later in the period from 1995 to 1998 would have produced a lower figure. A higher figure might have been produced. It must be borne in mind, however, that the liabilities were, in significant measure, "future" liabilities. The obligation to pay had not yet arisen in such cases. Indeed the identity of claimants would not be known.

Conclusion

6.21 I think that the following conclusions can be drawn about Coy's financial position in the period 1995–1998:

- (a) Coy's profitability decreased significantly in 1997 and 1998;

²³ Ex 2, Vol 3, Tab 12, p. 558.

²⁴ Ex 2, Vol 3, Tab 12, p. 558.

²⁵ Outline of further Submissions on 1995–1998 transactions, para. 8. See also JHI NV and ABN 60 Submission's in reply, para. K3.12(c)(ii).

- (b) its net assets were generally declining;
- (c) the amounts Coy was paying for asbestos claims and associated legal costs was increasing, but annual figures were still a relatively small proportion of Coy's net assets;
- (d) from around October 1996, Coy had an actuarial report assessing the net present value of its asbestos liabilities as being approximately \$230m; and
- (e) if, at any time during the relevant period, an actuarial report, had been made for the purpose of ascertaining the assets Coy needed to have available in order to be reasonably confident of being able to pay all future creditors, it would have shown the net present value of Coy's asbestos liabilities as being about \$440m.

C. Payment of the 1996 and 1997 dividends

6.22 The \$100.9m paid in the year ending 31 March 1996 consisted of two separate dividends. On 14 August 1995, the directors of Coy resolved to pay a dividend of \$60m to JHIL by drawing on Coy's current deposit account with James Hardie Finance Limited ("JHFL").²⁶ On 24 August 1995, the directors of Coy resolved to pay a dividend of \$40m to Coy's "X" class ordinary shareholder, Winstone Pty Ltd ("Winstone").²⁷ This dividend was then paid by Winstone to JHIL.

6.23 On 2 October 1996, directors of Coy resolved to pay that day the 1997 dividend of \$43.5m.²⁸ The dividend was paid to Borchester Investments Pty Ltd ("Borchester"), the holder of Coy's "X" class ordinary shares at the time.²⁹ Borchester, it seems, paid the dividend to JHIL.

6.24 Whether Coy's 1997 dividend was paid out of profits has been put in question.

²⁶ Ex 108, p. 5.

²⁷ Ex 108, p. 5.

²⁸ Ex 108, p. 6.

²⁹ Ex 108, p. 6.

6.25 The requirement that the dividend be paid out of profits was imposed by s 201(1) of the *Corporations Law* (as in force at October 1996). It was in the following terms:

“No dividend shall be payable to a shareholder of a company except out of profits or under section 191.”

Section 191 is not presently relevant.

6.26 Compliance with s 201(1) required that Coy’s financial position be such that its directors could have held a genuine opinion that there were profits out of which the dividend (being an interim dividend) could be paid at the time it was paid, and that these profits would be disclosed in the final accounts of Coy for the 1997 financial year.³⁰

6.27 Dr Barton was the only director of Coy at the relevant time to give evidence and in his supplementary statement of 24 May 2004, he said:³¹

“Dividend payment in 1996

1. The financial year of James Hardie & Coy Pty Limited (“JH & Coy”) commences on 1 April and ends on 31 March.
2. On 2 October 1996, JH & Coy declared an interim dividend in the amount of \$43,500,000.
3. Although I do not recall the amount of retained earnings at the time the Interim Dividend was declared, I understand (both from the Minutes of a Meeting of Directors of JH & Coy dated 2 October 1996 and the Director’s Report forming part of the company’s Financial Statements for the financial year ended 31 March 1997) that there must have been sufficient retained earnings to leave a positive balance following the payment of the Interim Dividend. This dividend was paid in accordance with the general dividend policy of JH & Coy set out in paragraph 15 of my Earlier Statement.
- ...
4. As stated on page 1 of JH & Coy’s Financial Statements for the financial year ending 31 March 1997, the negative retained earnings balance at the end of that financial year was caused by abnormal losses booked in the latter half of that financial year, mainly arising from a project called “Factory Australia”.

I believe that the Interim Dividend would not have been declared had the extent of the negative impact of “Factory Australia” on JH & Coy’s earnings been known to the Board at the time of declaring the Interim Dividend.

6.28 In his oral evidence concerning payment of the dividend, Dr Barton gave the following evidence:³²

³⁰ *Marra Developments Pty Ltd v B.W. Rofo Ltd* [1977] 2 NSWLR 616 at 622E–F.

³¹ Ex 175, Paras 2–9.

³² T 2706.45–2708.4.

- “Q. Now just can I ask you to go back to your supplementary statement in paragraph 4, and you say that you understand that there must have been sufficient retained earnings to leave a positive balance following the payment of the interim dividend, is that because you wouldn't have declared the dividend if those retained earnings weren't there upon 2 October?
- A. No, the accounts say that. The accounts for the full year say the interim dividend was paid out of retained earnings.
- Q. Well the accounts for the full year say that the dividend was paid after seeing the half yearly statements don't they? Tab B of your supplementary statement?
- A. Yes. Under attachment B, "Financial statements for year ending 31 March 97", on the first page under "dividends" it says "an unfranked interim dividend of 43 and a half million was paid from retained profits on 2 October".
- Q. After the completion of the half year accounts?
- A. Yep.
- Q. The likelihood is that it wasn't after the completion of the half year accounts isn't it?
- A. It's quite likely, but saying here it was paid from retained profits and working back from the full year accounts there was sufficient - appears to be sufficient retained profits at the half year, at the end of September to have paid that dividend from retained profits.
- Q. So are you now working backwards from the final result, plus your policy that you wouldn't have paid the dividend other than from retained profits?
- A. No, I'm not saying we wouldn't have paid it other than from retained profits, I can't recall what basis we paid the half year dividend was on. As I said before, I think I said before, it would probably have been or agreed it probably would have been at the request of the parent company.
- Q. And if the parent company requested it, you would have done it by hook or by crook, is that right?
- A. No, I mean to the extent that we were comfortable that there were sufficient funds left in the company, yes we would have met their request.
- Q. Do you recall that the dividend was in fact paid through the intercompany loan account?

- A. No I don't, I don't recall.
- Q. Would it surprise you if that were so?
- A. No.
- Q. And if that were the position, that again would indicate would it not, that the determination of Coy was to meet a request by JHIL to declare a dividend at that time, by hook or by crook?
- A. No, I wouldn't use those words.
- Q. Sorry?
- A. I wouldn't use those words.
- Q. What words would you use?
- A. Probably at a request of JHIL the Coy board agreed to pay a dividend, from retained earnings.
- Q. But when you say "from retained earnings", if it was necessary for it to do that, funding the payment of the dividend through intercompany accounts, that would indicate that the timing was very much at the behest of JHIL wouldn't it?
- A. Could well have been.
- Q. And do you now recall whether there was any urgency in JHIL's request for the payment of that dividend?
- A. No.”

6.29 Nothing in this evidence suggests the absence of a basis for a genuine belief that there were profits out of which the dividend could be paid as at October 1996, or and that those profits would not be disclosed in the final accounts for the 1997 financial year. The possibility that the timing of the payment of the dividend was at JHIL’s behest is immaterial so far as s 201(1) is concerned.

6.30 Coy’s profit and loss accounts for the 1997 financial year showed the following:³³

“	Economic Entity		Chief Entity	
Operating profit/(loss) before abnormal items and income tax	(8,841)	11,556	(9,025)	18,365
Abnormal items before income tax	(41,463)	97,813	(41,563)	97,813
Operating profit/(loss) before income tax	(50,404)	109,369	(50,588)	116,178
Income tax attributable to operating profit/(loss) before abnormal items	1,713	(6,785)	1,871	(6,653)

³³ Ex 175, Tab B, p. 3.

Income tax attributable to abnormal items	15,094	7,611	15,094	7,611
Income tax attributable to operating profit/(loss)	16,807	826	16,965	958
Operating profit/(loss) after income tax attributable to members of the Chief Entity	(33,597)	110,195	(33,623)	117,136
Retained profits at the beginning of the financial year	65,834	57,775	65,860	50,860
Adjustment resulting from change in accounting policy	-	(1,236)	-	(1,236)
Total available for appropriation	32,237	166,734	32,237	166,760
Dividends provided for or paid	(43,500)	(100,900)	(43,500)	(100,900)
Aggregate of amounts transferred to reserves	(5,305)	-	(5,305)	-
Retained profits(losses) at the end of the financial year	(16,568)	65,834	(16,568)	65,860

“

6.31 Two matters stand out. First, at the end of the year, profits of \$32.2m were available for appropriation, an amount significantly less than the \$43.5m dividend. Secondly, the bulk of Coy's losses for the year came from abnormal items. These were rationalisation costs of approximately \$32.6m and provision for product liability costs of approximately \$9m.³⁴

6.32 More light is shed on the position as it might have been known to the directors of Coy in October 1996 by Exhibit 180, a computer printout of Coy's profit and loss accounts, prepared by management, as at September 1996. It shows a profit for abnormal items of around \$3.9m, indicating that the losses from abnormal items had not yet been incurred.³⁵ It also shows an operating profit after tax of around \$4m.³⁶

6.33 Ultimately, I am of the view that there is no basis for finding that the 1997 dividend was paid other than from profits. As of September 1996, the position appears to have been that Coy had retained profits of around \$65.8m³⁷, and an

³⁴ Ex 175, Tab B, p. 7.

³⁵ Ex 180, p. 6.

³⁶ Ex 180, p. 6.

³⁷ Ex 175, Tab B, p. 3. This differs from Ex 180, which shows retained losses of around \$67.7m. However, as retained profits/losses is an historical figure, which would not have changed over the course of the financial year, the figure in Coy's financial statements for 1997 is to be preferred over that in the management accounts in September 1996.

operating profit of about \$4m.³⁸ This is more than sufficient to support payment of the 1997 dividend. The position might be different if it could be established that the directors of Coy were aware that substantial abnormal losses would shortly be incurred. But Dr Barton's evidence on this issue, which I accept, contradicts this.³⁹

D. Management fees 1995–1998

6.34 Prior to 1998 the approach to the calculation of management fees “wasn't very scientifically designed”.⁴⁰ As Dr Barton said⁴¹:

“Q. Wasn't it the case that the system under which the subsidiaries paid management fees was at the initiation of JHIL?

A. Yes.

Q. JHIL effectively told the subsidiaries that they were to pay management fees to it?

A. Yes.

Q. And that was so that JHIL would have income from those fees?

A. Yes.

Q. It was tax effective because it gave JHIL a small assessment income which permitted it to claim a rebate?

A. Yes.

Q. And is it fair to say that your decision on behalf of Coy to pay those fees was made not so much having regard to the separate financial position of Coy but on the basis that it was in the interests of the group for Coy to make that payment?

A. Well I guess the decision making was similar to dividends. I would have looked at management fees and dividends in terms of what the shareholder needed or wanted, but also in terms of what was needed for the company to be a going concern.

Q. For which company?

A. Coy. To be a going concern.”

6.35 Mr Salter dealt with management fees in the period 1990–1997 as follows⁴²:

“9. Between 1990 and 1997, the management fees charged within the group were not the subject of detailed review from year to year. A subsidiary's

³⁸ Ex 180.

³⁹ See Ex 175, para. 4.

⁴⁰ Dr Barton T2695.51-52.

⁴¹ At T2696.

⁴² Ex 103, paras 9–13.

management fee would typically be based on the fee paid by it in the previous year. The total management fees charged within the group were approximately equal to JHIL's budgeted costs for the year in which they were charged and were apportioned between:

- (a) the group's finance company (which, from 1991 to 1998, was James Hardie Finance Limited); and
 - (b) the group's Australian operating companies.
10. Management fees were not negotiated between JHIL and its subsidiaries. However, the management fees paid by operating subsidiaries were approximately proportionate to their respective activity levels and the fees charged were felt to reflect, approximately, the value of the services provided by JHIL to each operating subsidiary. At all times at which James Hardie & Coy Pty Limited paid management fees it was solvent and was a wholly-owned subsidiary of JHIL.
11. Management fees of this nature were never paid by subsidiaries of JHIL incorporated outside Australia. This was because foreign subsidiaries may not have been able to claim tax deductions in respect of management fees paid to JHIL and such a situation would have represented a net loss to the group.
12. The fact that foreign subsidiaries did not pay management fees of the nature paid by the Australian subsidiaries was never considered to be inappropriate. There were two reasons for this.
- (a) JHIL's foreign subsidiaries were largely self-sufficient and derived little benefit from services provided by JHIL's head office in York Street (later, Pitt Street), Sydney. For example, foreign subsidiaries typically obtained legal and tax advice independently of head office and bore those costs in their own accounts. Similarly, human resources and information technology services were typically procured (and paid for) by foreign subsidiaries themselves. Foreign subsidiaries did use intellectual property held by other companies within the group, but that intellectual property was typically licensed under separate agreements. ... Some foreign subsidiaries were also parties to technical services agreements with Australian subsidiaries under which the foreign subsidiary paid for the costs of services provided to it.
- Consequently, while the Australian subsidiaries may have borne a greater proportion of head office's costs than was strictly attributable to their operations, the amount of any such excess would have been relatively small.
- (b) Given the probable inability of foreign subsidiaries to deduct management fees from their taxable incomes, the payment of management fees by the Australian subsidiaries alone was clearly in the best interests of the group as a whole.
13. Prior to 1997, the allocation of management fees within the group for any particular year was typically advised to subsidiaries at the beginning of each year and debit notes were issued quarterly. In circumstances where it was decided that a subsidiary would prepay all or part of its management

fee for a particular year, I would draft the letter offering prepayment and forward it to the relevant subsidiary with instructions to sign and return it.”

6.36 In May 1997 it was decided to put the calculation of management fees on a more defined basis. Mr Salter then decided to adopt a system whereby the costs of JHIL were to be reimbursed on the basis of demand for services and ability to pay of the four operating subsidiaries.

6.37 The method of calculation was set out in a file note of Mr Salter dated 21 May 1997.⁴³ It included the following statements of the principle:

- “3. JHIL anticipates being able to recover its costs, including a reasonable commercial mark-up, from the business operations which benefit, and in a manner which reflects to some degree both the demand for services and ability to pay.

JHIL therefore looks to recover in the area of \$30 million from operating subsidiaries in the 1998 year.

4. No foreign subsidiaries will be included in the recovery plan because expatriate personnel are typically arranged to provide the services needed at the direct expenses of the foreign operation.
5. James Hardie Finance Limited is attributed with \$3m in value of services provided by JHIL.
6. The balance of \$27m will be allocated to operating divisions on the basis set out below.
7. Demand for services will be measured by the following factors, each weighted equally:
Sales Turnover
Gross Capital Employed
Number of Employees
8. Ability to pay will be measured by the “economic profit” attributable to each operating division and, compared with the foregoing regime of characteristics, will be weighted by a factor of two.”

6.38 The manner of calculation was set out in paragraphs 9, 10 and 11 of that document:

⁴³ Ex 103, Tab 3.

9. Table of Factors:
(Source: 1998 Business Plan)

• Sales Turnover (1998 Year)

	\$mill	%
Building Boards Australia	238.9	36
Windows	90.9	14
Pipelines Australia	102.1	15
Building Systems	<u>238.3</u>	<u>35</u>
	<u>670.1</u>	<u>100</u>

• Gross Capital Employed (March 1997):

	\$mill	%
Building Boards Australia	193.2	42
Windows	43.9	10
Pipelines Australia	122.2	26
Building Systems	<u>99.8</u>	<u>22</u>
	<u>459.1</u>	<u>100</u>

• Number of Employees (March 1998):

	No:	%
Building Boards Australia	923	29
Windows	771	25
Pipelines Australia	700	22
Building Systems	<u>946</u>	<u>24</u>
	<u>3140</u>	<u>100</u>

• Economic Profit/(Loss) (1998 Year):

		\$mill	%
Building Boards Australia		10.398	94
Windows	(8.839)		-
Pipelines Australia	(2.732)		-
Building Systems		<u>.636</u>	<u>6</u>
		<u>11.034</u>	<u>100</u>

(Note: Only EP positives are selected)

10. Table of Weightings:

	(Wtg)	BBA	Windows	Pipes	BS	Total
Sales	(1)	36	14	15	35	100
GCE	(1)	42	10	26	22	100
Employees	(1)	<u>29</u>	<u>25</u>	<u>22</u>	<u>24</u>	<u>100</u>
Sub-Total	(3)	107	49	63	81	300
EP	(2)	<u>188</u>	-	-	<u>12</u>	<u>200</u>
Total	(5)	<u>295</u>	<u>49</u>	<u>63</u>	<u>93</u>	<u>500</u>
Percentage		59	10	13	18	100

11. Application to operating division total.

The total of \$27 million will be distributed on the above percentage basis and rounded to the nearest \$.5 million.

The outcome is as follows:

	\$mill
BBA (James Hardie & Coy P/L)	16.0
Windows (James Hardie Windows P/L)	2.5
Pipelines (James Hardie Plumbing & Pipelines P/L)	3.5
Bldg Systems (James Hardie Building Systems P/L)	<u>5.0</u>
	<u>27.0</u>

(Coy was described in the calculation as "Building Boards Australia").

6.39 The operating subsidiaries were then charged with management fees calculated in this way.

6.40 As is apparent from the calculation, it has the consequence that:

- (a) The starting point is not how much the services provided by JHIL are worth to the subsidiary, but rather how much JHIL has to recoup from its subsidiaries to “recover its costs, including a reasonable commercial mark-up”.
- (b) Because Coy was the subsidiary likely to have the dominant profit, and because of the weighting given to “Economic Profit”, the amount payable by Coy was very significantly higher than the amount payable by any other subsidiary.

6.41 One aspect of the calculation of management fees which has been questioned is the appropriateness of not charging the foreign subsidiaries.

6.42 I have referred above to Mr Salter’s evidence that JHIL’s overseas subsidiaries were largely self-sufficient. There was also evidence from Mr Morley to much the same effect:⁴⁴

“The James Hardie group could not obtain tax deductions in the United States or New Zealand for management fees charged to and paid by its subsidiaries in those countries. The James Hardie Group companies in those jurisdictions had their own respective centralised administration and were responsible for preparing their own accounts, tax returns and for satisfying local human resources requirements (eg superannuation, pension plans). The United States and New Zealand subsidiaries received some benefit from being part of the overall group. In particular they had borrowing advantages, the benefit of international tax planning and the oversight of the Board and Chief Executive Officer of the parent. However if any employee of the parent travelled to and worked in either of those countries the cost of his or her doing so was paid by the local company. Taking all these things into account a decision was made that costs for the James Hardie group incurred in Australia were required to be borne and allocated among the Australian subsidiaries.”

6.43 This issue was the subject of oral evidence by Mr Macdonald:⁴⁵

Q. (Witness shown exhibit 107.) Do you have that, Mr Macdonald?

A. I do.

⁴⁴ Ex 122, Vol 1, para. 13.

⁴⁵ T 2285.42–2287.30.

...

Q. Could you go to the third page of the exhibit which is headed, "York Street expenditure by function" and I want to focus principally upon the period from 1994 until 1998. You were president of the United States operations from September 1994. If you'd look at the page I've shown you, it divides up the York Street expenditure under various headings. First of all, there "KAB", the managing director. Now, did Dr Barton have anything to do with the United States operations during the period that he was managing director?

A. Certainly as CEO of the company and managing director, he had responsibility for the US operations, but in fact they didn't report directly to him. They reported up until 1998 to Mr Ken Boundy in the international division, so Mr Barton was not - didn't spend a great deal of time in the United States and didn't directly manage those operations.

COMMISSIONER: Q. So "KAB" on the list is Mr Boundy?

A. He is.

MEAGHER: Q. Moving down then, "PGM", that is Mr Morley, Chief Financial Officer. What financial and other services did his group provide to the United States operations in that period from 1994 to 1998?

A. The United States operations were set up on a stand-alone basis and had their own CFO who reported to me. We completed our accounting and tax returns and sent the required reporting materials through to Australia, but there was a relatively light involvement by the corporate office in the financial reporting and matters of the company in the United States.

Q. What was the light involvement if you can be more specific about that?

A. Well, it's very difficult to put a percentage, but I doubt that it would be more than ten per cent of Mr Morley's resources were applied to the United States at that time given that we had our own functions in the United States carrying out those operations.

Q. Well, then, the next group is under the heading "KAB" that's Mr Boundy; is that right?

A. That's correct.

Q. Could you tell us what of the services described there were services provided to the United States operations?

A. By elimination, the international development and architectural business systems were focussed on the Asian business and were not applied in the United States. There was some small element of the CB marketing and value based management training materials were applied, I guess maybe 10 or 20 per cent of the United States, and then Mr Boundy's primary focus was the growth of the business in Asia, but he did supervise me. So perhaps 20 or 30 per cent of his resources could have been said to apply to the US. So if it was a weighted average it's probably something between 10 and 15 per cent of international applied to the United States.

