Allens Arthur Robinson

Special Commission of Inquiry into the Medical Research & Compensation Foundation

Submissions

of

James Hardie Industries NV

and

ABN 60 Pty Limited

on

Terms of Reference 2 & 3

Allens Arthur Robinson
The Chifley Tower
2 Chifley Square
Sydney NSW 2000
Tel 61 2 9230 4000
Fax 61 2 9230 5333
www.aar.com.au
Ref: MLBS:205200345:SALS

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The specific findings which JHINV and ABN 60 submit the Commissioner should make in relation to the issues stated in the paper dated 28 June 2004 prepared by counsel assisting the Commission appear on the following pages.

Issues 1 to 4, 74 and 75 are addressed in separate written submissions.

1. Overview

1.1 James Hardie corporate structure

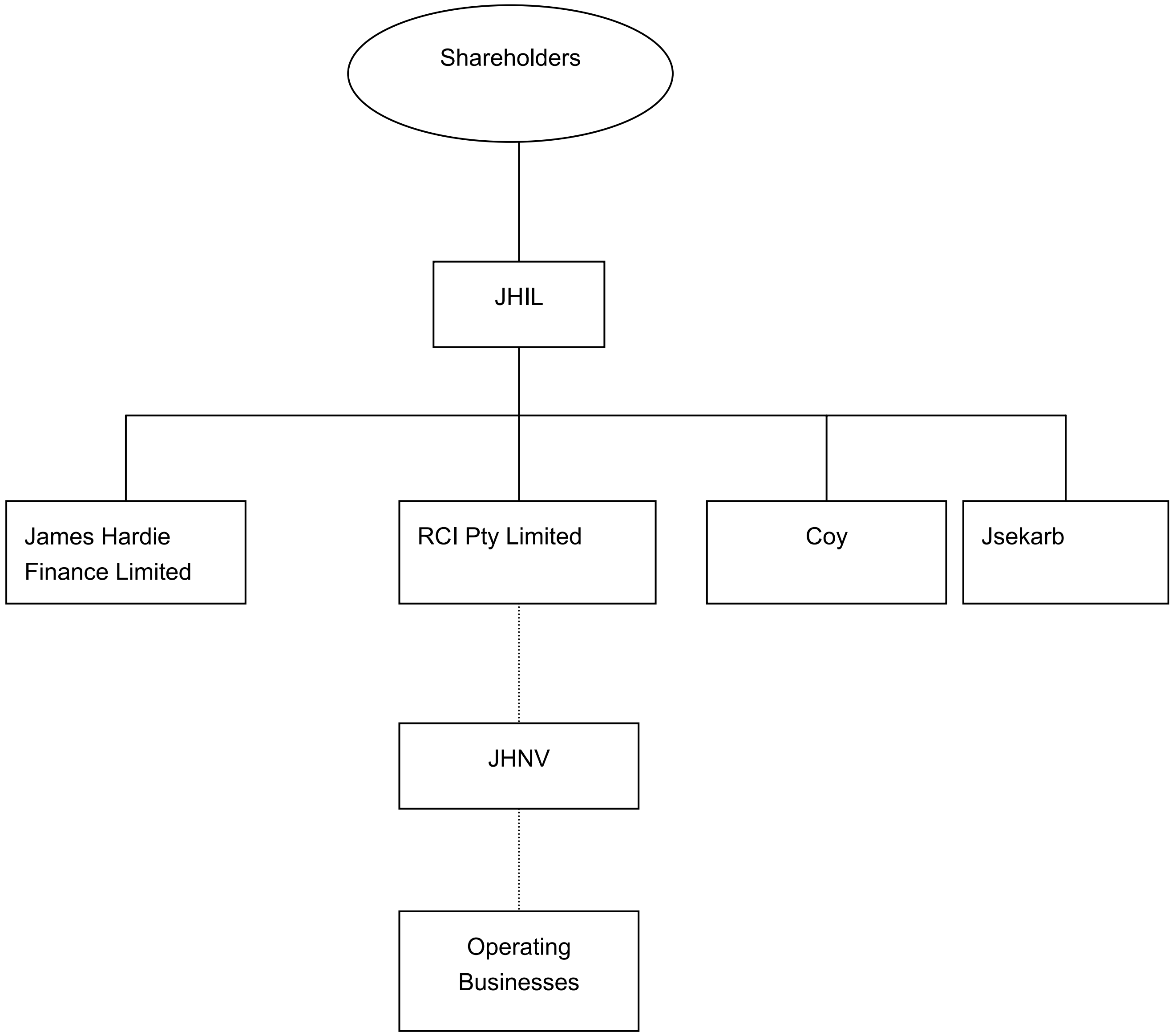
1.1.1 On 16 February 2001, James Hardie announced the establishment of the Medical Research & Compensation Foundation, a charitable trust which would hold the shares of two former asbestos subsidiaries of the group.

1.1.2 The company which made the announcement, James Hardie Industries Limited (***JHIL***), was then the parent of the James Hardie group and had been listed on the Australian Stock Exchange since 1951.

1.1.3 JHIL was incorporated on 23 June 1920 as Hardie Asbestos Cement Pty Limited and changed its name several times until 2 August 1979 when it became known as JHIL.

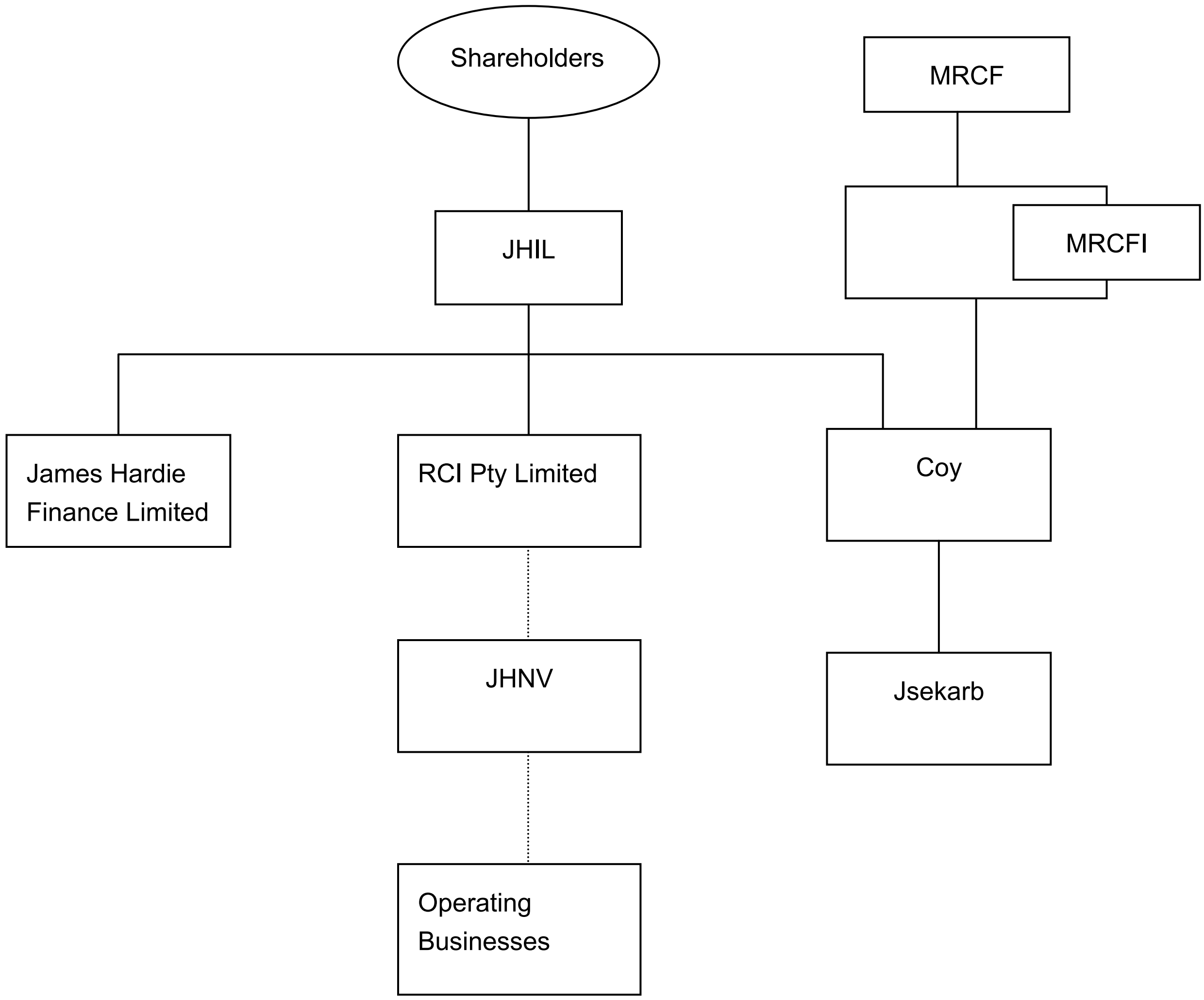
1.1.4 The two subsidiaries which were transferred by JHIL to the Medical Research & Compensation Foundation, Amaca Pty Limited and Amaba Pty Limited, had previously been known as James Hardie & Coy Pty Limited (***Coy***) and Jsekarb Pty Limited (***Jsekarb***). Both of those companies had, in the past, been involved in the manufacture and sale of products containing asbestos. Coy was incorporated in 1937 and, from that date, had carried on substantially all of the James Hardie group's asbestos cement business in Australia. Jsekarb, previously known Hardie-Ferodo Pty Limited, was incorporated in 1962 and had been involved in the manufacture of asbestos brake pads, initially as part of the Hardie-Ferodo joint venture and later as part of the Better Brakes business. JHIL had itself been involved in the manufacture and sale of asbestos products prior to the incorporation of Coy in 1937, at which time JHIL transferred its business to Coy and became a holding company: Ex 81: Ex 81, attachment D, p1-3; Ex 284, tab 1, p51; Ex 286.

1.1.5 In a restructuring of the group in 1998 (discussed in section 4), the core operating businesses of the group had been transferred to subsidiaries of a group company known as James Hardie NV. In the case of operating companies with prospective asbestos liabilities, such as Coy, the businesses of those companies were sold to subsidiaries of James Hardie NV but the shares in those companies were not. As a result, immediately prior to the establishment of the Medical Research & Compensation Foundation, Coy and Jsekarb remained directly held subsidiaries of JHIL but were not subsidiaries of James Hardie NV. Coy held substantial assets, representing the proceeds of the sale of its business to a subsidiary of James Hardie NV. As a result of those transactions, the structure of the group as at 14 February 2001 was as follows.



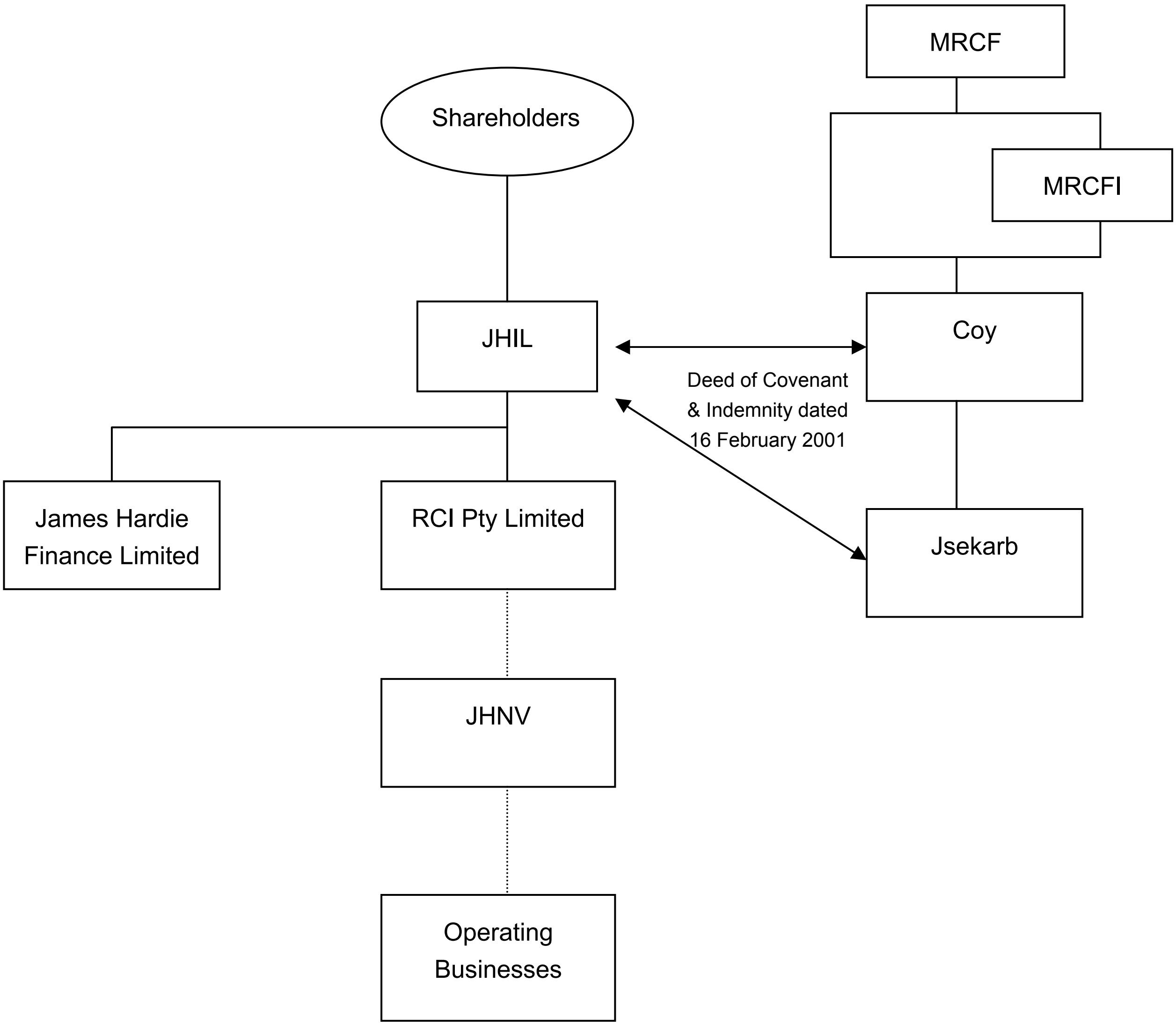
James Hardie group 14 February 2001

1.1.6 On 15 February 2001, Jsekarb issued 1,000 ordinary shares to Coy and cancelled all of the shares held by JHIL in Jsekarb. As a result, Jsekarb became a wholly owned subsidiary of Coy. Also on 15 February 2001, each of the Medical Research & Compensation Foundation (a company limited by guarantee and the trustee of the Medical Research & Compensation Foundation trust) and its wholly owned subsidiary MRCF (Investments) Pty Limited were issued with 500 shares in Coy. As a result, as at 15 February 2001 the structure of the group was as follows.



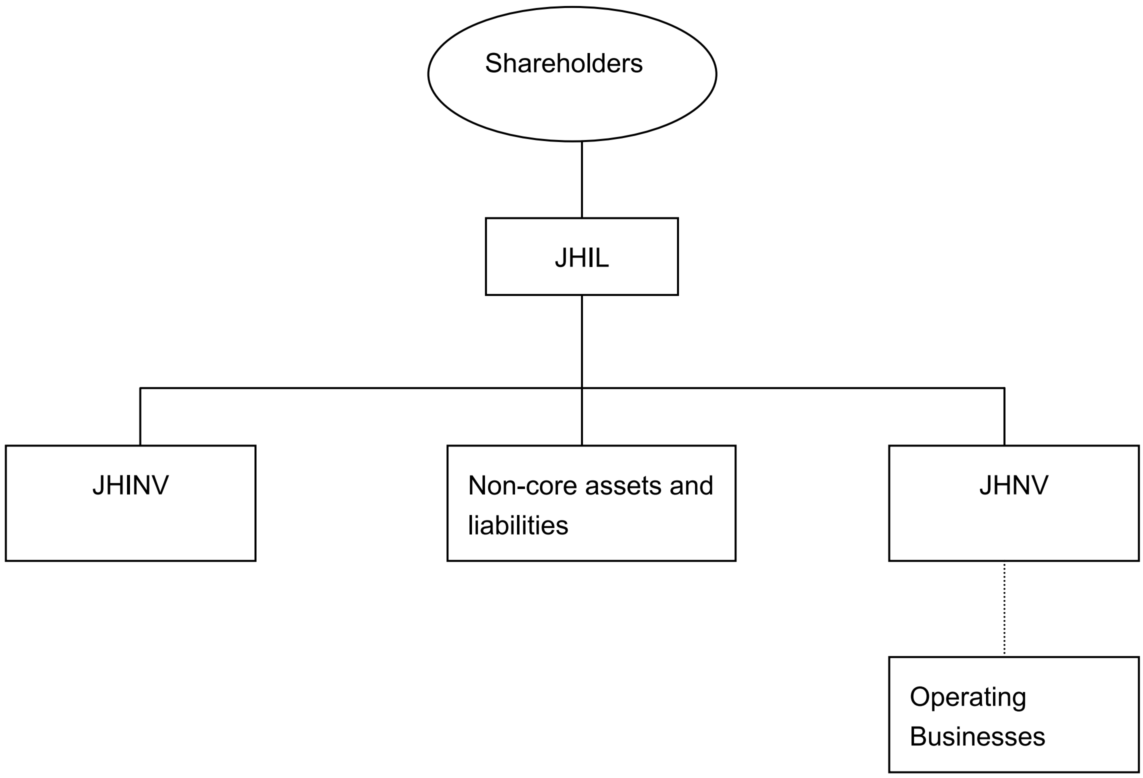
James Hardie group 15 February 2001

1.1.7 On 16 February 2001, the remaining shares held by JHIL in Coy were cancelled and, as a result, Coy and Jsekarb became wholly owned subsidiaries of the Medical Research & Compensation Foundation. Immediately prior to that cancellation, JHIL entered into a Deed of Covenant & Indemnity with Coy and Jsekarb under which, amongst other things, JHIL undertook to make payments totalling $112.5 million over 42 years in return for an indemnity and covenant not to sue in relation to certain asbestos claims and inter-company transactions. As a result, after the establishment of the Foundation, the structure of the group was as follows.



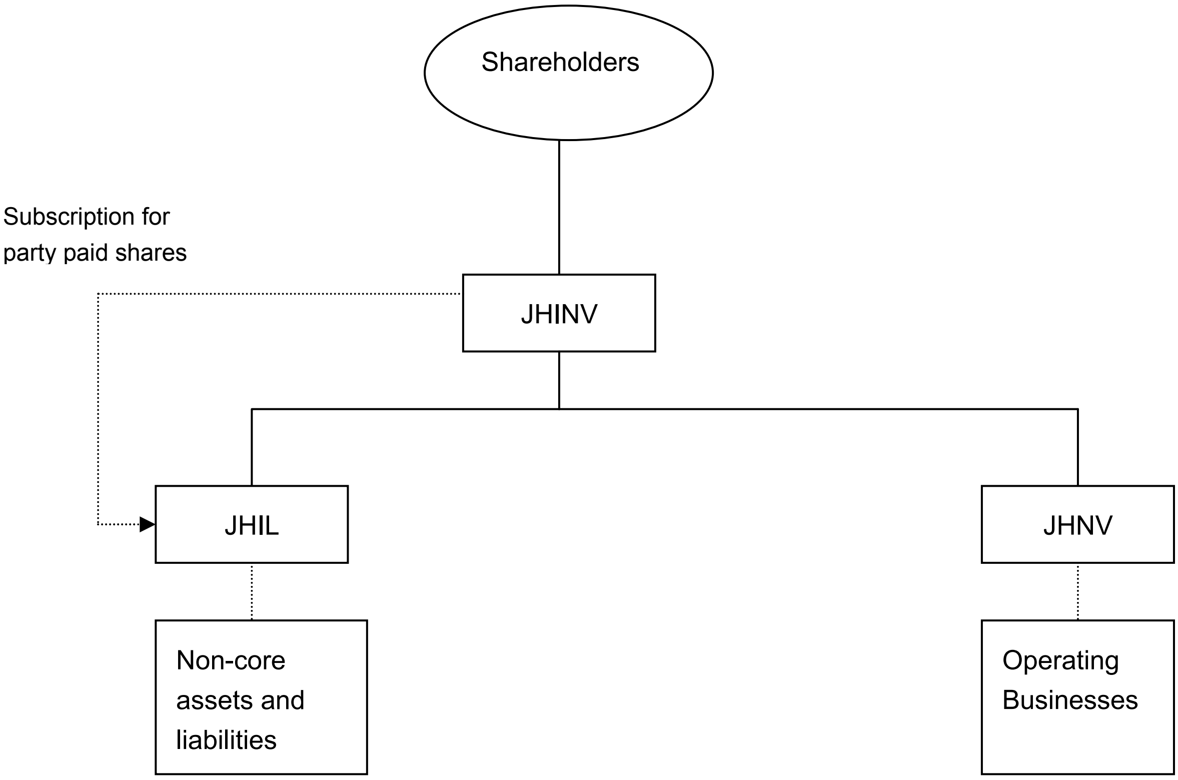
James Hardie group 16 February 2001

1.1.8 In October 2001, the James Hardie group was restructured under a scheme of arrangement approved by shareholders on 28 September 2001 and by the Supreme Court of New South Wales on 8 October 2001. Prior to the implementation of the scheme, a group company then known as RCI Netherlands Holdings BV was renamed James Hardie Industries NV (***JHINV***) and transferred within the group such that it became a subsidiary of JHIL but was no longer a holding company of James Hardie NV (***JHNV***). As a result, the structure of the group prior to the implementation of the scheme was as follows.



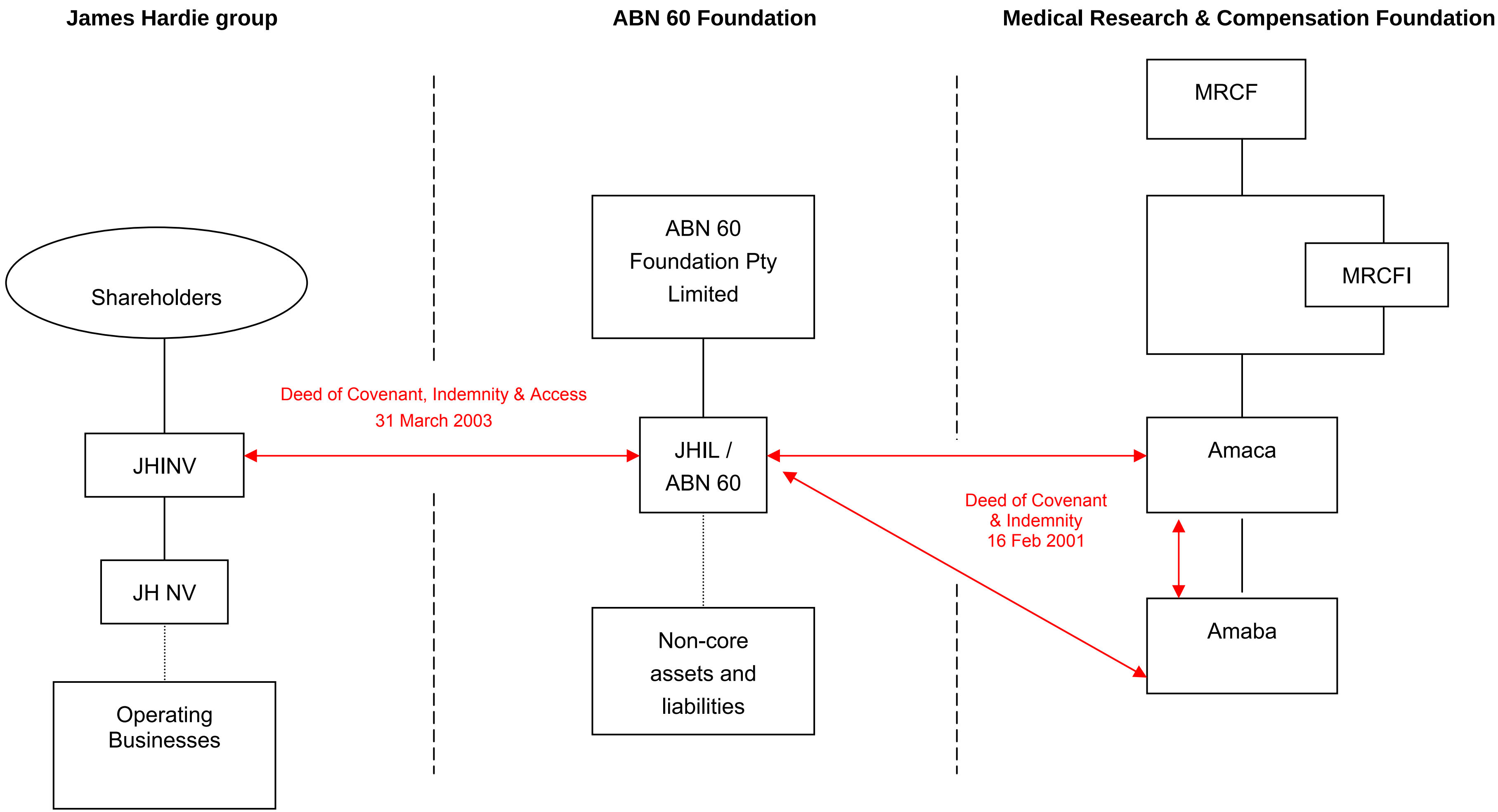
James Hardie group prior to the scheme of arrangement

1.1.9 Under the scheme of arrangement, ownership of JHNV was transferred from JHIL to JHINV and shareholders exchanged their shares in JHIL for shares in JHINV. As a result, JHINV became the ultimate holding company within the group. Also as part of the scheme of arrangement, the new parent (JHINV) subscribed for partly paid shares in the former parent (JHIL) with an issue price calculated by reference to the market capitalisation of JHIL prior to implementation of the scheme. As a result, following the scheme of arrangement the structure of the group was as follows.



James Hardie group following the scheme of arrangement

1.1.10 On 15 March 2003, JHIL, now known as ABN 60 Pty Limited (ABN60), cancelled all of the partly paid shares then on issue to JHINV. On 31 March 2003, ABN 60 issued 1000 shares to ABN 60 Foundation Pty Limited, the trustee of a new charitable trust (to be known as the ABN 60 Foundation), and cancelled the remaining shares held by JHINV in ABN 60. As a result, ABN 60 became a wholly owned subsidiary of ABN 60 Foundation Pty Limited and ceased to be a member of the James Hardie group. Immediately prior to the cancellation of shares on 31 March 2003, ABN 60 entered into a Deed of Covenant, Indemnity & Access with JHINV. Immediately following the establishment of the ABN 60 Foundation the position was as follows.



The James Hardie group, the ABN 60 Foundation and the Medical Research & Compensation Foundation immediately following 31 March 2003

1.1.11 JHIL continues to owe substantial payment obligations to Amaca and Amaba under the Deed of Covenant & Indemnity dated 16 February 2001.

1.2 James Hardie's asbestos activities from 1920 to cessation in 1987

1.2.1 The following chronology summarises James Hardie's asbestos activities from 1920 to their cessation in 1987.

1920s	JHIL commences production of asbestos cement building products at Camellia (NSW), Brooklyn (Vic.) and Newstead (Qld).
1926	Production of asbestos cement pipes commences.
1930s	Production of asbestos brake pads and asbestos thermal insulation products commences.
1937	Incorporation of Coy. JHIL becomes a holding company and Coy carries on the business of manufacturing and selling asbestos products.
1950s	Joint venture between Coy and Wunderlich established in Adelaide.
1960	Coy becomes the sole owner of the South Australian business after buying out Wunderlich.
1963	Hardie-Ferodo joint venture. Jsekarb (then known as Hardie-Ferodo Pty Limited) begins manufacture of asbestos brake pads.
1964	Coy forms Hardie-BI joint venture with CSR and Bradford Insulation for the manufacture of asbestos thermal insulation products.
1968	Coy ceases use of crocidolite (blue asbestos).
1974	Hardie-BI joint venture dissolved and Coy ceases production of thermal insulation products.
1977	Acquisition of asbestos cement business of Wunderlich Limited
1978	Ferodo withdraws from Hardie-Ferodo joint venture. Jsekarb continues business as Better Brakes.
1981	Brooklyn (Vic.) and Sunshine (Vic.) factories cease production of flat sheet asbestos cement.
	Brooklyn (Vic.) factory ceases production of asbestos mouldings.
1982	Camellia (NSW), Rosehill (NSW), Ennoggera (Qld), Largs Bay (SA) and Welshpool (WA) factories cease production of flat sheet asbestos cement.
	Sunshine (Vic.), Ennoggera (Qld) and Rivervale (WA) factories cease production of asbestos corrugate and mouldings.
1983	Newstead (Qld) and Wacool (Qld) factories cease production of

	flat sheet asbestos cement.
	Camellia (NSW) and Newstead (Qld) factories cease production of asbestos corrugate and mouldings.
1985	Welshpool (WA) factory ceases production of asbestos corrugate.
1987	Jsekarb's business sold to Futuris. James Hardie no longer involved in the manufacture of asbestos brake pads.
	Coy ceases manufacture of asbestos cement pipes.
	James Hardie no longer involved in the manufacture of asbestos products.

(See Ex 75, vol 7, tab 90, p 2455-2467 and Ex 61, vol 1, tab 1.)

1.3 Dealings between James Hardie and Trowbridge between 1996 and 2001

1.3.1 JHIL first obtained an actuarial assessment of the James Hardie group's asbestos liabilities in 1996. That assessment was prepared by John Trowbridge Consulting Pty Limited. The following chronology summarises the dealings between JHIL and Trowbridge between 1996 and 2001.

1996	
April 1996	JHIL General Counsel, Stephen Gellert, instructs Trowbridge to provide JHIL with an actuarial review of the group's asbestos liabilities: Ex 50, [12].
5 June 1996	Trowbridge delivers "initial review" of asbestos liabilities: Ex 2, tab 11. Estimates present value of asbestos liabilities as at 31 March 1996, using an 8% pa discount rate, at $175 million.
11 July 1996	Trowbridge proposes a second stage actuarial review with a final report to be delivered by 30 September: Ex 176.
24 July 1996	Gellert advises that the consideration of Trowbridge review and presentation by the JHIL Board is scheduled for 3 September: Ex 177.
3 September 1996	Trowbridge slide presentation to JHIL Board. Present value of asbestos liabilities using 8%pa discount rate $193 million: Ex 178.
10 October 1996	First complete Trowbridge report: Ex 2, tab 12. Estimates present value of asbestos liabilities as at 31 March 1996, using an 8% pa discount rate, at $230 million.
1998	
1 April 1998	Trowbridge confirms Allen Allen & Hemsley's instructions to prepare an actuarial assessment of the group's asbestos liabilities as at 31 March 1998: Ex 50, tab 2.

10 September 1998	Second Trowbridge report: Ex 2, tab 13. Estimates present value of asbestos liabilities as at 31 March 1998, using a 7% pa discount rate, at $254 million.

2000

10 March 2000	Allen Allen & Hemsley instruct Trowbridge to prepare an actuarial assessment of the group's liabilities as at 31 March 2000: Ex 50, tab 2.
9 May 2000	First draft of Trowbridge 2000 report received: Ex 56, [49]; Ex 57, p 121.
16 June 2000	Final draft of Trowbridge 2000 report issued: Ex 2, tab 14. Estimates present value of asbestos liabilities as at 31 March 2000, using a 7% pa discount rate, at $294 million. Report notes that inclusion of payments expected under settlement with QBE ($32 million) would result in a present value of $262 million (p 9).

2001

16 January 2001	First telephone conversation between Wayne Attrill and David Minty concerning a revised report: Ex 56, [166]; Ex 50, [30]. Wayne Attrill's note records, "Can run with the data we have." (Ex 57, p 956).
17 January 2001	Second telephone conversation between Wayne Attrill and David Minty concerning a revised report: Ex 56, [109]; Ex 57, p 959.
19 January 2001	Meeting between Messrs Shafron, Morley, Attrill, Minty and Marshall concerning a revised report: Ex 56, [114]; Ex 57, p 970; Ex 50, [31].
30 January 2001	Allen Allen & Hemsley formally instruct Trowbridge to prepare a revised report: Ex 50, tab 12.
2 February 2001	First draft of 2001 report sent by Trowbridge to Roy Williams, Peter Shafron and Wayne Attrill: Ex 50, tab 13; Ex 56, [118]; Ex 57, p 980; Ex 17, [167].
13 February 2001	David Minty and Karl Marshall present draft February 2001 report to Foundation directors: Ex 50, [44].
14 February 2001	Final version of February 2001 report sent by Trowbridge to Peter Shafron with letter of consent to use by prospective Foundation directors: Ex 50, [51] and tab 22.

2. Transactions before Project Chelsea

2.1 Summary of financial position of JHIL, Coy and Jsekarb years 1990 to 1997

2.1.1 The financial position of JHIL, Coy and Jsekarb, in the years ended 31 March 1990 to 1997 is summarised in the table below. Except where otherwise noted, figures appearing in the table are taken from the financial statements of the entities.

	JHIL ($000)	Coy ($000)	Jsekarb ($000)
1990			
Revenue	157 300	265 364	3 572
Profit after Tax	43 200	18 933	3 572
Net Assets	514 200	76 140	6 408
1991			
Revenue	168 000	239 198	-
Profit after Tax	55 400	21 893	2
Net Assets	555 300	77 807	5 414
1992			
Revenue	224 100	232 728	-
Profit after Tax	143 500	4 636	(38)
Net Assets	678 200	58 124	3 606
1993			
Revenue	89 600	247 538[1]	-
Profit after Tax	19 000	19 011	-
Net Assets	668 800	58 948	3 606
1994			
Revenue	198 400	257 242	-
Profit after Tax	3 800	4 938	(396)
Net Assets	638 200	63 886	3 210
1995			
Revenue	58 900	283 495	-
Profit after Tax	(14 800)	22 182	(398)
Net Assets	595 000	86 068	2 812

1996			
Revenue	185 000		
Profit after Tax	95 400	117 136	(437)[2]
Net Assets	648 800	100 951	
1997			
Revenue	177 000		
Profit after Tax	64 100	(33 623)	(84)[3]
Net Assets	692 100	20 794	

Note 1: This figure is taken from Coy's 1994 accounts: Ex 1, vol 1, tab 9, p 156. There is a $10,000 difference between that figure and the figure recorded in Coy's 1993 accounts: Ex 1, vol 1, tab 10.

Note 2: Ex 103, tab 46, p 585. Jsekarb was not required to prepare statutory accounts for the years ended 31 March 1996 and 1997. The evidence before the Commission does not establish the revenue and net assets of Jsekarb in those years.

Note 3: Ex 103, tab 47, p 586.

2.2 JHIL's policy in relation to acquisition of new assets by Coy following January 1997

2.2.1 Some time around 1994 or 1995, it was decided that new assets to be used in the Australian Building Boards business would be purchased by James Hardie FC Pty Limited and leased to Coy: T2735.6. Under the arrangement, assets were acquired by James Hardie FC Pty Limited and leased to Coy for an annual rental equal to the depreciation on the assets: Ex 121, vol 2, tab 20, p 890. The purchase price of the equipment was lent by Coy to James Hardie FC Pty Limited, resulting in a debt owed by James Hardie FC Pty Limited to Coy for the value of the assets acquired. The annual rental payments were offset against that debt: Ex 121, vol 2, tab 20, p 892. Evidence before the Commission suggests that the arrangement only operated between January 1995 and 31 March 1998. Given that James Hardie FC Pty Limited was only incorporated on 20 February 1996, it is possible that the arrangement operated over a shorter period: Company search of James Hardie FC Pty Limited, Ex [ ]. Over the course of the arrangement, James Hardie FC Pty Limited purchased assets with a value of around $42.5 million (assessed as at 31 March 1998). On 31 March 1998, the assets which had been purchased by James Hardie FC Pty Limited were sold by it at fair market value, as assessed by Gray Eisdell Timms, to James Hardie Fibre Cement Pty Limited: Ex 121, vol 2, tab 20, p 892; Ex 121, vol 1, tab 7. Coy also sold its plant and equipment to James Hardie Fibre Cement Pty Limited on the same date, also for fair market valued as assessed by Gray Eisdell Timms (see section 4.2 below).

2.2.2 Dr Barton's evidence is that the purpose of the decision to capitalise new assets in James Hardie FC Pty Limited was to maintain flexibility for the future in terms of dealing with new assets; they would be easier to sell if they sat in a company other than Coy. The asbestos liabilities of Coy made it unsaleable: T2735.42. Mr Shafron assumed that the reason for the practice was so that the new assets would not be available to asbestos claimants: T1783.45. That is not quite the reason that was offered by Dr Barton, who was in the best position to know the true reason.

2.2.3 The policy adopted by JHIL was not wrongful. It served a proper corporate purpose. It was not suggested to anyone, such as Dr Barton, that the directors of Coy permitted corporate opportunities to be diverted from Coy. Any suggestion along those lines would be absurd. The evidence of both Dr Barton (T2735.47, T2736.25 and T2711.33) and Mr Morley (T2213.29 and T2214.6) is that the policy only extended to the acquisition of fixed assets. That is consistent with the purpose recorded in Ex 140, "to prevent the further accumulation of valuable assets in JH & Coy". To the extent that Mr Katz's memorandum of 27 March 1998 (Ex 61, vol 2, tab 5, p 24) appears to ascribe a broader purpose to the policy, the evidence of Dr Barton (who was involved in the decision) and Ex 140 (which, unlike Mr Katz's memorandum, is a contemporaneous record) are to be preferred. JHIL as the owner of Coy was entirely within it rights to acquire new assets in the name of James Hardie FC Pty Limited and to rent those assets to Coy. Furthermore, Dr Barton's evidence was that Coy had a very mature business in Australia and there was not much in the way of new ventures for Coy: T2737.28. That evidence has not been contradicted.

2.2.4 The consequence of the policy was that the new assets were not owned by Coy and therefore not ultimately available to Coy's creditors (including asbestos creditors). That did not make the policy unlawful.

2.2.5 In any event, the policy of acquiring fixed assets in James Hardie FC Pty Limited between January 1995 and March 1998 ultimately had no effect on the financial position of Coy. The rent paid by Coy for the use of those assets was equal only to their depreciation. All plant and equipment used in the Australian Building Board business (whether held by Coy or James Hardie FC Pty Limited) was transferred to James Hardie Fibre Cement Pty Limited on 31 March 1998. The result was that Coy's financial position as at 31 March 1998 was no different to the position Coy would have been in had it acquired all new plant and equipment itself between January 1995 and March 1998.

Issue 50

50. There is evidence which suggests that by some time in 1994 or 1995 there was a policy, at least within some levels of management of the James Hardie Group, of minimising Coy's assets with a view to reducing the extent to which assets of the James Hardie group might be available to asbestos claimants. Should a finding be made to this effect?

The Commissioner should not make a finding to this effect. The Commissioner should make a finding that:

- between January 1995 and March 1998, there was a policy within the group of acquiring fixed assets to be used in the business of Coy in James Hardie FC Pty Limited;
- the policy served a proper corporate purpose; and
- the financial position of Coy was ultimately not affected by the policy.

2.3 Transfer of building Boards technology from Coy to JH Research on 1 April 1995

2.3.1 On or about 12 April 1995, Coy sold certain intellectual property rights to James Hardie Research, which was a dedicated R&D entity: Ex 174, tab C. The price was $75 million. The background to that transaction is set out in Dr Barton's first statement: Ex 174, [3] - [14].

2.3.2 The sale was made following a review, initiated by Dr Barton in 1993 or 1994, of the R&D activities of James Hardie. It was part of a strategy to integrate and centralise the research and development activities conducted within the James Hardie group, "the purpose of which was to increase the group's productivity and financial performance through greater co-ordination, management, efficiency and direction, with a view to increasing shareholder value": Ex 174, [20].

2.3.3 In about July 1994, Coopers & Lybrand were retained to assess the fair market value of James Hardie's Core Technologies, which included the property that was sold by Amaca to James Hardie Research Pty Limited on 12 April 1995. Coopers & Lybrand prepared two valuation reports in March 1995, one long and one short: Ex 174, tabs A - B. Both reports support the sale price of $75 million.

2.3.4 Mr Humphreys' report (Ex 245) comments on the net sales figure of $390 million that was utilised by Coopers & Lybrand. He said that Coopers & Lybrand provided no explanation as to why they adopted $390 million [1.10(e)] and that with hindsight "it would appear that $450 million would have been a more realistic figure" [1.13]. If $450 million had been used, the value would have been approximately $87 million rather than $75 million. During cross-examination, Mr Humphreys' conceded that he had "raised a query and no more": T3182.50. He accepted, for example, that the difference might be explained by the fact that the figure of $390 million excluded sales for non-royalty products: T3182.46.

2.3.5 Mr Humphreys referred in his report to questions raised by Leadenhall Australia Limited in relation to the valuation of the Core Technology: [1.10(c) - (d)]. He had not been provided, however, with a copy of the valuation prepared by Leadenhall: Ex 248, T3180.15. The Leadenhall view was provided in the context of inquiries being made by the Australian Taxation Office. Leadenhall expressed an indicative view that the value of the technology was $19 million and that Coopers & Lybrand had overstated the true value.

2.3.6 No weight should be given to the very tentative views that Mr Humphreys expresses in his report on this topic. There is no reasonable basis for a conclusion that the figure of $75 million understated the fair market value of the property that was sold.

2.3.7 The commercial motives for the transaction were proper and the transaction itself was undertaken in manner that is not open to criticism.

Issue 52

52. The evidence suggests that the transfer of Coy's core technology to JH Research Pty Limited:

(a) was for fair value;

(b) was made for legitimate commercial purposes;

(c) was approved by the directors of Coy consistently with their directors' duties.

Should a finding be made to this effect?

The Commissioner should make a finding to this effect.

2.4 Transfer of controlled entities

2.4.1 Coy also sold a number of its controlled entities during the financial year ending 31 March 1996: Ex 174, tab F. These sales were undertaken as part of a restructure to flatten the group structure. The sales yielded a profit of $38,255,000 for Coy. Once again, neither the commercial motives for the sales nor the sales themselves can be attacked.
Mr Humphreys did not raise any queries over these sales.

3. Dividends and management fees 1990 to 2000

3.1 Summary of payments 1990 to 2000

3.1.1 Between 1990 and 2000, Coy paid management fees and dividends as follows: Ex 68, tab F (note that Ex 4 is not reliable):

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

3.2 Interim dividend – year ending March 1997

3.2.1 The dividend paid in the year ending 31 March 1997 was an interim dividend of $43.5 million paid on 2 October 1996. The dividend was paid to Coy's X class shareholder (Borchester Investments Pty Ltd), following a meeting of the directors of Coy (Dr Barton and Mr McFadden) on 2 October 1996: Ex 175, tab B.

3.2.2 In January 2001, a question arose as to whether this dividend had been properly paid. This question is addressed below. Allens prepared a draft advice on this question: Ex 187, tab 12. The advice was not sent to JHIL but it provides a useful analysis of the legal issues. The advice concluded:

> In conclusion, whilst there may be question marks over the prudence of the 1996 dividend, which would need further factual analysis, this is very different to a consideration of whether the Court would be prepared to set aside a dividend in the face of the fact that it appears from the materials reviewed that sufficient profits were available at the relevant time to support the payment of the dividend, and given the fact that since the payment Coy has maintained a position of solvency at all times.
>
> As mentioned above, in order to come to a concluded view, we would need to investigate further the decision making process of the directors of Coy, the facts known to them at the

time, the nature of the rationalisation costs and the financial position of the company when the dividend was declared.

3.2.3 The conclusion that the dividend was paid out of profits can be confirmed by the material in evidence before the Commission. In particular:

(a) as at 31 March 1996, the retained profits were $65,834,000: Ex 174, tab G;

(b) while the retained profits at 31 March 1997 were ($16,568,000), which was after taking into account the interim dividend, the earnings deteriorated in the second half the year (ie after the dividend was paid) due to abnormal items: Ex 174, tab B; and

(c) therefore, at the time the dividend was paid, there was sufficient retained profit from which the dividend could properly be paid (see also: Ex 175, [4]).

Mr Humphreys expresses the view that "As there were retained earnings from previous years, this dividend could still be paid out of profits…": Ex 245, [2.13].

3.2.4 The financial statements for Coy for 31 March 1997 (Ex 174, tab B) state that the interim dividend was paid after completion of the half yearly accounts. It is possible that the half yearly accounts were not completed as at 2 October 1996 and that there is an error in the financial statements. This matter was addressed in the cross-examination of Dr Barton (but not in the cross-examination of Mr Morley, who also signed the financial statements). Dr Barton said that on 2 October 1996 it is likely that he had the management reports up to August 1997: T2700.23. It is also likely (notwithstanding Ex 180) that at the year end, when the financial statements were prepared, the half year accounts in fact showed that as at 30 September 1996 there had been sufficient profit to pay the interim dividend: T2707.11.

3.2.5 The draft Allens advice of 13 February 2001 did not to come to a concluded view on the prudence of the interim dividend. It could not do so without investigation of the decision-making processes of the directors. The directors were Dr Barton and Mr McFadden. The Commission now has the benefit of the evidence of Dr Barton, who is a very experienced company director (T2750.33) which strongly answers unresolved questions about the prudence of the dividend. Mr McFadden has not given evidence, but Dr Barton accepts that he, and not Mr McFadden, probably took ultimate responsibility for quantifying asbestos obligations (T2701.51). The following observations emerge from Dr Barton's evidence:

(a) Dr Barton said that there were two considerations that were taken into account before paying a dividend. The first was what the shareholder wanted. The second was whether the company could pay that dividend and continue to operate – including the payment of creditors: T2693.27. That is perfectly sound.

(b) Dr Barton was satisfied that the Coy was a pretty strong operating company that was able to pay its debts as and when they fell due, including asbestos liabilities: T2694.3, T2699.26. He was quite comfortable, right up until he left, that Coy could cover its asbestos liabilities: T2728.27.

(c) Dr Barton was unable to recall what, if any, actuarial material he had at the time that the dividends were paid: T2693.45. The evidence suggests that before the payment of the dividend, Dr Barton may have been aware that Trowbridge had provided an initial review on or about 5 June 1996 which showed an indicative estimate of potential liability of $175 million: Ex 2, vol 2, tab 11. Dr Barton could not recall whether he saw the report in 1996, he may or may not have been given a summary: T2702.27, T2703.39, T2712.16-.37. Trowbridge was briefed on 11 July 1996 to undertake further work, but Dr Barton doubts that he saw the proposed retainer: Ex 176; T2730.47. A presentation to the James Hardie Board by Trowbridge was apparently rescheduled from 31 July 1996 to the meeting on 3 September 1996: Ex 177. There is no evidence about why this occurred but there is no basis to suggest that it was done for a sinister purpose. Further, the minutes of the meeting of directors held on 1 October 1996 suggests that by that time Trowbridge had submitted a report and an analysis of the report would be submitted to the 7 November 1996 meeting: see Ex 283]. The Trowbridge report submitted before 1 October 1996 is not easily identified. There is some evidence that Trowbridge had estimated that the present value of the asbestos costs was $193 million: Ex 178. At the time the dividends were paid, Dr Barton could not have seen the Trowbridge report dated 10 October 1996, which showed an estimate of potential liability of $230 million: Ex 2, vol 2, tab 12. That figure was reported to the Board at the meeting held on 7 November 1996: Ex 176. There could be no suggestion that Dr Barton or Mr McFadden deliberately pushed back the date for hearing from Trowbridge and rushed the interim dividend through before any bad news was received.

3.2.6 Having regard to Dr Barton's evidence, it would not be open to find that the directors of Coy were imprudent when they decided to pay the interim dividend of $43.5 million. There is no basis for concluding that either Dr Barton or Mr McFadden acted in breach of their duties to Coy.

3.2.7 Additionally, Dr Barton also strongly resisted the proposition that in 1996 he was proceeding on the premise that Coy's asbestos liabilities were effectively the group's liabilities. He said, "No, not at all, I mean they were clearly Coy's liabilities": T2698.7; T2738.29. He did not agree that it was implicit that JHIL would meet the liabilities if Coy could not: T2698.37. He was not aware of an intention that JHIL would not meet the liabilities (Ex 175, [9]), but more importantly, he was not aware of an intention that JHIL would meet the liabilities – the issue did not come up because Coy was a going concern and there was no suggestion that Coy could not meet its liabilities: T2698.41; T2711.40. Dr Barton did not ever regard JHIL as having committed itself in any way to meeting Coy's obligations to creditors: T2752.52; T2739.10.

Issues 53 to 56

Issues 53 to 56 are largely misconceived and the Commissioner should find that they do not arise. The question is not whether the dividends should have been paid having regard to an actuarial assessment of the NPV of Coy's asbestos liabilities – liabilities which would be discharged over a period in the order of 40 years. And the question certainly is not whether the payments should have been made having regard to an assessment of those liabilities with the benefit of hindsight. Rather the questions are whether:

(a) the dividends were paid out of profits;

(b) if the dividends were paid, Coy could still be expected to meet its liabilities as and when they fell due.

For the reasons given above, both those questions should be answered in the affirmative. If the Commissioner concludes that they do arise, they should be answered as follows.

Issue 53

53. As for Coy's financial position:

(a) By 5 June 1996 Trowbridge had, on a preliminary basis, assessed JHIL's present and future asbestos liabilities, as at 31 March 1996, as being approximately $175 million (Ex 2, v 3, p 559).

(b) On 3 September 1996 Trowbridge produced a presentation intended for the Board of Coy with an assessment of James Hardies' present and future asbestos liabilities, as at 31 March 1996, at approximately $193 million (Ex 178, a document produced to the Commission by James Hardie – JHI.0002.002-004).

(c) In October 1996 Trowbridge produced a report assessing James Hardies' present and future asbestos liabilities, as at 31 March 1996, as being approximately $230 million (Ex 2, v 3, p 585).

(d) Would it be appropriate to infer that if Trowbridge had performed an assessment of Coy's present and future asbestos liabilities, as at August 1995, it is likely that it would have assessed those liabilities as being somewhere in the range of $175-$230 million.

No.

(e) *Would it be appropriate to infer that if, in conducting any of the assessments of Coy's present and future asbestos liabilities identified in paragraphs (a)-(d) above, Trowbridge had made appropriate allowance for superimposed inflation, and the need for a better than 50/50 chance of being able to fund all claims, the assessment as at 31 March 1996 would have been in the order of $530 million (see Ex 2, v 3, p 636 – high claim numbers plus high claim inflation).*

No.

(f) *Coy's present and future asbestos liabilities, as at 14 August 1995, may now be seen, with the benefit of hindsight, to have been in excess of $1 billion.*

There is no basis for this assertion.

(g) *According to Coy's financial statements for the year ended 31 March 1996 ("YEM 1996"), its net assets were approximately $100.9 million. Allowing for the dividends paid that year and the profit realised on assets sold in 1998, would it be appropriate to infer that immediately prior to the declaration of dividend on 14 August 1995 Coy's net assets were roughly as follows:*

(i) *book value as at 31 March 1996 - $100,925,000*

(ii) *add back August 1995 dividends - $100,900,000*

(iii) *add profit on sale of trade marks ($116,500,000), plant and equipment ($12,532,919) and sale of business ($16,500,000) (see Morley, Ex 121 paras 34, 64 and 80)*

(iv) *total - $347,357,919?*

No.

(h) *In the year ended 31 March 1996, Coy:*

(i) *earned net operationing profit of $11.7 million; and*

(ii) *paid dividends of $100.9 million.*

(i) *In the year ended 31 March 1997, Coy:*

(i) *suffered a net loss after abnormals of $33.6 million; and*

(ii) *paid a dividend of $43.5 million.*

(j) *Is it correct that neither Coy nor JHIL obtained an actuarial assessment of their asbestos liabilities prior to June 1996?*

Yes.

Issue 54

54. Having regard to the matters set out in the last paragraph:

(a) Was it was a breach of their duties by the directors of Coy, to act with care and diligence, and to exercise their powers in good faith in the best interests of the corporation (see sub-sections 232 (2) and (4) of the Corporations Law) to resolve to pay the August 1995 dividends without any actuarial assessment of Coy's present and future asbestos liabilities made for the purpose of ascertaining the level of assets that it was necessary or appropriate for Coy to have in order to be reasonably confident of being able to pay all potential future creditors?

No.

(b) If the directors of Coy had commissioned and reviewed such an actuarial assessment would they have resolved to pay the August 1995 dividends?

Yes.

(c) If the directors of Coy had known the true extent of Coy's present and future asbestos liabilities as at August 1995 could they have resolved to pay the August 1995 dividends consistently with their duties as directors?

Yes.

(d) Were the August 1995 dividends paid under a mistake, and if so were they recoverable on that ground?

No and no.

(e) Was JHIL a director of Coy in August 1995 within the meaning of s9 of the Corporations Law?

No.

(f) Having regard to the answers to the preceding issues, as at 13 February 2001 did Coy have available to it a valuable cause of action in respect of the August 1995 dividends against Dr Barton, Mr McFadden, Mr Ghantous or JHIL?

No.

If so, are such claims now statute barred?

Yes.

If so, would the fact of such a bar be damage attributable to any misconduct of JHIL or any other person in respect of the separation events?

No.

Issue 55

55. As for Coy's further financial position:

(a) As at September 1996, Coy's profit and loss account showed an operating profit before income tax of around $9.2 million and after tax of around $4 million.

(b) Is it reasonable to infer that the August 1996 management accounts for Coy would have been likely to show a similar operating profit before and after income tax?

Yes.

(c) Would the directors of Coy have had at least the August 1996 management accounts available to them when they declared the October 1996 dividend?

Yes.

(d) Coy's profit and loss account for the year ended 31 March 1997 showed:

(i) an operating loss before income tax of around $50.4 million and after income tax of around $33.6 million;

(ii) retained profits at the beginning of the financial year of around $65,834,000; and

(iii) total profits available for appropriation at the end of the financial year of around $32.2 million.

Issue 56

56. Having regard to the matters set out in the previous paragraph:

(a) As at 2 October 1996, could the directors of Coy have held a genuine opinion that profits out of which the October 1996 dividend could be paid existed?

Yes.

(b) Was the October 1996 dividend paid other than from profits in contravention of section 201 of the Corporations Law?

No.

(c) As at 2 October 1996 was JHIL a director of Coy for the purposes of the Corporations Law?

No.

(d) Did the directors of Coy breach their duties, under section 232 of the Corporations Law, to act with care and diligence, and to exercise their powers in good faith in the best interests of the corporation, in resolving that Coy pay the October 1996 dividend?

No.

(e) *If the directors of Coy resolved to pay the October 1996 dividend without first reviewing the October 1996 Trowbridge report, was this a breach of their directors' duties?*

No.

(f) *If the directors of Coy had first reviewed the October 1996 Trowbridge report, or had notice of its contents, could they have resolved to pay the October 1996 dividend consistently with their duties as directors?*

Yes.

(g) *Alternatively, was it a breach of their duties for the Coy directors to resolve to pay the October 1996 dividend without an actuarial assessment of Coy's present and future asbestos liabilities made for the purpose of ascertaining the level of assets that was necessary or appropriate for Coy to have in order to be reasonably confident of being able to pay all future creditors?*

No.

(h) *If the directors of Coy had commissioned and reviewed such an actuarial assessment would they have resolved to pay the October 1996 dividend consistently with their duties as directors?*

Yes.

(i) *If the directors of Coy had known the true extent of Coy's present and future asbestos liabilities as at 2 October 1996 could they have resolved to pay the October 1996 dividend consistently with their duties as directors?*

Yes.

(j) *Was the October 1996 dividend paid under a mistake, and if so was it recoverable on that ground?*

No and no.

(k) *Having regard to the answers to the preceding issues, as at 13 February 2001 did Coy have available to it a valuable cause of action in respect of the October 1996 dividend against its Dr Barton, Mr McFadden, Mr Ghantous and JHIL?*

No.

If so, are such claims now statute barred?

Yes.

If so, would the fact of such a bar be damage attributable to any misconduct of JHIL or any other person in respect of the separation events?

No.

3.3 Management Fees

3.3.1 Before dealing specifically with the experience of Coy, it is important to place the issue of management fees into a proper context.

3.3.2 It is commonplace in Australia for a business structure to operate by means of a group of companies. In a group context, ordinarily the holding company, which may be the listed entity in the group, pays dividends to shareholders. In order to do that, the holding company must receive income. If the holding company does not trade itself, as is often the case, it must receive the income from the subsidiaries in the group. One way of remitting funds from subsidiary to parent is by the payment of dividends.

3.3.3 Today, groups of companies are able to submit a consolidated tax return. That has not always been the case. Prior to 1 October 2002, it was necessary for each company in the group to file its own tax return. That gave rise to taxation planning issues. One such issue arose because parent companies were able to obtain a tax rebate in respect of dividends received from subsidiaries. That made sense because otherwise the revenue of the subsidiary would be taxed when it was earned by the subsidiary and taxed again when it was remitted to the parent. However, the rebate operated against tax that would otherwise have to be paid by the parent. And so, if the parent's only income was from dividends, there was no opportunity to take advantage of the rebate – tax was therefore paid twice. Accordingly, it was in the interests of the parent to have income otherwise than from dividends in order to take advantage of the tax rebate. That is the position that JHIL found itself in (see Mr Morley's supplementary statement: Ex 122, [7].

3.3.4 It was and is also commonplace for the parent in a group of companies to provide services to its subsidiaries and to otherwise incur costs that benefit the group as a whole. For example, a holding company listed on the ASX will incur corporate costs as a listed entity. The listing gives the parent access to capital which ultimately is to the advantage of the group overall. Where an operating subsidiary is benefited by the activities of its parent, it is reasonable that a fee is paid. The payment of the fee is income to the parent, and is income against which the parent might be able to claim a rebate in respect of dividends received from its subsidiaries. This is a legitimate means by which a company can reduce the amount of tax that it would otherwise have to pay. That is, it provides an opportunity to the parent to take advantage of tax rebates. In circumstances where a parent can legitimately claim a management fee from a subsidiary and where the receipt of income by way of a fee rather than by way of dividend provides taxation advantages, it would be remiss of the parent not to charge the fee.

3.3.5 Take the position of a subsidiary in a group that is solvent and has profits that it is free to distribute to its parent. As between the subsidiary and the parent, on a plain income basis, it does not matter whether income is distributed by way of a dividend or by way of a management fee. That practical reality was acknowledged by Mr Humphreys (T3192.28-

.46), and see Mr Morley's evidence at T2166.26. Mr Salter's uncontradicted evidence is that payment of management fees is common practice in a group context: Ex 103, [6]. That is unsurprising. In such a context, to expect an arms length negotiation to take place to determine the fee is unreal. The real question is what level of fee can be justified having regard to the taxation laws and the obligations that a company has to its creditors.

3.3.6 Dr Barton accepted that in his time, "the payment of management fees wasn't very scientifically designed": T2695.52; T2716.40. Mr Salter, who was responsible for calculating management fees paid by companies in the James Hardie group after 1989 (Ex 103, [4]) agreed that prior to 1998, there was no scientific basis for the calculation of management fees other than what was already established: T1922.40; see also Ex 122, [8]. The total management fee charged within the group was approximately equal to JHIL's budgeted costs for the year in which they were charged and were apportioned between the group's finance company and the Australian operating subsidiaries: Ex 104, [9]. Mr Salter said that "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 to each operating company": Ex 104, [10]. Mr Salter says that management fees were never paid by foreign subsidiaries because they might not have been able to claim tax deductions in respect of management fees, which would have represented a net loss to the group: Ex 104, [11]. Mr Morley's evidence is that the James Hardie Group could not obtain tax deductions in the United States or New Zealand. He also said that while the foreign subsidiaries received some of the benefit from head office activities, if an employee of the parent travelled abroad to work in the United States or New Zealand the costs would be paid by the foreign subsidiary: Ex 122, [13]. These are all reasonable and acceptable reasons for apportioning the head office costs between the Australian operating subsidiaries.

3.3.7 In about May 1997, a decision was made to document the allocation of management fees in a more formal way: Ex 104, [14]; Ex 122, [9]. That decision gave rise to Mr Salter's file note of 21 May 1997: Ex 104, tab 3. Mr Sheppard from PricewaterhouseCoopers (***PwC***) had suggested that it would be a good idea to bring such a document into existence: (T1993.44). Mr Salter's file note contemplates an allocation of costs between the Australian subsidiaries based on a weighting of sales, gross capital employed, number of employees and economic profit. The same apportionment method was adopted for 1999: Ex 180 and Mr Salter's note dated 3 June 1998. As a matter of accounting practice, these are all factors that may properly be taken into account as a basis for the allocation of joint costs (see Humphreys at T3190.30-.57 and Gardner at T3105.43-3106.18). The use of weighting is also a method that is sometimes used: T3191.5. It may be that the allocation contemplated by Mr Salter's file note was more sophisticated than is commonly used in other groups of companies. It may well be that the approach adopted was one that endeavoured to provide a commercial explanation for the fee and that the level of the fee was driven to a greater or lesser extent by taxation planning considerations. But provided that the commercial justification or explanation is open, it is a perfectly reasonable thing to do.

3.3.8 The issue of the management fees paid by Coy was addressed by both Grant Samuel and PwC in their respective valuations of Coy: Ex 121, tab 20 - 21 respectively. Grant Samuel deal with management fees at page 890 and 911 to 913. PwC deal with the subject at page 939. For valuation purposes, both valuers have made an adjustment to the management fees by considering Coy's contribution to total net sales of the James Hardie group worldwide. Grant Samuel make further adjustments, for example by excluding the costs associated with being a listed public company, on the grounds that an arms length purchaser would not necessarily incur these costs: Ex 121, tab 20, p 911. Grant Samuel also excluded a large amount for asbestos litigation, on the grounds that the asbestos litigation was not being transferred: T3103.25.

