Chapter 23 –Trowbridge's Conduct

A. Negligence in the preparation of the February 2001 Report

23.1 The fact that Trowbridge's projection of future liabilities in February 2001 significantly understated the position raises the question whether its assessment was performed with due professional skill and care. It has been suggested that it fell below the requisite standard in four respects: *first*, in its adoption of a 25 per cent nil claim assumption; *secondly*, in not allowing for superimposed inflation; *thirdly*, in assuming a peak of claims in 2001, and *fourthly*, in adopting the Berry-Medium curve for projecting claim numbers.[1]

Nil Claims

23.2 I have earlier indicated my acceptance of Mr Wilkinson's evidence that adoption of a 25 per cent nil claims rate was inappropriate. It is appropriate to give a brief explanation. The relevant data is set out in Mr Wilkinson's report:[2]

Table 5.7: Nil and non-nil settlements for mesothelioma claims

Settlement Year	Number of Nil Settlements	Total Settlements	Percentage Nil %
Earlier	12	45	27%
1991/92	4	23	17%
1992/93	10	29	34%
1993/94	10	62	16%
1994/95	10	68	15%
1995/96	9	72	13%
1996/97	5	47	11%
1997/98	30	92	33%
1998/99	15	74	20%
1999/00	10	68	15%
Total	115	580	20%

[1] JHI NV Initial Submissions on Terms of Reference 2 and 3, ch 13, and esp para. 13.1.7.
[2] Ex 252, p. 47.

23.3 What appears is that the overall rate is 20 per cent, the rate for the last three years (weighted average) was 23 per cent, and the 33 per cent rate which occurred in 1997/98 has the appearance of being an "outlier" (i.e. a statistical anomaly), as it is more than double the rate over the previous four years, and 66 per cent higher than the rate over all years.

23.4 The appropriate conclusion is that adoption of a 25 per cent projected nil settlement gave disproportionate weight to the outcome for 1997/98 – disproportionate because the average over *any* period ending in 2000 other than the 1997–2000 period would have produced an average of 20 per cent or less, and the choice of a three year period was in a sense arbitrary.[3]

23.5 Despite this, it is not clear that Trowbridge fell below the standard of a reasonable actuary in adopting a 25 per cent rate. It may have been reasonable to think that the nil claims for the 1999/2000 year were too low, and would "grow" as more data became available.[4] It may also have been reasonable to give greater weight to the recent period than to earlier data.[5] Finally, the main significance of the non-nil rate was that it affected the ultimate assumed settlement cost assumption, and Trowbridge's overall estimate of $135,000 per mesothelioma claim was not materially below what KPMG regarded as the low end of a reasonable range.[6]

Superimposed Inflation

23.6 It is important to distinguish between two issues: whether the February Report was misleading or negligent as regards James Hardie, and whether it was misleading or negligent as regards the incoming directors of the Foundation. As regards James Hardie Trowbridge's position has to be assessed in light of the fact that the February Report was explicitly intended to be no more than an update of the 2000 Trowbridge Report taking Watson & Hurst into account. James Hardie knew that the 2000 Report was based on an assumption of a continuation of the current real

[3] Marshall, T 3432.10–3434.11. See also Minty at T 3307.35.
[4] Minty, T 3308.30–.40.
[5] Minty, T 3308.30–.40.
[6] Ex 252, p. 59, applying a 23 per cent nil-settlement rate to the low end total costs of $175,000 gives $134,750.

quantum of damages[7], and of the current environment regarding legal principles and settlement practices.[8] The 2000 Trowbridge Report is not consistent with the expression of an opinion that no superimposed inflation is likely. It is noted that the potential exposure "will be heavily influenced" by court decisions and legislation, which may affect the quantum of damages.[9] It was indicated that the assessment was sensitive to changes in assumptions, including settlement costs,[10] and a sensitivity for superimposed inflation at 4 per cent was included.[11]

23.7 Moreover, Mr Attrill and Mr Shafron had seen drafts of the 2000 Report that described sensitivities that could increase the estimate by up to 50 per cent as "plausible", specifically referring to high claim inflation in that context. Mr Shafron asked for this to be omitted.[12] He also asked that Trowbridge change this sensitivity from 4 per cent to 3 per cent.[13] Trowbridge was "adamant" that it remain as it was.[14] Mr Minty, it seems, had previously told Mr Attrill that 4 per cent would be a best estimate of super-imposed inflation.[15] These circumstances make it difficult for James Hardie to criticise Trowbridge for failing to allow for super-imposed inflation except in the sensitivity analysis in the 2000 Report.