Q. And the sales into Asia, were they sales of any particular company in the group?

- A. The sales into Asia, the product supply that went into Asia was from primarily James Hardie and Coy in Australia, but there was also some supply from New Zealand.
- Q. Were there also sales into the Middle East which came under Mr Boundy's jurisdiction?
- A. That's correct. There were also sales to the Middle East that were primarily from Australia.
- Q. Which countries sold products into the Middle East?
- A. Primarily James Hardie and Coy.
- Q. And then the next group is BB. What do the initials "BB" refer to?
- A. That's an individual Brad Bridges who was in charge of the human resources function in the company.
- Q. And what human resources services, if any, were provided by head office to the American operations?
- A. There was work provided in terms of training and organisation development, but otherwise the US was stand alone because of the unique US laws for superannuation and employment benefits and such, so it would have been, I think, at most 20 per cent or so of human resources from Australia that applied to the United States.
- Q. Were there any systems or procedures in place for the charging of the United States operations for services provided by any of the Australian operations?
- A. Yes, there were. It was quite common when we would be starting up a new factory and going through issues where experienced people would be very helpful to second people from James Hardie and Coy or James Hardie and New Zealand to help with those matters. When those people were seconded all their costs were forward charged to the United States, so it absorbed those costs."

6.44 In the end I am satisfied that whilst a proportion of the costs of JHIL were attributable to non-Australian operations, the very significant aspect of it relating to its activities in Australia.

6.45 Speaking more generally, the level of management fees was undoubtedly high, and that was commented on by both Grant Samuel and PricewaterhouseCoopers.

6.46 Grant Samuel provided Coy with a report dated 17 September 1998 in relation to the 1998 proposed restructure. The subject of the report was:⁴⁶

⁴⁶ Ex 121, Tab 20, p. 887.

“The directors of James Industries Limited (“James Hardie Industries”) have announced a proposed restructure of James Hardie Industries involving, in part, the sale of its core business operations to a newly incorporated and wholly owned subsidiary, James Hardie NV and the subsequent initial public offering of a 15% interest in James Hardie NV to United States retail and international institutional investors.

James Hardie & Coy Pty Limited (“James Hardie & Coy”) is a wholly owned subsidiary of James Hardie Industries whose principal activity is the manufacture and sale of fibre cement building products in Australia. The business of James Hardie & Coy, excluding certain real property and asbestos related liabilities, is one of the core business operations being transferred to James Hardie NV.

The directors of James Hardie & Coy, through James Hardie Industries, have requested Grant Samuel & Associates Pty Limited (“Grant Samuel”) to prepare a report setting out its opinion as to the fair market value of the business of James Hardie & Coy for the purpose of assisting the directors of James Hardie & Coy in determining the price at which the business will be transferred to James Hardie NV and the stamp duty and taxation costs of restructuring James Hardie Industries’ operations.”

6.47 In that report Grant Samuel said⁴⁷ that management fees paid to JHIL have had:

“a major impact on total costs and EBITDA. The management fee represents an allocation of James Hardie Industries corporate costs. In years prior to 1998, there was no consistent basis of allocating corporate costs, although a high level of corporate costs was allocated to James Hardie & Coy, one of the most profitable businesses in the group. In the year ended 31 March 1998, the basis of allocation was changed to reflect James Hardie & Coy’s contribution to total Australian group sales turnover, gross capital employed, number of employees and economic profit. Each of these factors was weighted equally in the calculation, resulting in an allocation of corporate costs of approximately 59% to James Hardie & Coy in the year ended 31 March 1998. Grant Samuel has estimated the corporate cost allocation for the year ending 31 March 1999 by applying a percentage based on James Hardie & Coy’s contribution to total net sales of the James Hardie Industries group to forecast corporate costs for the year ending 31 March 1999 of approximately \$19million. Further details on these calculations are set out in Appendix 2 to this report. Whilst management fees will not be paid to James Hardie Industries in the future, this allocation of corporate costs reflects an estimate of the corporate costs that would be incurred by James Hardie & Coy if it operated on a stand alone basis.”

⁴⁷ Ex 121, tab 20, p. 890.

6.48 In Appendix 2 Grant Samuel said:⁴⁸

“James Hardie Industries’ corporate costs are only allocated to its Australian operations. Grant Samuel has been advised that, in fact, head office provides management, legal and other services to the whole of the James Hardie Industries group of companies, including its United States, New Zealand and Asian operations. Consequently, this basis of allocation is not representative of the services that each of the business operations received from James Hardie Industries.

Grant Samuel has revised the allocation of corporate costs for the year ending 31 March 1999 on the basis of each operating business’ contribution to total net sales of the James Hardie Industries group, including the United States, New Zealand and Asian operations. Based on estimated head office costs of \$19.1m, this results in the following allocation of corporate costs for the year ending 31 March 1999:

James Hardie Industries – Allocation of Corporate Costs			
Business	Forecast 1999 Net Sales A\$ millions	Percentage of Total	Allocation of Corporate Costs A\$ millions
James Hardie & Coy Pty Limited	223.6	16.4%	3.1
James Hardie Building Systems Pty Limited	170.8	12.6%	2.4
James Hardie Windows Pty Limited	95.3	7.1%	1.4
James Hardie Building Products Limited (New Zealand)	64.2	4.7%	0.9
James Hardie Building Products Inc (United States)	791.3	58.2%	11.1
Asian operations	13.5	1.0%	0.2
Total	1,358.7	100.0%	19.1

6.49 On 19 April 1999 PricewaterhouseCoopers carried out an assessment of:⁴⁹

“... the fair market value as at 20 January 1997 of the trademarks (including brand names) and goodwill of James Hardie and Coy Pty Limited (JH&C).

The purpose of our valuation is to assist the directors of James Hardie Industries Limited (JHIL) in determining whether any capital losses or capital gains tax liabilities have arisen as a result of the deemed disposal of JH&C’s trademarks and goodwill, as at 20 January 1997.”

6.50 In doing so they adjusted management fees for the following reasons:⁵⁰

“Management fee payable to JHIL

⁴⁸ Ex 121, Tab 20, p. 912.

⁴⁹ Ex 121, Tab 21, p. 916.

⁵⁰ Ex 121, Tab 21, p. 942.

The BBA business pays annual management fees to JHIL. These currently approximate 6% to 8% of total revenue, net of rebates.

We have revised this management fee to represent an allocation of JHIL's total head office costs, based on JH&C's total sales relative to the entire James Hardie Group. An estimate have (sic) been made for 1998 based on prior years."

6.51 The amount of the adjustments was to reduce:⁵¹

1995	Actual \$20.324m by \$15,687m
1996	Actual \$21.5m by \$16.446m
1997	Forecast \$28m by \$22.947m
1998	Forecast \$28m by \$22.947m

6.52 The amounts by which any management fees actually charged by JHIL to Coy might have exceeded the amount chargeable on the basis used by Grant Samuel and PricewaterhouseCoopers may be calculated as follows⁵²:

Year	Fee Charged \$m	Appropriate Fee \$m	Difference \$m
1995	20.3	4.6	15.7
1996	21.5	5.0	16.5
1997	20.3	5.0	15.3
1998	<u>15.6</u>	<u>3.1</u>	<u>12.5</u>
	77.7	17.7	59.7

6.53 There was, however, nothing inherently inappropriate in calculating a management fee by reference to the factors identified by Mr Salter. Thus Ms Gardner of Grant Samuel said:⁵³

"Q. How did you then go on to estimate or form a conclusion that an estimate of 3.1 million for the coming year was an appropriate allowance for management fees?

A. The rationale for that is set out in appendix 2 to that report. We looked at a number of bases, including contribution to earnings, number of staff, bases of that nature."

6.54 And she later gave the following answers:⁵⁴

"Q. I just wondered if you had a scheme that involved say a number of employees, capital employed and profit generated and gave a weighting to those would that be an appropriate way of calculating it?

⁵¹ Ex 121, Tab 21, p. 941.

⁵² Taken from Ex 121, Tab 20, p. 889; Ex 121, Tab 21, p. 941.

⁵³ T 3091.17–23. See too at T 3091.31–45.

⁵⁴ T 3106.1–18.

- A. It's not really for me to say what is appropriate for someone to allocate for their management expenses but that would appear reasonable.
- Q. I just wondered one other thing about this. The criterion that was adopted in the particular case for the purposes of the exercise that you engaged in at paragraph 2.2 was one whereby it was one involving each operating business contribution to total net sales. Is that a standard criterion or is it one very commonly adopted or unusual or what's the position?
- A. I don't know that there are any standard criteria. It was information that was available to us. It seemed a reasonable basis and that was what we used."

6.55 My overall view is that the management fees charged exceeded a fair arms length price for the value of JHIL's services to Coy. Coy evidently subsidised, at least to some extent, the provision of corporate services by JHIL to its foreign subsidiaries. The level of management fees paid by Coy significantly exceeded that which Grant Samuel and PwC calculated as the corporate costs Coy would have incurred if it operated on a stand-alone basis. Even so, given the evidence from Mr Salter and Mr Macdonald about the limited consumption of JHIL's corporate services by foreign subsidiaries, I would not conclude that Coy's management fees should have been at the level assessed by Grant Samuel and PwC. I do not think it is possible, however, on the evidence, to identify with any accuracy the amount by which management fees paid by Coy between 1995 and 1998 (inclusive) were excessive.

E. Directors of Coy

6.56 In the period 1995 to 1998:⁵⁵

- (a) Dr Barton was a director of Coy throughout the entire period;
- (b) Mr McFadden was a director of Coy until 28 February 1997; and
- (c) Mr Morley was a director of Coy from 28 February 1997 to 16 February 2001.
- (d) The directors of Coy in August 1995, when the YEM 1996 dividends were paid, were Dr Barton, Mr McFadden and Mr Ghantous. Mr Ghantous was not present at the directors' meetings when payment of the dividends was authorised.⁵⁶

⁵⁵ Ex 108.

⁵⁶ Ex 108.

6.57 Counsel Assisting and the Foundation have submitted that JHIL was a “shadow director” of Coy at these times. JHI NV and ABN 60 resist such a finding.

6.58 At the relevant times, s 60(1)(b) of the *Corporations Law* defined a “director” as:

“... a reference to a director, in relation to a body, includes a reference to:

...

(b) a person in accordance with whose directions or instructions the directors of the body are accustomed to act.”

6.59 There is no controversy about the meaning of this part of the definition of “director”. Ultimately, the question is whether the appointed directors of Coy were accustomed to act in accordance with JHIL’s directions or instructions.

6.60 Counsel Assisting identified three aspects of the definition which have not been disputed. They are⁵⁷:

- (a) s 60(1)(b) is designed to capture those situations in which “the third party calls the tune and the directors dance in their capacity as directors” (*Harris v S* (1976) 2 ACLR 51 at 64);⁵⁸
- (b) there is no need to show that formal directions or instructions were given by the shadow director;⁵⁹ and
- (c) there need not be directions or instructions embracing matters involving the board, all that is required is that as and when the directors are instructed they are accustomed to so act.⁶⁰

6.61 I do not consider anything in *Standard Chartered Bank of Australia Limited v Antico (No.2)*⁶¹, to which JHI NV and ABN 60 referred, to be inconsistent with the above.

6.62 Much of the evidence relevant to this issue came from Dr Barton, and in his examination by counsel for JHI NV and ABN 60, there was the following exchange:⁶²

⁵⁷ These aspects of the definition are drawn from *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504; 133 ALR 1.

⁵⁸ *Australian Securities Commission v AS Nominees Ltd* (1995) 133 ALR 1, 52.

⁵⁹ *Australian Securities Commission v AS Nominees Ltd* (1995) 133 ALR 1, 52.

⁶⁰ *Australian Securities Commission v AS Nominees Ltd* (1995) 133 ALR 1, 52.

⁶¹ (1995) 38 NSWLR 290.

⁶² T 2693.20–30.

“Q. Could I just ask you a couple of questions about the dividend which was declared and paid in October 1996, that is a dividend of JH and Coy, can you tell us as best you recall your thought process, or reasoning process in relation to the declaration of payment of that dividend at that time?

A. Well dividends were paid out of the company I guess to criteria. Firstly, what did the shareholder want, the only shareholder; and secondly, what did the company need to keep in order to operate? Pay its creditors and run its operations. They were both the general considerations.”

6.63 During examination by counsel for the Foundation, Dr Barton gave the following evidence:⁶³

“Q. You said in answer to a question from Mr Meagher just now that the two factors you took into account in determining a dividend to be paid by a subsidiary included what the shareholder wanted?

A. Yes.

Q. What it indicates is that the dividends were effectively driven by JHIL's financial needs in this way, did the Board of JHIL work out what income it needed and then go about finding that income from its subsidiaries?

A. You can put it that way, but I think both myself and the Board looked to consolidate accounts, really didn't spend too much time on subsidiary accounts. And depending on how those accounts looked, and the cash flow of the corporation, we then made a decision on what dividends we could pay to our shareholders. And along with that, we had to decide how we're going to upstream dividends from subsidiaries.

Q. So from a financial point of view is it fair to say that the group operated perhaps without regard to the many corporate bales, and really from a consolidated approach?

A. The group operated at the board level. Largely.

Q. Referring to the JHIL board?

A. The JHIL board operated as though it was a consolidated group from a financial point of view.

Q. Did JHIL also make decisions about any strategic restructuring?

A. Strategic restructuring of the group?

Q. Yes?

A. Yes.

Q. And JHIL was effectively the taxpayer in the group?

A. Yes you could say that.”

and:⁶⁴

⁶³ T 2695.10–46.

⁶⁴ T 2696.5–34.

“Q. Wasn't it the case that the system under which the subsidiaries paid management fees was at the initiation of JHIL?

A. Yes.

Q. JHIL effectively told the subsidiaries that they were to pay management fees to it?

A. Yes.

Q. And that was so that JHIL would have income from those fees?

A. Yes.

Q. It was tax effective because it gave JHIL a small assessment income which permitted it to claim a rebate?

A. Yes.

Q. And is it fair to say that your decision on behalf of Coy to pay those fees was made not so much having regard to the separate financial position of Coy but on the basis that it was in the interests of the group for Coy to make that payment?

A. Well I guess the decision making was similar to dividends. I would have looked at management fees and dividends in terms of what the shareholder needed or wanted, but also in terms of what was needed for the company to be a going concern.

Q. For which company?

A. Coy. To be a going concern.”

6.64 These parts of Dr Barton’s evidence indicate several matters. First, the JHIL board treated the James Hardie Group as a consolidated group from a financial point of view. Secondly, JHIL determined the level of dividends to be paid by its subsidiaries after deciding what dividend it could pay to its shareholders. Thirdly, JHIL made decisions about the strategic restructuring of the James Hardie group. Fourthly, JHIL directed its subsidiaries to pay management fees to it.

6.65 In the first portion of Dr Barton’s evidence set out above, he also indicated that in deciding whether to pay a dividend, the directors of Coy would consider what JHIL wanted and what Coy needed to pay its creditors and run its operations. There is an element of artificiality about this evidence, given that Dr Barton was a director of JHIL, which would nominate the dividend it wanted Coy to pay, and also a director of Coy. I am satisfied that Coy’s approach to the payment of dividends was eventually to pay what JHIL requested.

6.66 I would add that I am also satisfied that JHIL did not knowingly seek dividends from Coy which it thought would prevent Coy from paying its creditors, or otherwise conducting its operations, at least in the short term.

6.67 There is also some evidence that, from at least 1995, JHIL exercised control over Coy in respect of its acquisition of assets and possibly its pursuit of new businesses opportunities.⁶⁵ Certainly, from 1995 it was the case that all new assets to be used in the Building Boards Australia business were acquired by companies in the James Hardie Group other than Coy⁶⁶, a purpose, in my view, being that those assets could not be available to asbestos creditors.⁶⁷

6.68 Looking at these matters in combination, I am satisfied that JHIL was a shadow director of Coy at the relevant times. The directors of Coy were, in my view, accustomed to act in accordance with JHIL's instructions on the payment of dividends and management fees, in strategic restructuring of the James Hardie group, and on the acquisition of assets for use in Coy's Building Boards Australia business. Of course, it does not follow that there was a breach of those duties.

F. Duty to act in good faith the best interests of the company as a whole

6.69 At the relevant times, the statutory source of the directors' duties to act in the best interests of the company as a whole was s 232(2) of the *Corporations Law*, which was in the following terms:

“An officer of a corporation shall at all times act honestly in the exercise of his or her powers and the discharge of the duties of his or her office.”

6.70 *Chew v R* had held that an equivalent provision (s 229(1)) of the *Companies (Western Australia) Code* incorporated a duty to act in good faith in the interests of the company as a whole.⁶⁸

6.71 An analogous duty also existed under the general law. The weight of authority suggests that the principal point of distinction between the statutory and general law duties was that the statutory duty would not be breached by a director

⁶⁵ Ex 61, Vol 2, Tab 5, pp. 20–24.

⁶⁶ Ex 61, Vol 2, Tab 5, pp. 20.

⁶⁷ Barton, T 2736.36–39.

who honestly believed he was acting in the best interests of the company as a whole⁶⁹, whereas the general law duty could be breached if that belief were unreasonable.⁷⁰

6.72 There is no doubt that the interests of a company as a whole include those of its shareholders and creditors.⁷¹ The question is the circumstances in which the interests of creditors should be paramount.

6.73 The question was addressed in the submissions of both Counsel Assisting JHI NV and ABN 60. Both relied on what had been said by Cooke J in *Nicholson v Permakraft (NZ) Ltd (in liq.)* (1985) 43 ACLC 453,⁷²:

“... creditors are entitled to consideration, in my opinion, if the company is insolvent, or near insolvent, or of doubtful solvency, or if a contemplated payment or other course of action would jeopardise its solvency...”

6.74 That statement was quoted with approval by Street CJ, Hope and McHugh JJA agreeing, in *Kinsela v Russel Kinsela Pty Ltd (in liq.)*⁷³. It has since been adopted in *Sycotex Pty Limited v Baseler*⁷⁴ and *Linton v Telnet Pty Ltd*.⁷⁵

6.75 The real difference between the submissions on this subject concerns what it means for a company to be “near insolvent or of doubtful solvency”. JHI NV and ABN 60 have submitted, in effect, that a company will not be in this position unless it is in “imminent danger” of insolvency.⁷⁶ Counsel Assisting have submitted that what is required is “a real or not negligible risk that a particular transaction or course of action may prejudice [the interests of creditors]”.⁷⁷

6.76 In my view, as a general proposition, the formulation of Counsel Assisting is to be preferred. It would be unsatisfactory if the interests of creditors were not to be considered in circumstances where there was a real or not negligible risk of their

⁶⁸ (1991) 5 ACSR 473 at 499.30.

⁶⁹ *Corporate Affairs Commission v Papoulias* (1990) 20 NSWLR 503, S; *Southern Resources Ltd v Residual, Treatment & Trading Co Ltd* (1990) 56 SASR 455. A different view has been taken in some cases: see *Ford's Principles of Corporations Law* [8.065] under “Historical Note”.

⁷⁰ *Linton v Telnet Pty Ltd* (1999) 30 ACSR 465 at 471–472.

⁷¹ *Walker v Wimbourne* (1976) 137 CLR 1 at 7.8.

⁷² (1985) 3 ACLC 458.

⁷³ (1986) 4 NSWLR 722 at 731E–F.

⁷⁴ (1994) 13 ACSR 766.

⁷⁵ (1999) 30 ACSR 465 at 473–474.

⁷⁶ See JHI NV Submissions in Reply on Terms of Reference 1 to 3, para. K3.12(b).

⁷⁷ Counsel Assisting's Initial Submissions, Section 4, para. 40.

interests being prejudiced. Secondly, the formulation is consistent with what Lord Templeman said in *Winkworth v Edward Baron Development Co Ltd*:⁷⁸

“.... a company owes a duty to its creditors, present and future. The company is not bound to pay off every debt as soon as it is incurred and the company is not obliged to avoid all ventures which involve an element of risk, but a company owes a duty to its creditors to keep its property inviolate and available for the payment of its debts.” (Emphasis added by Wallace J.)

That statement was adopted by Wallace J in *Jeffree v National Companies and Securities Commission*.⁷⁹ Thirdly, the formulation proposed by Counsel Assisting permits closer consideration of a company’s financial circumstances than that proposed by JHI NV and ABN 60, which limits attention to the company’s ability, in the short term, to meet its debts as and when they fall due.

Breach of directors’ duties

6.77 The question whether Coy’s directors breached their directors’ duties falls to be considered separately in respect of each payment of dividends and management fees. It is convenient to deal first with payment of the 1996 dividends.

6.78 The 1996 dividends totalled \$100.9m. In August 1995, when the dividends were paid, the financial position of Coy may be summarised as follows:

- (a) Coy was in the middle of a very profitable financial year, although much of the profit made in that year was due to the sale of its intellectual property to JHR;
- (b) at the end of the previous financial year, Coy had net assets of about \$251.9 million, which would increase to around \$385.3m (ignoring the payment of dividends and management fees) by the end of the 1996 financial year;
- (c) the amounts Coy was required to pay each year for asbestos claims and associated legal costs had been increasing since 1993, although the amounts were still a relatively small proportion of Coy’s net assets;

⁷⁸ [1986] WLR 1512 at 1516.

⁷⁹ [1990] WLR 183 at 187–188.

- (d) had the directors obtained an actuarial report for the purpose of ascertaining the level of assets Coy needed to have in order to be reasonably confident of being able to pay all future creditors, they would have been informed that Coy needed, at that time, assets of at least \$440 million dollars – well in excess of what it had.