3.3.9 These are several reasons why it is dangerous and wrong to use the Grant Samuel and PwC valuations to draw a conclusion that there is anything improper about the management fees that were paid in fact.

3.3.10 First, there are various ways by which costs can legitimately be allocated. The fact that one person chooses one method does not mean that a different method is wrong.

3.3.11 Secondly, valuations serve a particular function that influences the approach to management fees. The valuer looks to the business and seeks to address what an arms length purchaser would pay for the business (or the asset being valued). The valuer looks to the business as a stand alone operation, which is contrary to the fact when the business is part of a larger business or a company within a conglomerate of companies: see Ms Gardner at T3090.49. Thus in a company group, there is no reason at all why the costs a holding company incurs as a listed company should not be allocated in some way to the companies in the group. Further, the sense in allocating asbestos litigation costs to Coy during the 1990's is obvious. In allocating the corporate costs as she did, Ms Gardner did not seek to say that what JHIL had done was in any way improper or wrong. She did not address that question (T3105.41); she said that it was not really for her to say what was appropriate for someone to allocate their management expenses: T3106.5.

3.3.12 Thirdly, while it is not suggested that the approach taken by either Grant Samuel or PwC was wrong, upon analysis there is an argument that a different allocation may have given a superior or fairer view of the real costs that were incurred in the running of the businesses. Ms Gardner was advised by management of James Hardie that they only allocated management fees to the Australian operations whereas in fact they provided services to all of their operations, including those in the United States: T3091.10. This was the result of "high level discussions" (in the sense of the nature of the discussions): T3091.27-.56. That advice was correct. Although Ms Gardner acknowledges that there is no standard criteria to allocate costs, an allocation based on contribution to total net sales seemed reasonable and so that is what she used: T3106.16. On that approach, 58% of the costs to be allocated were notionally allocated to the United States operations. Evidence that has emerged during the course of the Inquiry demonstrates that the corporate head office costs were largely (but not wholly) incurred in connection with the Australian operations because to a substantial extent the operations offshore, particularly in the United States, operated on a standalone basis. Mr Salter's view was that around 5% of JHIL's service costs were attributable to the United States operations. See also Salter's note of 3 June 1998 (Ex 180) which records that "no foreign subsidiaries will be included in the recovery plan because expatriate personnel are typically arranged to provide the services needed at the direct expense of the foreign operation". Mr Macdonald dealt with the subject in more detail, by reference to Ex 107 at T2285.42-2287.30. That evidence shows that the use of corporate costs by the United States operations did not correlate strongly with total net sales. Ms Gardner was not provided with information as specific as this. Ms Gardner provided a draft report to management but it does not appear that this matter was specifically addressed: T3104.20. If she had been provided with the information, it might have affected her allocation of costs: T3104.31. Mr Humphreys position was essentially the same: T3190.17. If a higher proportion of corporate costs had been allocated to Coy for valuation purposes, the value of the business would have fallen, and JHIL would have paid Coy less for the assets.

Issue 57

57. As for Coy's payment of management fees:

(a) The management fees paid by Coy to JHIL between 1990 and 1998 (inclusive) were, according to Coy's accounts, $19.5 million (1990), $19.5 million (1991), $19.5 million (1992), $21.5 million (1993), $20.3 million (1994), $20.3 million (1995), $21.5 million (1996), $25.9 million (1997) and $15.6 million (1998).

(b) The net assets of Coy as disclosed in its financial statements between 1990 and 1998 (inclusive) were $76.1 million (1990), $77.8 million (1991), $58.1 million (1992), $58.9 million (1993), $63.8 million (1994), $86.1 million (1995), $100.9 million (1996), $20.7 million (1997) and $47 million 1998).

(c) With the benefit of hindsight, at all times from at least 1990 onwards, Coy's present and future asbestos liabilities were in excess of $1 billion.

(d) On what basis were the management fees calculated in this period? What factors were taken into account in deciding the extent to which particular subsidiaries of JHIL should bear the proportion of JHIL corporate costs attributed to them?

This question is dealt with above.

(e) Is it right that the management fees paid by Coy to JHIL were calculated on the basis that only Australian companies in the James Hardie Group would contribute to Group overheads? If so, did this result in a fair attribution of corporate costs to Coy?

Yes and yes.

(f) Were the management fees fair payment for the services rendered to Coy by JHIL?

This question is misconceived. The real question is whether the management fees paid by Coy were properly paid to which the answer, for the reasons given above, is yes.

Issue 58

58. Having regard to the extent of Coy's future asbestos liabilities, and the matters in the previous paragraph:

(a) Was it a breach of the Coy directors' duties, under section 232 of the Corporations Law, to act with care and diligence and to exercise their powers in good faith in the best interests of the corporation, to authorise payment of the management fees to JHIL from at least the financial year ending 31 March 1995 (if not earlier) without:

(i) an actuarial assessment of Coy's present and future August 1995 asbestos liabilities made for the purpose of ascertaining the level of assets necessary or appropriate for Coy to have available in order to be reasonably confident of being able to pay all future creditors; or

No.

(ii) an assessment of a fair arms length price for the value of the services rendered by JHIL to Coy?

No.

(b) If the directors of Coy had commissioned and reviewed such an actuarial assessment would they have resolved to pay the management fees or all of them to JHIL?

Yes.

(c) If the directors of Coy had known the true extent of Coy's present and future asbestos liabilities could they have resolved to pay the management fees or all of them to JHIL consistently with their duties as directors?

Yes.

(d) If the directors of Coy authorised payment of the management fees to JHIL for 1997 and 1998 without first reviewing the October 1996 Trowbridge report, were they in breach of their directors' duties?

No.

(e) If they had first reviewed the October 1996 Trowbridge report, could the directors of Coy have authorised payment of the management fees, or all of them, to JHIL for 1997 and 1998 consistently with their duties as directors?

Yes.

(f) Was JHIL a director of Coy for the purposes of the Corporations Law between 1995 and 1998 (inclusive)?

No.

(g) *Are any remedies available to Coy in respect of these matters? If so, what is their basis (statutory or otherwise) and against whom are they available?*

No. Not applicable.

4. Project Chelsea

4.1 Development of Project Chelsea

4.1.1 Project Chelsea was conceived in early 1997 by a former director of JHIL, Mr Pedley: Ex 121, vol 1, tab 1 [12]. Initially known as Project Scully, Project Chelsea was a project to reconstruct the James Hardie group. It developed throughout 1997 and culminated, with only partial success, in early 1999.

4.1.2 From the beginning, Project Chelsea was a response to the structural imbalance that arose from the fact that the James Hardie group's operations and perceived future were increasingly centred on the United States market whereas its management and shareholder base were located in Australia: Ex 121, vol 1, tab 1 - 2. The imbalance restricted the ability of the group to encourage investment in it by United States shareholders (and thus to access United States and global capital markets) and gave rise to financial and taxation disadvantages. Mr Pedley's seminal paper (Ex 121, vol 1, p 1) prepared in January 1997 gave this account of the issues which motivated Project Chelsea:

> The forward momentum in the USA, engendered by fibre cement's success and the decision to progress the Group's plasterBoard interests, allied to the much better than expected exit from both the US irrigation interests and Australian building services, leaves a group which appears increasingly unbalanced geographically. The very success of the US activities and the disposals to date, superimposed upon the psychological commitment to quit both plumbing and pipelines, will most certainly ensure that, by next Christmas, Hardie's ANZ interests will be limited to fibre cement, windows and building systems, whose EBIT potential will be a small fraction of that of the US interests.
>
> In addition to these unbalanced operational characteristics, there will be the rather peculiar appearance of a Group with little or no net debt, but with very substantial amounts of gross debt in the US, offset by equally large cash balances in Australia, in an endeavour, firstly, to utilise the Australian tax losses as rapidly as possible and, secondly, to hedge the US exposure for the Australian shareholders. No doubt there will also be calls for the purchase of sufficient franking credits to "legitimatise" the US income.
>
> The centre of operations will, in fact, have moved from Australia to the US and, unless that fact is reflected in the structure of the Group overall, the distortions then apparent, in terms of financial characteristics, can only be expected to worsen. Furthermore, it will be glaringly obvious that the Group CEO will have to be a US resident (if not a US national), as there will be a great deal to occupy his time, with commensurately little to do in Australia.

4.1.3 Mr Pedley's recommendation was that, in order to address those issues, James Hardie needed to move from Australia to the United States: "a change of domicile, or its equivalent". The group's Australian asbestos liabilities and the Firmandale litigation were identified as the two impediments to an offering of JHIL shares in the United States. The

Firmandale litigation involved a claim, unrelated to asbestos, brought against JHIL and James Hardie Finance Limited in 1995. The proceedings were settled in March 1998, before the announcement of Project Chelsea: Exhibit 122, [104] - [107]. Given the compelling case for a move to the United States, Mr Pedley's view was that a solution to those issues needed to be found in order to allow the move to occur. Under the approach suggested by Mr Pedley:

(a) the Australian and New Zealand operations would be transferred to a group company (**USCO**) which owned the United States operations, with the result that JHIL would own 2 entities:

(i) USCO which, in turn, would own all of the group's operations and/or operating companies throughout the world; and

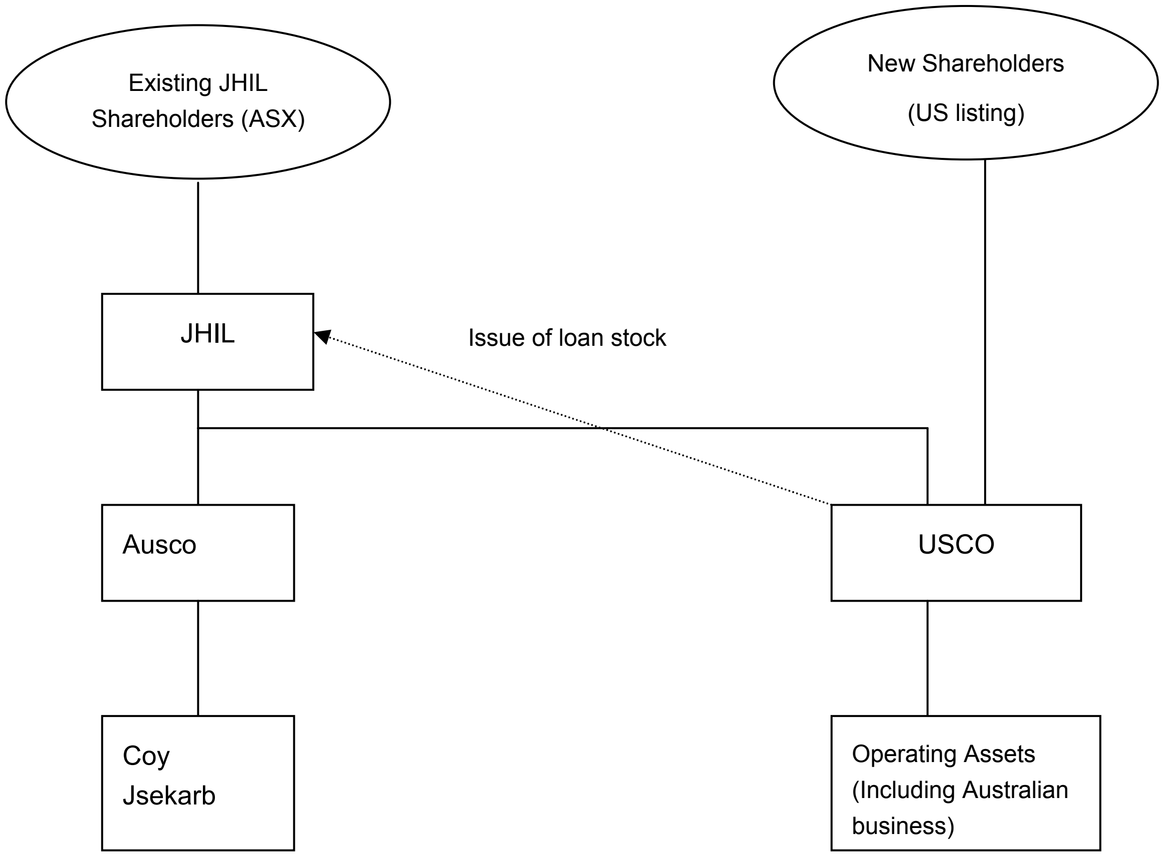
(ii) an Australian company (**Ausco**) containing the asbestos liabilities;

(b) the capital of USCO would then be reconstructed so as to comprise both ordinary shares and loan stock which would bear a fixed rate of interest and be convertible into ordinary shares of USCO at any time for the next 20 years;

(c) there would then be an initial public offering (**IPO**) of some of the ordinary shares in USCO;

(d) as a result, immediately after the IPO, JHIL would continue to hold all of the loan stock in USCO plus the remaining ordinary shares in USCO (which would give JHIL a controlling interest) and cash, including the proceeds of the IPO.

4.1.4 JHIL would then need to make a decision regarding its ongoing capital requirements and, in particular, what capital it needed in order to meet the asbestos and Firmandale liabilities. JHIL would then make a return of capital to its shareholders of surplus cash and/or ordinary shares in USCO. JHIL would continue to hold its USCO loan stock and would meet the asbestos liabilities of its subsidiaries from interest earned on it.



Pedley Paper of January 1997: proposed group structure post-IPO but before JHIL capital reduction

4.1.5 Mr Pedley's paper concluded:

> Current shareholders in JHIL will probably receive some new shares in USCO and some cash, via the in specie distribution, and will continue to hold their existing JHIL shares, which, in turn, will continue to hold a very significant percentage of USCO's capital. In total, shareholders could expect to benefit, most immediately, by allowing the rapidly growing United States earnings base to be capitalised at the higher United States multiples and, in the longer term, by the removal of the operational and structural distortions noted previously.
>
> JHIL would cease to have a CEO, being a passive investment company administering its liabilities, but would, no doubt, take a close interest in the affairs of USCO, with appropriate Board representation. As matters relating to the asbestosis and Firmandale issues were resolved, so would surplus assets of both USCO stock and cash be distributed to JHIL shareholders, thus leading to the eventual termination and winding up of JHIL.

4.1.6 It is evident that the separation of the group's operating assets from its asbestos liabilities was, from the very first formulation of Project Chelsea, regarded as essential to the success of James Hardie's move to the United States.

4.1.7 The separation of the group's asbestos liabilities and a subsequent United States offering of shares in a company holding only the operating assets of the James Hardie group remained a part of all subsequent formulations of Project Chelsea, including the final proposal which was announced on 2 July 1998.

4.1.8 On the other hand, numerous different proposals were considered concerning the future of JHIL following the proposed IPO. It was intended that JHIL would be left with sufficient assets to enable all future asbestos liabilities of the group to be met: T2741.22. It was also intended that funds beyond the amount needed by JHIL to meet those asbestos liabilities would be returned to shareholders: Ex 61, vol 1, tab 21. In that context, it was felt that JHIL would face at least two significant issues:

(a) the risk of a predatory takeover, directed at obtaining control of the shares held by JHIL in USCO/JHNV: Ex 61, vol 1, tab 20, p 112; and

(b) the ultimate fate of JHIL and, in particular, how its subsidiaries' asbestos liabilities affected JHIL's future.

The first of these issues was taken up in a second note prepared by Mr Pedley in July 1997: Ex 121, vol 1, tab 2.

4.1.9 The annexures to the minutes of the Project Chelsea Board sub-committee meeting on 18 February 1998 are illustrative of the range of options considered in relation to these issues: Ex 61, vol 1, tab 24.

4.1.10 It was recognised that, as JHIL's interest in USCO/JHNV was sold down over time, JHIL would be left holding the shares in the group's former asbestos producing subsidiaries together with assets (most likely including shares in USCO/JHNV) which would be held against those future liabilities. The shares in the former asbestos producing subsidiaries and other assets not transferred to USCO/JHNV came to be referred to as the "rump": Ex 175, [12].

4.1.11 Ultimately, no decision was made by JHIL concerning the fate of the rump, nor its intentions regarding the further sale of shares in USCO/JHNV following the IPO: Ex 121, p 479. Consideration of those issues was postponed until after the IPO which, in the end, did not proceed: Ex 175, [13] - [14]. However, there was ongoing discussion of those issues during the course of 1997 and early 1998.

4.1.12 By late 1997, it had become clear during the consideration of "rump" issues that an accurate assessment of the group's asbestos liabilities would be needed. In particular, given the intention that JHIL be left with sufficient funds to allow it to meet the asbestos liabilities of its subsidiaries, it was realised that an accurate assessment of those liabilities was needed in order to determine the amount of funds which JHIL could return to shareholders. The minutes of the Project Chelsea Board sub-committee meeting of 16 December 1997 record:

> Need to review the quantum of cash and other assets to be held by Chelsea against the asbestos liability is required. This will determine the quantum of the IPO selldown and the

> buy-back; need to consol [sic] the need to revise actuarial study on the asbestos liability will answer this. Peter Pedley will review the previous actuarial study prior to the next sub-committee meeting.

4.1.13 A Project Chelsea "Critical Issues Check List" (Ex 61, vol 1, tab 20, p 112) records that a decision had been made by 28 January 1998 to update Trowbridge's 1996 report:

> Decide if Trowbridge report to be updated.
>
> ***Yes. Need to know scope to know size of capital return.***

4.1.14 Similarly, the minutes of the Project Chelsea Board sub-committee meeting of 3 February 1998 (Ex 61, vol 1, tab 121, p 138) record under the heading "Asbestos and Rump":

> It is becoming more and more likely that the asbestos issue needs to be addressed by JHIL. It is likely that some disclosures will be required in the SEC registration statement and the Explanatory Memorandum for JHIL shareholders. Furthermore, the Board will not be able to resolve to return surplus capital without a clear understanding of the full scope of the retained liabilities. This information will likewise be material to shareholders in approving the transactions.
>
> The whole process will require the company to be proactive and transparent in relation to asbestos liabilities. This is an issue which, even without Chelsea, would require attention now the business restructuring has finished.
>
> The initial step is to update the actuarial report on asbestos based on the further two years of reliable data now available. With legal advice (still pending), the results of the actuarial report would be disclosed and sufficient asset backing (cash) retained to cover these liabilities (with sufficient margin). This would determine what was truly surplus capital, which could then be returned to shareholders.

4.1.15 Also in February 1998, Allen Allen & Hemsley prepared a paper titled "Project Chelsea, Asbestos Liability: Quantification and Disclosure" discussing the need to obtain a revised report from Trowbridge (Ex 61, vol 1, tab 22, p 142) which also noted that it would be necessary to obtain a revised Trowbridge report to permit an informed view to be made of the extent of funds which JHIL could properly expend on a buy-back of its own shares. Allen Allen & Hemsley's note was discussed at the Project Chelsea Board sub-committee meeting on 18 February 1998 and the need to obtain an updated actuarial report from Trowbridge was agreed Ex 61, vol 1, tab 24, p 161. A memorandum prepared by SBC Warburg Dillon Read shortly before that meeting records JHIL's then current intention regarding the funding of its subsidiaries' asbestos liabilities (Exhibit 61, vol 1, tab 23, p 152):

> The recent Board sub-committee and Board meetings discussed the plan for dealing with remaining shares in Newco and the asbestos liabilities (which will remain with JHIL). The Chairman concluded the company needed to be proactive and transparent in relation to asbestos. This will involve the company making a fresh provision based on an actuarial report and leaving more than sufficient cash to fund the provision.

4.1.16 On 31 March 1998, Allen Allen & Hemsley instructed David Minty of Trowbridge to prepare a revised report assessing the asbestos liabilities of JHIL's subsidiaries: Ex 61, vol 2, tab 7, p 29 refers to the separate letter of instruction of that date.

4.1.17 Allen Allen & Hemsley specifically asked Trowbridge to consider James Hardie's potential liabilities arising out of claims in the United States and provided Trowbridge with detailed material in order to allow Trowbridge to consider the possibility of United States claims when preparing their report (Ex 61, vol 2, tab 7, p 29). The material provided to Trowbridge included:

(a) material relating to James Hardie's asbestos-related activities in the United States;

(b) details of all cases which had been commenced against James Hardie in the United States (numbering only three);

(c) advice from Shea & Gardner on James Hardie's exposure to asbestos claims in the United States; and

(d) advice from Shea & Gardner on James Hardie's potential liability for punitive damages in the United States.

4.1.18 Allen Allen & Hemsley offered to arrange a conference call between Trowbridge and Shea & Gardner should Trowbridge wish to discuss any aspect of Shea & Gardner's advice for the purpose of preparing their report.

4.1.19 Trowbridge subsequently decided not to include United States claims in their 1998 Report. Their report records the decision and the reason for it (Ex 75, tab 48, p 1541):

> We were asked to update our 1996 review, taking into account the emerging experience and developments in the medical and legal arenas, and endeavouring to include all areas of potential exposure where sufficient data exists to make reasonable projections of future experience.
>
> Our estimates cover only those areas of exposure which we regard as 'well-established' in terms of both legal principles and emerging experience. No allowance is made for areas we regard as 'speculative' and still subject to a significant medical or legal debate or to the strong likelihood of statutory change.
>
> In summary, our review has considered the following areas:
>
> …
>
> *(a) additional areas considered (not quantified due either to speculative nature or lack of relevant data)*
>
> - claims originating outside Australia and New Zealand

4.1.20 On 13 May 1998, in order to assist Mr Minty with the preparation of the 1998 Trowbridge report, Allen Allen & Hemsley sent Mr Minty a detailed paper addressing trends in asbestos litigation involving the James Hardie companies: Ex 259. Allen Allen & Hemsley's review specifically addressed the question of judicial inflation or superimposed inflation:

> … awards of general damages in the DDT since around 1990 have risen steadily (well in excess of inflation).

4.1.21 Trowbridge issued the final version of their 1998 report on 10 September 1998, after Project Chelsea had been announced.

The final proposal

4.1.22 The Board of JHIL approved the public announcement of the restructure at its meeting on 30 June 1998: Ex 121, tab 12. On 2 July 1998, the company announced a "corporate reorganisation and capital restructuring": Ex 121, tab 13. The media release sets out the background to the plan and explains what was proposed.

4.1.23 An important part of the proposal involved the sale and listing on the New York Stock Exchange (***NYSE***) of approximately 15% of the shares in a company called JHNV and a reduction of capital of JHIL. Those steps required shareholder approval and, for that purpose, JHIL published an Information Memorandum for shareholders: Ex 121, tab 14. The reorganisation, as explained in the Information Memorandum, comprised the following:

(a) the core operations within the James Hardie group would be sold at fair market value into a new group of companies. The holding company of that group was to be JHNV, which was an indirectly held wholly owned subsidiary of JHIL;

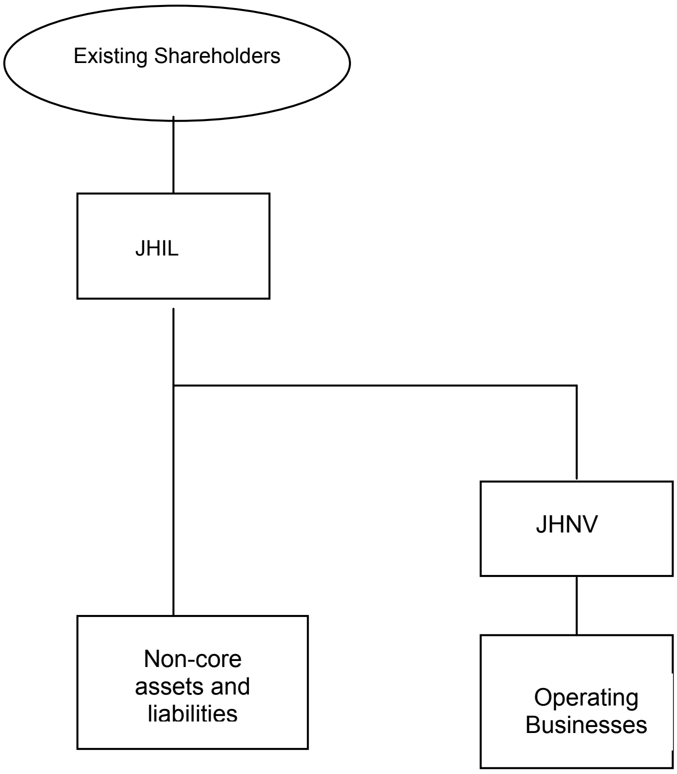
(b) by that means, the core operations (including for example the international fibre cement businesses) would be held within the "JH Operating Group" and would be separate from what was called "non-core investments and liabilities, including the liability for asbestos related claims, which are unrelated to the core operating assets": Ex 121, p 519;

(c) approximately 15% of the shares in JHNV would be sold, primarily to United States investors and JHNV would apply to be listed on the NYSE;

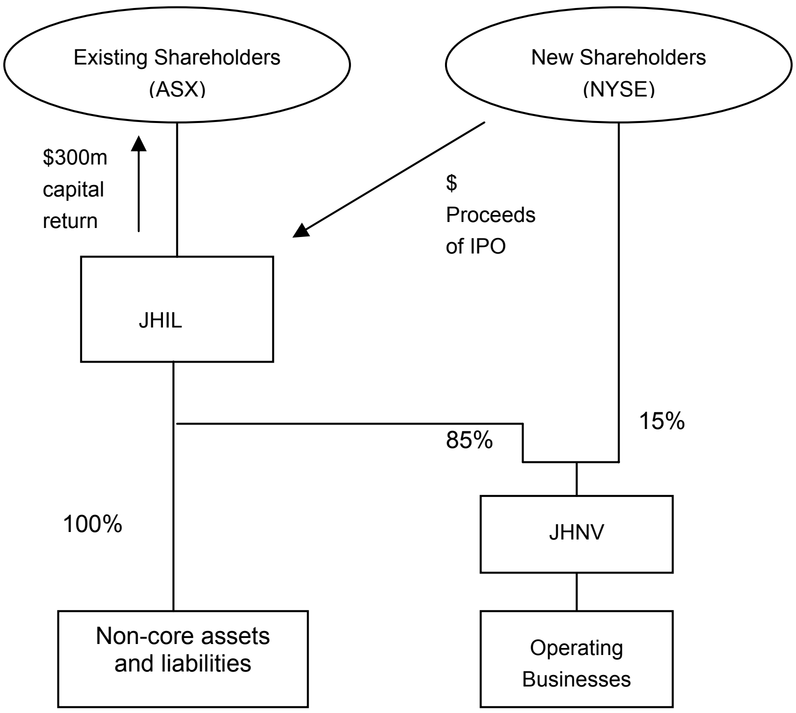
(d) senior executives would relocate to the United States;

(e) the capital structure of the JH Operating Group would be more efficient than the existing structure (improved debt maturity profile etc), and improved from a financial and taxation perspective; and

(f) there would be a capital reduction, by which cash would be returned to JHIL shareholders.



Project Chelsea: group structure after transfers of core operating businesses



Project Chelsea: group structure contemplated after IPO

4.1.24 The introduction to the section entitled "rationale for the proposal" explains in a concise way the background that led to the proposal: Ex 121, p 518. No decision had been made concerning a long term strategy for JHIL: p 550.

4.1.25 At an extraordinary general meeting held on 16 October 1998, the shareholders of JHIL resolved (almost unanimously) to pass the resolutions that were put to them, which were required for the proposal to proceed: Ex 121, tab 15.

4.1.26 In connection with Project Chelsea, James Hardie Industries NV was incorporated on or about 26 October 1998: Ex 121, [43]. At that time, it was known as RCI Netherlands Holdings BV. It held, directly and indirectly, all of the issued shares in JHNV.

4.1.27 Project Chelsea envisaged that all shares and assets transferred to JHNV would be transferred at fair market value: Ex 17, [14]; Ex 121, [14]; Ex 121, pp 519, 528 and 672; T2747.10. Independent valuations were obtained in respect of all assets transferred by Coy (see sections 4.2ff below).

4.1.28 The Information Memorandum was accompanied by an Independent Expert's report, prepared by Grant Samuel & Associates. Grant Samuel analysed the proposal in detail and concluded that the restructuring was in the best interests of shareholders. Grant Samuel also considered the position of creditors, and made the following observation: Ex 121, vol 2, tab 14, p 672 - 673:

> The creditors of companies in the residual James Hardie Industries Group include both short term trade creditors and longer term contingent creditors such as potential asbestos litigants. The future level of trade creditors in the residual group will be minimal. However, there are contingent creditors of certain group companies which may be very large. In particular, James Hardie & Coy and James Hardie NZ both may face future claims for asbestos related illnesses.
>
> The restructuring does involve the sale by James Hardie Industries and certain subsidiaries (including James Hardie & Coy and James Hardie NZ) of businesses, assets or shares in other companies. These are all being sold at estimated fair market value. Some intercompany debts will also be settled. Accordingly, the value of the pool of assets available to creditors of any individual company in the residual James Hardie Industries Group (other than James Hardie Industries itself) at the date of the restructuring should be unaffected by the proposed restructuring. In place of their current businesses, these companies will now have cash equal to the estimated fair market value of the assets sold. Arguably, this reduces risk for creditors, but it does take away the opportunity for the business to grow in value and increase the safety margin for creditors. Creditors, including contingent creditors, will of course be exposed to the future investment decisions of each individual company. This is no different to the present position.

4.1.29 The assumptions and methodology of the report have not been attacked.

Purpose of Project Chelsea

4.1.30 From its inception in January 1997 through to February 1999, the overriding purpose of Project Chelsea was to address the structural imbalances caused by the strong growth of

James Hardie's business in the United States. It was not to avoid payment of any asbestos liabilities.

4.1.31 Dr Barton was the Chief Executive Officer of JHIL at the time of Project Chelsea. His evidence regarding the purpose of Project Chelsea was as follows: Ex 175, [11].

> It was recognised by the Board of JHIL that:
>
> (a) JHIL's fibre cement business was rapidly growing in the US and it was anticipated that within 5 years, up to 80% of JHIL's profits could be derived from the US;
>
> (b) despite the growth in the US, JHIL's management was in Australia and that management was too far from JHIL's main market;
>
> (c) there was a structural imbalance, with large cash deposits in Australia and sizeable debts in the US;
>
> (d) in the longer term, funds would have to be repatriated from the US in order to pay dividends to its shareholders, a majority of which were in Australia; and
>
> (e) building companies were valued more highly in the US than they were in Australia.
>
> Accordingly, the Board determined that it would be in the best interests of shareholders of James Hardie's group of companies (the "Group") to relocate management of JHIL to the US and to list the operating assets of the Group on the New York Stock Exchange. This would enable JHIL to crystallise the value of its core business and increase the value of its shares for the benefit of shareholders. It was anticipated that the US market would value JHIL's core business more highly than the Australian market. The project also envisaged that the funds raised from the float would be distributed to the shareholders by way of a capital reduction.

4.1.32 The evidence of Mr McGregor, JHIL's Chairman, was also that the primary purpose of Project Chelsea was to address structural imbalances caused by the growth of the United States business (Ex 80, [4] - [5]):

> Throughout the 1990s, and particularly towards the end of that decade, JHIL was confronted with a number of issues regarding its corporate structure and the suitability of that structure for its future operations. The company's fibre cement business in the United States of America was expanding rapidly, while management and shareholders remained mainly in Australia. This created an organisational imbalance as well as taxation inefficiencies. In particular, as a result of taxation treaty arrangements between the USA and Australia with respect to withholding tax, earnings in the USA were being taxed at three levels before being distributed to shareholders as dividends.
>
> Project Chelsea was James Hardie's first attempt to address those issues. Project Chelsea also aimed to improve the rating of the company amongst the investment community by aligning investment interests more closely with American investors. It was anticipated that American investors would be likely to have a greater awareness of the company's growth potential and to assess the company at a higher price-earnings ratio.

4.1.33 The evidence of Messrs Shafron, Morley and Peter Cameron, JHIL's principal external legal advisor at the time, was also to the effect that the primary purpose of Project Chelsea was to create a structure which allowed shareholders to receive the fullest benefit possible from the growth of the group's United States operations and the higher value attributed to building products businesses by United States investors: Ex 17, [6]; Ex 121, [17], [20] and [22]; Ex 148, [40]; Ex 224, [6].

Separation of asbestos liabilities

4.1.34 Project Chelsea was consciously structured to ensure that the company which was to be listed on the New York Stock Exchange, JHNV, held no subsidiaries with asbestos liabilities. The Information Memorandum sent to JHIL shareholders in connection with Project Chelsea (Ex 121, vol 2, tab 14, p 561 - 562) said:

> The Proposal, and specifically the Corporate Restructuring, involves the structural separation of the core operations from non-core assets and liabilities. The improved transparency resulting from the Corporate Restructuring may enhance the ability to value the Company's core operations as held by the JH Operating Group, clearly and structurally separated from the uncertainties associated with the non-core assets and liabilities, as held by the Company.
>
> …
>
> The structural separation is intended to create a more attractive investment vehicle. This is desirable for the Offering as US investors are likely to prefer a simple and focused investment case. Additionally, any complications and uncertainty associated with non-core assets and contingent liabilities are likely to impact adversely on the success of the Offering.

4.1.35 It was regarded as important to the success of the IPO, and thus Project Chelsea as a whole, that JHNV be free of asbestos liabilities. Dr Barton's evidence was that, in order to achieve a successful listing, it was necessary to aggregate James Hardie’s core business within the vehicle to be floated. That aggregation process necessitated the separation of the core businesses from non-core operations and asbestos liabilities so that the core businesses could be valued by the United States market and valued without being adversely affected by other issues, such as Coy’s future asbestos liabilities: Ex 175, [12].

4.1.36 Messrs Morley and Macdonald also gave evidence that a significant benefit which Project Chelsea sought to deliver to shareholders was the removal of the "distorting effect" on the market's assessment of the group's core businesses by allowing those businesses to be valued independently of the group's asbestos liabilities: Ex 121, [22(a)]; Ex 148, [4(e)]. It was believed that United States investors were likely to be particularly sensitive to asbestos liabilities: Ex 17, [9]; Ex 148, [4(e)].

4.1.37 JHIL intended that JHNV be asbestos free and intended that JHNV hold the core businesses of the group, including Coy's. It follows that it was an intended consequence of Project Chelsea that Coy's business be isolated from asbestos claimants. However, putting the operating assets of Coy beyond the reach of claimants was not a motivation for Project Chelsea (McGregor, Ex 80, [7]) and was viewed as an effect, rather than a purpose, of Project Chelsea by those involved at the time. The evidence of Mr McGregor is illustrative (T1436.15 - .46):

Q Why were you selling the assets of the company?

A Of James Hardie & Coy?

Q Yes.

A To rearrange the group structure preparatory to forming the new structure for Project Chelsea.

Q What purpose did it serve to sell the assets of Coy in that context?

A Because all the operating companies were to be in a new Netherlands-based company, and the financing was to be done through that Netherlands-based company.

Q And what was the purpose of excluding Coy from that group controlled by the Netherlands company?

A Because its operating businesses were to become part of the Netherlands company, and that was the structure that we adopted.

Q Why were the assets to become part of The Netherlands company rather than Coy becoming a subsidiary of The Netherlands company directly?

A I don't think I can tell you that.

Q Was it related, put it more correctly, to isolating asbestos liabilities in those companies?

A No, I don't believe so.

Q Did isolating the asbestos liabilities play any part in it?

A It was an effect of it, but it wasn't a reason.

4.1.38 Dr Barton expressed his understanding in similar terms (T2747.37):

Q A consequence of the sale of Coy's business and its intangible assets in 1998 was to deprive it of the opportunity to participate in the growth of the revenue that would be derived, expected to be derived from the exploitation of itself, its trade marks in the United States?

A That was the effect.

4.1.39 In any event, the fact that Project Chelsea was structured to ensure that JHNV would not face asbestos claims was never concealed by JHIL. JHNV's registration statement, which was filed with the Securities & Exchange Commission and sent to the Australian Stock Exchange, for a statement of that intention (Ex 1, vol 3, tab 46, p 914):

> The Reorganization has been structured so that no asbestos-related claims are being assumed by the Company …

4.1.40 That intention was not a secret because there was no reason for it to be. In circumstances where Coy received fair market value for the transfer of its business, it was entirely proper for the directors of Coy to have regard to the benefits expected to accrue to Coy's ultimate owners, the shareholders of JHIL, from the implementation of Project Chelsea.

Issue 51

51. There is also evidence which suggests that one of the purposes of Project Chelsea was to isolate the business of Coy and the assets used in that business from Coy's liabilities to asbestos plaintiffs ("the…structure has been designed to insulate [JHNV] from such claims" – Ex 91, pg 5), with a view to ensuring that assets of the James Hardie group which were thought to be of value to its continuing operations were not available to asbestos claimants. Should a finding be made to this effect?

The Commissioner should make no finding in relation to this issue as it is unnecessary to do so. In the terms in which it is phrased, the issue leads nowhere. No consequence would flow from such a finding without an accompanying finding regarding the consideration paid to Coy for those assets and/or JHIL's intention regarding that consideration.

If a finding is to be made in relation to this issue, it should be that:

(a) Project Chelsea was not motivated by a desire to isolate the assets used in the business of Coy from asbestos claimants;

(b) JHIL considered it to be important to the overall success of Project Chelsea, and in the best interests of JHIL shareholders, that the company whose shares were to be offered in the United States be free from asbestos liabilities;

(c) in that context, an intended consequence of Project Chelsea was that the operating assets of Coy would not be available to asbestos claimants but that Coy would receive the fair market value of those assets in return for their transfer; and

(d) JHIL's intention and belief was that creditors of Coy, including asbestos claimants, would not be prejudiced by Project Chelsea.

4.2 Sale of plant and equipment Coy to JHFC on 31 March 1998

4.2.1 On 31 March 1998, Coy and James Hardie FC Pty Ltd sold plant and equipment to James Hardie Fibre Cement Pty Ltd: Ex 121, [24] and tab 5. The property was leased back to Coy and James Hardie FC Pty Ltd. The sale was made in anticipation of the proposal that emerged from Project Chelsea and was effected to crystallise a gain for taxation purposes: Ex 121, [25]. Coopers & Lybrand suggested that the transfer should take place, with the intention of freshening up some tax losses: Ex 61, vol 2, tab 3. Mr Morley identifies other taxation advantages that were obtained by the transfer: Ex 121 [26] - [27].

4.2.2 The sale price (as adjusted) reflected an independent valuation by Gray Eisdell Timms dated 1 June 1998: Ex 121, tab 7. The gross proceeds of the sale of equipment were $37,065,498, which resulted in a profit to Coy, over the written down book value, of $12,532,919. There has been no attack on Gray Eisdell Timms' assumptions or methodology. Mr Humphrey described them as realistic and appropriate.

4.3 Sale of Coy's Trade marks to JH Research on 30 June 1998

4.3.1 On 30 June 1998, the directors of Coy (Dr Barton and Mr Morley) resolved to transfer the trade marks of the company to James Hardie Research Pty Ltd at fair market value: Ex 121, tab 23. The transfer was effected by an agreement made on 30 June 1998: Ex 121, tab 22.

4.3.2 The amount paid for the trade marks was $139,500,000, which was supported by a Grant Samuel valuation dated 17 September 1998: Ex 121, tab 24.

4.3.3 While Mr Humphreys initially had some issues with the Grant Samuel valuation, Ms Gardner has addressed the issues comprehensively: Ex 234, [45], [77], [88] – [101. Mr Humphreys acknowledged that Ms Gardner's statement had resolved what appeared to him to be some anomalies in the figures: T3177.34. There is no basis to conclude that the valuation was defective by reason of flawed assumptions or methodology.

4.4 Sale of Coy's business assets to JHA

4.4.1 JHINV was incorporated on or about 26 October 1998: Ex 121, [43]. It held, directly and indirectly, all of the issued shares in JHNV.

4.4.2 On or about 28 October 1998, Coy's core businesses were sold to James Hardie Australia Pty Ltd (**JHA**), which was indirectly owned by JHNV. The sale was reflected in three agreements and the total purchase price was $30,130,676, including $16.5 million for goodwill: Ex 121, tabs 10, 16 - 17.

4.4.3 The amount paid for goodwill was supported by a valuation from Grant Samuel dated 17 September 1998: Ex 121, tab 20. Grant Samuel valued the business in the range of $28.5 million to $52 million and concluded that it was reasonable to adopt the midpoint of the valuation range of $40.2 million.

4.4.4 The difference between the Grant Samuel valuation of $40.2 million and the purchase price of $30,130,676 is explained by the fact that valuation included some receivables and payables that were not transferred with the sale agreements; see the re-examination of Mr Morley (T2755.54-2759.49) and Ex 183. There was some suggestion that the difference was explained by the improper non-recognition of a superannuation surplus: see Mr Humphreys' report Ex 245, [1.21] and the cross-examination of Mr Morley (T2202.29-2205.1). However, the difference was not explained by the superannuation surplus (which was transferred and paid for), as was shown during Mr Morley's re-examination (T2756.5-.21) and accepted by Mr Humphreys during his evidence in chief (T3177.15-.27).

4.4.5 Mr Humphreys made some criticisms of the Grant Samuel valuation that he did not withdraw during his evidence in chief. He concluded at Ex 245, [1.17] on a prima facie basis and subject to the level of profit attributed to NZ fibre cement operations in the Group Statistics figures that, the 1999 forecast and thus the Grant Samuel calculation of future maintainable earnings appeared materially to overstate the estimated profit for 1999. Ms Gardner dealt with this topic at Ex 234, [81] - [84]. She rejected Mr Humphreys' criticism and she was not examined about this during the course of oral evidence. Moreover, during cross-examination Mr Humphreys accepted that his query about the Grant Samuel forecast had been explained: his mistake was his failure to appreciate that the group statistics' figures were consolidated and so eliminated intercompany transactions: T3183.28-3187.45.

4.4.6 The only other matter that Mr Humphrey raised by way of criticism was what appeared to be an oversight in failing to make any allowance for costs that would have been saved as a result of ceasing to own properties Ex 245, [1.19]. Mr Humphreys agreed that he did not know whether the forecast included land tax or not (T3189.38) and was not in a position to say whether the amount was material: T3189.44.

4.4.7 During the course of oral evidence, some time was spent comparing the Grant Samuel valuation with a valuation of the trade marks and goodwill of Coy undertaken by PwC. The PwC valuation is dated 19 April 1999 but values Coy as at 20 January 1997. Thus the report postdates the Grant Samuel report but values Coy at an earlier point in time. The PwC report was obtained for CGT purposes (see Mr Morley's evidence at T1999.32). The difference between the Grant Samuel midpoint valuation of goodwill ($40.2 million) and the PwC midpoint valuation ($117.5 million) is substantial.

4.4.8 It has not been shown that either the Grant Samuel valuation or the PwC valuation was wrong or unreliable, or that the difference is explained by anything other than changes that occurred in the passage of time between 20 January 1997 and 17 September 1998. In her statement, Ms Gardner cautioned against deriving conclusions about the accuracy of the reports simply by a comparison of the conclusions: Ex 234, [103]. At that time, Ms Gardner had not seen the PwC report. She was shown a copy of it before she gave oral evidence, and her oral evidence did not show any discrepancies in either report: T3098.1-3100.26. To suggest that there was a very large discrepancy between the PwC valuation and the Grant Samuel valuation (T1790.45) does not really do justice to the two reports. There was not a discrepancy, rather there was a difference that is best explained by the fact that the valuers were valuing a business at different points in time.

4.4.9 Mr Morley, initially, gave evidence that he did not believe that the higher multiple used in the PwC valuation was justified: Ex 121, [74]. During cross-examination it was demonstrated that Mr Morley had made an error: he proceeded on the basis that PwC had used an EBITDA figure of $25 million when in fact it was an EBIT figure. Mr Morley subsequently prepared an analysis which identified the differences between the Grant Samuel and PwC forecast earnings: Ex 184; T2760.15-2761.17; Ex 185; T2762.19-2763.18. The analysis shows that the Grant Samuel 1999 forecast for gross margin ($63.9 million) was substantially less than the PwC 1997 forecast ($94.3 million). This is the major explanation for the difference between the PwC and Grant Samuel valuations of goodwill. It has not been shown that the Grant Samuel forecast, which was based on management forecasts, was too conservative. Mr Gardner's evidence on this topic did not undermine the forecast: T3093.53-3096.55.

4.4.10 It was an object of Project Chelsea to float JHNV, which was to be a company without asbestos liabilities. That was considered to be a sensible way to get value for shareholders. The transfers of trade marks and businesses from Coy to companies owned by JHNV in 1998 served that objective. The objective of the transfers was not to deprive creditors of Coy, including asbestos creditors, of a target to sue: see the cross-examination of Dr Barton at T2720.1-.8.

4.4.11 It was put to Dr Barton that a consequence of transferring Coy's business away from it was, for practical purposes, to deprive it of the opportunity to participate in the growth of the Australian business of James Hardie and the opportunity to participate in the growth of revenues that might be obtained from the exploitation of trade marks in the United States: T2747.6-.44. It was put to him that the sales took away the opportunity for the business to grow and increase the safety margin of creditors: T2750.14-.24. It is of course axiomatic that when Coy sold the business and trade marks, it would no longer own those things and would not enjoy whatever fruits came from ownership of those things. So much was effectively conceded by Dr Barton.

4.4.12 Dr Barton was quick to make the fair and critical point that the assets were sold at fair value, taking into account the expected future earnings that the business would enjoy T2747.10. It would be an extraordinary thing if the directors of a company could not sell an asset of the company for fair value because the asset might grow in value and increase the safety margin of creditors. The obligation to creditors could not be such as to disentitle the directors from selling assets at fair value and to compel them to seek to exploit the assets so as, hopefully, to increase the safety margin for creditors. In the present context, such a proposition may have an emotive appeal, but it is not well founded as a matter of principle.

4.4.13 Furthermore, given that it was perceived that a successful float of JHNV in the United States could only be achieved if it did not have asbestos liabilities, there must be some doubt about the extent to which opportunities for growth were open to Coy.

Issue 59

59. *The evidence indicates that the transfer of Coy's plant and equipment to JHFC was for fair value. Is this correct?*

Yes.

Issue 60

60. *There is evidence, which suggests that the transfer may have been, in whole or in part, for the purpose of preventing those assets being available to asbestos plaintiffs. Is this correct?*

This question does not arise if the transfer was at fair market value (which it was). Alternatively, this question should be answered no.

Are any remedies available to Coy in respect of these matters?

No.

If so, what is their basis (statutory or otherwise) and against whom are they available?

No.

Issue 61

61. *The evidence suggests that the transfer of Coy's trade marks to JHR was for fair value. Should the Commission make a finding to this effect?*

Yes

Issue 62

62. *What were the purposes of the transfer of Coy's trade marks to JHR? Was it a purpose of the transfer to isolate Coy's trade marks from its liabilities to asbestos plaintiffs, with a view to preventing those assets being available to such plaintiffs? Are any remedies available to Coy in respect of these matters? If so, what is their basis (statutory or otherwise) and against whom are they available?*

This question does not arise if the transfer was at fair market value (which it was). Alternatively, the questions should be answered as follows. The transfer was made in order to centralise the James Hardie group's intellectual property in one company, where it could be better managed. The specific questions should be answered: no; no; not applicable.

Issue 63

63. Grant Samuel valuation of business report dated 1 October 1998 ("GS Report")

In respect of the GS Report

(a) Was the EBITDA forecast for 1999 ("1999 forecast") used in the GS Report appropriate?

Yes.

(b) How did the 1999 forecast compare with the actual EBITDA of Coy's core business for 1999?

The evidence before the Commission does not permit this comparison to be done. The evidence does not support a finding of any material difference.

(c) Should the 1999 forecast have been increased to allow for a reduction in costs associated with Coy's properties (and, in particular, land tax) as a consequence of those properties not being sold with the business and if so with what consequences?

No.

(d) Was the capitalisation multiple used in the GS Report was appropriate?

Yes.

(e) What are the reasons for the difference in the value of Coy's goodwill as assessed by PwC in its draft business valuation report dated 31 March 1998[1] in its goodwill and trade marks valuation report dated 19 April 1999 and as assessed in the GS Report?

The different valuation contained in PWC's report dated 19 April 1999 is attributable to the different effective date used.

The reasons for the remaining differences cannot be discerned from the evidence before the Commission.

Issue 64

64. Having regard to these considerations, is there a basis for concluding that the fair value of the goodwill of Coy's business as at 1 October 1998 exceeded the amount paid for it upon the sale of the business to subsidiaries of JHNV?

No.

Issue 65

65. Would Coy have been able to fund a greater proportion of its liabilities to creditors, including asbestos plaintiffs, if its trade marks and core business had not been transferred?

No.

If so, would it be correct to conclude that even if the transfer of Coy's trade marks and core business was for fair value, those transactions reduced the assets available to creditors of Coy?

No.

Was such an outcome expected or thought likely to be the case by the directors of Coy when the transfer occurred?

No.

Issue 66

66. In the circumstances, did the directors of Coy breach their duties, under section 232 of the Corporations Law, to act with care and diligence, and to exercise their powers in good faith in the best interests of the corporation in approving the transfer of the trade marks and core business? If so, does Coy have a valuable remedies available to it? If so, what is their basis (statutory or otherwise) and against whom are they available?

The answer to the first question is no. The other questions do not arise.

Issue 67

67. Was JHIL a director of Coy for the purposes of the Corporations Law in the year ending 31 March 1999?

No.

Issue 72

72. Is there any basis for concluding that any of the 1995-1998 transactions is a transaction that might be voidable or the subject of some other remedy were a liquidator appointed to Coy, or voidable under s37A of the Conveyancing Act 1919 (NSW)? Provisionally, the answer appears to be "No".

No.

Issue 73

73. Is there any basis for thinking any claim might be made by Coy or a liquidator of Coy in respect of interest payments made by Coy to JHIL or other James Hardie companies prior to 15 February 2001? Provisionally, the answer appears to be "No".

No.

4.5 Leasing of 5 freehold properties (Rosehill, Camellia, Welshpool, Meeandah and Carole Park) by JHA

4.5.1 The sale of Coy's business to JHA did not include certain freehold properties (see clause 6.2 of the acquisition agreement): Ex 121, tab 10, p 284. The properties were located at Rosehill NSW, Camellia NSW, Welshpool WA, Meeandah Qld and Carole Park (Wacol) Qld. Each of the sites was contaminated with asbestos. It was a condition of the sale that the properties were leased to JHA (see clause 4.1(a)). The leases were executed in November 1998 and each lease was supported by an independent valuation prepared by JLW Advisory: Ex 121 [84] - [95].

4.5.2 Mr Eccleston, a valuer, analysed the leases in a report prepared for the Commission: Ex 238. He also gave oral evidence. Considered as a whole, Mr Eccleston's evidence does not permit any adverse findings about the rent in the leases.

4.5.3 In his report, Mr Eccleston identified what he thought to be two key, incorrect assumptions applied to the cashflows which, he said, have the effect of significantly reducing the assessment of the rental market. The first assumption was that there was no allowance for income growth over the period of cash flow: Ex 238, p 25, p 28 (second last paragraph). Mr Eccleston retracted his views concerning this assumption in light of observations that had been made in writing by one of the JLW valuers, Mr Ellis: Ex 239; T3126.34. The second assumption was the absence of rent for surplus land (p 25-27). Mr Eccleston said this assumption "has a much less impact on the rental income, but is still relevant". Mr Eccleston was cross-examined about his views concerning this assumption at T3152.39-3159.6. The following points emerged from that cross-examination:

(a) Mr Eccleston identified possible "surplus land" which might have attracted a rent at the properties at Carole Park, Meeandah and Welshpool: T3153.45. The table on page 27 of his report includes calculations for possible rent for the surplus land.

(b) Unlike the persons who undertook the valuations (T3140.36), Mr Eccleston did not carry out an inspection of the sites: T3159.5. Without having the slightest clue about the nature of the surplus land (it could have been jungle (T3155.4) or cliffs (T3153.12) for all he knew), Mr Eccleston attributed rental value to the land even thought the valuer who had inspected the land had attributed nil rental value. Without knowing more about the land, Mr Eccleston was in no position to second guess the JLW valuations. He accepted that his opinions about additional rental were "hypothetical": T3156.38; see T3163.20 for a similar concession.

(c) In relation to the Carole Park calculations, Mr Eccleston conceded that he had made an error – he took the figure of $1,250 from the third column of the JLW rental opinion (Ex 75, tab 27, p 506) instead of $200 from the fourth column: T3155.12-.47.

(d) Mr Eccleston was unable to provide a possible rental rate for the surplus land on the Meeandah site: T3156.58.

(e) The possible additional rental that is attributed to the Welshpool surplus land is calculated by reference to JLW's assessment of the rental value of a hard stand area: T3157.23. The hard stand area has a particular use which may be more valuable than the "surplus land", whatever that might be: T3157.46.

Having regard to this evidence, neither of the assumptions that Mr Eccleston deals with in his report can properly lead to any criticism of the JLW methodology.

4.5.4 During his oral evidence in chief, Mr Eccleston said that a JLW kerbside valuation of Meeandah (Ex 244) confirmed his opinion that "the face rental value should have been the rental value that should have been adopted": T3130.47. That was not an opinion that he expressed anywhere in his report. Upon analysis, it is apparent that the opinion is perverse. The analysis is as follows:

(a) Both JLW and Mr Eccleston distinguish between a face or market rental on the one hand and an effective rental on the other hand: Ex 75, tab 27, p 504-506; Ex 238, p 28. The face rent is the rent stated in the lease. It is sometimes called the nominal rent. In the marketplace, landlords frequently have to provide what are called (perhaps misleadingly in some instances) "incentives" to attract tenants. An obvious incentive is a rent free period. Another is cash.[1] The effective rent is a calculation of the true underlying rent taking into account incentives and like matters. For example, a tenant paying $80psm with a rent free period of 3 months might have an effective rent of $75psm: T3132.47. Thus if there were no incentives being offered, the market or face rent and the effective rent would be the same: T3134.21.

(b) Mr Eccleston agreed that the effective rent is calculated by taking the market rent and then taking into account the incentives, the letting up period and other things the landlord has to incur (such as marketing and agency fees) in order to achieve the market or face rent: T3133.6; T3134.33; T3143.40; T3166.20-.29.

(c) Mr Eccleston accepted that the JLW assumptions in relation to letting up and rental incentives appear reasonable: Ex 238, [3.1]; T3151.34-3152.10. Nor was he able to argue with JLW's calculations of effective rent: T3163.44, T3165.49.

(d) As a matter of logic, the following analysis must be correct. Consider a property that would ordinarily command a face rent of $100psm with a rent free period of 1 year on a five year lease. Let it be assumed that the effective rent is calculated to be $80psm. A hypothetical tenant may take the view that it would be prepared to forego the rent free period. But the sane tenant in that case would not give up the rent free period and agree to pay $100psm. Where there are no incentives, the rent that would be struck between rational parties would be the effective rent calculated on the basis of a market face rent of $100psm and a rent free period of one year. In other words, in this case particular case the face rent, and the effective rent, would be $80psm. This logic is the same logic that was revealed in the Commissioner's questions: T3173.17-3174.21. Mr Eccleston resisted the logic of the analysis but not persuasively. His point seemed to be that landlords (particularly institutional property owners – see Ex 238, p 41, [1]) maintain face rental at all cost. This suggests that what Mr Eccleston is really saying is that he does not believe that an institutional property owner would be willing to negotiate to, in effect, provide the market incentive to a tenant by reducing the face rent rather than by some other method (rent free period, cash etc). The perversity of Mr Eccleston's position is perhaps most apparent in the case of a sitting tenant who has exercised an option to renew a lease at a rent to be determined by Mr Eccleston. Mr Eccleston would apparently have the tenant pay a face rent calculated having regard to market incentives even though the tenant does not receive any fresh incentives.

(e) In the present case, none of the leases between Coy and JHA included incentives payable by Coy to JHA: Ex 75, tabs 36 - 39; Ex 121, tab 31. The leases gave to Coy advantages beyond those that could be expected by the hypothetical landlord who owned the various properties. That being so, it was appropriate for the face rent in the Coy/JHA leases to be struck by reference to the prevailing market effective rents rather than by reference to the prevailing market face rents.

[1] For a useful and striking analysis of "face rent" and "effective rent", see *State of New South Wales v SAS Trustee Corporation* unreported Bryson J 22 October 1997 (which was upheld on appeal). In that case there was a cash incentive of $68m.

4.5.5 In oral evidence, Mr Eccleston described as his “main criticism” the fact that JLW calculated the effective rents on the assumption that the properties (apart from Camellia): were let by reference to marketable portions rather than as a single site to a single tenant T3148.26-.47; T3152.17. A similar theme was explored with Mr Shafron (see below). The reason JLW approached the valuation as they did is easily explained. JLW was instructed to assess the rental as if the premises were being offered vacant to a third party. It is apparent from JLW’s analysis that they conclude that each of the properties, other than Camellia, will achieve a higher rent in the marketplace if the property is subdivided into marketable portions: see Ex 75, tab 26, p 493 (Meeandah); tab 27 p 504 (Carole Park); tab 28 p 521 (Rosehill); tab 29 p 542 (Welshpool); and Ex 121, tab 31, p 1480 (Camellia). It is reasonable to suppose that if JLW had been instructed to assume that each property was leased to a single tenant, the market rent for each property would almost certainly have been lower. That is because if the valuer concludes that the property is too large to lease to one tenant then there is really only a market for the property in parts. Mr Eccleston initially resisted this proposition (T3149.39) but that was really to deny the obvious and Mr Eccleston ultimately seemed to accept the proposition: T3152.19-.25.

4.5.6 Mr Eccleston’s real point seemed to be that he thought it was inappropriate to use a rental opinion prepared on the basis of multiple tenancies in circumstances where a tenant was willing and able to lease the entire property: T3175.12. This point is addressed below in the context of Mr Shafron’s evidence on this topic.

4.5.7 Mr Eccleston included in his report a comparison of the total rental income that could be received for the Rosehill property based on an effective rental calculation compared with a face rental calculation: Ex 238, p 33A.[2] A number of errors in the comparison have been identified:

(a) The comparison does not compare like with like because Mr Eccleston’s face rent calculation assumes, incorrectly, that property known as “Hobas” was included in the demised premises: T3137.32-3139.25; T3167.9-.27; Ex 121, tab 32; T1797.48. This has the effect of overstating the face rent calculation.

(b) The effective rent calculation takes into account a variety of incentives and the like whereas Mr Eccleston’s face rent calculation assumes only an incentive of 12 months’ rent free, which again means that he is not comparing like with like: T3139.27-3140.17; T3167.29-.48.

The analysis on page 33A should be ignored.

4.5.8 In their calculations, JLW use a discount rate of 9% for all properties apart from the Welshpool property in WA, where 11% was used. In his report, Mr Eccleston suggested

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[2] The heading on page 33A refers to “Devon St Camellia”. This is an error. It should be a reference to Devon St Rosehill.

that "it would not be unreasonable to adopt a common discount rate": p 28, [3.1]. He accepted during cross-examination that he has not assessed the market and is therefore not in a position comment on the discount rate of 11%. He conceded that it may be appropriate to use different discount rates: T3145.30-.57.

4.5.9 Mr Shafron was cross-examined about the rental assessments: T1792.7-1798.21. Mr Shafron was involved in obtaining the rental assessments. It was suggested to Mr Shafron that what he was trying to do, by use of the assumptions put to JLW, to bring the rental down: T1795.53. Mr Shafron rejected the suggestion. The assumptions do not, in any event, push rent the one way. For example, common sense suggests that an assumption that there was no contamination of the premises (see Ex 75; tab 26, p 294), when the reality was different, would have the effect of increasing the rent. Nor is it obvious that an assumption of vacant possession would tend to reduce market rental.

4.5.10 Mr Shafron explained that the assumptions were developed in discussion with JLW as a means of reaching what might be a negotiated position between two parties: T1793.11-.22. Mr Shafron and Mr Ellis discussed the things which the landlord and tenant might bring to the negotiation table: T1794.25.44. He said that they were looking to replicate a "pseudo negotiated situation" (T1797.17), to see how the "tussle" between landlord and tenant might end up: T1797.54. That is consistent with what Ellis describes in his letter dated 15 June 2004: Ex 239 at p4.

4.5.11 It was suggested to Mr Shafron that if he had wanted to do the balancing exercise, he would have had valuations done on the basis that the premises were occupied by James Hardie on leases which had expired and they wished to continue in occupation. Mr Shafron said that that was not the guidance he had from JLW: T1798.20. It was also put to Mr Shafron that if there had been an arms length negotiation, Coy would have had the whip hand. Mr Shafron did not accept the proposition: T1794.8.

4.5.12 The points suggested to Mr Shafron are by no means self evident. While it is true that JHA was perhaps in the position of a sitting tenant, occupying the whole of each site, the evidence from JLW suggests that JHA was the only likely party who would be willing to lease the whole of the properties. That would, in an arms length negotiation, give a tenant substantial power. In addition, the tenant has the general power of threatening to leave: T1794.53. It may be true that the inconvenience of having to move gives the landlord power over a sitting tenant. But if premises were readily available elsewhere and attractive incentives were on offer, the inconvenience may be slight. Some organisations see a shift of premises as rejuvenating or giving an opportunity to reconfigure or improve plant lay-out. A sitting tenant may well be able to negotiate a rent below the prevailing market rent. There is no reason to doubt that the approach adopted by JLW was a fair means of determining a fair rent for the respective properties.

4.5.13 If the consequence of the JLW valuations and the manner in which they were used was that JHA agreed to pay a rent that was too low, then that is plainly a benefit to JHA. It is possible that to some extent at least, the benefit would be ameliorated by rent reviews. It is conceded that the effect of the rent review provisions in the leases serves to lock in a market effective rent rather than a market face rent: see for example clause 4.7 of the Rosehill lease Ex 75, tab 38 p 1146.