23.8 It should be also be noted that Allens (Mr Williams) had expressed a strong view that a nil allowance for super-imposed inflation was unrealistic.[16] Mr Ashe had recorded a similar view,[17] which Mr Attrill had endorsed.[18]

23.9 As regards the incoming directors the position is quite different. The February Report contained only a partial and somewhat elliptical reference to the topic.[19] The subject was not further illuminated by the oral presentation on 13

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[7] Ex 2, Vol 4, Tab 14, p. 843, 857–8.
[8] Ex 2, Vol 4, p. 849, 843.
[9] Ex 2, Vol 4, p. 844.
[10] Ex 2, Vol 4, p. 848.
[11] Ex 2, Vol 4, pp. 889, 892.
[12] Ex 57, Vol 2, p. 428.
[13] Ibid, p. 432.
[14] Ex 57, Vol 3, p. 515; see also Vol 2, p. 496.
[15] Ex 57, Vol 2, p. 332.
[16] Ex 75, Vol 5, Tab 54; pp. 1785–1786, Ex 61, Vol 4, Tab 13 (23.6.00).
[17] Ex 61, Vol 4, Tab 33, p. 162.
[18] T 1189.45–1190.06.
[19] Ex 50, Tab 23, p. 199.

February.[20] On the basis that Trowbridge did not in fact regard an assumption of nil superimposed inflation to be realistic (as opposed to convenient for the purposes of analysis because of the difficulty of making an estimate), the February Report and the oral presentation were negligent and misleading, as the "best estimate" did not in truth represent an estimate that was "neither optimistic nor conservative".[21] On the contrary, it was distinctly optimistic.

Choice of Berry-Medium

23.10 Trowbridge's adoption of this curve for the "best estimate" projection was based on its assumption that by 2000 James Hardie's event and claim numbers had levelled.[22] Of these two Trowbridge seemed to focus attention on claim numbers. The explanation for this was not clear. For the purposes of the exercise being undertaken in February 2001, Trowbridge's method was necessarily based on *events*, rather than claims, because the Watson and Hurst projections were of mesothelioma cases (equivalent to events), not "claims" in the sense employed in the James Hardie database.

23.11 In any event, Mr Minty accepted that the *first* question was whether it was appropriate to infer that the number of events had levelled.[23] In truth, as both he and Mr Marshall ultimately accepted, the available evidence did not support a conclusion that events had levelled. Rather, the pattern was of consistent increases over some years.[24] Moreover, the rate of increase was greater than the rate of increase in mesothelioma cases in the community at large, a circumstance probably explained by an increase in the propensity of victims to sue James Hardie.[25] Trowbridge had no reason to think that the propensity to sue had peaked, and substantial reason to think it had not.[26] However, the implications of this were not even considered. In these circumstances, the failure to adopt the Berry High curve as a best estimate seems to me unjustifiable, and not consistent with appropriate professional care.

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[20] Ex 50, para. 44
[21] cf Ex 50, para. 44.
[22] Minty, T 3322.30–40.
[23] T 3324.19–22.
[24] See Minty, T 3322.50–3323.22; Ex 251, p. 4–19, T 3326.10–38. Marshall, T 3440.35–3441.51.
[25] Marshall, T 3442.35–45; Minty, T 3326.40–55.
[26] Minty, T 3326.56–3327.20; Whitehead, T 3209.44–3210.33.

Claim Numbers

23.12 Trowbridge had also been criticised for not going further, and adopting a projection of claim numbers greater even than Berry High, as Mr Wilkinson did. The main elements of the criticism were the implications of a rough exposure model for the liabilities, and European predictions for mesothelioma there. The former involves little more than taking the period of peak usage of asbestos in Australia (1964–1974)[27] and adding the average latency period for mesothelioma (45 years) to derive a likely peak of incidence of mesothelioma (2009 – 2019). The latter was based on the premise that European experience of asbestos diseases was broadly similar to that in Australia,[28] and that Professor Peto and others had predicted a peak of incidence of mesothelioma in the UK in the period 2010–2020, something of which Trowbridge was aware.[29] Professor Leigh and others had predicted a peak for Australia in 2010.[30]

23.13 It must be accepted, however, that assessments of this kind are qualitative, and very much matters for judgment. There was a range of reasonable opinion. The views of Professor Leigh were not consensus views in Australia.[31] While Mr Whitehead used the exposure analysis outlined above as a reasonableness check to confirm the Trowbridge 2003 estimate, it does not follow that the analysis was robust enough to be used, as it were, negatively, to support a conclusion that projecting an earlier peak was *un*reasonable. Mr Whitehead himself did not do so. Indeed he had reservations about Mr Wilkinson's exposure model.[32]

23.14 The evidence does not warrant a conclusion that Trowbridge was negligent in not projecting mesothelioma claims in numbers greater than were suggested by the Berry-High curve.