6.79 Given these matters, in my opinion it is arguable that *if* the directors of Coy had had an actuarial report of the kind described, or otherwise known that the company needed assets of at least \$440m in order to be reasonably confident that it would be able to meet all claims, it would have been a breach of their duties to act in good faith in the best interests of the company as a whole for them to resolve to pay the 1996 dividends. Coy's net assets were worth significantly less than the amount needed to meet all future claims. The dividends themselves reduced those assets by more than a quarter.

6.80 For the same reason, it follows that it may have been a breach of the directors' duties, if they had the information about the extent of Coy's asbestos liabilities, which an actuarial report of the type described would have provided, to resolve to pay the 1997 dividend of \$43.5m.

6.81 Turning to management fees, the same follows. If the directors had known what an actuarial report of the kind described would have told them, they would have appreciated that Coy's assets were below the level needed in order to be reasonably confident of being able to meet all claims. When this is allied to the fact that the management fees were in excess of what Coy should have been obliged to pay, it may well be that the directors would have breached their duties to act in good faith in the best interests of the company as a whole in approving payment of the management fees.

6.82 The difficulty with the foregoing theories, of course, is that Coy's directors did not have an actuarial report of the kind described. As I have said, Coy was meeting its liabilities, including its asbestos liabilities, as and when they fell due. There was no reason to believe it would not do so in the future.

6.83 The question was also raised whether it was a breach of the directors' duties of care and diligence not to obtain an actuarial report of the nature dealt with above.

The duty of care and diligence (whether under statute – relevantly s 232(4) of the *Corporations Law* - or the general law) may require directors to inquire further into matters concerning the financial position of the corporation.⁸⁰

6.84 In the present circumstances it is true that the amounts Coy was paying as a result of asbestos claims were increasing, a significant part of Coy's asbestos exposure related to diseases which had a long incubation period⁸¹, and that the United States experience had shown that asbestos liabilities could increase significantly.⁸² In addition, prior to October 1996 Coy had no finalised actuarial assessment of the extent of its asbestos liabilities, and the 1996 Trowbridge Report was not designed to show the value of assets Coy needed to be reasonably confident of being able to meet all claims. In these circumstances, it is argued that Coy's directors breached their duties of care and diligence in failing to obtain an actuarial report of the nature described.

6.85 It is then contended that if an actuarial report of that kind had been obtained, there are two possible results. Either the dividends and management fees would not have been paid, or they would have been paid but this would have involved a breach of the duty to act in good faith in the best interests of the company as a whole, as discussed above.

6.86 I was left with the view that all these submissions are exercises in hindsight. Until 1998 Coy was an operating company. True it is that it was not acquiring new businesses, but there was nothing to suggest that it would not be able to pay its liabilities, asbestos or otherwise, in the future.

6.87 In my opinion a claim by Coy against its directors at the relevant times (including JHIL) for breaches of directors' duties in authorising payment of the 1996 and 1997 dividends and the 1995–1998 management fees would be unlikely to succeed. I note that such a claim would appear to be statute-barred.

⁸⁰ *Daniels v Anderson* (1995) 37 NSWLR 438 at 503

⁸¹ Barton, T2727.15-32

⁸² Barton, T2727.46-57

Recovery of 1996 and 1997 dividends for mistake

6.88 Counsel Assisting have also submitted that, independently of any question of breach of directors' duties, Coy could recover the 1996 and 1997 dividends from JHIL because they were paid under mistake,⁸³ the mistake being as to the extent of Coy's present and future asbestos liabilities. JHI NV/ABN 60 have submitted that the dividends are not recoverable on this basis:

- (a) because a dividend is a payment in the nature of a gift⁸⁴;
- (b) because there was no mistake, but merely a "misprediction" of Coy's asbestos liabilities⁸⁵;
- (c) because a change of position defence could be made out⁸⁶.

6.89 It is true that a dividend is in a sense a payment in the nature of a gift. But, as Counsel Assisting pointed out, gifts are sometimes recoverable under the law of mistake.⁸⁷ *Segenhoe Limited v Akins*⁸⁸, to which JHI NV/ABN 60 referred, indicates that there may be some room for argument about whether a dividend, paid under a mistake, can be recovered. I do not think, however, that that case decides that a dividend paid under mistake cannot be recovered.

6.90 The distinction between a mistake and a mere misprediction seems to be based mainly on the academic writings of the late Professor Birks.⁸⁹ As Counsel Assisting noted, those writings, and their adoption by Cooper J in *Re: Strang Patrick Stevedoring Pty Limited v Owners of Motor Vessel Sletter (Formerly the Hibiscus Trader)*⁹⁰, relate to expectations of future reward, such as A's belief that if he cleans B's car, B will pay him for it.⁹¹ The mistake in question here, is not one of that kind. Further, some other authorities may indicate that a person who pays a future liability under a mistaken belief as to its existence or extent, may be able to recover the

⁸³ See Counsel Assisting's Initial Submissions, Section 4, paras 60–62 and 86.

⁸⁴ JHI NV Submissions in Reply on Terms of Reference 1 to 3, paras K3.16–3.20.

⁸⁵ JHI NV Submissions in Reply on Terms of Reference 1 to 3, paras K3.21–3.29.

⁸⁶ JHI NV Submissions in Reply on Terms of Reference 1 to 3, para. K3.35.

⁸⁷ Outline of further Submissions on 1995–1998 transactions, para. 14–18.

⁸⁸ (1990) 29 NSWLR 569.

⁸⁹ JHI NV Submissions in Reply on Terms of Reference 1 to 3, paras K3.22–3.23.

⁹⁰ (1992) 38 FCR 501 at 524

⁹¹ Outline of further Submissions on 1995–1998 transactions, paras 26–27

amount of any overpayment.⁹² In my view it is possible that a mistake as to the extent of Coy's asbestos liabilities *might* found an entitlement to recovery of the dividends.

6.91 That leaves the change of position defence. In the case of the second of the dividends paid in August 1995, it is common ground that it was paid to Winstone and ultimately to JHIL. So far as the 1997 dividend is concerned, it was paid to Borchester and ultimately to JHIL. Both Winstone and Borchester are likely to have good change of position defences, but Coy could still seek to recover the dividends from JHIL.⁹³ The first of the dividends paid in August 1995 went directly from Coy to JHIL. JHIL may well have available to it a change of position defence, but there is no evidence of what JHIL would have done if it had not received this dividend (or the others). Accordingly, no conclusion can be reached one way or the other.

6.92 I am reluctant to be drawn further into expressing any view on the prospects of success of any claims Coy might have against JHIL in respect of these transactions. It is possible that Coy would have an arguable claim for recovery of the 1996 and 1997 dividends from JHIL for mistake, but it would be difficult to make out. A question would be whether the additional funding provided on separation could not be set off against the claim. I would also note that such a claim if brought now would also appear to be statute-barred.

⁹² Outline of further Submissions on 1995–1998 transactions, paras 21–25 (No.2)

⁹³ See *Spangaro v Corporate Investment Australia Funds Management Ltd* [2003] 47 ACSR 285 at [50].

Chapter 7 – Transfer Of Coy’s Operating Assets and Core Business in 1998

A. Summary of the Sales

7.1 In a series of three principal transactions, which occurred during 1998, Coy sold its operating assets and core business to other companies in the James Hardie group. Each transaction was preparatory to or an aspect of Project Chelsea.

7.2 On 31 March 1998, JHFC paid Coy \$60,048,642 for its plant and equipment, having agreed to purchase the same at fair market value.¹ On 1 July 1998, Gray Eisdell Timms (“GET”) assessed the fair market value of the plant and equipment at \$36,915,099.² This amount was increased to \$37,065,498 for items of plant and equipment sold by Coy in the normal course of its business.³ Some time between 1 July 1998 and 31 March 1999, Coy repaid \$22,983,144 – being the difference between what it had originally received and the assessed fair market value of the plant and equipment – to JHFC.⁴ Ultimately, therefore, JHFC purchased Coy’s plant and equipment for \$37,065,498, which represented a profit of \$12,532,919 to Coy on the book value of those assets.⁵

7.3 On 30 June 1998, Coy sold its “Building Board” trade marks to JHR, pursuant to an agreement that JHR would pay the fair market value of the trade marks at that date as assessed.⁶ On 17 September 1998, Grant Samuel said that a reasonable estimate of the fair market value of the trade marks, as at 30 June 1998, was \$139.5m.⁷ JHR paid Coy that amount for the trade marks.⁸

¹ Morley, Ex 121, paras 24 and 28.

² Morley, Ex 121, para. 31; Vol 1, Tab 7.

³ Morley, Ex 121, para. 34.

⁴ Morley, Ex 121, para. 33.

⁵ Morely, Ex 121, para. 34.

⁶ Morley, Ex 121, para. 77.

⁷ Morley, Ex 121, Vol 3, Tab 24, pp. 970–971.

⁸ Morley, Ex 121, para. 80.

7.4 On 28 October 1998, Amaca's core business was sold (effective as at 1 November 1998) to JHA, which was an indirectly held wholly-owned subsidiary of JHNV.⁹ There were three transactions:

- (a) Coy's business, excluding those parts conducted in Queensland, was sold directly to JHA under a business acquisition agreement between Coy, JHA and JHIL.¹⁰
- (b) The parts of Coy's business conducted in Queensland were initially sold to James Hardie US Investments Carson, Inc ("Carson") under a business acquisition agreement between Coy, Carson and JHIL.¹¹
- (c) Carson then sold Coy's Queensland business to JHA under a business on-sale agreement between Carson, JHA and JHIL.¹²

7.5 JHIL was the ultimate holding company of each of Coy, JHA and Carson, and guaranteed the obligations of the vendor (either Coy or Carson) under each agreement.

7.6 It is likely that the parts of Coy's business conducted in Queensland were sold to JHA via an intermediate sale to Carson in order to minimise the stamp duty payable on the sale.¹³

7.7 The assets sold as part of Coy's business were its goodwill, intellectual property used in the business (including rights to use intellectual property not owned by Coy), the benefit of all current contracts entered into by Coy in their course of the business, and the business' inventories of raw materials, works-in-progress and stock.¹⁴ Some land at Kellyville, New South Wales, was also sold as part of Coy's non-Queensland business.¹⁵

⁹ Morley, Ex 121, paras 52–71.

¹⁰ Morley, Ex 121, para. 52(a); Vol 1, Tab 10, p. 277.

¹¹ Morley, Ex 121, para. 52(b); Vol 2, Tab 16, p. 710.

¹² Morley, Ex 121, para. 52(c); Vol 2, Tab 17, p. 799.

¹³ See Ex 61, Vol 1, Tab 20, p. 40.

¹⁴ Morley, Ex 121, para. 52(c); Vol 2, Tab 17, p. 799.

¹⁵ Morley, Ex 121, para. 52(c); Vol 2, Tab 17, p. 799.

7.8 Other assets were excluded from the sale of Coy's business. Those assets included Coy's trade receivables, all past, present and future liabilities of the business (including asbestos-related liabilities) other than those expressly assumed under the sale agreements, and real property held by Coy which had been contaminated by asbestos.¹⁶

7.9 In total, Coy received \$30,130,675 for the sale of its core business to JHA.¹⁷ The individual amounts making up this total are set out in the table below:¹⁸

	Goodwill	Net Assets	Adjustment	Total
Non-Queensland business	\$12,000,000	\$4,750,183	\$607,585	\$17,357,768
Queensland business	\$4,500,000	\$8,272,908	-	\$12,772,908
Total	\$16,500,000	\$13,023,041	\$607,585	\$30,130,676

7.10 Three matters should be noted about these individual amounts:

- (a) The total amount of \$16.5m for goodwill was equal to the mid-point of a valuation range between \$4.8m and \$28.3m, which Grant Samuel & Associates ("Grant Samuel") had attributed to Coy's goodwill in a valuation of its businesses dated 17 September 1998.¹⁹ The division of that total between Coy's non-Queensland businesses (\$12m) and its Queensland businesses (\$4.5m) was consistent with Grant Samuel's allocation of Coy's goodwill on the basis of sales generation in each State and export sales.²⁰
- (b) The amounts for Coy's net assets were taken from net assets statements prepared, as at 1 November 1998, by JHA, following completion of the sale of Coy's business, as it was required to do under the sale agreements.²¹

¹⁶ Morley, Ex 121, para. 55(c); Vol 1, Tab 10, p. 284; Vol 2, Tab 16, p. 715; Vol 2, Tab 17, p. 805.

¹⁷ Morley, Ex 121, para. 63.

¹⁸ The table is taken from Morley, Ex 121, par 63.

¹⁹ Morley, Ex 121, para. 64; Vol 2, Tab 20, P 887.

²⁰ Morley, Ex 121, Vol 2, Tab 20, p. 898.

²¹ Morley, Ex 121, paras 58 and 61. Copies of the net assets statements are at Ex 121, Vol 12, Tabs 18 (non-Queensland) and 19 (Queensland).

- (c) The addition of \$607,585 to the sale price for Coy's non-Queensland business appears to have been an adjustment for prepayments made by Coy on goods, services or other benefits (such as gas, electricity, water etc) which were to be received by JHA after the sale of the business had been completed.²²

7.11 There is no issue about the price at which Coy's plant and equipment and trade marks were sold. There is nothing to suggest that they were sold at other than fair value. However, whether Coy's core business was sold for fair value was in issue.

B. Grant Samuel Valuation Methodology

7.12 The Grant Samuel valuation of Coy's business dated 17 September 1998²³ was used to determine the price at which Coy's goodwill was sold to JHA. Accordingly, the methodology of the valuation requires attention. It is described in Appendix 1 of the valuation.²⁴

7.13 The purpose of the valuation was to value Coy's business by assessing the fair market value of its business operations.²⁵ "Fair market value" was defined by Grant Samuel as "the maximum price that could be realised in an open market over a reasonable period of time assuming potential buyers have full information."²⁶ Grant Samuel's purpose may be distinguished from that of determining the price at which Coy's businesses "should" be sold to JHA because considerations other than the fair market value of Coy's businesses operations could have been relevant to this.²⁷

²² Morley, Ex 121, para. 59; Vol 1, Tab 10, p. 290.

²³ Ex 121, Vol 2, Tab 20, p. 898.

²⁴ Ex 121, Vol 2, Tab 20, pp. 902–904.

²⁵ Ex 121, Vol 2, Tab 20, p. 902.

²⁶ Ex 121, Vol 2, Tab 20, p. 902.

²⁷ See Gardner, Ex 234, par 39.

7.14 The methodology used in the valuation was identified by Grant Samuel as “capitalisation of earnings”,²⁸ which involved “capitalising the earnings of a business at a multiple which reflects the risks of the business and the stream of income it generates”.²⁹ The methodology was plainly an appropriate one.³⁰

7.15 The starting point for the valuation was the selection of a level of earnings for Coy’s business “which a purchaser would utilise for valuation purposes”,³¹ i.e., a level of earnings likely to be achieved in the future. The level of earnings Grant Samuel selected was Coy’s July 1998³² forecast EBITDA for the year ending 31 March 1999 (before payment of a management fee from Coy to JHIL) of \$23.1m, adjusted for considerations relevant to future years such as anticipated cost savings from the rationalisation of Coy’s factories, a lower royalty rate payable for the use of James Hardie trade marks due to declining sales, and the payment of rent for land which was not to be sold as part of Coy’s businesses.³³ This gave an adjusted forecast EBITDA for Coy’s business operations in 1999 of \$24.8m.³⁴ The valuation was based on that level of earnings.

7.16 The next step was to determine the appropriate capitalisation multiple to apply to the adjusted forecast EBITDA.³⁵ Grant Samuel applied multiples of 6 and 7 times to the adjusted forecast.³⁶ In selecting these multiples, regard was had to the attributes of Coy’s business and key factors affecting it (such as the impact of increased competition in the fibre current market), conditions within the building materials industry, the share marketing rating of JHIL, and market evidence of the EBITDA multiples at which companies comparable to Coy were trading.³⁷

²⁸ Ex 125, Vol 2, Tab 20, p. 902.

²⁹ Ex 121, Vol 2, Tab 20, p. 902.

³⁰ See Ex 121, Vol 2, Tab 20, p. 902 where Grant Samuel observed that capitalisation of earnings “*is the most commonly used method for valuation of industrial business*”, and also Humphreys, Ex 245, para. 1.17.

³¹ Ex 121, Vol 2, Tab 20, p. 902.

³² Ex 235, p. 6; Gardner T3094.40–47.

³³ Ex 121, Vol 2, Tab 20, p. 893.

³⁴ Ex 121, Vol 2, Tab 20, p. 893.

³⁵ Ex 121, Vol 2, Tab 20, p. 902.

³⁶ Ex 121, Vol 2, Tab 20, p. 897.

³⁷ Ex 121, Vol 2, Tab 20, p. 887.

7.17 The application of these capitalisation multiples to Coy's adjusted forecast EBITDA for 1999 gave a range for the gross value of Coy's business of between \$148.8m and \$173.6m.³⁸

7.18 Four adjustments were then made to give a range for the net value of Coy's business operations:

- (a) An amount of \$9.9m was added, being the portion of JHIL's superannuation surpluses (that is, where the market value of JHIL's superannuation investments exceeded the present value of accrued benefits) which Grant Samuel allocated to Coy.³⁹
- (b) \$3.7m was subtracted to account for the fact that the lower royalty rate on which the 1999 adjusted forecast EBITDA had been calculated would not come into effect until 1 April 2000.⁴⁰
- (c) A further \$106m was subtracted from the range of gross values for Coy's business, this being the value of land and equipment used in the businesses but not owned by Coy.⁴¹
- (d) The value of the Building Boards trade marks in Australia, which were used by Coy in its business but no longer owned by it, was also subtracted.⁴² That range was estimated by Grant Samuel in a separate valuation, also dated 17 September 1998, as being between \$20.5m and \$21.8m.⁴³

³⁸ Ex 121, Vol 2, Tab 20, p. 887.

³⁹ Ex 121, Vol 2, Tab 20, p. 887 and 913.

⁴⁰ Ex 121, Vol 2, Tab 20, p. 887 and 894.

⁴¹ Ex 121, Vol 2, Tab 20, p. 887 and 893.

⁴² Ex 121, Vol 2, Tab 20, p. 887 and 898.

⁴³ Ex 121, Vol 3, Tab 22, p. 970–995.

7.19 Accordingly, Grant Samuel assessed the next value of Coy's business operations as being in the range of \$28.5m and \$52m.⁴⁴ Grant Samuel considered it reasonable to adopt the mid-point of this range, \$40.2m, as a point estimate of the value of Coy's business.⁴⁵

7.20 To identify a range of values for Coy's goodwill, Grant Samuel deducted the value of Coy's net tangible assets employed in its business from the net value of its business operations.⁴⁶ This gave a range of values between \$4.8m and \$28.3m for goodwill. Grant Samuel concluded that \$16.5m, the mid-point of this range, was an appropriate value for the transfer of Coy's goodwill on 1 October 1998.⁴⁷

C. Possible Bases for Attack on Price Adopted

7.21 There are two possible bases for attack on the price adopted for the sale of Coy's business to JHA:

- (a) the approximately \$13m for Coy's net assets was too low; and
- (b) the \$16.5m paid for Coy's goodwill was too low (which involves a conclusion that Grant Samuel under valued the goodwill).

D. Amount paid for Coy's net assets

7.22 The question whether the amount paid for Coy's net assets was too low arises because Grant Samuel valued Coy's net assets at \$23.7m,⁴⁸ but only \$13,023,091 was paid for the assets⁴⁹ on the basis of the net assets statements prepared by JHA following completion of the sale of Coy's business.⁵⁰

⁴⁴ Ex 121, Vol 2, Tab 20, p. 887.

⁴⁵ Ex 121, Vol 2, Tab 20, p. 887.

⁴⁶ Ex 121, Vol 2, Tab 20, p. 887 and 891–893.

⁴⁷ Ex 121, Vol 2, Tab 20, p. 887 and 898.

⁴⁸ Ex 121, Vol 2, Tab 20, p. 887.

⁴⁹ Morley, Ex 121, para. 63.

⁵⁰ Ex 121, Vol 2, Tabs 18 and 19.

7.23 The main evidence on this question came from Mr Morley, first during his examination by Counsel Assisting⁵¹ and then during his re-examination,⁵² at which point a document in which he explained the difference between Grant Samuel's valuation of Coy's net assets and the amount paid for them was put in evidence.⁵³

7.24 In the end the explanation for the difference between Grant Samuel's valuation and the amount paid for Coy's net assets has two elements: one is that some of the assets valued by Grant Samuel were not sold to JHA (and so were not paid for), the other is that some assets had changed in value between 31 March 1998 (the date of the information Grant Samuel used to value the net assets)⁵⁴ and 1 November 1998 (the effective date for the transfer of Coy's businesses to JHA).⁵⁵ The details of this are set out in Ex 183. The most significant single factor was that while Grant Samuel valued Coy's trade receivables (\$46.3m) and payables (\$21.8m),⁵⁶ giving a net amount of Coy's favour of \$24.5m, those receivables and payables were not transferred to JHA as part of Coy's business.⁵⁷ Accordingly, Coy remained entitled to collect the receivables and liable to pay the payables itself.

