

# **ANNEXURE Q**

**This is a copy of Exhibit 85**



**INTERNAL MEMORANDUM**

**To:** Peter Macdonald  
**From:** Peter Shafron  
**Date:** 9 November 2001  
**Subject:** Foundation

**James Hardie Industries Limited**  
ABN

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**DRAFT: 9 November 2001-11-08**

Confidential and Privileged

Peter,

I have looked at the Foundation letter of 24 September 2001 and here are my preliminary comments in relation to the various statements and assertions. As you know, Phillip Morley, Stephen Harman, Greg Baxter, Steve Ashe and Wayne Attrill were, in addition to yourself, others and me from James Hardie Industries Limited, involved in the set up, as were external advisers Trowbridge Consulting, Allen Allen and Hemsley, PwC Legal, Access Economics, Towers Perrin and others. To prepare a comprehensive response we would need to get their input also, but this will serve in the meantime.

A point worth making at the outset is that the JHIL team used their best, good faith efforts to secure the best outcome for JHIL, the Foundation and its subsidiaries, and claimants. To the extent that the Foundation letter suggests otherwise or infers that the set up work was done with less than best efforts or other than good faith, it is to be strongly rejected.

Given the nature of the matters set out in the Foundation letter, it seems advisable to put a response to it on the record.

Addressing the main points in turn:

Addressee

The letter is addressed to you as Managing Director of James Hardie Inc. Any issues that the Foundation has should more properly be raised with James Hardie Industries Limited since that was the company that set up the Foundation. James Hardie Inc has no connection whatsoever to the Foundation.

"20 Years was critical to the decision of (Foundation) Directors"

In our meetings with the prospective directors, particularly Peter Jollie and Michael Gill, Phillip Morley and I said that whatever the level of funding there could be no guarantees that the level of funding would be enough over the long haul. We said that it was possible that the funding - whatever it was - could run out and that was because no one could predict the future and that the history of asbestos litigation was that it usually got worse. We said that we did not want anyone to join the board of the Foundation on any false premise in that regard.

Michael Gill responded at one point that he would not take on the position of director unless he felt comfortable that the funds were likely to last 10 or 15 years.

We prepared modelling that showed that on certain claims and earnings scenarios the fund could last forever – with a surplus - or it could last 15 or 20 years on more pessimistic assumptions. It was clear that the model was sensitive to the various assumptions, including fund earnings rates and the rate, size and timing of claims. The JHIL directors in their decisions setting up the Foundation recognised that different outcomes were possible but that on the most balanced assumptions the liabilities would be fully funded.

We went through the model with the prospective Foundation directors who asked intelligent questions. Peter Jollie asked that the model be run with lower earnings assumptions and that was done.

I believe that towards the end of the process the prospective Foundation directors may have said that they were (now) looking for a likely life of the fund of 20 years – at least. Our modelling supported that.

#### The Foundation re-engaged Trowbridge and Towers Perrin

We have not seen the most recent assumptions used by Trowbridge or Towers Perrin. It is possible that the claims position has deteriorated, it is also possible that the earnings projections have diminished. The life of the fund is clearly a function of both and neither can be predicted with certainty.

#### Insolvency and value of future claims

We do not know what lies behind the earnings and claims projections. I assume that they have given us their absolute “worst case” scenario. The numbers seem pessimistic, particularly in view of the modelling that we did so recently. The point is that any projection 9 or 10 years out is inherently unreliable and speculative.

The larger point is this. Nothing in the establishment of the Foundation caused or contributed to the future or likely future of claims or the life of the fund (other than the actual management being carried out by Foundation personnel). The Foundation was essentially a structure to ensure that proper management focus was brought to bear on the very important issue of asbestos claims against former JHIL subsidiaries, and to ensure that dedicated funds were made available for research into asbestos related diseases. Rights of present and future claimants were not adversely affected – they were enhanced by:

- ◆ Additional funds being contributed by JHIL to the subsidiaries (against the initial advice of our external lawyers who argued that JHIL directors had a duty not to add any additional funds to the subsidiaries);
- ◆ Qualified, dedicated and focused new directors and management;
- ◆ Removal of the business risk to the existing funds that were in the subsidiaries (which up to that point had been held as receivables on intercompany loan account);
- ◆ Dedication of funds for medical research into cures and treatments for asbestos diseases.

To reiterate: JHIL did not expunge or extinguish any rights with the creation of the Foundation. To the extent that claims could have been brought against JHIL (our advice is that other than pre 1937 manufacture they cannot validly be brought) or any other company prior to the set up of the Foundation, they can be brought in an identical fashion after the Foundation. (Indeed, two or three claims have commenced against JHIL since the set up of the Foundation and we are currently defending them; others, such as a large number by Pacific Power, have been settled since the Foundation.)

#### Additional \$200 million required

Again, this number strikes me as very high, but without seeing the materials it is difficult for us to see where the error may lie.