4.5.14 Grant Samuel took the JLW valuations into account for the purposes of the valuation of the Coy assets being sold to JHA. That is, the valuation took into account the fact that Coy would retain the properties as landlord and the business that was sold would have to pay rent: Ex 121, tab 20, p 894-895. It is apparent from the valuation that the adjusted EBITDA would have been lower if the rental obligation was higher: Ex 121, tab 20, p 893. Further, given that Grant Samuel used a midpoint multiple of 6.5 (p 887), an extra $1 million rent would have reduced the gross value of the business operations by $6.5 million. It follows that while Coy would be disadvantaged by a rent that was too low in one sense, the lower rental was reflected in a higher price that it earned for the sale of the business assets.

Issue 68

68. The evidence suggests that at the time JHIL was instructing JLW Advisory to assess a fair rental as between Coy and JHA for JHA's occupation of each of the Carole Park, Welshpool, and Rosehill properties, JHIL intended that JHA would lease the properties for 10 years and was aware that JHA would otherwise have to relocate substantial business operations. Is this correct?

Yes.

Issue 69

69. If this was the use to which it was intended the properties would be put, was it appropriate for JHIL to adopt rentals for the leases which were set by reference to rental opinions which:

(a) assumed that the properties were vacant;

(b) proceeded on the basis that some of the properties were too large to be let to a single tenant;

(c) proceeded on the basis that some properties or parts of properties would not be leased for a ten-year term?

Yes.

Issue 70

70. JHIL adopted the net effective rentals calculated by JLW on the assumptions set out above in the leases of the properties. In the circumstances, were the resulting rentals fair market rentals as between Coy and JHA?

Yes.

Issue 71

71. Did the directors of Coy breach their duties, under section 232 of the Corporations Law, to act with care and diligence, and to exercise their powers in good faith in the best interests of the corporation, in authorising Coy's entry into the leases with JHA having regard to the basis on which the rental was calculated? If so, did Coy suffer any loss as a result, when regard is had to the basis on which the goodwill of its business was assessed for the purpose of the core business transfer?

The answer to the first question is no. The other questions do not arise. However, Coy did not suffer any loss from the sale of its business.

4.6 Manner in which proceeds of sale of businesses and assets were accounted for as between Coy and other companies in the JHIL group.

4.6.1 The proceeds from the sales were used by Coy to repay intercompany debt and to make intercompany loans. Coy's financial statements for the year ending 31 March 1998 showed a non-current intercompany debt of $147,874,000 (and net assets of $47,009,000): Ex 1, tab 5. The special purpose financial statements for the year ending 31 March 1999, show that that debt had been repaid: Ex 121, [96], [97], tab 9. Those statements show that net assets had increased from $40,009,000 to $148,040,000. The increase reflected the fact that the sales during the year enabled the true value of assets to be realised and reflected in the books of Coy: Ex 121, [102].

4.7 The decision not to proceed with the IPO

4.7.1 The IPO and capital reduction that were part of Project Chelsea did not proceed. It became clear in February 1999 that JHIL would not be able to sell the JHNV shares at what was thought by the directors to be a sufficiently high price and, on 5 March 1999, the Board resolved not to proceed with the sale of the shares: Ex 121, tab 34; and see Dr Barton's evidence at T2718.27-2719.3:

> The US market was interested in a company called JHNV which had no asbestos liabilities. The fact that we weren't able to get enough interest and therefore float 15 per cent of it had nothing to do with asbestos liabilities within the larger group. It had to do with market conditions at the time.

It followed that the proposed capital reduction was also unable to proceed.

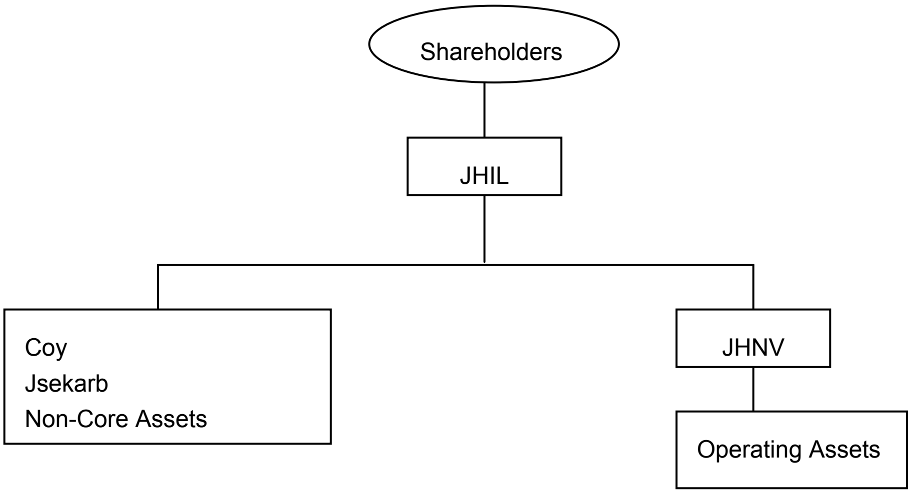
4.7.2 As a result of Project Chelsea, the James Hardie group had been restructured. The core business, including the operating assets, were held within the JH Operating Group under JHINV and, ultimately, JHIL. The non-core assets and liabilities, including the asbestos liabilities, continued to be held under JHIL, but they were not part of the JH Operating Group. This outcome was not achieved by any secret or underhand dealings. The restructuring was deliberate and could not have been made more public. Separation of the non-core assets and asbestos liabilities was designed to give JHIL a vehicle that would be attractive to United States investors.

4.7.3 JHIL took the interests of creditors into account and specific consideration was given to the interests of persons who might have claims one day on account of exposure to asbestos. It is correct that those prospective claimants were not to be given access to the assets derived from any growth of the core operating businesses. That is because Coy and Jsekarb were being left behind as part of the non-core business. However, there was no legal or even moral obligation to do otherwise (assuming for the moment that it makes sense to speak of morals in the context of corporate personality). Coy received full value for the operating assets that were sold into the JH Operating Group. The pool of assets that was available for future claimants was undiminished by the transactions and, arguably, the change in the asset pool (cash rather than operating businesses) reduced risk for creditors. In all the circumstances, it would have been remiss for the directors of JHIL not to have taken advantage of the benefits of the restructuring that became available as a result of Project Chelsea.

5. Project Green and its development prior to February 2001

5.1 Rationale and development after February 1999

5.1.1 As a result of the decision not to proceed with the initial public offering of shares in James Hardie NV (***JHNV***) in February 1999, the group was left with a structure in which JHIL remained the ultimate parent (and the only listed entity) but in which the operating assets of the group's core businesses had been separated, within the group, from the group's non-core assets and most of its asbestos liabilities, which were liabilities of Coy and Jsekarb.



Group structure following the decision not to proceed with the IPO

5.1.2 That structure continued to suffer from the same problems which Project Chelsea had sought to address.

(a) First, the high withholding tax costs associated with distributing profits earned in the United States to shareholders in Australia remained. JHIL's view was that those inefficiencies would inevitably increase over time as the group's United States operations grew (Ex 148, [7]) a view that was later confirmed by advice received from UBS Warburg: Ex 75, vol 6, tab 62, p 2168.

(b) Secondly, it was still felt that investors applied a disproportionate discount to JHIL's shares on account of its subsidiaries' asbestos liabilities:Ex 148, [7]; Ex 17, [77]; Ex 121, [133] ff; Ex 80, [10] – [12].

5.1.3 A short term solution was found to deal with the tax inefficiencies, but it was anticipated that that solution would only remain viable for a one to three year period: Ex 121, [133] - [135].

5.1.4 In addition, the possible implementation of exposure draft accounting standard ED88 was identified as an issue for JHIL. JHIL received advice on ED88 from PwC on 5 November 1999: Ex 61, vol 4, tab 5, p 19. PwC's advice records that JHIL had provided them with a summary of Trowbridge's 1998 report (page 19) and the mock-up consolidated accounts of JHIL prepared by PwC and attached to their advice, contemplating the adoption of ED88, included a provision based on Trowbridge's assessment of Coy's future asbestos liabilities ($254 million, page 33).

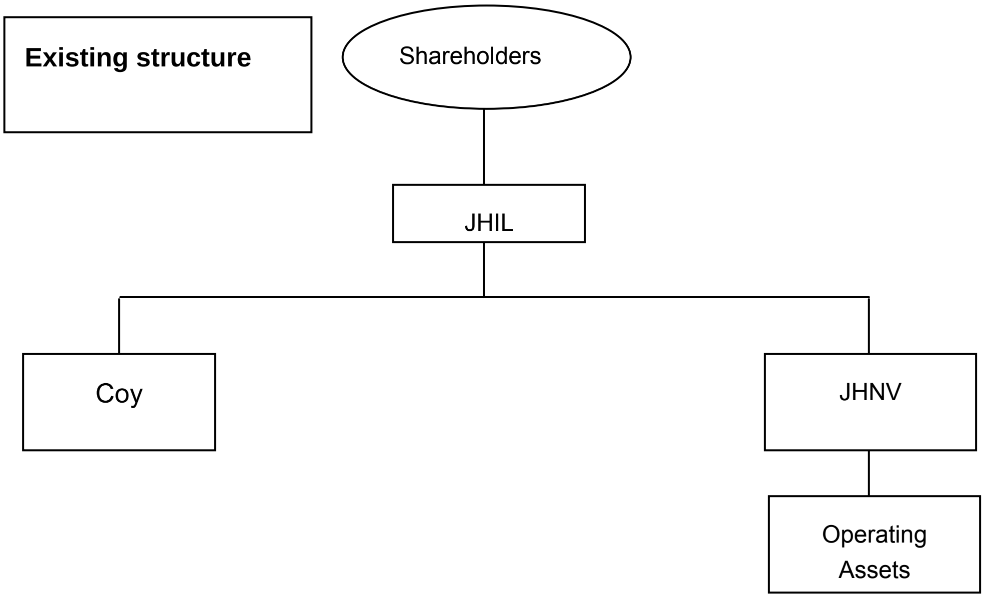
5.1.5 At first, the possible implementation of ED88 does not appear to have been viewed as a major issue for the group and received only a passing mention in the February 2000 Board papers: Ex 75, vol 6, tab 57, p 1862. It also appears that there was at least an initial difference of opinion between PwC and Allen Allen & Hemsley as to whether the adoption of ED88 would properly require JHIL to make provision, in its consolidated accounts, for the actuarial assessment of its subsidiaries' asbestos liabilities, notwithstanding that those liabilities might exceed the assets of Coy and Jsekarb: Ex 61, vol 4, tab 5; email from John Martin to Peter Shafron dated 5 November 1999 attaching letter of advice on ED88, Ex [ ]; email from John Martin to Peter Cameron dated 9 November 1999 attaching a note on ED88 prepared by Peter Shafron, Ex [ ]. However, over the course of 2000, ED88 became a matter of greater concern to JHIL as it became clearer that it would be necessary to provide fully for the subsidiaries' asbestos liabilities. The presentation to the August 2000 Board meeting indicated that adopting ED88 would require JHIL to increase its provision for asbestos liabilities by $220 million: Ex 75, vol 6, tab 61, p 2102.

5.1.6 By late 1999, JHIL and its advisers had begun to consider ways in which these issues could be addressed.

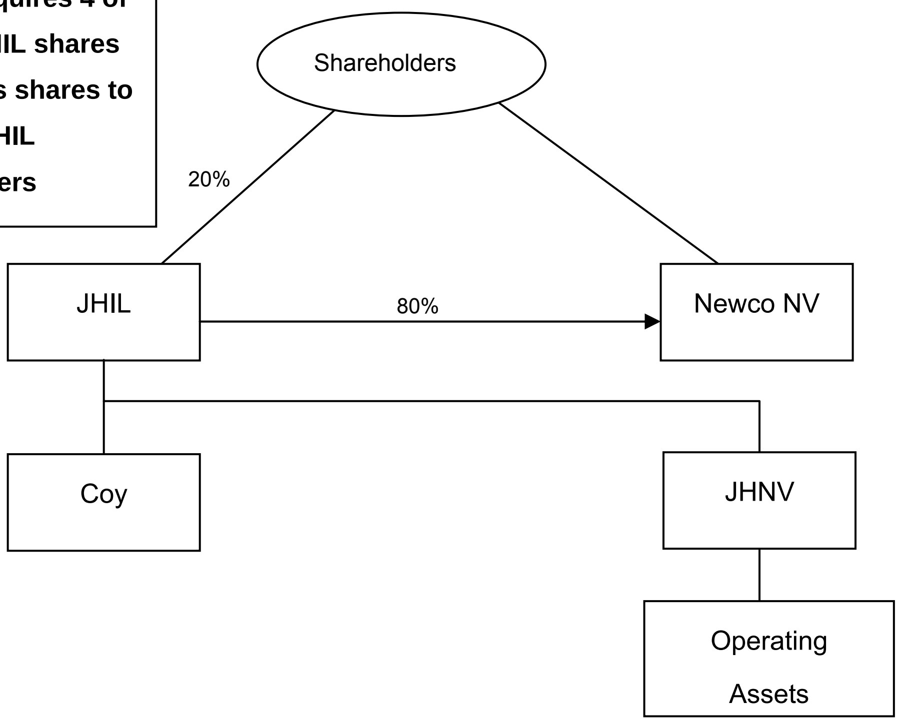
5.1.7 Papers prepared by Allen Allen & Hemsley in October 1999 (Ex 61, vol 4, tab 4) and Mr Morley in December 1999 (Ex 121, vol 4, tab 51) considered a possible restructuring of the group. Allen Allen & Hemsley's advice indicates that the contemplated restructure was originally devised by PwC: Ex 61, vol 4, tab 4, p 13. Under the proposed restructure, James Hardie shareholders would exchange 4 of every 5 JHIL shares held by them for 4 shares in a newly incorporated Dutch company (Newco NV). JHIL would then buy back the JHIL shares owned by Newco NV in consideration for all shares held by JHIL in JHNV. As a result, James Hardie shareholders would be left holding shares in both JHIL and Newco. Newco would own, through JHNV, all of the operating assets of the group. JHIL would have a substantially reduced share capital and would continue to own Coy and Jsekarb and manage asbestos claims.

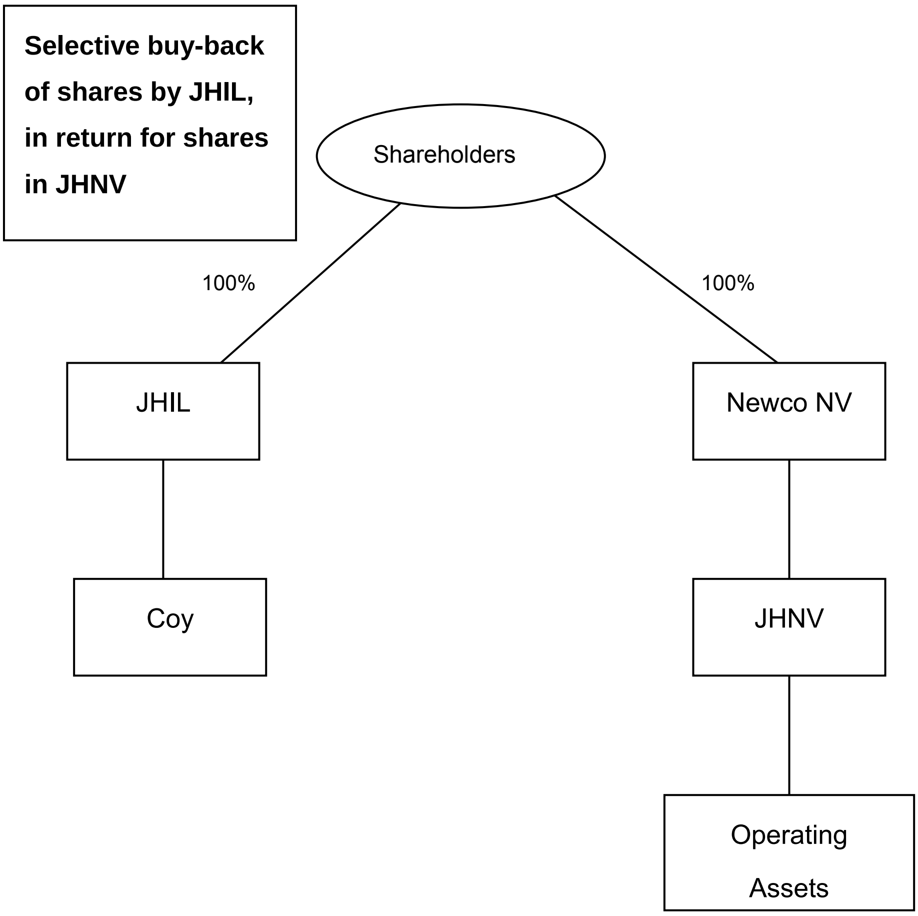
Restructure contemplated in Allen Allen & Hemsley's advice of 12 October 1999 and Mr Morley's paper of 3 December 1999

Existing structure



Newco acquires 4 of every 5 JHIL shares and issues shares to existing JHIL shareholders





5.1.8 The Allen Allen & Hemsley paper advised that the same outcome could also be arrived at by way of a joint takeover by two companies (instead of a scheme of arrangement).

5.1.9 One of the developments since Project Chelsea which made such a restructuring more attractive was the announcement of scrip-for-scrip rollover relief from capital gains tax for foreign acquisitions of existing companies:Ex 61, vol 4, tab 4, page 14; Ex 121, vol 4, tab 84, p 1831).

5.1.10 Also in late 1999, Mr Shafron prepared a discussion paper which canvassed a number of options for dealing with the group's asbestos liabilities: Ex 61, vol 4, tab 9. The options considered were:

(a) legislation;

(b) a voluntary group settlement;

(c) liquidation;

(d) a court approved scheme;

(e) insurance defeasance; and

(f) provisioning to worst case.

February 2000 Board meeting

5.1.11 Papers prepared by Mr Morley and Mr Shafron, discussing possible restructuring options for the group, were included with the Board papers for the February 2000 Board meeting. By that time, the restructuring of the group appears to have been identified as a definite project as both Mr Shafron's and Mr Morley's papers refer to "Project Green".

5.1.12 Mr Morley's paper also canvassed the possibility of a joint takeover, previously discussed in the Allen Allen & Hemsley paper of October 1999, as an alternative restructuring mechanism to a scheme of arrangement: Ex 121, tab 53.

5.1.13 Mr Shafron's paper (Ex 75, tab 57; Ex 283) was based on his earlier paper (Ex 61, vol 4, tab 9) but now canvassed 10 alternatives for dealing with the group's asbestos liabilities:

(a) a legislated scheme governing compensation;

(b) a voluntary group settlement;

(c) a class action settlement;

(d) liquidating Coy;

(e) a court approved scheme of arrangement with creditors;

(f) insurance defeasance;

(g) provisioning to a worst case scenario;

(h) establishing a trust;

(i) a company split/reorganisation; and

(j) a defence cooperation scheme.

5.1.14 Mr Shafron's description of the "company split/reorganisation" alternative envisaged a restructuring of the type discussed in Mr Morley's paper. That option was assessed as the most attractive of the alternatives discussed in the paper. It was noted that, in the case of James Hardie, a split of its asbestos liabilities had already been achieved within the group. A range of issues were identified as associated with a restructuring, including the level of assets to be left behind in the old group, potential adverse reaction from asbestos claimants and the ultimate ownership of the shares in JHIL. It was said that the trust structure had some potential to assist with the last two of these issues and could possibly serve as a fall back position.

5.2 Development of Project Green during 2000

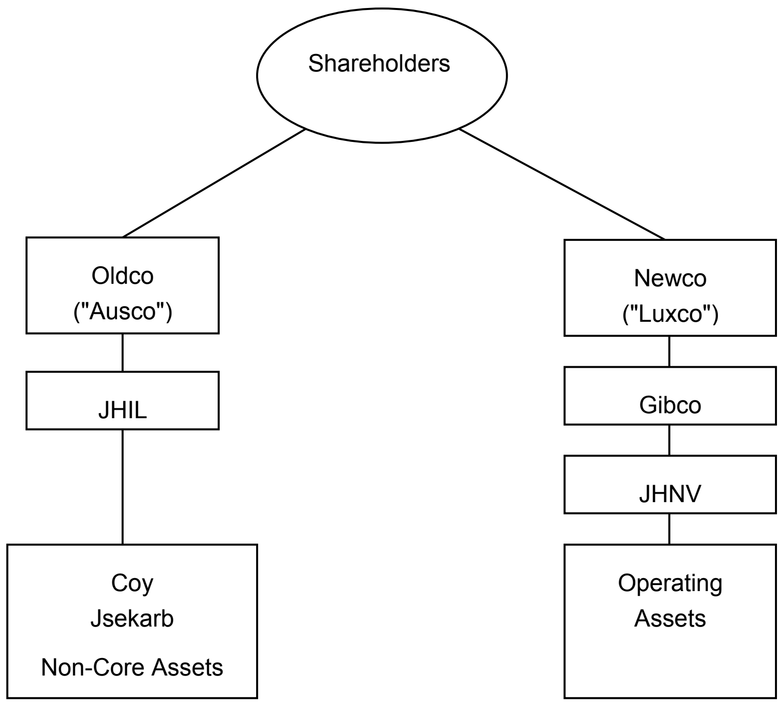
5.2.1 By the time of the April 2000 Board meeting, the joint takeover mechanism had replaced a scheme of arrangement as the preferred restructuring alternative. Under the proposal:

(a) two newly formed companies would jointly bid for shares in JHIL. One of those companies was to be incorporated in Gibraltar (**Gibco**) and the other company was to be incorporated in Australia (**Ausco**). Gibco and Ausco were to offer to acquire all of the issued shares in JHIL in consideration for the issue of shares in Gibco and Ausco to James Hardie shareholders;

(b) a newly formed Luxemburg company (**Luxco**) would then acquire all of the issued shares in Gibco in return for the issue of Luxco shares to James Hardie shareholders;

(c) there would then to be a buy-back of JHIL shares held by Gibco in exchange for the transfer to Gibco of all of the issued shares in JHNV.

5.2.2 As a result, James Hardie shareholders would hold shares in two distinct entities: Ausco (also referred to as "Oldco") and Luxco (also referred to as "Newco"). Ausco would own all of the shares in JHIL which would, in turn, own all of the shares in Coy and Jsekarb. Luxco would own (indirectly) all of the shares in JHNV.



Structure discussed at the April 2000 Board meeting

5.2.3 The resulting structure was essentially similar to that which had been set out in Mr Morley's paper for the February 2000 Board meeting; the group would be separated into two separate entities, one of which held the group's core operating assets and the other of which held its non-core assets and the subsidiaries with asbestos liabilities.

5.2.4 At this stage, it was envisaged that the quantum of assets retained in Oldco would be equal to the actuarial assessment of its asbestos liabilities: Ex 23, p 21). Trowbridge's 2000 Report, which was due shortly, was expected to show a net present value figure for future claims of around $250 million, to which would need to be added approximately $30 million of current claims. An estimate of the likely net worth of Oldco as at 30 September 2000 had been prepared and suggested a net worth of $295 million (if the $43 million provision for notified claims were reversed).

5.2.5 At its simplest, the restructure contemplated would leave shareholders holding shares in each of Oldco and Newco. However, the Board paper also reviewed three alternatives for dealing with Oldco:

(a) the sale or gift of the shares in Oldco to a third party, possibly an insurance company;

(b) obtaining insurance to cover the asbestos liabilities; and

(c) the creation of a trust to hold the shares in, or assets of, Oldco. It was envisaged that Oldco, or James Hardie shareholders, would be the beneficiary of such a trust in order to entitle it, or them, to any surplus of assets remaining once asbestos claims had been satisfied.

5.2.6 Each of those options had been canvassed in Mr Shafron's paper of 4 February 2000.

5.2.7 The creation of a trust was also discussed as a possible fall-back option which would address the group's asbestos position if the proposed restructuring were unsuccessful.

August 2000 Board meeting

5.2.8 The proposal considered by the April 2000 Board meeting remained the preferred structure between April and July 2000. A minor change to the proposal occurred around May 2000, when the Netherlands replaced Luxembourg as the preferred domicile for Newco: Ex 21, tab 55).

5.2.9 Between April and July 2000, it was still contemplated that Oldco's asbestos liabilities would be funded either by providing Oldco with assets equal to the actuarial estimates of future claims or by purchasing insurance in respect of part or all of that exposure. In July 2000, it remained JHIL's "base case" to pass sufficient cash from JHNV to JHIL to achieve the structural separation and migration to the Netherlands: Ex 75, tab 60, p 2060. By that time, JLT had been retained to obtain alternative proposals to insure the asbestos liabilities or provide a tranche of cover above the actuarial estimate of liability: Ex 75, tab 60, p 2060.

The July Board presentation stated that it remained a continuing objective of the group to find a solution regarding Oldco which would deliver value to shareholders. The sale or gift of Oldco to a third party remained a possibility.

5.2.10 However, by early August, the prospects of achieving a separation of the group's asbestos liabilities had diminished. Initial responses had been received from insurers and were at the upper end of the expected range, requiring up-front premiums in the order of A$400 million: Ex 61, vol 4, tab 38, p 242; Ex 75, tab 61, p 2123; Ex 148, [13]). Mr Macdonald's memorandum of 7 August 2000 stated that, given the higher cost indications from potential insurers, JHIL may not have sufficient funds to achieve asbestos separation: Ex 75, tab 61, p 2078.

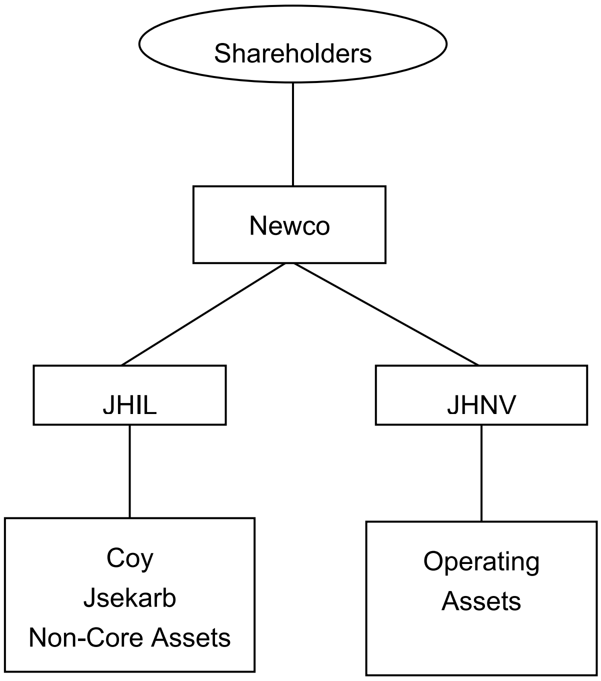
5.2.11 The alternative of funding Oldco with cash equal to the actuarial estimate of liabilities also could not be afforded and the remaining option, allowing Oldco to retain an interest in Newco in order to fund the asbestos liabilities, was unfavourably viewed on account of the ongoing link it would create between Oldco and Newco: Ex 75, vol 6, tab 61, p 2124.

5.2.12 As a result, consideration was given to whether the restructuring of the group should proceed without the separation of the group's asbestos liabilities. Alternatives were presented to the August Board meeting:

(a) "Restructure and separate" (the proposal which had been considered by the Board meetings of April, May and July); or

(b) "Restructure but no separation".

5.2.13 Under the "Restructure but no separation" option, a new, Dutch holding company (**Newco**) would be substituted for JHIL. The group's asbestos liabilities would be retained in JHIL and its subsidiaries (but would continue to remain separate from the group's operating assets). Newco would own both JHIL and JHNV.



"Restructure but no separation" option proposed to the August 2000 Board meeting

5.2.14 The key benefit of the "Restructure but no separation" option was that the desired tax benefits would be achieved without the difficulty of funding the group's asbestos liabilities.

5.2.15 While "Restructure and separate" remained the "preferred alternative" if it was achievable at a reasonable cost, given the difficulties in funding Oldco's future asbestos liabilities, it was not recommended to the August 2000 Board meeting: Ex 75, tab 61, p 2124.

5.2.16 The Board presentation recorded that the "Restructure but no separation" option was to be recommended if, amongst other things, separation of the asbestos liabilities was not feasible in the short term: Ex 75, tab 61, p 2129.

Development of the "Restructure but no separation" option and the November 2000 Board meeting

5.2.17 Between August and November 2000, JHIL and its advisers proceeded to develop the "Restructure but no separation" option presented to the August Board meeting. The possibility of providing JHIL with access to capital following the restructure by issuing partly paid shares (with a face value of $135 million to enable it to pay off Coy's intercompany receivable) to Newco had arisen by 21 September 2000: Ex 61, vol 4, tab 52, p 333). That aspect of the proposal also appeared in the presentation made to the November Board meeting except that by that stage the face value of the partly paid shares was to reflect the value of the shares in JHNV previously held by JHIL: Ex 61, vol 5, tab 8, p3 of Allens' overview.

5.2.18 Under the "Restructure but no separation" option, Coy was to remain in the group. For that reason, advice was sought on the rules which would apply to the treatment of Coy's asbestos liabilities in Newco's accounts. Those accounts would be prepared in accordance with United States GAAP, unlike JHIL's accounts which were prepared in accordance with Australian GAAP (which, as yet, did not include ED88). That subject was discussed by Mr Morley with PwC on 17 or 18 October 2000. Following the discussion, Mr McClintock of PwC Australia sent an email to Mr Morley expressing a preliminary view that, under United States GAAP, Newco would be required to give detailed disclosure about Coy's asbestos liabilities: Ex 61, vol 5, tab 4, p 12). Given his views, Mr McClintock suggested that it would be worthwhile investigating whether Coy could be "deconsolidated" so as not to be a subsidiary of JHIL or Newco. Deconsolidation for accounting purposes depended on neither JHIL nor Newco having control of Coy. The possibility of deconsolidating Coy by transferring it to an independent trustee was not raised in Mr McClintock's email.

5.2.19 It is apparent from the email that PwC had not yet reached a concluded view on the treatment of Coy's asbestos liabilities in Newco's consolidated accounts under United States GAAP and, in particular, whether it would be necessary for Newco's accounts to provide for asbestos liabilities of Coy which had been incurred but not reported (IBNR). It also appears from the email that there was some divergence of views within PwC on this topic and, in particular, between Mr McClintock of PwC Australia (who had advised JHIL on ED88 in November 1999: Ex 61, vol 4, tab 5) and Mr Moore of PwC USA (who would give the final advice on United States GAAP). It appears that Mr McClintock and Mr Moore had expressed different views as to the application of essentially similar accounting standards: ED88 under Australian GAAP and Financial Accounting Standard 5 under United States GAAP (FAS5).

5.2.20 Mr Harman subsequently forwarded a memorandum prepared by Mr Shafron to Mr Moore on 24 October 2000 in order to allow PwC USA to give further consideration to the treatment of asbestos liabilities in Newco's accounts: Ex 61, vol 5, tab 5, p 14.

5.2.21 The Board papers for the 15 November 2000 Board meeting were despatched around 6 November 2000. The proposal considered in the Board papers was the "Restructure but no separation" option recommended to the August 2000 Board meeting. However, the Board papers noted that:

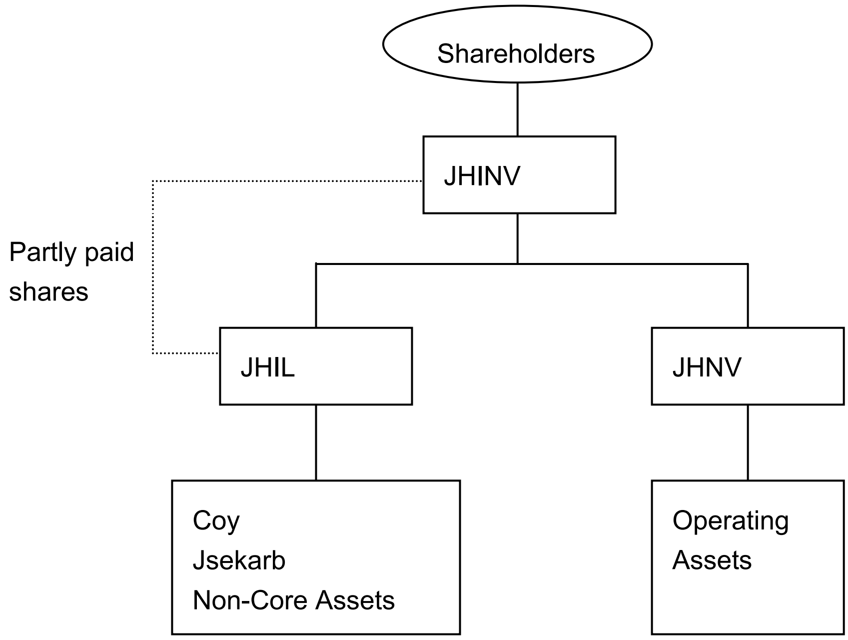
(a) in order to list Newco ADRs (American Depositary Receipts) for trading on the New York Stock Exchange, Newco would file a registration statement (Form F-20) with the Securities & Exchange Commission which would require extensive disclosure regarding Newco;

(b) the documents for the scheme of arrangement would show the accounts of each of JHIL and Newco. While the JHIL accounts would be prepared on the basis of then current (pre-ED88) Australian accounting standards (and would therefore not make provision for Coy's IBNR asbestos liabilities), PwC had been asked to confirm the accounting treatment for group exposures in respect of Newco and whether foreign accounting standards required a different treatment of Coy's liabilities; and

(c) a concluded view needed to be reached on whether the application of ED88 imposed a broader disclosure obligation on JHIL and, if it did, whether that affected the United States accounting treatment for Newco.

5.2.22 Mr Moore appears to have reached a more settled view shortly before the November 2000 Board meeting. An email sent by Mr Shafron to Mr Peter Cameron on Sunday, 12 November 2000 (Sydney time) records that PwC USA had advised JHIL that, if Coy remained in the group, then Newco would need to show an estimate of Coy's asbestos liabilities in Newco's consolidated accounts, beyond the net assets of Coy, unless the directors of JHIL resolved not to support Coy in the future: Ex 224, tab 18. Mr Shafron's email also records PwC's advice that, if the assets or shares of Coy were controlled by a trustee, then Coy would not be consolidated with Newco and Newco's accounts would not be required to show Coy's asbestos liabilities.

5.2.23 PwC's advice appears not to have been final or was otherwise not considered immediately fatal to the "Restructure but no separation" option, which was still recommended to the JHIL Board meeting of 15 November 2000: Ex 75, tab 62.



Proposal recommended to the November 2000 Board meeting

5.2.24 However, the presentation to the Board in November 2000 noted that:

(a) disclosure requirements for asbestos liabilities were still being investigated under both United States GAAP and Australian GAAP;

(b) United States GAAP requirements were similar to the requirements which would apply under Australian GAAP if ED88 were introduced; and

(c) these issues needed to be resolved before the recommendation could be finalised.

5.2.25 These issues were "key outstanding issues" requiring resolution as a next step (page 75 of the Board presentation).

5.3 Development of the trust proposal

5.3.1 Messrs Morley and Harman appear to have begun investigating the possibility, suggested by PwC, of deconsolidating Coy by use of a trust immediately following the November Board meeting. On 16 November 2000, they met with Messrs Minehan, McClintock and Clemens of PwC at PwC's offices in Sydney: Ex 121, [157]. Mr Peter Cameron also participated in the meeting by telephone. Mr Shafron was not present at the meeting. Under the proposal prepared by PwC: Ex 121, tab 63, p 2362:

(a) the shares in Coy would be transferred to the trustees of a trust, the beneficiary of which would be the New South Wales Cancer Council;

(b) there would be a condition that Coy not be liquidated prior to all outstanding asbestos claims being satisfactorily resolved; and

(c) the trustees would have complete power over the shares in Coy and would appoint their own directors to Coy.

5.3.2 PwC's note of the meeting records that it was considered likely that Coy would be able to enhance its ability to deal with claims and accumulate assets if the directors of Coy sought to retain an insurance company to manage Coy's claims and assets. PwC advised that if the proposal were implemented prior to 31 March 2001, then Coy would no longer be included as a subsidiary of JHIL and it would be unlikely that JHIL would need to raise a provision against asbestos claims of Coy. It was agreed that Messrs Morley and Harman would brief Mr Shafron on the meeting (Ex 121, p 2362).

5.3.3 Mr Peter Cameron appears to have raised several questions during the meeting with PwC, as a result of which PwC prepared a revised trust proposal for James Hardie to consider (Ex 121, tab 64, p 2365). Mr Clemens' email which circulated the revised trust proposal also noted that Mr Moore was continuing to consider United States GAAP accounting issues and would consider whether disclosure of asbestos issues in JHINV's (Newco's) accounts would be necessary if the trust structure were adopted.

5.3.4 United States and Australian accounting issues were discussed by JHIL and its advisers on a conference call on 21 November 2000 (Sydney time) (email from Mr Sweetman dated 20 November 1999, Ex [ ]) and the possibility of addressing those issues by transferring Coy to a trust was discussed, possibly also on that call, by Messrs Morley and Macdonald with PwC and Allen Allen & Hemsley on the same day: (file note of Mr Robb dated 21 November 2000, Ex [ ]).

5.3.5 The day following the advisers' call, Mr McClintock sent an email to Messrs Morley and Harman which recorded that PwC was to advise, amongst other things, on the disclosure requirements in the financial statements of Newco if Coy were transferred to a trust prior to the establishment of Newco. Mr McClintock's email said that he would discuss the point with Mr Moore: Ex 61, vol 5, tab 28, p 91. Mr McClintock's email also noted that PwC were awaiting a draft letter from JHIL regarding an intention not to contribute further funds to Coy, in order to consider the effect of such a letter on accounting treatment under United States GAAP.

5.3.6 Also on 22 November 2000 (Sydney time), Mr Shafron prepared a paper considering issues associated with the establishment of such a trust and circulated it to PwC, Allen Allen & Hemsley and UBS Warburg (Sydney time) (Ex 75, vol 6, tab 65).

5.3.7 It is clear from the issues paper circulated by Mr Shafron that concern had already arisen over the question of whether the JHIL directors could, consistently with their duties to JHIL, make a gift of the shares in Coy to the trustee. Indeed, that was the first question raised in the issues paper (p 2248) and likely reflects a concern raised by Mr Peter Cameron on 16 November 2000 (compare paragraph (d) of Ex 121, p 2366 with paragraph (d) of Ex 121, p 2361 and see the advice subsequently given by Mr Cameron at Ex 75, vol 6, tab 70, p 2285). The issues paper raised the question of whether ratification by JHIL shareholders should be obtained to address the issue.

5.3.8 The issues paper also proposed that Jsekarb be included in the trust and that JHIL hold no residual interest in the trust (p 2248), unlike the trust proposal put to the April 2000 Board meeting.

5.3.9 The issues paper identified Sir Llewellyn Edwards as a possible trustee director. Sir Llewellyn was suggested as a possible director in order to provide the trust, and Coy, with continuity.

5.3.10 The possibility of Coy suing JHIL had been identified as a potential issue associated with the creation of the trust by this time - well before advice had been obtained on the 1996 Dividend or the prospect of asbestos claims being successfully brought against JHIL in respect of the period after 1937. Allen Allen & Hemsley were asked to advise on whether the trustee could be constrained from allowing Coy to sue JHIL (p 2250).

5.3.11 Mr Shafron's Issues Paper also asked PwC, Gibson Dunn & Crutcher, Allen Allen & Hemsley and UBS Warburg to advise on accounting disclosure issues, including:

(a) what disclosure of asbestos liabilities would need to be made in the consolidated accounts of JHIL, prepared under Australian GAAP;

(b) what disclosure would need to be made in respect of asbestos liabilities in the consolidated accounts of JHINV, prepared under United States GAAP;

(c) what would JHINV's Form 20-F need to disclose; and

(d) what impact would ED88 have, when introduced?

5.3.12 Mr Shafron's covering email, attaching the issues paper, noted that a number of options were being explored concurrently. The trust idea was only one of those options but JHIL wanted to explore it as soon as possible.

5.3.13 One of the other options being considered concurrently with the trust was the possibility of JHIL passing a resolution not to support Coy in the future. Such a resolution was one possible approach which had been identified by PwC USA in order to avoid having to make provision for Coy's future asbestos liabilities in Newco's consolidated accounts: Ex 224, tab 18. Mr Shafron prepared a draft letter of representation to be given by JHIL to its auditors following such a resolution and provided the draft to Messrs Macdonald, Morley and Harman: Ex 17, [87] – [90]. It is likely that that draft letter was then provided to PwC USA for their consideration: Ex 61, vol 5, p 92.

5.3.14 By 23 November 2000, PwC had prepared a revised version of the trust proposal which Mr Clemens sent to Messrs Morley, Harman and Shafron on that date: Ex 121, [159], tab 64; Ex 17, [91]; Ex 75, tab 69. Under the revised proposal:

(a) the shares in Coy would be transferred to the trustees of a trust, the beneficiary of which would be a foundation which supported medical research into respiratory illnesses;

(b) possible terms of the trust deed included:

(i) Coy could not be liquidated prior to all outstanding asbestos claims being satisfactorily resolved;

(ii) the trustees could not call for distributions from Coy prior to 10 years unless Coy received approval to undertake a reduction of capital;

(iii) the trustee would procure that Coy did not make any cross-claim against JHIL;

(iv) the trustee must be a company, the shares of which were owned by the Perpetual Trustee and the directors of which must include Sir Llewellyn Edwards or a nominee of JHIL;

(v) the trustee would procure that Coy made annual donations to the Institute for Research of Respiratory Conditions of a nominated amount; and

(vi) JHIL could be a beneficiary of the trust and receive a distribution in the event that Coy had surplus assets after meeting all asbestos claims and the research foundation beneficiary had received a stipulated amount;

(c) the trustees would have complete power over the shares in Coy and would be likely to appoint their own directors to Coy (presumably, subject to (b)(iv)).

5.3.15 Like PwC's previous note on the trust proposal, Mr Clemens' note recorded that, on present estimations, it was expected that Coy's assets would be sufficient to meet future claims over the next 10 years.

5.3.16 On 27 November 2000 (Sydney time), Mr Peter Cameron sent Mr Shafron an initial advice on the points raised in Mr Shafron's issues paper: Ex 17, [92]; Ex 75, tab 70. Mr Cameron's initial advice was concerned with whether the directors of JHIL could resolve to make a gift of the shares in Coy without that constituting an impermissible reduction in the capital of JHIL (by the disposal of a valuable asset) or otherwise breaching their duty to act in the best interests of JHIL. Mr Cameron's advice was that the value of JHIL's interest in Coy was central to that question. If it was the case that Coy was essentially valueless and JHIL could not access substantial dividends from Coy, then Mr Cameron concluded that it was difficult to see why the directors of JHIL could not resolve to vest the shares in Coy in a trustee without that constituting a capital reduction.

5.3.17 Mr Cameron also advised that JHIL should probably not make a gift of the shares in Coy unless the terms of the trust included a covenant to prevent claims for contribution by Coy against JHIL and an indemnity against breach of that covenant or against third party claims against JHIL where Coy was primarily liable: Ex 75, p 2285. This suggestion appears to be the source of the covenant and indemnity in respect of asbestos claims ultimately included in the Deed of 16 February 2001. Again, the suggestion was made prior to JHIL receiving the JHIL Discovery Project advices of 12 January 2001 and 9 February 2001 concerning the prospects of claims succeeding against JHIL in respect of the period after 1937: Ex 81; Ex 94. It is clear from the context in which it appears that Mr Cameron's suggestion was directed towards ensuring that the directors of JHIL did not breach their directors' duties by making a gift of the shares in Coy.

5.3.18 It is also apparent from Mr Cameron's advice that:

(a) Mr Cameron understood JHIL's motivation for establishing the trust to be the avoidance of United States GAAP accounting treatment of Coy's asbestos liabilities and the consequent market perception of Newco; and

(b) if the trust were established by transferring only the net assets of Coy, JHIL's expectation was that those assets could be exhausted within 12 years (page 2286). The existence of such a belief at that time is also evidenced by Ex 92, tab 5 (Mr Robb's notes of the JHIL Board meeting of 17 January 2001) and Ex 187, tab 4; Ex 224, tab 22 (the brief to Mr Allsop SC dated 15 December 2000).

5.3.19 The trust proposal and, most likely, Mr Peter Cameron's advice, were discussed on the Project Green advisers' call of 28 November 2000 (Sydney time): Ex 75, tab 71. Mr Cameron appears to have expressed the view that JHIL directors probably could implement the trust proposal consistently with their duties to JHIL, on the basis that the shares in Coy were of little or no value. In order to advise the directors of JHIL on that issue, Allen Allen & Hemsley subsequently retained Grant Samuel to conduct a valuation of the shares in Coy: Ex 17, [108]; Ex 75, tab 82.

5.3.20 The view also appears to have been expressed, not necessarily by Mr Cameron, that there was some benefit in setting up the trust before proceeding with a scheme of arrangement in order to avoid court interference. The so called "court interference" referred to appears to be that identified in the Allens' memo which was part of the November Board Papers: Ex 61, vol 5, tab 8, p3; Ex 75, tab 62. The terms in which that view is reported in Mr Shafron's email suggest that it was regarded as a secondary benefit and it was not a benefit referred to in Mr Cameron's advice of the previous day. Someone on the call advised that a corresponding advantage to including the establishment of the trust as part of the scheme of arrangement was that doing so would allow shareholder approval to be obtained, again reflecting a concern that making a gift of Coy to the trust might involve the JHIL directors in a breach of duty.

5.3.21 PwC appear to have considered Mr Shafron's draft letter of representation by this time and advised that, under United States GAAP, there would need to be disclosure of the full range of the directors' estimate of Coy's asbestos liabilities, even if a resolution of no further support were passed and a letter of representation were provided: Ex 75, tab 71.

5.3.22 It is also likely that, during the conference call of 28 November 2000, Allen Allen & Hemsley were requested to conduct a review of transactions between JHIL and Coy over the previous 10 years. An email sent by Mr Harman on 30 November 2000 records that "in our advisers' meeting a few days back" he undertook to prepare an analysis of Coy's financial profile over the last decade: Ex 61, vol 5, tab 33, p 108. The financial profile prepared by Mr Harman was attached to his email, which was sent to JHIL's advisers including Messrs Peter Cameron, Robb and Frangeskides.

5.3.23 On 2 December 2000 (Sydney time), Mr Shafron sent a revised version of his issues paper to UBS Warburg, Allen Allen & Hemsley and PwC (Ex 17, [94]; Ex 75, tab 72) which was discussed by them on the Project Green advisers' call on 5 December 2000 (Sydney time).

5.3.24 Around 11 December 2000, PwC appear to have reached a concluded view about the accounting treatment and disclosure requirements concerning future asbestos liabilities under United States GAAP, namely that:

(a) if Coy remained in the group and no resolution were passed regarding future support of Coy, then United States GAAP would require JHINV's consolidated accounts to make provision for Coy's IBNR asbestos claims;

(b) if Coy remained in the group and a resolution of no further support were passed, then United States GAAP would require JHINV's consolidated accounts to make provision for Coy's IBNR asbestos liabilities, but only up to the amount of Coy's net assets, with a significant description as to why provision for those liabilities had been limited to Coy's net assets; and

(c) if Coy were transferred to a charitable trust in January 2001, then United States GAAP would not require provision to be made for Coy's asbestos liabilities in JHINV's consolidated accounts.

(See Ex 61, vol 5, p 118 - 122.)

5.3.25 Also around 11 December 2000, Mr Shafron prepared a draft paper setting out a trust proposa:Ex 17, [98]; Ex 75, tab 75. The proposal set out in that paper was substantially similar to the proposal which was later discussed with prospective trustee directors (Ex 75, tab 90) and was substantially similar to the proposal set out in the Board papers considered by the JHIL Board on 17 January 2001 (Ex 75, tab 95A). Under the proposal:

(a) all of the shares in Coy and Jsekarb would be transferred to an external trustee, "ClaimSure Nominees Pty Limited";

(b) ClaimSure would:

(i) hold those shares on trust for the benefit of victims of asbestos related diseases; and

(ii) manage a fund of money for medical and scientific research into asbestos related diseases;

(c) ClaimSure would be completely independent from the James Hardie group;

(d) no additional funds would be provided to Coy, Jsekarb or ClaimSure;

(e) there would be no covenant not to sue or indemnity granted in favour of JHIL.

5.3.26 The advice of Mr Allsop SC was also sought in relation to the trust proposal around this time. On 15 December 2000, a brief to advise was sent by Allen Allen & Hemsley to Mr Allsop: Ex 187, tab 4; Ex 224, tab 22. The brief recorded JHIL's objectives in establishing the trust as follows.

(a) By removing Coy from the group, to improve investors' perception of the JHIL group as a group which did not include a company with asbestos liabilities.

(b) To avoid the JHIL group being required to make provision, in its consolidated accounts, for the full extent of future asbestos claims of Coy. Reflecting PwC's advice, the brief to Mr Allsop stated that that accounting treatment would occur:

(i) when ED88 became operative for Australian companies, then scheduled for financial years ending on or after 30 June 2002; or

(ii) if the JHIL group was restructured so as to report under United States GAAP, including Financial Accounting Standard 5.

(c) To eliminate the management distraction associated with Coy's asbestos claims, allowing management to focus on the continued growth of the group's fibre cement business.

(d) To eliminate asbestos related reporting in JHIL's earnings and prevent JHIL's financial performance being distorted by the costs of asbestos related claims.

5.3.27 The brief to advise is a privileged document. It is a reliable record of JHIL's purpose in pursuing the trust proposal. Significantly, the objectives recorded in the brief make no mention of a desire to avoid court interference with, or scrutiny of, the arrangements for the separation of the group's asbestos liabilities.

5.3.28 The first question on which Mr Allsop was asked to advise was whether the directors of JHIL could transfer the shares in Coy for no consideration consistently with their duties to JHIL. Mr Allsop was also asked whether ratification by JHIL's shareholders of the trust proposal was desirable or necessary.

5.3.29 Although the proposal set out in Mr Shafron's draft Board paper (Ex 75, tab 75) did not include a covenant not to sue, Mr Allsop was nevertheless asked to advise on whether:

(a) the external trustee could covenant to procure that Coy not sue JHIL;

(b) whether Coy could covenant not to sue JHIL;

(c) whether the external trustee could indemnify JHIL against any claim made by Coy (for contribution) or by an asbestos claimant?

5.3.30 Allen Allen & Hemsley subsequently met with Mr Allsop on 20 December 2000. The notes of their conference (Ex 75, tab 83) record:

(a) Mr Allsop's advice that a fundamental assumption to the trust achieving its objectives was the ongoing soundness of *Putt's* case. The notes of conference record that Allen Allen & Hemsley were, at that time, conducting an investigation to ensure that the facts of *Putt's* case remained constant throughout the period during which Coy was involved in the manufacture and sale of asbestos products. Assuming that was the case, Mr Allsop's opinion was that the risk of *Putt's* case being overruled was remote;

(b) that Mr Allsop was of the view that the directors of JHIL could resolve to establish the trust consistently with their duties to JHIL and that it was open to them, in reaching that decision, to have regard to objectives of the type referred to above, including avoiding the consolidation of Coy into the group accounts under ED88 or United States GAAP;

(c) there was no reason why the trustee could not give a covenant to procure Coy not to sue JHIL. However, such a covenant would be of limited value once Coy approached insolvency;

(d) a direct covenant not to sue from Coy would require valuable consideration to be paid to Coy. Subject to that, there was no reason in principle why JHIL could not purchase such a covenant from Coy.

5.3.31 Mr Allsop's advice was provided to the JHIL Board with the Board Papers for the January 2001 Board meeting, sent on or around 9 January 2001 (Ex 75, tab 95A). By that time, a draft valuation of the shares in Coy and Jsekarb had been provided by Grant Samuel (Ex 17, [109]). The draft advice indicated that Grant Samuel would value the shares in Coy and Jsekarb at nil, as Mr Allsop had been asked to assume for the purpose of providing his advice. (Grant Samuel's draft advice was not included with the January Board papers but was referred to in them (Ex 75, tab 95A, p 2519) and was tabled at the February meeting: Ex 75, tab 122.)

5.3.32 Sometime between 9 January 2001 and 16 January 2001, and most probably as a result of the meeting with the prospective Foundation directors on 15 January 2001, the possibility of topping up the assets of Coy and Jsekarb prior to transferring them to the trust began to be considered.

5.3.33 On 15 January 2001, after the meeting with the prospective Foundation directors, Mr Morley had a telephone conversation with Mr Brown, a non-executive director of JHIL and the chairman of JHIL's audit committee: Morley T2003.10; Ex 121, [187]. Messrs Morley and Brown discussed the possibility of increasing the assets of Coy by a payment of $59.5 million or $59.9 million. By this time, Allen Allen & Hemsley had communicated to JHIL the initial results of their 10 year review of Coy's intercompany transactions and had identified the October 1996 dividend as the only one which "appeared unusual", although they were still completing their advice on that dividend: Morley T2004.5. The figure of $59.5 million represented the amount of the dividend, $43.5 million, plus compound interest of $16 million from 1996 to 2001: Morley T2003.57.

5.3.34 Mr Morley told Mr Brown that making such a payment to Coy would change the problems associated with the trust proposal from stakeholder concerns to the question of whether JHIL could fund the payment. Messrs Morley and Brown appear to have looked at the effect on JHNV's gearing ratios of funding a payment of $59.9 million by JHNV taking on additional external debt (Ex 121, tab 83, p 2491).

5.3.35 On the morning of 16 January 2001, Messrs Morley, Shafron and Macdonald participated in a conference call with some of JHIL's external advisers, including Mr Peter Cameron, Mr Robb, Mr Wilson and Mr Sweetman: Morley T2006.12. The possibility of increasing Coy's assets by a payment of $57.2 million by reversing or returning the 1996 dividend was discussed. Mr Morley's evidence was that Mr Cameron cautioned against reinstating the 1996 dividend, advised that it would be a "big call" to reach a view that the dividend had been wrongly paid at the time and said that it would be difficult for a court to put itself into the shoes of the Coy directors at the time the dividend was paid: Morley T2006.35-.56. That evidence is consistent with Mr Morley's note of the call: Ex 121, tab 84, p 2492. The possibility of JHIL funding any additional payment to Coy by an offering of shares in JHIL was discussed: Morley T2010.28.

5.3.36 Later on 16 January 2001, a meeting of the JHIL audit committee was held. Mr Morley's evidence was that the meeting was attended by himself, Messrs McGregor, Brown, Gillfillan, Macdonald and Shafron and Ms Hellicar: Morley T2010.51. At the meeting, Mr Morley reported on the results of Allen Allen & Hemsley's 10 year review. Mr Morley reported that the October 1996 dividend was the only transaction which had stood out as being "unusual": T2011.14. Mr Morley's notes of the meeting ("legal advice OK to pay a dividend") indicate that Allen Allen & Hemsley had advised that the dividend appeared to have been legally paid. Mr Morley informed the audit committee that reversing the dividend would bring Coy's assets to $272 million.

5.3.37 Mr Morley also reported to the audit committee on the meeting with the prospective Foundation directors of the previous day and informed them that the prospective directors wanted the trust to have a life of at least 10-15 years: Morley T2011.51. At this time, JHIL's view appears to have been that, without additional funds, the life of the trust might be as low as 12 years: Ex 75, tab 70; Ex 92, tab 4; Ex 224, tab 22, p 269 and the possibility of extending the life of the trust by reinstating the 1996 dividend was considered by the meeting. Mr Morley's note records Mr McGregor concluding that the meeting had reached a "coincidence of minds" regarding reversing the dividend: establishing a trust with assets of $275 million would be "more palatable" than with $214 million and the additional funds would satisfy the Foundation directors' desire for a life of 10-15 years: Ex 121, tab 85, p 2495).

January 2001 Board meeting

5.3.38 On 17 January 2001 (Sydney time) the Board of JHIL met to consider the trust proposal. The directors present at the meeting were Messrs McGregor, Macdonald, Willcox, Koffel, Gillfillan, Terry, Brown and O'Brien (as an alternate director for Sir Selwyn Cushing) and Ms Hellicar. Sir Llewellyn Edwards was not present at the meeting. The meeting was also attended by Messrs Morley, Shafron, Baxter, Wilson, Sweetman, Peter Cameron and Robb.

5.3.39 It is clear from the evidence before the Commission that the directors of JHIL found the issues presented by the "net assets" proposal set out in the Board papers difficult ones: Ex 80, [22]; Ex 148, [32]. The directors were aware that establishing the trust with only the existing assets of Coy and Jsekarb would mean that it would be unlikely that there would be sufficient funds to meet all future asbestos claims against those companies: Ex 148, [31]; Ex 80,[21]. Mr Robb's notes of the meeting record that Mr Macdonald informed the Board that such a fund would have a projected life of between 9 and 13 years: Ex 92, tab 5; Ex 187, tab 9.

5.3.40 On the other hand, previous advice to the Board that JHIL was not liable for the asbestos claims faced by Coy and Jsekarb was reaffirmed. It is evident from Mr Morley's notes of the meeting that the Board was advised on the circumstances in which a parent company could be held liable for the debts of its subsidiaries: Ex 121, tab 87, p 2497. Mr Morley's evidence was that Mr Shafron briefed the Board on the results of the JHIL Discovery Project and that Mr Cameron advised the Board that *Putt's* case remained good law: T2014.22-.35. That evidence is consistent with Mr Morley's notes of the meeting. Mr Morley's notes also record Mr McGregor as stating that, at the end of the day, it was necessary for the directors to have regard to what were and were not their legal liabilities: Ex 121, tab 87, p 2500.

5.3.41 In addition to the net assets proposal set out in the Board papers, the meeting discussed the possibilities of funding the trust by reversing the 1996 dividend or, alternatively, providing the trust with sufficient funds to meet Trowbridge's estimate of Coy and Jsekarb's asbestos liabilities: Ex 121, [197].

5.3.42 The difficulties associated with reversing the 1996 dividend were discussed. Mr Robb's notes of the meeting record that Mr Cameron advised the directors that it was not clear that the 1996 dividend had been unlawful and that the directors could not agree to the reversal of the dividend without establishing why that reversal was in the best interests of JHIL: Ex 92, tab 5; Ex 87, tab 9, p 36.

5.3.43 There was discussion of whether JHIL could afford to fund the trust to meet Trowbridge's estimates of future liabilities and Mr McGregor appears to have made the point that, as a result of the Watson & Hurst research, future liabilities could be up to 20% higher than had previously been predicted by Trowbridge: Ex 80, [22]; Ex 121, tab 87, p 2499.

5.3.44 Messrs Macdonald and Terry were in favour of establishing the trust with only the net assets of Coy and Jsekarb or, alternatively, their net assets supplemented by the reversal of the 1996 dividend: Ex 148, [32]; Morley T2018.12, T2019.32; Ex 121, tab 87, pp 2499, 2500. Other directors, including Mr Willcox, had not yet reached a decision: Ex 121, tab 87, p 2498.

5.3.45 Mr Willcox and Ms Hellicar expressed the view that, if it was possible for JHIL to provide Coy and Jsekarb with sufficient funds to meet Trowbridge's best estimate of future liabilities, then it would be desirable to do so: Ex 121, tab 87, p 2499; T2017.28, T2017.28.48.

5.3.46 Mr Morley's notes suggest that the possibility of legislative intervention was discussed at the meeting. However, Mr Morley did not recal that being a topic which was discussed at length: T2017.14. There was also discussion to the effect that, by setting aside a dedicated source of funds to meet asbestos claims, JHIL would be doing more than had been done by its competitors, many of whom were then in liquidation having made no provision for future claimants: T2018.28; Ex 121, tab 87, p 2499.

5.3.47 Mr Morley's notes of the meeting also record a question, apparently asked by Mr O'Brien, about whether the trust and group restructure could be implemented together: Ex 121, tab 87, p 2500. The first reason given for not doing so appears to have related to the United States registration statement to be filed by JHINV. The disadvantage of the trust arrangements being in the public arena during the scheme of arrangement appears to have been given only as an additional reason.

5.3.48 No decision was reached at the January meeting regarding the level of funding to be provided to the trust nor whether the proposal would ultimately be implemented. The consensus reached by the directors was that they should investigate whether it was possible to provide the trust with sufficient funds to allow it to meet Trowbridge's estimate of future claims:Ex 80, [22]; Ex 148, [33]; Ex 17, [132]. There is no evidence to suggest the Board's intention went beyond that. In particular, it was no longer proposed that the trust be provided with a "buffer" of funds above and beyond the actuarial estimate of future claims.

5.3.49 Following the Board meeting, there was a meeting between Messrs Morley, Shafron, Macdonald, Baxter, Wilson, Sweetman, Peter Cameron and Robb:Ex 121, [196]; Ex 224, [48]. Mr Morley's notes of that meeting (Ex 121, tab 89) record, amongst other things, that an actuarial report was to be obtained from Trowbridge. Allen Allen & Hemsley also appear to have been asked to finalise their advice regarding the 1996 dividend and to provide an advice addressing Mr O'Brien's question concerning whether the trust and scheme of arrangement could be implemented together: Ex 121, tab 88, p 2532.

5.3.50 The propositions which emerge from these events are that:

(a) the JHIL Board was independent of management, and from time to time overruled management, in particular in relation to management's restructuring proposals;

(b) the JHIL Board delayed making any final decisions until there had been a full consideration of any issue, and

(c) while there was general support for a measure of separation, there was no intention or fixed contemplation on key matters such as:

(i) whether that separation was to be absolute,

(ii) how it was to be implemented;

(iii) what level of funding there should be

at any time prior to 15 February 2001.