7.25 I am satisfied that the amount paid for Coy's net assets was not too low and does not afford any basis for attacking the price at which Coy's business was transferred to JHA.

E. Amount paid for Coy's goodwill

7.26 Doubt about whether the amount paid for Coy's goodwill was too low arose because the \$16.5m paid was substantially less than a value of between \$110m and \$125m of Coy's goodwill in a valuation by PricewaterhouseCoopers Securities Ltd⁵⁸ dated 19 April 1999, but as at 20 January 1997.

⁵¹ Morley, T 2201.21 – 2205.1.

⁵² Morley, T 2754.53 – 2759.52.

⁵³ Ex 183.

⁵⁴ See Ex 236.

⁵⁵ Ex 183; Morley, T2757.40–2758.21.

⁵⁶ Ex 121, Vol 2, Tab 20, p. 891.

⁵⁷ Ex 121, Vol 1, Tab 10, p. 284; vol 2, Tab 16, p. 715; Vol 2, Tab 17, p. 805.

⁵⁸ Ex 121, Vol 3, Tab 21, pp. 914–955.

7.27 The main evidence on the adequacy of the amount paid for Coy's goodwill was given by the following witnesses:

- (a) Mr Morley at paras 72–74 of his first statement,⁵⁹ in examination by Counsel Assisting,⁶⁰ and during re-examination⁶¹ when documents prepared by Mr Morley attempting to explain the differences between Grant Samuel's and PricewaterhouseCoopers' valuation of Coy's goodwill were put in evidence;⁶²
- (b) Jaye Gardner, who was responsible for the day-to-day conduct of the Grant Samuel valuation,⁵⁴ in her statement of 8 June 2004,⁶³ and during her examination by Counsel Assisting;⁶⁴
- (c) Charles Humphrey, who was the signing partner on the PwC valuation,⁶⁵ in his second statutory declaration;⁶⁶ and
- (d) Robyn Humphreys, a chartered accountant retained by the Solicitor to the Commission, in his first report dated 24 May 2004,⁶⁷ his oral evidence,⁶⁸ and a further report dated 26 July 2004.⁶⁹

7.28 Submissions on this subject were made by Counsel Assisting,⁷⁰ JHI NV and ABN 60,⁷¹ and Grant Samuel.⁷²

⁵⁹ Ex 121.

⁶⁰ Morley, T2205.3–2212.48.

⁶¹ Morley, T2759.54–2763.50.

⁶² Ex 184 and 185.

⁵⁴ Ex 234, para. 13.

⁶³ Gardner, Ex 234.

⁶⁴ Garner, T3088.50–3100.29.

⁶⁵ Ex 333, para. 2.

⁶⁶ Ex 333.

⁶⁷ Ex 245, paras 1.16–1.24 and 1.34–1.38.

⁶⁸ Humphreys, T3183.28–3187.45.

⁶⁹ Ex 321, paras 9–16.

⁷⁰ Counsel Assisting's Initial Submissions, Section 4, paras 122–134; Counsel Assisting's Submissions in Reply, paras 4.23–4.27.

⁷¹ JHI NV Initial Submissions on Terms of Reference 2 and 3, paras 4.4.5–4.4.9; JHI NV Submissions in Reply on Terms of Reference 1 to 3, paras K5.2–K5.3

⁷² Gardner Initial Submissions; Gardner Supplementary Submissions.

7.29 Whether the amount paid by JHA for Coy’s goodwill was less than fair value ultimately depends largely on a comparison between Grant Samuel’s valuation of the goodwill and PricewaterhouseCoopers’ valuation, and on an assessment of the reasons for the differences between them.

7.30 The methodology employed by PricewaterhouseCoopers to value Coy’s business was broadly the same as that used by Grant Samuel. The purpose of the valuation was to assess the fair market value, as at 20 January 1997,⁷³ of the trademarks and goodwill of Coy.⁷⁴ The value of Coy’s goodwill was assessed by valuing its underlying business (by capitalisation of future maintainable earnings) and subtracting from that the fair value of its net operating assets and trademarks (using the relief from royalty method), the remainder being attributed to goodwill.⁷⁵ In paragraph 6 of Grant Samuel’s Supplementary Submissions, it is suggested that Grant Samuel did not use a “*capitalisation of future maintainable earnings methodology*” when assessing the gross value of Coy’s businesses, but rather capitalised “*the forecast earnings for a single year, being the year ending March 1999*”. However, this overlooks the fact that the Grant Samuel valuation adjusted Coy’s 1999 forecast EBITDA to account for likely changes to its business in the future. That was evidently done to align the 1999 forecast EBITDA more closely with Coy’s likely earnings in subsequent years. Although PricewaterhouseCoopers seems to have had regard to a wider range of factors in determining Coy’s future maintainable earnings (such as Coy’s earnings in previous years and economic issues affecting its business and earnings generally)⁷⁶ than did Grant Samuel in adjusting Coy’s 1999 forecast EBITDA, this does not constitute a significant difference in methodology between the valuations.⁷⁷

7.31 Grant Samuel and PricewaterhouseCoopers also used the same methodology in valuing Coy’s trade marks. This was a relief from royalty methodology which

⁷³ This date was selected because it was against the value of Coy’s trademarks and goodwill as at that date that any capital gain or loss on those assets was to be assessed for capital gains tax purposes. See Humphreys, Ex 333, para. 5; Salter, T1963.15–1963.56.

⁷⁴ Ex 121, Vol 3, Tab 21, p. 937.

⁷⁵ Ex 121, Vol 3, Tab 21, p. 937–938.

⁷⁶ Ex 121, Vol 3, Tab 21, pp. 940–945.

⁷⁷ Mr Humphrey concluded that Grant Samuel and PwC had adopted consistent valuation methodologies; see Ex 333, para. 26.

involves determining a notional, arms length, commercial royalty for exploitation of the trade marks, applying this to the estimated level of future maintainable sales of products utilising the trade marks, and then either capitalising the resultant royalty stream or conducting a discounted cash flow valuation.⁷⁸

7.32 The substance of the Grant Samuel and PricewaterhouseCoopers valuations was compared by Mr Humphrey in his second statutory declaration.⁷⁹ The following points revealed by that comparison are significant:

- (a) PricewaterhouseCoopers had access to Coy's 1996 actual earnings, and its forecast earnings for 1997 and 1998. Grant Samuel had access to Coy's actual earnings for 1996, 1997 and 1998, and its forecast earnings for 1999. The forecast earnings for 1997 and 1998 to which PricewaterhouseCoopers had access were very close to Coy's actual earnings for those years. Accordingly, with the exception of the 1999 forecast to which PricewaterhouseCoopers did not have access, PricewaterhouseCoopers and Grant Samuel based their valuation on similar information about Coy's earnings.⁸⁰
- (b) While Grant Samuel used an adjusted forecast EBITDA figure of \$24.8m as the basis for its valuation, PricewaterhouseCoopers used a future maintainable EBIT figure of \$25m. Grant Samuel's figure equated to an EBIT of \$16.2m.⁸¹
- (c) In its valuation, PricewaterhouseCoopers used a capitalisation multiple in the range of 10.5 to 11.5 times Coy's future maintainable EBIT. Grant Samuel used a capitalisation multiple in the range of 6 to 7 times Coy's adjusted forecast EBITDA. This equated to an implied EBIT multiple in the range of 9.2 to 10.7 times.⁸²
- (d) Mr Humphrey assessed the impact of the different earnings figures used by PricewaterhouseCoopers and Grant Samuel in their valuations

⁷⁸ See Ex 121, Vol 3, Tab 22, pp. 985–988; Ex 121, Vol 3, Tab 21, pp. 937–938; Humphrey, Ex 333, para. 27.

⁷⁹ Ex 333.

⁸⁰ See Humphrey, Ex 333, para. 12.

⁸¹ Humphrey, Ex 333, paras 17 and 18.

⁸² Humphrey, Ex 333, paras 19–23.

as being in the order of \$96.8m.⁸³ This was the product of multiplying the difference of \$8.8m in the EBIT figures used by PricewaterhouseCoopers and Grant Samuel 11 times, that being the mid-point of the range of multiples used by PricewaterhouseCoopers.⁸⁴

7.33 The impact so calculated of the different earnings figures used by PricewaterhouseCoopers and Grant Samuel is similar to the different values attributed to Coy's goodwill in their respective valuations.⁸⁵ The mid-point of Grant Samuel's valuation of goodwill is \$16.5m⁸⁶ that of PricewaterhouseCoopers' valuation is \$117.5m. The difference between them is \$101m.

7.34 This directs attention to the accuracy of the 1999 forecast EBITDA which was the starting point for the adjusted forecast EBITDA used by Grant Samuel in its valuation. Mr Humphreys, sought to identify Coy's actual EBITDA for 1999 as a means of assessing the accuracy of the forecast. In his oral evidence, expanding on paragraph 1.17 of his 24 May 2004 report,⁸⁷ he agreed with a series of calculations giving an estimated actual EBITDA for Coy in that year of around \$39m.⁸⁸ If correct, this would mean that Coy's actual EBITDA was substantially in excess of its forecast for 1999 of \$23.1m.

7.35 Difficulties with Mr Humphreys' attempt to calculate Coy's actual EBITDA for 1999 were identified by Ms Gardner in her 8 June 2004 statement.⁸⁹ In particular, Ms Gardner pointed out that Mr Humphreys had used forecast rather than actual depreciation to estimate Coy's actual EBITDA for 1999.⁹⁰ Similarly, Mr Humphreys used forecast EBIT for JHIL's New Zealand operations in his calculations.⁹¹ Ms Gardner also accepted, however, that without the actual figure for

⁸³ Humphrey, Ex 333, para. 24.

⁸⁴ Humphrey, Ex 333, para. 24

⁸⁵ There were also differences between PwC and Grant Samuel in valuing Coy's grade marks, see Humphrey, Ex 333, paras 27–31. However, the impact of these differences was not of the same order of magnitude as that of the different earnings figures used.

⁸⁶ Ex 121, Vol 2, Tab 20, p. 898.

⁸⁷ Humphreys, Ex 245.

⁸⁸ Humphreys, T3183.28–3184.28.

⁸⁹ Gardner, Ex 234, para. 83.

⁹⁰ Gardner, Ex 234, para. 83(b).

⁹¹ Humphreys, T3183.55–3184.10.

depreciation the forecast figure used by Mr Humphreys was a “*reasonable ... second best approximation*”.⁹² In a similar vein, the forecast EBIT for JHIL’s New Zealand operations was also a reasonable approximation for Mr Humphreys to use in the absence of the actual EBIT. Accordingly, despite the use of these forecasts, Mr Humphreys’ attempt to calculate Coy’s actual EBITDA for 1999 may still be of some assistance.

7.36 Another potential difficulty with Mr Humphreys calculation was identified in the course of his oral evidence, namely that the central figure he had used to calculate Coy’s actual EBITA (the 1999 profit for JHIL’s Australian and New Zealand operations) *excluded* intercompany charges, while the forecast EBITDA used by Grant Samuel *included* some intercompany charges.⁹³ When examined about this, Mr Humphreys accepted that if his estimated 1999 actual EBITDA were adjusted to include intercompany charges it would reduce to an amount fairly cost to \$24m or \$25m, and that this would satisfy his query about the 1999 forecast EBITDA.⁹⁴ In his report of 26 July 2004, Mr Humphreys withdrew his acceptance of this, and concluded that Coy’s 1999 forecast EBITDA of \$23.1m required only limited adjustments to be comparable with the estimated actual EBITDA he had calculated.⁹⁵ Those adjustments increased the forecast EBITDA to \$32.7m, still \$6.3m less than the \$39m at which Mr Humphreys estimated Coy’s actual EBITDA for 1999.⁹⁶ No submission has been made that Mr Humphreys’ adjustments to Coy’s 1999 forecast EBITDA to remove intercompany charges were wrong, or that further adjustments should have been made. There are no intercompany charges apparent in the 1999 forecast EBITDA other than those for which Mr Humphreys made adjustments. Accordingly, it appears that the figure of \$32.7m is probably a reasonably accurate adjustment of Coy’s 1999 forecast EBITDA excluding intercompany charges.

7.37 On balance, the accuracy of Coy’s 1999 forecast EBITDA of \$23.1m is difficult to assess. Given the use of forecasts for depreciation and the EBIT of JHIL’s

⁹² Gardner, T3095.16–22.

⁹³ Humphreys, T3184.56–3187.45.

⁹⁴ Humphreys, T3187.27–3187.45.

⁹⁵ Humphreys, Ex 321, para. 14.

⁹⁶ Humphreys, Ex 321, para. 14.

New Zealand operations, the figure of \$39m which Mr Humphreys derived for Coy's 1999 actual EBITDA, while not useless, cannot be more than a rough guide to what the actual EBITDA was. It was not advanced as being anything more than that. Although all discernible intercompany charges have been removed from the forecast EBITDA, the possibility of hidden intercompany charges means there must remain some doubt about whether it is perfectly comparable with the estimated actual EBITDA result. Therefore, while Mr Humphreys' evidence suggests a reasonable possibility that Coy's 1999 forecast EBITDA of \$23.1m was understated, it does not permit a firm conclusion to this effect or as to the extent of any understatement.

7.38 The impact of the different earnings figures used by Grant Samuel and PricewaterhouseCoopers in their valuations also directs attention to the adjustments Grant Samuel made to Coy's 1999 forecast EBITDA for likely changes to its business in future years. Only one of those adjustments has been the subject of any criticism. That is the reduction of EBITDA by \$5.1m to account for rental the purchaser of the business would have to pay on properties owned by Coy and not being transferred to it.⁹⁷ Mr Humphreys suggested that this adjustment should have been accompanied by an increase in EBITDA to account for expenses connected with ownership of properties (such as land tax and the costs of and structural or capital repairs), which a purchaser of Coy's business would not have to meet.⁹⁸ Ms Gardner accepted that, assuming the initial forecast included such expenses, Mr Humphreys was correct,⁹⁹ but neither Mr Humphreys nor Ms Gardner was able to comment on the materiality of such an increase in Coy's EBITDA.¹⁰⁰ Ultimately, while this may mean that the adjustment forecast EBITDA used by Grant Samuel in its valuation was slightly understated, there is no basis for concluding that this had any material effect on the result of the valuation.

⁹⁷ Ex 121, vol 2, Tab 20, pp. 893–895.

⁹⁸ Humphreys, Ex 245, para. 1.19.

⁹⁹ Gardner, T3093.33–51.

¹⁰⁰ Humphreys T3189.40–43; Gardner T3093.33–51.

7.39 A further explanation for the difference between the Grant Samuel and PricewaterhouseCoopers valuations may be that they assess the value of Coy's goodwill at different times, 17 September 1998 for the Grant Samuel valuation and 20 January 1997 for the PricewaterhouseCoopers valuation. Mr Morley referred to this explanation in this oral evidence,¹⁰¹ and JHI NV and ABN 60 referred to it in their written submissions.¹⁰² In favour of this explanation there is evidence that in the period between 20 January 1997 and 17 September 1998 Coy faced increasing competition in the Australian fibre cement market. However, PricewaterhouseCoopers' valuation referred to the same competitive considerations as Grant Samuel's, the actual earnings of Coy for 1997 and 1998 were much the same as the forecast earnings to which PricewaterhouseCoopers had access when preparing its valuation, and there is no evidence of so dramatic a deterioration in Coy's businesses between early 1998 and mid 1998 as to reduce the value of its goodwill by around \$100 million. Accordingly, the different times to which the valuations relate are unlikely to be an adequate explanation for the full extent of the difference between them.

7.40 Overall, in my view, the evidence does not reveal any entirely satisfactory explanation for the difference between the values attributed to Coy's goodwill by Grant Samuel and PwC. The difference may be the result of a number of factors, such as the 1999 forecast EBITDA taken by Grant Samuel as its starting point being somewhat conservative and the value of Coy's goodwill diminishing between January 1997 and September 1998. Whatever the full explanation, there is no basis for finding that the difference between the valuations is the result of Coy providing wrong or incomplete information to Grant Samuel for its valuation, or of any negligence on the part of Grant Samuel in conducting the valuation. While there may be some room for speculation as to whether the amount paid for Coy's goodwill was fair value, there is no clear evidence that it was not.

7.41 Accordingly, there is no sound basis for finding that the price JHA paid for Coy's core business was other than fair value.

¹⁰¹ Morley, T 2210.44–48.

¹⁰² JHI NV Initial Submissions on Terms of Reference 2 and 3, paras 4.4.8.

Chapter 8 – Leases And Rental Valuations

A. Summary of the properties, leases, and rental valuations

8.1 Under clause 4.1 of the agreement for the sale of Coy's non-Queensland businesses to JHA, it was a condition of completion that Coy to JHA for ten years would lease five properties at Devon Street, Rosehill and 1 Grand Avenue, Camellia, in New South Wales, Rutland Avenue, Welshpool, in Western Australia, and 46 Rundle Road, Meeandah and 1-35 Cobalt Street, Carole Park, in Queensland.¹

8.2 Prior to entry into the sale agreement, in June 1998 Mr Shafron retained the firm JLW Advisory to conduct rental valuations of those properties.² Although in his first statement Mr Shafron refers to four properties (he does not refer to the property in Camellia, New South Wales),³ valuations of all five properties, each issued in July 1998, are in evidence.⁴

8.3 JLW Advisory conducted the rental valuations on particular assumptions. The detail of the assumptions varied slightly between the different properties, but they were broadly as follows:⁵

- (a) that each property was being offered vacant to a third party or parties;
- (b) that each property was too large for one tenant to lease, with the result that each was divided up into more marketable parcels hypothetically leased to different parties;⁶
- (c) that the properties would not attract long term tenants and that leases would generally be for five years or less;

¹ Ex 121, Vol 1, Tab 10, p. 283.

² Shafron, Ex 17, para. 38.

³ Shafron, Ex 17, para. 41

⁴ Ex 121, Vol 3, Tabs 27–30 and Vol 4, Tab 31.

⁵ See Ex 121, Vol 3, Tab 27, pp. 1080–1081; Tab 28, pp. 1183–1184; Tab 29, pp. 1315–1317; Tab 30 pp. 1408–1409; Vol 4 Tab 31, pp. 1480–1481.

⁶ It is not clear that this assumption applied to the property at Camellia, New South Wales; see Ex 121, Vol 4, Tab 31, pp. 1480–1481.

- (d) that prior to the commencement of each lease term there would be a significant letting up period of a number of months;
- (e) that there would be agency fees and marketing costs incurred at the start of each lease term; and
- (e) although each of the properties was contaminated by asbestos, that no remediation would be required.

8.4 For each property, the methodology employed by JLW Advisory in conducting its valuation was as follows:⁷

- (a) first, an annual market rental per square metre was identified for each marketable parcel of the property by reference to rentals for comparable properties;
- (b) secondly, this was used to calculate the total annual market rental for each parcel (or sometimes for a number of parcels combined);
- (c) thirdly, that total annual market rental was divided by 12 to give a monthly market rental for the parcel(s);
- (d) fourthly, the monthly market rental, together with the costs of each letting up period, agency fees and marketing expenses, was entered into a spreadsheet and discounted to give the net present value of the cash flow of the parcel(s) over ten years;
- (e) fifthly, the net present value of the cash flow was then used to give an effective rental annuity, and that figure was itself divided by the number of square metres being rented to give an effective annual rental per square metre.

8.5 The effective rental annuity for each parcel of property was added up to give the total rental annuity for that property. This total rental annuity was then used to set the rental payable by JHA to Coy under the lease for that property (subject to

⁷ Ex 121, Vol 3, Tab 27, pp. 1084–1092; Tab 28, p. 1187–1191; Tab 29, pp. 1323–1324; Tab 30, pp. 1412–1425; Vol 4, Tab 31, pp. 1484–1486.

periodic reviews in accordance with the lease terms). Each of the properties was, in fact, leased to JHA for 10 years, save for Camellia, which was leased to JHA for two years.

B. Accuracy of the rental valuations

8.6 Counsel Assisting has submitted that the assumptions and methodology in the JLW Advisory rental valuations may not have been appropriate, with the result that the leases did not provide for JHA to pay fair market rentals to Coy for the properties.⁸ Essentially, that is said to be because the rental valuations were conducted without reference to the fact that it was intended that JHA would occupy the whole (or nearly the whole) of each property for 10 years and that JHA needed to do so if it were to avoid significant costs associated with relocating those parts of Coy's business which it was acquiring to new premises.

8.7 JHI NV/ABN 60 have resisted that submission,⁹ pointing out that the evidence suggests that JHA was the only party likely to have been willing to lease the whole of the properties and that this would have given it substantial power in an arms length negotiation. They have also speculated that JHA may not have faced much inconvenience in relocating if there had been premises available elsewhere.

8.8 The evidence on this issue, other than the documents to which reference has already been made, comes mainly from Mr Eccleston of BEM Property Consultants Pty Limited. He is a registered property valuer who was retained by the Commission to report in relation to the leases between Coy and JHA and the rental opinions prepared by JLW Advisory. Mr Eccleston produced a report as requested¹⁰ and also gave oral evidence.

8.9 In addition, the Commission has received a copy of a letter from Robert Ellis, one of the JLW Advisory valuers responsible for the rental opinions in

⁸ Counsel Assisting's Initial Submissions, Section 4, paras 148–155; Counsel Assisting's Submissions in Reply, paras 4.33–4.37.