I am not sure what conclusion the Foundation is seeking to draw here; if any. In view of the advice we have had from Allens I do not see that there is any basis for JHIL making additional contributions to the Foundation or its subsidiaries outside of a court finding. Allens, as you recall, had major difficulties with the additional funding that was in fact provided to the Foundation subsidiaries for the reason that the directors of JHIL had a duty to its shareholders not to give away funds in the absence of a legal duty to do so. The basis for that advice, in addition to the law on directors' duties, was the doctrine of the "corporate veil" – a parent company is not liable for the debts of a subsidiary absent some fraud or agency. That principle was affirmed in the context of asbestos litigation in the *Putt* case.

In terms of the original decisions setting up the Foundation, that was supported by a great deal of third party analysis and advice as well as careful consideration by board members. Again, the JHIL directors recognised that different outcomes were possible but that on the most balanced assumptions the liabilities would be fully funded. In any event, from the legal point of view, that outcome (i.e. fully funded) was not a sine qua non for the establishment of the Foundation. I do not see any basis for the current JHIL board members to reconsider the decisions.

#### "James Hardie Claims Data not provided"

The claims data that Trowbridge produced and the numbers in our modelling were March 2000 numbers. The report, which Trowbridge made available to the Foundation directors, makes clear on its face that the underlying claims data was March 2000 data. They were the most up to date "clean" numbers that we had at that time.

We had a discussion with Trowbridge - late in calendar 2000 - in relation to the fact that the data which we had available was March 2000 – at that time more than 6 months old. Trowbridge indicated that because of the nature of the actuarial exercise – basically drawing lines of future best fit to more than 10 years of data points – it was unlikely that another 6 months or so of data would make much difference to the result.

Towards the end of the calendar year 2000 or early 2001 we became aware that Trowbridge (but not the individuals that we had spoken to) had produced a public report indicating that their previous industry estimates of the future incidence of asbestos disease were too conservative and that the future was likely to be bleaker. They had produced some new models of likely claims and some new generic curves. In light of this new information we asked Trowbridge to rerun their models using the James Hardie subsidiary company data and the latest (and more pessimistic) industry projections. They did that and the report that they produced and made available to the Foundation directors and that was factored into the model together with predicted earnings etc reflected the latest Trowbridge thinking on industry claim trends.

However, there can never be certainty in actuarial work. As Trowbridge wrote in the report provided to the Foundation directors:

*While due care has been taken in preparation of the review Trowbridge Consulting accepts no responsibility for any action which may be taken based on its contents. The nature of the problem is such that experience could vary considerably from our estimates. Variations are normal and are to be expected.*

*The projections of future asbestos-related disease cases are based on epidemiological work that is subject to inherent uncertainty. In addition, the behaviour of potential claimants (the propensity to sue) is uncertain and the potential exposure will be heavily influenced by legal decisions that are impossible to predict. Our estimates are based on a continuation of the current environment regarding legal principles and settlement practices.*

There were other "raw" figures available in January 2001. In a presentation to the prospective directors in January 2001 Wayne Attrill set out the latest management figures that he had for the asbestos claims. In this way, Foundation directors were made aware of the most recent numbers that were available. Those figures showed an upward trend in total damages payouts, a trend that appears to have commenced in 1999. On the other hand, legal costs are showing a clear trend in the other direction (i.e. getting smaller).

### March 2001 figures available 8 weeks after Foundation establishment

The Trowbridge data for March 2001 is clearly just a starting point and only one point. The accuracy of an actuarial model cannot be determined by reference to a single year. We know from past experience that some years are worse than others and some better. Some years show an increase in claims or costs from the previous year, and some years show a decrease. An actuarial projection will be a line of projected best fit, with yearly data points expected to appear both above and below that line.

### Most up to date data

Allens had asked Trowbridge to prepare actuarial reports to assist them in their advice to JHIL and the subsidiaries in 1996, 1998, and 2000. In each case the claims data used was the claims data as at March 1996, March 1998 and March 2000. In each case, Trowbridge had taken around 3 to 4 months to retrieve the data; understand, check and clean it; update their models; draft a report for input and comment; finalise and sign the report (the 2000 report was unsigned on account of on going discussions with Trowbridge).

The fact that data was available as soon as 8 weeks following the year-end says very little about the lead times to prepare a report on the basis of that data. It is interesting to note that the Foundation letter is dated 24 September 2001. We can only assume that the period between the year end data becoming available and the commissioning of the report, checking it etc and the delivery of the report consumed some months, which is why the Foundation letter is dated in September and not May. That is certainly consistent with prior reports from Trowbridge.

In the final analysis, there is always a lag time between data becoming available and the preparation of analysis based on that data. In our case, we were satisfied that with over 10 years of prior claims history, with the most up to date industry trends being used by Trowbridge, and given the inherent uncertainties in any actuarial forecast, the Trowbridge numbers were as reliable an input to the model as was likely to be available at that time.