6. Knowledge of asbestos liabilities and costs

6.1 Knowledge of JHIL Board members

6.1.1 The sole, or at least the primary, source of the JHIL Board's knowledge of Coy and Jsekarb's asbestos litigation exposure were the asbestos litigation reports prepared by Mr Attrill and circulated by Mr Shafron prior to Board meetings as part of the Board papers: Ex 17, [159]; Ex 148, [51]. The asbestos litigation reports received by the Board members in the period March 2000 to February 2001 were the reports as at March 2000, May 2000, June 2000, September 2000 and as at December 2000. These were provided with the Board papers for JHIL Board meetings held, respectively in May 2000, July 2000, August 2000, November 2000 and February 2001: Ex 76, tabs 104–108; see also Ex 148, tab 21.

6.1.2 These reports show a pattern of rising and falling asbestos litigation costs. Putting aside legal and consultancy costs and payments received from insurance sources, Ex 17 tabs 104 and 105 (the March and April/May 2000 results) indicate a rise in litigation costs once compared to the same period in the previous year and the yearly monthly average. By contrast, Ex 17, tabs 106 and 107 (the June and July to September 2000 results) indicated a decline in costs. Exhibit 17 tab 108, the report for the three months ended 31 December 2000, indicates a substantial increase in settlement payments in comparison to the previous quarter and the yearly quarterly average. The increase was attributed to four very expensive settlements in the *Hope, Weller, Edwards* and *Turner* cases: Ex 17, tab 108, p 2600.

6.1.3 The JHIL Board did not receive copies of Trowbridge's actuarial reports. However, at the August 2000 Board meeting there was a presentation that included a summary of the conclusions in the draft June 2000 Trowbridge report: Ex 76, tab 61, pp 2087-2092. The presentation suggested that Trowbridge's projections for 1996, 1998 and 2000 had been relatively consistent (ie $249m, $254m and $263m): Ex 76, p 2087. Note that the analysis put to Mr McGregor about these numbers was mathematically incorrect: T1545.41-1546.37. As time passes, the forecast NPV of all liabilities should fall slightly, but not by the annual outlay.

6.1.4 It is relevant to note in this context that JHIL itself had very few asbestos costs. While JHIL was joined as a party from time to time, the evidence suggests that JHIL has never been found liable or settled a case concerning post 1937 asbestos activities: Ex 81, [37]–[38].

6.2 Knowledge of management

6.2.1 ***Mr Macdonald's*** knowledge of Coy and Jsekarb's asbestos claims exposure came through updates he received in the course of preparing the JHIL Board papers, and, from time to time, communications from Mr Shafron: Ex 148, [51].

6.2.2 Mr Macdonald received and reviewed Mr Attrill's Operating Plan Review (Ex 57, vol 4 , p 804ff) prior to 12 December 2000: see Macdonald, Ex 308, [36]. However, it was one of many OPRs that he received at that time and he did not review it sufficiently closely to become familiar with the figures and claims information contained in it.

6.2.3 By late January 2001, Mr Macdonald was aware that Coy and Jsekarb's asbestos liabilities for the three months to 31 December 2000 were unusually high: Ex 148, [52], tabs 18-20. Mr Macdonald also reviewed the asbestos litigation report that was included in the Board papers for the 15 February 2001 meeting: Ex 148, [57]-[58]. His evidence is that one of the directors at the meeting asked:

> Is there anything in these figures which causes management to reconsider its view that the proposed funding is sufficient to meet anticipated claims?

To which Mr Shafron responded:

> No. We asked David Minty that and he said that a couple of quarters of data was not going to shift a 10 year curve.

Mr Macdonald's evidence is that it was consistent with his experience that significant increases in claim costs were followed by significant decreases in subsequent periods: see Mr Macdonald's supplementary statement dated 12 July 2004, [33]. Mr Macdonald believed the increase to be part of a well-observed historical pattern of fluctuations. In the 26 January to 16 February 2001 period he believed that the unusually high figure for the December 2000 quarter was just an aberration or statistical "outlier": Ex 148, [57].

6.2.4 ***Mr Shafron's*** primary source of knowledge of Coy and Jsekarb's asbestos costs and liabilities were Mr Attrill's asbestos litigation reports and ad hoc discussions he had with Mr Attrill: Ex 17, [160]. He also had reviewed Trowbridge's reports. Through his examination of the litigation reports, Mr Shafron was aware, as at November 2000, that in the six month period to 30 September 2000, cost figures were in line with the same period in the previous year: Ex 17, [161].

6.2.5 Like Mr Macdonald, Mr Shafron also received a copy of Mr Attrill's OPR on about 12 December 2000: T1738.38. He received some additional information on 10 January 2001, but may not have read it: Ex 54, vol 4, p 904; T 1742.40.

6.2.6 In mid January 2000, Mr Shafron viewed the report for the quarter ended 31 December 2000, and became aware that litigation costs for this quarter were unusually high: Ex 17, [162]. The information on which this awareness of the increased costs for the December quarter was based, was supplemented by information contained in emails from Mr Harman and Mr Macdonald: Ex 17, [163]-[164]; Ex 17, tabs 109-10.

6.2.7 Mr Shafron considered the December 2000 quarter figures to be a statistical outlier, attributable to four unusually expensive settlements ("lightning strikes") in that quarter:

Ex 17, [165]; T1419.8; 1709.25. These four “lightning strike” claims are identified in the asbestos litigation report which went before the 16 February 2001 JHIL Board meeting: Ex 17, tab 108.

6.2.8 Mr Shafron was also conscious that Mr Attrill’s litigation reports were prepared on a cash flow basis and therefore it was possible for insurance recoveries in respect of claims paid (and reported) in one quarter to be received (and reported) in the following quarter: Ex 17, [166].

6.2.9 So far as Mr Shafron was concerned, in January and early February 2001, he had seen nothing in the recent data that was out of line with the broad past trends of James Hardie’s asbestos liabilities: T1709.46. He gave the following evidence (T1745.12):

> Q. Just while you have that [Ex 43, p 904] there, do you want to think again Mr Shafron, about your evidence, that you didn't believe at this time, January/February 2001, that James Hardie's asbestos experience was on a deteriorating trend?
>
> A. I think December was a bad quarter, and it was looking that January was a bad month, but I think that I was still of the mind that the litigation costs had been around 20 million, less sometimes. I was conscious that there had been years where costs were less in the year after, the year before, if you know what I mean, the costs had gone down in the year and that had happened a few times, so I think I was in a state of mind that said if you have your ups and downs, and that we knew that the early part of 2000, or calendar 2000, was down, but that I don't recall feeling that there was a serious deterioration going on.

6.2.10 ***Mr Morley’s*** knowledge of asbestos costs and liabilities had a similar source (although, like Mr Macdonald, he did not see the Trowbridge reports for 1996, 1998 and 2000, for reasons connected with legal professional privilege: T2159.23). He too had access to the asbestos reports provided to the Board and obtained information (such as the OPR as at 30 September 2000 and litigation cost reports: Ex 54, pp 803, 904) from Mr Attrill. He gave this evidence (T2027.46):

> A. Well, the company had experienced variability over many years in asbestos payments. In that nine-month period to December 2000, there were, I think, from memory, about four or five large and unusual claims - one of which in particular occurred in April of that year. I recall a case called Judawich which was settled for about three million, and then in the second quarter, which is a June quarter for us, a claims experience - September quarter, we've gone down, and then in the final quarter there was a - about four, I think, from memory, four or five large cases settled. I'm going to say around about half million to 600,000 each. So I - I didn't put any more store in it than that, that there was some unusual large settlement cases.

His position is essentially similar to that of Mr Macdonald and Mr Shafron.

7. Dealings between Trowbridge and JHIL and Coy between February 2000 and February 2001

7.1 Draft June 2000 report

7.1.1 JHIL had obtained actuarial reports from Trowbridge about the prospective asbestos liabilities of Coy and Jsekarb as at 31 March 1996 and 31 March 1998: Ex 76, tabs 47 and 48. On about 9 March 2000, Mr Shafron asked Mr Attrill to make arrangements to obtain a fresh Trowbridge report: Ex 17, [64]; Ex 56, [31].

7.1.2 Mr Attrill contacted Mr Minty. Trowbridge was formally retained by a letter from Allens dated 10 March 2000: Ex 50, tab 2. Mr Attrill immediately proceeded to provide information to Trowbridge from JHIL's accounting database as well as other information and data as requested from time to time by Trowbridge: Ex 56, [33]-[39], [44]. Starting in about May 2000, Trowbridge began to provide Mr Attrill with drafts of parts of their report. Over a period of about a month, the report went through several drafts. There were emails, facsimiles, meetings and telephone calls, which reflected dealings between JHIL (Mr Shafron and Mr Attrill and Trowbridge (Mr Minty and Mr Marshall): Ex 56, [49]-[55]; pp119-751. Mr Shafron and Mr Attrill gave extensive comments to Trowbridge and made various suggestions about the content of the report. Some of the suggestions were accepted, others were not.

7.1.3 On or about 16 June 2000, Trowbridge provided the last draft of their report: Ex 76, tab 52. It was not signed and was marked "draft". It was addressed to Mr Williams of Allens and was marked "confidential and legally privileged". The report showed a present value of projected potential exposure for known and potential asbestos-related claims as at 31 March 2000 of $294m. Mr Wilkinson's evidence is that he would have assessed the liability to be $539.7m rather than $294m: Ex 252 (see section 14 below). JHIL had no reason to think that the Trowbridge number was unreliable.

7.1.4 In mid 2000, one option that was actively considered by JHIL was the purchase of insurance to cover the asbestos liabilities of Coy: Ex 16, [65]. With Mr Minty's consent, the June 2000 report was provided by JHIL's insurance broker (JLT) to a number of global reinsurers in June and July 2000: Ex 76, [74]. The results of JLT's (still incomplete) investigations were presented to the JHIL Board in August 2000: Ex 76, [76], tab 56, pp 1806-1810.

7.2 Watson and Hurst

7.2.1 On 29 November 2000, Mr Watson and Mr Hurst, both actuaries form Trowbridge, presented a paper to the Accident Compensation Seminar of the IAAust. The presentation updated Trowbridge's existing models for projecting asbestos related disease claims in

Australia taking into account increases in claim numbers and amounts and developments in epidemiological studies in Australia and elsewhere: Ex 50, [26]. A copy of the presentation was posted on Trowbridge's website.

7.2.2 On 1 December 2000, Mr Minty informed Mr Attrill of the Watson and Hurst presentation by email: Ex 56, [62]. Shortly afterwards, Mr Shafron circulated a copy of the Watson and Hurst presentation to Mr Macdonald, Mr Morley and Mr Baxter: Ex 56, vol 4 p 767. Mr Shafron noted that:

> Existing reports based on the Andrews study (eg Trowbridge reports) are now out of date and would seem to require an up tick factor of at least 40%.

The figure of 40% is the increase in reserving against “A&A High” that was suggested in the presentation: Ex 121, tab 91, p 2557.

7.2.3 Mr Macdonald and Mr Shafron were unhappy that Trowbridge had published the report without giving advance notice to JHIL: Ex 17, [134]; Ex 56, p 795. Mr Macdonald, reasonably, would have liked an opportunity for JHIL to consider the presentation and its possible ramification for JHIL before the report went public, so that JHIL could respond appropriately to questions that might arise for the company from the report.

7.2.4 On 4 December 2000, Mr Minty and Mr Attrill had a telephone conversation: Ex 56, [67]. Mr Minty explained the material in the Watson and Hurst presentation in general terms: Ex 50, [28]. Both Mr Attrill and Mr Minty reported about the content of the conversation by means of internal emails shortly after the conversation concluded: Ex 56, p 801; Ex 50, tab 11. Mr Attrill reported that Mr Minty said that as for the impact on the James Hardie estimate, you could not just increase the figure by 40% as suggested by the report. Mr Attrill told Mr Minty that he would get back to him if JHIL wanted any further work done.

7.3 The February 2001 Report

7.3.1 There was a meeting between Mr Shafron, Mr Morley, Mr Attrill, Mr Robb and the prospective incoming directors on 15 January 2001 (the dealings between JHIL and Coy and the incoming directors are dealt with in section 9 below). During the course of the meeting, Mr Shafron agreed that JHIL would provide the prospective directors with an actuarial report from Trowbridge. Mr Shafron believed that the directors were concerned to see some evidence that the funds would meet the 10 to 15 year criteria specified by Mr Gill: Ex 17, [122]; (T1600.19). This belief is supported by the contemporaneous notes taken at the meeting: see [9.3] below.

7.3.2 On 16 January 2001, Mr Shafron spoke with Mr Attrill and said that, as Mr Attrill knew from the meeting on 15 January 2001, the prospective directors required an updated Trowbridge report: Ex 56, [105]. Mr Shafron asked Mr Atrrill to contact Mr Minty. Mr Attrill’s evidence is that he asked Mr Shafron if a fresh “data dump” was necessary and that Mr Shafron said that it was not necessary, that the March 2000 data would be used but Trowbridge would be asked to update the claim numbers having regard to the Watson and Hurst presentation. Mr Shafron did not recall this conversation: T1706.42; T1713.25. Mr Attrill spoke with Mr Minty on 16 January 2001: Ex 56, p 956. He arranged a briefing meeting for 23 January 2001. Mr Attrill's note of the conversation indicates that Mr Minty said that Trowbridge:

> Can run with the data we have.

7.3.3 On 17 January 2001, Mr Shafron spoke to Mr Attrill during a break in the JHIL Board meeting and told him that the Board wanted to slow the pace and that there was no need for Mr Minty to carry out the further review: Ex 56, p958. Mr Attrill passed that on to Mr Minty: Ex 56, p959. However, on 18 January 2001, Mr Shafron reversed his previous instruction and asked Mr Attrill to arrange a meeting with Mr Minty as soon as possible: Ex 56, p 960.

7.3.4 The JHIL Board had been told about the Watson and Hurst study and were informed that the new work meant that the Trowbridge number was likely to increase, and could be as high as $350m: see Ex 56, p 960. That figure was very roughly based on the Trowbridge June 2000 figure, less the value of the QBE receivable plus 40%: T1599.13. The JHIL Board asked management to find out what the revised Trowbridge figures would be and see if there was a way that the company could meet the number: T1421.21-.31. From 18 January 2001, the purpose of the new Trowbridge retainer was twofold. First, it was required in order to undertake the analysis that was requested by the Board on 17 January 2001. Second, it was required in order to provide the incoming directors comfort that the fund would last for 10 or 15 years: T1421.31-.40.

7.3.5 On 19 January 2001, there was a meeting between Mr Shafron, Mr Morley, Mr Attrill, Mr Minty and Mr Marshall. There is conflicting evidence about what was said at this meeting.

7.3.6 Mr Shafron's evidence is that JHIL wanted Trowbridge to value projected asbestos related cashflows for Amaca and Amaba for periods of 10, 15 and 20 years, and at a range of different discount rates. He said that there was a conversation about data as follows (Ex 17, [140]; T1416.3):

[Me]:	We have a current report from you which uses March 2000 claims data. Will you need to see more recent claims data to do this work?
Mr Minty and Mr Marshall:	I don't think so. When you have 10 or more years of data, you've got a lot of data points to draw your trend lines. It would be unlikely that an additional short period of data would make much difference.

7.3.7 Mr Minty and Mr Marshall also said (Ex 17, [144]):

> What we will do is look at the historical claims data for Amaca and see how well it fits the industry data that has been collected in the Watson and Hurst report from insurers and the like. You see, the Watson and Hurst report is based on claims from a number of different

defendants and they may on average have ceased asbestos related activities before or after Coy and Jsekarb. It may be that because of things like the time of first exposure and the historical latency periods for the Coy data, the Berry high model is appropriate or it may be that Berry medium is appropriate. It will all depend on how the Coy data fits with the data underlying the Watson and Hurst models.

7.3.8 Mr Shafron understood that Trowbridge would look at the Amaca and Amaba data up to 31 March 2000 having regard to the new learning from Watson and Hurst's study and determine which model best fitted the Amaca and Amaba experience: Ex 17, [145]. In other words, they would re-populate the data on the new curves: T1418.19.

7.3.9 Mr Morley gave evidence of a conversation as follows (Ex 121, [203]):

Mr Shafron:	Could you update your June 2000 report to take account of Watson and Hurst: Do we need the latest claims data to do that?
Mr Minty:	I've got ten years of data. A couple of quarters won't make that much difference.
Mr Shafron:	The data is pretty much in line with what you have looked at before. Could we have a revised report as soon as possible covering 20 years?

7.3.10 Mr Morley denied that Mr Minty asked for James Hardie's up to date claims information: T2195.30, 2196.10. Mr Morley's understanding was that Trowbridge would move from the Atkins and Andrews curves to the Watson and Hurst curves and that movement would incorporate a higher number of claims over a longer period, and that would compensate for any data not used in the period since 31 March 2000: T3031.24. Mr Morley could not recall Mr Minty saying that "James Hardie meso numbers have levelled off recently": T2241.42. Mr Morley's understanding of what Trowbridge were to do was similar to Mr Shafron's (T2242.32):

My recollection is that the actuaries were going to try and fit the James Hardie experience to this pattern or incorporate in their thinking the Berry medium and Berry high pattern.

7.3.11 Of all the persons at the meeting, Mr Morley was least familiar with Trowbridge's work and with the data issues. At that time he had not seen the earlier Trowbridge reports, on the basis that they were privileged: T2159.20-.33. Mr Shafron and Mr Attrill had conducted all recent communications with Trowbridge as at January 2001 and it was the first time that Mr Morley had met them: T2239.57.

7.3.12 Mr Attrill took a note of the meeting: Ex 56, p 070. It is apparent that Mr Minty provided an explanation of the Watson and Hurst study. The note suggests that Mr Minty said:

JH meso numbers have levelled off recently – so Berry medium may be the best line for JH. JH may have had different exposure to the rest of the community.

7.3.13 Mr Attrill could not recall Mr Minty raising the subject of the intervening data: T1007.51. He denied that there was a conversation about the data since March 2000 or about

Trowbridge requiring the data: T1006.37-.55; T1137.1-.30. Mr Attrill's evidence is that Mr Minty indicated that Trowbridge was prepared to do a report on the basis of James Hardie data up to 31 March 2000 and updated by reference to the Watson and Hurst learning: T1009.25. This is inconsistent with the proposition that Mr Minty asked for the most recent data. Mr Attrill's notes also record:

> Keep claims $ to 2 yearly reviews.

7.3.14 This too indicates that the Trowbridge contemplated that its report was to be prepared without updated James Hardie claims data. Mr Attrill also denied that the comment that meso numbers have levelled off recently was a reference to the current experience: T1007.17. That makes sense, because Mr Minty did not have that data. Mr Minty was speaking of the numbers as at 31 March 2000: T1136.14. During cross-examination, Mr Attrill also gave the following evidence (T1010.11-.44):

> Q. Did you at any stage think about volunteering the information which was in your possession, whether asked for or not, to Trowbridge, summarising the intervening data up to the end of December or the end of January?
>
> A. Not really because I actually recall thinking at the time that the uplift figures that were identified in Watson and Hurst was so large, that the claims experience that I was seeing coming through in the figures would be easily accounted for in a Watson and Hurst upgrade, so at the time, I felt that this was a reasonable approach to producing an updated figure.

7.3.15 Mr Attrill could not remember Mr Shafron saying that the data is pretty much in line with what Trowbridge had looked at before: T1138.15. Mr Attrill also gave evidence as follows:

> Q. Did you ever say to Mr Minty or Mr Marshall that it was not possible to produce to either of them records in relation to claims experience post 31 March 2000?
>
> A. No, I don't believe I did.
>
> Q. Did you ever hear in your presence Mr Morley or Mr Shafron say that to either of those gentlemen?
>
> A. Not that I recall, no.
>
> Q. Did you ever say to either of those gentlemen that you were unable to produce that information because Mr Andrew Kerr was not available to you to assist?
>
> A. No, I did not say that.
>
> Q. If you had made such a statement, would it have been a false statement?
>
> A. Yes.
>
> Q. Did you hear Mr Morley or Mr Shafron make a statement to that effect in your presence?
>
> A. No.

7.3.16 Mr Minty gave evidence that he asked for James Hardie's up to date claims information and that Mr Shafron said that James Hardie was unable to get the data to Trowbridge in the time available, and further that Mr Shafron said that there was not anything in the data that would affect the results: Ex 50, [31]. His oral evidence was that it was his experience that it usually took a week to a couple of weeks for James Hardie to produce data from its database: T680.57. He also said that either Mr Attrill or Mr Shafron said that Mr Kerr was unavailable and so it was not possible to extract the information: T681.2. Mr Minty's evidence was shown to be unreliable. He conceded that it is possible that he could be mistaken: T790.50. It was demonstrated that in fact James Hardie had previously supplied information within the period of a few days: T795.31; T812.55. Mr Minty made the following significant concession:

> Q. Mr Minty, you were provided with all of the information that you sought in March which was information you described to Hardies as information you required?
>
> A. Yes, that's correct.
>
> Q. And I suggest to you that in January and February 2001, you didn't ask for this sort of information because you believed that you had sufficient information to establish trends to which you could apply the revised Berry medium and Berry high curves--
>
> A. We had--
>
> Q. --do you agree with that?
>
> A. I agree with that statement.

7.3.17 That is, Mr Minty conceded that he did not ask for the information because he thought he had sufficient information. Subsequently, Mr Minty said that he did ask for up to date data: T813.15. Mr Minty's evidence on this topic is inconsistent and unreliable. It should be disregarded. Mr Minty accepted that it was his view and he said at the meeting that 6 to 9 months data was unlikely to make any statistical difference: T806.38-.46.

7.3.18 Mr Marshall gave evidence that Mr Minty asked whether James Hardie will be able to provide updated claims information and that Mr Shafron said (Ex 54, [11]):

> No, we'd like you to up-date the numbers based on the March 2000 data.

7.3.19 Note that Mr Marshall read Mr Minty's statement before preparing his own: T867.30; T912.33.

7.3.20 It is also important in this context to draw in another piece of evidence. Mr Attrill's evidence is that he has a vague recollection of speaking with Mr Marshall in late January or early February 2001 about the deterioration in Coy's claims and expenditures in the year ended 31 March 2001: T977.25-.45; T1009.28-1010.9. Mr Marshall confirmed that the conversation occurred. He could not recall specifically what Mr Attrill had said other than (T852.31; T910.40-911.8):

> it was high level that the numbers had deteriorated and I recall that it was specifically reference to the December quarter, per quarter.

7.3.21 Further, Mr Marshall agreed that the high probability is that he would have communicated the information to Mr Minty, although he cannot specifically recall doing so: T911.31-.39.

Mr Minty's evidence is that it was not his understanding in the period from 16 January 2001 to the date the report was presented on 13 February 2001 that there was evidence of a deterioration in the claims experience since March 2000: T791.12; T799.43. This evidence should not be accepted. His evidence on this subject was, as noted above, shown to be unreliable. There can be no doubt that Mr Marshall was told (which shows that there was no great secret about it) and, as Mr Marshall agreed, the probability that Mr Marshall communicated the fact to Mr Minty is high. The reason why Mr Minty did not take the matter further, including with the directors of the Foundation, was because he believed (as did Mr Shafron, Mr Morley and Mr Attrill) that the deterioration was accounted for in the revised model that was being used. Mr Minty agreed that that was the only possible explanation: T799.45-800.3.

7.3.22 In terms of timing, several things are clear:

(a) On 18 January 2001, and afterwards, it was Mr Shafron's desire for the Trowbridge report to be prepared quickly.

(b) At that time, it was possible for JHIL to supply a great deal of data almost instantly from its database.

(c) Mr Shafron believed, based on past experience, that if Trowbridge were to undertake a full study, as they had in 1998 and 2000, the report would take about 3 months to prepare: T1419.31. He said that in 1998 and 2000 (T1419.55):

> there was quite a lot of toing and froing and checking of data and verifying data and things of that kind.

7.3.23 The toing and froing, checking and verifying is no doubt what is meant by making the numbers "clean": T1714.46-1715.19. Before data can properly be used in a model, it is common sense that it is essential to be confident that the data is complete, accurate, consistent and precisely in a form to be used. The word "clean" in this context should not be seen as casting a slur on data that is not clean, ie dirty. It is simply a reference to the fact that the data for a model must be in a proper form. The process of cleaning data is one that requires the detailed input from the actuary (or the person running the relevant model). In January 2001, the only data that had been cleansed by Trowbridge was the data up to March 2000. Mr Shafron was undoubtedly correct when he believed in January 2001 that it would probably take Trowbridge quite some time to prepare a full report based on data up to 31 December 2000.

7.3.24 Mr Shafron hoped that the proposal to use the March 2000 data, but updated to take into account the Watson and Hurst study, would provide a mechanism by which a useful and reliable report could be produced within the time frame JHIL had in mind for the transaction. His evidence is that it was a matter for the expert, Mr Minty, to determine whether the exercise was a suitable one. He said that he would have accepted Mr Minty's advice that he could not prepare a report without the data, if that advice was given: T1712.55-1713.11. That was a reasonable approach.

7.3.25 The following conclusions should be drawn having regard to the evidence:

(a) Trowbridge agreed to provide cash forecasts for 10, 15 and 20 years based on discount rates of 6, 7 and 8%, based on the March 2000 data and updated to take into account the Watson and Hurst study.

(b) It was Mr Shafron's preference for Trowbridge to proceed based on the March 2000 data, but ultimately it was a matter for Trowbridge to advise about whether that would provide useful forecasts.

(c) Mr Minty and Mr Marshall were asked whether they needed the updated data but said that they did not because it was unlikely to make a statistical difference.

(d) There was no attempt to withhold information from Trowbridge.

(e) Notwithstanding Mr Morley's evidence, it is unlikely that Mr Shafron said anything to suggest that Coy's most recent experience liability was flat. Mr Morley's recollection of what Mr Shafron said ("the data is pretty much in line with what you have looked at before") might be incorrect or out of context. If Mr Shafron had said something that was untrue, Mr Attrill would have known at once and would not have permitted the mistake or falsehood to go without remark.

(f) There was no secret in the recent Coy experience. Mr Marshall was told that there had been a deterioration in the December quarter. The strong likelihood is that this was passed on to Mr Minty. There is no suggestion that in light of this information, either Mr Minty or Mr Marshall had queried anything said to them on 19 January 2001. Nor did they change the course taken in respect of their report. If they had thought that a deterioration mattered for the task that they had undertaken, they surely would have said or done something about it. (In a different context, the same information was provided to the incoming directors by way of the presentation on 15 January 2001 and was emailed to Mr Bancroft on 5 February 2001 (Ex 95, tab 22) and was provided to Mr Cooper in the Operating Plan Review.)

(g) Everyone expected the results of the revised report to show a strong increase in the projected liability forecasts. In terms of Trowbridge's assignment, no-one was troubled by the recent deterioration in the Coy experience because they believed that was consistent with what would flow from the application of the Watson and Hurst findings to the James Hardie March 2000 data.

Issue 5

5. *The February Report was, at the request of JHIL, prepared without reference to the Current Data. Some evidence suggests that Messrs Minty and Marshall wished to have, and asked for, the Current Data for the purposes of preparing the February Report. Other evidence suggests that Mr Minty or Mr Marshall said that the Current Data was not required, or would not make any difference to their report.*

   (a) *What evidence as to the circumstances resulting in the non-inclusion of the Current Data in the February Report should be accepted?*

   This question is dealt with above.

   (b) *Would the Current Data have affected the estimates in the February Report, and if so, to what extent? In this regard, there is evidence that:*

      i) *Trowbridge, with knowledge of the Current Data, would have increased its estimated 20 year NPV from $286 million to $373 million and the total (50 year) NPV from $322 million to $437 million (in each case, with no allowance for super-imposed inflation) (see Ex 50, pg 338; see however Wilkinson, Ex 252, pages 77-84);*

      ii) *KPMG, with knowledge of the Current Data, would have increased its estimated NPV from $694.2m to $1044.5m (in each case, with super-imposed inflation at 2%) (Ex 252, pg. 86).*

   The evidence of Mr Wilkinson should be accepted on this issue.

   (c) *To what extent, if at all, was JHIL influenced to ask Trowbridge to prepare the February Report by reference to the data as at 31 March 2000 by:-*

      i) *a concern that this reference to the Current Data would unduly delay completion of the report;*

      ii) *a belief that data after March 2000, or perhaps June 2000, was not "clean"?*

   To the extent indicated above.

Issue 7

7. *The February Report does not appear to have:-*

   (a) *allowed for US litigation costs and settlements, remediation claims, exemplary and punitive damages, Dust Diseases Board reimbursement claims, and the risk of change in the medical or legal environment;*

   (b) *made full allowance for so-called "third wave" or "downstream" claims;*

   (c) *provided for further increases in propensity to sue.*

To the extent that such matters were not allowed for:-

(d) Having regard to the actual purpose for which the February Report was intended by JHIL to be used, and was in fact used, should allowance have been made for such matters?

To the extent sugggested by Mr Wilkinson.

(e) Would allowance for such matters have made any difference of significance to an assessment in February 2001 of the liabilities of Coy and Jsekarb or the likely longevity of the MRCF?

No.

Issue 8

8. Evidence has been given that at the meeting on 19 January 2001, Mr Minty said words to the effect that James Hardies' mesothelioma numbers had levelled off recently.

(a) Was this an accurate statement of James Hardie's mesothelioma claims experience as at January 2001?

With the benefit of hindsight, no.

(b) If not:-

i) Were the executives of JHIL who were present on 19 January 2001 aware of this?

ii) Ought they have been so aware?

iii) Did they at any time communicate an accurate statement of the current position to Trowbridge?

iv) If not, why not?

v) Was the omission deliberate?

The evidence is a handwritten note. The circumstances in which that particular note was made are unclear. What is clear is that Trowbridge was aware that recent claims experience had deteriorated. Mr Marshall said so in evidence. It appears to have been assumed, reasonably but wrongly, by those involved that the deterioration was an "outlier" which was consistent with normal fluctuations. There can be no question that information was deliberately withheld. The most recent claims data was presented to the incoming directors and their solicitors were given a copy of that presentation. That occurred before the incoming directors met with Trowbridge. That conduct is completely inconsistent with a deliberate intention to withhold information from Trowbridge.

8. Preparation of cashflow models and analyses presented to incoming directors and JHIL Board

8.1 Way in which cashflow models developed

8.1.1 The cashflow model had its origins in some work that Mr Harman was asked to do in September 2000. Mr Harman was asked to determine the level of funding that would be required from the "New World" to ensure the solvency of the "Old World": Ex 68, [14]. Mr Harman used material from Trowbridge's June 2000 report to perform his analysis (Ex 68, tab C), which is found at Ex 68, tab D.

8.1.2 A further model of cashflow from the perspective of "JHIL Group, ex Coy" was circulated by Mr Harman to various internal managers (Mr Morley and Mr Shafron) and external advisors (Mr McClintock, Mr Sweetman and Mr Sheppard) by email on 18 December 2000: Ex 121, tab 68. This model compared "separation" and "no-separation" scenarios and did not contemplate supplementary payments to Coy of the former scenario: Ex 121, [162]-[165].

8.1.3 In early 2001, the cashflow model underwent a number of iterations. A revised model went from Mr Harman to Mr Shafron and was copied to Mr Morley, Mr Cooper and Mr Sweetman on 4 January 2001: Ex 121, tab 75 and [175]. On 7 February 2001, Mr Harman sent a revised model to Mr Morley: Ex 121, tab 98. This was the first version that included data that had been supplied by Trowbridge pursuant to Trowbridge's January 2001 retainer; it included analysis based on Berry High, Berry Medium and Current projections and assumed indemnity or other payments to Coy. It considered pre-tax earnings rates of 10%, 12.5% and 15%.

8.1.4 Trowbridge provided some revised projections on 9 February 2001: Ex 121, tab 99. The revised projections and some other matters were taken into account by Mr Harman in a further revision of the model, which was circulated to Mr Shafron, Mr Morley and Mr Macdonald on 9 February 2001 (in Sydney): Ex 121, tab 100. A further model was sent about 2.5 hours later (Ex 121, tab 101) and another was sent to Mr Cowper and Mr Sweetman after a further 4 hours or so (Ex 121, tab 102). Another version was circulated a few minutes later to Mr Cowper and Mr Sweetman (copied to Mr Shafron, Mr Morley and Mr Macdonald): Ex 121, tab 103. Yet another version was sent by Mr Harman to Mr Morley and Mr Shafron and others early on 13 February 2001 (California time): Ex 121, tab 105.

8.1.5 On 13 February 2001 at 4.38pm (California time), Mr Harman sent to Mr Morley and Ms Seddon a revised model, which combined the position of Coy and Jsekarb and allowed a sinking fund of $1m per annum: Ex 121, tab 108. This version of the model was reviewed by PwC and Access Economics (see below).

8.1.6 A version of the cashflow model (showing cashflows out to 20 years) was presented by Mr Morley to the incoming directors on 13 February 2001: Ex 121, tab 107 and [227]. That model showed the cashflows with earnings rates of 10.65% and 13.70%. On 14 February 2001 at 8.50pm (California time), Mr Harman sent to Mr Cooper (copies to Mr Morley and Mr Shafron), an additional cashflow analysis with an earnings rate of 11.70% and an additional sensitivity analysis: Ex 121, tab 110. That was sent following a request by Mr Cooper: Ex 121, tab 109.

8.1.7 A copy of the model, together with a list of assumptions and sensitivity analysis was tabled at the JHIL Board meeting on 15 February 2001: Ex 75, tab 121; Ex 121, [236], tab 112. Copies of the model were sent by email to Board members who were overseas: Ex 121, tab 116.

8.1.8 At sometime between 13 and 15 February 2001, Mr Jollie asked for a copy of the cashflow model using an earnings rate of 7%. Mr Harman produced such a model and Mr Morley's evidence (which was not challenged) is that a copy was provided to Mr Jollie on the evening of 15 February 2001: Ex 121, [269], tab 128. That model showed cashflows to 50 years. Mr Jollie's evidence is that he does not recall seeing it and does not believe that he did. Mr Jollie is likely to be mistaken. Given the undoubted fact that Mr Jollie asked for a cashflow using 7% and given the handwritten annotations on the document, it is overwhelmingly likely that Mr Jollie was shown the model on 15 February 2001 and that he has now forgotten that he saw it.

8.1.9 A further cashflow model was generated at Mr Morley's request on 19 February 2001: Ex 121, [275], tab 129.

8.2 Elements of the cashflow model

8.2.1 In broad terms, the cashflow model simply made a forecast of the money coming into and out of Coy and Jsekarb over 20 years or 50 years: cash came in from various sources over various periods of time, including the payment of principal and interest by JHIL (and other intercompany payments), from the payment of the indemnity sum, from the QBE receivable, returns on investments, from rent and from the disposal of real property. Cash flowed out because of the asbestos liabilities and from running costs. Some of the cashflows were fixed by agreement (eg the intercompany loans, the indemnity payments and the QBE receivable). Other elements required estimation (eg the rent, the prices that properties would achieve, the movement of running costs). These elements were refined as successive iterations of the model were produced.

8.2.2 Mr Harman agreed that two critical elements in the model were the Trowbridge estimates of the future cashflows for liabilities (T1296.36) and, to a lesser extent, the assumed earnings rate (T1296.38). The earnings rate was relevant to the anticipated returns from the investments that were expected to be made by the Foundation. Mr Harman agreed with the proposition that the other elements were operating at the margins (T1297.8), as did Mr Morley (T2245.20).

8.2.3 In the cash flow model presented by Mr Morley to the Board meeting of 15 February 2001, the assets of the Foundation as at 31 March 2001 were shown to be $187,603,000 (Ex 121, vol 7, tab 116, p 2894). That figure excluded the value of future payments to be received from JHIL under the Deed of Covenant & Indemnity (having a present value of around $73 million) and from QBE under the terms of the 1998 settlement (having a present value of around $30 million). The assets of $187,603,000 comprised:

	($000)
Property, Plant & Equipment	66 423
Loan to JHIL	70 000
Investments	51 180
	187 603

8.2.4 Of those amounts, the assumed earnings rate of 11.7% pa applied only to the investments of $51,180,000. Income on the Foundation's other assets was not calculated by reference to the assumed earnings rate but was modelled using the actual income which would be received by the Foundation: rent under the leases with James Hardie Australia Pty Limited, in the case of Property, Plant & Equipment; and interest under the Loan Deed at 2.5% pa above the bank bill rate (BBSW), in the case of the loan to JHIL. Payments due from QBE and from JHIL under the Deed of Covenant & Indemnity were modelled using the amounts actually due (Morley T2245.2-.16).

8.2.5 As a result, only the following amounts in the model were subject to the 11.7% pa earnings rate assumption in the years ended 31 March 2002, 2003 and 2004:

	($000)
YEM02	51 180
YEM03	50 668
YEM04	64 597

8.2.6 The table below compares the interest which would be earned on those amounts at 11.7% pa and 7% pa (the lowest rate mentioned by Mr Minty).

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

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

8.3 Manner in which earnings rate determined

8.3.1 Mr Morley had primary responsibility for consideration of the earnings rate that was to be used in the cashflow model. Mr Morley reviewed data published by Towers Perrin, Mercer Investment Consulting and InTech on the historical rates of return achieved by equities, pooled funds and superannuation funds. The Towers Perrin survey recorded average annual after tax rates of return over a 10 year period ranging from 9% to 14.9% for various classes of funds: Ex 121, tab 120, [251]. The Mercer survey recorded an average annual after tax rate of return of 10.7% for a group of 28 Australian pooled funds: Ex 121, tab 122, [252]. The InTech survey recorded an average annual after tax rate of return of 11.7% for a group of 14 pooled funds over a period of 15 years: Ex 121, tab 122, [253]. In addition, Mr Morley considered historical data on long term returns achieved by various indices of relevance to investors provided by UBS Warburg: Ex 121, tab 123 – note the data was provided prior to 15 February 2001; Ex 121, [254].

8.3.2 One of the assumptions in the cashflow model was that there would be no taxation liability over the life of the fund: Ex 68, tab H. That assumption was based on advice obtained by PwC Sydney Tax Services and has not been challenged as an appropriate assumption: Ex 68, [47]. It was appropriate therefore to run the model using a pre-tax rate of return. The rates of return used for comparison purposes were all after tax rates of return and, for the purposes of comparison, it was necessary to make an allowance for taxation. Mr Morley's evidence (which was not attacked) is that the 11.7% rate of return used in the final version of the model (Ex 68, tab H) was equivalent to an after tax rate of return of 7.6% (this assumes a tax rate of 35%): Ex 121, [257], [261]. That rate was very low compared with the rates being used for comparative purposes. The other rate used in the model (14.55%) was equivalent to an after tax rate of return of 9.5%, which was generally in line with the historical comparables: Ex 121, [262], [263]. It was these comparisons that led Mr Morley to the conclusion that the earnings rate of 11.7%, as used in the model, was conservative: Ex 121, [264]. Mr Harman also formed the view that the rates were within a reasonable range: T1309.37.

8.3.3 Mr Harman was asked, probably by either Mr Morley or Mr Shafron, to identify an earnings rate that would ensure that the fund would live through the entire 50 years: Ex 68, [48]; T1267.34. To find the answer required running the model with different earnings rates, to determine which rate just permitted the fund to have positive assets after 50 years T1268.13-.32; T1269.13. The number produced was 11.7%. That number was then tested, as described above, to see whether it was a reasonable rate. Mr Morley concluded that it was a conservative rate. It is true that the process did not proceed by first posing the question: "what is an appropriate earnings rate?" Rather, the rate of 11.7% was identified first and then it was tested for reasonableness. There is nothing wrong with the method that was used. It demonstrates that management were striving to produce a fund that could properly be said to be fully funded.

Issue 18

18. The evidence suggests that the future earnings rate assumed in the cash flow model developed by JHIL in connection with the separation proposal was, after the Trowbridge projections of costs, the most important assumption in the model. There is evidence that it was derived from the model, as a calculation of the rate necessary to keep assets in the MRCF subsidiaries until all the Trowbridge "most likely" projected claims were paid. It was then judged for reasonableness by reference to historical data, that is, after tax returns over 3 month to 15-year periods ending in 2000 for Australian pooled equity funds. The result was an assumed 11.7% earnings rate for the fund, before tax. Is this an accurate statement of what occurred?

This issue is dealt with above.

8.4 Dealings with PwC, Access Economics, UBS Warburg

8.4.1 As noted above, UBS Warburg provided data about historical rates of return to JHIL at some time prior to 15 February 2001 and confirmed the information in a letter dated 19 February 2001. At sometime prior to 15 February 2001, Mr Sweetman of UBS Warburg was asked by Mr Morley to provide views about future earnings that might be achieved by the fund: T1325.34, T2249.16. UBS Warburg declined to provide the information that was requested – it was outside the scope of their business: T1326.17.

Issue 20

20. There is evidence that JHIL did not retain any expert to estimate future earnings rates for a fund of this kind (UBS Warburg having declined to do so). If this is correct, why were PWC and Access Economics not asked to review the earnings rate assumption?

It was not felt necessary to do so, having regard to the work done by Mr Morley.

Issue 21

21. There is evidence that the PWC and Access Economics reports were obtained in response to the suggestion of Mr Stephen Loosley that it was desirable that JHIL be able to say that two independent reviews had agreed with JHIL's calculations that in all probability there would be sufficient money for victims. If this is correct:

It is probably not correct that the suggestion came from Mr Loosley. Notwithstanding that, these questions should be answered as follows:

(a) Why were PWC and Access constrained by their instructions not to examine or comment upon the assumptions in the model?

It was not considered necessary.

(b) Was the consequence that the PWC and Access reports were of little or no utility?

The consequence was that the reports were of less utility.

(c) Were the limitations of the PWC and Access Economics reports made known to the JHIL Board, and if not, why not?

This issue is dealt with in section 12 below.

(d) Was the import of the reports fairly represented by JHIL to the public and stakeholders in the period after the creation of the MRCF? If not, why not?

Yes.

Issue 23

23. There is evidence that JHIL was advised in a draft report by Access Economics that an assumed earnings rate of 11.6% was "a high figure, especially over such a long period of time", a figure about which Access was "cautious" and which it believed JHIL "will need to test more fully" and that at the request of a JHIL executive this was deleted from the Access Economics advice. If this be correct:

(a) Why was the request made?

Mr Harman believed that UBS Warburg were providing advice on future earnings rates.

(b) Was the Access Economics advice not acted on, and if not, why not?

This issue is dealt with above and in section 12 below.

(c) Was the Access Economics advice passed on to the JHIL Board, and if not, why not?

This issue is dealt with above and in section 12 below.

Issue 24

24. There is evidence that the draft report by PWC urged the JHIL Board ***"to seek an independent review, or otherwise*** *satisfy themselves as to whether the values and assumptions used in the model are reasonable" and that at the request of a JHIL executive the emphasised words were deleted from the PWC advice. If this is correct:*

(a) Why was the request made?

(b) Was the advice acted on and if not, why not?

(c) Was the PWC advice passed on to Mr Morley or to the JHIL Board?

(d) If not, why not?

This issue is dealt with above and in section 12 below.

Issue 25

25. The Access Economics Report of 15 February 2001 noted the failure of the cash flow model to allow for volatility, and said, "a poor return in an early year can jeopardise the viability of the entire scheme over the forecast horizon." The PWC report gave a similar warning.

(a) Was anything done to investigate this issue or allow for it? If not, why not?

No. It was thought unnecessary.

(b) How should it have been addressed?

It was not unreasonable to adopt the approach that was adopted.

(c) Were these observations passed on to the JHIL Board? If not, why not?

This issue is dealt with in section 12 below.

Issue 26

26. The PWC Report of 14 February 2001 mentioned additional limitations of the model. First, it contained no decision rules as to whether the level of funds at any time was prudent or necessary. Secondly, it did not systematically explore the risks inherent in the forecasts by recognising the risk adjusted time value of money.

(a) Were these matters considered or dealt with by JHIL? If not, why not?

No. It was thought unnecessary.

(b) How should they have been addressed?

It was not unreasonable to adopt the approach that was adopted.

(c) Were these observations passed on to the JHIL Board? If not, why not?

This issue is dealt with in section 12 below.

8.5 Appropriateness of earnings rate adopted

8.5.1 PwC and Access Economics were both retained on about 12 February 2001. The reports provided by those organisations are at Ex 68, tabs O and P respectively. PwC found the model to be "logically sound and technically correct, within the limitations imposed by this kind of model". Access Economics concluded: "The structure of the model itself appears sound for the analytical work for which it has been designed". Neither PwC nor Access Economics were asked to review or provide an opinion on the underlying assumptions.

8.5.2 It is not clear where the idea to retain PwC and Access Economics came from. It was suggested to Mr Morley that the idea came from Mr Loosley, probably on 9 or 10 February 2001: Ex 145; Ex35, [10]; T2251.15. Mr Loosley did not give evidence about that subject and his first meeting with Mr Ashe, Mr Baxter and Mr Macdonald was on 9 February: Ex 135, [10]. However, the proposal to retain PwC and Access Economics existed at that time. On 8 February 2001, Mr Ashe sent an email to Mr Shafron confirming that those entities were "willing to do the work" and that they could commence the following Monday, 12 February: Ex 150, p 119. On the same day (8 February) Mr Shafron requested that Mr Harman get PwC and Access Economics "bless your model". On Sunday, 11 February 2001, Mr Baxter advised by email (Ex 150, p 128) as follows:

> We are getting … Access Economics, PwC and … to check and verify various aspects of these numbers so that we will be able to refer to these independent opinions to help validate what we say about the likely future outcome.

8.5.3 It is possible that the existing proposal was discussed with Loosley on 9 or 10 February and confirmed by him as appropriate.

8.5.4 Mr Morley understood on 10 February 2001, that all PwC and Access Economics were to do was to review the calculations in the model, which essentially is what they did – if “calculations” includes the logical integrity and structure of the model: T2252.46.

8.5.5 Mr Morley agreed with the proposition that the exercise undertaken by PwC and Access Economics was arid and pointless: T2252.51-2253.1; T2253.17. There are three important points to make in relation to this evidence. First, it is not altogether surprising that Mr Morley would take this view given that he and Mr Harman were the two persons who had most responsibility for the preparation of the model. Mr Morley no doubt had confidence in his own work and fully expected that the independent reviewers would conclude that the model was sound. The benefit of the review was to give persons relying on the model other than the authors of the model, ie not Mr Morley, some comfort that the model was sound. Mr Macdonald, for instance, considered that it was important to him that there was some independent verification of an internally generated model: T2602.7. Second, Mr Morley was questioned about whether he brought the views of PwC and Access Economics to the attention of the JHIL Board (this is taken up in more detail below) – see eg T2256.26. That suggests that there was something of value in the reports, in which case it cannot be suggested that the exercise that PwC and Access Economics undertook was arid or pointless. Third, one would expect that if PwC or Access Economics was asked to do something that they considered to be arid and pointless, they would have said so. They did not.

8.5.6 A sweeping assertion that JHIL should be criticised for not asking PwC or Access Economics to review the model’s assumptions should not be made. It seems now to be accepted that the only assumptions of significance in the model were the assumptions concerning Trowbridge's assessment of the asbestos liabilities and the earnings rate (in relation to other assumptions, there seems to be no contest that a conservative approach was adopted – see eg Ex 68, [51], [56]). In any event, it is not suggested that a review of any of the other assumptions would have revealed any flaws in the model. That leaves the Trowbridge numbers and the earnings rate. In hindsight, it may have been useful for some expert to review the Trowbridge calculations. PwC apparently had that expertise: Ex 67, [25]. However, at the time it was perfectly reasonable for JHIL management to take the view it was unnecessary for a second actuary to review the work of Trowbridge.

8.5.7 Accordingly, the only assumption of relevance for present purposes concerns the assumption about the earnings rate. Mr Morley conceded that he did not have any expertise or special training in forecasting long-term or index returns: T2249.12. Nor did Mr Harman profess to be qualified to express an opinion about future stock market returns: T1307.42. Nevertheless, Mr Morley concluded that following his analysis of historical rates, as outlined above, and following discussions with management and the Board, he could be satisfied that the earnings rate used in the model was appropriate (T2249.54-2250.30) – indeed, as noted above, he thought that the rate of 11.7% (as a pre tax rate) was conservative.

8.5.8 Looking back with the wisdom of hindsight, no doubt it would have been a good idea to ask PwC or Access Economics or both of them to address the earnings rate. Neither Access Economics nor PwC has been asked to undertake the hypothetical exercise of what they would have done if they had been asked to undertake such a review in February 2001. It is not known what would have come from such a review (subject perhaps to one qualification in relation to Access Economics – see below). At the time, the management of JHIL and the Board took the view that they could work out an appropriate earnings rate themselves and that Mr Morley's analysis showed that the rate of 11.7% (pre-tax) was reasonable or conservative. That was a business judgment that was open to them.

8.5.9 A draft of the PwC report included the observation: "The model results are sensitive to these values and assumptions, and we urge the directors of JHIL to seek an independent view, or otherwise satisfy themselves, as to whether the values and assumptions used in the model are reasonable.": Ex 67, tab 14. It seems that the draft was provided to Mr Harman and that Mr Harman made some suggestions to Mr Brett about some possible amendments to the report. One of the suggestions, which was taken up by Mr Brett, was the deletion of the words "to seek an independent view, or otherwise" from the passage set out above. Mr Brett initially denied that is what occurred (T1229.42-1230.24) but, prompted by Ex 61, vol 6, tab 13, he later agreed that it looked like Mr Harman did suggest the changes: T1246.29. Mr Harman agreed: T1314.6. Mr Harman denied that he was seeking to keep the advice from the Board (T1314.27) and said that he thought that the

Board was capable of forming its own view as to whether it needed further advice: T1314.38.

8.5.10 It was not suggested to Mr Brett that he was pressured against his will or better judgment to delete the words. It appears to have been a suggestion that Mr Brett was happy to adopt. No doubt he would have declined to delete the words if he considered that they should remain. It is noteworthy that the suggestion about seeking an independent view was not put as an absolute in the draft: the directors were urged to seek an independent view <u>or</u> otherwise satisfy themselves that the assumptions were reasonable. In the end, Mr Brett only urged the Board to satisfy themselves that the assumptions were reasonable; and that is what the Board did.

8.5.11 Mr Harman also saw a draft of the Access Economics report on 14 February 2001: Ex 41, tab 7, T1315.15. The draft contained a final paragraph as follows:

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

It seems that following a conversation with Mr Harman (Ex 41, [18]; T1316.29), Mr Waterman redrafted the final paragraph to read as follows Ex 41, tab 3:

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

Mr Harman's evidence is that at the time of his conversation with Mr Waterman, he believed that UBS Warburg was to provide advice on future earnings rates (which was a belief that was, as it turns out, incorrect). Once again, it has not been suggested that Mr Waterman was suborned by Mr Harman. Mr Waterman was no doubt content to sign his report in its final form. He advised the Board to give the assumption about earnings rate detailed consideration – and that is what occurred.

8.5.12 Access Economics provided draft advice that 11.2% and 11.6% were high figures, especially over a long period of time: Ex 41, tabs 6 - 7. Mr Morley could not recall seeing the draft advice (T2258.52), and it was not suggested to him that he did. If he had seen it, Mr Morley may well have caused the matter to be explored in greater detail, after all he held the view that 11.7% was conservative: T2259.23. One thing that may well have emerged on further analysis is that Access Economics were thinking in terms of an after tax earnings rate. As noted above, Mr Morley considered that the 11.7% used in the model was equivalent to an after tax rate of 7.6%.

8.6 Trowbridge and earnings rates

8.6.1 There is some evidence that Mr Minty and Mr Shafron spoke of investment returns. Mr Minty's evidence was that he discussed with Mr Shafron the sorts of rates of return they might be able to achieve at the present time on an actively managed portfolio of investments: T819.47. The inference is that Mr Minty did not think that returns of 7, 8 and 9% to be implausible: T820.38. However, Mr Minty also said that he did not turn his mind to forming a professional opinion on the subject before 13 February 2001: T817.28. Furthermore, Mr Minty apparently did not indicate whether these returns were pre or post tax. It would be inappropriate to place any weight on the apparently casual remarks made by Mr Minty about earnings rates.

Issue 22

22. There is evidence to the effect that Mr Minty advised Mr Shafron that appropriate commercial (as opposed to risk free) rates of return for periods as long as the likely claims MRCF experience were rates between 7 and 9%. If this is correct:

(a) Why was this advice not adopted in the JHIL cash flow model?

The view was formed that a higher rate of return was appropriate.

(b) Was Mr Minty's advice passed on to or otherwise known by:

(i) Mr Morley;

Yes.

(ii) Mr Harman;

No.

(iii) Mr Macdonald;

No.

(iv) the JHIL Board?

No.

(c) If not, why not?

Because Mr Minty's advice on this question was not sought or provided as the expression of a professional opinion.

Issue 12

12. Was the February Report suitable to be used for the purpose of estimating the likely longevity of the MRCF (whether by use of its assessed NPV of claims or by use of its undiscounted projections in the cash flow model) having regard to:-

(a) the matters in paragraphs 4-11 above;

(b) the purposes for which the February Report and its predecessors were prepared, as understood by Trowbridge;

(c) the degree of uncertainty attached to the projections?

The February 2001 Report was negligently prepared and so was not suitable to be used for the purpose of estimating the likely longevity of the MRCF. However, JHIL did not have knowledge of that fact and believed it to be suitable for that purpose.

8.7 Appropriateness of earnings rate adopted – Kingston analysis

8.7.1 Dr Kingston gave expert evidence concerning estimating the extent to which a "closed fund" is likely to be able to satisfy liabilities which will accrue for up to 40 years into the future: Ex 237. He was asked to answer some general questions concerning the estimation of earnings rates as at February 2001: Ex 237, p 2. He was not asked to review Mr Harman's cashflow model. He has not seen the cashflow model: the only document he was given was the InTech material that Mr Morley and Mr Harman relied upon (among other things) to consider earnings rates: T3109.4.

8.7.2 Dr Kingston hypothesised a fund with a weighting to Australian equities as to 60% and Australian cash as to 40%. That is to be contrasted with Mr Harman's assumption of 25% Australian fixed interest, 35% overseas shares and 40% Australian shares: Ex 68, [44]. Dr Kingston then considered what returns might be expected for a fund with the hypothesised weighting.

8.7.3 For equities, Dr Kingston considered forecast real returns and forecast inflation separately. His "compromise projection" contemplated a real return on equities of 5.5% and a forecast inflation rate of 2.2%, producing a nominal return of 7.9%: Ex 237, p 10. Dr Kingston could conceive of a logic that produced an inflation figure slightly higher than 2.2%, conceivably up to 3%: T3113.15-.54. The figure of 2.2% is low by historical standards and is derived from the price of 10 year indexed and non-indexed bonds.

8.7.4 The rate of inflation was an assumption that was built into the cashflow model for reasons unconnected with the earnings rate. An inflation rate of 4% was built into Trowbridge's actuarial calculations of asbestos-related claims. That was preserved in the model for litigation outlays: Ex 68, [51]. On the other hand, the model used an assumed inflation rate of 3% in connection with cash inflows. This was a conservative approach: it assumed cash outflows grew faster than cash inflows. Access Economics' view was that the inconsistent inflation rate assumptions could be distorting and they adjusted the model to assume a constant rate of inflation across all variable: Ex 68, tab P. Access Economics adjusted the rate down to 3% on the basis that this was consistent with their view about Australia's inflation rate: T496.40. Mr Harman did not make this adjustment, which would have given the fund a longer projected life: T1316.7. Presumably, Access Economics would also have concluded that an implicit inflation rate of 2.2% built into the earnings rate could distort the model and would have included 3% in this context as well. Dr Kingston has not, for obvious reasons, given any opinion about this.

8.7.5 For cash, Dr Kingston considered short term government bond rates: T3116.1. The forecast yield was 4.56%. A blend of other kinds of fixed interest securities (long term government bonds and corporate bonds), which could be included in a balanced portfolio (T3116.54) could yield a higher expected return (T3117.2, T818.39), but of course one would need to consider the portfolio as a whole. That is, taking on riskier forms of debt might need to be offset by more conservative investment in equities.

8.7.6 Dr Kingston provided a forward-looking estimate of future earnings of the liquid assets in the fund, before inflation, of 6.4%: Ex 237, p 10. If an inflation rate of 3% had been assumed rather than 2.2%, the figure would have been 6.9%. If in addition the portfolio was weighted slightly more in favour of equities (75% to 25%, rather than 60% to 40%) as assumed by Mr Harman, the figure would have been 7.5%. An assumed rate of return on debt securities of 5.5% rather than 4.56% (note that the historical average return to cash in Australia since 1937 is 6%: Ex 237, attachment C) would increase the figure to 7.75%.

8.7.7 Dr Kingston's evidence is that it was inappropriate to rely on past average in the period from 1986-2000, because performance in that period was exceptionally good: Ex 237, p 11. Using the data from that period, his hypothetical fund produced a return of 11.8%. Given that this was close to the 11.7% shown by the InTech report, he concluded that his hypothetical fund did not represent an over-simplification.

8.7.8 Dr Kingston was asked to consider a closed fund of a certain dimension, with liquid assets starting at $50m. While he did not consider the actual fund contemplated in this case, he said that "we're talking about a pretty large scale fund here" (T3123.29) and did not suggest that the closed nature of the fund presented any particular problem in terms of projections of returns.

8.7.9 The usefulness of Dr Kingston's opinions is diminished by the fact that he has not looked at the cashflow model and analysed the expected cashflows, both in and out. It might have been important for him to know, for example, that a substantial part of the investing in liquid funds was expected to occur after 10 years – particularly bearing in mind that as at the beginning of 2001, the returns being achieved on stock were relatively poor, given that equity values were high.

8.7.10 Mr Morley’s consideration of past returns analysed data from the past 5, 10 and 15 years. With expert assistance, he may well have considered earlier data and undertaken a more sophisticated analysis. On the other hand, it is important to remember that he considered the rate of 11.7% used in the model as equivalent to an after tax rate of 7.6%, which is not greatly different to the 6.4% identified by Dr Kingston and very close to a rate that could be identified by the use of assumptions that could reasonably have been adopted.

8.7.11 Finally, the evidence indicates that in mid-2001 the MRCF commissioned Towers Perrin to prepare a model which included expected investment returns on its assets. That model used a "most likely investment return" of 7.5% pa: Ex 296, Beacroft, tab 4, p 3.

Issue 19

19. Was the method adopted for deriving and assessing an assumed earnings rate for the fund reasonable, having regard to:

(a) the evidence of Dr Kingston as to historical earnings rates over longer periods;

(b) the need suggested by Dr Kingston to allow for inflation (both past and as anticipated for the future);

(c) the warnings given in Ex 121, vol 7, pgs 2925, 2926 and in the UBS Warburg report of 19 February 2001 against using past returns to predict future returns;

(d) the historically high price/earnings ratios for Australian equities as at December 2000, as noted by Dr Kingston;

(e) the risk of volatility of investment returns, mentioned by both PWC and Access Economics, and highlighted by the much lower arithmetic average rates of return found by Tower Perrin for the 6 months and the year ending 31.12.00 (1.3% and 7.1% respectively);

(f) the fact that the funds surveyed by JHIL were not closed funds but rather funds open to new investment?

Yes

8.8 Consideration of the model by the Board

8.8.1 Mr Harman's cashflow model was circulated to JHIL Board members and tabled at the meeting on 15 February 2001: Ex 121, [236]. The Board papers included a presentation on Project Green: Ex 80, tab 7. Part of the presentation concerned "Fund life expectancy/sensitivity": Ex 80, tab 7, p 167 - 168. Mr Morley gave this part of the presentation: T2255.39. The PwC and Access Economics reports were not circulated as part of the Board papers, but Mr Harman was at the meeting and he had copies with him: T2256.1-.5.

8.8.2 Mr Morley's evidence was that (T2255.48-.56):

> I told the Board that Access Economics and PwC had only reviewed, and were only asked to review the calculation of the model, that they made some comments about we should get independent advice or review of the assumptions, and then I took the Board back through the assumptions that were used. We supplied the Board with the sensitivity on various assumptions, and there was a fair bit of discussion about the earnings rate and how we arrived at the earnings rate.

8.8.3 Mr Morley also recalled that he discussed the fact that earnings could be volatile, that he could not remember the exact words that he used (T2256.30) but was fairly sure that he discussed the warnings given by PwC and Access Economics about volatility: T2257.30.

8.8.4 Mr McGregor gave evidence about the presentation at the Board meeting: Ex 81, [27]-[35]; T1467.1-.25; T1573.1-1575.23. After the time that has elapsed, Mr McGregor cannot be expected to remember everything that was said about the topic. It is possible that issues were discussed and he has forgotten them. It is also quite possible that particular matters raised by Access Economics and PwC were not discussed. Plainly some judgment must be made about the topics that need to be raised and discussed. Critically, however, Mr McGregor concluded that he could be satisfied that the Foundation would be provided with sufficient funds such that if the Trowbridge best estimates were realised, all claims would be met: Ex 81, [35].

8.8.5 Macdonald also gave evidence about "extensive" discussion before the Board about the earnings rates: T2575.27; T2632.38. Morley explained how the earnings rate had been selected and there was then discussion between Morley and a number of the directors. That discussion extended to whether lower rates of return should have been used: Ex 308, Macdonald, paras 46, 47.

8.8.6 The evidence points strongly to the conclusion that:

(a) Mr Morley and Mr Harman created and developed the model in a genuine attempt to forecast the cashflows that could be anticipated by the fund and to genuinely form a view abut the likely life of the fund;

(b) the model was closely considered by the JHIL Board, similarly with a genuine desire to form a view abut the likely life of the fund; and

(c) the model was not perfect but was the product of the genuine and diligent work of JHIL management.