⁹ JHI NV Initial Submissions on Terms of Reference 2 and 3, para. 4.5.12.

¹⁰ Ex 238.

question, addressed to Karen Davies, legal counsel for Jones Lang LaSalle.¹¹ In that letter, Mr Ellis responds to some of Mr Eccleston's comments on the rental opinions.

8.10 An important issue which arose in Mr Eccleston's evidence was the difference between "market rental" or "face rental", and "effective rental". The former is the amount of rent required by the lease to be paid periodically by a tenant. The latter is the average amount received by the landlord in each period over the course of the lease, taking into account incentives which might be offered to the tenant such as rent free periods and possibly also costs such as agency fees and marketing expenses.¹²

8.11 In parts of his evidence, Mr Eccleston appeared to express the view that JHA should have paid the market rental as assessed by JLW Advisory for each of the properties, not the effective rental.¹³ However, the point made by JHI NV and ABN 60 was that the effective rentals payable by JHA took into account incentives which would otherwise have been paid to tenants of the properties and other costs which JLW Advisory assumed Coy would have been incurred if the properties had been leased to third parties.¹⁴ When this was put to Mr Eccleston, he suggested that use of an effective rental rather than a market rental might affect the outcome of a discounted cash flow valuation of the type done by JLW Advisory.¹⁵ However, JLW Advisory did its discounted cash flow valuation for each property using the market rental for that property in order to derive its effective rental. Accordingly, Mr Eccleston's suggestion falls away. It follows that there is no reason for concluding that JHA should have paid the market rental as assessed by JLW Advisory, rather than the effective rental.

8.12 The central concern raised by Mr Eccleston, however, was that, in circumstances where (except for Camellia) the properties were to be leased to JHA for 10 year terms, JLW Advisory's rental valuations should not have been conducted on the assumptions that each property (except the Camellia property) was to be

¹¹ Ex 239.

¹² Eccleston, Ex 238, p. 28; Eccleston, T3132.36–3133.9.

¹³ Eccleston, Ex 238, p. 31; T3130.54–3131.36.

¹⁴ JHI NV Initial Submissions on Terms of Reference 2 and 3, paragraph 4.5.4(d).

¹⁵ Eccleston, T 3137.7–3137.30.

leased vacant to multiple third parties, in smaller parcels, for no more than a few years at a time, with the result that Coy would be exposed to multiple letting up periods, agencies fees, marketing expenses and so on.¹⁶ This is, in effect, the argument put by Counsel Assisting. As noted above, JHI NV and ABN 60 have responded that being the only party interested in the whole of each property would have put JHA in a strong negotiating position. In determining a fair rental, some consideration would have to be given to that.¹⁷ The fact that the business JHA had acquired was already established at properties owned by Coy would also have put Coy in a strong position. I was left with the impression that the assumptions on which JLW Advisory's rental opinions were to proceed did not give weight to Coy's strength in this regard. Although JHI NV and ABN 60 have also said that it might not have been inconvenient for JHA to move to new premises, there is no evidence to support that view and, given the nature of the business it had acquired, I think it unlikely to have been the case.

C. Conclusion

8.13 There is some substance in the criticism that the opinions prepared by JLW Advisory may have understated the rentals which Coy should have received for the properties leased to JHA, and accordingly that JHA paid something less than fair market rental for the properties. The evidence, however, does not permit a conclusion to be drawn as to what the fair rental for each property would have been. Mr Eccleston expressly stated that he was not in a position to give such evidence.¹⁸ No party has submitted that any conclusion on what would have been fair market rentals can now be drawn from JLW Advisory's opinions.

8.14 In addition, as JHI NV/ABN 60 explain in their submissions, any increase in the rentals payable by JHA would have led Grant Samuel to reduce the adjusted forecast EBITDA on which its valuation of Coy was based, with the result that what Coy might have gained in additional rental income it might have lost on the sale

¹⁶ Eccleston, Ex 238, p 31, para. 2; Eccleston, T 3164.6–14.

¹⁷ It might also have been appropriate to give consideration to the fact that the properties were contaminated by asbestos, and this is perhaps the sole respect in which the assumptions on which JLW Advisory proceeded favoured Coy rather than JHA. However, that consideration might not have been material if there were in fact no need to remediate the properties, and there is no evidence to suggest there was such a need.

¹⁸ Eccleston, T 3132.17–34.

price of its business.¹⁹ Further, the four properties with 10 year leases were sold by Amaca on 24 March 2004 for \$70 million to Multiplex.²⁰ For these reasons, no consequences of significance seem to attach to the likelihood that Coy received less than fair market rentals for the properties it leased to JHA.

¹⁹ JHI NV Initial Submissions on Terms of Reference 2 and 3, para. 4.5.14.

²⁰ Slattery QC, T 19.10–20.6.

Chapter 9 – Other Matters

A. The effect of the dealings 1995-2001

9.1 The preceding Chapters in this Part have dealt principally with whether the transfers and dispositions of property by Coy in this period were for full market value. Term of Reference 3, however, involves also whether any “corporate reconstruction or asset transfers” – even if at full value – may have affected Amaca’s ability to “meet its current and future asbestos related liabilities”.

9.2 The events which took place in 1995 to 1998 have not affected Amaca’s ability to meet its *current* asbestos related liabilities. It has paid them as they fell due, in doing so, and will continue to do so, as I have found, until the first half of 2007.

9.3 The events of 1995 to 1998 have also had *some* effect on Amaca’s ability to meet its future asbestos related liabilities. If Coy had not paid the dividends and management fees which it did, it would have more assets. It is also possible to say that if Coy had continued as the operating business it would have been generating revenue and thus continuing in the future to have funds available to meet asbestos liabilities as they became due.

9.4 But there are difficulties with these views. There seems no reason why JHIL was obliged to keep Coy actively in business. Nor does there seem any reason why the United States business should necessarily be carried on by Coy.

B. Purposes of the 1998 Transactions

9.5 A further issue – in relation to each of the 1998 transactions – is whether they were entered into to put the relevant assets outside the reach of present and future asbestos plaintiffs.

9.6 Mr Morley gave evidence of a number of credible commercial purposes behind the sale of Coy's plant and equipment to JHFC.¹ In brief, the sale crystallised a gain against which Coy's tax losses could be offset, it allowed the plant and equipment to be subject to a higher level of depreciation (which was also beneficial for tax purposes), and it avoided stamp duty on the transaction which would have been payable had it occurred as part of the sale of Coy's core business.

9.7 Mr Shafron gave evidence of at least two legitimate commercial purposes behind the sale of Coy's trade marks to JHR,² namely to rationalise the holding and administration of intellectual property in within the James Hardie Group, and to further demonstrate that JHR had been established for a genuine commercial purpose.

9.8 It does not follow, of course, that it was not also a purpose of the sale of Coy's plant and equipment and trade marks to put those assets beyond the reach of asbestos plaintiffs. Nor does that evidence say anything as to the purpose behind the transfer of Coy's core business to JHA.

9.9 Counsel Assisting has submitted that I should find it was a purpose of each transaction that the assets be put beyond the reach of asbestos plaintiffs. JHI NV/ABN 60 resist such a finding in respect of any of the transactions.

9.10 The evidence of Mr Shafron and Mr McGregor is of significance on this issue.

9.11 Mr Shafron gave evidence that it was part of the plan of Project Chelsea that the operating assets which were ultimately to be held by JHNV would not be available to asbestos claimants,³ and that it was intended that, after Project Chelsea, the assets available to asbestos plaintiffs would be limited to the debts owed by James Hardie companies to Coy and Jsekarb and some asbestos-contaminated real estate.⁴ He also agreed, in respect of the transfer of Coy's trade marks specifically, that the James Hardie Group did not want the trade marks on products being sold in

¹ Ex 121, pp. 4–5, paras 25–27.

² Ex 17, pp. 3, para. 15.

³ Shafron T 1777.5–9.

⁴ Shafron T 1777.10–17.

the United States to be held by a company that was subject to asbestos claims in the way that Coy was.⁵

9.12 Mr McGregor accepted that it was an object of Project Chelsea to separate the James Hardie group's operating businesses from the core liabilities, and that this was achieved,⁶ and that that was the reason the operating business assets of Coy were transferred out of it, rather than Coy becoming a subsidiary of JHNV.⁷

9.13 JHI NV and ABN 60 have submitted that the evidence does not support a finding "that the purpose of Project Chelsea was to put Coy's operating assets beyond the reach of asbestos plaintiffs".⁸ Rather, it is said, the evidence shows that it was important to the success of Project Chelsea that the company to be floated on the New York Stock Exchange was free of asbestos liabilities, and that this purpose "inevitably had the consequence that Coy's operating assets would not be available to asbestos plaintiffs".⁹

9.14 A consequence of a transaction may often be one of its purposes and I regard the distinction sought to be drawn between the purpose of the transactions and their "inevitable consequence", for relevant purposes, rather illusory. I am satisfied that one of the purposes was to make the operating assets not available to asbestos plaintiffs. I would add that it is not very surprising that a Group, faced with constant litigation against one of its subsidiaries, should seek to achieve that purpose. It would avoid the possibility of attempts to "freeze" the assets themselves.

9.15 I would reject the contention that the 1998 transactions were for an improper purpose. I think it was understandable that they might be entered into, and I regard the receipt of full value for them as significant.

⁵ T 1788.50–55.

⁶ T 1566.16–33.

⁷ T 1566.35–41.

⁸ Submissions in Reply of JHI NV and ABN 60 on Terms of Reference 1 to 3, para. K5.6.

⁹ Submissions in Reply of JHI NV and ABN 60 Terms of Reference 1 to 3, para. K5.6.

C. Breach of directors' duties – a further comment

9.16 I should mention an aspect which arises from the views expressed above. I accept that it is not the case that the conclusion must always be drawn that a transaction is in the best interests of a company to sell assets, merely because full value has been received for them. Thus in *Jeffree v National Companies and Securities Commission*¹⁰ the Full Court of the Western Australian Supreme Court held that, when motivated by an improper purpose, the transfer of a company's assets, even though it may have been for fair value, was contrary to the interests of its present and future creditors.

9.17 Ultimately, for the reasons given earlier, I would not be prepared to find that Coy's directors breached their duty to act in good faith in the best interests of the company as a whole in approving the 1998 transactions.

¹⁰ [1990] WAR 183.

Part 4 – Term of Reference 2

Chapter 10 – Introduction to Part 4

10.1 Separation of Coy and Jsekarb from the James Hardie Group was achieved in February 2001. It was effected by the establishment of a trust which would become, directly or indirectly, holder of all the shares in Coy and Jsekarb. The move towards adoption of the trust mode began in early 2000 and gained momentum at the end of that year. The events of 2000 in that connection are discussed in **Chapter 11**.

10.2 The two important meetings of the JHIL Board in relation to separation were held on 17 January and 15 February 2001. Before coming to them, however, I discuss in **Chapter 12** some of the basic legal and practical issues involved in separating Coy and Jsekarb from the Group.

10.3 At the 17 January 2001 Board meeting, the Board was asked to indicate that it was in favour of separation of Coy and Jsekarb, there being no funding provided in addition to their net assets. Members of the Board suggested that further funding should be investigated. The 17 January 2001 JHIL Board meeting is discussed in **Chapter 13**.

10.4 At the JHIL Board meeting of 15 February 2001 the Board approved the proposal for separation of Coy and Jsekarb. The formal proceedings of the Board on that occasion are discussed in **Chapter 14**. Many surrounding aspects are dealt with in other Chapters.

10.5 The announcements to the ASX approved by the Board that day were to state that the Foundation was to be “fully-funded”. The announcement also was to say that the fact that the Foundation was fully funded would bring “certainty” to claimants and to shareholders; the asbestos shadow having lifted. The critical inputs to the decision of the JHIL Board, in the light of the nature of the proposal, were the estimates of the outgoings which the Foundation would encounter, and of its likely revenues.

10.6 The estimates of outgoings derived principally from the actuarial reports. That requires an examination of the 1996, 1998 and 2000 Trowbridge Reports, particularly the 2000 Report. That takes place in **Chapter 15**. Two other aspects were germane, the November 2000 Watson and Hurst presentation, and JHIL’s December 2000

Operating Plan Review in relation to asbestos. These aspects are dealt with respectively in **Chapter 16** and **Chapter 17**.

10.7 The ultimately important Trowbridge Report is that of 13 February 2001. It is dealt with first in **Chapter 18**. Other aspects are dealt with in later Chapters in this Part.

10.8 The other major input to the JHIL Board's decision was the cash flow model for the Foundation, the Twelfth Cash Flow Model, which was prepared within JHIL to show as an estimate of the Foundation's incoming funds and outgoing expenditures over a period of approximately 50 years. It is dealt with in **Chapter 19**.

10.9 In order for separation to proceed it was necessary for JHIL to obtain approval from persons who would act as directors of the Foundation, and of Coy and Jsekarb. Those persons were Sir Llew Edwards, Mr Michael Gill, Mr Peter Jollie and Mr Dennis Cooper. Sir Llew Edwards had been a director of JHIL for many years. He was resigning to become a director of the Foundation. Mr Cooper was an executive of the James Hardie Group, whose term of employment was coming to an end. He was unconnected with the asbestos aspects of the Group. Mr Gill and Mr Jollie were solicitor and chartered accountant respectively. Mr Gill had acted for JHIL previously; Mr Jollie was unconnected with the James Hardie Group. I discuss their participation in **Chapter 20**.

10.10 As I have mentioned earlier, the additional funding from JHIL came in return for entry by Coy and Jsekarb into the Deed of Covenant and Indemnity. It is discussed in **Chapter 21**.

10.11 I have referred earlier to the media announcements made on 16 February 2001 to the ASX. **Chapter 22** contains a discussion of that topic.

10.12 It is necessary to examine further Trowbridge's conduct in relation to the February 2001 Trowbridge Report, in particular whether it was negligent in preparation of that Report, or was negligent or engaged in misleading or deceptive conduct in relation to the manner of its use. These topics are discussed in **Chapter 23**.

10.13 In Chapters 3 and 23, reference has been made to some deficiencies in the February 2001 Trowbridge Report. **Chapter 24** deals with whether JHIL bears responsibility for those deficiencies.

10.14 JHIL engaged in 2001 in the second stage of its Project Green, the move of its holding company to The Netherlands. This was effected pursuant to a Scheme of Arrangement approved by the Supreme Court of New South Wales in October 2001. Questions have been raised whether there was adequate disclosure of relevant matters to the Court in connection with that application. That issue is dealt with in **Chapter 25**. The new holding company was JHI NV.

10.15 It did not take long after the establishment of the Foundation for the Foundation to discover that its outgoings were significantly higher than expected. This gave rise to a number of unsuccessful attempts by the Foundation to obtain further funding from JHIL. In **Chapter 26** I discuss the deterioration in relations between JHIL and the Foundation after February 2001.

10.16 Following the implementation of the Scheme of Arrangement there was a continuing deterioration in the relationship between the Foundation and JHIL. In the event negotiations between them came to an end, and in March 2003 JHIL and JHI NV cancelled the partly paid shares which JHI NV held in JHIL and JHI NV transferred ownership of JHIL, now ABN 60 to a new Foundation, the ABN 60 Foundation. These events are discussed in **Chapter 27**.

10.17 The arrangements between JHI NV and ABN 60 included a Deed of Covenant, Indemnity and Access between them. The effect which this Deed had on the efficacy of any rights which the Foundation might have against ABN 60 is dealt with in **Chapter 28**, as is a Deed of Rectification of that Deed entered into in February 2004.

10.18 In **Chapter 29** I add some concluding remarks in relation to this Term of Reference.

Chapter 11 – The Move Towards A Trust

A. Introduction

11.1 I have referred earlier to the failure of the 1998 IPO. There seems no reason to deal in detail with the events of 1998 and 1999 following that failure other than to note:

- (a) Some consideration continued to be given to possible restructuring¹ to deal with, amongst other matters, the asbestos liabilities.
- (b) On 31 October 1999, Dr Barton resigned as Managing Director of JHIL, Mr Macdonald becoming Chief Executive Officer and a director of JHIL.² Dr Barton had no further involvement in the management of the affairs of the Group. Mr Macdonald had previously been the Chief Operating Officer of JHIL.³
- (c) Dr Barton had also been a director of Coy and of Jsekarb. From 1 November 1999 his place as such was taken by Mr Donald Cameron.⁴

B. Early 2000: Separation proposals and the JHIL Board, Project Green

11.2 It was in early 2000 that the issue of separation again came to the fore,⁵ and the JHIL Board Papers for the Board's 17 February 2000 meeting contained two documents of particular present relevance, "Asbestos"⁶ by Mr Shafron and "Project Green – Update" by Mr Morley.⁷

¹ See for example the advice from Mr Peter Cameron and Mr Martin of Allens of 12 October 1999 (Ex 61, Vol 4, Tab 4) and Mr Shafron's "Big Picture Options for James Hardie's Asbestos Liabilities in Australia" of 22 November 1999 (Ex 61, Vol 4, Tab 9).

² Ex 174, p. 1, para. 1. Dr Barton's intention to depart at that time had been public knowledge for quite some time: Barton T 2721.18–29.

³ Ex 148, p. 1, para. 1.

⁴ Ex 276, Tab 2, p. 3, and Tab 3, p. 3.

⁵ Perhaps because Mr Macdonald, who had been based in the United States for some years, had become the new CEO, and was keen to "reposition the Group".

⁶ Ex 283, Vol 5, Feb 00 Tab

⁷ Ex 283, Vol 5, Feb 00 Tab. Mr Shafron said that the name "Project Green" was adopted in February 2000: Ex 17, p. 14, para. 79.

11.3 Mr Shafron’s paper dealt with a number of topics including “Part C – QBE Asbestos Insurance Litigation Strategy” and “Part D – Big Picture Options”.

11.4 In Part C – which related to negotiations with QBE Insurance Limited to settle an outstanding dispute over insurance coverage for asbestos claims – Mr Shafron discussed the means of resolution of any conflict between the position of Coy (the insured) and of JHIL (the beneficiary of Project Green). He said⁸ that to secure the best settlement, they had been planning their strategy on the basis that it would be necessary to recommence legal proceedings against QBE, and that there was a Statement of claim virtually ready to file. He went on to say, however, that:

“ ... litigation would not be helpful to JHIL as Project Green may require a court approved scheme of arrangement or other public process that provides an opportunity for asbestos claimant “spoilers”. Spoilers may be able to take advantage of litigation between JHC and QBE to underscore a claim that the level of James Hardie’s asbestos liabilities is inherently uncertain, and quite possibly worse than it has been leading the market to believe.”

11.5 Notions of this kind, that there might be “spoilers”, that they might seek to demonstrate that the level of asbestos liabilities was higher than disclosed, and that opportunities for public scrutiny of the amount of asbestos liabilities should be avoided or limited, recur in the Group’s documents. Perhaps a contributing reason is that the provisions in the consolidated financial statements of JHIL and its subsidiaries did not make provision for all future liabilities, but it also seems to have been a reflection of a passion, almost an obsession, for secrecy for its own sake. (Mr Shafron’s approach appears to have been a main contributor to this development.) The James Hardie Group documents are littered with claims for legal professional privilege, in circumstances where the claims, if challenged, would have been very difficult to justify.

11.6 In Part D of his paper, Mr Shafron discussed a number of options available for the Group, which he introduced:⁹

“Context and Summary

The environment in which James Hardie’s asbestos related liabilities are determined is unfavourable to JH. There is a strong institutional bias against JH

⁸ Ex 283, Vol 5, Feb 00 Tab, p. 9.

⁹ Ex 283, Vol 5, Feb 00 Tab, p. 11.

and the other asbestos product manufacturers; it is apparent in courts, juries, and in government and is especially well developed in NSW. ...

The asbestos litigation is not helpful to the operating business of JH, representing a distraction to senior management and an uncertainty factor in the JH share price. It therefore makes sense to examine the big picture options – theoretically available to JH or previously pursued by companies in positions similar to JH – to remove these impacts. The interests of all stakeholders, including creditors, must be fully considered and *any resolution must not disadvantage legitimate asbestos claimants*. (Emphasis added)

11.7 He said then that, broadly speaking, the “menu of alternatives” included, in no particular order:

- “
- Legislated Scheme;
 - Voluntary Group Settlement;
 - Class Action;
 - Liquidation/Bankruptcy;
 - Court Approved Scheme;
 - Insurance Defeasance;
 - Provisioning to Worst Case;
 - Trust;
 - Company Split/reorganisation; and
 - Defense Cooperation Schemes.”

and his view was that of the options:

“ ... the company split/reorganisation is the most attractive and has some precedents among former US asbestos manufacturers. For JH, the “split” has been achieved and there remains the restructure. *A range of issues will be confronted requiring careful planning and resolution, including the level of assets to be left behind in the old group*, potential adverse reaction of asbestos claimants, and the ultimate ownership of JHIL shares. The trust structure has some potential to assist the last two of these issues, and possibly to serve as a fall back position. Insurance or other financial investors may also be interested in securing the JHIL shares from shareholders. The company split and trust and discussed in more detail in sections 8 and 9 below.” (Emphasis added)

11.8 The practical importance of the “level of the assets to be left behind in the old group” was underscored in his discussion in Section 9 of his preferred option “Company Split/Reorganisation” where he discussed two United States companies which he said appeared to have successfully split their asbestos business from their other business, but noted:¹⁰

¹⁰ p. 1863. This is the passage to which I referred in Chapter 2.