### Next formal study may show a worse position

It is possible that the next study shows a worse position. It is equally possible that it will show an improved position. The figures produced by Wayne Attrill for the prospective directors in January 2001 show for example that total costs for 1996 were less than total costs for 1995; total costs for 1999 were less than total costs for 1998. In other years the trend was the opposite.

### Potential for other types of Claims not included in projections

On at least one occasion in discussions with Michael Gill, and on at least one occasion involving the whole Board of potential Foundation directors, the subject of what was and was not included in the Trowbridge report was raised. During those discussions, JHIL made clear that the following potential matters were not included in the report by reason of the fact that there were no material payments being made and/or because there were no data points for Trowbridge to work with:

- ◆ Overseas cases (we mentioned that asbestos products were sold in some Asian countries and in the US);  
Wharf cases (although Trowbridge had included an amount of \$10 million);
- ◆ Environmental claims;
- ◆ Punitive/exemplary damages; and
- ◆ Dust Disease Board reimbursement.

By the same token, no allowance had been made for potential positive developments, such as the possibility that some very promising medical developments might cause a reduction in future claims or that the NSW

government (or other governments) may act to limit recovery to reasonable levels as it has in areas such as workers compensation, motor vehicle accidents, and medical negligence.

In relation to US claims, it is our understanding and expectation that they are unlikely to be material. The relevant former subsidiaries did not export large amounts of product to the US, there have been few claims in the past (prior to the recent claims, there had been no claims since the early 1980s), and where unmeritorious claims have been made recently the plaintiff attorneys have been willing to discontinue.

For reasons stated above, JHIL was simply not in a position legally (directors' duties and corporate veil) to donate extra against all worst case scenarios.

#### Valuation: Annual Payment

There is a question raised on the annual payment from JHIL. The issue of discretion is a technical one only, that operates for the benefit of the Foundation in that it ensures that the Foundation is not required to bring to tax in any one year the whole payment stream.

In its most recent annual accounts (March 2001 - particularly at note 19), JHIL records a payable to the Foundation of \$73.4 million and reports that it has established a provision in that amount. It also describes the right of the Foundation to call for early repayment in certain circumstances. There can be no doubt that the Foundation is a creditor to JHIL for the full amount of the annual payments.

#### Valuation: Manufacturing Sites

The various manufacturing sites were all independently valued by JLW and it was on that basis that they were and are (I assume) held in the accounts of Amaca.

Our experience with the sale of other sites on which asbestos products have been manufactured has been that we realised book value or something over that amount – Largs Bay, Brooklyn and Camellia are all cases in point. Although, it is true to say, we had to be patient during the sale process.

James Hardie Australia is the current lessee of all the Amaca sites. There is some 8 years to run on all the sites and JHA has an option to extend the lease for another 10 years. As far as I am aware, other than Welshpool, JHA intends at this stage to continue to occupy for the foreseeable future and possibly would consider, I imagine, a proposal to commit now for the next term – particularly if there was a risk of not securing the sites after the initial term. (I note that other Group companies have or are contemplating manufacturing site leases outside of Australia substantially in excess of 10 years.)

#### “no way saw this as a structural device to remove responsibilities”

I would say that we are in agreement with the view of the Foundation that in no way did JHIL see it as a structural device to remove responsibilities. As explained above, the only responsibilities that altered as a result of the Foundation were management responsibilities. The underlying liabilities for claims and responsibility for them did not alter nor did the ability of the relevant companies to pay the claims change.

If there is an inference creeping in here that JHIL saw this as a structural device to remove responsibilities then obviously that is to be rejected in the strongest possible terms. It simply does not accord with the facts and the law.

#### Satisfying ourselves as to the validity of the information

It is difficult to see what would be achieved by our looking over the shoulder of the Foundation to the various reports that it has commissioned. We could, I am sure, point out areas of difference in assumptions or inputs from the work that we did - but for what purpose?

We did intend to lose management responsibility for the claims with the creation of the Foundation and we did intend to put careful, diligent and responsible people in charge of the Foundation funds and the subsidiaries. It is doubtful that we could add anything to the work that has been done.

Reviewing reports prepared by or on behalf of the Foundation carries several risks:

- ◆ that JHIL will be characterised as somehow assisting in the managing of the companies and therefore has responsibility and liability as a deemed officer or "shadow director";
- ◆ that JHIL will be assumed or deemed to be in a position of control or influence such that JHIL is required to re-consolidate the former subsidiaries in an accounting sense; and
- ◆ that JHIL will be implied to be acknowledging that - contrary to legal principle, past court decisions and the facts - it does take responsibility for the asbestos related activities of the former subsidiaries.

Please let me know what else you need in relation to this issue:

Regards,



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Peter Shafron  
General Counsel