Issue 27

27. Having regard to the evidence, including:

(a) Mr Morley's oral evidence as to the utility of the PWC and Access Economics Reports;

(b) Mr Harman's evidence as to the utility of his cashflow model, having regard to the comment of PWC and Access Economics;

(c) the failure of James Hardie to obtain any independent expert opinion as to future earnings rates;

(d) the matters raised in these issues as to the February Report;

(e) the warnings expressed in Ex 121, vol 7, pgs 2925, 2926;

(f) the fact that the funds surveyed in Ex 121, vol 7, tabs 120-122 (PGM1, pp 2922-2931) were not closed funds;

(g) the limited purpose of the PWC and Access Economics reports, as compared to the recommendation of Mr Loosley recorded in Ex 145;

should it be concluded that JHIL and Mr Macdonald:

(h) did not exercise reasonable care in permitting the cash flow model to be used to assist the JHIL Board, the outgoing Coy and Jsekarb directors and the incoming MRCF directors to assess the likely longevity of the MRCF or what level of funding would be appropriate to found a reasonable likelihood that all claims, or all claims for a particular period, against Coy and Jsekarb would be met;

(i) did not believe the cash flow model to be suitable for use in assessing the likely longevity of the MRCF or what level of funding would be appropriate to found a reasonable likelihood that all claims, or all claims for a particular period, against Amaca and Amaba would be met; or were indifferent as to whether it was suitable for such use.

No conclusions should be drawn in relation to Mr Macdonald. He did not have any particular expertise to permit him to form a view on the cash flow model which was more reliable than the view of others on the JHIL Board. As for JHIL, for the reasons given earlier, the cash flow model was a reasonable and genuine attempt to model the likely financial position of the MRCF.

9. Dealings between JHIL and Coy and incoming MRCF Directors between December 2000 and February 2001

9.1 Meetings and information provided to Edwards, Cooper, Gill and Jollie

9.1.1 Although final Board approval was not obtained until 2001, the proposal to restructure so as to separate Amaca and Amaba was sufficiently advanced towards the end of 2000 for extensive external advice to be taken and for active steps to recruit new directors to commence.

9.1.2 By 22 November 2000, Mr Shafron had proposed a trust with three directors: Sir Llewellyn Edwards and two James Hardie executives: Ex 75, tab 64, p 2244. That was refined that day to include the possibility of third party directors, from a trust company / insurance company background: Ex 75, tab 65, p 2249. The issue was debated in the next 2 weeks, when differing views were expressed (for example, Mr Shafron favoured the "JH superannuation trust company" as the most viable model while Mr McClintock from PwC thought there should be no more than one JH director: Ex 75, tab 72, p 2288; Ex 75, tab 71, p 2287).

9.1.3 By 11 December 2000, Mr Shafron prepared a paper which reflected a Board with 4 members: Ex 75, tab 75, p 2318. Sir Llewellyn Edwards was to be the chairman, Michael Gill a director, and an ex-James Hardie Senior Executive (presumably Mr Cooper) was an alternative member. Each of Sir Llewellyn, Messrs Gill and Edwards was approached in December, while Mr Jollie was approached in the first week of January.

9.1.4 This section addresses the following topics:

(a) the way in which each of the incoming directors was initially approached by James Hardie and their reactions;

(b) the meeting of 15 January 2001;

(c) the period from 15 January - 13 February 2001;

(d) the 13 February 2001 meeting;

(e) the attitude of the incoming directors to the funding of the MRCF;

(f) the knowledge of the incoming directors of the basis on which the Trowbridge report had been prepared; and

(g) the knowledge of the incoming directors of the terms of the proposed Deed of Covenant and Indemnity.

9.2 Approaches to the incoming directors

9.2.1 The approach to each of the incoming directors is addressed in turn below. It was Mr Shafron's expectation at the outset that each of the incoming directors would be provided with an information pack and that they would undertake some form of due diligence: see Shafron email 15.12.00, Ex 17, Tab 78. When he wrote to Mr Jollie on 4 January 2001, Mr Shafron said (Ex 17, Tab 85):

> We are expecting to be guided by the prospective directors in relation to additional documents and information requests.

Sir Llewellyn Edwards

9.2.2 Sir Llewellyn Edwards turned 66 in 2001: Ex 13, [2]. He had been a director of JHIL since 2 August 1990: Ex 13, [19]. By the second half of 2000 he had been aware that management and the Board had, for some time, been interested in separating the asbestos liabilities from the productive assets in the company: Ex 13, [30}, [32] and [39].

9.2.3 Sir Llewellyn was approached by Mr McGregor on around 15 December 2000: Ex 80, [16] – [17] and on 16 December 2000 by Mr Macdonald. Mr McGregor said that Sir Llewellyn was interested: Ex 80, [17]; Mr Macdonald said in a contemporaneous email that he was "very supportive": Ex 80, tab 2, p 3. Sir Llewellyn indicated his readiness to chair the new entity: Ex 13, [43]. A further measure of his enthusiasm was his willingness himself to introduce himself to, and recruit, Mr Jollie (see below).

Mr Dennis Cooper

9.2.4 Mr Cooper was the Chief Information Officer for the James Hardie Group, based in the United States. He had worked for James Hardie since June 1994: T50.32-.34. His contract was due to end: T49.55-.58. He was returning to Australia and looking for employment.

9.2.5 He spoke to Mr Shafron on 15 December, and met with Messrs Shafron and Morley on 22 December 2000: Ex 17, [104] and [106]; Ex 75, tab 79, p 2332; Ex 75, tab 81, p 2347 (after which Mr Shafron described him as "interested"). Mr Shafron's notes of this meeting record discussion in relation to the funding of the trust and actuarial work (Ex 76, Tab 1):

> – it is enough? Should be good for 10 years

9.2.6 At this meeting Mr Cooper was given a copy of the James Hardie asbestos liabilities management plan for the years ended March 2001 to 2003 (Ex 7, MRCF1, Tab 5, pp52-89) and a copy of the James Hardie Operating Plan Review as at September 2000 (Ex 7, MRCF1, Tab 5, pp90-103). Mr Cooper subsequently read each of those documents carefully: Ex 5, [31]-[32].

9.2.7 Mr Cooper was given access to Mr Attrill upon his return to Australia. They met on 10 January. Mr Attrill's note records "briefing Dennis Cooper on litigation": Ex 56, Vol 4, p888. Mr Cooper's evidence in relation to those meetings was as follows (T107.48-108.12):

Q. And you had meetings with Mr Attrill on 10 and 11 January?

A. Yes.

Q. And are you able to recall how long those meetings lasted?

A. I believe the meeting went most of the afternoon and continued on the next day.

Q. You understood the purpose of the meetings was to enable you to ask Mr Attrill any questions you wanted to ask him about James Hardie's asbestos experience claims and what have you?

A. Yes.

Q. And at that time, you believed you had free access to Mr Attrill?

A. Yes.

Q. In relation to those subjects?

A. Yes.

Q. And you exercised that access?

A. Yes.

9.2.8 Mr Cooper made his decision very shortly upon his return to Australia, and before any reports from Trowbridge had been circulated. Mr Shafron wrote on 10 January (Ex 121, tab 77, p 2458)

> Phil has just phoned to confirm that Dennis had made his decision. He will be the GM/executive director. Phil is going to be taking Dennis to see Towers Perrin this afternoon, to start to put him to work. ...
>
> Obviously there is still the fine print of the contract to resolve, but Phil has agreed the package fundamentals.

9.2.9 That package was a salary of $120,000 based on a 30 hour week, plus 12% superannuation, plus a car, plus various allowances (for clubs, entertainment, travel, professional advice): Ex 75, tab 131, p 2964. That was why Mr Attrill's proposal for outsourcing the management of asbestos litigation of 12 January 2001 (Ex 7, vol 1, tab 7) was addressed to Mr Shafron, copied to Mr Cooper and extensively annotated by Mr Cooper, who looked at it with the other directors, particularly Mr Gill: T43.40-.43.

Mr Michael Gill

9.2.10 Mr Gill had advised James Hardie during 2000 on a proposal:

> to achieve an unbridgeable corporate split between the legal entities which carry the risk of asbestos related liability and the legal entity in which the ongoing business is conducted and assets are held.": Ex 200, tab 5.

9.2.11 During that process, he had met with Messrs Shafron and Attrill. As a result of those communications, Mr Gill became familiar with the Andrews and Atkins model: T327.50-58.

9.2.12 When the meeting with Messrs Shafron and Morley was arranged on the afternoon of 20 December 2000 (T330.3, T1702.10 (Ex 90), he was told that they "wish to speak further about the proposal to isolate JHC from JHIL": Ex 100, tab 16.

9.2.13 At that meeting Mr Gill expressed concerns that he receive independent advice (and was told Mallesons were retained) and that Phillips Fox, in accordance with partnership policy, receive around $50,000 of fees to justify the risk and distraction: Ex 75, tab 80, p 2346. He received a package of initial documents on 21 December 2000: Ex 29, [4].

9.2.14 Following that meeting, Mr Shafron's belief was "he will sign on": Ex 75, tab 80, p 2346. However, it became clear following the meeting of 15 January 2001 that he, like Mr Jollie, required first to see an actuarial report.

9.2.15 In January, Mr Gill downloaded a copy of the Watson and Hurst presentation (Ex 7, MRCF3, Tab 8) and sent copies of it to Mr Jollie and Mr Edwards: T328.26-329.25. At that time it is likely that he read the presentation carefully.

Mr Peter Jollie

9.2.16 On Thursday 4 January 2001, Sir Llewellyn Edwards called Mr Jollie unexpectedly (Ex 7, vol 3, tab 1), followed by Mr Macdonald (Ex 7, vol 3, tab 2) to ask whether he was prepared to meet Messrs Shafron and Morley the following morning. Sir Llewellyn did so at Mr Macdonald's request, sent by fax to his holiday accommodation at Noosa: Ex 121, tab 72, p 2408; this is a further measure of Sir Llewellyn's enthusiasm for the Foundation at this early stage.

9.2.17 Mr Jollie met with Messrs Shafron and Morley on Friday 5 January 2001 at 7.30am. The meeting lasted around 45 minutes: Ex 121, tab 74, p 2417. Mr Jollie's notes of that meeting are at Ex 7, vol 3, tab 3. They show that he was told, and noted (Ex 7, vol 3, tab 3, p 3):

> Possible in future not solvent
>
> NPV of future claims line ball. Not quite enough towards the end

9.2.18 Later that day, Mr Shafron sent an email report of that meeting, which included, as an issue covered:

> Solvency (may not be enough in the long term)

and

> Peter seemed happy with the way we are approaching these issues. He asked questions in the following areas:
>
> · Actuarial advice? (Yes we get it, it shows there could be a shortfall).

9.2.19 Later that afternoon, Mr Jollie was sent by email a bundle of material setting out the proposal: Ex 7, vol 3, tab 6. Mr Jollie read it that weekend, and then met Mr Morley again on Tuesday 9 January 2001. Mr Jollie identified a number of topics, including solvency, that he wished to raise, and there was an "interactive briefing" in which Mr Jollie did not feel inhibited from asking Mr Morley any questions: T463.30-55. The meeting lasted between 1.5 and 2 hours: T463.56-.464.1.

9.3 The meeting of 15 January 2001

9.3.1 The notes taken by Mr Attrill (Ex 75, tab __, p 2495) and Mr Robb (Ex 187, tab 15, p 57) are the most reliable contemporaneous record of what was said at the meeting of 15 January 2001 (and also that of 13 February 2001). The Attrill and Robb notes are entirely consistently with the brief notes taken by others (including Messrs Cooper, Gill, Jollie and Morley). More importantly, each is, in a manner which lends confidence to both of them, very substantially corroborated - down to the actual words used - by the other (see below). It is perhaps unsurprising that the most reliable record of these meetings comes from men each of whom was trained as a lawyer and neither of whom was a principal participant in the business of the meetings.

9.3.2 It is clear that the 15 January 2001 presentation proceeded on the bases that:

(a) the Foundation would have assets of $210 million;

(b) the Foundation would obtain “actuarial reports each year”;

(c) the Foundation would “report on IBNR basis.”

There was, at this stage, no deed of covenant and indemnity, and no additional payment by James Hardie.

9.3.3 The incoming directors met with Mr Bancroft separately. When the meeting resumed, the following concerns were articulated (according to the notes of Mr Attrill: Ex 75, tab 92, vol 2498:

> - Want more information before Michael and Peter will agree
>
> - Trowbridge report circulated, want to meet with Trowbridge, want an update on liabilities
>
> ...
>
> - Want Trowbridge to give reasonably adequate cover for future claims
>
> - Want the new co to get a reputation as a good corporate citizen which will contribute to the better management of the liabilities. Good PR.
>
> - Tony will give a sign-off of comprehensive risk analysis for the new directors.

9.3.4 Mr Robb’s notes include (Ex 187, tab 15, p 59):

> Sir Llewellyn:
>
> More info
>
> - Trowbridge Report
> - meet with Trowbridge
>
> ...
>
> Want new identity as a good citizen
>
> - want PR done on establishment
>
> TB - risk analysis will be provided to the Board.

9.3.5 At that stage, the Attrill and Robb notes record statements by Mr Shafron and then Mr Gill. The Attrill notes record Mr Shafron saying:

> Draft report - current version
>
> Most recent complete report 1998
>
> Seeks to give the ultimate cash flow
>
> This is not the liability position of the co - rep by debtors and creditors
>
> Future cashflow doesn't impact on solvency.
>
> On certain assumptions, the assets left in JHC will not be sufficient to meet all claims.
>
> Comes out to $270m on conservative earnings rate.
>
> Good chance on Trowbridge numbers, there won't be enough.

9.3.6 Mr Gill is recorded as replying:

> If funds adequate for 10-15 yrs, OK
>
> Question if funds less than adequate for 10-15 yrs.
>
> Want to see trend going forward.
>
> Current draft of T should be circulated tomorrow.

9.3.7 Mr Robb's notes record the following:

> PS Trowbridge - most recent complete is 98
>
> 99 is in draft
>
> - $250 mill NPV @ 7%
>
> ∴ on that basis, not sufficient
>
> MG How long will funds last - if 10-15 then OK
>
> If way less then an issue.

9.3.8 No other potential director is recorded as qualifying or dissenting from Mr Gill's statement in either the Robb or Attrill notes. Both notes make it plain that they are recording Mr Gill's words, essentially verbatim. If there were a qualification or dissent by another incoming director, the probabilities are that they would have been noted too.

9.3.9 In giving oral evidence to the Commission:

(a) Mr Gill readily accepted that his decision was based on there being funds for the next 10-15 years (eg T299.5-.8; T382.18-.22; T384.45-.57);

(b) Mr Cooper and Mr Jollie stated that they could not recall Mr Gill making those statements: T121.19-.56 ("I can't verify, I can't recall that"); T466.2-.14 ("I don't recall that"; "You don't remember Mr Gill saying that? — No";

(c) Sir Llewellyn had no independent recollection beyond what was contained in his statement: T256.25-.40.

9.3.10 For those reasons, ultimately there is no real factual challenge to the accuracy of the Attrill and Robb notes as records of the substance of what was said on 15 January 2001.

9.3.11 Mr Attrill's notes of the meeting on 15 January include (Ex 56, Vol 4, p941):

> Sir Llew: Available 10am Tuesday next week.

9.3.12 That is a reference to a proposed meeting with Trowbridge on 23 January. Mr Attrill was asked to arrange that meeting. He spoke to Mr Minty on 16 January: see Mr Attrill's note (Ex 56, Vol 4, p956). In that conversation, Mr Minty said that he could prepare a further report using existing data. Mr Attrill's note records:

> Can run with data we have
>
> Karl has some projects on his place
>
> Should be able to do the work fairly quickly.

9.3.13 At the same time, Mr Attrill sent an email to Mr Shafron advising that he had arranged for Mr Minty to give a presentation on that day: Ex 56, Vol 4, p957. On 17 January, Mr Shafron telephoned Mr Attrill from the Board meeting to advise that the "pace" had slowed and that it was likely that the meeting on 23 January would be cancelled: Ex 56, Vol 4, p958.

9.4 The period 15 January 2001 - 13 February 2001

9.4.1 Mr Shafron gave a report of the 15 January meeting to the Board on 17 January 2001. The Board considered papers on the trust (Ex 80, tab 3) but concluded with the Chairman noting that the concept had some merit, but the question of funding for the Company required more work. He requested that management continue developing the concept and to report progress, particularly in relation to funding, at the February Board meeting (Ex 80, tab 4).

9.4.2 Mr Shafron then circulated, at 5.59pm on 17 January 2001, a note to update the potential trust directors: Ex 121, tab 82, p 2489. On the subject of "Life of Fund - Actuarial Advice" his note was in the following terms:

> a. Actuarial advice
>
> i. Privileged to JHIL
>
> ii. Never finalised - unresolved issues
>
> b. Minty to review with independent directors current Trowbridge report of future costs

9.4.3 Mr Shafron suggested that Mr Macdonald discuss the note with Sir Llewellyn, and if he was agreeable, for Mr Cooper to distribute it and confirm with all of the directors to "confirm suitability of arrangements".

9.4.4 On 18 January, Mr Shafron had a further discussion with Mr Attrill. In that discussion, Mr Shafron's note was amended by Mr Attrill as follows (Ex 56, Vol 4, p961):

> (b) Minty to review with independent directors current Trowbridge thinking on future costs

9.4.5 Thus the contemporaneous documentation suggests that at the meeting on 15 January the incoming directors requested to be provided with a copy of the current draft of the Trowbridge report and the opportunity to meet with Trowbridge: see Ex 187, [43]; Ex 187, Tab 15. It was arranged for Mr Minty to prepare a revised report to take account of the Watson and Hurst analysis (without using any updated data). It was also arranged for Mr Minty to meet with the incoming directors to review their current (and revised) position. That meeting was then deferred because the JHIL Board decided to make its decision at is February meeting.

9.4.6 Mr Shafron, Mr Morley and Mr Attrill met with Mr Minty and Mr Marshall of Trowbridge on 19 January. Mr Attrill made notes at the meeting: Ex 56, Vol 5, p970. Those notes record Trowbridge were asked to prepare an analysis which indicated what funds would be required to meet the projected liabilities for periods of 10, 15 and 20 years using earning rates of 7, 8 and 9%. The Trowbridge analysis was to be "updated with latest thinking on epidemiology".

9.4.7 As between the incoming directors, Mr Gill and Mr Jollie made inquiries in relation to the actuarial analysis. Mr Gill was entrusted with the primary responsibility for ensuring that the Trowbridge report was one on which the directors could rely: Gill T16.54-.57. On 5 February, Mr Gill telephoned Mr Attrill to arrange a meeting on 6 February to go over "what the directors and trustees will expect to see in the actuary's report". In that conversation Mr Gill said to Mr Attrill that the other directors were looking to him for direction in relation to the matter: see Mr Attrill's note Ex 56, Vol 4. See also Mr Attrill's email of 6 February Ex 56, Vol 4, p990.

9.4.8 In his email to Mr Shafron (Ex 56, Vol 4, p990), Mr Attrill said of Mr Gill: "He wants me to understand exactly what they want the report to cover …".

9.4.9 Following the 15 January 2001 meeting, Messrs Gill and Jollie also took steps to obtain further information in relation to the proposal. Mr Gill was entrusted with primary carriage of ensuring that the Trowbridge report was one on which the directors could rely: T468.50-.58; T469.1-.4. Mr Attrill wrote to Mr Shafron saying that Mr Gill had said “the other directors are looking to him for direction on this part of the exercise”: Ex 75, tab 112, p 2609. This is consistent with Mr Gill raising questions about Trowbridge at the 15 January 2001 meeting.

9.4.10 Mr Gill had wanted to meet Mr Attrill to go over “what the directors and trustees will expect to see in the actuary’s report”. Mr Attrill said “He wants me to understand exactly what they want the report to cover so that Tuesday proceeds smoothly”. Mr Attrill wrote (and later received from Mr Shafron the preliminary answers in brackets):

> The particular areas he mentioned on the phone are:
>
> - the assumptions underlying the projections (David to discuss);

- does the report take account of the latest Trowbridge projections (yes);

  (Ex 75, tab 112)

- has the actuary taken account of all potential areas of claim (he mentioned land remediation and third party claims - DDB?) (Only to the extent that those claims are likely to result in claims);

- will the report clearly set out how long the money will last on various bases (eg high, medium and low future claim levels) (yes)?

He reiterated that unless the money lasts at least 15 years, then "James Hardie would need to look at another model in which you acknowledge up front that you intend to appoint an administrator." (It will last at least 15 years).

9.4.11 In cross-examination, Mr Gill had "little doubt" that that was what he had said, although he could not recall it: T343.26-.29. This request led to the meeting between Gill and Attrill on 9 February.

9.4.12 As has been mentioned, Gill had obtained a copy of Trowbridge's 29 November 2000 paper by Watson and Hurst on or before 22 January 2001, and distributed it to Messrs Cooper and Jollie by email that morning; Ex 33. He also mailed copies to Sir Llewellyn and Mr Jollie: T328.43-.45. Mr Jollie received his hard copy on 24 January: Ex 7, vol 3 tab 8. It was read by Mr Jollie, who understood that Trowbridge were concerned to replace the old Andrews and Atkins model in the light of new information with modelling known as "Berry medium" and "Berry high": T467.5-.17. Mr Cooper had seen it on the internet: T 95.37-38.

9.4.13 Mr Gill having read the Watson and Hurst paper, must be taken to have understood the reference to "recent work" in the 13 February 2001 Trowbridge report as a reference to that work; certainly, he had no alternative explanation: T348.16-.28.

9.4.14 For all of those reasons, by February 2001 the incoming directors, particularly Messrs Gill and Jollie, were aware of the Watson and Hurst paper and its contents and knew that it had implications for the positions they were considering. The Watson and Hurst paper stated that:

(a) the former method of projecting future asbestos claims was out of date;

(b) the 1990's data was worse than expected;

(c) the 1980's experience tended to be understated, particularly for insurers;

(d) many companies may now have sufficient claims data to apply a more direct method: Ex 7, vol 3, tab 8, p 103.

(e) the increases suggested were substantial: 109% (Berry medium) and 153% (Berry high): Ex 7, vol 3, tab 8, p 105.

Other factors were changes to legislation, weakening of lung cancer criteria, increased Stevedore claims, plaintiff lawyer activity: Ex 7, vol 3, tab 8, p 108.

9.4.15 On 9 February 2001, in response to his request, Mr Gill met Mr Attrill, together with Messrs Shafron and Morley, to go through the what was going to be found in the Trowbridge report. He agreed that he had free access to Mr Attrill: T351.7-.26:

> Q During this period you had fairly free access to Mr Attrill?
>
> A. Well, Mr Attrill was available.
>
> Q. He was available to you to ask questions as you understood it?
>
> A. Yes.
>
> Q. And no one suggested to you that you couldn't ask questions of him if you chose to do so?
>
> A. No.
>
> Q. Indeed each time you asked for a meeting with him you were granted one?
>
> A. Well, I think there was only the one occasion.
>
> Q. But I take it that's because you thought that at the end of that one occasion you had been provided with whatever information you required?
>
> A. It was specifically on the Trowbridge report, yes.

9.4.16 At that meeting, Mr Gill was provided with a draft forecast of cashflows under the Current, Best estimate and High Scenarios: Ex 29, p 69-72; T345.49-.52. On the first of those cashflows, Mr Gill had written and circled the words “MARCH 2000". He ultimately agreed that the most likely explanation was that he was told that the figures were based on March 2000 numbers: T348.16-.28:

> Q. Can I suggest to you that when you were given these documents in February, you understood that the current projections which are on page 70 referred to Trowbridge projections using the old model, that is the Andrews and Atkins model and Hardie's numbers up to March 2000?
>
> A. I don't have a recollection that I actually formed the view that the numbers were at March 2000. I do acknowledge that the note is there.
>
> Q. Looking at it now that's a sensible explanation of the document?
>
> A. In the absence of anything more plausible I would agree with you.

9.4.17 There is no such annotation on the second or third cashflow, but Mr Gill agreed that the likelihood was that he was not told that the new approach had been applied to data as at any date other than March 2000; otherwise he would have made a note: T349.7-.21; T349.45-.54:

> Q. And it's likely, isn't it, that if you were told or understood that those high scenario and best estimate scenarios had been applied to data other than the March 2000 data, you would have made a note about it?
>
> A. Possibly Mr Meagher, yes.
>
> Q. The likelihood?
>
> A. Yes, the likelihood is if I'd been told another date for those and it was as to the underlying data I would have made a note.

COMMISSIONER: Q. Other than what?

A. March 2000.

...

Q. Can I suggest to that if someone had told you that these high scenario and best estimates scenarios were based on other than the March 2000 Hardie's numbers you would have made a note about it?

A. I may well have.

Q. If you understood that as a result of your own discerning process then equally you would have made a note about it?

A. Yes, I suspect so.

9.4.18 That informed Mr Gill's understanding of the Trowbridge presentation at the 13 February 2001 meeting.

Issue 10

10. *Evidence suggests that the incoming MRCF directors asked for the June 2000 Trowbridge report, but that this was not provided to them. If this is correct:-*

(a) *was it withheld because of a concern that its disclosure would highlight the limitations of and uncertainty surrounding the Trowbridge estimates, or the deterioration of the Trowbridge estimates from 1996 to 2000;*

No.

(b) *was it withheld out of a concern about legal professional privilege;*

That was one of the reasons why the report was withheld.

(c) *was it withheld for some other reason, and if so what;*

It was felt that it was unnecessary to provide the incoming directors with the June 2000 report once it was to be superseded by the February 2001 report.

(d) *if it had been disclosed to the incoming directors, would it have been likely to have made any difference to their decisions in relation to the establishment of the MRCF?*

No.

9.5 Meeting of 13 February 2001

9.5.1 On 13 February 2001, the incoming directors received the letter of that date from Trowbridge. This was the letter which they, especially Mr Gill, had been waiting for the best part of a month: T352.16-.20. It was distributed either at, or shortly before, Mr Minty's presentation to the meeting. The footer of the draft at Ex 7, vol 1, tab 16, p 302, states "13 February 2001 12.02pm".

9.5.2 The following matters are plain on the face of the draft report:

(a) it was a draft;

(b) it referred to previous draft advice which had been revisited following the recent work Trowbridge Consulting had carried out;

(c) it was expressed to be "Based on all of the information available";

(d) the text of the report and appendix D made it perfectly clear that claims would continue to be reported for at least forty years; and

(e) the cashflow analyses and calculations of total liabilities in appendices A. B and C were all confined to periods of 10, 15 and 20 years.

9.5.3 Mr Jollie was concerned that the report was addressed to Mr Williams of Allen Allen & Hemsley. This was remedied by a later letter making it clear that the incoming directors were intending to rely upon it.

9.5.4 On the factual issue of what was said during Mr Minty's presentation, once again the best record is found in the contemporaneous notes Mr Attrill (Ex 75, tab 113A, p 2667 and Mr Robb (DAR1 1/61).

9.5.5 The questions to Mr Minty were mostly asked by Mr Gill, Mr Attrill's notes record:

MG: Out of scope:

- Remediation risks
- Exemplary damages
- Any extraordinary changes
- DDB reimbursement
- Product export risk (Aust & a few NZ claims)

Are we getting better at picking the peak?

DM: We're getting a better understanding of latency of meso. US studies, not 35 years, more likely 45 years. But are big questions about the underlying number of claims. Significant info only came to light in 2000. Berry's models now look good - in 1996 they looked extreme.

MG: "Current model" - March 2000?

DM: Yes

MG: Less than 12 mths old?

DM: Yes

MG: 9-12 mths out - dramatic move again.

DM: Yes - new information has impacted on the assessment.

PJ: We intend to rely on this.

9.5.6 Mr Robb's notes of the same meeting are at Ex 187, tab 16, p 61. They contain the following;

D Minty - background - started review in '96

- last review as at March 2000

-future is not clear

- dependent on medical/nature of claims/court decisions

- that said, there is a claims history

- future cash flows analysis

- cash flows over the next 10 + 15 years are reasonably predictable

- based on experience + evidence, ie based on best info available, this is Trowbridge view.

M Gill - out of scope

- exemplary damages

- DDB reimbursement

- product export risk

Are we getting better at working out the peak and knowing when?

D Minty - better info on latency periods

- not clear who + how many Aust. Were exposed

- March 2000 model

- James Hardie specific

DM - numbers have changed since March 2000

Due to recent US experience

P Shaf - no event, as such, that has occurred since that date

DM - case of superimposed inflation

- Board of Coy - addressed to Board of Coy

9.5.7 Both of those notes suggest that Mr Minty said, expressly, that the report was based on figures as at March 2000.

9.5.8 Further corroboration of the first proposition is found not merely in the evidence of Messrs Minty (Ex 50, [44]) and Marshall (Ex 54, [22] and [25]), but also in the annotations made by Mr Gill (who may be expected to have been most fully appreciative of the actuarial issues) and Mr Cooper.

9.5.9 Mr Gill had, in the manner set out in the previous section, been told on 9 February 2001 that the data on which the projections were based was as at March 2000 and made a note of it. In cross-examination in relation to what he was told on 13 February 2001, he gave the following evidence: T354.26 - 355.9:

> Q. I suggest to you that when you read the draft Trowbridge report on 13 February 2001 you understood that each of the projections, current best and high, were based on Hardie's numbers as at March 2000?
>
> A. I haven't got that recollection Mr Meagher, I think I've said that before.
>
> Q. Are you able to suggest any other understanding you may have had at the time of the actual Hardie's number upon which those projections were based?
>
> A. Not that I can recall.
>
> Q. And you've thought long and hard about that, haven't you?
>
> A. I've given it some thought.
>
> Q. Although you don't have a recollection the only possible understanding you believe you could have had was that they were based on March 2000 actual figures?
>
> A. I don't have any other explanation Mr Meagher.
>
> Q. In other words you agree with what I just put?
>
> A. Yes.
>
> Q. Is it likely that at the time you discussed your understanding of these actuarial reports and numbers with Mr Jollie?
>
> A. I can't recall discussing them than with the other directors.
>
> Q. Although it might be seen to have been a separate task for each director is it your recollection that you were the proposing director who was leading the analysis of the actuarial information?
>
> A. I was the only one who did the meeting on the 8th of February.
>
> Q. Did you have a recollection of passing on your information, and unless as a result of the meeting of 9 February and the meeting of 13 February, to your other proposing directors?
>
> A. No, I don't.

9.5.10 Mr Cooper, too, had annotated the 13 February Trowbridge report with the circled words “March 2000": Ex 7, vol 1, tab 16, p 308. His evidence in cross-examination was (T131.21-30):

> Q. When you go to page 308, when you wrote "March 2000 forecast", you were recording something which was said during this meeting, weren't you?
>
> A. I attempted to answer this this morning, Mr Meagher, and I wrote that at the time, and so I wrote that as a result of what was being discussed at the meeting.
>
> Q. My point is, it is highly likely to record something which was said rather than something which you deduced?
>
> A. Yes.

9.6 Attitude of incoming directors to funding of the MRCF

9.6.1 The Commissioner should find that:

(a) all of the incoming directors were interested only in whether the Foundation would be likely to be able to meet asbestos claims for the next 10-15, or at the outside, 20 years;

(b) all of the incoming directors appreciated that there was a chance that the Foundation would be unable to do so.

It is convenient to deal with these propositions in reverse order.

First proposition - real risk of insufficient funds

9.6.2 Each of the incoming directors appreciated there was a real risk that the Foundation might not have sufficient funds to meet all claims. This is clear from the following.

9.6.3 First, it is apparent on the face of the Trowbridge report of 13 February 2001, especially the projected rate of mesothelioma claims up to around 2041. Even focussing only on 20 years, the assets to be controlled by the Foundation approximated the Trowbridge estimate of liabilities in that period. In other words, there was little or no margin for higher than expected rates of claims or quantum of claims or lower than expected rate of return, and it was plain that claims would continue for decades past the 20 years projected.

9.6.4 Secondly, the qualifications and exclusions in the Trowbridge 13 February 2001 report included:

(a) "the nature of the problem is such that experience could vary considerably from our estimates";

(b) "the projections of future asbestos-related disease cases are based on epidemiological work that is subject to inherent uncertainty";

(c) "the behaviour of potential claimants (the propensity to sue) is uncertain and the potential exposure will be heavily influenced by legal decisions that are impossible to predict".

The notes of Messrs Attrill and Robb of 13 February 2001 reproduced above both record Mr Gill stating that exemplary damages, DDB reimbursement and product export risks were out of the scope of the report.

9.6.5 Thirdly, there were statements made to some of them individually, recorded in contemporaneous documents, that there might not be sufficient to meet claims. Most particularly, statements made to Mr Jollie, recorded in his own notes of his very first meeting of 5 January 2001, and in Mr Shafron's report of that meeting, are reproduced above.

9.6.6 Fourthly, the statements made to the incoming directors collectively by Mr Shafron at the 15 January 2001 meeting, especially:

(a) "Good chance on Trowbridge numbers, there won't be enough" (Attrill's note); and

(b) "$250 mill NPV @ 7% ∴ on that basis, not sufficient" (Robb's note).

9.6.7 Fifthly, the advice they received from Mr Bancroft, reflecting his understanding that all directors appreciated that there was a risk of insolvency. His evidence (T1841.43-56) was as follows:

Q. You said in answer to a question this morning, that the directors were specifically looking to you in relation to matters of insolvency?

A. Legal liability, yes.

Q. Did you discuss why the incoming directors were concerned about insolvency?

A. Because there was a prospect that the entities, the foundation entities may become insolvent at some future time.

...

Q. Specifically, do you recall whether the reference to the subject of insolvency was a reference to something which was regarded as theoretical, or as something which was regarded as a real likelihood?

A. My impression is that it was regarded as a real likelihood, but at some considerable time into the future and my recollection is a period of 15 to 20 years.

Q. Was that a concern that continued through to the 15th and 16th of February?

A. I believe so, yes.

Second proposition - directors concerned with 10-15 years, at most 20 years

9.6.8 Turning now to the proposition that the incoming directors were interested only in projections for the next 10-15, and, at the outside, 20 years, again it might have been thought that that was obvious from the contemporaneous documents, not least:

(a) the 13 February 2001 Trowbridge report (which contained projections for 10, 15 and 20 years);

(b) the notes of the 15 January 2001 meeting of Mr Attrill ("If funds adequate for 10-15 yrs, OK");

(c) the notes of the 15 January 2001 meeting of Mr Robb ("How long will funds last - if 10-15 then OK");

(d) the briefing note prepared by Mallesons following a meeting with the incoming directors on 6 August 2001 when they confirmed "that a minimum expected life of some 15 to 20 years was critical" to their decision: Ex , Beacroft, para 6, tab 4, p2.

(e) The meeting between Ashe and Cooper on 7 August 2001 reported to Shafron in Ashe's email of that date: Ex 150, p167. During that meeting Cooper said:

> … it is the Foundation's view that based on the information provided at commencement, funding would last 15 to 20 years only. … The 11.7% earnings rate was unrealistic and that it was their view that 8.7% was more realistic, and this got them to 15-20 years.

9.6.9 Nevertheless, in their evidence in chief, some of the Foundation directors, especially Sir Llewellyn and Mr Jollie, with varying degrees of strength, contended that they had understood that the Foundation would be funded for a period beyond twenty years. That stance did not credibly survive cross-examination. The evidence of each is addressed below.

Sir Llewellyn Edwards

9.6.10 In his statements, Sir Llewellyn asserted his expectation that the funding would be sufficient to cover all expected new claims, without however providing any precise time when those statements were said to have been made. In cross-examination, he confirmed that his focus was confined to claims made in the next twenty years (T203.27-.53):

> Q. Whilst you were on the Board, you were used, were you not, to getting Trowbridge reports put forward that put forward an estimated liability in relation to James Hardie's asbestos liabilities through to approximately the year 2030 and beyond?
>
> A. Forecasts were considered by the Board from Trowbridge on a number of occasions in that area.
>
> Q. Yet the Trowbridge report of 13 February only went out to twenty years?
>
> A. I do believe that in that the discussions that I had in all my time associated with preparation for this consideration felt that we needed to be assured over a period of twenty years, so I would not be surprised if there was that consideration being made.
>
> Q. But Sir Llewellyn, as I understand it, you brought some experience in relation to asbestos related disease both to the Board of JHIL and to the Foundation, is that correct?
>
> A. That is correct.
>
> Q. You were well aware of the lag period that can exist between exposure to asbestos and the development of mesothelioma?
>
> A. Yes, but I thought at that time and still do that a twenty year forecast is probably the best one can do in scientific matters and the epidemiology of diseases.

9.6.11 That is, of course, consistent with the contemporaneous documents, leading up to the 13 February Trowbridge report, which confined the projections to 10, 15 and 20 years. It is also inherently unlikely that his concern would extend beyond 20 years, at which time he would have been 86, and have been subject to the requirement of annual extension of his appointment by special resolution pursuant to s201C of the *Corporations Act* for the previous 14 years.

9.6.12 Accordingly, the Commissioner should reject the suggestion that it was important for Sir Llewellyn to have been assured that the Foundation would have been funded for any period beyond 20 years.

Mr Cooper

9.6.13 Mr Cooper's decision was made before the first meeting of 15 January 2001 (see above). He readily admitted in cross-examination that he understood that the asbestos exposure would extend beyond 20 years, but was content to obtain an actuarial analysis for no longer than 20 years: T131.58 - 132.13:

> Q. So you understood clearly that this report was telling you that the claims and the liabilities would run well beyond the twenty year period?
>
> A. Yes.
>
> Q. But that the report only contained a cashflow analysis for a period of twenty years?
>
> A. Yes.
>
> Q. And you understood when you got the draft report that it did that because that is what had been previously discussed, is that right?
>
> A. Yes, twenty years was seen as a reasonable number of years.

9.6.14 See also Cooper's statement to Ashe on 7 August 2001 that it was the incoming directors' view at the relevant time that with a realistic earnings rate of 8.7% the funding would last 15 to 20 years only: Ex 150, p167.

Mr Gill

9.6.15 Mr Gill readily acceded to the view that what was important to him was that there be funds for 15 or 20 years: T299.5-.8; T382.18-.22; T384.45-.57. He plainly communicated that view at the time (as recorded in the Attrill and Robb notes). In his letter of resignation (para 28) he wrote:

> At the time the belief was that the Foundation and its related entities had been more than adequately funded for the next 15 or 20 years; indeed some statements by James Hardie were to the effect that the funds would cover the full run-off.

Mr Jollie

9.6.16 Mr Jollie's statements that he only became a director on the basis that the *entirety* of the asbestos tail would be able to be met should not be accepted. They are at odds with:

(a) the contemporaneous documents (particularly Messrs Attrill's and Robb's notes of the 15 January 2001 meeting);

(b) the forecasts prepared by management, including that at a rate of return of 7% at Mr Jollie's own request, which lasted only for 20 years;

(c) the Foundation's own minutes;

(d) Mr Gill's own letter of resignation (referred to above);

(e) Mr Jollie's own rough "back of the envelope" calculations based on 15 and 20 years (Ex 7, vol 3, tab 10, p 186; T472-473; T478.19-.21);

(f) Mr Jollie's concession that the cashflow calculations were very sensitive to rates of return, and that if those rates were 6.5% or 7%, on at least one of the projected scenarios the money would run out within 20 years: T474.25-.42; T476.1-.16:

Q Before becoming a director you knew that a low earning ratio of 7 percent within a 20 year scenario that this Foundation wouldn't have enough money to pay out all claims?

A. Yes.

Q. And it wouldn't have enough money to pay out all claims on some assumptions within 20 years, it certainly wouldn't have enough money to pay out all the claims until they stopped coming in?

A. That follows, yes.

Q. Because there were hundreds of millions of dollars of claims expected to come in after the 20 years expired, weren't there?

A. That's correct.

(g) The briefing note prepared by Mallesons in August 2001 (referred to above).

9.6.17 The position of the directors is further confirmed by a paper that was attached to a report prepared by Mr Cooper and distributed to Sir Llewellyn, Mr Jollie and Mr Cooper in August 2000: Ex 7, tab 6; Ex 297 tab 4. The report states:

> Directors confirmed during their August 6 meeting that a minimum expected life of some 15 to 20 years was critical to their decision to participate in the Foundation.

Any suggestion that any of the directors was concerned that the fund would last indefinitely must be rejected.

Issue 9

9. The February Report only projected liabilities twenty years into the future; the present value of later claims was not assessed.

(a) What significance, if any, was there in selecting a period of 20 years?

(b) What importance, if any, was attributed to the new entity having an economic life of at least 20 years by

i) the incoming MRCF directors

ii) the outgoing directors of Coy and Jsekarb

iii) the Board or management of JHIL?

This issue is dealt with above and in sections 11 and 12 below.

9.7 Knowledge of incoming directors of basis on which Trowbridge report prepared

9.7.1 For the reasons set out above (based principally on the notes of Messrs Attrill and Robb of 13 February 2001, the annotations of Mr Cooper and Mr Gill on that day, and the testimonial evidence of Messrs Minty and Marshall), the Commissioner should find that the incoming directors were told that the Trowbridge report was based on the March 2000 data.

9.7.2 The incoming directors also appreciated that the methodology adopted in the Trowbridge report was to update the draft June 2000 approach by reference to the new information exposed in the Watson and Hurst paper. In particular, Mr Gill appreciated at the time that Andrews and Atkins was being replaced by Berry curves: T338.52 - 339.25.

9.7.3 However, they were not told by Trowbridge or anyone else that later data was available. Mr Jollie’s evidence was (T471.39 - 52):

Q. Did they, at any time, tell you that there was other information that they knew of, that they weren't using?

A. No.

Q. Did they tell you that they were using the best information available?

A. I believe they did.

Q. When you say you believe they did, do you have a recollection of Mr Minty or Mr Marshall saying that, or is that simply an assumption that you are making?

A. It's based on the statement in the Trowbridge report, that they have based their report on the latest, and I believe that was the thrust of Mr Minty's presentation.

Issue 6

6. There is evidence that the incoming MRCF directors did not appreciate that the February Report and the cash flow model produced by Mr Harman of JHIL did not employ the Current Data for the "best estimate" and "high" iterations of the model? If this is correct, should they on or before 15 February 2001 have appreciated this was the case, having regard to:-

i) the language and content of the February Report, including the language of the 15 February version of the report;

ii) the terms of the cash flow models they saw;

iii) what the incoming MRCF directors were told by Trowbridge, JHIL representatives and their own lawyers;

iv) documents seen by them; and

v) any other circumstances?

Yes.

9.8 Knowledge of incoming directors of proposed Deed of Covenant and Indemnity and matters relevant to its effect

9.8.1 Mr Gill met Messrs Shafron, Morley and Attrill on 9 February 2001 (his notes are Ex 29, p 68), where he received spreadsheets showing that JHIL proposed to contribute an additional $63 million to the Foundation. He noted on the spreadsheet, next to the "indemnity receipt" column:

> Coy, in return for accepting this payment, gives up its right to sue JHIL (Exhibit 29, p71)

9.8.2 Likewise, Mr Cooper knew about the indemnity prior to the 13 February meeting: T128.41-.49.

9.8.3 The incoming directors were provided on 13 February 2001, with a document described "SET UP AND STRUCTURAL ISSUES" (Exhibit 29, p 98-99). The document included the following (p99):

> Extra funding and Hold Harmless
>
> The JHIL Board will be asked to approve the injection of additional capital into JH & Coy & Jsekarb so that they will be better able to meet claims that may be made against them, and ultimately fund medical research. The additional amount recommended by management is $70M - to be paid at 12.5M pa - and allocated primarily to JH & Coy with a portion to Jsekarb. In return, Coy and Jsekarb will agree to hold JHIL harmless and indemnify JHIL against claims that may be made against it in relation to the manufacture of asbestos containing products post 1937 by JH & Coy. No amount will be payable where JHIL has insurance cover. JHIL would remain at risk and unindemnified for the manufacture of asbestos containing products prior to 1937,

In addition, and also in consideration of the additional funding, JH & Coy will agree to acquire all the outstanding shares in JHIL, should JHIL be offered to it at some future time not holding any business operations, delisted, and otherwise non operational."

9.8.4 Mr Shafron spoke to that paper at the meeting on 13 February 2001. According to Mr Attrill's note (Ex 75, tab 113A, p 2665) he said:

> Add'l capital into JHC NPV = $70m paid over time.
>
> JHIL will in return will receive an indemnity from JHC, other than for claims arising out of pre-1937 A production.
>
> Indemnity would be given by the existing Boards.

9.8.5 However, it seems clear that none of the incoming directors turned their minds to the full scope of the deed (insofar as it extended to management fees, dividends, and contribution claims). There are two good reasons for this.

9.8.6 First, the outgoing directors, not the incoming directors, were to execute the deed.

9.8.7 Secondly, the indemnity was the price of the very substantial capital injection by JHIL. The evidence of Mr Cooper was as follows:

> Q. The Deed of Covenant and Indemnity involved Amaca and Amaba giving up rights, you understood that?
>
> A. Yes.
>
> Q. If the rights were worth more than was promised in exchange, then it was a bad deal?
>
> A. I agree.
>
> Q. And a bad deal for claimants against Amaca?
>
> A. Yes.
>
> Q. I know it is a transaction that you had no role in, Mr Cooper, but I just need to ask you this. Did you make any enquiry yourself as to the benefits that James Hardie expected to achieve from the creation of the Foundation?
>
> A I didn't see the transaction that way, Mr Sheahan, I saw the transaction as a method by which Hardies could provide the necessary funds to the Foundation.

Issue 30

30. The evidence discloses that Sir Llewellyn Edwards and Messrs Gill, Jollie, and Cooper were selected by JHIL to join the MRCF.

(a) To what extent, if any, were the incoming MRCF directors effectively independent of JHIL, having regard to the nature and extent of the prior dealings and relationships between Sir Llewellyn, Mr Cooper, Mr Gill and JHIL?

They were effectively independent.

(b) Did the incoming MRCF directors:

(i) Properly and diligently assess the adequacy or otherwise of the funding associated with the establishment of the MRCF/Amaca/Amaba?

(ii) Properly and diligently pursue JHIL for information which would assist them to assess the adequacy or otherwise of the funding associated with the establishment of the MRCF/Amaca/Amaba (eg, the June 2000 Trowbridge report; cash flows extending beyond 20 years; cash flows assuming a 7% earnings rate; evidence or opinion to support an assumed 11.7% earnings rate; advice as to how the warnings and criticisms of PWC and Access Economics as to the cash flow model were, or should be, addressed?

(iii) Pursue JHIL in an effective and timely way for remedies or assistance when it appeared there was likely to be a shortfall earlier than anticipated?

The incoming directors did all they should have done.

(c) What if any duties did the incoming MRCF directors have in these respects? What was the source and content any such duty?

The incoming directors owed no relevant duties.

(d) To what extent, if at all, does time pressure explain the acts or omissions of the incoming MRCF directors?

This issue is dealt with in section 12 below. Time pressure is one of the matters which is relevant to understanding why things occurred as they did.

10. Dealings between incoming MRCF Directors and Bancroft

10.1 History of the dealings

10.1.1 Mr Bancroft of Mallesons Stephen Jaques was asked by JHIL in December 2000 to give independent legal advice to the proposed incoming directors: Ex 95, [10]. The letter to Mallesons of 9 January 2001 made it clear that Mr Bancroft's instructions included to advise the incoming directors on any matters "in connection with the trust proposal that they may raise". Although there was no need to do so it also made plain that Bancroft was expected to directly contact each of the incoming directors and to advise them in the absence of any JHIL representatives: Ex 17, tab 88. He understood his role to be to give a “comprehensive risk analysis to the directors”: T1831.49. In the letter of advice of 15 February 2001 given to the incoming directors, it is stated that (Ex 95, tab 47):

> JHIL has instructed us to advise the proposed incoming directors of MRCG and the Former Subsidiaries of the legal issues relevant to accepting an appointment as a director of these companies.

10.1.2 Mr Bancroft was an experienced corporate partner in a highly regarded law firm. It must be inferred that he was appointed in order to ensure that the proposed incoming directors received the best available legal advice about what they were doing.

10.1.3 Mr Bancroft accepted that in order to understand the legal risks faced by the new directors, he had to have an understanding of the assets and liabilities which the Foundation and its subsidiaries would have, going forward: T1863.41. He took steps to inform himself about those matters: see eg T1863.43-.59. He attended the meeting between JHIL and the proposed incoming directors (his clients) on 15 January 2001, during which he gained the impression in relation to insolvency that (T1865.37):

> it was regarded as a real likelihood, but at some considerable time into the future and my recollection is a period of 15 to 20 years.

10.1.4 As at the 15 January 2001, the model under consideration was the net asset model, that is without the additional consideration flowing from entry into the DOCI. Nevertheless, Mr Bancroft (T1865.50):

> always considered that there was some eventual risk of insolvency.

10.1.5 Mr Bancroft advised his clients that it was inappropriate for them to execute any documents in connection with the proposed transaction, other than their consents to act as directors: Ex 95, [62]. He sought and obtained instructions from his clients that he advise Allens that his clients were unwilling to execute any transaction documents, or to resolve to do so, on behalf of Coy or Jsekarb. This was conveyed to Allens: Ex 95, [64]. Having regard to this, it cannot be suggested that there was some kind of sinister plot on the part of JHIL to ensure that the outgoing directors executed the transaction documents.

10.1.6 Nevertheless, Mr Bancroft and Mallesons did consider and were involved in the finalisation of the terms of the DOCI. Although Mr Bancroft could not specifically recall doing so, the evidence points conclusively to the fact that he did so:

(a) Mr Bancroft's time sheets record that he spent 3 hours on 14 February on "various issues on documents": Ex 95, tab 49, p 644; T1869.55;

(b) On 15 February 2001, Mr Frangeskides from Allens sent an email to Mr Bancroft and Ms Hunter, which stated (Ex 95, tab 42; T1870.38):

> Further to your telephone call with David yesterday, I attach a revised draft of the Deed of Covenant and Indemnity … please let me know as soon as possible if you have any remaining comments on the Deed;

(c) On the evening of 15 February, Mr Bancroft participated (with Mr Gill) in the drafting of clause 4A of the DOCI: T1873.37.

10.1.7 Mr Bancroft accepted that he had to understand the DOCI and what it purported to do in order to advise his clients: T1871.24. He had to understand the benefits and obligations arising from the DOCI: T1871.31-.37. His evidence is also that (T1872.31):

> I believe we sat down on the evening of the 15th and the [DOCI] was reviewed with one or more of the directors.

10.1.8 Even though Mr Bancroft accepted that, in order to give the advice he was required to give, it was necessary for him to understand the benefits and obligations flowing from the DOCI, his evidence is that he did not review the document adequately: T1871.42. He said that he said to his clients that he had not had time to review the document adequately and therefore would not be able to give them comprehensive advice: T1871.44. Mr Bancroft did not urge his clients not to proceed with the transaction until he had had a proper opportunity to review the DOCI: T1842.31.

10.1.9 The written advice of 15 February 2001 merely indicates, by omission, that Mallesons has not reviewed the DOCI (which in any event was not entirely correct). It does not say that a comprehensive advice would require Mallesons to review the DOCI: Ex 95, tab 47. That advice concludes:

> we do not consider that accepting the office of director of MRCF or the Former Subsidiaries will expose any proposed director to an unacceptable degree of risk.

10.1.10 The advice was signed after the DOCI was "reviewed" by Mr Bancroft with the directors on the evening of 15 February 2001: Ex 95, [73].

10.1.11 So far as JHIL and its officers and advisors were concerned, the proposed incoming directors had the benefit of expert legal advice. JHIL had no reason to suppose that Mr Bancroft would give anything other than skilled and independent advice. The evidence of Mr Bancroft suggests that he had not provided comprehensive advice and that the incoming directors knew that was so. They could have insisted upon receipt of that advice but they did not. On the other hand, Mr Bancroft did not caution them against proceeding before obtaining that kind advice (which was the very advice he was instructed to provide at the outset). The efficacy of the independent advice appears to have failed to some degree, but that is entirely the fault of the incoming directors or Mr Bancroft or both. No blame can properly be levelled at JHIL.

11. Transactions of 15-16 February 2001

11.1 Summary of the transactions

11.1.1 On 15 February 2001, the Board of JHIL met to consider the transactions which would bring "the Foundation" into existence. This Board meeting continued into the early hours of 16 February 2001: Ex 75, Vol 8, tab 118 (minutes of meeting); Ex 75, Vol 8, tab 119 (Board papers). Board meetings of Jsekarb and Coy also took place on 15 and 16 February respectively.

11.1.2 An overview of the various transactions of 15 and 16 February 2001 can be obtained if they are analysed as follows:

(a) Transactions creating the Foundation corporate group;

(b) Transactions between JHIL and Coy;

(c) Other service agreements;

(d) The JHIL Board on 15 February 2001 and changes in directorships; and

(e) Subsequent corporate name changes.

Transactions creating the Foundation corporate group

11.1.3 **Incorporation of the MRCF**: The MRCF was incorporated as a public company limited by guarantee on 15 February 2001. Clause 5 of the Foundation's constitution provides that the objects for which the Foundation is established are solely for charitable purposes to further medical research in asbestos-related diseases.

11.1.4 **Incorporation of MRCFI and relation to MRCF**: MRCF (Investments) Pty Ltd (***MRCFI***) was created on 15 February 2001. All shares in MRCFI were issued to MRCF, thereby making MRCFI a wholly owned subsidiary of MRCF.

11.1.5 **Cancellation of shares in Coy and Jsekarb**: On 15 February 2001, the Board of JHIL, consented to the cancellation of JHIL's shares in Coy and Jsekarb: Ex 75, Vol 8, tab 118, p2721-2722. The shares were then cancelled as follows:

(a) Pursuant to a resolution passed at a general meeting of Jsekarb on 15 February 2001, all of JHIL's (fully paid) ordinary shares in Jsekarb held were cancelled for no consideration.

(b) Pursuant to resolution passed at a general meeting of Coy on 16 February 2001, all of JHIL's (fully paid) ordinary shares in Coy were cancelled for no consideration.

11.1.6 The prelude to this transaction occurred at meetings of Coy and Jsekarb on 14 February, in which it was resolved to consolidate all the ordinary shares in Coy into one ordinary share (held by JHIL), and all the ordinary shares in Jsekarb into one share (held by JHIL).

11.1.7 **Issue of shares in Coy**: On 15 February 2001, both the MRCF and MCRFI were issued 500 shares each in Coy. These are the only shares issued in Coy: Ex 42, tab 31; see also Ex 75, Vol 8, tab 118, p 2723 (JHIL ratification of Coy Board resolution).

11.1.8 **Issue of shares in Jsekarb**: On 15 February 2001, Coy was issued 1,000 ordinary shares in Jsekarb. These are the only shares issued in Jsekarb. The transaction resulted in Jsekarb being a wholly owned subsidiary of Coy: see Ex 75, Vol 8, tab 118, p 2723 (JHIL ratification of Jsekarb Board resolution).

11.1.9 **The MRCF trust and JHIL's gift**: The MRCF became the trustee of a trust for charitable purposes established under a deed executed on 16 February 2001: Ex 3, vol 1, tab 6 (alternatively: Ex 7, vol 6, tab 10 and Ex 75, tab 130). JHIL made a payment of $3m to the Foundation to be used for scientific and medical research aimed at finding treatments and cures for asbestos diseases: see also Ex 75, Vol 8, tab 118, p 2722.

11.1.10 The effect of the transactions described above was to create a corporate group, the members of which are MRCF, MRCFI, Coy and Jsekarb. In evidence before the Commission this corporate group was described as "the Foundation". The relationship between MRCF and Coy and Jsekarb may be described as follows:

(a) MRCF either directly, or indirectly through its wholly owned subsidiary MRCFI, is the owner of all shares in Coy; and

(b) MRCF, through the interposed entities of Coy and MRCFI, is the indirect owner of all shares in Jsekarb.

Transactions between JHIL and Coy

11.1.11 Deed of Covenant and Indemnity (***DOCI***): On 15 February 2001, the JHIL Board resolved to execute the DOCI and make the payments as required under it. The DOCI was actually executed in the early morning hours of 16 February 2001: Ex 75, Vol 8, tab 128. Under the Deed of Covenant and Indemnity, Coy and Jsekarb covenanted not to sue JHIL in respect of, and indemnified JHIL against, asbestos-related liabilities arising from the manufacture of asbestos products by Coy and Jsekarb. In return, JHIL promised to make a series of annual payments to Coy and Jsekarb totalling $112m over the 41 years to 15 February 2042.

11.1.12 **Loan Deed**: On 16 February 2001, JHIL and Coy executed a loan agreement (Ex 75, vol 3, tab 129) which formalised the terms of a $70m loan previously provided by Coy to JHIL: Ex 75, Vol 8, tab 118, p 2721.

Other service agreements

11.1.13 On 16 February 2001, the following transactions were also entered into:

(a) A General Manager's Contract between Coy and Dennis Cooper: Ex 75, Vol 8, tab 131.

(b) A Consultancy Agreement between Coy and Litigation Management Systems Pty Ltd: Ex 75, vol, 8, tab 133 (draft).

(c) A deed poll in the form of an "Establishment Letter" by JHIL addressed to the MRCF which established the assistance that in connection with transitional arrangements of day to day management with Coy and Jsekarb, and an agreement to reimburse MRCF and Coy with any costs incurred by them in effecting the creation of the Foundation: Ex 75, tab 132; Ex 75, Vol 8, tab 118, p 2722.

The JHIL Board on 15 February 2001 and changes in directorships

11.1.14 At the time of the 15 February 2001 meeting, the Board of JHIL comprised: Messrs AG McGregor (Chairman), PD Macdonald (Managing Director and CEO), Sir Llewellyn Edwards, Ms M Hellicar, Messrs PJ Willcox, MR Brown, GJ Terry, P O'Brien (as alternate for Sir Selwyn Cushing), MJ Gillfillan and MM Koffell: Ex 75, Vol 8, tab 118, p 2717.

11.1.15 This meeting was attended by two officers of JHIL, Mr PG Morley (Chief Financial Officer) and Mr PJ Shafron (General Counsel and Secretary). Also in attendance for part of the meeting were Messrs GJ Baxter and SE Harman; IG Wilson and AJ Sweetman (UBSW); P Cameron and D Robb (Allen Allen & Hemsley): Ex 75, Vol 8, tab 118, p 2717.

11.1.16 Mr Edwards resigned from the Board of JHIL in order to become the Chairman of MRCF and the other three entities within the Foundation: Ex 13, [19]. His resignation was effective after the JHIL Board transactions of the meeting of 15 February 2001 (including the transactions at that meeting which were entered into on the morning of 16 February 2001): see also Ex 75, Vol 8, tab 118, p 2723.

11.1.17 Following the creation of the MRCF and MRCFI on 15 February 2001, the Board of directors of MRCF, MRCFI, Coy and Jsekarb comprised Messrs Edwards, Gill, Jollie and Cooper: Ex 5, [108]. Prior to the transactions which created the Foundation corporate group, these four persons were briefed in their capacity as "incoming directors" of the MRCF on 15 February 2001.

11.1.18 Mr Gill resigned from the MRCF Board in late January 2003 and was replaced by Mr Hutchinson: Ex 26, [2], [11].

Subsequent corporate name changes

11.1.19 Following the transactions of 15 and 16 February, several entities changed their names. Coy changed its name to Amaca on 22 February 2001. Jsekarb changed its name to Amaba on 19 February 2001.

11.1.20 Much later, on 4 January 2002, JHIL changed its name to HAH Pty Limited. On 30 April 2002, this name was also changed, and the company became ABN 60 000 009 263 Pty Ltd.

Summary of 15–16 February transactions

11.1.21 The transactions described above in the paragraphs above effected a separation between JHIL on the one hand, and the Foundation entities (Coy, Jsekarb, MRCF and MRCFI) on the other. The transactions replaced company law rights and obligations between these parties with new contractual relationships.

11.1.22 Prior to these transactions, JHIL was the sole shareholder in Coy and Jsekarb. The intention of the transactions was to transfer ownership and control of Coy and Jsekarb to the MRCF and MRCFI. Rather than transfer the existing shares in Coy and Jsekarb to the Foundation entities, it was resolved to issue new shares and cancel JHIL's existing shares in Coy and Jsekarb. Thus, following the cancellation of JHIL's shares, new Coy shares were issued to the new entities MRCF and MRCFI; and new Jsekarb shares were issued to Coy. After the transactions, JHIL was no longer a shareholder in any of the Foundation entities.

11.1.23 The DOCI and the Loan Deed (and to a lesser extent the Establishment Letter) reflected the new contractual rights and obligations between JHIL and the Foundation entities.

11.2 The decision of Coy and Jsekarb directors of 15.2.01

11.2.1 So far as the outgoing directors of Coy and Jsekarb are concerned, the most significant decision that they made on the evening of 15 February 2001 was to resolve for the two companies to enter into the DOCI: Ex 42, tab 25.

11.2.2 In order properly to understand how the directors of Coy and Jsekarb (Mr Morley and Mr Cameron) came to make that decision, it is necessary first to appreciate how the idea of the indemnity arose.

11.2.3 During the course of the planning of Project Green in 2000, there had been some consideration of seeking an indemnity from the proposed trust company: Ex 17, [168]. When the incoming directors were first approached and up to mid January 2001, the trust proposal envisaged JHIL transferring Coy and Jsekarb to the trust company with their net assets and not making any additional payment: Ex 75, tab 95A, pp 2516-2517. That was made clear to the incoming directors: Ex 121, [181]. No indemnity was contemplated at that time: Ex 17, [168].