“Other US companies have attempted similar company splits/reorganisations and become mired in litigation, typically alleging “fraudulent conveyances” – a US legal doctrine with no direct Australian equivalent. Examples in this category include Raymark and Celotex. The overall US experience on reorganisations, as described by JH’s US attorneys, has some admittedly fairly obvious lessons for us:

In sum, the US experience has shown thus far that a carefully planned reorganisation that makes fair provision for the asbestos claims has some chance of succeeding. But any attempt at reorganisation that does not leave significant assets for the asbestos claims will, at a minimum, spawn lengthy and costly litigation with the plaintiffs’ bar, and may ultimately be unsuccessful.”

These observations were prescient but the “fairly obvious lessons for us” from the United States experience appear to have been put aside or forgotten.

11.9 Mr Shafron went on to say that James Hardie had already achieved:¹¹

“ ... a split of its asbestos (JHC) from its non-asbestos (JHNV) companies. The next step would be to achieve separation such that the companies were no longer held by the same holding company (JHIL). There are structures which would seem capable of achieving this (scheme of management, intra group takeover). *Clearly the level of assets to be left behind in JHIL/Coy is a major issue, as is managing public and stakeholder reaction.* Another open question is the fate of JHIL, once its operating businesses have left the group.” (Emphasis added)

11.10 In discussing the “trust” proposal – his second preference – Mr Shafron noted first that a trust structure per se did not itself effect separation from the asbestos liabilities, because claims could still be brought against the same defendant, but he observed that a trust:

“ ... could ... be used to create a buffer between JH and asbestos claimants and could provide some sense or apprehension among claimants and/or the market that the litigation was no longer a company problem or distraction but an issue for the trust. The trust could be appointed agent for service of claims and could be empowered to manage and settle claims. It could have its own staff and be given power – within limits – to take other action to support existing and future claims, e.g. funding medical research or other beneficial programs. The trust could be funded up front or progressively according to agreed criteria. Attempting to fully fund the trust would have a similar financial impact to provisioning, with some added benefits.

The trust property could be a fund, shares in JHC, or shares in JHIL.”

¹¹ p. 1863.

11.11 He said that the trust concept might have particular use if Project Green did eventuate, but that it might also have use if Project Green did not eventuate:

“to help put the litigation at one remove from JHIL, and to serve as a fall back position.”

and that:¹²

“In both cases the main direct benefit to claimants would include that once the trust was established no money could leave the fund (although, at the risk of diluting the security aspects of the concept, JH could provide for a return of cash in defined circumstances such as a major surfeit of funds). During Project Chelsea, one or two claimants expressed concern about the company split then achieved and the potential for the assets of JHC to be depleted by dividend or capital return. JHC responded that the directors had no present intentions in that regard.”

He noted also:

“In the context of Project Green, it may be possible to form a trust for the express purpose of acquiring all shares in JHIL post separation. The beneficiaries of the trust could be asbestos claimants. The trust vehicle could be a company or individuals, and the purpose of the trust could be to manage the company for the benefit of asbestos claimants. If the trust took title to shares in JHIL, there would be no liability attaching to those shares. The trust concept could be a viable alternative to a third party financial or insurance purchaser of shares in JHIL post separation.”

11.12 Mr Morley’s paper dealt with the fact that in January a working party had given detailed consideration to “a potential structure which would permit a separation of James Hardie NV from the rump assets and liabilities of James Hardie”. It was thought desirable, for taxation reasons, to incorporate the proposed new company outside the United States, options considered in detail being The Netherlands, Luxembourg, Switzerland and Bermuda. In the event the proposal then recommended by Mr Morley was:¹³

“a Luxembourg incorporated listed vehicle, with a Luxembourg/DGP financing structure. When the DGP financing structure is no longer effective, expected to be within 3 years, the financing subsidiary would be moved to Ireland.”

The Netherlands, rather than Luxembourg, was the ultimate choice.

¹² The consideration in this passage may well be the genesis of the term “certainty”, so much used in relation to the establishment of the Foundation.

¹³ Ex 283, Vol 5, Feb 00 Tab, pp. 4–5 of Mr Morley’s document. A “DGP” is a Delaware General Partnership, *ibid.* p. 3.

11.13 No decision appears to have been made at the Board meeting of 17 February 2000, the minutes simply record:¹⁴

“ASBESTOS

Mr PJ Shafron spoke to his paper on asbestos and answered questions from directors.

PROJECT GREEN STRUCTURE

Mr PG Morley spoke to his paper on Project Green and answered questions from directors.”

C. The course of Project Green: February to June 2000

11.14 From February to November 2000 activity relating to Project Green proceeded on a number of fronts. One of some present importance was that it was obvious that a more up-to-date actuarial assessment of asbestos liabilities was needed and in March 2000 Trowbridge was asked to provide:¹⁵

“ ... an update of its 1998 review as at 31 March 2000 and in particular provide:

- (a) an actuarial estimate of potential exposure for known asbestos-related claims as at 31 March 2000;
- (b) a 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.”

11.15 Discussions took place between Mr Attrill and Mr Minty as to the inputs necessary for that Report. Mr Attrill supplied what was required; no suggestion is made that any information required was withheld from Trowbridge. The report ultimately provided was the 2000 Trowbridge Report. It is discussed in Chapter 15.

11.16 The JHIL Board was next to meet on 13 and 14 April 2000. Its Board Papers¹⁶ included a very substantial body of material on Project Green. The Executive Summary of that material, under the heading “Need for Action”, said:¹⁷

“As a result of the failure of the IPO James Hardie has a range of residual issues which are reducing shareholder value. The issues are:

- JHIL has annual cash requirements in Australia of A\$100m (asbestos litigation, dividends, Head Office running costs) which require ongoing financing through a combination of capital returns from subsidiaries,

¹⁴ Ex 75, Vol 6, Tab 58, p. 1880.

¹⁵ Ex 57, Vol 1, p. 39.

¹⁶ Ex 75, Vol 6, Tab 58.

¹⁷ Ex 75, Vol 6, Tab 58, pp. 1892–4.

dividend inflows from the Australian finance company or dividend inflows from operations in the USA. This funding requirement results in a significant withholding tax costs for the company, the extent of which will increase over time.

- The company's asbestos liability has a range of consequences.
 - ⇒ It prevents James Hardie from using its scrip as currency for acquisitions, mergers etc. as potential targets and partners are not prepared to assume exposure to asbestos liability.
 - ⇒ It prevents the company's operating assets from being fully valued by the equity markets. Just as targets and partners will not hold James Hardie shares, neither will some equity investors.
 - ⇒ A change in Australian GAAP for liabilities is expected to become effective around July 2001 and may result in James Hardie having to disclose the full expected future liability of all asbestos related claims. This liability may be more than the market is currently estimating.
- James Hardie is currently a small, illiquid, Australian dollar denominated and listed security. This increases the difficulty and cost associated with raising capital. As debt providers and equity investors globally seek to place funds in large, liquid and low risk companies, James Hardie is becoming a less attractive risk/investment.
- The Australian sharemarket is aware of our residual structural issues and remains concerned that the company will be forced to implement some form of restructuring in the next 1–2 years. Investors are concerned that such a restructuring could disenfranchise them.”

11.17 The Executive Summary then expressed the view that:

“Combined, these factors contribute to a ‘structural discount’ on James Hardie’s market valuation and act to impede the company’s growth.

James Hardie sees its future as the global leader in fiber cement and as an effective global participant in the gypsum industry. To achieve these positions there will be further significant growth in operations outside Australia, potentially involving mergers, acquisitions, joint ventures and other kinds of alliances. It is unlikely that such developments could be funded using JHIL scrip as currency.”

11.18 The paper stated¹⁸ the objectives of Project Green as being to address “growth, financial structure and asbestos separation”. It was said:

“All three objectives need to be developed before implementation will be recommended. The Project Team has adopted the following criteria in developing its separation and financial structure proposals:

¹⁸ Ex 75, Vol 6, Tab 58, p. 1892-4.

- James Hardie’s non-core assets and liabilities must retain their legal separation from ongoing operations *and be adequately funded to meet claims*
- any structure must be easily communicable to shareholders and analysts and be “reasonable” (the ‘sniff’ test), be developed in consultation with major stakeholders and enjoy their support
- all existing shareholders must benefit from the value created by any restructure, with minimal tax consequences
- any newly-issued stock must be readily marketable to allow James Hardie to take part in merger and acquisition activity using scrip
- restructure costs must be kept to a reasonable level
- IPO market risk must be minimised or eliminated
- there must be a strong probability that the transactions to establish the structure can be completed, without disruption by spoilers or legal/regulatory difficulties
- the structure must be tax efficient” (Emphasis added)

11.19 The parts emphasised in the first two criteria were not followed in relation to the February 2001 separation. Rather the funding was quite inadequate, the consultation with major stakeholders was mostly after the event.

11.20 The material for the April Board meeting included a substantial “Advice on Structure and Separation Issues” from Allens,¹⁹ which responded²⁰ to questions raised by Mr Shafron in a letter dated 15 March 2000 to Mr Peter Cameron of Allens. The letter²¹ asked for advice, for the purpose of being provided to that meeting, on a number of issues and questions concerning:

1. Takeover ...
2. Share Buy-back ...
3. Listing of Luxco on the ASX ...
4. Listing of Ausco on the ASX ...
5. Separation: Asbestos risks and liability

¹⁹ Ex 75, Vol 6, Tab 58, p. 1899.

²⁰ Ex 75, Vol 6, Tab 58, p. 1909.

²¹ Ex 75, Vol 6, Tab 58, pp. 1995–7.

- (a) Can directors be comfortable with the proposed separation in terms of directors' duties and other bases of legal liability for directors and the relevant companies?
 - (b) Are the following options of providing/leaving behind:
 - (i) actuarial assessment of all future claims; and
 - (ii) the actuarial assessment plus a (say) \$50 m premium insurance policy open to the directors?
 - (c) What additional support would it be prudent for the directors to obtain:
 - (i) QC opinion – addressed to them as individuals?
 - (ii) QC opinion on liability generally as well as the adequacy of the insurance policy?
 - (iii) Additional protections (the Allens deed of access to documents etc that some but not all directors currently have)?
6. Breaking Through ...
7. Forming a trust over JHIL shares or JHIL assets
- (a) Is it possible to mesh in a trust concept with the takeover/buy-back?
 - (b) Need for a JHIL members meeting?
 - (c) Requirements/impediments?
 - (i) trust deed?
 - (ii) stamp duty?
 - (iii) what else?
 - (d) Options for dealing with the surplus (access share, charitable donation, etc).
 - (e) Would a trust be a valid option for directors, at least in the context of Project Green as a whole?
 - (f) Are the following options of settling a trust with:
 - (i) the actuarial assessment of all future claims; and
 - (ii) the actuarial assessment plus a (say) \$50 m premium insurance policy open to the directors?
8. Other Options
- (a) Are other options open to JH to resolve the asbestos issue?
 - (b) If other options exist what do they entail and what are the pros and cons?"

11.21 Allens were also invited to “comment” on timing issues and:

“any other matter you think may be relevant or appropriate. Please cover the issues raised but do not confine yourself to them.”²²

Allens were not limited to the strict legal questions. That was recognised in Allens’ Advice. In “Part 2: Separation: Asbestos Risks and Liability”²³ it was noted that:

“2. Duties to creditors

The directors of JHIL do not owe a duty to creditors except in the circumstances of actual or imminent insolvency, although their duty to the company will require the interests of creditors to be taken into account.

In our view, existing and known asbestos-related claimants against Coy may be creditors of Coy but not of JHIL, nor are unknown potential asbestos-related claimants of Coy or JHIL. This approach to determining who is a creditor is not inconsistent with JHIL’s current provisioning in relation to asbestos-related liabilities in its latest financial statements.

Nevertheless, the Directors of JHIL will need to manage against the actions of potential spoilers and the future insolvency of Coy. This means that the Directors of JHIL need to take into consideration the existing claims against Coy and how to ensure that Coy has the ability to meet those and future obligations. This issue is discussed further in Part 5 (Other Options).”

and:

“3. Buffer issues²⁴

The directors of JHIL and Coy will need to consider what is an appropriate buffer in the circumstances in light of Coy’s most recent financial position. In deciding upon an amount of buffer, the current actuarial update of the potential exposure to asbestos-related claims of the Group being carried out by Trowbridge Consulting should provide the directors with a proper basis for their decision.

The Trowbridge update has not been commissioned especially for Project Green, but is part of a clear pattern over the last 5 years for the Group to obtain expert actuarial and legal advice to assist management and the Board in relation to the management of the Group’s potential asbestos-related liabilities.

It is always open for the directors to take a cautious view about the assumptions in the analysis of Trowbridge and ensure against the risk that the buffer which is left behind in Coy is insufficient to meet future claims. The directors could manage this risk by providing a larger cash buffer or by taking out an insurance policy (which we understand is an expensive option). This raises the issue of the balance between the interests of creditors and shareholders – where should the line in the

²² Ex 75, Vol 6, p. 1997.

²³ Ex 75, Vol 6, p. 1916.

²⁴ pp. 1946–1947.

sand be drawn in relation to division of assets? A key feature of a buffer is that it would involve a fund which is in reality potentially available to both a class of potential and unknown creditors and shareholders. To the extent to which the fund is not required for those unknown creditors it could be available for return to shareholders. Directors need to be cognisant of the rights and interests of shareholders who could legitimately argue that it is not part of the business of the company to give money away to unproven potential creditors nor to lock up capital indefinitely.” (Emphasis added)

and:²⁵

“4. Opinions

In light of legal risks outlined above, we think that it would be prudent for JHIL to obtain senior counsel’s opinion which the directors could rely upon dealing with the directors’ duties issues for JHIL and Coy in the separation process and establishing an appropriate buffer for Coy to satisfy future asbestos-related claims. JHIL should also consider obtaining an expert valuation of Coy which will establish an independent value for the company.”

11.22 These passages make it apparent that the Board of JHIL should have been aware of the potential desirability of a “buffer” being provided in addition to handing over only the net assets of Coy and Jsekarb. (In fact the Board meeting of January 2001, dealt with later, suggests that the Board was conscious of this).

11.23 The Advice also, in Part 5,²⁶ considered voluntary liquidation or liquidation on just and equitable grounds as options, but did not appear to warm to them.

11.24 Project Green was the principal subject discussed on the second day of the April 2000 Board meeting and the minutes²⁷ recorded the conclusion as being:

“PROJECT GREEN STRUCTURE

Mr Macdonald raised a number of market and structural issues facing the Company and outlined a Company vision and business strategy. Presentations were then made by members of the Group Management Team as follows:

Background and need for action	- Mr Morley
Asbestos resolution	- Mr Shafron
Corporate restructure and separation; financial implications	- Mr Morley
Portfolio Growth Options	...

²⁵ Ex 75, Vol 6, p. 1917.

²⁶ Ex 75, Vol 6, p. 1926.

²⁷ Ex 75, Vol 6, Tab 59, p. 2044.

Group management Team members answered questions from the Board on each of the areas presented, then withdrew from the meeting.

In the absence of management the Board discussed the various options presented. The Chairman asked Mr Macdonald to continue work on each of the separate elements of Project Green, for further consideration by the Board.”

July to August 2000

11.25 The next JHIL Board meeting, on 13 July 2000, had received a paper from Mr Macdonald dated 30 June 2000 in which he said:²⁸

“Asbestos Separation

It remains our intention that no creditor be disadvantaged by a separation from asbestos.”

11.26 The Board minutes record:²⁹

“PROJECT GREEN

Mr Macdonald and Mr Wilson reported on progress in relation to Project Green.

The Board discussed a number of issues relating to restructure, funding and separation. The Chairman noted that in the event of any separation, the Board would need to be satisfied that sufficient funds remained to meet the claims of creditors.

Mr Macdonald and Mr Morley reported on the sale process that had been commenced by the Republic Group Corporation.”

11.27 Of course in both Mr Macdonald’s paper of 30 June 2000 and the Board’s minutes it is possible that “creditor” was being used to refer to persons who would have an existing entitlement to sue, or to be paid a judgment or settlement, but it seems the more likely view is that the term was being used to include all who *might* sue Coy or Jsekarb.

11.28 The possibility of the use of a form of trust structure had been discussed at a meeting on 18 July 2000 at Phillips Fox at which Mr Adams and Mr Gill (of Phillips Fox) and Mr Attrill and Mr Ashe (with Mr Shafron participating by telephone). Mr Attrill’s notes of the meeting³⁰ appear to indicate that on the question of funding

²⁸ Ex 75, Vol 6, Tab 60, p. 2060.

²⁹ Ex 75, Vol 6, Tab 61, p. 2071.

³⁰ Ex 100, Tab 7.

it was said that it was an “open question as to who is a creditor” but that JHIL had advice from Allens that, probably, only existing claimants were creditors. That, however, was said to be academic since the Board “will provide for everyone who may bring a claim”. A matter raised by Mr Gill was whether, if the funds ultimately proved to be insufficient, the James Hardie Group would “put in more money”, to which the answer by Mr Shafron was “No”.

11.29 On 7 August 2000 Mr Macdonald produced another report for consideration at the Board meeting to be held on 18 August. He noted in summary³¹ that some issues had emerged “that impact on the stand alone implementation of Project Green”. They were:

- “ • Further investigations have caused us to feel less sanguine about the political and social environment in which we would be seeking to achieve separation.
- CSR has stated it is in negotiations with possible re-insurers in an effort to arrange for a take-out or extended cover for its asbestos liabilities. CSR has also said that it is considering making a significant increase in its asbestos provisions around its year end in March '01 (when it will likely have large gains on sale of sugar and aluminium assets to take to account). We would prefer not to be running behind CSR in case its endeavours raise the profile of the issue politically and in the markets.
- PwC advises that Exposure Draft 88, dealing with long term contingent liabilities, is now back on the Accounting Review Board agenda. Timing is uncertain, but post March '01 seems likely. We would prefer to have separation in place before our hand was “forced” by ED 88.
- We have received early indications from re-insurers on the costs of covering ongoing asbestos liabilities which are at the upper end of our expectations in both premium and cover. Further investigation and negotiation is required before a recommendation can be made.
- The Netherlands tax authorities have not been able to provide the assurances we desired about our preferred structural alternatives and further work is required to achieve the certainty we require at reasonable cost.
- As of today's date, we are still “alive” in the negotiations to acquire Republic Group within price levels ... that create value for James Hardie. A range of alternatives are being considered ...

³¹ Ex 75, Vol 6, Tab 60, p. 2078.

- Given the higher cost indications from potential re-insurers, we may not have available funds to achieve the separation. We are considering alternatives to make the separation economics work. ...”

11.30 Mr Macdonald’s summary of the issues reflected some features which appear ultimately to have influenced JHIL in the courses which it took in the move towards the February 2001 separation. They were the prospect of ED 88 implementation, and the cost of insurance. The implementation of ED 88 was likely, as the Board Papers indicated, to require that the Group’s liabilities increase by \$220m.³² The quotations for insurance cover required very substantial “up front” payments and high overall cost.³³

11.31 Mr Macdonald’s paper reflected also the possible need to fund asbestos liabilities to a level exceeding any legal obligation. He said:³⁴

- “ • Stand Alone Case
- Restructuring without a compelling business case increases focus on separation and financial restructuring. We have partially completed a review of the stakeholders who will be most concerned about separation. As a consequence, *we are concerned about the potential for these stakeholders to place the issue onto the political agenda unless they are satisfied with the level of future payment security provided* – that level may be well in excess of our legal obligations. The only issue of relevance to these stakeholders is that of security of payment for current and future creditors and a compelling business case will only ameliorate these concerns slightly. A compelling business case would, however, assist in balancing public debate and gaining support of other stakeholders.

Asbestos Separation

It remains our intention that no creditor be disadvantaged by a separation from asbestos.

- Base Case
- Our base case was to pass sufficient cash back up from JHNV to JHIL to achieve structural separation and migration to the Netherlands. JLT has obtained proposals to cover our asbestos liabilities at costs and coverage above levels we had targeted. We are encouraged that there are several parties interested in taking on the risk, but need to do more work to satisfy ourselves that the cost of putting the cover in place is economically justifiable and when James Hardie can fund it.” (Emphasis added)

³² Ex 75, Vol 5, Tab 56, p. 1814.

³³ Ex 75, Vol 5, Tab 56, p. 1810.

³⁴ Ex 75, Vol 6, Tab 60, p. 2079.

11.32 Mr Macdonald's reference to a "review of the stakeholders who will be most concerned about separation" was concerned with a project being undertaken by Mr Ashe, who reported to Mr Baxter. On 23 July 2000 Mr Ashe had sought some assistance from Mr Shafron, emailing him:³⁵

"Greg and I discussed where we are at with the stakeholder management work late last week and have set the following dates going forward:

Friday 28/7 : Draft to yourself, Wayne and Allens
Tuesday 1/8 : Comments to be back to us
Friday 4/8 : Finalise Draft
Monday 7/8 : Draft to Peter M
Thursday 10/8 : Inclusion in Board Papers

In relation to spoilers, I need some advice (either internal or external) re their legal options to spoil and our legal options to respond.