11.2.4 The advice from management to the JHIL Board in the January Board papers was that (Ex 75, tab 95A, p 2516-2517):

> There is no sound rationale for increasing the net assets of JH & Coy and Jsekarb and thereby expanding this quantum of funds available to claimants.

11.2.5 It was suggested that there was no legal obligation to do so. That was because the only assets available to claimants were the existing net assets of Coy and Jsekarb. Moreover, it was pointed out that if the directors did contribute additional funds in the absence of a legal obligation, the directors risked being in breach of their duty to act in the interests of JHIL shareholders. Indeed, there was serious concern about whether the directors could justify, in effect, giving away a company that had financial statements showing net tangible assets of $147 million. This was the subject of advice from Mr Allsop SC: Ex 75, tab 95, pp 2557-2563. Notwithstanding the advice of management, the Board concluded that the question of funding required more work: the Board wanted to know what was required in order to place Coy and Jsekarb into a position to fund all anticipated claims: Ex 17, [132], Ex 75, tab 95.

11.2.6 From that point until the Foundation was established, management set about working out how much additional funding was required in order for Coy and Jsekarb to have a realistic expectation of meeting all asbestos claims and working out how the directors could justify a decision to provide that funding.

11.2.7 When Mr Shafron received the first draft of Trowbridge's projections at the beginning of February 2001, the numbers were lower than he expected. For Mr Shafron, this meant that JHIL could seriously consider the JHIL Board's question of whether JHIL could provide top up money to Coy to give it a reasonable chance of meeting all future claims: Ex 17, [167], [169].

11.2.8 It was at this time that the idea of an indemnity re-emerged. On 1 February 2001, Mr Shafron indicated by email to Mr Macdonald and Mr Morley and others that he wanted to revisit the issue of an indemnity/release from Coy and Jsekarb. He noted (Ex 148, tab 13; and see also Ex 76, tab 111) :

> If we are being generous with Coy (and arguably we are, particularly if we hand across the 57) then that should support a waiver/indemnity in respect of Coy manufacture.

The "57" was a reference to the additional funds that were being considered as a payment to Coy and Jsekarb. Mr Macdonald thought Mr Shafron's point was a good one and that it provided (Ex 189, p 232):

> a very sound reason for us to increase the amount to the prospective Foundation directors.

11.2.9 The proposal for JHIL to pay extra money to Coy and Jsekarb in return for an indemnity was raised with the prospective incoming directors in the papers that were circulated on about 8 February 2001: Ex 17, [175], [176]. By that time the additional amount contemplated was $70 million (NPV) to be paid at $12.5 million per annum: Ex 76, tab 113, p 2651. The same papers also raised the possibility of a put option, by which Coy would agree to acquire all of the shares in JHIL (if it did not hold any business operations and was delisted). The consideration given by the incoming directors and their legal advisor to the DOCI is addressed in section 10 above.

11.2.10 It was plain to Mr Shafron, Mr Morley and Mr Cameron that Mr Morley and Mr Cameron would have to exercise their judgment about entry into the DOCI and do so consistently with their duties as directors. It was suggested to Mr Cameron and Mr Morley during cross-examination, in effect, that the decision should have been one for the incoming directors: T519.30; T2147.47. That overlooks the fact that the incoming directors made it plain through their solicitor that they regarded the transaction as one for the outgoing directors (see section 10 above).

11.2.11 By no later than 9 February 2003, Mr Shafron recognised that Mr Morley and Mr Cameron should receive independent advice. On 8 February 2001, Allens produced a draft of the DOCI: Ex 98, tab 4. Allens drafted the DOCI "from JHIL's perspective" and recognised that "Coy may have its own issues": Ex 215. This was raised with Mr Shafron, who responded that Mr Morley and Mr Cameron would provide a copy of the draft to their independent lawyer "and come back with any changes": Ex 215. That is what happened.

11.2.12 Mr Koeck from Blake Dawson Waldron was selected to provide advice to Mr Morley and Mr Cameron. Once again, he was an experienced corporate partner from a respected law firm. He could be expected to provide astute, independent advice. Mr Koeck caused some amendments to be made to the draft DOCI to narrow the scope of it: T1889.28-1890.29.

11.2.13 For the reasons identified above, from JHIL's perspective, the amount of money that was calculated as being a suitable additional sum to pay to Coy and Jsekarb was being driven by the amount calculated as necessary to fund all of the estimated asbestos claims. This was the exercise that Mr Harman was undertaking by way of his cashflow models (see section 8 above). Mr Morley of course was fully aware of that fact (his role in the analysis has been summarised in section 8). So too was Mr Cameron: T661.5.

11.2.14 What JHIL was offering to Coy and Jsekarb in exchange for the indemnity, the covenant not to sue and the put option was approximately $80m (in net present value terms: Ex 137). Mr Morley and Mr Cameron fully appreciated that this was, to use a colloquial but apt expression, "a pile of money": T1876.31.

11.2.15 Was it worth it? Mr Morley and Mr Cameron certainly thought so. Mr Morley's evidence is that he:

> Thought that [the] release and indemnity had little value.

See Ex 121, [271]; Ex 122, [22]. He and Mr Cameron plainly saw the $80 million as a real bargain, and certainly in the best interests of the two companies: T2148.29; T2154.11.

11.2.16 The elements of the indemnity and covenant not to sue upon which there has been some attention during the course of the Inquiry are:

(a) JHIL's prospective liability for asbestos claims; and

(b) JHIL's prospective liability to Coy on account of dividends or management fees.

It is correct that Mr Koeck did not provide independent advice to Mr Morley or Mr Cameron on either of these matters. Nor did Coy or Jsekarb otherwise receive independent advice. This can be explained.

11.2.17 As to the first matter, Mr Morley and Mr Cameron took advantage of the advice that Allens and Mr Allsop SC had provided to JHIL: T2170.10-2171.29. JHIL had obtained detailed advice about its likely asbestos exposure from solicitors with special knowledge of JHIL's position. Mr Morley and Mr Cameron knew what the substance of the advice was and Mr Cameron had spoken about the matter with Mr Williams of Allens: Ex 42, [64]-[69]; T2152.23. There was every reason for Mr Morley and Mr Cameron to think that this was a highly reliable view about JHIL's liability. There was not much sense in seeking another view. Further, no evidence has been adduced during the course of the Inquiry that suggests that JHIL (now ABN60) in fact does have a post 1937 liability for asbestos disease. That is, the assessment made by Mr Morley and Mr Cameron to the effect that there was a low risk that JHIL would ever need to call on the indemnity has not been shown to be wrong.

11.2.18 In relation to the second matter, Mr Cameron's evidence is that it was not pointed out to him that the DOCI included a covenant not to sue in respect of dividends or management fees: T535.29. He had no reason to believe that the payments were not properly made: T535.53. As it turns, this view accords with the fact: see sections 3 and 4 above. Mr Morley was certainly cognisant of the issues concerning dividends and management fees. Mr Morley was satisfied that the earlier management fees and dividends were properly paid: T2150.39; T2168.55. Mr Morley as the Chief Financial Officer of JHIL and a director of Coy since 28 February 1997 was well placed to make his own judgment about the propriety of the payments. Mr Morley also relied on the advice given by Mr Peter Cameron during the course of a JHIL Audit Committee meeting on 16 January 2001: T2150.43; T2154.1; T2224.44. It is significant to understand the context of the Allen's advice on 16 January 2001. At that time, there was thought to how an additional payment to Coy and Jsekarb might be justified. There was a desire on the part of at least some Board members to find a way to provide the additional funding without breaching duties owed by the directors to JHIL. The reversal of the October 1996 dividend was perceived as one possible means to justify a payment. Mr Cameron's advice was that it would be a "big call" to declare that dividend bad. The analysis in section 3 above shows that the call, if made, would have been wrong. After about 17 January 2001, no doubt in response to Mr Cameron's advice, the idea of reinstating the dividend faded away: Ex 122, [21].

11.2.19 The important observation is that Mr Morley did not receive Mr Cameron's advice in an ordinary adversarial context. In the circumstances, Mr Morley concluded that it was unnecessary for him to obtain separate advice on the question from Mr Koeck. He also concluded that it was unnecessary for Coy to obtain separate legal advice on the issue.

Those conclusions were open to him in the proper performance of his duties as a director. There was no breach of any director's duties by either Mr Morley or Mr Cameron. They and they alone made the decision that Coy and Jsekarb should enter into the DOCI.

11.2.20 Mr Morley was asked whether he thought about the value of the separation of Coy to JHIL with a view to assessing whether JHIL might pay more for the benefit of achieving separation: T2157.50; T2158.14; T2243.36. Mr Morley did not think about it in these terms. But that is not surprising. From Mr Morley and Mr Cameron's perspective, JHIL was offering Coy and Jsekarb over $80m in exchange for:

(a) a promise to indemnify JHIL against a risk that was remote;

(b) a covenant not to sue JHIL to recover payments that were probably not recoverable; and

(c) an option that would not burden Coy in any practical way.

Further there is no real reason to think that the indemnity, covenant not to sue or put option were essential to what JHIL wanted to achieve. The idea to seek these benefits was almost an afterthought on Mr Shafron's part. Coy did not have a bargaining chip of any significant value.

11.2.21 Furthermore, this was a case of a parent company entering into a transaction with a wholly owned subsidiary. To view such a transaction as an arm's length transaction with each party trying to extract the best deal possible is not appropriate. The only reason for a subsidiary not to enter into such a transaction is if it prejudices creditors in some wrongful way. In the present case, it did not. On the contrary, both Mr Morley and Mr Cameron believed that the DOCI provided an opportunity for Coy and Jsekarb to be in a position to meet all present and future liabilities: T538.23; 2158.1. It would have been quite an unreal thing if Mr Morley and Mr Cameron had tried to hold out for a bigger payment.

11.2.22 The DOCI remains as good a deal now for Coy and Jsekarb as it was on 15 February 2001. If it was set aside, the payments made by ABN60 to Coy and JHIL would have to be repaid and no further payments would be made. With the full benefit of hindsight, there is no reason to doubt that the transaction was a beneficial one for Coy and Jsekarb.

Issue 32

32. How was the consideration for the DOCI arrived at?

(a) Should any additional factors have been taken into account by the outgoing directors of Coy and Jsekarb, in particular, the extent of any commercial and other advantages anticipated to be available to JHIL in the event separation were achieved in a timely way?

This issue is dealt with above.

(b) *What, on a proper assessment, was the value to JHIL of achieving separation from Coy and Jsekarb?*

This is not relevant to any claim the MRCF might have and there is insufficient evidence for the Commissioner to form a conclusion on this issue.

(c) *If such matters were not taken into account by the outgoing directors of Coy and Jsekarb was this consistent with their duties of care and diligence (Corporations Law s180) and good faith (s181)?*

Yes

(d) *If not, what are the consequences? Are valuable remedies available to Amaca and Amaba? Is the DOCI liable to be set aside?*

No

(e) *Was JHIL a knowing participant in any such breach of duty? Was JHINV a knowing participant?*

No. No.

(f) *What remedies may be available against them?*

Not applicable.

Issue 33

33. *The DOCI included a covenant by Coy and Jsekarb not to sue in respect of intercompany payments including dividends and management fees.*

(a) *What advice did JHIL receive by 15 February 2001 as to the possible merits of such claims?*

(b) *Was such advice passed on to the directors of Coy and Jsekarb (Mr Morley and Mr D Cameron). If not, why not?*

(c) *Did JHIL elect not to obtain detailed advice as to this matter, and if so why?*

(d) *There is evidence that information as to possible claims of these kinds was not given to the independent lawyers for Mr Morley, Mr d Cameron, and the incoming directors. If this is correct, why was this so?*

This issue is dealt with above.

Issue 34

34. *Mr Morley says he relied on Allens to advise Coy and Jsekarb in relation to such matters.*

(a) *Did he in fact rely on Allens to advise Coy and Jsekarb?*

No.

(b) *Were Allens in fact retained to do so?*

No.

(c) *If not, were the interests of those companies not addressed by any informed legal advice as to the DOCI?*

No. The directors obtained independent legal advice. There was no relevant difference between their position and that of the companies; and apart from the directors and shareholder there was no entity which could give instructions or receive advice on behalf of the companies.

(d) *Did Mr Morley or Mr Shafron appreciate that, in the circumstances, the interests of Coy and Jsekarb might not be protected?*

The interests of Coy and Jsekarb were protected by the independent advice that their directors received and Mr Morley and Mr Shafron had no reason to doubt that that was the case.

(e) *If not, should they have appreciated this? Was this a breach of duty on the part of the directors of Coy and Jsekarb? Was JHIL or JHINV a participant in any such breach?*

See (d) above. No. No.

Issue 35

35. *Were the directors of Coy and Jsekarb, given the financial circumstances of those two companies, obliged to exercise reasonable care and diligence to achieve higher consideration for the DOCI than that offered by JHIL? Does this depend on them having formed a view as to the likelihood of Amaca and Abaca being able to pay all their present and future creditors with the offered funds? If so:*

(a) *Did the directors of Coy and Jsekarb form a view on that subject? If so, insofar as that view was based on Trowbridge's estimates of present and future liabilities, was the view reasonable having regard to what the directors knew or ought to have known concerning the Trowbridge estimates and their limitations?*

(b) *Insofar as the directors relied on the cash flow model in forming such a view, was the view reasonable having regard to what the directors knew or ought to have known concerning the model and its limitations?*

This issue is dealt with above.

Issue 36

36. *What was the actual or potential liability of JHIL for asbestos related claims as at the date of separation?*

This issue is dealt with by KPMG's report.

Issue 37

37. *The DOCI would not protect JHIL against claims by third parties if Coy and Jsekarb were no longer in a position to indemnify it. Was the put option, which obliged Coy to acquire all the shares in JHIL for a nominal consideration of ten dollars, included in the DOCI in order to cater for that situation?*

No.

Issue 38

38. As at 15 February 2001 were JHIL, Mr Shafron or Mr Macdonald directors of Coy and Jsekarb for the purposes of the *Corporations Law*?

No.

12. The decision of the JHIL Directors on 15 February 2001

12.1 The decision of the JHIL Directors on 15 February 2001

12.1.1 The consensus of the JHIL Board at the 17 January 2001 meeting had been that JHIL should investigate whether it was possible to separate Coy and Jsekarb from the group with sufficient assets to allow them to meet an actuarial projection of asbestos claims faced by those companies. By 5 February 2001, when the Board papers for the 15 February 2001 meeting were circulated, JHIL management believed the answer to that question was "yes". Mr Macdonald's memorandum to directors said (Ex 75, tab 119):

> We have developed a comprehensive solution to critical issues that James Hardie has been facing for over five years. The solution should be implemented now to maximise potential improvements in shareholder value.

12.1.2 The proposal to establish the Foundation was considered by the JHIL Board at its meeting of 15 February 2001. The directors present at the meeting were Alan McGregor, Peter Macdonald, Meredith Hellicar, Peter Willcox, Michael Brown, Greg Terry, Daniel O'Brien (as an alternate director for Sir Selwyn Cushing), Michael Gillfillan and Martin Koffel. The meeting was also attended by Phillip Morley, Peter Shafron, Greg Baxter, Stephen Harman, Ian Wilson and Anthony Sweetman (of UBS Warburg) and Peter Cameron and David Robb (of Allen Allen & Hemsley).

12.1.3 Sir Llew Edwards was present for the start of the meeting and tendered his resignation as a JHIL director, to take effect upon the Board's resolution to establish the Foundation: Ex 121, tab 111. The minutes of the meeting record that Sir Llew made a short speech during which he said that he and Messrs Gill, Jollie and Cooper had completed their "due diligence" and had decided to become directors of the Foundation. Sir Llew reported that he and his fellow prospective directors believed that JHIL had been "generous" in its proposed funding of the Foundation and that he and his fellow directors were happy to have that known. Mr McGregor and Mr Macdonald each attached some significance to Sir Llew's speech. Mr McGregor understood Sir Llew to be saying that he and the other prospective Foundation directors had made their own inquiries regarding the Foundation's level of funding and were prepared to have their approval of that funding known publicly: Ex 80, [25]. Mr Macdonald gave evidence to a similar effect: Ex 308, [37].

12.2 Results of Trowbridge's February 2001 Report

12.2.1 Trowbridge's February 2001 report was not tabled at the Board meeting and the Board was instead given a presentation on Trowbridge's results by either Mr Shafron or Mr Morley: Ex 80, [28] to [30].

12.2.2 Mr McGregor recalled that Trowbridge's results were presented to the Board in the form of a graph which showed 3 curves representing different projections by Trowbridge: Ex 80,

[28]. Either Mr Shafron or Mr Morley informed the Board that Trowbridge had advised that the middle projection was the "most likely" projection for Coy and Jsekarb: [28].

12.2.3 It seems clear that none of the JHIL directors understood Trowbridge's projections to be median figures or projections which had only a 50% chance of being sufficient. It was understood that it was possible that future claims might exceed the Berry medium projection but the directors based their deliberations on their understanding that Trowbridge had advised that the Berry medium projection was the "most likely" scenario, or Trowbridge's "best estimate", for James Hardie. Not surprisingly, the Board did not attach any particular meaning to "most likely". Mr McGregor's evidence was (T1574.30):

> Q. What did you understand by "most likely" in the context of Trowbridge's estimates? Did you understand it to mean a significant preponderance of likelihood?
>
> A. I understood it to be one of their three columns that they - they were asked what's most likely and they said that's the most likely.
>
> Q. Specifically the most likely of the three?
>
> A. I can't tell you whether it was already three columns and they said that's the most likely, or whether they were asked for a most likely figure, which is what's in that column.
>
> Q. Were you told Trowbridge's most likely numbers, or their best estimate, was merely the set of numbers that they thought had a 50/50 chance of being achieved?
>
> A. I don't recall whether that was said or not.

12.2.4 Mr Macdonald's evidence was similar (T2573.50):

> Q. Now the high estimate you would appreciate that they had proposed as being not merely frivolous?
>
> A. Well, I don't know I particularly formed a view about it. It wasn't the curve that they recommended we should use.
>
> Q. It represented, as you understood it, an outcome of which there was at least a non-negligible risk?
>
> A. I don't know that I formed a view about its probabilities, sir. I just understood it wasn't the one we were told to use.

12.2.5 Indeed, Mr Macdonald's evidence was that the first time he had ever heard it suggested that, by their expression "best estimate", Trowbridge really meant a median figure was during this Commission's proceedings: Ex 308, [42].

12.2.6 The fact that Trowbridge's report had been prepared using data up to 31 March 2000 was known to the JHIL Board: McGregor T1442.44 and T1446.51; Macdonald, T2356.13. Moreover, several witnesses gave evidence of an exchange during the Board meeting in which the question of whether James Hardie's March to December 2000 claims data affected the Board's ability to rely on Trowbridge's 2001 report was discussed. The Board papers for the meeting had included a paper by Messrs Shafron and Attrill which reported that James Hardie's asbestos claims had increased during the December 2000 quarter: Ex 75, tab 119, p 2810. Mr McGregor's evidence was (T1446.16):

> Q. Did Messrs Macdonald, Morley and Shafron make a joint presentation to the Board in February concerning these figures?
>
> A. Well, concerning the whole trust structure and all the information.
>
> Q. Could you give us, in substance then, what was said by those three people concerning how Trowbridge had taken these increased figures into account?
>
> A. Well, we asked the question: were they taken into account, or what was the effect of them on the assessment, and the answer given was that their response was that the increase did not interrupt, in their view, the trend. So--
>
> COMMISSIONER: Q. That is what they said they had been told by Trowbridge, is it?
>
> A Yes.

12.2.7 Mr Peter Cameron and Mr Macdonald gave evidence to the same effect: Cameron, T3020.28 to T3021.37; Macdonald, T2356.10. Mr Cameron's recollection was that the question had been asked by Mr McGregor. Mr Cameron rejected the suggestion that he had only a vague recollection of the discussion (T3021.9); his evidence was that he was "reasonably comfortable" with that recollection (T3021.26). The evidence of Messrs McGregor, Macdonald and Cameron should be accepted on this point.

12.3 Consideration of the cashflow model

12.3.1 Mr Morley explained the cashflow model to the Board meeting. A copy of the model, together with the sensitivity analysis prepared by Mr Morley, was tabled at the meeting: Ex 75, tab 121. The model presented to the meeting predicted that a small surplus of assets would remain in the trust after the last predicted asbestos claim had been met in around 50 years time, assuming:

(a) Trowbridge's "best estimate" claims figures; and

(b) an earnings rate of 11.70% per annum on the trust's investments.

12.3.2 The sensitivity analysis presented by Mr Morley considered the effect on the life of the trust if Trowbridge's high scenario figures were used. That sensitivity analysis showed that, using an assumed earnings rate of 11.7% per annum, the assets of the trust would be exhausted in less than 20 years (p 2823).

12.3.3 The sensitivity analysis also showed that, assuming Trowbridge's best estimate figures, the assets of the trust would be exhausted in less than 25 years if an earnings rate of 10.7% per annum or less was assumed.

12.3.4 The evidence also indicates that there was discussion of whether it was reasonable to assume an earnings rate based on returns on equity investments for the purpose of assessing the life of the trust: Ex 308, [46]. Mr Macdonald's evidence was that Mr Morley said that an equity market earnings rate was appropriate for use in the model because the model suggested that income earned from rent, interest and payments from JHIL and QBE would be sufficient to fund asbestos claims for around 25 years. He also said that there was discussion of the possibility of using a risk free rate of return at that Board meeting and that Mr Morley explained that the rate of 11.7% per annum had been selected as reasonable on the basis that it represented a discount of around 20% to historic equity market rates of return: see Macdonald Ex 308, paras 46, 47 and T2575.27, T2632.38.

12.3.5 Neither the PricewaterhouseCoopers advice (Ex 121, tab 118) nor the Access Economics advice (Ex 121, tab 119) on the cashflow model was tabled at the Board meeting. Mr Macdonald's evidence was that he was aware that PricewaterhouseCoopers and Access Economics were not advising JHIL on future earnings rates but that he understood that they had advised that the model was suitable for the purpose for which it was being used: Ex 308, [44]. That evidence is supported by the description of PricewaterhouseCoopers' and Access Economics' advice which appeared in the presentation given at the Board meeting (Ex 75, tab 123, p 2855):

> Analysis reviewed by PwC and Access Economics

12.3.6 Mr Macdonald did not believe that PricewaterhouseCoopers' and Access Economics' advice was limited to checking the arithmetic accuracy of the model: Ex 308, [44]. And a fair reading of each report confirms that they were not so limited. PricewaterhouseCoopers noted that the purpose of the model was to demonstrate to the directors that there was a surplus of funds available to MRCF. It did not state that the model could not be used for that purpose. It noted the limitations upon the model (which involved the need for various sensitivity analyses) and the need to verify the assumptions upon which the inputs to the model were based: see Ex 121, tab 118. The Access Economics report was to the same effect. It advised that the structure of the model was sound for the purpose of projecting future cashflows. The limitations with respect to the key assumptions and desirability of a sensitivity analysis upon the results were adverted to: Ex 121, tab 119.

12.3.7 The only qualification to those advices which Mr McGregor recalled was that the Board was informed that PricewaterhouseCoopers had suggested the model make allowance for a variation in rates of return: T1464.14. There is no evidence that the understanding of the other directors differed from that of Mr Macdonald, namely, that PricewaterhouseCoopers and Access Economics had advised that the model was suitable for the purpose for which it was being used.

12.3.8 Reference should also be made to the evidence given by Mr Morley. He said that he told the Board that the two firms had only reviewed the calculations in the model: T2255.48-.56. He recalled discussion about the fact that earnings could be volatile and was also fairly sure that he discussed the warnings given by PricewaterhouseCoopers and Access Economics concerning volatility: T2256.30, T2257.30. This evidence is not inconsistent with the recollections of Messrs Macdonald and McGregor as to what was said at the meeting.

12.4 The desire to establish the Foundation in February 2001

12.4.1 It is clear that JHIL's desire was to establish the Foundation as soon as reasonably possible. Mr Macdonald's memorandum to directors of 5 February 2001 recommended "the immediate establishment of a Foundation" and stated that "James Hardie needs to act now": Ex 17, tab 119, p 2738. Further, by February 2001, JHIL appears to have formed the view that separation of Coy and Jsekarb from the group was a pre-condition to the proposed restructuring of the group: Ex 75, tab 123, p 2846. The reasons for that desire on JHIL's part included -

(a) JHIL believed it was possible that ED88 would be promulgated before the end of the 2001 financial year. Accordingly, delaying the establishment of the Foundation beyond 31 March 2001 significantly increased the risk that JHIL's accounts for the following year would need to make provision for the full amount of Trowbridge's estimates of Coy and Jsekarb's asbestos liabilities: Ex 75, tab 119, p 2738.

(b) JHIL felt that it was desirable to establish the Foundation prior to the group restructure in order to decrease the complexity involved in its transaction.

12.4.2 At the time the Foundation was established the Board of JHIL had also received Allen Allen & Hemsley's advice of 7 February which was attached as Annexure F to the February 2001 Board papers. That advice was that establishing the Foundation prior to the scheme of arrangement would not prevent the Court scrutinising the arrangements between JHIL and the Foundation: Ex 75, tab 119, p 2808. Allen Allen & Hemsley said:

> While the first limb of this transaction can be effected with minimal execution risk, the subsequent financial reconstruction will involve the directors of JHIL considering the interests of creditors and is likely to involve a rigorous analysis by the Court of issues affecting creditors, with the possibility that the Court will seek to investigate the trust and related arrangements.

12.4.3 The primary reason for JHIL's desire to establish the Foundation prior to 31 March 2001 was to avoid the risk of being forced to prepare consolidated accounts of JHIL which were required to make provision for the asbestos liabilities of Coy and Jsekarb, either as a result of ED88 being introduced or for the purpose of JHIL's registration statement to be filed in connection with the proposed listing on the New York Stock Exchange. Those considerations were legitimate commercial reasons for seeking to establish the Foundation prior to 31 March 2001. Indeed, Mr Allsop SC had previously advised JHIL (on 20 December 2000) that such considerations were proper benefits to which JHIL might have regard when establishing the Foundation: Ex 75, tab 95A, p 2558.

12.5 The decision of the JHIL Board and its intentions regarding funding

12.5.1 The Commission should find that, at the time they resolved to establish the Foundation, the JHIL directors honestly believed that the most likely outcome was that the Foundation would have sufficient assets to meet all future claims received by Coy and Jsekarb. That was the conclusion stated and sought to be justified in the presentation to the directors at the Board meeting on 15 February (Ex 75, tab 123):

> Gross assets should be sufficient for future claims (p 2848)

and:

> Surplus most likely outcome (p2855)

12.5.2 That was also Mr Macdonald's evidence (Ex 308, [50] and [51]) and Mr McGregor's evidence (T1447.54):

> Q. As of February 15, 2001, how long did you expect the Foundation to last?
>
> A. Well, our expectation was that on - I'm trying to think of the words Trowbridge used - but the most likely column of their claims, which is on the model that you were looking for earlier, and the financial modelling, we expected them to last forever.
>
> Q. Very well.
>
> A. Past 51 years, by which time the predictions are that the claims have virtually ceased.

12.5.3 There is no basis to suggest that the other seven members of the JHIL Board allowed public statements to be made to the effect that the likely outcome was that all future claims would be met when that was not their honest belief.

12.5.4 It should be found that the JHIL directors had a reasonable basis to believe that the most likely outcome was that all future claims received by Coy and Jsekarb would be met. The following elements provided the basis for that belief.

(a) The cashflow model presented to the Board indicated that, assuming Trowbridge's most likely projected claims costs and an earnings rate of 11.7% pa, the Foundation would have sufficient funds to meet all future claims faced by Coy and Jsekarb. The JHIL directors were entitled to rely on management's report that PricewaterhouseCoopers and Access Economics had advised that the model was suitable for the purpose for which it was being used.

(b) The JHIL directors were also entitled to rely on management's report of Trowbridge's advice that the Berry medium projection was the "most likely" scenario for James Hardie. The Board specifically asked whether developments in James Hardie's claims experience between March and December 2000 affected the Board's ability to rely on Trowbridge's report and was informed that Trowbridge had advised that those figures would not affect their assessment. The Board was entitled to rely on management's report of that advice.

(c) Finally, the explanation given by Mr Morley to the Board in discussion and in support of an assumed earnings rate of 11.7% pa was a reasonable basis for the Board to be satisfied with the use of that rate in the model.

12.5.5 It is not in dispute that the JHIL directors understood that it was possible that the Foundation would not ultimately have sufficient funds to meet all future claims. The sensitivity analysis presented by Mr Morley to the Board at the February meeting suggested that the Foundation's funds would be exhausted in less than 20 years if Trowbridge's high scenario proved correct. That was clearly understood. Both Mr McGregor (T1440.20) and Mr Macdonald (T2582.22) agreed that there could be no certainty in quantifying future asbestos claims. Mr Morley also stated that the fund would have a life of less than 25 years if an average earnings rate of less than 10.7% pa was achieved.

12.5.6 However, the fact that Coy and Jsekarb's future asbestos claims could not be predicted with certainty and the fact that an opinion had to be formed as to an appropriate investment earnings rate did not mean that JHIL could not reasonably seek, based on actuarial estimates and an assessment of likely future earnings rates, to fund Coy and Jsekarb's future claims.

12.6 What would have happened if the Trowbridge estimate was significantly higher

12.6.1 The JHIL's Board deliberations in February 2001 started from the position that JHIL was not liable for the asbestos liabilities of Coy and Jsekarb. Mr Macdonald's memorandum dated 5 February (Ex 148, tab 15, p 175) said:

> **Separation from legacy issues.** James Hardie Industries Limited (JHIL) does not have legal liability for the obligations of its former asbestos producing subsidiaries.

12.6.2 Moreover, the legal advice provided to the JHIL directors had consistently stated the need to ensure that any decision to dispose of the shares in Coy and Jsekarb or to provide additional payments to those companies could be justified as being in the best interests of JHIL: see, for example, analysis in Board paper for JHIL meeting of directors on 17 January at Ex 140, tab 5, p 103.

12.6.3 Mr Macdonald's belief was that, by contributing any funds to the trust beyond the assets of Coy and Jsekarb, JHIL was doing more than it was legally obliged to do: Ex 148, [37].

12.6.4 In the event, the Foundation was established because the additional funding provided by JHIL,

(a) was an amount which the JHIL directors could reconcile with their duties to act in the best interests of JHIL, by reference to the intangible benefit (such as accounting treatment) which accrued to JHIL as a result of the separation;

(b) was an amount which satisfied the prospective Foundation directors by providing the Foundation with assets equal to Trowbridge's discounted value of claims over the next 20 years;

(c) was an amount which JHIL believed meant that the most likely outcome was that the Foundation would have sufficient assets to meet all future claims received by Coy and Jsekarb; and

(d) was an amount which JHIL could “afford” to commit and pay over time.

12.6.5 In January and February 2001 JHNV was near the limit of the amount which it could borrow whilst retaining a gearing ratio of 55%: Morley T2004.20-.57. Without taking into account any contribution to the MRCF above the value of the net assets of Coy and Jsekarb, that gearing ratio was 54.5%. Whilst there was no gearing ratio limit for the group, the ratio at that time was 65.8%: Morley T2005.9. Management’s advice to the Board when it agreed to contribute further funds to the MRCF was to the effect that the “approved amount … was manageable but … would be close to the limits of” the group’s financing covenants: McGregor Ex 80, para 46(b).

12.6.6 Accepting for the moment that Trowbridge, with the knowledge of that data, would have increased its total (50 year) net present value estimate of the liabilities from $322 million to $437 million (Ex 50, p 338), a question could arise as to what might have happened had the JHIL Board been given the “revised” number. This hypothetical was addressed by Mr McGregor: Ex 80, paras 45 to 47. His evidence was that it was unlikely that an additional amount in excess of $60 million could or would have been agreed to: Ex 80, para 47; T1431.47. It was in his view unlikely that the Board would have agreed to the separation in circumstances where there was a large deficiency between the assets of MRCF and the likely asbestos claims. However, he was not prepared to predict what the Board might have done in circumstances where the gap was “unbridgeable”: T1577.1-.50.

12.6.7 If the KPMG numbers are accepted as reasonable, it is most unlikely that JHIL could have funded the separation. That assessment was of liabilities as at February 2001 of $694.2 million in the absence of the nine months data and $1,044.5 million with that data: Ex 252 at para 7.4 (pp 84-86).

12.7 Deed of Covenant & Indemnity

12.7.1 The proposal that JHIL receive indemnities from Coy and Jsekarb in respect of liabilities arising from the subsidiaries' manufacture and sale of asbestos products and in respect of inter-company transactions, including dividends and management fees, was contained in the Board papers for the February 2001 meeting: Ex 75, tab 119, p 2739. The Board papers also recorded the advice of Mr Allsop SC and Allen Allen & Hemsley that, in order for the Coy and Jsekarb directors to resolve to grant those indemnities, Coy and Jsekarb would need to receive consideration on arm's length terms (p 2739).

12.7.2 The JHIL directors were aware of advice received by JHIL on both of the potential liabilities in respect of which indemnities were proposed: they had received advice from Mr Cameron at the January Board meeting on the dividend paid by Coy in 1996; and JHIL's potential exposure to asbestos claims in the period 1978 to 1987 was referred to in the February 2001 Board papers and discussed in the advice of Mr Allsop which was tabled at the meeting: Ex 75, tab 120; see also Ex 80, [37] to [39].

12.7.3 Even with their knowledge of those potential liabilities, there was no doubt in the minds of the JHIL directors that Coy and Jsekarb were receiving consideration on arm's length terms under the Deed of Covenant & Indemnity. Indeed, Messrs McGregor and Macdonald believed that the terms of the Deed were significantly more favourable (to Coy and Jsekarb) than arm's length. Mr McGregor's evidence was that he thought the indemnities being given by Coy and Jsekarb were worth "substantially less" than the $70 million being paid for them by JHIL (Ex 80, [40]) and that possible inter-company claims between JHIL and Coy were "more than covered" by additional funding to be paid by JHIL under the Deed (T1472.7). Mr Macdonald did not consider the proposed indemnity in respect of asbestos manufacture to be of any real value to JHIL: Ex 148, [39]. Such a view was also reflected in the Board papers for the February 2001 meeting (Ex 75, p 2739):

> The possible validity of an indemnity and waiver has been confirmed by external counsel James Allsop. The main issue raised was consideration or value to JH & Coy, based on arms' length terms and on advice. On the proposal, given the strength of JHIL's defences, the existence of excellent insurance reserves available to JH & Coy in the period when JHIL is most vulnerable (1978–1987), and the size of the capital injection, existing JH & Coy directors have a sound basis to be comfortable with the decision.

12.7.4 The conclusion that the JHIL directors believed JHIL was being generous to Coy and Jsekarb under the Deed of Covenant & Indemnity is supported by the advice sought of Mr Allsop as to whether the JHIL directors could approve the Foundation proposal consistently with their duties to JHIL: Ex 75, tab 120.

12.8 Public relations and government

12.8.1 There can be no doubt that JHIL devoted keen attention to its public relations strategy in respect of separation from Coy and Jsekarb, and no doubt it was a strategy that was directed towards the successful conclusion of the transaction. Provided that a public relations strategy does not involve conduct that is misleading or deceptive or otherwise wrongful, there is nothing wrong with using public relations to seek to advance corporate goals. Public relations are an inescapable aspect of the business of any large corporation or group of companies. In the case of a group of companies where some members of the group have an asbestos legacy, the public relations challenge is a difficult one.

12.8.2 It could hardly be surprising to learn that the James Hardie's management structure included a corporate affairs group that was responsible for public relations. The group was small (approximately 4 or 5 staff, headed at relevant times by Mr Baxter) and the cost of the department to James Hardie was around two-thirds of the cost of similar departments in comparable businesses: T2662.15-2663.15.

12.8.3 It is clear that the anticipated public and government reaction to the establishment of the Foundation was a significant issue for JHIL. In particular, while the risk of legislative intervention (making JHIL liable for the asbestos liabilities of its subsidiaries) was assessed as "low", the consequences of such action led to this issue receiving detailed consideration in the Board papers for the February 2001 meeting: Ex 75, tab 119, p 2750.

12.8.4 The presentation to the Board meeting on 15 February 2001 reported on advice which had been provided to JHIL by Stephen Loosley, Gary Gray and John Denton (of Corrs Chambers Westgarth): Ex 75, pp 2864ff. In particular, Mr Loosley was reported to have advised that JHIL should provide additional funds to the trust so that "the most likely outcome was that all claims would be met".

12.8.5 The presentation to the Board also reported on a meeting which had been held on Tuesday, 13 February 2001, between Stephen Loosley, Graham Wedderburn (then chief of staff of the New South Wales Premier), Matthew Strassberg (then chief of staff of the Special Minister of State), Greg Baxter and Steve Ashe (both of James Hardie's Corporate Affairs department) for the purpose of briefing the New South Wales government on the proposal to establish the Foundation: Ex 75, tab 123, p 2867; Ex 135, [10] to [14]. The presentation stated:

- On Tuesday we briefed the chiefs of staff of the NSW Premier and Industrial Relations Minister
- The briefing was confidential and simply sought a likely read on government reaction as a precursor to subsequent formal meetings between JH and the government before the announcement
- The briefing was much more positive than expected – Loosley described the briefing as "a pearler – they don’t get much better than that"
- All key messages well understood, key issues teased out and discussed openly

12.8.6 James Hardie issued a press release on 16 February 2001, announcing the establishment of the MRCF Foundation: Ex 1, tab 66.

12.8.7 The process that is ordinarily employed by James Hardie in the preparation of a press release is explained by Mr Macdonald: Ex 308, [12].

12.8.8 The 16 February 2001 press release was prepared by Mr Baxter. It appears from the evidence that it was not finished until shortly before it was issued. Mr Shafron wanted to obtain a copy of it to show to Mr Minty before it was issued but was unable to do so in time: see Mr Shafron’s second supplementary statement at [36], [37]. Mr Shafron did not see it before it was released. At the time he approved this press release Mr Macdonald believed that the procedures described above had been complied with and was not aware that Mr

Attrill or anyone else had expressed any concerns about the terms of the release: Ex 308, paras 55, 56.

12.8.9 The release has 16 paragraphs and needs to be read as a whole. Most of the release is free of controversy. The release includes the following paragraphs:

> 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…
>
> "James Hardie is satisfied that the Foundation has sufficient funds to meet anticipated future claims," Mr Macdonald said.

12.8.10 It is apparent today that the Foundation does not now have sufficient funds to meet all legitimate compensation claims. One has to be careful, however, when looking at earlier statements of opinion with the benefit of hindsight.

12.8.11 As at 16 February 2001, JHIL and Mr Macdonald genuinely held the view that the Foundation was fully funded, because the company's analysis showed that on the basis of what they considered to be reasonable assumptions, the Foundation was expected to meet Trowbridge's best estimate of the future liabilities. The work undertaken by management in analysing the expected financial position of the Foundation provided a reasonable basis for the statement of opinion. In January 2001, the Board had given management the instruction to work out how much would be required to fund anticipated claims, and management diligently endeavoured to give an answer.

12.8.12 Mr Macdonald was asked (T2571.54):

> Q. You would wish to defend that statement as a full and fair statement of the position, as you understood it, on 16 February?

Mr Macdonald did not simply answer yes. By their nature, media statements are rarely "full": of necessity they usually involve a summary. Mr Macdonald's answer, which should be accepted, was:

> A: In the context of the total release, sir, you need to read it in context, not by reading just one paragraph from the release. I think that it's a reasonable statement of the company's views at the time.

12.8.13 Looking back, it may be said that the release could have been drafted more felicitously. The use of the word "certainty" for instance is perhaps ambiguous. The Foundation did provide certainty in the sense that there was from that time onwards a dedicated fund for those who suffer from an asbestos disease. However, there was not certainty in the sense that every person who contracts an asbestos disease would receive full compensation. Of course, that kind of certainty can never be achieved. Implicit in the use of the word “anticipated” is the possibility that there may be some who go uncompensated, or less than fully compensated.

12.8.14 Nevertheless, the release was not misleading or deceptive and expressed views about matters that were based on reasonable grounds.

12.9 Conclusions

12.9.1 The directors of JHIL cannot be criticised for the decision they took on 15 February 2001. Nothing done by JHIL disadvantaged any asbestos claimant. Claimants with a cause of action against JHIL did not lose that cause of action as a result of the establishment of the Foundation. In the case of claimants whose only cause of action lay against Coy or Jsekarb, the payment of additional funds under the Deed of Covenant & Indemnity increased the assets available to meet those claims.

12.9.2 Having received advice that JHIL was not liable for the asbestos liabilities of Coy and Jsekarb, the directors resolved to provide funds to those companies in any event.

12.9.3 The JHIL directors honestly believed that the most likely outcome was that all asbestos claims received by Coy and Jsekarb would be met and had a reasonable basis for that belief.

12.9.4 The JHIL directors, to the extent that they approved the terms of the press release, were entitled to believe that there was a reasonable basis for each of the statements made in the release.

Issue 11

11. *There is evidence that the Trowbridge "best estimate" or "most likely" estimate represented a median outcome, that is, the outcome in the range of possibilities such that 50% of possible outcomes would be higher and 50% would be lower. Is this correct? If so*

(a) *To what extent was this appreciated by:*

i) *the incoming directors of the MRCF;*

ii) *the Board of JHIL;*

iii) *the outgoing directors of Coy and Jsekarb;*

iv) *Messrs Harman, Morley, Shafron or Macdonald?*

This was not appreciated by any of the above persons.

(b) *Insofar as it was not appreciated by those persons, would that knowledge have been likely to affect their decisions concerning the establishment of the MRCF?*

The evidence does not allow a conclusion to be drawn on this issue.

Issue 31

31. *Was JHIL under any time constraints in early 2001 in relation to achieving separation of Coy and Jsekarb?*

Yes

Was the commencement of the accounting standard known as ED88 a relevant factor? If so, why?

This was a relevant factor. It is dealt with above.

To what extent, if at all, do time pressure or perceptions of time pressure explain the acts or omissions of JHIL in respect of the separation process? To what extent, if at all, does time pressure explain the acts or omissions of the incoming MRCF directors?

As is apparent from the narrative above, this factor may explain some of the events discussed.

Issue 39

39. *There is evidence that JHIL regarded the possibility of adverse public and government reaction as a major risk in relation to achieving successful separation from Coy & Jsekarb, and devoted particular attention to its public relations strategy in respect of separation, in order to maximise the chances of its success. Is this correct?*

This is not an accurate description of what occurred.

Issue 13

13. Having regard to the evidence, including:

(a) Mr Shafron's memo to Mr Macdonald, 11.10.00, Ex 189, p 3;

(b) the scope and limitations of the 2000 Trowbridge report, as disclosed by its *terms and/or by the August 2000 Board Papers (Ex 148, vol 1, tab 1, pp 3-9, 12,* 25, 28, 31);

(c) the February 2001 Project Green Board papers (Ex 80, tab 6, p 78-152);

(d) Mr R Williams's letter of 23 June 2000 (Ex 75, p 1784-7, PJS1, vol 5, tab 54);

(e) Mr Shafron's email to Mr R Williams of 8 March 2001 (Ex 209);

(f) that Trowbridge was not given the Current Data for the preparation of its February 2001 report;

(g) the information available to Mr Shafron and Mr Macdonald as to James Hardie's claims experience to 31 January 2001, and expected claims to 31 March 2001 (including Ex 150 p 196, Ex 148, vol 1, tab 5, p 88; tab 15 p 207, 208, 219, tab 18; Ex 57 vol 4 p 804ff; Ex 61 vol 5 tab 43, p 184, 185, 186, 187; Ex 75, vol 7 tab 109, 110);

(h) in the case of Mr Shafron, his knowledge that Mr Minty believed that James Hardie mesothelioma claims experience had levelled recently;

(i) further in the case of Mr Shafron, Ex 57 pg 144 (vol 1); Ex 61 vol 4 tab 33; Ex 61 vol 4 tab 49; Ex 61 vol 4 tab 50; Ex 65;

(j) James Hardie's estimates of the level of risks associated with areas of potential liability excluded from Trowbridge's analysis (Ex 57, vol 1, pgs 14-16);

(k) the meaning of a "best estimate" in a Trowbridge report;

should it be concluded that Mr Shafron and/or Mr Macdonald:

(l) did not exercise reasonable care in permitting the February Report to be used to assist the JHIL Board, the outgoing Coy and Jsekarb directors and the incoming MRCF directors to assess the likely longevity of the MRCF or what level of funding would be appropriate to found a reasonable likelihood

that all claims, or all claims for a particular period, against Coy and Jsekarb would be met;

No.

(m) *believed that the February Report was not suitable for such use; or*

No.

(n) *were indifferent to whether the February Report was suitable for such use?*

No.

Issue 14

14. *Was the conduct of JHIL fraudulent in that Mr Shafron falsely represented to the incoming MRCF directors or the outgoing directors of Coy and Jsekarb that the February Report was suitable to be used for the purpose of assessing the likely longevity of the MRCF, intending them to use it for that purpose, when they did not believe that it was suitable for such use, or were recklessly indifferent to whether it was so suitable? If so, what are the consequences? Do Amaca, Amaba or the MRCF have valuable remedies as a result and if so, what is their basis (statutory or otherwise) and against whom would they be available? Is the DOCI liable to be set aside?*

Each of the above questions should be answered no.

Issue 15

15. *Did JHIL or Mr Shafron engage in conduct that amounted to negligent misrepresentation, or conduct that was misleading or deceptive or likely to mislead or deceive ("misleading or deceptive conduct"), by the use of the February Report and the cashflow model as regards the proposed directors of the MRCF or the outgoing directors of Coy and Jsekarb. If so what are the consequences – do Amaca, Amaba or the MRCF have valuable remedies as a result and if so, what is their basis (whether statutory or otherwise) and against whom are they available? Is the DOCI liable to be set aside, or varied to remove the covenant not to sue to the extent that it applies to claims other than asbestos claims?*

Each of the above questions should be answered no.

Issue 28

28. Was the conduct of JHIL fraudulent in that it falsely represented to the incoming MRCF directors or the outgoing directors of Coy and Jsekarb that the cash flow model was suitable to be used for the purpose of assessing the likely longevity of the MRCF, intending them to use it for that purpose, when it did not believe that it was suitable for such use, or was recklessly indifferent to whether it was so suitable?

No.

If so, what are the consequences?

This issue does not arise.

Do Amaca, Amaba or the MRCF have valuable causes of action as a result? Is the DOCI liable to be set aside?

No. No.

Issue 29

29. Did JHIL or Mr Shafron engage in conduct that amounted to negligent misrepresentation, or conduct that was misleading or deceptive or likely to mislead or deceive ("misleading or deceptive conduct"), by the use of the February Report and the cashflow model as regards:

(a) the proposed directors of the MRCF;

(b) the outgoing directors of Coy and Jsekarb?

If so, what are the consequences – do Amaca, Amaba or the MRCF have valuable causes of action as a result? Is the DOCI liable to be set aside, or varied to remove the covenant not to sue to the extent that it applies to claims other than asbestos claims?

Each of the above questions should be answered no.

Issue 43

43. Did the circumstances in which Coy and Jsekarb were separated from the James Hardie Group

(a) result in, or

(b) contribute to

a possible insufficiency of assets of either of those companies to meet its future asbestos related liabilities? If so, in what respect and to what extent were the assets of those companies affected?

No.

Issue 40

40. In the period commencing 16 February 2001 JHIL and its executives appear to have published statements to the effect that:

(a) the MRCF was "fully funded" and would be able to meet all legitimate claims (with (b), (c) and (d) below, published to the ASX on 16/2/01 – Ex 1, vol 7, tab 66);

(b) (by implication) there was a reasonable basis for such claims;

(c) in establishing the MRCF JHIL had sought or relied on expert advice from PWC and Access Economics in respect of the level of funding for the MRCF;

(d) the establishment of the MRCF would provide certainty for claimants;

(e) its belief that all claims would be met was on

(i) "the best available information"

(ii) "a reasonable rate of return on the funds invested"

(iii) "detailed expert and independent advice" from firms including PWC and Access Economics (see Ex 61, vol 6, Tab 21)

Is this correct?

This issue is dealt with above.

Issue 41

41. The separation of JHIL from Coy and Jsekarb in February 2001 did not attract a hostile government reaction. To what extent might this have been due to:

(a) the publication of statements of the kind set out above;

(b) JHIL's refusal to make the February Report, the PWC and Access Economics reports or the cash flow model public?

There is insufficient evidence before the Commission to reach a conclusion on this issue.

Issue 42

42. In light of the matters raised above, were JHIL's public disclosures concerning separation misleading or deceptive? If so:

(a) Did JHIL or Mr Macdonald contravene s995(2) of the Corporations Law?

No.

(b) Did JHIL or Mr Macdonald contravene s999 of the Corporations Law?

No.

(c) *Did Mr Macdonald commit an offence against s 1309(1) of the Corporations Law by permitting the furnishing of Ex 1, vol 7, tab 66 to the ASX, containing the information referred to above, which information was false or misleading in a material particular, namely, that the MRCF was not fully funded and would not be able to pay all legitimate claims and there was no reasonable basis for such claims, and further, which information omitted from it matter the omission of which rendered the information misleading in a material respect, namely, in that it omitted to state the limitations of the material on which the statements were based, (referred to more fully in earlier issues)?*

No.

(d) *Did Mr Macdonald commit an offence against s1309(2) of the Corporations Law by engaging in the conduct referred to in the last paragraph without having taken reasonable steps to ensure that the information was not false or misleading in a material particular and did not omit from it matter the omission of which rendered the information misleading in a material respect.*

No.

(e) *Was any other officer of JHIL knowingIf any of these issues is answered in the affirmative, what are the consequences?ly concerned in or a party to any contravention of the kind referred to in (b), (c) or (d)?*

No.

(f) *If any of these issues is answered in the affirmative, what are the consequences?*

Not applicable.

13. Reasonableness of Trowbridge assessments as at June 2000 and February 2001

13.1 KPMG assessment

Overview

13.1.1 The Commissioner should find that the February 2001 report departed from the standards to which professional actuaries are required to adhere. Had the report been prepared in accordance with such standards, the best estimate would have been hundreds of millions of dollars higher - so much so that it would not have been possible for JHIL to provide Amaca and Amaba with funding that would meet that expected expenditure.

13.1.2 The departures are essentially twofold:

(a) first, basing the analysis upon assumptions that were inappropriate; and

(b) secondly, not disclosing in the report the fact that those assumptions had been made, the reasoning said to justify them, and the significance of the assumptions to the projections of the assumptions.

June 2000 and February 2001 reports

13.1.3 The draft Trowbridge report of June 2000 projected James Hardies' exposure for asbestos-related personal injury claims that may emerge in future in Australia and New Zealand as $294,000,000. The February 2001 report estimated the value of future claims over the next 10, 15 and 20 years, on three bases: "current", "best estimate" and "high". At a discount rate of 7%, over 20 years, the estimates were some $269,000,000, $286,000,000 and $317,000,000.

13.1.4 Mr Wilkinson says that, applying the same discount of 7%, the total liability estimated at February 2001 should have been some $694,000,000: Exhibit 252, p viii.

13.1.5 Both Trowbridge reports treated future mesothelioma claims separately. So have the independent experts, Messrs Wilkinson and Whitehead. That is an appropriate course, because:

(a) the mesothelioma claims are, by far, the most significant component of future claims;

(b) their average cost is very considerably greater than non-mesothelioma claims, and

(c) their projected incidence is quite different from the projected incidence of non-mesothelioma claims.

13.1.6 The differences between Trowbridge and KPMG are substantially attributable to the different approaches taken to estimating the future mesothelioma claims.

13.1.7 The February 2001 Trowbridge report:

(a) assumed that the peak number of mesothelioma claims on that best estimate would be reached within the next two years;

(b) adopted as its best estimate "Berry medium", which was one of Professor Berry's projections from the history of Wittenoom employees;

(c) assumed that the cost of mesothelioma claims other than "nil settlements" would be $180,000, increasing in line with inflation at 4% per annum;

(d) assumed that 25% of those claims would be "nil settlements", so that the average claim would be 0.25 x $180,000 = $135,000.

13.1.8 In terms of the discrepancy between the Trowbridge and KPMG central estimates for February 2001, some $156,000,000 is attributable to the first two matters, some $156,000,000 to failing to include superimposed inflation, and $35,000,000 to the nil settlement rate: Exhibit 252, p viii.

13.1.9 It is plain that the output of the new modelling that underlay the February 2001 report was completed by Trowbridge no later than the morning of Friday 2 February 2001, when Mr Marshall emailed the projected mesothelioma numbers and dollar values: Ex 50, tab 13, p112ff. The documents which became the appendices to the 13 February 2001 report were in essentially final form, save for a later and relatively minor adjustment to the non-mesothelioma model apparently following a conversation between Mr Marshall and Mr Watson: T3419.27-3421.51. That includes the uncorrected $67,000,000 error in the undiscounted liabilities identified by Mr Wilkinson at 6.3.3 of his report exhibit 252 (which, fortunately, was not included in the cashflow analyses).

13.1.10 Such discussions between Mr Minty and Mr Marshall in relation to the assumptions on which the report was to be based appear to have been relatively informal. They are not documented in the material produced by Trowbridge. Nor was the discussion between Mr Marshall and Mr Watson which led to the changed shape of the non-mesothelioma curve: T 3420.1-3.

13.1.11 The February 2001 report did not contain any reasoned explanation for any of those assumptions. Indeed, the third and fourth assumptions were not even expressed in the report. That was a departure from section 24 of the Actuaries' Code of Conduct (Exhibit 252, Appendix D), which provides that:

> An actuary is expected to include in any report a statement indicating to whom the report is addressed, a statement describing or clearly identifying the data and the actuarial methods and assumptions employed, and a statement drawing attention to any important implications of those methods.

13.1.12 Moreover, *none* of the 4 assumptions referred to above were assumptions which, as at February 2001, was an assumption which an actuary exercising proper skill and judgment should have made. By including each of those assumptions into the February 2001 report, Trowbridge was departing from section 25 of the Code of Conduct:

> Actuaries should exercise their best judgement to ensure that any advice provided is based on sufficient and reliable data, on adequate and appropriate assumptions, and on sound actuarial principles.

13.1.13 The limited time, the relative informality that appears to have prevailed, and the failure to document either in working papers or in the report itself, all tend to confirm what is plainly the case, namely, that less consideration was given by Messrs Minty and Marshall to the reasonableness of those assumptions than was appropriate.

13.1.14 Each of those four assumptions, all of which Mr Minty agreed were important: T3283.30-3284.1, is addressed in turn.

First assumption: the curve would peak within 2 years

13.1.15 As may be seen from figure 4.6 on p4-19 of Mr Whitehead's report (exhibit 251), the number of mesothelioma events reported to James Hardie had been steadily increasing, with no sign of levelling off, over the previous 9 years. (The only exception was the high number of claims in 1995.) That fact very much undercuts the reliance by Trowbridge on the proposition that *claims* (as opposed to events) had to some extent apparently levelled off. The number of claims was based on the number of events, but varied depending upon extraneous factors such as the number of derivative claims under the various *Compensation to Relatives Acts.*

13.1.16 When confronted with this in cross-examination, Mr Minty conceded (T 3326.27-38):

Q. Were you aware of any circumstance that you can think of now, which would have suggested to you in doing the 2000 or 2001 reports, that James Hardie's numbers of events might no longer trend upwards?

A. No.

Q. I suggest Mr Minty, that in those circumstances, and given the unreliability of the relationship between claims and events, the appropriate assumption for you to adopt was that claims were likely to increase along with events?

A. In retrospect, if I put more weight on looking at the event data itself, yes.

13.1.17 This basic error was entirely unaffected by the most recent eight or nine months of data. It was common to the June 2000 draft report and the February 2001 report. In the former report, there is a *non sequitur* at section 4.4, between the observations that *claim numbers* had appeared to have reached a plateau, and the conclusion that:

> We consider that an assumption that the number of events has reached a peak and will start to decline together with the assumption that the number of claims relative to the number of events will be 1.15 is a reasonable basis on which to estimate the numbers of both claims and events that will be reported in the future.

13.1.18 Somewhat charitably, Mr Whitehead described that reasoning as "difficult to see the logic" (para 4.4.59). He conceded that it was inconsistent with his own "rough and ready" calculation which concluded that there would be a peak in the second decade of this century: T 3243.9-12.

13.1.19 There was no reasoning at all expressed in the February 2001 report to justify the assumption.

13.1.20 The assumption cannot be reconciled with the following obvious propositions, all of which were known to Messrs Minty and Marshall at the time:

(a) that Australia had the highest incidence of malignant mesothelioma in the western world;

(b) that the latency period for malignant mesothelioma was at least 40 years and possibly longer;

(c) that the use of asbestos products in Australia was broadly comparable to western Europe, including a peak in the early 1970s;

(d) that the UK incidence of mesothelioma was very similar, on a per capita basis, to the Australian incidence;

(e) that Messrs Watson and Hurst were advising that there might be a later peak in Australian mesothelioma incidents than had previously been expected;

(f) that Professor Peto was predicting an expected peak of malignant mesothelioma the UK between 2009-2019.

See T 3283.12 - 3286.28 (Minty); 3423.25-3424.30 (Marshall) .

13.1.21 Mr Whitehead's "rough and ready" analysis at 4.9.18-4.9.22 is compelling. One would need a very high degree of confidence in the reasoning underlying Trowbridge's analysis to dismiss the simple rationality of the conclusion from the facts that:

(a) peak exposure was in the 1970s and

(b) latency period was 40-45 years

that the peak was not imminent. The steadily increasing number of mesothelioma events, and the additional matters referred to above, further reinforce the strength of Mr Whitehead's analysis.

13.1.22 Trowbridge had, and has, no convincing explanation for why an important assumption inconsistent with the above was included in its model. The explanation initially proffered (exhibit 258, para 7) was that Trowbridge relied upon improved safety standards, a diminution in production in the 1970s, and a change in labelling. This was repeated by Mr Minty in the witness box: T 3288.28-55.

13.1.23 No such reasoning was included in the report, nor documented in the working papers.

13.1.24 Moreover, Mr Minty conceded that there was “not much” in the alleged decline of production: T3330.36-38. As much is plain from figure 3.5, p3-21 of Mr Whitehead’s report, which shows steady production throughout the whole of the 1970s. Mr Minty agreed that improved safety standards applied mainly to claims by James Hardie employees, and that safety standards in the industries which used asbestos products lagged behind: T3330.45-56.

13.1.25 On cross-examination by counsel assisting the Commission, a more realistic picture emerged from Mr Minty: T 3333.20-50:

Q. And when one simply added a latency period of 45 years to that 1964 to 1974 period, that would imply a peak period for the Australian mesothelioma experience some time in the decade commencing 2009? Did you have a level of discomfort in respect of those matters?

A. At that stage, personally, I did not, no.

Q. Is that because you didn't turn your mind to those matters in February 2001?

A. In February 2001, I did not.

Q. Can I ask you this, as you sit there now: Thinking about those matters would suggest that, examining the matter in February 2001, you ought to have adopted a later peak than the peak you, in fact, adopted for James Hardie mesothelioma experience?

A. We could well have done so, yes.

Q. Having regard to the matters that are referred to on this page by Mr Whitehead, the more sound judgment would have been to assume a later peak?

A. It would certainly have been a reasonable judgment to assume a later peak, yes.

Q It would have been more sound, I suggest, because the peak that you assumed is very difficult to reconcile with the data that's described by Mr Whitehead on this page; you agree?

A. Certainly there's - there is a difference between his - between what he has set out here and the views that I was taking into account then, yes.

13.1.26 The Commission should find that what happened in the February 2001 report was merely the application of the two (recalibrated) Berry curves contained in the Watson and Hurst November presentation, namely, Berry medium and Berry high, without a proper consideration of whether it was reasonable to assume that the peak would be reached in the next couple of years. Had there been a proper consideration, then the best estimate projection would have been based on mesothelioma claims increasing for more than the next one or two years.

Second assumption: the Berry medium curve was appropriate to model James Hardie data

13.1.27 If indeed a Berry curve was to be used, it was plain from a comparison of 5 years of actual national data following Professor Watson’s 1991 paper that the best predictor of future mesothelioma numbers was Berry high, not Berry medium. That was the point of the graphs on p11-13 of the Watson and Hurst presentation, and the statement on p12 that "Mesothelioma awards clearly higher than expected".

13.1.28 It was also plain that neither Berry medium nor Berry high closely fitted James Hardie actual incidence of mesothelioma events. That is obvious from a comparison on Schedule B of Mr Minty's statement between the "Actual Hardie" columns (8 and 9) and the "Selected" column (10). The selected column (representing numbers immediately before the plateau) shows a gradually increasing number of events, levelling off from 1997-2000. The "Actual Hardie" numbers show a steeply increasing number of events, with no significant levelling off.

13.1.29 One might ask, rhetorically, if Berry medium did not fit the national mesothelioma data (the point made by Messrs Watson and Hurst on p11 of their November 2000 presentation), and did not fit James Hardies' own data (as was apparent from Trowbridge's own calculations), what confidence could one have that it would reasonably project James Hardies' future mesothelioma numbers?

13.1.30 Despite the references to "adjusted Atkins and Andrews", the draft June 2000 report was based upon two very simple assumptions:

(a) a plateau of claims until 2006;

(b) a steady linear decrease in the number of events from 2006 for the following 20 years.

13.1.31 The first point to observe is that this was not a Berry curve at all.

13.1.32 What Trowbridge did, in the February 2001 report, was *not* to select a different Berry curve from the one chosen in the June 2000 draft report as the most likely projection of mesothelioma claims, but instead to introduce new models as their best and high estimates, derived from "Berry high" and "Berry medium".

13.1.33 Berry medium and Berry high were the curves identified by Dr Berry in his 1991 paper (Annexure A to Mr Minty's statement) which best fitted the Wittenoom data, assuming:

(a) mesothelioma incidence was proportional to exposure;

(b) mesothelioma incidence was exponential with time; and

(c) there was a "lag" of either 5 (medium) or 10 (high) years after exposure within which mesothelioma would not occur.

See Mr Whitehead's evidence: (T 3232.17-35)

Q. Although there are five variables that go into each of these, it is not particularly difficult, is it, to describe what became known as "Berry medium" and "Berry high"?

A. Right, yes.

Q. Both of those models assume that the rate of incidence is proportional to the cumulative exposure?

A. That's correct, yes.

Q. Both of those models assume that the rate of incidence is exponentially related to time?

A. I'm not sure - it related to an event of time subject to a lag.

Q. And the lag in those two models is the time period within which no mesothelioma event would occur?

A. That's correct, yes. That is to say, in one of them it was five years and the other of them was ten years.

13.1.34 Messrs Watson and Hurst had recomputed the Berry medium and Berry high curves in the light of data available up to 1996 from the Australian Mesothelioma register, and their projections (based on 431 incidents in 1996) were already available to Trowbridge and may be found in the right most two columns in Schedule B of Mr Minty's statement (described in the footnotes as "projections of national events" using those curves). Trowbridge then determined, on the basis of 89 events in the year ended March 2000, that claims against James Hardie would represent some 19.6% of the total national projected claims according to Berry medium, and 18.8% according to Berry high (T 3280.4-15), a straightforward calculation:

Q Once Watson and Hurst have done the work and recalibrated Berry medium and Berry high to the 1996 431 mesothelioma data, and they have got the second, the last and the second-last in the right columns, it's the work of a moment to work out what proportion James Hardie's claims bear to those numbers in 1999, and type that in, and it's the work of a moment to round that to the nearest integer, and it's the work of a moment to say that's 1.15 claims for those events?

A The actual calculation, as you say, is very straight-forward once you have made the decision that those are the assumptions you wish to make, yes.

13.1.35 Although there is nothing particularly complex in either of the Berry curves or the manner in which Trowbridge based its projections on those curves, it was an innovation for Trowbridge in its February 2001 report to reject the earlier basis of projection and to replace it with Berry medium. One would expect the reasons for rejecting the old model and including the new model to be explained. One might also expect the reasons for selecting Berry medium as the "best estimate" and Berry high as the "high estimate" to be explained. There are no such reasons in the February 2001 report.

13.1.36 There are powerful reasons that suggest, prima facie, that Professor Berry's models based on Wittenoom exposure to blue asbestos were not likely to be a good predictor of James Hardies' future mesothelioma claims, most of which were general liability, not workers' compensation, claims, based on brown and white asbestos products, the peak exposure from which occurred roughly a decade after the closure of Wittenoom. See Mr Wilkinson's report exhibit 252 at 4.3.3 (p33).

13.1.37 It may be that Trowbridge formed the view that it was impossible to prepare an exposure model (although Trowbridge had done exactly that for another client) which would have provided a more reliable basis for future projections. It is not unreasonable to think that such a model would have been more easily prepared in the case of companies with relatively large exposure such as James Hardie and CSR: Wilkinson, p34. But even assuming (favourably to Trowbridge) that it was entitled not to undertake that exercise, there is no explanation provided to the reader of the February 2001 report why the Berry curves are “appropriate assumptions” as required by section 25 of the Actuaries’ Code of Conduct. Nor is there anything in the Trowbridge working papers explaining what Trowbridge considered in selecting those curves.

Third assumption: that no allowance should be made for superimposed inflation

13.1.38 As the Commissioner observed in questions to Mr Minty, both the June 2000 draft report and the February 2001 report computed discounted values of the future cost of projected claims (T3304.37 - 3305.1).

Q. I see at p 30 of the exhibit under heading 'Summary and Results', you set out in the first paragraph under that heading that you assessed the exposure on two bases, one the expected future cost of claims already lodged before 31 March 2000 and the second is the projection of the cost of all claims to which you project Hardies will ultimately be exposed?

A. That's correct.

Q. Absent some limitation, that would seem to be, prima facie at least, saying that you were estimating what you thought the future costs of claims would be which one would think would take into account superimposed inflation, if there wasn't some limitation, I am really looking at where the limitations could be found?

A. The emergence of superimposed inflation in an actuarial model will depend on the way in which the model has been developed. As I indicated earlier, there are some models which don't incorporate superimposed inflation or would not incorporate superimposed inflation at all.

Q. Yours didn't?

A. We did not in this particular case, that's right.

13.1.39 That is to say, it would be unusual for a report expressly to make estimations of future cashflows without impliedly containing the representation that those cashflows were being inflated at a rate which was realistic. A report that did so would have to make it perfectly clear to its reader that that was an assumption being applied. That was especially true of a report which was in response to Allen Allen & Hemsley's letter of 30 January 2001 for an estimate of “prospective liability on a total cost basis”.

13.1.40 The June 2000 draft report contained statements in section 2.5 under the heading of “Allowance for Inflation” indicating that there were “further upward pressures” which tended to increase claims above the rate of wage inflation. It stated:

> Measurement of past superimposed inflation and forecasting of its future trends is very difficult, a difficulty exacerbated in the case of asbestos-related claims as there is limited past history.

The operative assumptions were then stated:

> For our model we have assumed that average claim costs will increase with general wage inflation in Australia. We have assumed no superimposed inflation. A future inflation rate of 4% per annum has been used, which is in line with current forecasts for wage inflation over the medium term.

Finally, in table 9.4, a sensitivity analysis for, *inter alia*, "High Claim Inflation" was undertaken, which showed that the modelling was very sensitive (increasing by $130,000,000 if 4% superimposed inflation were assumed) to the assumption of no superimposed inflation.

13.1.41 None of this was done in the case of the February 2001 report. There was no express statement of the inflationary assumptions applied. There was no sensitivity analysis. There was none of the commentary Mr Wilkinson says (exhibit 252, p35) he would have expected to see.

13.1.42 All that was done was to include the words:

> our estimates are based on the continuation of the current environment regarding legal principles and settlement practices.

Those words do not convey the fact that the best estimate is based on a counterfactual assumption that the cost of claims would increase by only 4% per annum.

13.1.43 The "current environment" was an environment, as Trowbridge's own report to the government (exhibit 262) made perfectly clear, in which

> the cost of claims have been rising for many years driven by personal injury claims (the increases are significant - more than 10% a year on average - and have probably been going on for 20 years or more (p i-ii)

Figure 5, on p16 of that report, suggested that the average claim size had increased at 12% per annum since 1990, significantly above average weekly earnings.

13.1.44 One of the drivers of increased costs in the "current environment" was that medical costs and technology were continuing to increase, leading to greater claims. Mr Minty said (T3305.21-33):

Q. So, we should read, should we, the sentence "our estimates are based on the continuation of the current environment regarding legal principles and settlement practises" as first of all extending to medical technology?

A. Yes.

Q. And secondly as excluding any future development of medical technology?

A. That's correct.

Q. That just doesn't appear on the page?

A. No it doesn't.

13.1.45 Mr Minty had also been told, expressly, by Mr Williams, that "awards of general damages in the DDT since around 1990 have risen steadily (well in excess of inflation)." (Exhibit 259, para 4.17); T 3298.44-49.

13.1.46 Perhaps most tellingly, Trowbridge's own estimate of James Hardies' average mesothelioma claim had increased from $155,00 to $180,000 between 1998 and 2000, a rise of 7.8% per annum.

13.1.47 In the light of that material, Mr Minty conceded (T3315.15-32):

Q. Having regard to the data that Mr Leeming took you to earlier, if you had gone through the two steps - the first of the two steps that were mentioned a minute ago, that is looking at James Hardie's claims history and looking at claims history in related areas, you would have ascertained I suggest that historical superimposed inflation at least in the last decade, had been significantly in excess of 4 per cent?

A,. Certainly in the four years from 1996 through to 2000, that was certainly the case. From looking at that average claim size graph where we were looking at years prior to that, it's less certain, because the numbers are relatively stable. There's again an obvious outlier I think around about 1990, 1991, but - so generally up until then fairly stable, but certainly in the period from 1998 to 2000, as Mr Leeming pointed out, an increase in the order of around about 8 per cent per annum over those two years which certainly translates that way.

13.1.48 In contrast to Mr Minty, Mr Marshall contended that there was no data clearly indicating superimposed inflation. In this he was in disagreement with Messrs Minty, Wilkinson and Whitehead. His evidence in this respect was also inconsistent, in that:

(a) first, he said that that James Hardies' "very very recent experience" suggested that the average cost of claims was merely volatile, rather than indicative of superimposed inflation: T3425.38.44; he said that by "very very recent" he meant the previous year: T 3425.46-48;

(b) secondly, when confronted with the actual increases in James Hardies' cost of claims over the period 1998 - 2000, he sought to expand the time frame to say that from the early nineties, he saw a high degree of volatility and little if any evidence of superimposed inflation in both James Hardie claims and claims generally within Australia: T3428.4-27, 3429.56-3430.32;

(c) finally, when confronted with Trowbridge's report to government on Public Liability Insurance (Exhibit 262) he conceded that (contrary to his previous explanation) that there was no real doubt that there had been significant superimposed inflation since the 1990s: T 3431.16-21.

13.1.49 For those reasons, Mr Marshall's evidence on this issue is unsatisfactory, and should be rejected in favour of the evidence of Messrs Minty, Whitehead and Wilkinson. The Commission should find that:

(a) the assumption in the February 2001 report that cost of claims would increase at 4% was not an "appropriate" assumption for Trowbridge to make within the meaning of Code of Conduct section 25; and

(b) that assumption, and the very significant implications flowing from it, was not sufficiently (or at all) disclosed in the February 2001 report, contrary to Code of Conduct 24.

13.1.50 There is no dispute but that had a superimposed inflation (whether 2% or 4%) had been included, the difference would have been in the order of hundreds of millions of dollars.

Fourth assumption - 25% Nil claims

13.1.51 The draft June 2000 report and the February 2001 report were based upon an assumption that 25% of the claims made to James Hardie would be nil-claims. That assumption, and the reasons for it, was nowhere stated in the February 2001 report, contrary to the Code of Conduct. Nor was it an appropriate assumption for Trowbridge to make.

13.1.52 The draft June 2000 report contains, in section 4.6, the reasoning upon which Trowbridge relied. The information Trowbridge had is found in table 4.3, which shows that:

(a) the average level of nil-settlements was 20%;

(b) except for the years 1992/93 and 1997/98, the level was *less* than 20%.

13.1.53 In order to justify a rate of 25%, Mr Marshall said that he relied upon a weighted average of the last three years, and then rounded up to take into account the fact that in the 1998 Trowbridge report, a level of 30% had been selected: T3432.39-53. However,

(a) Mr Marshall agreed that choosing a weighted average over *three* years was arbitrary (T3433.3-4);

(b) Mr Marshall agreed that had a weighted average been taken over 1, 2, 4, 5, 6, 7 or any other number of years, the average would have been *less than* 20% (T3434.5-9);

(c) despite Mr Marshall's denial of it, it is rationale to conclude that the 1997/98 figure is an outlier and should not been given much credence for this purpose.

13.1.54 That is in accord with Mr Minty's evidence that:

(a) the 1997/98 figure was "a candidate for being considered an outlier": T33085.4 - 3309.5;

(b) of the same figure, "it is a bit of an outlier": T3310.47-48; and

(c) at T 3309.16-20:

> Accepting that it could be an outlier, it is unsafe to rely upon an average of 23 per cent where a third of the components of that average is something which could be an outlier?
>
> A. Yes and we didn't rely on that average.

13.1.55 That is also in accord with Mr Wilkinson's evidence that:

> "My analysis indicates that a rate of 20% would be the maximum rate a reasonable actuary would support (and that it could reasonably be as low as 15%)" (Exhibit 252, p56).

13.1.56 It is no answer to this criticism, as was suggested in cross-examination of Mr Wilkinson by reference to table 5.13 in his report, that had Trowbridge selected a base average cost of $160,000 and a nil settlement rate of 23%, both at the extreme end of what Mr Wilkinson considered was reasonably open to Trowbridge, that the average cost of claims would be computed at $134.750 (T 3379.5). That does not make the selection of 25% in the first place an appropriate assumption within the meaning of section 25 of the Code of Conduct.

Issue 16

16. Did Trowbridge, Mr Minty or Mr Marshall fail to exercise due care and skill in preparing the February Report in the respects identified by Mr Wilkinson in Ex 252, and thereby breach a duty of care owed to Amaca, Amaba, or JHIL? If so, what are the consequences, and what remedy, if any, would be available?

Yes. A claim for damages may be available.

Issue 17

17. As at 15 February 2001, were Mr Minty or Mr Marshall aware that the incoming MRCF directors proposed to use the February Report in forming a view as to the likely longevity of the MRCF? If so, having regard to:

(a) the answers in respect of issues 4-11 above;

(b) the extent to which the terms of the February report disclosed the fact that it was not prepared by reference to up to date information;

(c) the knowledge of Mr Minty and/or Mr Marshall as to whether the incoming directors had access to the June 2000 Trowbridge report;

did Trowbridge engage in conduct that amounted to negligent misrepresentation, or conduct in trade or commerce that was misleading or deceptive as regards the incoming directors, Coy or Jsekarb? If so, what are the consequences, and what remedy, if any, would be available?

Yes. A claim for damages may be available.

14. Members' Scheme of Arrangement for JHIL and JHINV

14.1 Development of Scheme between November 2000 and August 2001

14.1.1 The scheme which was proposed and refined following the establishment of the MRCF was a members' scheme, whose essence was that shareholders in JHIL would exchange their shares for ordinary shares in a Dutch listed company JHI NV, which were to be listed on the Australian Stock Exchange as Chess Units of Foreign Securities ("CUFS"): Cameron, para 58. It was thus a "Top Hat" scheme: cf *Arakella v Paton* [2004] NSWSC 13 at [41]-[42]. JHI NV was at that time a Dutch subsidiary of JHIL, known as RCI Netherlands Holdings BV.

14.1.2 The brief to Noel Hutley SC sets out in more detail the steps to implement the proposal: DAR1 1/194-5. It is convenient to reproduce the first three steps:

> (a) under the scheme, JHIL shareholders will exchange their JHIL shares for ordinary shares in RCI Netherlands Holdings BV, to be converted from a BV to an NV and renamed James Hardie Indudtries NV (***JHI NV***), which is an existing subsidiary of JHIL incorporated in the Netherlands. The JHI NV Shares will be listed on ASX as CUFs.
>
> (b) Once JHIL is wholly owned by JHI NV, JHNV, a Dutch, wholly-owned subsidiary of JHIL, will be transferred from JHIL to JHI NV. This will be achieved by a reduction in capital carried out by JHIL, the ordinary shares in JHNV being transferred to JHI NV as consideration for the return of almost all of the paid up capital on the JHIL shares held by JHI NV. No JHIL shares will be cancelled.
>
> (c) JHIL, subsequently to the reduction in capital, will issue partly paid shares to JHI NV. On subscription, JHI NV will pay up a nominal amount of the issue price of those partly paid shares. The issue price of the partly paid shares will be equal to the book value of JHIL less the value of its financial reserves (most of which will be committed to pay the Foundation subsidiaries under the loan and indemnity document. JHIL is expected, through the partly paid shares and through its financial reserves, to have access to approximately A$650 million. Around one third of this amount will be committed to the Foundation and the other two thirds will most likely never be needed by JHIL.
>
> ...

14.1.3 At that stage, the partly paid shares to be issued to JHI NV were proposed to be calculated by reference to the book value of JHIL's assets other than its financial reserves.

14.1.4 Counsel was asked for the following advice:

> Further, Counsel is asked whether there is likely to be a need to disclose any Trowbridge Reports, the financial models, the Deed of Covenant and Indemnity or other internal documents generated during the set up of the Foundation (eg JHIL Board papers). Such documents are considered sensitive by JHIL (DAR1 1/198)

14.1.5 In conference on 10 May 2001, Hutley SC expressed the view that an indemnity might be given by JHI NV to JHIL, rather than issuing partly paid shares. That was conveyed by Mr Robb to Messrs Harman and Shafron by email (DAR1 1/206):

> In our conference with Counsel, Noel Hutley SC, last night, he asked whether instead of the partly paid shares, JHI NV could instead give an indemnity to JHIL. We didn't discuss the possible terms of the indemnity, in terms of whether it would be limitless or its scope, but basically his view would be that this would be a more usual, and less artificial way, of a parent company providing support to a subsidiary in case that subsidiary should become subject to liabilities which it could not cover in the future.
>
> We did talk about the fact that the partly paids may be more easily cancelled, but not with much focus as he was generally much more comfortable with the indemnity as a concept. We did discuss that the terms may be that the indemnity stopped when JHIL was insolvent or put into liquidation.

14.1.6 Mr Shafron attended the next conference with counsel, on 17 May 2001: Robb para 73. The notes taken by George Frangeskides at that conference (DAR1 1/207), record Mr Hutley saying:

> if going to have p paid, shd be at best est of value of co ➔ shd be at value JHNV was transferred for.

14.1.7 Those notes then record Mr Hutley's advice:

> Partly paid v indemnity - adv of indemnity is it is worth what it is worth
>
> → Indemnity can be released.
>
> → Partly paid can also be extinguished

14.1.8 Mr Shafron is then recorded as saying:

> However, there is a tax issue for indemnity →
>
> Indemnity treated as receipt of profit, no loss to offset it
>
> against → so must go the partly paids

14.1.9 At the Project Green conference call on 22 May 2001, Mr Hutley's preference for partly paid shares was conveyed. The notes of that conference include (DAR1 1/210):

> → Counsel's pref is to go in on p paids at mkt value, otherwise
>
> will need to explain why book val is enough
>
> → adv of mkt val is can argue no diff.
>
> → Peter Mac - will need to get appr of Bd if going at mkt value.

14.1.10 A second brief was sent to Mr Hutley on 6 July 2001 (DAR1 215). At that time it was proposed that counsel settle the form of the Information Memorandum before it was lodged with ASIC (see second paragraph of the 6 July 2001 letter). That brief raised, again, questions of appropriate disclosure in the information memorandum and to the court, in issues 1 and 4. Specifically, issue 4 was in the following terms (DAR1 1/217):

> In our earlier brief we included a copy of the Deed of Covenant and Indemnity. We have not referred to it in the Information Memorandum, although it is to be filed in hard copy only with the SEC under SEC requirements (and it is referred to in the current draft of the JHNV Sale Agreement, though this aspect is currently under consideration). The Deed of Covenant and Indemnity has two key features - JHIL pays money under it over many years to the former subsidiaries; and the former subsidiaries indemnify JHIL and agree not to sue it. In not making any disclosure about JHIL's future position with respect to asbestos and given that the scheme does not really impact on the Foundation, is some sort of disclosure necessary?

14.1.11 There was no further meeting with counsel prior to the lodgement of the draft Information Memorandum, on 16 July 2001 (DAR1 1/218).

14.1.12 The next conference with Mr Hutley took place on 20 July 2001. The notes of Messrs Frangeskides and Stephens are at DAR1 2/362-365. They record that the focus of the conference was on how to address questions of enforcement of Australian law in respect of the new Dutch parent (this turned out to be the principal issue which occupied Santow J). Both filenotes record or reflect counsel's advice that the affidavit "needs to explain all the steps". Although there is no express mention of the response to the specific question in relation to disclosure of the Deed of Covenant and Indemnity, it is reasonable to infer that counsel either made no reference to it at all, or else considered that the only matters that needed to be raised expressly were the steps of the scheme.

14.1.13 There was (for the reasons set out in detail below) no intention on the part of JHIL to cancel the partly paid shares. Counsel and solicitors and James Hardie management appreciated, as did Santow J, that partly paid shares could be cancelled without court approval pursuant to the Corporations Act, just as an indemnity could be released without court approval. There was no intention on the part of JHINV to exercise the put option.

14.1.14 Likewise, the matters that counsel did advise ought be raised were appropriate to be raised in accordance with the practice developed by Justices Santow and Austin to identify matters out of the ordinary course and/or which would require attention of the court. Those matters included:

(a) the issue of CUFS rather that direct shareholdings;

(b) the non-compliance with s259C (in respect of which ASIC granted relief);

(c) why the scheme was not contrary to s411(17) (scheme cannot be used to avoid the takeovers provisions);

(d) how the Australian takeovers provisions would be reflected in the articles of JHINV, and the extent to which this would be effective;

(e) how Australian shareholders could enforce their rights against the company.

14.1.15 See the letter to Justice Santow's Associate dated 9 August 2001, DAR1 2/377.

14.1.16 Moreover, counsel's advice notwithstanding, the issues paper *did* draw the Court's attention to the partly paid shares: DAR1 2/382.

14.2 Implementation of the scheme and dealings with the Court

14.2.1 The first return date was brought forward, by the Court, to 10 August 2001 (DAR1 2/376). On that occasion, Santow J asked a large number of questions, largely focussed on the enforcement of Australian legal rights via the Dutch articles of JHI NV. Not inaccurately, Santow J stated at DAR1 2/409.43-45:

> You really are indulging in some pioneering stuff. I am well aware that the questions I am asking are questions that if I were asked, I wouldn't have ready answers either.

14.2.2 At T11.24 - 12.4, Santow J addressed the issue of the partly paid shares, and suggested that there be a condition on the rights of JHIL to call upon the partly paid shares, lest there be a question of insolvency of JHI NV, which would not be able instantly to meet the call.

14.2.3 To Santow J's question "What effect will this have on asbestos claims against Hardie's?", counsel responded (DAR1 2/410-411):

> The position is this. The claims that are on hold are not against Hardie's. They are against organisation which were once subsidiaries of Hardies which have been put into a foundation but Hardies is a party to a number of claims. It will have no effect on those claims because the claims are against JHIL. JHIL your Honour will see is in a position to meet all claims, any claims from whatever source, we are talking about the whole of its business, ever be found against them because it has access to the capital of the group through the partly paid shares subject to the point your Honour raised as to whether it should be conditioned in some way.

14.2.4 That Friday afternoon hearing led to the preparation over the weekend of a written response to twenty questions raised by Santow: PSC1 2/483, as well as advice from the Dutch lawyers De Brauw Blackstone Westbroek: PSC1 2/502. The answer to the question "What effect will the Scheme, if implemented, have on asbestos claims against James Hardie?" was:

> As stated by Counsel in response to this query, the Scheme will not affect the position regarding asbestos claims. The former subsidiaries of JHIL against which almost all proceedings have been taken in the past in relation to asbestos claims were transferred to an independent Medical Research and Compensation Foundation in February 2001. JHIL has at times been joined as a party to such proceedings, but has always successfully resisted any claims against it. One adverse finding at first instance was overturned on appeal: see *James Hardie & Coy Pty Ltd v Hall (as Administrator of the estate of Putt* (1998) 43 NSWLR 554. That said, it cannot be said that JHIL will never be held liable. JHIL will have, through existing reserves and access to funding in the form of the partly paid shares, the means to meet liabilities which will or may arise in the future whether in relation to asbestos-related claims or other obligations to other persons.

14.2.5 Also proposed was a condition upon the partly paid shares that a call could only be made if the directors of JHIL formed the view, after due and careful consideration, that the payment of the call was necessary to ensure that JHIL was able to pay its debts as and when they fell due, and then only in such amount as was necessary to ensure that JHIL remained solvent.

14.2.6 There were further hearings before Santow J on 13, 15, 20 and 23 August 2001: Ex 187, [91]. On 23 August 2001, Santow J made orders convening a meeting of members for approval of the scheme: [2001] NSWSC 741, PSC1 2/577. A large majority of members approved the scheme on 28 September 2001. The day before the meeting, the Treasurer announced that he had signed a protocol with the United States Ambassador proposing changes to the United States-Australia Double Tax treaty; this was disclosed to members, but many had voted by proxy. Nevertheless, for reasons reported at (2001) 39 ACSR 552 (PSC1 2/581), Santow J approved the scheme, with effect from 11 October 2001.

14.3 Sufficiency of disclosure

14.3.1 Four matters have emerged as areas where the sufficiency of JHIL's disclosure to its members and to the Court warrant examination:

(a) any intention or contemplation to cancel the partly paid shares to be issued by JHIL;

(b) the put option contained in the Deed of Covenant and Indemnity;

(c) the matters raised by Mr Cooper on 19 April, 26 June and 7 August 2001; and

(d) the letter of 24 September 2001 from Sir Llewellyn Edwards to Mr Macdonald.

14.3.2 The notion, suggested and refuted in cross-examination (eg T 2951.8-12), that it was somehow necessary to tell the Companies Judge of the Supreme Court of New South Wales that partly paid shares might (like any other form of capital) be cancelled, and so any statements made about them should be preceded by the words "for as long as the partly paid shares exist", does not warrant detailed refutation, for the reasons given by Mr Cameron at T 3027.21-29:

> Q. Nothing by way of qualification to his Honour, for example, "for as long as the partly paid shares exist"?
>
> A. I believe it would have been absolutely unnecessary to say to Santow J that if circumstances changed or it became possible at some later time that capital was capable of cancellation - whether it be partly paid or fully paid or any other sort of capital - it would have been a debt capital, it would have been equally capable of changing if circumstances changed.

14.3.3 See also paragraph 72 of his statement:

> I think it was certainly unnecessary to say to his Honour that partly paid shares, like other forms of share capital, were susceptible to a capital reduction pursuant to the provisions of the Corporations Law, especially as he heard applications in relation to schemes, including those involving reductions of capital, very frequently and had provided many of the leading judgments on schemes and he gave close focus to the structure of the schemes he considered.

14.3.4 The starting point is that the only valid criticism that could be made is of a non-disclosure of a matter that was *material* to the Court.

14.3.5 The scheme was a "top hat" members' scheme. The primary focus of the Court's approval process was (as was correctly anticipated by solicitors and counsel) the extent to which the rights of members would be affected.

14.3.6 Mr Cameron's evidence is that neither the put option nor the cancellation of the partly paid shares was material in such a scheme.

14.3.7 Mr Cameron's experience and expertise in the area is unrivalled: he started doing mergers and acquisitions in the late 1970s, he has been involved in more than 20 schemes and in excess of 100 takeovers, he has served in the Takeovers Panel for 4 years, and advised the Law Council in relation to amendments to chapters 5 and 6 of the Corporations Law and developed ASIC and Panel policy: T 3085.47 - 3086.17. His evidence on materiality is unequivocal (T 3034.1-34):

> RUSH: Q. The matters concerning the potential liquidation of JHIL, that was not raised before Santow J?
>
> A. No I don't believe it was entertained by the directors or management at the time.
>
> Q. I don't think that was my question, that was not raised by Santow J?
>
> A. No it was not.
>
> Q. The potential vesting of JHIL back to the trust was not raised before Santow J?
>
> A. Correct.
>
> Q. As you have referred to in the advice to the Board of 9 February, the cancellation of the partly paid shares also, as I think we are agreed upon, was not raised before Santow J?
>
> A. All those three things, I believe, are correct.
>
> Q. What I want to put to you is the failure to raise those three things is by omission a misleading of the court?
>
> A. And I absolutely reject that. The expression failure implies some obligation to do so for two reasons at least. I don't believe there was any obligation to do so, firstly, because it wasn't material in the context of a members scheme for the reasons I have given earlier on and, secondly, the relevance of those issues would have required something beyond a canvassing of them as possibilities by management some ten months before the scheme, they would have required some degree of fixity of intention on the part of somebody who had power to bring those acts about, namely the directors. To my knowledge, there was no such intention.

14.4 Existence and disclosure of intention to cancel the partly paid shares

14.4.1 There is no dispute but that if JHIL intended, at the time the application was before the Supreme Court, to cancel the partly paid shares, then that ought to have been disclosed to the Court. That is plainly correct, and was the view Mr Cameron readily expressed: Cameron T 3014.22-31; 3027.38.

14.4.2 That view had already been stated in the Allen Allen & Hemsley advice of 7 February 2001, and that advice had been directed not merely to Messrs Shafron and Macdonald, but had been included in the Project Green JHIL Board papers: PSC1 2/384.

14.4.3 As a first matter, at the time of the scheme hearings, there were considerable obstacles to the cancellation of the shares which tended against the possibility of an intention to cancel:

(a) The directors of JHIL, knowing of the obligation to make payments under the Deed of Covenant and Indemnity to the Foundation, and knowing that there was the potential for asbestos related claims to be made against the company, would not lightly cancel its uncalled capital, knowing that if the provisions of s256B were not satisfied, they would themselves be contravening s256D(3). Mr Cameron's evidence was that he had advised JHIL on the new capital reduction provisions on a number of occasions since early 1998 and understood JHIL to be well aware of their implications: Cameron, para 71.

(b) The directors of JHIL could not sensibly take that step without assessing the magnitude of the potential claims that could be made against JHIL. That was eventually done (see the Allens advices of 31 January 2003 DAR1 2/535 and 7 March 2003 DAR1 2/562 (draft) revised 14 March 2003 DAR1 2/689), but not before a considerable amount of work was done, including an analysis of the workers' compensation provisions in all States.

14.4.4 That was why Mr Cameron said in cross-examination (T 3028.37-49):

> The investigation which one would have had to undertake to ascertain whether there was any potential for cancellation of the partly paid shares at a later time would have required an analysis of what the potential liability exposure of JHIL was through the future at the time when this was going to occur, absent which both the directors and anyone else involved would have had an exposure under the Corporations Law for a failure to reduce capital in accordance with the requirements of that law. So I'm not sure, in the context of your question, what investigation one could have undertaken which would have produced a meaningful response to that query. Have I misunderstood your question?

and (T 3032.21-29):

> one of the issues you would, or may have to deal with in the context of JHIL, if you ever did cancel the partly paid shares, was to undertake a capital reduction and you would have to then measure the claimants against the company. So I don't think that does - it follows from what you've just said that that is a reason why there was not any formal quantification. I don't think such a quantification could readily have been undertaken.

14.4.5 Secondly, the Commission has the benefit of the evidence of Messrs Cameron and Robb. They were very closely involved in the decision-making of JHIL by its management, its directors, and its other external accounting and tax advisers. It would have been necessary for those within the company harbouring any such intention to have concealed that intention from Messrs Cameron and Robb. That is, in the circumstances of this company, unlikely. Mr Cameron said (T 3034.55 - 3035.14):

> Q. Was it the position that as far as you were aware, management had under consideration the question whether they had under consideration at the time or before the time the application made before Santow J, the question whether the partly paid shares would be cancelled within a relatively short time after the approval given by Santow J?

> A. My clear view was that that was not the case. The issue of cancellation had been canvassed substantially in September/October of the year 2000. The nature of the discussions, it is apparent from some of the material that has flowed between client and lawyer, that there was obviously a reasonably high degree of frankness. I can't believe that an intention of that kind could reasonably have been entertained without there being some indication of it in that correspondence. We would have been alerted to it. It is shown, I think, pretty plainly in our February advice what our reaction to it was.

14.4.6 Thirdly, the contemporaneous documents are inconsistent with such an intention. The Information Memorandum, which the JHIL directors approved, stated:

> The callable amount under the partly paid shares will be equal to the market value of the James Hardie Group as at the Scheme Record Date less the subscription monies already paid up. The partly paid shares will provide JHIL with access to cash if required in the future to meet any liabilities of JHIL, whilst allowing JHI NV to obtain the financial efficiencies that the Proposal is expected to provide.

14.4.7 That statement is inconsistent with an intention to cancel the shares.

14.4.8 Similarly, on 14 and 15 May 2001, Mr Shafron sent to Messrs Macdonald, Morley, Baxter and Robb what he described as "A first take on a Q&A for the partly paid shares, explaining our logic and their possible use": PSC1 2/508. The document stated:

> The partly paid shares, together with other assets available to JHIL after the restructure, will be available to meet existing and future liabilities and obligations of JHIL. The JHIL directors do not expect that JHIL will be in a position such that it becomes necessary to make calls on the partly paid shares. However, in view of the various outstanding obligations of JHIL associated with many years of operations (eg parent company guarantees associated with business sales) - many of which cannot be reduced to certain dollar amounts - the JHIL directors felt that until those obligations were better understood the prudent course was to ensure JHIL remained in the same economic position as it was in prior to the restructure.
>
> ...

[following the reference to JHIL being joined to asbestos suits in its accounts, the document continued:]

> Should the liability position of JHIL change for any reason, and JHIL has no reason to expect that it will, then the partly paid shares would be available to meet any new liability.

14.4.9 In those circumstances, the only way there could have been an undisclosed intention is if persons whose minds were relevantly those of the company formed an intention to cancel those shares and deliberately concealed that intention from the external advisers until after the scheme had been approved by the Court.

14.4.10 That would be an extremely serious finding to make. There would appear to be no documentary or testimonial evidence upon which it could be based. No foundation in the cross-examination of the witnesses (including Messrs Macdonald and Shafron) has been laid for such a finding. It is inherently improbable that a company which, plainly, invested very considerable quantities of money and senior management time in taking the advice from professional experts would attempt to deceive those experts in the manner contemplated.

14.4.11 Far more probable is the proposition that the cancellation of the partly paid shares at some time in the future was something that was appreciated as a possibility, but as to which there had been no serious consideration let alone a final decision by any member of management or any director. What is appreciated or contemplated as a possibility is not an intention. Mr Cameron's explanation is accurate (T3013.51 - 3014.8):

> Q. You draw a distinction between "intention" and "contemplation"?
>
> A. Absolutely.
>
> Q. What is the difference in your mind between the two in terms of the obligation to disclose?
>
> A. There may be many things and many alternatives which are the subject of comment plus which have been canvassed which have been considered which have not become a matter of intention. The view which is put here is that under the subject matter of the obligation of the directors and the Corporations Law to declare their future intentions for JHIL might arise and on which it would be transferred to neither entity, if that was intended by the directors to such an extent that it would be in the context of a members scheme.

14.4.12 Finally, let it be assumed that, say, Mr Macdonald and Mr Shafron secretly harboured a fixed intention to cancel the partly paid shares and exercise the put option. Even making that assumption, it is plain that it did not follow that that intention could or would be effectuated. Messrs Shafron and Macdonald openly sought approval from the JHIL Board in January 2001 to restructure the company. They failed. They sought approval once again in February 2001, but were only partially successful. This was a company where, as Mr Cameron said, "the Board had already indicated a clear propensity to disagree with management and take a different direction when they wanted to": T 3034.41-43. The evidence before the Commission makes it perfectly clear that this is not a case where the intention of senior management can be imputed to the company.

Issue 44

44. In the period April to October 2001, what were the plans or intentions of JHIL as to:

(a) separating JHIL from the James Hardie group after the restructure;

(b) the possible cancellation of the partly paid shares intended to be issued by JHIL to JHINV as part of the restructure;

(c) the possible exercise of the put option in the DOCI?

This issue is dealt with above.

Issue 45

45. Having regard to:

- *JHIL's plans or intentions, such as they were;*
- *the relevance of them to JHIL's obligation to provide information in the 2001 Information Memorandum ("IM") ; and*
- *The relevance of them to the question whether the partly paid shares were an effective assurance that any creditors of JHIL would not be prejudiced by the restructure (and in particular, the reduction of JHIL's capital):*

(a) Was it a breach of JHIL's obligations under the Corporations Regulations not to refer to those plans or intentions in the Information Memorandum – Ex 1 vol 8, pp2373-2552 ("IM");

(b) Was the IM misleading or deceptive for failing to refer to those plans or intentions;

(c) Was it a breach of JHIL's duty of disclosure to the Supreme Court to fail to draw to its attention:

(i) those plans or intentions;

(ii) the existence of the put option in the DOCI;

(iii) the matters raised in Sir Llewellyn Edwards' letter to Mr Macdonald of 24 September 2001;

(iv) the matters raised by Mr Cooper on 19 April 2001 (Ex 150 pg.156), 26 June 2001 (Ex 150 p.163), 7 August 2001 (Ex 150 p.167);

while telling the court that "under the terms of the issue of the partly paid shares JHIL will be able to call upon JHINV to pay any or all of the remainder of the issue price…at any time in the future and from time to time" (Ex 61, vol 6 pg 120, pg 126) and with specific reference to asbestos liabilities, that "JHIL will have through existing reserves and access to funding in the form of the partly paid shares, the means to meet liabilities which may arise in the future" (emphasis added – Ex 61, vol6, pg 139)?

> (d) *If the answer to (a), (b) or (c) is affirmative, what consequences follows?*
>
> (e) *If the answer to (a), (b) or (c) is affirmative, did Allens breach a duty of care owed by it to JHIL? If so, did JHIL suffer any compensable loss as a consequence?*
>
> This issue is dealt with above.

14.5 Disclosure of the put option

14.5.1 Instructions were given by Mr Macdonald to Mr Shafron and copied to Mr Robb on 5 February 2001 to include the put option in the deed:

> We would also seek an option for JHINV to put JHIL to JH & Coy once it had no subsidiaries and at least zero net worth (Exhbit 150, p107).

14.5.2 Undoubtedly, those instructions were given because Mr Macdonald contemplated that there was a possibility that, whether by means of a takeover or a scheme, a new holding company might be put in place to hold the fibre cement assets, and that at that stage, it might be desirable to cause JHIL, as the remaining company with potential asbestos liabilities, to be put to the Foundation.

14.5.3 It does not follow that Mr Macdonald had a fully formed intention that that would occur. It did not in fact occur. There were a variety of other possibilities (a separate trust, liquidation, holding JHIL) all of which had some merit. The inclusion of the put option should be seen as an understandable means of preserving one of a number of opportunities, so as to maximise the flexibility for a future decision in the future.

14.5.4 That is in accordance with Mr Macdonald's evidence (T2386.19-.29):

> Q. You ultimately had an intention, did you not, on behalf of JHI NV, to exercise the put option in the deed of covenant indemnity to remove JHIL from the group?
>
> A. I don't think it's true to say I had an intention at this time. I had, I believe - the company had with, certainly at my instruction, created an option that we might be able to do that some time in the future.
>
> Q. You wanted to keep that option open, didn't you?
>
> A. Given that we created the option, I think it would be beneficial to keep it open, if that's possible.

14.5.5 That is also consistent with Mr Robb's evidence (see section 14.5.11(b) below) that the put option was such a minor part of the transaction that he had forgotten about it at the time of the scheme.

14.5.6 True it is that the existence of the put option was not disclosed in the Information Memorandum or to the Court. However, as a preliminary matter, it should first be noted that it was improbable that the put option would ever have been exercised without first cancelling or otherwise varying the terms of the partly paid shares. To do otherwise would have been contrary to the separation objective of severing companies with asbestos liabilities from the companies with the fibre cement business. For all the reasons set out above, just as there was no need to disclose any intention or contemplation to cancel the partly paid shares, there was no need to make any disclosure in respect of something contingent upon the cancellation of those shares.

14.5.7 Secondly, the mere existence of the right in the Deed of Covenant and Indemnity does not of itself warrant disclosure. If there were an intention to exercise that right, the position would be different. However, a good indication that there was no such intention is the fact that it was never exercised. Instead, the put option was relevant to and informed the lengthy negotiations regarding the consensual transfer of JHIL which took place during 2002 and 2003. That was what had been intended by Mr Macdonald, as recounted by Mr Cameron: T3067.48. Mr Cameron's evidence was:

> My understanding why it was there, and it was described to me by I think Mr Macdonald, it was an 11th hour request and he commented to me that he saw it as a marker of some kind, a marker in the sense of saying that if there came a time when it was appropriate to do so because both January and February Board papers had canvassed the alternatives for JHIL extensively, one of which was a transfer to the trust that if there came a time to do so he will be able to talk to the director of the Foundation and say: "You will recall at the time that the Foundation was established we had a discussion under which you agreed that if this was the course we wished to pursue you will be prepared to take JHIL on as part of these arrangements" because we were concerned at that time that JHIL had to cover its exposures so that was discussed. It wasn't a more sophisticated name than that, it wasn't a complicated regime in which I mean the issue of the interrelationship between the put and the partly paid I don't believe was being under active consideration in the middle of 2001.

14.5.8 In other words, any non-disclosure was a non-disclosure of a right which was never in fact invoked. It is difficult to see, especially with the advantages of hindsight, how such a nondisclosure could have been material.

14.5.9 Mr Cameron was cross-examined at some length (T 3062.26 - 2066.25) on the premise that the put option permitted the transfer to the Foundation of all the shares in JHIL *including the partly paid shares* and that possibility was something which should have been disclosed to the Court. The Commission should reject that proposition:

(a) first, it is a most improbable scenario - it is very difficult, to say the least, to see why JHI NV would permit JHIL to become subject to the control of the Foundation whilst leaving in place a facility to call upon very substantial amounts of capital from the MRCF in circumstances where the MRCF could not meet that call. Mr Robb's evidence on this point was (T2858.54-2859.5):

> Q. Because you knew, didn't you, that the exercise of the Putt option would inevitably mean the cancellation of the partly paid shares?
>
> A. Well, I certainly knew that in February, yes.
>
> Q. And nothing was told to you between February and mid August that caused you to change that view of the connection between those--

> A. Well, certainly if I had considered it in August, I would have held exactly the same view.

(b) secondly, it assumes that the put option was ambulatory and extended to putting the partly paid shares as well as the ordinary shares to the Foundation;

(c) thirdly, as Mr Cameron pointed out, any such decision by JHI NV required a consideration of the position of creditors of JHIL (T3064.43-58):

> Q. The effect of the put option was to give a unilateral right to JHI NV to render substantially ineffective the partly paid shares as a lifeline to the creditors of JHIL?
>
> A. It gave the power to do so but as to whether or not - but in order to do so JHI NV has an entity involved in the particular act would have to take into account the impact of so doing upon JHIL.
>
> Q. Why?
>
> A. Because if the consequence of putting the partly paid shares to the Foundation was that the lifeline to JHIL ceased to be a lifeline it had the same effect of a reduction in JHIL and that's not something which the directors of JHI NV could be party to any more than cancelling the partly paids themselves without considering the impact of that upon creditors of JHIL.

14.5.10 It is perhaps not surprising that, on the late afternoon of his third day in the witness box, Mr Robb acceded to the proposition that it would have been appropriate to have disclosed the put option: T2962.1-8. However, in this respect, Mr Cameron's evidence which was unambiguous and not seriously challenged should be preferred to that of Mr Robb.

Any non-disclosure of the put option was inadvertent

14.5.11 If contrary to the above, the Commissioner were to find that the existence of the put option should have been disclosed, he should find that the non-disclosure was inadvertent, for the following reasons:

(a) first, the Deed of Covenant and Indemnity which contained the put option was the subject of an express question to senior counsel to advise, and senior counsel did not advise that it needed to be disclosed;

(b) secondly, Mr Robb had, by the time of the scheme application, forgotten of the existence of the put right: T 2947.38-39; T 2962.14-18. That is why it was not raised expressly by him with counsel: T2962.

14.5.12 Moreover, JHIL entrusted, as it was entitled to do, its lawyers to advise on what was required to be disclosed and what did not. If there was any non-disclosure, the consequences should not rest with JHIL (T 2859.24-28 (Robb)):

> Q. And you knew that the legal obligation of your client was one of complete candour with the Court in what was an ex parte application?
>
> A. Well, it was probably an obligation of mine, rather than my client's.

14.6 Disclosure of oral communications between Edwards, Cooper and Macdonald

14.6.1 On 19 April 2001 Cooper raised the question of the funding of the MRCF with Macdonald for the first time. Macdonald's email to Shafron dated 23 April refers to that conversation: Ex 150, p156. It records:

> He said that the directors and he felt that JH might not have properly allowed for a rapid escalation in litigation costs in very recent times in setting up the Foundation provision. He felt that we probably had done a good job on claims numbers, but not using the latest claim costs meant that there was a risk of under-provision. He said that FY '01 costs would be well in excess of $22m that had been expected – and this would be a problem if the trend continued.

Macdonald's email records his reaction. He commented that he did not anticipate any action on the conversation and pointed out that he was meeting Edwards at his JHIL Board farewell dinner on 15 May.

14.6.2 On 15 May there was a meeting between Macdonald, Edwards and Cooper. Cooper made a file note of the meeting: Ex 7, MRCF2, Tab 2, p2A. The note records –

> "… Edwards and … Cooper reviewed the early operational experience of Amaca and the Foundation. Of key concern was the level of claims and settlements being received and, in particular, the results for the year end March 2001 just completed. These figures showed a significant excess over those projected during the due diligence program for prospective Directors.
>
> P. Macdonald confirmed that JHIL had taken all appropriate steps to ensure that the projections were as valid as possible. … He was pleased to receive information related to our concerns and would want to be kept informed if, following more extensive experience, our concerns remained."

14.6.3 At that meeting Cooper proffered a document Macdonald: Ex 7, MRCF1, Tab 33; Ex 5, Cooper paras 138-140. The document suggested that the expected life of the Fund was between 10 and 11 years assuming settlements $10m in excess of those originally projected assuming investment returns of between 8.7% and 11.7%. The document was not accepted and the matter appears to have been left on the basis that the MRCF was obtaining a further report from Trowbridge.

14.6.4 On 26 June 2001 Mr Cooper had a "general catch-up" with Mr Ashe: Ex 150, pp162-164. Ashe's note records that Cooper advised that the MRCF was undertaking a solvency analysis which involved new estimates from Trowbridge, a review of its investment earnings and a review of its property holdings. In relation to investment returns Cooper said that the MRCF was getting "well under 11%". On 7 August Ashe had a further conversation with Cooper. He reported that conversation to Shafron by email: Ex 150, p167. Cooper referred to a revised solvency model presented to the MRCF Board which reflected a dramatic change from the position in February 2001. He said that Edwards wished to discuss "the latest solvency position" with Macdonald. In the course of the discussion Cooper said that the MRCF's view, "based on the information provided at commencement" was that funding "would last 15 to 20 years only". In response to Ashe's statement that it was James Hardie's view that the MRCF was "fully funded" Cooper responded that the 11.7% earnings rate was unrealistic and that it was the view of the directors "that 8.7% was more realistic, and this got them to 15-20 years".

14.6.5 On 21 September 2001 there was a telephone conversation between Edwards and Macdonald. During that conversation Edwards said that the MRCF had a very limited life and that it was believed that it could be insolvent in less than 10 years. He also said that the current estimated value of future claims could be as high as about $600m. He inquired whether James Hardie was able to do anything about that state of affairs. Macdonald responded that James Hardie could not do anything about it and that it believed it had provided adequate funds to the MRCF: Ex 13, Edwards paras 145, 146. There was no suggestion of wrongdoing or fault on the part of James Hardie in this conversation.

14.6.6 No claim or demand was ever intimated in any of these conversations. It is difficult to see how any of these matters were relevant let alone material to the approval of a members' scheme, where the rights of members of JHIL remained the same, and the rights of creditors of JHIL were protected by the partly paid shares.

14.7 Sir Llewellyn Edwards' letter dated 24 September 2001

14.7.1 At a meeting of the executive committee of Amaca on 18 September 2001 a draft letter was tabled and then forwarded to Edwards to be considered at a further meeting: MFCF2, tab 10. A draft or final version of that letter was discussed with Bancroft of Mallesons on 25 September: Ex 97; Bancroft T1860.47. Edwards and the other directors of Amaca then decided to send a letter to Macdonald. However, before they did, they sought a confirmation from Bancroft of advice that their interests would not be prejudiced by sending that letter: Ex 97. That confirmation was not given until 2 October 2001: Ex 97.

14.7.2 In these circumstances and notwithstanding that the letter is dated 24 September, it is unlikely that it was seen by Macdonald before mid to late October: Ex 308, [3]. The letter of 24 September (Ex 3, vol 1, tab 9) advised that Amaca could be insolvent in less than 9 years, that the estimated value of future claims was $574 million and that additional funding of $200 million was required to achieve a 20 year life for the fund. The letter noted Trowbridge advice that the most up-to-date data in relation to claims was not provided for the purposes of the February 2001 report. It concluded by seeking an urgent meeting to discuss the matters raised and to consider "appropriate solutions".

14.7.3 The meeting requested in the letter, which eventually occurred on 20 November 2001 when Mr Macdonald returned to Australia (Exhibit 5, paras 161-2). Mr Cooper's filenote of the meeting is Ex 7, vol 2, p 16. It appears that no demands were made by the Foundation by Sir Llewellyn or Mr Cooper at that meeting. That tends to confirm that the implication in the letter was not forefront in the mind of its authors.

14.7.4 In short:

(a) JHIL was not aware of the letter at any time in which disclosure of it could have been made to the Court;

(b) even if JHIL had been aware, there was nothing in the letter to disclose.

15. Communications between MRCF and JHIL/JHINV between October 2001 and March 2003

15.1 Description of the communications

15.1.1 On 20 November a meeting was held between Edwards, Cooper and Macdonald to discuss the letter of 24 September. The discussion extended to the manner in which the Trowbridge February 2001 report had been prepared. In relation to the letter, Macdonald requested that it be withdrawn so that it was unnecessary to respond to it with a “strong rebuttal of all points”. Cooper’s note records that Macdonald stated that "at that time" he had “shared its contents only with Counsel”. That may be a reference to Shafron and the memorandum dated 9 November 2001 which he prepared concerning the letter: Ex 85; Ex 150, p194.

15.1.2 In Cooper’s report as managing director to the Amaca Board in January 2002 he recorded that Shafron had been “directly apprised of the issues and objectives relating to liability projections” as per the September letter: Ex 7, MRCF2, tab 12. A further meeting was scheduled for 22 March. Cooper prepared an agenda for that meeting which he circulated: Ex 7, MRCF1, tab 41; Ex 5, Cooper para 167. On 19 March he received an email from Shafron which attached an amended agenda: Ex 7, MRCF1, tab 42; Ex 5, Cooper para 167.

15.1.3 The meeting on 22 March was attended by Macdonald, Morley, Shafron, Edwards, Cooper, Jollie and Gill. Cooper’s notes of the meeting record that Edwards advising that claims were increasing dramatically both in terms of numbers and average cost and that the fund would only last 5 or 6 years or "maybe a bit longer". Cooper made a presentation in relation to the Trowbridge projections which indicated shortfalls based on the differing information available. Macdonald responded saying that James Hardie was now financially able to provide assistance and that it could deliver “more than $10m” to the MRCF: see Cooper’s notes Ex 7, MRCF1, tab 45; Ex 5, Cooper para 168.

15.1.4 Cooper met with Morley on 21 May. Morley made an offer that James Hrdie make available an additional $10m to $15m: Ex 7, MRCF1, tab 46. At the Amaca directors’ meeting on 22 May Cooper reported on his meeting with Morley. He described the offer made as “totally inadequate”: Ex 7, MRCF2, tab 19.

15.1.5 At the meeting of the Amaca executive on 11 June it was reported that Shafron had confirmed that two options were being considered for the early repayment to MRCF of the moneys due under the Deed of Covenant and Indemnity. The first was the exercise of the option to put the shares in JHIL to the MRCF: Ex 7, MRCF2, tab 21.

15.1.6 A further meeting was held on 16 July. Edwards, Jollie and Cooper met with Macdonald, Morley and Shafron. Cooper made notes: Ex 7, MRCF1, tab 47; Ex 5, Cooper para 178.

Macdonald outlined a proposal to provide the MRCF with $91m which was the amount due under the Deed of Covenant and Indemnity plus a further $15m by transferring JHIL to MRCF on a basis which would not involve Amaca paying income tax on the sum received. In the course of discussion Jollie stated that there was available data at the time of the transfer of Amaca to MRCF which would have produced a claims expectation of around $200m more than the amount provided and asked whether James Hardie would address that question. Macdonald said James Hardie would review its position in relation to that question and that he would report back to his Board on the MRCF's expected future and its directors' views. In a telephone conference on 25 July, Mr Shafron reported on this meetings to Messrs Blanchard and Robb. Mr Robb's notes record:

> no blame being attributed to James Hardie, no suggestion of this
>
> Not negative to the transfer of JHIL.

See Ex 303, tab 3 and tab 2 at p JRB14 which is Mr Blanchard's note.

15.1.7 At some stage after July James Hardie again proposed that it would transfer JHIL/ABN60 to Amaca. On 15 October 2002 JHINV replied in writing to Amaca's letter of 24 September 2001: Ex 3, vol 1, tab 12. The letter stated:

> In view of our discussions and in view of the proposal to transfer ABN60 to Amaca, I do not propose to send the Foundation a detailed written response to the letter.

On 17 October Allens wrote to Mallesons advising of the proposal to transfer the control of JHIL (ABN60) from JHINV to MRCF: Ex 187, Robb vol 2, tab 50. At the meeting of the directors of Amaca on 24 October the receipt of that proposal was noted. It was also noted that a meeting had been arranged with Mallesons to discuss the proposal: Ex 7, MRCF2, tab 25.

15.1.8 A proposed new Deed of Covenant, Indemnity and Access pursuant to which James Hardie proposed to put ABN60 to Amaca was provided to Cooper in late October: Ex 5, Cooper para 182; Ex 7, MRCF1, tab 44. Bancroft of Mallesons advised on the terms of that document by email on 12 November (Ex 7, MRCF1, tab 50) and by letter dated 22 November: Ex 7, MRCF1, tab 51. The first advice was idsmissed at a meeting with Bancroft on 13 November: Ex 7, MRCF1, tab 51.

15.1.9 At their meeting on 27 November the directors of Amaca instructed Cooper to advise James Hardie that the proposed form of deed was unacceptable: Ex 7, MRCF2, tab 27. Cooper communicated that position to Shafron on 2 December: Ex 5, Cooper para 186. On 5 December Robb sent Bancroft a copy of an email which he had received from Shafron in which the latter indicated that James Hardie was prepared to address the concerns which the MRCF had with the existing draft deed: Ex 7, MRCF1, tab 52.

15.1.10 On 16 December there was a further meeting between Macdonald, Edwards and Cooper. Cooper took notes: Ex 7, MRCF1, tab 53; Ex 5, Cooper para 190. Macdonald stated that

James Hardie wished to provide $100m to the MRCF as part of the ABN60 transfer. There were discussions about the effect of the proposed draft deed. Morley and Shafron were to meet with Cooper and MRCF's lawyers to make any necessary changes to the draft. Macdonald and Edwards agreed that they would maintain a direct dialogue in relation to any impediments to the matter proceeding. At their meeting on 17 December the directors of Amaca discussed Cooper's file note of this meeting and resolved that a revised deed containing no new commitments by Amaca would be considered by them: Ex 7, MRCF2, tab 29.

15.1.11 On 21 January 2003 Morley and Shafron met with Cooper to discuss a further draft of the deed. Cooper made notes: Ex 7, MRCF1, tab 55; Cooper para 191. There was also discussion about the MRCF's financial position. Cooper advised that the shortfall of funds to meet future claims was in the order of $500m. Morley and Shafron said that James Hardie could not meet any requirement for additional funds. They "defended" the extent of the assets originally provided despite the fact that the "latest data" was not used. At some stage during the meeting Cooper was advised that James Hardie intended to "put" ABN60 to MRCF by the end of March should negotiations on a deed not be successful. Cooper reported that fact at the January meeting of Amaca's directors: Ex 7, MRCF2, tab 30.

15.1.12 On 10 February 2003 Amaca (Edwards) wrote to James Hardie (Macdonald): Ex 3, vol 1, tab 13. The letter referred to the discussions which had occurred over the previous 2 years. It pointed out that MRCF's assets were expected to last only some 4 to 5 years. It stated that the MRCF directors were not presently prepared to become directors of ABN60 and that an additional $25m in assets was not sufficient to deal with the currently expected level of future claims. The letter requested that James Hardie give "serious consideration to now making further funds available to compensate future victims of asbestos disease". It concluded by urging James Hardie to "positively address" the current funding position of the Foundation and to take "fast and responsible" action.

15.1.13 At the Board meeting of Amaca on 12 February it was noted that a further meeting with Macdonald had been scheduled for later that week: Ex 7, MRCF2, tab 32. That meeting occurred on 13 February between Macdonald, Morley, Edwards, Jollie and Cooper. Cooper again made a file note of the matters discussed: Ex 7, MRCF1, tab 56; Ex 3, vol 1, tab 14; Ex 5, Cooper para 194. Macdonald reiterated that James Hardie wished to repay the funds due and an additional $20m surplus on a tax free basis. He acknowledged receipt of the letter of 10 February and advised that it had been discussed with the James Hardie Board. He reported that advice had been received by that Board to the effect that the James Hardie companies had no liability to MRCF and stated that to provide funds as requested by Amaca would be against the interests of James Hardie shareholders and that therefore directors could not agree to such a request. Jollie listed reasons why it may not be correct to say that a payment by James Hardie of the current deficiency of $500m could not be justified as in the interests of its shareholders. He referred to the corporate veil and prospects of attack which created a litigation risk and a potential avenue for unmet future claims. He also pointed out that Amaca may have a claim as to “incorrect calculations” at 15 February 2001 based upon past James Hardie decisions. He referred to Trowbridge reworked projections indicating that some $200m in excess of funds actually provided would have been required if all available data had been taken into account. At that time he proposed that such an amount could be payable by James Hardie. Macdonald said that he would consider this position.

15.1.14 On 19 February James Hardie responded to the Amaca letter of 10 February: Ex 3, vol 1, tab 15. The letter stated that JHINV was not able to make additional funds available to MRCF. It pointed out that discussions had focussed on a negotiated transfer of control of ABN60, noted that the JHINV Board remained hopeful that a negotiated solution could be achieved and stated that if that was not possible JHINV would be forced to exercise its right to put the shares in ABN60 to Amaca. The letter then put two alternative ways forward. The first was a negotiated transfer of the shares in ABN60 to MRCF. The second was the exercise of the put option. The letter concluded by asking for a response within 14 days as to which option the MRCF directors wished to pursue. That letter was considered by the Board of Amaca at its meeting on 26 February: Ex 7, MRCF2, tab 33. At that meeting it was resolved that a response to the letter be prepared addressing the key requirements of the MRCF in relation to the proposed deed.

15.1.15 On 3 March Amaca responded to the James Hardie letter of 19 February: Ex 3, vol 1, tab 16. The letter set out the amendments which Amaca required be made to the proposed new deed. The letter stated that the James Hardie suggested deadline for execution of the deed was unrealistic and indicated that there would be adverse implications to all parties if ABN60 was put to MRCF with a lesser level of cash assets than was proposed in the negotiated settlement.

15.1.16 James Hardie responded to that letter on 4 March: Ex 3, vol 1, tab 17. In that letter it agreed to make amendments to the draft deed to meet the requirements of the MRCF. The letter sought confirmation that all material matters had been covered and that the MRCF was ready to execute the new deed.

15.1.17 The directors of Amaca met on 12 March. The revised version of the deed was considered and the directors indicated that they were not prepared to undertake what were seen to be additional commitments included in the deed: Ex 7, MRCF2, tab 35. Following communications between the lawyers a further proposed deed was prepared by James Hardie on 16 March. That version was considered by the directors of Amaca and Bancroft in a meeting on 17 March. At that meeting it was decided that the deed contained provisions which were not in the best interests of Amaca. It was resolved that Mallesons should advise Allens of the Board’s rejection of the current version of the deed: Ex 7, MRCF2, tab 35. On 17 March Mallesons wrote to Allens advising that MRCF was not prepared to accept a negotiated proposal for the transfer of ABN60: Ex 187, Robb vol 3, tab 70. On 20 March James Hardie wrote to Amaca advising that it was considering its options and that it would provide a 48 hour notification should it decide to exercise the put option: Ex 3, vol 1, tab 19. On 2 April James Hardie again wrote to Amaca advising that ABN60 had been transferred to a new Foundation: Ex 3, vol 1, tab 21.

16. Cancellation of the partly paid shares

16.1 The cancellation of shares under the Corporations Act.

16.1.1 By letter dated 14 March 2003, JHINV requested that the directors of ABN 60 (Mr Morley and Mr Salter) cancel the partly paid shares for no consideration: Ex 122, tab 15. On 15 March 2003, the directors of ABN 60 resolved to reduce the capital of the company by cancelling all of the partly paid shares for no consideration: Ex 122, tab 19. The minutes of the meeting of directors record that the directors had formed the view that the reduction of capital would not materially prejudice the Company's ability to pay its creditors and would be fair and reasonable to the Company's shareholders.

16.1.2 ABN 60's power to reduce its share capital came from section 256B of the *Corporations Act*. Section 256B(1) provides:

> A company may reduce its share capital in a way that is not otherwise authorised by law if the reduction:
>
> (a) is fair and reasonable to the company's shareholders as a whole; and
>
> (b) does not materially prejudice the company's ability to pay its creditors; and
>
> (c) is approved by shareholders under section 256C.
>
> A cancellation of a share for no consideration is a reduction of share capital, but paragraph (b) does not apply to this kind of reduction.

16.1.3 Given that the cancellation of ABN 60's partly paid shares occurred for no consideration, paragraph (b) did not apply. Accordingly, section 256B presented no impediment to the cancellation of the partly paid shares even if the capital reduction did materially prejudice the company's ability to pay its creditors.

16.1.4 Nevertheless, the directors of ABN 60 did turn their minds to the question of whether the cancellation materially prejudiced the company's ability to pay its creditors. That is apparent from the minutes of the meeting of directors held on 15 March 2003 (and is taken up in detail below). The conclusion of the directors of ABN 60, that the cancellation did not materially prejudice the company's ability to pay its creditors, was open to them and correct. If it be suggested that the consideration was flawed or inadequate, it is important to remember that section 256B did not require the consideration to be given in the first place.