For example, in relation to the NSW Government, I have noted that the potential action they may take includes:

- The Premier or Minister requests urgent talks with us
- They take out an injunction
- They call an inquiry (may or may not be public)
- They introduce spoiling legislation
- They request amendments such as:
 - ⇒ provision of additional funding
 - ⇒ a guarantee of no short fall
 - ⇒ an alternative structure all together"

11.33 He went on to say:

"Without a proper understanding of their powers/options and our legal position re a response the stakeholder management work will be deficient.

We should have this advice for the spoilers that can actually stop the transaction. These would appear to be:

- NSW Government
- Other state governments
- Federal Government
- Shareholders

Could you please give me a call to discuss."

³⁵ Ex 61, Vol 4, Tab 18.

11.34 Mr Shafron's response on 25 July (copied to Mr Barton, Mr Attrill and Mr Sweetman) was:³⁶

"Confidential and Privileged

We can talk tomorrow – let me know your availability first thing your time.

In relation to the stakeholders, judging by the Board last time they are unlikely to agree to anything that is not "guaranteed not to fail". It seems to me that if that is right (and let's talk tomorrow) then we need to assume that we will have to talk to the major stakeholders, in detail, early. We will effectively need to report back to the Board that they are all OK before we press the button. It follows that we will need inducements."

and:

"Greg, you said that the Board needs to understand that they may have a fight. I think that if we have a fight they are likely to go to water, and if we tell them that they may have a fight (albeit one that we should win) they will not proceed (a sufficient number will not have the heart). Hence my current thinking.

A suggestion that we discussed last week at the Green team meeting was bringing on professional crisis managers e.g. Control Risk Group to assist. We should discuss that. I don't think we should underestimate the value the Board will place on outside third party advisers (as insulting as that is to the company's internal advisers – myself included)."

11.35 "Stakeholder management" was discussed at length in a telephone conference on 25 July 2000 between Mr Shafron, Mr Attrill, Mr Ashe and Mr Adams and Mr Gill of Phillips Fox.³⁷ In addition Mr Jack Forrest QC of Melbourne was retained to give an opinion on potential challenges which might be made to separation.³⁸ Phillips Fox also gave written advice.³⁹

11.36 In the event Mr Ashe produced:

- (a) a "Review of the Draft Trowbridge Report in the Context of Stakeholder Management" dated 8 August 2000;⁴⁰ and
- (b) a detailed document entitled "Project Green Stakeholder Management".⁴¹

³⁶ Ex 61, Vol 4, Tab 18.

³⁷ Ex 61, Vol 4, Tab 19; Ex 100, Tab 10.

³⁸ Ex 61, Vol 4, Tab 27.

³⁹ Ex 100, Tab 12; Ex 61, Vol 4, Tab 31.

⁴⁰ Ex 61, Vol 4, Tab 33.

⁴¹ Ex 61, Vol 4, Tab 18.

11.37 This material, or at least the latter document, was the subject of a conference call on 10 August 2000 between Mr Shafron, Mr Baxter, Mr Ashe and Mr Attrill.⁴² Mr Shafron, who had been speaking to Mr Macdonald, reported on the “mood in the camp” as follows:⁴³

“Very negative.

Not much prospect of separation without a major portfolio acquisition or us coming back with a more positive story.”

11.38 A discussion then took place, noted by Mr Attrill as:⁴⁴

“PDM was strongly influenced by SA/GB’s note to him. Highlighted likely strong govt. opposition.

GB: Is this view exaggerated ? We haven’t give up on finding a way through.

Yes – my view hasn’t changed. It will be difficult but is ‘doable’. The opposition may not emerge Very fluid situation.

GB: SA & I are in a position to run a lot of these issues to the ground. We will be led to the right answer for JH.

Deadline: 1 week to Board meeting.”

11.39 A few days later Mr Macdonald appears to have regarded separation as being “dead”.⁴⁵ Nonetheless, there was a Project Green presentation to the Board on 18 August 2000. It included a summary of the 2000 Trowbridge Report, and a comparison of the projections in the 1996, 1998 and 2000 Trowbridge Reports.⁴⁶

⁴² Ex 61, Vol 4, Tab 38.

⁴³ Ex 61, Vol 4, Tab 38, p. 2.

⁴⁴ Ex 61, Vol 4, Tab 38, p. 2.

⁴⁵ Ex 61, Vol 4, Tab 45, p. 253.

⁴⁶ Ex 75, Vol 6, Tab 61, p. 2088.

1996-1998-2000 Projection Comparisons

	1996	1998	2000 (Draft)	98/00 (% Change)
General Liability:meso	133	140	190	35%
General Liability:non meso	46	27	49	81%
Legal Costs	69	100	73	(27%)
Workers Comp. Claims	10	14	7	(50%)
Insurance Recoveries	(28)	(27)	(66)	(144%)
Waterside Workers Cases (est.)	-	-	10	-
Discount Rate Adjustment*	19	N/A	N/A	-
	249	254	263	

* 8% assumed in 1996; 7% in 1998 and 2000.

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Added were the following comments:⁴⁷

Key Observations

- Still draft
- Meso average settlement costs up 45% over 5 years.
- Non-meso average settlement costs nearly doubled over 2 years.
- Legal and associated costs down.
- Insurance recoveries up.
- Workers cases dropping off.
- Meso claims appear to have plateaued.

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⁴⁷ Ex 75, Vol 6, Tab 61, p. 2087.

11.40 I find it hard to see how the view could be expressed that mesothelioma claims appeared to have “plateaued”⁴⁸ when the Summary and Extract of Mr Shafron and Mr Attrill’s “Asbestos Liabilities Management Plan YEM03”⁴⁹ dated 30 June 2000, and prepared for the Board, had noted:⁵⁰

“3.2 Claims in YEM00

- James Hardie received 185 new asbestos-related claims last year, an increase over YEM99 of 20%.
- The number of new mesothelioma claims increased for the first time in two years (from 81 in YEM98 and YEM99 to 91 in YEM00). The trend in disease types in new claims is now reported to the Board.
- James Hardie resolved 135 claims in YEM00, a decrease of 19% over the 166 claims resolved in YEM99.
- James Hardie received its most expensive claim in YEM00 (Judzewitsch, \$3m, paid in YEM01), and its youngest claimant (Clarke, 22 year old with mesothelioma).
- James Hardie also received 6 claims (total now 11) commenced in the Superior Court of the State of California.
- Slate & Gordon intend to bring a large number of claims (more than 200) for compensation by former waterside workers or their families arising out of exposure to asbestos on wharves in Australia. The likely cost of the wharf claims cannot accurately be assessed at this time as investigations into them are continuing, but the cost may be significant (\$10m or so).
- New South Wales remains the preferred jurisdiction, with over half the new claims being commenced in the DDT (58% for product/public, 62% for workers claims). The DDT awards the highest level of damages in Australia.
- There was an increase in Western Australian claims, both new claims and settlements. We believe this was due to an increase in staff at Slater & Gordon’s Perth office.
- There remains a significant level of forum shopping in the DDT, with 24 Queensland-based claims being brought in the DDT last year. James Hardie is presently pursuing a “test case” which seeks to establish a precedent for the transfer of these claims out of the DDT and into the Supreme Court of Queensland under state cross-vesting legislation.”

It had also noted that individual claims were increasing in size⁵¹ and that Coy’s average share of settlements had increased.⁵²

⁴⁸ Which appears to have originated from Mr Attrill: see Ex 61, Vol 4, Tab 46, p. 254.

⁴⁹ Ex 75, Vol 6, Tab 60, p. 2062.

⁵⁰ Ex 75, Vol 6, Tab 60, p. 2063.

⁵¹ Ex 75, Vol 6, Tab 60, p. 2064.

11.41 The outcome of the August Board meeting, set out in the Board minutes, was:⁵³

“PROJECT GREEN Messrs Macdonald, Morley, G Baxter, I Wilson and A Sweetman presented reports on the possible financial restructuring of the Company. Mr PJ Shafron reported on some legal and litigation related aspects.

Mr Macdonald summarised progress to date by noting that “business as usual” did not deliver satisfactory financial or structural outcomes, that there were models for restructure that appeared promising but needed further investigation, and that complete structural separation of the Company from its operating companies would not form part of any Project Green restructure.

The directors asked a number of questions of management and requested management to continue its work and report again at the November 2000 Board meeting.”

D. November 2000 JHIL Board Meeting

11.42 The Board’s next meeting was on 15 November 2000. Included in the Board papers was a Memorandum by Mr Macdonald in relation to Project Green:⁵⁴

“Project Green Outline

We are asking for authority to continue work on the revised Project Green restructure, including completion of a Scheme of Arrangement booklet, approvals and advices, so that the Board can be in a position to make a decision at its February 14 meeting.

Indications at this time are:

1. Method of implementation – Scheme of arrangement
2. Path to the Netherlands – direct at a cost of \$13.3M Dutch capital duty and NSW stamp duty.
3. Timing
 - approve and announce in February ’01
 - shareholder approval in April ’01
 - scheme effective late April ’01
4. Total cost (indicative – including advisors fees) - \$18–20M

⁵² Ex 75, Vol 6, Tab 60, p. 2064.

⁵³ Ex 75, Vol 6, Tab 62, p. 2141.

⁵⁴ Ex 75, Vol 6, Tab 62, p. 2145.

As you will see from the Agenda for the November 15 meeting, we have allocated significant time to allow for:

- A comprehensive presentation on the project.
- Presentations from, and questions to, our key external advisors:
 - Tony Clemens – PwC tax partner
 - Peter Cameron – Allens corporate partner
 - Ian Wilson – UBSW corporate advisory consultant
- Off shore and other advisors have prepared materials, details of which are either attached, or will be contained in the Board presentations ...

I look forward to presenting a major step forward for James Hardie’s structure.”

11.43 The proposal then under consideration was for a scheme of arrangement. As set out in a Memorandum from United States attorneys Gibson, Dunn and Crutcher LLP it was:⁵⁵

“ ... the creation of a newly formed Netherlands company (“**Newco**”), which would acquire 100% of JHIL’s publicly held stock pursuant to a scheme of arrangement. The scheme would be approved by JHIL’s stockholders and by an Australian court. Subsequently, JHIL would buy back its shares from Newco in exchange for the transfer of James Hardie NV (“**JHNV**”) to Newco, resulting in Newco directly holding JHIL (which, in turn, holds the non-core businesses and liabilities) and JHNV (which, in turn, holds the active operations). Newco’s shares would be listed on the ASX and have American Depositary Receipts (“**ADRs**”) listed on the New York Stock Exchange (“**NYSE**”).”

11.44 A memorandum from Allens of 7 November 2000 noted in relation to the proposal:⁵⁶

“1. Comparison with Previous Transaction Structure

This transaction differs from the version under consideration in August in several respects but notably:

- there is no separation of JHIL (and downstream entities) into two;
- in consequence, the new holding company will have asbestos exposure within the Group which may impact investor appetite for the stock;
- there is no (or no immediate) permanent diminution in the true net worth of JHIL, although:
 - the nature of its assets and its balance sheet change dramatically;
 - JHIL will not derive income or growth from its large uncalled capital;
- the transaction is proposed to be implemented by way of scheme of arrangement rather than takeover bid.

⁵⁵ Ex 75, Vol 6, Tab 62, p. 2148.

⁵⁶ Ex 75, Vol 6, Tab 62, p. 2146.

2. Transaction Rationale

- Reflecting those differences, it is no longer possible to point to value enhancement resulting from having a holding company free from asbestos exposure as a key driver. Equally, it is substantially less possible to criticise the transaction on the basis of its potential impact upon claimants/creditors.
- The rationale is said to be:
 - “more suitable and efficient corporate structure and domicile”; and
 - “enhanced after-tax shareholder returns” of a material amount, but may be seen by the market as largely “**tax**”, as happened with Chelsea.
- The Board needs consider and resolve objectives for the transaction and the company needs ensure those objectives are met in the final transaction structure.”

11.45 An element of the proposal was the issue by JHIL to a new Dutch holding company of partly paid shares. Since the role of partly paid shares was much discussed in evidence, I shall mention this element at this point. It was described in a presentation to the Board as follows:⁵⁷

“Funding JHIL and Oldco subsidiary group (continued)

- ◆ As a result of the share buy-back, JHNV will be moved out from under JHIL
- ◆ JHIL’s net assets will be materially reduced by JHIL’s share buy-back which transfers direct ownership of JHNV to Newco NV
- ◆ Economic position of JHIL however, does not change
- ◆ Subsequent to the buy-back, JHIL will issue partly paid shares to Newco NV to the value of the buy-back (say\$1.5bn)
- ◆ The partly paid shares will be paid to \$80m, with an uncalled balance of \$1.4bn
- ◆ The partly paid shares will not have a defined call program
 - timing and amount of future calls will be at the discretion of the JHIL Board
- ◆ Calling of unpaid amounts creates a legal liability for Newco NV to pay those amounts
 - JHIL may sue for payment if necessary
- ◆ Consequently, JHIL’s economic position and ability to pay creditors will not be diminished by the buy-back
- ◆ The net asset position of JH & Coy will not be affected by this Proposal”

⁵⁷ Ex 75, Vol 6, Tab 62, pp. 2188–9.

11.46 The result of the November Board meeting appears from the minutes as being:⁵⁸

“PROJECT GREEN Messrs P Cameron (Allen Allen & Hemsley), T Clemens (PricewaterhouseCoopers); I Wilson and A Sweetman (UBS Warburg); and G Baxter join the meeting.

Mr Macdonald outlined a model for corporate restructure that would create a more efficient financial structure for existing operations as well as for future international growth. Mr I Wilson discussed market considerations as well as listing considerations. Mr Baxter covered communication issues, Mr Morley financial issues, and Mr Shafron and Mr Cameron legal issues. Mr T Clemens explained taxation aspects of the restructure model.

The directors discussed the restructure model and asked questions of management and advisors.

The Chairman noted that the model appeared to have some merit and requested management to continue developing the concept for further discussion at the next meeting.

Messrs Cameron, Clemens, Wilson, Sweetman and Baxter withdrew from the meeting.”

E. Trust Structure Revived

11.47 Notwithstanding the terms of that resolution, management turned their attention to the proposal for a trust structure.⁵⁹ The revival of interest appears to have arisen because of advice to Mr Shafron from PwC US. The essence of that advice, was recorded in an email from Mr Shafron to Mr Peter Cameron of 12 November 2000:⁶⁰

“The issue arises from PwC US advice that Newco NV will need to show an estimate of asbestos liabilities, beyond the net assets of Coy, in its consolidated accounts, unless the JHIL directors resolve not to fund Coy in the future (not sure the Board are ready for that, nor what the disclosure requirements might be). If, though, the assets or shares of Coy were controlled by a trustee (there it is again) then Coy would not be grouped with NV and NV would not show anything at all for Coy. (Liquidation would give the same outcome.) ...”

11.48 On the day following the November Board meeting, the question of a trust was discussed at a meeting at which Mr Morley and Mr Harman were present on behalf of James Hardie, Mr Peter Cameron (by telephone) and Mr Minahan from

⁵⁸ Ex 61, Vol 5, Tab 8.

⁵⁹ See Shafron Ex 17, para. 83; Macdonald Ex 148, p. 5, para. 15.

⁶⁰ Ex 224, Tab 18, p. 250.

Allens, and Mr McClintock and Mr Clemens from PricewaterhouseCoopers. It was noted that:⁶¹

“(f) Thought is being given to assigning its shares in JH & Coy to the trustees of a Trust, the beneficiary of which will be the New South Wales Cancer Council, provided that JH & Coy shall not be liquidated prior to all outstanding claims in relation to the product liability of JH & Coy being satisfactorily resolved. The trustees will have complete power over the JHIL shares and therefore would be likely to appoint their own Directors to the company. It is likely that JH & Coy will be able to enhance its ability to effectively deal with claims and to accumulate increased net worth if the trustees of the Trust were to appoint Directors who sought to retain possibly an insurance company to manage the claims suffered by JHIL as well as the financial assets of JH & Coy. It is noted, in this regard, that at present JH & Coy relies upon an extremely conservative investment strategy and substantial outside help to manage its product liability claims

It may be that the above strategy would be undertaken prior to 31 March 2001. If so, JH & Coy would no longer be included as a subsidiary of JHIL. In the Financial Statements of JHIL, on the write-down of its investment in JH & Coy, an accounting loss would be borne equal to the book value of the shares in JH & Coy (\$30m). In the Consolidated Financial Statements of JHIL, there would be an extraordinary loss arising from the deconsolidation of JH & Coy equal to the net assets of JH & Coy (\$190m). It is unlikely that JHIL would raise a provision against future claims of JH&Coy for the factors described above. Naturally, upon the compulsory adoption of the provisions of ED 88, the Directors of JH & Coy will need to establish some estimate of potential claims (in present value terms) and to raise a provision accordingly.

It is thought that as JHIL will not be disposing of an asset which its accounts disclose to have any value, and indeed a valuer is likely to confirm this as being worth Nil, such a disposal to a trustee would not give rise to an obligation to seek approval for a reduction of capital.

If indeed the net assets of JH & Coy, which on present estimations of likely future claims over the next 10 years should be full and sufficient to meet such liabilities, are eventually in excess of the amount that is required to be paid as claims, such excess value in JH & Coy shall be realised upon a liquidation of JH & Coy for the benefit of the beneficiaries of the Trust, mainly the New South Wales Cancer Council.

No actions in relation to JHIL would occur in the course of establishing the Trust.

At the time of any adoption of Project Green, the present proposed steps, including a subscription for partly paid shares by JHI NV in JHIL, will remain.

It was agreed that Phil Morley and Stephen Harman would brief Peter Shaffron (sic) on the details of the meeting and that it would be appropriate to further consider this issue with Peter Cameron.”

11.49 Pausing at that point, it is extremely difficult to see how the view could have been expressed that the net assets of Coy could eventually have been “in excess of the amount that is required to be paid as claims” in the light of:

⁶¹ Ex 224, Tab 19, p. 252.

- (a) the several Trowbridge Reports;
- (b) the view that Trowbridge's estimates were on the low side – a matter to which I shall come;
- (c) the views taken by potential insurers that the liabilities were more likely to be of the order of \$675m;⁶²

but the notion that there might be an excess thereafter appeared in various presentations to the Board and elsewhere.

11.50 From that point onward the trust proposal would move, relatively inexorably, towards its February conclusion. So far as the Board was concerned Mr Macdonald on 13 December 2000 sent to Board members a "Project Green Update"⁶³ which foreshadowed:

"... that management will likely be seeking Board approval in January to establish a trust over the shares in JH&Coy, thereby deconsolidating JH&Coy from the James Hardie group.

Management has been evaluating alternative financial restructuring proposals for James Hardie which could best position the corporation for global growth. Moving to an appropriate structure will likely require James Hardie to comply with different accounting standards than are currently the case affecting, among other things, asbestos provisioning and reporting."

11.51 The proposal was then expressed to be:

"Resolution:

We recommend transferring the shares in JH&Coy to a company trustee (a new subsidiary of JHIL) which will act in the interests of the trust beneficiaries, essentially asbestos-related claimants, with any residue passing to a medical charity – not JHIL. (JH&Coy is the company within the JHIL group that is liable for asbestos injuries to both employees and product liability victims). At September 2000, JH&Coy has net worth of AUD147 m in the James Hardie accounts, net of a provision for asbestos costs of AUD43 m and unearned income on the QBE insurance receipt of AUD27 m. The total assets available for creditors and potential claimants, including asbestos costs, are AUD217 m. While it is not possible today to accurately estimate the total likely asbestos cashflows, it is possible that an independent expert would determine that such total cost is at least equal to the net worth of JH&Coy. To move ahead on restructuring, it is proposed that the following steps be undertaken:

⁶² Ex 61, Vol 4, Tab 38. This was an undiscounted figure, which should be compared with the 2000 Trowbridge Report's undiscounted figure of \$557,069,096 (Ex 2, Vol 4, Tab 14, p. 890): see Shafron T 1584.52–1586.53.

⁶³ Ex 283, Vol 5.

1. **Creation of a Trust over JH&Coy.** Ownership of the shares of JH&Coy be transferred to a new trustee company. An independent valuation of JH&Coy will likely confirm management's view that JH&Coy does not have positive net worth, taking into consideration likely future creditor claims. Such an independent valuation would enable Directors to feel comfortable that the granting of ownership of the shares in JH&Coy to the trustees would not be detrimental to current shareholders – to whom Directors owe their primary fiduciary duty. It is probably sensible to create a trust over the JH&Coy shares whether the Board decides to proceed with Project Green or not. Stamp duty (transfer tax) of approximately \$3.5M is an issue to be resolved.
2. **Accounting for Trust Creation.** In creating the trust, the James Hardie accounts would be recognizing a reduction in book value of AUD147 m, booked as an extraordinary charge. JHIL would also need to make arrangements to repay the loan it currently has from JH&Coy of AUD125 m, reducing the cash available for ongoing operations by that amount.
3. **Public Position.** Press releases would explain the creation of the trust as providing certainty for creditors and potential claimants that the assets of JH&Coy are irrevocably secured for their benefit.”

11.52 Mr Macdonald's "Project Green Update" also dealt with the proposals for the further restructuring. He said:

“Subsequent Implementation of the proposed financial restructuring under US GAAP.

Subsequent to, but independent of the creation of a trust as outlined above, JHIL would implement the proposed "Project Green" restructure including redomicile to the Netherlands. Because of loss of control, under both AGAAP and US GAAP, JH&Coy would no longer be a consolidated subsidiary. The restructuring would be a relatively low key financial restructuring, with very clear benefits, upon which an independent expert would opine prior to the Board making any decision to proceed. The timing for announcing Project Green is currently mid March (2 months after establishing the trust) but dates could shift as further work is completed.”

11.53 The next Board meeting was to be held on 17 January 2001. It, and the Board meeting of 15 February 2001, are the crucial meetings in connection with separation.

Chapter 12 – Legal and Practical Aspects of Establishing The Trust

A. Legal Aspects

12.1 I mention four matters.

12.2 *First*, there was no fundamental legal impediment to JHIL, by its directors and management, devising and implementing a proposal to effect a separation of Coy and Jsekarb (and accordingly their asbestos liabilities) from the profit-earning sources in the Group.¹ There may well have seemed good reasons why, in the interests of the shareholders in JHIL, it was desirable to explore, or implement, such proposals.

12.3 The *second* legal aspect relates to the nature of the asbestos liabilities. They were based on tortious conduct of James Hardie Group companies – usually negligence in the manufacture or distribution of asbestos products² - which had occurred in 1987 or earlier. Liabilities yet to be satisfied could fall into three categories:

- (a) claimants whose claims had been made but the litigation was not yet completed.³
- (b) claimants who had contracted an asbestos related disease and who had not yet sued.
- (c) the majority of cases, i.e. where there had been exposure to asbestos (before or after 1987), but the asbestos related disease had not yet occurred.

12.4 There was also a fourth class, where exposure to asbestos had not yet occurred, but would occur in the future. This class⁴ typically involved persons

¹ That position was accepted by Mr Slattery QC (for the Foundation, Amaca and Amaba) and by Mr Rush QC (for the unions and asbestos support groups in their final oral submissions). See T 3568.21–48 and T 3619.44–3620.4.

² Mining or transportation of asbestos to the James Hardie plants might also give rise to claims.

³ This includes cases where there had been judgment or settlement but the amount of the judgment or settlement had yet to be paid. For example a judgment might be the subject of appeal.

⁴ Sometimes called the “third wave”, or “home renovators”.

demolishing, altering or renovating houses and other structures who might encounter or create asbestos fibres while so doing.

12.5 The occurrence of damage is an essential element of a cause of action in tort. In the first and second classes it would have occurred. In the third class the damage would not have occurred.⁵ In the fourth class neither exposure nor damage would have occurred. A further complication is that the identity of the persons constituting the third class at any time would not be known. And, of course, nor could the identity of those who might have the misfortune to join the fourth class. What can be said, however, is that:

- (a) the long lead time between exposure and the onset of mesothelioma means that for many years there will be cases of mesothelioma resulting from exposure to asbestos during or before 1987.⁶
- (b) where exposure to asbestos occurred after 1987, or has not yet occurred, the time when mesothelioma may occur could be many years into the future.

12.6 The *third* legal aspect concerns the identity of the James Hardie companies which were legally liable for the asbestos liabilities. There are relevantly three possibilities: JHIL, Coy and Jsekarb.⁷

12.7 The companies which were primarily liable were the operating companies, i.e. those which had been engaged in the manufacture and distribution of the asbestos products. That would mean that:

- (a) Coy would be liable to claimants suffering asbestos-related diseases in consequence of its negligence.
- (b) Jsekarb would be liable to claimants suffering asbestos-related diseases in consequence of its negligence.

⁵ Although it has been held in the case of mesothelioma that the damage occurs a short time before the disease manifests itself: *Orica Ltd v CGU Insurance Ltd* (2003) 53 NSWLR 14 at [28–33] and [72–83].

⁶ A person exposed to asbestos fibre as a 17 year old builder's apprentice in 1987 could suffer mesothelioma as a building contractor in 2027, and would still be under 60.

⁷ JHI NV and JH NV and JHA were not involved in mining asbestos, or manufacture or distribution of asbestos products, and were not part of the Group at those times.

- (c) JHIL could be liable for its own torts in the period before 1937, when it was the operating company. In such cases, however, even though the “damage” – the occurrence of an asbestos-related disease – occurred many years after 1937,⁸ the difficulties of establishing (in 2000 or later) negligence at the time when JHIL was the operating company would be considerable.

12.8 In the ordinary course, however, it would not follow that any one of JHIL, Coy or Jsekarb was liable for the torts of any other of the three. This was the position even though JHIL was the “parent”, the holding company for each of Coy and Jsekarb. As Mason J said in the High Court of Australia in *Walker v Wimborne* (1976) 137 CLR 1 at 6–7:

“To speak of the companies as being members of a group is something of a misnomer which may well have led his Honour into error. The word “group” is generally applied to a number of companies which are associated by common or interlocking shareholdings, allied to unified control or capacity to control. In such a case the payment of money by company A to company B to enable company B to carry on its business may have derivative benefits for company A as a shareholder in company B if that company is enabled to trade profitably or realize its assets to advantage. Even so, the transaction is one which must be viewed from the standpoint of company A and judged according to the criterion of the interests of that company.

Here, however, the companies were not members of a group in the sense already described. ... The “group” argument therefore provides no justification for what occurred.

Indeed, the emphasis given by the primary judge to the circumstance that the group derived a benefit from the transaction tended to obscure the fundamental principles that each of the companies was a separate and independent legal entity, and that it was the duty of the directors of Asiatic to consult its interests and its interests alone in deciding whether payments should be made to other companies. In this respect it should be emphasized that the directors of a company in discharging their duty to the company must take account of the interest of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them. The creditor of a company, whether it be a member of a “group” of companies in the accepted sense of that term or not, must look to that company for payment. His interests may be prejudiced by the movement of funds between companies in the event that the companies become insolvent.”

⁸ For example, during the carrying out in 2000 of renovations to a 1936 industrial building.

12.9 It does not follow that a holding company is never responsible for the torts of its subsidiaries. It may be so in any of a number of circumstances referred to by Sheller JA in *James Hardie & Co. Pty Ltd v Putt* (1998) 43 NSWLR 554 (“*Putt*”) at 579G–580A:

“The characterisation of a group of companies, linked by shareholding, as a single enterprise where one is an actor, whose acts or omissions should be attributed to another or others within the group, involves either “lifting the corporate veil”, treating the actor as an agent or imposing upon another or others within the group a duty by reason of the degree or manner of control or influence over the actor. The distinction between these ideas is easily blurred.”

12.10 In *Putt* it was held that the facts established in that case did not have the consequence that JHIL was responsible for damage caused to employees of its New Zealand subsidiary, and that neither JHIL nor Coy had in fact exercised such control over the New Zealand workplace that it was responsible for the workplace safety there. The High Court of Australia refused special leave to appeal in *Putt*.

12.11 A consequence of the above, and a consequence which reflected the notion of limited liability as seen in cases of companies under the *Corporations Law*⁹ was that the maximum *extent* of the liability of Coy and Jsekarb to creditors was limited to their assets. Once those assets were exhausted, a claimant would have no entitlement to anything from another James Hardie companies, unless one of the circumstances referred to in paragraph 12.9 was present: See the concluding part of the passage quoted earlier from *Walker v Wimborne*.

12.12 It was submitted on behalf of the Foundation and the UASG that *Putt* was a case based on its own facts and might be distinguishable if different facts emerged, in particular facts similar to those in *CSR Limited v Wren* (1997) 44 NSWLR 463, where the degree of actual management control exercised by the parent over the subsidiary had the result that both were liable to the plaintiff injured by the negligence of the subsidiary. “I agree, but it *would* be necessary to show the facts made *Putt* distinguishable.”

⁹ The law in force in 2000 and 2001, until the con
(Cth).

July 2001 of the *Corporations Act 2001*

12.13 The *fourth* point is that an injured plaintiff's ability to sue for damages in respect of the injury will not be effective if there is not a financially substantial defendant available and responsible for the damage. If the tortfeasor is insolvent, or the injury happened in circumstances where there was no insurance, compulsory or otherwise, of the tortfeasor, a plaintiff's claim for damages will go unsatisfied.

12.14 A reflection of this is that in theory JHIL might have caused Coy or Jsekarb to be put into liquidation, in which case future claimants, not yet having contracted an asbestos related disease, indeed in some cases not yet having been exposed to asbestos, would have no one to recover against once the assets of the company in liquidation had been distributed, and any insurance spent.

12.15 But that was the legal position; the practicalities were very different.

B. The Practicalities

12.16 I have referred above to a number of occasions on which the view was expressed that on any separation enough would have to be left in, or provided to, Coy and Jsekarb to ensure that they were able to satisfy asbestos liabilities.

12.17 Mr Forrest QC had concluded his Opinion of 16 August 2000 by saying:¹⁰

“99. Provided it can be confidently established that Coy and Jsekarb will be able to meet future asbestos claims I think that there is a reasonable prospect of the restructure being achieved without major adverse consequences. I repeat that it is no part of my brief to consider any implications for either JHG or its directors under the Corporations Law...

106. Insofar as both Courts and the public are concerned, if it can be established that the provisioning for Coy is adequate then the question of other attacks (be it in the Courts, through lobbying of Government or in the press) will be minimized.”

12.18 Indeed from an early point in consideration of restructuring it was recognised that there were potential “spoilers” in the process, and that they included unions, asbestos support groups, public opinion, and governments. Governments, of course, had the capacity to procure legislation which could alter the principle that the

¹⁰ Ex 61, Vol 4, Tab 47, pp. 303–304.

parent company was not liable for the torts of its subsidiaries. Thus in 1997 one of the Project Blue Sky “Objectives” had been to:¹¹

- avoid forum for creditors or other parties to object eg asbestos claimants...”

12.19 In Dr Barton’s note for the JHIL Board’s 1 July 1997 meeting,¹² he noted, in relation to Project Scully, that asbestos was “the critical issue”, and that the “key spoilers considered so far” included “Asbestos”.¹³ Advice should be sought, he suggested, from Allens and Skadden Arps (a United States firm) with regard to the “identity of potential spoilers, tactics they may use and counter measures available”.

12.20 The Project Chelsea-Board Sub-Committee’s meeting of 3 February 1998 noted that¹⁴ it had “become clearer that the two strategic issues for JHIL relate to asbestos and dealing with the rump” and, under the heading “6. Asbestos and Rump”:

“It is becoming more and more likely that the asbestos issue needs to be addressed by JHIL ...

The whole process will require the company to be proactive and transparent in relation to asbestos liabilities ...

The initial step is to update the actuarial report on asbestos ... With legal advice ..., the results of the actuarial report would be disclosed and sufficient asset backing (cash) retained to cover these liabilities (with sufficient margin). ...”

12.21 As late as 10 August 2000, Mr Robb and Mr Attrill, when discussing a proposal to retain Tillinghast as actuaries in addition to Trowbridge, worked on the assumption that James Hardie “would provide a buffer”.¹⁵

12.22 I think that proposals to remove Coy and Jsekarb from the Group leaving them with nothing more than their net assets (or proposals which contemplated the winding up of Coy or Jsekarb) had no practical prospect of success unless it was apparent that the funds left to Coy and Jsekarb were sufficient to satisfy the asbestos liabilities. To achieve public acceptance of a separation of Coy and Jsekarb from

¹¹ Ex 61, Vol 1, Tab 4, p. 12.

¹² Ex 61, Vol 1, Tab 8, p. 62.

¹³ Ex 61, Vol 1, Tab 8, p. 65.

¹⁴ Ex 61, Vol 1, Tab 21, p. 139.

¹⁵ Ex 61, Vol 4, Tab 35, p. 184; see too T 1192.22–36.

JHIL, Coy and Jsekarb had to be left with an amount which appeared sufficient to meet their asbestos liabilities. The extent to which proposals were developed to target stakeholders and particular sections of the media in order to convey that message is eloquent evidence of that.¹⁶

12.23 In short my view is:

- (a) JHIL was perfectly entitled to seek a means whereby it could pursue its aims without it being perceived, rightly or wrongly, as associated with ongoing asbestos liabilities.
- (b) To do so as a practical matter required that it make provision for the separated Coy and Jsekarb to have access to the funds necessary to meet the on-going asbestos liabilities, i.e. to provide the “right” amount, not the legal minimum of such funding.
- (c) Views would differ, of course, on how the “right” amount should be calculated, but to provide an amount which was manifestly not “right”, by being far too low, would be very difficult to defend.

12.24 I would add that, as Mr McGregor accepted in his oral evidence, options such as liquidation, or a declaration by JHIL of no further support for Coy and Jsekarb would have been practically unacceptable.¹⁷

¹⁶ T 1535.30–51.

¹⁷ T 1535.30–51.

Chapter 13 – The 17 January 2001 Board Meeting

13.1 Presentations were made at the 17 January board meeting by Messrs Macdonald, Morley, Wilson and Shafron.¹ It was the first occasion on which the proposed trust structure was presented to all the directors.²

13.2 Mr Morley recalled³ reporting to the directors that ED 88 was the biggest issue currently facing the company. Several directors, he said, queried whether disclosure would be limited to the net assets of Coy or the results of an actuarial report.

13.3 In relation to the proposal for separation, he said⁴ that “there was general disagreement over the method of funding future claims, ranging from net assets only, to a reversal of the \$43.5m dividend payment, to a payment which, on current estimates, was likely to meet all liabilities”. He elaborated on his notes in examination by Mr Meagher SC⁵. The matters canvassed during the Board meeting appear to include the following:

- (a) There appears to have been discussion of the subsidiary/parent company relationship and reference to the requirements to undertake due diligence in relation to Coy to ascertain that assets and liabilities were properly recorded. There is also a reference to an Industrial Hygiene Unit said to have been conducted by JHIL in the days of asbestos manufacturing, and whether this would make the then JHIL/Coy relationship “closer to *Wren* than *Putt*”.
- (b) Mr Morley spoke about ED 88 and the concern that CSR had announced in November 2000 that it was going to adopt ED 88 early in March 2001.
- (c) There was a discussion about alternative funding.

¹ Ex 17, p. 24, para. 130–131.

² Ex 121, p. 30, para. 196.

³ Ex 121, p. 30, para. 197.

⁴ Ex 121, Tab 87, p. 30, para. 197 and Ex 123, pp. 4–8.

⁵ T 2013.44–2020.14.

- (d) Mr Brown, a director, was attracted to the proposal but raised a moral issue as to whether JHIL was prepared to use the corporate veil, and he refers to the difficulties associated with the complexities of reversing the dividend and the debt structure between the trust and JHIL.⁶
- (e) Mr Wilcox had not made a decision on the trust. He saw the PR question as being important and saw the potential for government legislation as a practical issue, and noted that JHIL cannot say all debts are covered, and concluded by making a comment that the “whole proposal needs more work”. It appears that Mr Willcox was raising the issue of funding up to the best estimate. Mr Terry, the Brierley representative, put the view of net assets only.
- (f) Ms Hellicar is recorded as raising the question of “how much is enough to pay all claims, and if this is less than Trowbridge, what can be done”. She also commented that JHIL looked guilty by putting money into a trust.

13.4 Mr Robb was also present. His notes of the meeting⁷ record a number of statements made by participants at the meeting. Amongst other things Mr McGregor said that the “new Board”, (i.e. the persons who were to become directors of the Foundation) wanted a life of 10–15 years, Mr Shafron said that Coy was “in the books at \$141m”, that there were Trowbridge Reports “which looked at the cash flow impact, rather than legal liability and that they showed the net present value of payments at \$230m, \$254m and \$263m in the 1996, 1998 and 2000 reports respectively. He said that the 2000 report took into account the QBE payments and a big increase in claimants. Mr Robb noted Mr Shafron as saying one needed to “add QBE back in at \$293m”.⁸ Mr Robb’s note was that Mr Morley said that he had:

“... projected claims payment x life of fund – looks like it is 12–13 years but assumes has sold properties

∴ likely already insolvent

⁶ T 2016.25–48.

⁷ Ex 187, Vol 1, Tab 9.

⁸ See too Mr Shafron’s oral evidence at T 1800.26–1802.16.

∴ crunch time closer to 9 years”

13.5 Mr Morley, asked whether the note refreshed his memory as to what he had told the Board on 17 January, said:⁹

“A. Yes I had supplied the board with a model which the gross assets of 214 million, and the claims payment numbers had been supplied to us from Peter Shafron. I am fairly sure from the June 2000 report, but I can’t be certain, and what we did in the finance department was to run those claims payments forward and run forward the earning on the then assets of the group and projecting it out, it looked like, given those claims payments about the life was about 12 to 13 years, but as Robb says there, we needed to sell the properties.

...

Q. What about the line “therefore likely already insolvent”?

A. Well, my understanding of insolvent is a company is insolvent if it can’t pay its debts as and when they fall due. When the projected claims payments were, contingent payments, obviously going forward, this was you know, not a legal interpretation of what insolvent was.

Q. Just the accountant’s interpretation?

A. Yes.

Q. That is a disastrous position really, isn’t it, that you gave to the board on 17 January 2001 concerning the potential liabilities of Coy?

A. Coy, yes.

Q. From your own calculations, you were of the view that James Hardie and Coy would reach, using your words, crunch time in about 9 years?

A. That’s right based on those numbers supplied at the time.

Q. That was your view at 17 January?

A. Yes.

Q. How did you inform the directors, the incoming directors of that view on 15 January, what did you say to them?

A. On 15th of January, we told them it was a net asset model and I, my view at the time was I think I looked, I talked about 12 to 13 years or the 10 to 15 year period, I don’t think I talked about 9 years.

Q. I suggest Mr Morley, you told the incoming directors a story that was totally different to what you informed the board two days later in relation to the life of the fund?

⁹ T 2164.48–2165.46.

- A. No because looking at these notes which records the conversation I had, my view was the properties would be sold and it would give it a life of 12 to 13 years. I think the comment about “crunch time closer to 9 years” assumes no sale of properties in the 9th year.”

13.6 If Mr Morley’s view of that point was that the Foundation’s life would be about 12 to 13 years, assuming a sale of the leased properties, one might be forgiven for having little confidence in the view that the later addition of the amounts paid periodically pursuant to the Deed of Covenant and Indemnity would have the extraordinary different effect given to them by the Twelfth Cash Flow Model. The change in results effected by the infusion of these funds was dramatic. Instead of having a life of 12 to 13 years if the leased properties were sold, and nine years if they were not, the Foundation would have \$159m left after 20 years and \$38.586 would be left after 50 years.

13.7 The discussion concluded with Mr McGregor indicating that the need for the fund to have a life of 10 to 15 years was “a deal breaker”.¹⁰

13.8 The evidence to which I have referred makes it apparent that some members of the Board favoured the infusion of further funds to the Foundation if separation occurred. There was some other evidence. For example, Mr Macdonald thought¹¹ that it was Messrs Wilcox and McGregor who led a discussion about the reputational and corporate citizenship issues involved in the proposal. He believed Mr Wilcox posed the question “What would be the impact if we set aside extra to meet the actuarial estimate of the most likely cost of future asbestos claims?” Other directors thought they would like to have the information before a final decision.

13.9 In the event the Board minutes record the decision as being:¹²

“TRUST

The directors noted a paper discussing a stand alone trust company that could support asbestos related medical research and manage the asbestos liability of subsidiary companies.

Mr. PD Macdonald outlined what the objectives of such a trust would be. Mr. I Wilson explained possible features of a trust and its structure and commented on

¹⁰ Ex 187, Vol 1, Tab 9; Robb T 2830.21–33.

¹¹ Ex 148, para. 33.

¹² Ex 61, Vol 5, Tab 25, p. 80.

likely market reaction. Mr. PJ Shafron reported on a recent meeting of potential trust directors. Mr. PG Morley explained the financial and accounting implications. Mr. Shafron, Mr. P Cameron and Mr. D Robb discussed legal issues and risks associated with the trust concept. Mr. G Baxter outlined a possible communications strategy. Mr. Macdonald commented on the debt position of the Company and several means to raise funds to satisfy intercompany debt to James Hardie & Coy Pty Limited.

The directors discussed the trust concept and asked questions of management and advisers.

The Chairman noted that the concept appeared to have some merit, but that the question of funding for the Company required more work. He requested management to continue developing the concept and to report progress, particularly in relation to funding, at the February meeting.”

13.10 Mr Robb also referred to the Board meeting in a subsequent meeting of senior JHIL management and advisers on 23 January 2001 and his note of that meeting recorded that there had been a mixed Board reaction to the trust proposal, with a majority wanting to proceed as soon as possible, but a minority concerned about separation.¹³ Mr Macdonald raised the issue of “tipping more in as an offer to the Govt (one of the directors’ suggestions)”.¹⁴ It was at that meeting, according to Mr Morley,¹⁵ that it was decided that a new actuarial report “was necessary to assess the funding requirements of any future claims for the purposes of the proposed Foundation as well as a study of payment patterns to work out cash flow requirements”.

¹³ Ex 187, Vol 1, Tab 11.

¹⁴ Ex 187, Vol 1, Tab 11.

¹⁵ Ex 121, paras 198–199.