16.1.5 On the assumption that the reduction of capital was permitted only if it did not materially prejudice the company's ability to pay its creditors, it is then necessary to determine who are "creditors" for the purposes of section 256B.

16.2 Changed circumstances resulting in a decision to consider cancellation of the partly paid shares

16.2.1 In the period prior to April 2002 the MRCF had pressed James Hardie to provide further funds and James Hardie had proposed making the funds due under the DOCI plus an additional $10 million available to the MRCF on a tax effective basis: see paras 14.6, 14.7 and 15.1 above. In early April JHINV sought advice from Allens as to the best way of transferring moneys payable under the DOCI to MRCF: supplementary statement of David Arthur Robb dated 5 July 2004, Ex 303, [13]. An early note of Blanchard records that JHINV was now in a position to pay out the liability under the DOCI because of the sale of the gypsum business and that one way of achieving that result was to transfer JHIL to the MRCF: Ex 303, [14] to [16], JRB1. On 12 April the matter was discussed further at a meeting attended by Morley, Sheppard, Robb, Blanchard and Priestley. Priestley made a file note of the meeting: Ex 187, para 100, Tab 49. The note records that four main options were discussed as ways of transferring funds to the MRCF. Those options were:

(a) transfer of the shares in JHIL;

(b) give the Foundation more cash now up to the tax losses incurred – no tax leakage;

(c) give the Foundation more cash now – irrespective of tax leakage; and

(d) New Co-Solution (under which we retain control of JHIL, keep the partly paid shares on foot, keep the indemnity and get the liability off the balance sheet).

16.2.2 Blanchard also made notes during that meeting: Ex 303, Robb, paras 17 to 27, Tab 2. Those notes suggests that Robb was concerned that proposals to transfer JHIL and cancel the partly paids or put JHIL into liquidation, coming so soon after the scheme of arrangement, would cause the market or regulators to query whether that had been proposed but not disclosed at an earlier point in time: Ex 303, Robb, paras 21, 22. There is no suggestion in the note or of matters as recalled by Robb that anyone said that what was being discussed had in fact been intended or even seriously contemplated at the time of the scheme of arrangement.

16.2.3 Morley recalled discussions in about July or August 2002 with Macdonald and Shafron in which the possibility of exercising the put option in the DOCI was addressed: see Mr Morley's supplementary statement Ex 122 at [33]. In view of the earlier Allens notes it is likely that these discussions commenced in March or April. The impetus for these discussions was the prospect of approximately US$50m in funds becoming available to JHINV in March 2003 upon completion of the sale of a mine site in Las Vegas and also the new tax consolidation legislation, which would permit ABN 60, as a subsidiary of Amaca and Amaba, to make indemnity payments to its parent without imposing a taxation liability on the parent: T2042.47.

16.2.4 It is arguable, given the terms of the put option in the DOCI, if JHINV held the partly paid shares at the time it exercised the option, it could have to put the partly paid shares to Amaca: but see paragraph 14.5.9(b) above. JHINV never contemplated putting the partly paid shares to Amaca. It was always contemplated that the partly paid shares would be cancelled before the put option was exercised. Accordingly, the exploration of the possibility of exercising the put option also meant exploring the possibility of cancelling the partly paid shares. It was to that end that in August 2002, Mr Morley began to consider the extent of ABN 60's liabilities. He thought that ABN 60 would have to be capitalised to the extent of its liabilities and that capital would replace the partly paid shares: Ex 122, [34]. Mr Morley asked Mr Attrill to provide a report on ABN 60's asbestos litigation, and a report was provided on 18 October 2002: Ex 122, [34], [35], tabs 9 and 10. Mr Morley also asked Mr Salter to take steps to "clean up" ABN 60's balance sheet, so that it showed a company receivable on one side of the balance sheet and the liability to the Foundation on the other: T2041.7; Ex 119; Ex 120; Ex 116 (T1981.15 – T1984,47; T1985.47 – T1986.12; T1992.45 – T1993.34) (Mr Salter's step plans).

16.3 Negotiations with the Foundation and Legal Advice

16.3.1 The decision on 15 March 2003 to cancel the partly paid shares must be considered in light of the various legal opinions that were provided to ABN 60 and JHINV and against the backdrop of the negotiations with the MRCF (which are dealt with to some extent in pargraphs 15.1.16ff above. The following paragraphs trace that background.

16.3.2 Mr Velez of Watson Mangioni was retained in about August 2002 to advise ABN 60 and its directors (Mr Morley and Mr Salter) about the matters that should be addressed in making any decision to cancel the partly paid shares: Ex 122, [36]; Ex 103, [42], tab 17, T1926.33. Between late August 2002 and early October 2002, Mr Velez was briefed and provided with the documents he required to advise Mr Morley and Mr Salter: Ex 103, tab 18 – 20, T1926.43.

16.3.3 In September 2002, the management of JHINV sought approval from the Board to work towards transferring ABN 60 to the Foundation, which would include the cancellation of the partly paid shares: Ex 121, tab 136 p 3251.

16.3.4 On 17 October 2002, Allens (acting for JHINV) wrote to Mallesons (acting for the Foundation): Ex 187, tab 50. A copy of the letter was forwarded by Mallesons to Mr Cooper: Ex 296, tab 10. The letter concerned a proposal by JHINV to the Foundation concerning the change of control of ABN 60, from JHINV to the Foundation. The letter expressly refers to the proposed cancellation of the partly paid shares. It also referred to the proposal to transfer from ABN 60 to JHINV all of ABN 60's non-cash assets and liabilities at their approximate fair value and the provision of cash assets to the value of approximately $91m. Allens proffered a draft Deed of Covenant, Indemnity and Access for consideration. The cover letter stated:

Prior to the transfer of control of ABN60 to a Foundation Entity it is proposed to:

- transfer from ABN60 to JHINV all of ABN60's non-cash assets and liabilities at their approximate fair market value;

…

- cancel the partly paid shares of ABN60 before effecting the transfer of control and execution of the Proposed Deed.

16.3.5 The proposal was put as an alternative to the exercise of the put option in the DOCI.

16.3.6 On 1 November 2002, a Dutch law firm, De Brauw Blackstone Westbroek, gave advice to JHINV about whether Dutch law posed any problems in relation to the cancellation of the partly paid shares. The advice was that it did not.

16.3.7 A draft advice from Mr Velez was provided to Mr Morley on 19 November 2002 and copied to Mr Salter at about the same time: Ex 103, [48], tab 24. By way of summary, Mr Velez advised:

(a) ABN 60 may cancel the shares if the reduction does not materially prejudice ABN 60's ability to pay its creditors;

(b) The better view is that "creditor" includes a person who may bring a claim against ABN 60 with respect to asbestos-related disease where the act giving rise to the claim occurred before the reduction of capital, even if ABN 60 has no notice of the claim;

(c) a reduction of capital without regard to the impact on potential claimants may expose the directors to claims, penalties etc; and

(d) it is strongly advisable for the directors to commission an actuarial analysis to quantify the potential liability of ABN 60 to claims in relation to asbestos-related disease.

16.3.8 By the time of the final draft version went to Mallesons, on 16 March 2003, the DOCI had been split into two: Ex 187, tab 62. One was a DOCI between JHINV and Amaca and Amaba. The other was a DOCI between JHINV and ABN 60. There was to be no agreement between ABN 60 on the one hand and Amaca or Amaba on the other. Thus, neither Amaca nor Amaba was proposing to give to ABN 60 a covenant not to sue in respect of anything, including the establishment of the Foundation (note that the cross-examination of Mr Morley on this subject at T22628-2266.24 appears to proceed on the false premise that the negotiations contemplated that Amaca and Amaba would give ABN 60 a covenant not to sue in respect of the establishment of the Foundation).

16.3.9 On 10 December 2002, Allens provided Mr Shafron with an advice concerning the question of who could properly be regarded as creditors for the purposes of section 256B of the Corporations Act: Ex 187, tab 51. The advice concluded:

As can be seen by the above analysis courts in different contexts come to different views about who are creditors and what are debts. In the absence of any direct decisions on point, to come to a view on who should be considered creditors for the purpose of s256B we must consider the appropriateness of the analysis in these other contexts. Whilst it is possible to express what should be the appropriate outcome, given it is only a process of reasoning it is clearly possible for minds to differ.

However in our opinion the better view, is that the following people are creditors for the purposes of section 256B:

1. a person owed a certain sum of money pursuant to a current binding obligation;

2. a person with a current claim against the company, or who has threatened to make such a claim, whether for a certain sum or for unliquidated damages;

3. a class of people having the potential right to claim under circumstances which have already arisen giving them such a right and whose claims are predictable and reasonably certain to occur in the future. The strongest example in the context of people exposed to asbestos are those who currently manifest symptoms of an asbestos induced disease but who are yet to make a claim. It is quite possible that people exposed to asbestos who have not yet manifested any symptoms are also creditors for these purposes, provided such claims are predictable and reasonably certain to occur in the future. Including such people as creditors is certainly a prudent approach to adopt.

16.3.10 Allens also noted that they had briefed Mr Archibald QC to consider the same issue.

16.3.11 Mr Archibald provided a written opinion dated 20 December 2002: Ex 187, tab 53. That opinion concluded that “creditors” of ABN60 would include persons who “by reason of prior exposure to asbestos, are reasonably likely to manifest such symptoms at a later time, and to have not instituted a claim or indicated an intention to institute a claim”.

16.3.12 Meanwhile, the negotiations between JHINV and the Foundation concerning the transfer of control continued: see paragraphs 15.1.8ff above. The Foundation requested some amendments to the proposed deed on 20 December 2002 and Allens responded with some redrafting on 14 January 2003: Ex 187, tab 55. The negotiations centred around the differences between the proposed deed and the DOCI: Ex 187, [105], tab 56. In January 2003, there were meetings between the lawyers and draft agreements travelled back and forth: Ex 75, tab 153. There were discussions between Mr Shafron and Mr Cooper (Ex 75, tab 155) and also between Mr Macdonald and Sir Llewellyn Edwards: Ex 75, tab 156. The signs at this "stage strongly" suggested that the change of control would take place. It seemed that the parties were very close to agreement.

16.3.13 On 31 January 2003, Allens gave advice to JHINV on the proposed change of control of ABN 60 from JHINV to the Foundation: Ex 187, tab 57. The advice included advice on the creditors of ABN 60 to whom the directors of ABN 60 must have regard (see section 4 from p 541) and also enclosed Mr Archibald’s advice.

16.3.14 On the same day, Allens provided a separate advice to JHINV and ABN 60 on the merits of a claim being brought by the Foundation or its subsidiaries or directors against JHINV or

ABN 60 in connection with the establishment of the Foundation: Ex 187, tab 57, p 557. Allens concluded that "we think it will be very difficult for the directors to establish that they or Amaca or Amaba have a right to a substantial remedy". This advice (which, it is submitted, is the correct advice) is very similar to the advice that the Foundation was receiving from its lawyers at around the same time. In August 2002, Mr Walker SC advised that Amaca and Amaba had no reasonable prospect of successfully mounting a misrepresentation case against JHIL in respect of funding. That advice was confirmed on 31 March 2003 by Mallesons, who wrote: "Amaca/Amaba have not suffered loss as a result of any misrepresentation": Ex 296, tab 14 (see first and last pages).

16.3.15 By early February 2003, Mr Morley, having received Allens' advice, had formed the view that it was not necessary for ABN 60 to make any provision for a liability to the Foundation or Amaca and Amaba arising out of the matters raised by Sir Llewellyn Edwards in his letter dated 24 September 2001. He was satisfied that the Foundation did not have a compensable claim: T2053.19, T2125.48. Mr Salter was also of this view (T1945.30). It was suggested to Mr Morley that the Foundation was saying to him that a claim would be pursued. He said that he would not put it as strongly as that. He thought the Foundation was negotiating to try to get more money: T2053.2; T2033.8. Given that by this time the Foundation had been advised by Mr Walker and Mallesons that the Foundation did not have a claim against ABN 60, it is unlikely that the directors would be asserting that they would be bringing a claim. It is certainly not accurate to suggest that at this time ABN 60 "had a claim potentially on the horizon for 250 million dollars at least from the Foundation": T2126.8. That is not consistent with what the lawyers on both sides thought at the time. In short, the Foundation was not a creditor of ABN 60 within the meaning of section 256B(1) of the *Corporations Act* or within the meaning of the *Corporations Act* generally.

16.3.16 In February 2003, Mr Morley was also investigating ABN 60's position in respect of claims involving worker's compensation: Ex 122, [38] - [39].

16.3.17 By 5 February 2003, the negotiations between JHINV and the Foundation had advanced to a state that enabled Allens to issue to Mallesons a Completion Agenda and a copy of the proposed documents for execution: Ex 297, tab 12. The draft documents included all of the documents necessary to cancel the partly paid shares. Any suggestion that the Foundation and Mallesons were unaware of the possibility that the partly paid shares might be cancelled does not accord with the evidence and the facts. Moreover, the evidence strongly suggests that they were told of the cancellation on about the very day it occurred (see below).

16.3.18 There was a meeting of the directors of JHINV on 12 February 2003 in New Zealand: Ex 121, tab 135. Mr Shafron spoke to a paper he had prepared (and which was included in the Board papers) concerning the ABN 60 transfer and cancellation of partly paid shares:

Ex 121, tab 136. The background and overview section of Mr Shafron's paper provides (footnotes omitted):

> For reasons previously discussed with the Board and more fully set out below, it would seem to make sense – for both JHINV and ABN 60 (formerly James Hardie Industries Limited) – that the Foundation be given direct access to the full amount of the indemnity payments due to it (see section 3 below).
>
> Circumstances have changed somewhat since the set up of the Foundation in February 2001 and the October 2001 restructure. From a cash point of view, the Company was not in a position to repay or pass across the indemnity amount in a lump sum prior to the sale of James Hardie Gypsum in April of 2002 (see sections 3 and 4 below). From a debt market point of view, the Company did not fully appreciate that continued arrangements in place between the Company and the Foundation would compromise its ability to borrow or refinance on optimal terms (see section 5). Nor did the Company anticipate the accounting treatment that the Foundation would adopt in respect of the indemnity payment receivable; it effectively ignores the future payments in the presentation of its balance sheets (see section 6).
>
> The preferred method of giving the Foundation direct access to the indemnity payments is by the transfer of control of ABN 60 to the Foundation. If the indemnity payments were simply repaid as a lump sum from ABN 60 to the Foundation then the Foundation would lose a large amount of that payment in Australian tax. In any event, ABN 60 is not able to force the Foundation to accept early repayment – other than on the specific terms of the indemnity document. Transferring control of ABN 60, with the indemnity payment and other funds in ABN 60, avoids tax leakage and ensures that the largest possible amount remains available to claimants. This result was not possible prior to the enactment of new tax consolidation rules in Australia on 1 July 2002 (see section 7).
>
> One of the issues arising from the transfer of control of ABN 60 is the question as to whether there is any continued need for the partly paid shares that were issued by ABN 60 to JHINV in October of 2002 (see section 8). It does not make sense for the Foundation to acquire the partly paids for reasons set out more fully below. Investigations by ABN 60 since earlier this year indicate that, while there can be no absolute certainty, there would seem to be no ongoing or future need for the partly paid shares to remain in place (see section 9). Section 10 sets out some of the advantages to the Foundation of being transferred control of ABN 60; Section 11 identifies the legal advice obtained and Section 12 covers timing and logistics; Section 13 lists the relevant Annexures to this paper.

16.3.19 Various documents were attached to Mr Shafron's paper, including the latest negotiated draft of the DOCIA (annexure C, p 3265): Ex 76, tab 12. Clause 5.1 of the draft indicated that it was proposed that JHINV would give ABN 60 an indemnity, but it would not extend to asbestos liabilities or any claim by Amaca or Amaba concerning the establishment of the Foundation. Mr Shafron's paper is a detailed and thoughtful analysis of the issues.

16.3.20 On 7 March 2003, Mr Robb sent Mr Macdonald by email an updated advice concerning the valuation of claims that might be brought against Amaca and Amaba: Ex 187, tab 58.

16.3.21 On the same day, Mr Macdonald confirmed a Board teleconference to approve the cancellation of the partly paid shares. The call was to take place on 11 March 2003

(Sydney time). Mr Macdonald circulated a slightly updated version of Mr Shafron's paper on the subject: Ex 121, tab 137.

16.3.22 The teleconference took place on 11 March 2003 as scheduled: Ex 121, tab 138; T2867.34. The directors resolved to transfer control of ABN 60 to Amaca and Amaba, by agreement if necessary or otherwise by the exercise of the put option in the DOCI. The Board also resolved to request ABN 60 to cancel the partly paid shares. The resolutions were subject to further review by a Board committee.

16.3.23 On Wednesday 12 March 2003 at 5.37pm, Mr Bancroft sent an email to Mr Robb, which indicated that the directors of the Foundation wanted some amendments to the proposed DOCIA: Ex 187, tab 59. It appears that there was a meeting on the following day (or later on the same day) that left at least Mr Shafron confident that the deal would proceed and that the Foundation would be in a position to complete on the following Monday (17 March 2003) or early in the week: Ex 122, tab 13; Ex 187, tab 60.

16.3.24 In March 2003, Mr Morley was analysing and calculating potential workers compensation claims against ABN 60. He used Allens' advice concerning the proper methodology. A further updated advice on this subject was provided to him on 14 March 2003: Ex 121, tab 140. He also took advice from Mr Velez about the subject: Ex 122, [41]. Mr Morley also studied and relied on Trowbridge's actuarial reports of September 1998 and June 2000 (T2117.3 - T2119.1) and also relied on an oral statement made by Mr Cooper to the effect that total claims faced by the Foundation may amount to $600 to $650 million. Mr Morley gave evidence about the process he followed: Ex 121, [307] - [323], tabs 141 - 144; Ex 122, [43]. In undertaking the analysis, Mr Morley sought to err on the conservative side (see his email of 16 March 2003 to Mr Robb: Ex 122, tab 21; T2119.39; T2122.30-.44).

16.3.25 A JHINV Board committee meeting was held (largely by teleconference) on 14 March 2003: Ex 122, tab 140. The committee was comprised by Mr McGregor, Ms Hellicar and Mr Macdonald. Mr Morley, Mr Shafron and Mr Robb attended. Mr Morley reported that he had analysed ABN 60's potential future liabilities, with the aid of Allens' advice, and that on each scenario ABN 60 was left with surplus assets.

16.3.26 On 14 March 2003, JHINV formally requested ABN 60 to cancel the partly paid shares: Ex 122, tab 15.

16.3.27 Negotiations between JHINV and the Foundation continued on Friday 14 March 2003: Ex 187, tab 61. It was still hoped that the agreement would be completed on Monday 17 March 2003.

16.3.28 On Saturday 15 March 2003 (Sydney time), Mr Morley sent by email a number of documents to Mr Salter, Mr Shafron and Mr Robb, being (Ex 122, tab 16; Ex 103, tabs 25 – 26):

(a) a memorandum that Mr Morley had prepared, which analysed and quantified the potential amount of claims that might be made against ABN 60;

(b) Allens' draft change of control advice dated 14 March 2003;

(c) advice from JLT concerning workers compensation insurance;

(d) an email from Mr Shafron concerning the worker's compensation claims experience; and

(e) the draft advice from Mr Velez dated 19 November 2002.

16.3.29 Later on 15 March 2003, Mr Morley circulated an amended quantification memorandum: Ex 122, tab 17.

16.3.30 Mr Salter reviewed the documents: Ex 103, [53]. He came to grips with Mr Morley's calculations:T1942.54.

16.3.31 Afterwards, Mr Morley and Mr Salter had, by telephone, a meeting of the directors of ABN 60. They discussed the documents that Mr Morley had sent to Mr Salter: Ex 122, [48]; Ex 103, [54]. Each of the directors was satisfied that the creditors of ABN 60 would not be materially prejudiced by the cancellation of the partly paid shares. The shares were cancelled: Ex 103, tab 27. On the same day, JHINV passed the necessary resolutions as the sole member of ABN 60 for the cancellation to occur: Ex 187, tab 67.

16.3.32 It was suggested to Mr Salter in cross-examination that he did not independently apply his mind to the best interests of ABN 60 to decide whether the or not the partly paid shares should be cancelled. He rejected the suggestion: T1932.50. Mr Salter's evidence is that he believed that he and Mr Morley had applied themselves to the best interest of ABN 60: T1997.31. He said that he and Mr Morley were aware of their separate and distinct responsibilities to ABN 60: T1942.37.

16.3.33 Mr Salter was also asked whether he seriously considered the possibility of not cancelling the partly paid shares. He initially said that he did not follow the question. The question was not, with respect, altogether clear because he was being asked whether he considered a negative. In the end he said that he did not consider not cancelling the shares: T1933.1-.36). This evidence was explained in re-examination. Mr Salter's evidence is that he did not consider not cancelling because he was satisfied that cancellation was appropriate. He said that if he formed the view as a director of ABN 60 that the shares should not be cancelled, he would not have proceeded with the cancellation: T1997.44-.17.

16.3.34 Mr Morley also appreciated that he was required as a director of ABN 60 to consider the interests of ABN 60: T2052.36. He maintained that he genuinely sought to ascertain the liabilities of ABN 60: T2118.17, T2119.54.

16.3.35 During the course of the Inquiry, it came to Mr Morley's attention that there is an error in his quantification analysis: T2120.7. Mr Morley explained the error in re-examination and reproduced his quantification calculation without the error: T2754.4-.39; Ex 182. The revised calculation indicates that the error did not have a substantive impact. Mr Morley's original calculation of the present liability of ABN60 for workers compensation claims covering the Wren period (essentially the period from 1980 to 1987) was $10.763 million on a worst case scenario: Ex 121, Tab 151. (This was the effect of the advice given by Allens by letter dated 9 February 2001: Ex 94, p6). His amended calculation was $12.237 million: Ex 182, p 3 (amendments are underlined). KPMG's assessment of the net present value of that liability as at June 2003 was $1.5 million: see Ex 252, para 10.4.2. Therefore, Mr Morley's calculations were well in excess of an actuarial assessment of the liability. As Mr Morley believed that $18.5 million had been set aside to meet these liabilities there was a substantial surplus of assets available even taking into account his calculations and error.

16.3.36 Negotiations between the lawyers continued on Sunday 16 March 2003: Ex 187, tabs 62 and 69. On 16 March 2003, Allens provided Mallesons with an updated completion agenda. Mallesons produced to the Commission, in answer to a summons dated 1 June 2004, a completion agenda printed on 16 March 2003, which showed a completion date of 17 March 2003: [Ex 296], tab 13. Included in the completion papers were executed copies of:

(a) JHINV's request for ABN 60 to cancel the partly paid shares, dated 14 March 2003 (tab 4);

(b) minutes of the meeting of directors of ABN 60 held on 15 March 2003, resolving to cancel the partly paid shares (tab 11);

(c) resolution of JHINV as sole member of ABN 60, dated 15 March 2003 (tab 14); and

(d) ASIC notifications concerning the cancellation of the partly paid shares (tabs 19 - 21).

16.3.37 The completion agenda also indicated that the cancellation had been completed. The Commission should find that the Foundation was fully on notice about the cancellation of the partly paid shares. It was put to Mr Morley that he did not tell the Foundation about the proposal to cancel the partly paid shares because he did not want the Foundation to know about it: T2054.20-.39. The proposition is entirely inconsistent with the evidence.

16.3.38 By 16 March 2003, at least 13 versions of the DOCIA had been prepared in the course of negotiations between JHINV and the Foundation: Ex 76, [16] - [18], tabs 5 - 14.

16.3.39 On Monday 17 March 2003, the Foundation pulled out of the deal: Ex 187, tab 70; and see paragraph 15.1.7 above.

16.3.40 Later in the month, final copies of the Watson Mangioni advice and Mr Morley's quantification analysis were prepared and circulated: Ex 103, tab 29; Ex 121, tab 151.

16.4 Conclusions

16.4.1 At the time that the partly paid shares were cancelled, Mr Morley and Mr Salter had formed the view that the only creditors of ABN 60 were former employees who might have a claim in relation to an asbestos disease. That conclusion was supported by legal advice and was correct. Mr Morley undertook detailed calculations in order to determine whether claims by those creditors were likely to be able to be met by the assets of ABN 60. The calculations suggested that the liabilities (which he had calculated to be in the order of $11 million) could comfortably be met. Based on these calculations, Mr Morley and Mr Salter concluded that cancellation of the partly paid shares did not materially prejudice the company's ability to pay its creditors.

16.4.2 Mr Morley and Mr Salter did not obtain an updated actuarial report, as had been advised by Watson Mangioni. Mr Morley was content to undertake his calculations relying upon the Trowbridge reports of 1998 and 2000 and updated data from Mr Attrill and Mr Cooper. Perhaps it could be said that it would have been desirable for an actuary to be retained. However, Mr Morley was entitled to use his business judgment on this question and did so. Moreover, it has not been shown that an actuary would have given advice that would have shown Mr Morley's calculations to be wide of the mark. Indeed, the KPMG analysis indicates that the net present value of the liabilities was only $1.5 million.

16.4.3 Of course JHINV was involved in the cancellation of the partly paid shares. That was essential because JHINV was the holder of the shares and it was the sole member of ABN 60. As such, it had to approve the reduction in capital: section 256B(1)(c). It was JHINV's property that was being cancelled. It was also naturally important for JHINV as ABN 60's parent to satisfy itself that ABN 60 was not acting wrongfully in cancelling the partly paid shares. None of these things convert JHINV into a shadow director. This is another case (like the payment of dividends) of a shareholder asking a company to do something and the directors being free to do what has been asked of the company provided the interests of creditors are considered and any other requirements of the Corporations Act are met. Mr Morley and Mr Salter were satisfied that the cancellation did not materially prejudice the position of its creditors and, accordingly, they were free to have ABN 60 do what its parent had requested. Ultimately, the decision to cancel the shares was a decision made by, and only by, Mr Morley and Mr Salter acting as directors of ABN 60. They were not merely carrying out directions given by JHINV.

16.4.4 Accordingly, even if paragraph 256B(1)(b) of the Corporations Act applied, the requirement was satisfied and ABN 60 did not contravene the prohibition in section 256D(1). The better view, however, is that the paragraph did not apply because the shares were being cancelled for no consideration.

Issue 46

46. On 15 March 2003, ABN 60, by resolution of its directors Mr Salter and Mr Morley, acting pursuant to s.256B of the Corporations Act, cancelled the partly paid shares which had been issued to JHINV as part of the 2001 Restructure (see Ex 122, PGM2, vol 1, p.130).

(a) Did the cancellation of the shares materially prejudice ABN60's ability to pay its creditors within the meaning of s.256B(1)(b)? In this regard, were Amaca and Amaba "creditors" as regard potential claims of the kind referred to in issues 5-38 above?

No.

(b) Was JHINV a director of ABN 60 as at 15 March 2003, within the meaning of s9 of the Corporations Act?

No.

(c) Did the directors of ABN60 act consistently with their duties of care and diligence (s.180(1) Corporations Act 2001 (Cth)) and good faith (s.181(1)) in resolving to cancel the shares, having regard to

(i) the terms of the legal advice they received as directors;

(ii) the terms of any other legal advice of which they were aware as executives of JHINV;

(iii) the matters raised by representatives of the MRCF and referred to in the immediately preceding paragraph;

(iv) Mr Morley's knowledge of the circumstances surrounding the separation of Amaba and Amaca from ABN 60;

(v) any other relevant matters?

Yes.

(d) If the answer to (a) is negative

(i) Did ABN60 contravene s.256D(1) of the Corporations Act?

(ii) If so, were any persons involved in the contravention within the meaning of s79 of the Corporations Act?

(iii) If yes to (i) or (ii), what are the consequences? Are there valuable remedies available to ABN60, its creditors or any liquidator of ABN60? If so, what is their basis (whether statutory or otherwise), and against whom are they available?

No to each question.

(e) If the answer to (b) is negative, what are the consequences? Are valuable remedies available to ABN60, its creditors or any liquidator of ABN60? If

so, what is their basis (whether statutory or otherwise), and against whom are they available?

These questions do not arise.

Issue 47

47. Was s.256B properly available to be used by JHIL in circumstances where statements of the nature referred to above had been made to the Supreme Court in connection with the creation of the partly paid shares.

Yes.

17. The formation of the ABN 60 Foundation and execution of the deed of covenant, indemnity and access

17.1.1 After the Foundation pulled out of the negotiations involving the change of control of ABN60 on 17 March 2003, JHINV reconsidered how it should proceed. Late on 17 March 2003, Mr Shafron circulated a decision table, which examined various options: Ex 122, tab 24. He recommended attempting a negotiated solution. If that could not be achieved, he recommended as an alternative the establishment of a second foundation, which he called Foundation Mark II.

17.1.2 After reviewing Mr Shafron's table, Mr Macdonald prepared a draft analysis of the options for the management of ABN60 and concluded that the best option was to create an independent foundation: Ex 122, tab 25. Mr Macdonald noted that Mr Don Cameron had already indicated a willingness to become a director of ABN60 and noted that he would be a very strong executive director. Mr Macdonald also amended and expanded Mr Shafron's decision table. These documents were circulated on 18 March 2003.

17.1.3 Mr Macdonald spoke with Mr McGregor during the day on 18 March 2003. Mr McGregor supported proceeding with the recommended option forthwith. That was communicated to Mr Shafron, Mr Morley, Mr Robb and Mr Blanchard by Mr Macdonald by email on 18 March 2003: Ex 122, tab 26. It was in that context that Mr Macdonald said "No communication with the MRCF for now". That simply reflects the fact that on 18 March, Mr Macdonald decided that the preferable course was to establish a new foundation rather than attempt to continue to negotiate with the Foundation, which involved a departure from the course that Mr Shafron had recommended on 17 March 2003. Later on 18 March, following a telephone conference call, Mr Robb and Mr Blanchard advised that they agreed with the proposal to establish a second foundation: Ex 187, tab 72. Mr Salter was not included in the email communications, but he was aware of what was happening: Ex 103, [57].

17.1.4 On 21 March 2003, Mr Macdonald circulated to the JHINV directors a memorandum concerning the proposed ABN60 Foundation: Ex 121, tab 149. The memorandum attached the resolutions necessary to give effect to the new foundation.

17.1.5 At about the same time, Mr Morley had a telephone conversation with Mr Don Cameron, and reminded him of the DOCI and said that all other liabilities except for asbestos claims and the creation of the Foundation would be covered by JHINV: Ex 122, [61].

17.1.6 On 21 March 2004, Allens circulated by email a transaction summary document and diagram: Ex 122, tab 27. The summary noted that: "JHI NV and ABN 60 enter into a Deed of Covenant, Indemnity and Access where, broadly speaking, JHI NV indemnifies ABN 60 for all non-asbestos liabilities and ABN 60 indemnifies JHI NV for all asbestos liabilities".

17.1.7 On 21 March 2003, Allens also circulated a revised DOCIA – which was based on the latest version of the deed negotiated with the Foundation: Ex 122, tab 28. Allens had made some amendments to the last version of the DOCIA that had been negotiated with the Foundation. The marked up version of the DOCIA showed the changes. Significantly, the marked up clause 5.1 was as follows:

> **5.1 Indemnity by JHI NV**
>
> Subject to clauses 5.3 and 5.4, JHI NV must, to the greatest extent permitted by law, indemnify and hold harmless each ABN 60 Party in respect of all Claims which any person other than ~~a Foundation Entity~~ ABN 60 brings or makes against such ABN 60 Party whenever arising and whenever alleged concerning any act by, undertaking of or omission of ABN 60 or its directors or officers which occurred or did not occur, as applicable, at any time before Completion, other than concerning or alleged to concern any Asbestos Claim; or Asbestos ~~Liability, Additional Claim or Additional~~ Liability.

17.1.8 In addition, the definition of Foundation Entity (which meant "either of Amaca or Amaba") had been deleted and the definition of Intragroup Claim had been amended to refer to "the establishment of the Foundation II" rather than "the establishment of the Foundation". The change to clause 5.1 meant that the indemnity excluded claims by ABN60 against an ABN60 Party, rather than claims by Amaca or Amaba against an ABN60 Party. This change in the effect of the DOCIA escaped the attention of Mr Morley and Mr Shafron, both of whom had proceeded at all times in the belief that the DOCIA did not provide for an indemnity by JHINV in favour of ABN60 in respect of claims by Amaca or Amaba.

17.1.9 Mr Macphillamy was approached by Mr McGregor at about this time about whether Mr Macphillamy would be willing to serve as a director of ABN60: Ex 173, [4] - [6]; Ex 273, [7]. Mr Macphillamy had no prior involvement with the James Hardie group: (T2666.29). He and Mr McGregor had previously served together as director and chairman of an unrelated company: T2667.26.

17.1.10 A further draft of the DOCIA, prepared by Ms Marchione (in house counsel), added "Intragroup Claim" to the carve out of the clause 5.1 indemnity: Ex 122, tab 30. This was circulated on 24 March 2003.

17.1.11 On 25 March 2003 (Sydney time), the directors of JHINV resolved that it was in the best interests of the Company to effect the ABN60 separation: Ex 121, tab 148. It was resolved to enter into the DOCIA as tabled subject to such amendments as may be approved by a Board committee.

17.1.12 Mr Blanchard circulated a further draft of the DOCIA on 26 March 2003: Ex 122, tab 36. This version of the DOCIA did not include an Intragroup Claim carve out from clause 5.1.

17.1.13 On 26 March 2003, Mr Robb and Mr Blanchard met with Mr Cameron and Mr Macphillamy to explain the transaction: Ex 187, [116]. Mr Robb reported on the meeting by email to Mr Macdonald (copy to Mr Shafron and Mr Morley): Ex 187, tab 74. Mr Robb reported that Allens gave a full description of the transaction but did not go into detail on the recent difficulties with the MRCF Foundation or the Foundation's concerns about funding promises.

17.1.14 In an email dated 27 March 2003 to Mr Blanchard, Ms Marchione noted that:

> I believe we should make it abundantly clear that JH will not indemnify ABN 60 for any claim that Amaca or Amaba or any third party could make against ABN 60 arising from the creation of the MRCF or the separation of Amaca/Amaba from the group: Ex 122, tab 39.

Mr Robb responded on the following day, commenting that the point made good sense: Ex 122, tab 40. He suggested reinserting "Intragroup Claim" as a carve out to the clause 5.1 indemnity and noted that the question was which elements of the definition were to remain. These emails went to Mr Robb, Mr Shafron, Mr Morley and Mr Kneeshaw. Unfortunately, Mr Robb's suggested solution did not achieve its goal, which became clear only after the DOCIA was executed – see paragraph 17.1.18 below.

17.1.15 On 28 March 2003, Mr Stevenson from Corrs Chamber Westgarth was briefed to advise Mr Cameron and Mr Macphillamy as proposed incoming directors of ABN60: Ex 124, [2] and [4]. He received a draft of the DOCIA on that day. Mr Macphillamy and Mr Cameron selected Mr Stevenson: Ex 173, [9]. Mr Stevenson was a personal friend of Mr Macphillamy: T2671.34.

17.1.16 Mr Shafron was surprised by Ms Marchione's email of 27 March 2003; he had assumed that the point was already clear: Ex 76, [39]. He sent an email to Mr Robb, Ms Marchione and Mr Blanchard on 28 March 2003 (Sydney time) raising the question of the version of the DOCIA that went to Mr Stevenson: Ex 76, [39], Ex 77, tab 28. Mr Robb responded by email, asking for instructions about whether the DOCIA should be amended as Ms Marchione suggested, in which case a revised deed should be provided to Mr Stevenson: Ex 77, tab 29.

17.1.17 Early on the morning of 28 March 2003, Mr Robb also circulated to Mr Shafron and Mr Morley two final advices concerning the change of control of ABN60: Ex 187, tab 86. The advices were addressed to the directors of JHINV. The first advice addressed the question about whether the views Allens had earlier expressed (in its two letters of 31 January 2003 and its letter of 17 March 2003) concerning the proposal to give control of ABN60 to the Foundation had changed in view of the changes to the proposed transaction. Save for one matter, which is not now important, the advice was that the views expressed earlier were unaffected. The second advice provided revised advice about how to value ABN60's potential exposure to claims.

17.1.18 Later on the morning of 28 March 2003, Mr Robb sent a revised DOCIA (in revision mode) to Mr Stevenson: Ex 187, tab 85. The cover email stated the "changes clarify that the indemnity not cover matters that may be connected with asbestos creditors". The indemnity in clause 5.1 was amended to add "Intragroup Claim" as a carve out. However, this amendment did not make clear what Mr Shafron and Ms Marchione wanted to be made clear. The definition of Intragroup Claim referred to “any transaction effected between ABN 60 and any of the other members of the JH NV Group”. The definition of JH NV Group excluded Amaba and Amaba. Thus the amendment did not achieve the object of making it clear that JHNV would not indemnify ABN 60 for any claim that Amaca or Amaba or any third party could make against ABN 60 arising from the creation of the MRCF or the separation of Amaca/Amaba from the group.

17.1.19 On the afternoon of 28 March 2003, Mr Macphillamy met with Mr Stevenson, Mr Donovan and Ms Saltos (all from Corrs): Ex 124, [4]. Later, Mr Robb and Mr Blanchard joined the meeting. Ms Saltos' notes of the meeting suggest that there was discussion that ABN60 would obtain an indemnity from JHINV about non-asbestos matters: see Ms Saltos' notes, Ex 131. There was discussion about ABN60's prospective liability for asbestos matters. See also Mr Stevenson's notes: Ex 132.

17.1.20 On 28 March 2003 (Sydney time), Mr Shafron sent an email to Board members who were on the committee concerning the separation of ABN60 and to others (Mr McGregor, Ms Hellicar, Mr Brown, Mr Macdonald, Mr Morley and Mr Robb): Ex 121, tab 150, p 3464. Mr Shafron advised that it was desirable for the committee to meet to give the transaction a final sign off. His email attached a copy of the appropriate resolutions and various other documents, including Allens' advice dated 31 January 2003 concerning the potential claim by the Foundation against ABN60.

17.1.21 Meanwhile, on 28 March 2003 Mr Salter was working on the papers for a meeting of directors of each of ABN60 and ABN60 Foundation Pty Ltd: Ex 103, [62] - [64], tabs 36 - 38.

17.1.22 By a letter dated 28 March 2003, JHINV asked ABN60 to undertake certain actions in connection with the proposed establishment of the ABN60 Foundation: Ex 122, [76], tab 43A. On the same day, the directors of ABN60 received the final version of Watson Mangioni's advice: Ex 122, [77], tab 43B.

17.1.23 Late on 28 March 2003, Mr Blanchard circulated (to Mr Macdonald, Mr Shafron, Mr Morley, Mr Salter, Mr Kneeshaw, Mr Salter and Ms Marchione) a copy of the transaction documents: Ex 76, tab 34.

17.1.24 On 29 March 2003, there was a meeting of directors of ABN60 by telephone: Ex 122, [79]; Ex 103, [65]. The directors resolved to enter into the DOCIA and to otherwise take the steps necessary for the establishment of the ABN60 Foundation: Ex 122, tab 45. Both Mr Morley and Mr Salter believed that the DOCIA included an indemnity by JHINV in favour of ABN60 that:

(a) extended to claims brought against ABN60 arising out of earlier transactions (such as earlier asset and business sale transactions and tax liabilities), but

(b) excluded asbestos related claims and claims arising from the creation of the MRCF Foundation and the separation of Amaca and Amaba from the group and claims by Amaca and Amaba relating to intercompany payments.

See Ex 122, [79] and Ex 103, [66] - [67].

17.1.25 On 29 March 2003, the committee of the JHINV Board also resolved to approve the ABN60 separation: Ex 148, [72], tab 27. Mr Morley advised that ABN60 was likely to have a surplus of assets following the entry into the transactions (which included a capital reduction of $1.43m).

17.1.26 On Sunday 30 March 2003, Mr McGregor and Mr Macphillamy had another telephone conversation: Ex 273, [12]. Mr McGregor's recollection is that he told Mr Macphillamy that:

(a) the Medical Research & Compensation Foundation had claimed that James Hardie had not provided it with sufficient funds when it was established;

(b) the relationship between James Hardie and the directors of the Medical Research & Compensation Foundation was not particularly good at that time;

(c) the Medical Research & Compensation Foundation was still contemplating what it would do about the shortfall in funds confronting it; and

(d) although no threat to commence proceedings had been made at that time, it was possible that the Medical Research & Compensation Foundation's claims would subsequently develop into legal action.

17.1.27 Mr Macphillamy's evidence is that he was not told anything about a claim from the Foundation: T2668.2. He also said that he does not have a recollection of the call or the detail of the call: T2666.52. At the time, the Foundation had not made a claim against ABN60 in the sense of commencing legal proceedings. There is no inconsistency in the evidence of Mr McGregor and Mr Macphillamy. Shortly after the telephone call between Mr McGregor and Mr Macphillamy, Mr McGregor spoke with Mr Macdonald. Mr Macdonald communicated to Mr Robb (and Mr Shafrom and Mr Morley) that "Alan [McGregor] says John [Macphillamy] is aware of the background to both Foundations and is fine with that": Ex 187, tab 87. This supports Mr McGregor's evidence.

17.1.28 On 31 March 2003, there was a meeting involving Mr Macphillamy, Mr Don Cameron (part), Mr Robb, Mr Stevenson and Ms Saltos: Ex 124, [8]; Ex 173, [13]. There were some minor amendments to some of the transaction documents – but not in any relevant respect. Ms Saltos' notes (Ex 134) indicate that the amendment to clause 5.1 to exclude Intragroup Claims from the scope of the JHINV indemnity, which were introduced in the draft sent on 28 March, were noted and discussed during this meeting. Mr Macphillamy came away from the meeting understanding that JHINV would indemnify ABN60 in relation to all claims by third parties other than those related to asbestos or by Amaca and Amaba: Ex 173, [13]. Mr Macphillamy maintained during the course of cross-examination that he understood that any claim against ABN60 by Amaca or Amaba was carved out of the indemnity being given by JHINV: T2675.50, T2682.4, T2686.29, T2688.17. The precise way in which Mr Macphillamy obtained this understanding might be difficult to identify with precision, but it should not be doubted that he held the understanding. Mr Don Cameron’s understanding was the same: T568.22-.46.

17.1.29 On the morning of 31 March 2003, Mr Morley confirmed to Mr Kneeshaw (then company secretary to ABN60) that the DOCIA could be executed without alteration and asked him to execute it as company secretary: Ex 101, [27]. Mr Kneeshaw’s evidence is that he understood that there was an indemnity by JHINV in favour of ABN60 but asbestos liabilities were excluded from the scope of the indemnity: Ex 101, [30]. He had no belief one way or the other about whether the indemnity covered claims arising from the establishment of the MRCF Foundation. However, it is plain from Mr Kneeshaw’s evidence that the business judgments in making the decision to enter into the DOCIA were exercised by the directors, Mr Morley and Mr Salter, and not by Mr Kneeshaw: T1905.42.

17.1.30 On 31 March 2003, the ABN60 Foundation was established. The DOCIA was executed on behalf of JHINV by Mr Robb under a power of attorney and was executed by ABN60 (Mr Salter signed as director and Mr Kneeshaw as secretary): Ex 187, tab 88. At this time, Mr Robb was taking instructions from Mr Shafron.

18. The execution of the deed of rectification

18.1 Final form of the DOCIA

18.1.1 In its final form, clause 5.1 of the DOCIA provided as follows:

5.1 Indemnity by JHI NV

Subject to clauses 5.3 and 5.4, JHI NV must, to the greatest extent permitted by law, indemnify and hold harmless each ABN 60 Party for any Loss incurred in respect of all Claims which any person other than ABN 60 brings or makes against such ABN 60 Party whenever arising and whenever alleged concerning any act by, undertaking of or omission of ABN 60 or its directors or officers which occurred or did not occur, as applicable, at any time before Completion, other than concerning, alleged to concern, in connection with or arising as a result of, directly or indirectly, any Asbestos Claim, Asbestos Liability or Intragroup Claim.

18.1.2 The expression "Intragroup Claim" was defined to mean:

Intragroup Claim means any Claim, whenever arising, in connection with, arising from or incidental to, whether directly or indirectly:

(a) any transaction effected between ABN 60 and any of the other members of the JH NV Group, whether by way of dividend, distribution, management fees or otherwise; or

(b) any acts (or omissions) concerning the establishment of the ABN 60 Foundation, the acquisition of the ABN 60 Foundation, the acquisition of control of ABN 60 by it and all matters incidental thereto;

(c) the cancellation of all the ABN 60 Partly Paid Shares; or

(d) the issue of shares in ABN 60 to ABN 60 Foundation and the cancellation of the shares in ABN 60 then held by JHI NV,

other than any such Claims that arise in the performance of any Subsisting (Property) Contracts;

18.1.3 The expression JH NV Group was defined to mean:

JH NV Group means ABN 60 and each body corporate that was a Related Body Corporate of ABN 60 on or before 16 February 2001 other than Amaca and Amaba (whether or not it is still in existence when any provision of this Deed is invoked);

In effect, Intragroup Claims were carved out of the indemnity but transactions between ABN60 and Amaca/Amaba were carved out of the carve out. This meant that the effect of clause 5.1 was that JHINV agreed to indemnify ABN60 in respect of:

(a) claims by Amaca and Amaba in respect of dividends, management fees paid and distributions;

(b) the creation of the MRCF Foundation;

(c) but not in respect of other transactions between ABN60 and other members of the ABN60 group before 16 February 2001;

18.1.4 This was not the intention of either Mr Morley or Mr Salter, who were the relevant minds of ABN60 on 31 March 2003 when the DOCIA was executed. Nor was it the intention of Mr Macdonald (T2459.32-2460.19) or Mr Shafron, who were the relevant minds of JHINV when the DOCIA was executed: Ex 76, [52].

18.2 Events leading to the execution of the Deed of Rectification

18.2.1 Mr Robb became aware on 17 June 2003 that the indemnity that JHINV gave to ABN60 by clause 5.1 of the DOCIA included an indemnity in respect of the establishment of the MRCF Foundation: Ex187, [134]. That realisation came in the context of a discussion with other lawyers from Allens about correspondence that Mr Macdonald had received from Clayton Utz. In the second part of 2003, Allens investigated the matter: Ex 188.

18.2.2 Mr Shafron learned from Allens in about November 2003 that it was possible that the DOCIA resulted in JHINV giving an indemnity to ABN60 in respect of claims by Amaca or Amaba arising from the establishment of the Foundation: Ex 76, [56]. In an email dated 12 November 2003, Mr Shafron said (Ex 77, tab 38):

> I am not sure that the definition of “Intrgroup Claim” and “JHNV Group” is right. It seems to me that the intention behind “JHINV Group” was the opposite of what we have reflected. I will talk to David Robb about that – it may be that there is a rectification argument.

18.2.3 There was a meeting on 17 November 2003 between Mr Shafron and Mr Morley, and Mr Ball, Mr Robb and Mr Lawrance (all from Allens). Mr Morley took a note of the meeting: Ex 122, tab 53. His note includes the following: “Intention not sufficiently precise, clear to overcome what is a fairly high burden for the Courts to overturn”. The precise circumstance in which this was apparently said is unclear. It was probably merely a preliminary remark. The evidence before the Commission demonstrates that the intention of the parties was both precise and clear. This no doubt became apparent as the matter was investigated and before the parties executed the Deed of Rectification in February 2004.

18.2.4 The evidence referred to in paragraphs 17.1.24 and 18.1.4 above demonstrates that each of Mr Morley, Mr Salter, Mr Macdonald and Mr Shafron intended that JHINV would indemnify ABN60 in respect of transactions effected between ABN 60 and any other of the members of the JHINV group but would not indemnify ABN60 in respect of claims (of any kind) by Amaca or Amaba. It is significant to note that although Mr Cameron and Mr Macphillamy were not the relevant minds of ABN60 when the DOCIA was executed, the evidence also clearly establishes that they had precisely the same understanding as the others: see paragraph 17.1.28 above. The DOCIA achieved the opposite of what everyone intended.

18.2.5 On 18 November 2003, Allens circulated a draft without prejudice letter to be sent to Mr Cameron: Ex 122, tab 54. The letter suggested that JNINV and ABN60 should amend the

DOCIA. A copy of the letter, amended in some respects, was forwarded to Mr Cameron by email on 23 November 2003: Ex 122, [92], tab 55. The letter states that:

> It has recently come to my attention that the Deed does not accurately reflect the agreement reached between JHI and ABN 60. In particular, paragraph (a) of the definition of *Intragroup Claim* refers to "any of the other members of the JH NV Group" where it should instead refer to "either or both of Amaca and Amaba".
>
> The consequence of this mistake is that, as the Deed currently reads:
>
> (a) JHI **is** obliged to indemnify ABN 60 against claims arising from the payment of dividends, distributions and management fees by Amaca and Amaba to ABN 60; but
>
> (b) JHI **is not** obliged to indemnify ABN 60 against claims arising from the payment of dividends, distributions and management fees by other group companies to ABN 60.
>
> This is the opposite of the agreement which I believe was reached between JHI and ABN 60. Moreover, while it was part of the agreement that the indemnity granted by JHI would not extend to claims which arose from the establishment of the Medical Research & Compensation Foundation, it is not clear that the Deed reflects this.
>
> I believe the definition of ***Intragroup Claim*** should be corrected, in order to avoid any future disputes about the scope of the indemnity granted by JHI.
>
> Accordingly, JHI proposes the following:
>
> 1. JHI and ABN 60 amend the Deed to correct the definition of *Intragroup Claim* as described above.
>
> Please let me know whether ABN 60 agrees to this proposal.

18.2.6 On 27 November 2003, Mr Cameron indicated that ABN60 agreed with the proposal and asked for the proposed amendment for review and execution: Ex 122, tab 57. A draft deed of rectification was forwarded to him on 2 December 2003: Ex 122, tab 58. The draft proposed an amendment (with retrospective effect) to the definition of Intragroup Claim. Paragraph (a) was to be deleted and replaced with: “Any transaction effected between ABN60 and either or both of Amaca and Amaba, whether by way of dividend, distribution, management fees or otherwise”.

18.2.7 Mr Cameron sought advice from Corrs on 9 December 2003: Ex 126. He sent a copy of the draft Deed of Rectification to Ms Saltos on that day: Ex 124, tab C. His email said that “we have agreed to amend the agreement to clarify the original intent of the parties”.

18.2.8 There was a meeting on 16 December 2003 between Mr Morley, Mr Cameron, Mr Ball and Mr Lawrance. Mr Cameron queried the effect of the proposed amendments and the benefit to ABN60: Ex 122, [96]. Mr Cameron met on the same day with Mr Stevenson and Ms Saltos: Ex 124, [12]; Ex 127.

18.2.9 On 19 December 2003, Mr Macdonald sent a letter to Mr Cameron seeking to explain the operation and intended operation of the DOCIA: Ex 124, tab E.

18.2.10 On 22 December 2003, there was a meeting between Messrs Cameron, Macphillamy, Morley and Macdonald at which Mr Morley explained to Messrs Cameron and Macphillamy what had been the intention of ABN 60 at the time of entering into the DOCIA: Ex 122, [100] and [101].

18.2.11 On 12 January 2004, Ms Saltos sent an email to Mr Cameron and Mr Macphillamy: Ex 47. The email sought to summarise the main issues arising from Mr Macdonald's letter of 19 December 2003. The email states, in effect, that as drafted, the JHINV indemnity in favour of ABN60 in the DOCIA does not extend to intragroup claims apart from claims brought by Amaca and Amaba and that the proposed deed of rectification reversed that position.

18.2.12 Mr Cameron met with Mr Stevenson and Ms Saltos on 13 January 2003: Ex 124, [14], Ex 128, [129]. Ms Saltos' notes of the meeting provide the best evidence of what transpired: Ex 129. During the course of the meeting, which lasted some two hours, there were telephone calls with Mr Lawrance and with Mr Ball: Ex 124, [15]. There was discussion about the drafting of the Deed of Rectification. Part of the discussion concerned the impact of the proposed rectification of the definition of the expression "Intragroup Claim" on the covenant not to sue given by JHINV to ABN60 by clause 4.1 of the DOCIA. By that clause, JHINV covenanted not to sue ABN60 in respect of any Intragroup Claim. Corrs suggested some drafting changes.

18.2.13 Later on 13 January 2004, Mr Lawrance sent to Mr Stevenson and Mr Cameron a revised draft of the Deed of Rectification: Ex 122, tab 61; Ex 124, [15]. The revised draft picked up the matters discussed during the telephone conversations earlier in the day. A copy was also sent to Mr Shafron and Mr Morley: Ex 122, tab 61.

18.2.14 Mr Cameron and Mr Macphillamy met with Mr Stevenson and Ms Saltos on 15 January 2004. There is evidence that Mr Stevenson advised them that the deal was that ABN60 was indemnified for everything but Amaca/Amaba and asbestos: Ex 130. Mr Stevenson's evidence is that he advised Mr Cameron and Mr Macphillamy that if they were satisfied that both parties had a common intention when the DOCIA was entered into, which was not reflected in the DOCIA, the it was in order to rectify the DOCIA by entering into the Deed of Rectification: Ex 124, [16].

18.2.15 As a matter of fact, both ABN60 and JHINV had a common intention when the DOCIA was entered into, which was not reflected in the DOCIA. Given the communications between Mr Cameron and Mr Morley and Mr Shafron, it is easy to see how Mr Cameron and Mr Macphillamy could properly be satisfied that the parties had a common intention when the DOCIA was entered into, which was not reflected in the DOCIA. Moreover, as demonstrated above, both Mr Cameron and Mr Macphillamy were themselves active when the DOCIA was executed and each of them also shared the common intention.
Mr Cameron and Mr Macphillamy had also confirmed their understanding of the intention of

ABN 60 at the time it entered into the DOCIA by meeting with Mr Morley: see paragraph 18.2.10 above.

18.2.16 Mr Salter was not consulted in connection with the Deed of Rectification: T1948.40. It may have been prudent to have done so. However, there is no doubt that Mr Salter would have confirmed that he too shared the common intention that, by error, was not recorded in the DOCIA.

18.2.17 Mr Macphillamy gave evidence that he did not appreciate that he was giving up a valuable indemnity by the execution of the Deed of Rectification: T2677.34. That evidence must be viewed against the evidence that Mr Macphillamy understood from the beginning that any claim against ABN60 by Amaca or Amaba was carved out of the indemnity being given by JHINV: T2675.50, T2682.4, T2686.29, T2688.17. Furthermore, Mr Macphillamy saw and read the email from Ms Saltos that explained that the proposed rectification would have the consequence that ABN60 would not be indemnified against claims initiated by Amaca and Amaba: Ex 173, tab 6, T2688.37-2689.2.

18.2.18 The Deed of Rectification was executed on 3 February 2004 by Mr Macdonald and Mr Shafron for JHINV and by Mr Cameron and Mr Macphillamy for ABN60: Ex 122, tab 62. It was expressed to have retrospective effect. In the DOCIA, Intragroup Claim included:

> (a) any transaction effected between ABN 60 and any other of the members of the JH NV Group, whether by way of dividend, distribution, management fees or otherwise:

18.2.19 The Deed of Rectification rectified the DOCIA by deleting that definition. The consequence was that ABN60 would be indemnified in respect of those claims whereas under the DOCIA it was not. This was to the benefit of ABN60.

18.2.20 The Deed of Rectification also rectified the DOCIA by inserting a new paragraph 4(ab), which provided that JHINV covenanted not to:

> make any Claim, whenever arising, against ABN60 in connection with, arising from or incidental to, whether directly or indirectly, out of any transaction effected between ABN 60 and any other of the members of the JH NV Group, whether by way of dividend, distribution, management fees or otherwise.

18.2.21 The effect of this was that the covenant by JHINV not to sue ABN60 was not cut back by the change to the definition of Intragroup Claim. This rectification was essentially neutral.

18.2.22 The DOCIA was also rectified by changing the carve out in clause 5,1 to read “Intragroup Claim or Claim by Amaca or Amaba”, instead of simply “or Intragroup Claim”. The substance of the rectification was that Claims by Amaca or Amaba were also carved out of the indemnity given by JHINV to ABN60. This was to the benefit of JHINV. The effect of it really was to undo what had been done in error by Mr Blanchard on 21 March 2003 (Ex 122, tab 28) when he amended the draft DOCIA to exclude claims by the Foundation against ABN60. The error was perpetuated when Mr Robb suggested an alteration to the draft DOCIA which did not achieve what was intended: see paragraph 17.1.18 above.

18.3 Legal effect of the Deed of Rectification

18.3.1 JHINV and ABN60 executed a deed that was called a "Deed of Rectification". The word "rectification" in this context is to be understood as an alternative expression for the term "variation". It is not to be understood as a reference to the equitable doctrine of rectification under which a party to a contract may approach the Court to have the contract varied. JHINV and ABN60 did not seek relief from a court of equity.

18.3.2 The intention of the parties is paramount to determining the legal status of the variation: *Federal Commissioner of Taxation v Sara Lee Household & Body Care* [2000] HCA 35; 201 CLR 520, [23]–[24]. The parties clearly intended to kept the DOCIA on foot, in its varied form, and with retrospective effect from the original date of the DOCIA (see clause 2.2). Absent any statutory constraint, or the assertion, in equity, of a right by an innocent third party who has gained rights for value based on the original wording of the DOCIA, there is nothing that can hinder the retrospective effect of the Deed of Rectification on the DOCIA. In private law, the default rule of legal capacity is that whatever is not prohibited is permitted: *R v Somerset CC; ex parte Fewings* [1995] 1 All ER 513, 524 approved [1995] 3 All ER 20, 25 (CA); *R v Secretary of State for Health; ex parte C* [2000] HRLR 400, 405 (CA); see also *Lange v Australian Broadcasting Corporation* (1997) 189 CLR 520, 564. Here there is no reason why ABN60 and JHINV could not amend their written agreement with retrospective effect. The amendment was made for good reason: the parties acknowledged that the DOCIA did not reflect the mutual intention of the parties at the time the DOCIA was signed (see Recitals to the Deed of Rectification) and wanted to amend the Deed so that it did. The use of the word "rectification" in this context is not inapt.

18.3.3 An effect of the Deed of Rectification is that JHINV is not (and never was) obliged to indemnify ABN60 (or its post 31 March 2003 directors and officers) in respect of any Claim (as defined) by Amaca and Amaba.

18.3.4 This narrowed the scope of the indemnity in favour of ABN60. However, certain claims by Amaca and Amaba were already excluded by the DOCIA before the Deed of Rectification was executed. The definition of "Intragroup Claim" always included: "(c) the cancellation of all the ABN60 Partly Paid Shares". Thus, JHINV never agreed to indemnify ABN60 against claims from Amaca or Amaba arising from the cancellation of the partly paid shares on 15 March 2003. On the other hand, it appears that claims by Amaca or Amaba concerning the establishment of the MRCF Foundation, the execution of the DOCI and claims by Amaca or Amaba concerning management fees and dividends were excluded from the indemnity by the operation of the Deed of Rectification.

18.3.5 On the other hand, claims by other companies in the James Hardie group were brought within the scope of the indemnity by operation of the Deed of Rectification. Mr Salter said that at the time of execution of DOCIA, he was probably not on notice of such a claim but that there was a continuing stream of expenses that ABN60 faced in connection with businesses that ABN60 had disposed of in the past: T1949.30. This part of the rectification cannot be seen as tokenistic. There is evidence that there was a tax audit current at the time the DOCIA was executed and any claim by the Commissioner was brought within the scope of the indemnity as a result of the rectification: Ex 131, pp 2,3.

18.3.6 Mr Cameron and Mr Macphillamy were properly satisfied that the DOCIA contained an error and did not reflect the mutual intention of the parties at the date of execution. They took advice and heeded the advice. In the circumstances, it would have been unconscientious of them to decline to execute the Deed of Rectification. Both companies had an equity in the rectification which could, if necessary, have been obtained through a court of equity. Fortunately, common sense prevailed. Mr Cameron and Mr Macphillamy acted both diligently and in good faith.

Issue 48

48. By a deed dated 3 February 2004 between ABN60 and JHINV (Ex 42, Tab 39) the terms of the DOCIA were varied.

(a) What were the effects of the variation as regards the rights and obligations of ABN60 and its present and former directors?

(b) Was an effect of the variation to deprive ABN60 of the right pursuant to clause 5.1 of the DOCIA to be indemnified by JHINV in respect of claims, which might be made against ABN60 by MRCF, Amaca or Amaba in relation to:

(c) the separation of Amaca (Coy) and Amaba (Jsekarb) from ABN60 (JHIL);

(i) the creation of the MRCF;

(ii) the execution of the DOCI in February 2001;

(iii) transactions between Coy, Jsekarb and JHIL (or other companies in the James Hardie Group) prior to 16 February 2001, including payment of dividends and management fees;

(iv) the cancellation of the partly paid shares?

See above.

(d) If the answer to the last issue is affirmative:

(i) Was the execution of the deed of rectification in the interests of ABN60, having regard to any benefits derived by it under the deed and the prospect of those benefits being achieved without reducing

the scope of the indemnity available to it under the existing terms of the DOCIA;

Yes.

(ii) *Did the directors of ABN60 (Mr D. Cameron and Mr Macphillamy) act consistently with their duties of diligence (s.180(1)) and good faith (s.181) in causing the deed of variation to be executed?*

Yes.

(iii) *If not, what are the consequences? Does ABN60 have any valuable causes of action against them?*

This question does not arise.

Issue 49

49. Having regard to the answers in respect of the last issue, did Corrs Chambers Westgarth breach any duty of care to ABN60 in advising its directors in respect of the deed of rectification? If so, did the breach cause ABN60 any compensable loss?

This question does not arise.