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[27] Ex 251, p. 3–15; and para. 4.9.21.
[28] Minty, T 3284.30–3285.5.
[29] See Minty, T 3285.10–3286.15; Ex 2, Vol 3, Tab 13, p. 794.
[30] Marshall, T 3448.16–27; Ex 269.
[31] Wilkinson, T 3403.45–57.
[32] T 3215.30–3217.15.

B. Use of the February 2001 Report

23.15 The issue addressed here is whether Trowbridge was negligent, or engaged in misleading or deceptive conduct in contravention of s. 52 of the *Trade Practices Act*, in two respects relating to the February 2001 Report. The *first* is whether the report was inadequate or misleading in failing to make clear that it was based on data to March 2000 and not the latest available James Hardie data. The *second* is whether Trowbridge was guilty of negligence or misleading conduct in permitting the incoming directors to rely on the report. This reduces to whether Trowbridge knew or ought to have appreciated that the report was being used to assess the life of the Foundation as a closed fund.

Currency of Data

23.16 As is mentioned elsewhere, two version of the February 2001 report were given to the incoming directors. The first was that discussed on 13 February 2001. A copy of it is Annexure P1. Nothing in its terms discloses the limits of the data on which it is based. Mr Wilkinson's evidence was that proper professional practice called for a clear statement of those limitations.[33] Even if that were not so, the language of the report itself created such a need. It claimed to be a revisiting of claim number assumptions "in view of recent work". It refers to Trowbridge's "recent review of trends in asbestos-related disease claims". It says it is "based on all of the information available". In the absence of some clear reason to think that the incoming directors knew that the data to December 2000 was not available, this language made it imperative for Trowbridge to make explicit that the report was based only on data to March. It is no answer to this to say, as Trowbridge do in their submissions, that:

> "the February Report did not suggest that the update was based upon any James Hardie data post March 2000."[34]

23.17 In its submissions[35] the Foundation summarised a number of significant concessions by Mr Minty. The most important are:

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[33] T 3409.40–3410.30.

[34] Trowbridge Initial Submissions, para. 336(d).

(a) he was told during January and the first part of February that there was to be a change of management of Coy and Jsekarb (T714.25–.28);

(b) he appreciated that the February Report would be provided to the incoming directors of the MRCF (T714.19–.23);

(c) he knew that the February Report was going to be provided to people who did not have years of accumulated knowledge about the James Hardie Group (T714.40–.44);

(d) he knew that the February Report would be provided to people (the incoming directors) who were reliant on him to give an accurate picture of the asbestos-related disease liabilities for the purpose of taking over or coming into the management of the MRCF (T714.45–50);

(e) he knew that in those circumstances he had to be particularly cautious to ensure that the figures he was giving were accurate and represented the product of his professional opinion (T714.55–715.1);

(f) Trowbridge did not *"directly"* indicate to anyone reading the February Report that it was based on out of date figures (T715.45–.48);

(g) there was a real and radical difference between telling someone the date of the figures and telling them the significance of that date (T715.54–716.1);

(h) he had relied on assurances from the management of James Hardie that there had been no change in the trends in relation to post-March 2000 data (T716.58–717.8);

(i) the February Report made no reference to the fact that Trowbridge had relied on such assurances (T717.10–.17);

(j) a period of 10 and a half months had passed since 31 March 2000 and that that period *"may have been"* sufficient to enable the compilation of statistics which would be meaningful for an actuary (T717.25–.35);

(k) Trowbridge didn't have any statistics for the 10 and a half months relating to James Hardie (T717.35–.40);

(l) he was unable to make any independent judgment for himself whether those statistics for that period reflected any kind of trend one way or the other (T717.42–.45);

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[35] MRCF Initial Submissions, para. 40.51.

(m) he was relying on an oral statement (concerning trends since 31 March 2000) from someone who was not an actuary (T718.1–.3);

(n) a judgment about a trend would have been significant to his actuarial calculations and should have been a matter for an actuary (T718.5–15–.16);

(o) at the time he was preparing the February Report he knew, because of his previous work with James Hardie, that they had a claims database (T718.25–.29);

(p) it may not have taken very long once he received the Current Data from James Hardie to factor that data into his models (T719.25–.29);

(q) on the morning of 13 February 2001 it was his understanding that the February Report was to be given to the persons who were to be *"the new Australian management"* of Coy and Jsekarb (T720.24–31);

(r) at the meeting held on 13 February 2001 he used the February Report as the basis for his oral presentation (T721.8–.14);

(s) the reference in paragraph 4 of the February Report to *"supplemented the results of the review"* was a reference to the Watson & Hurst work (T721.33–.37);

(t) the Watson & Hurst work did not necessarily reflect James Hardie's particular experience (T721.48–.51);

(u) the last paragraph on the first page of the February Report conveyed the impression that the Watson & Hurst work was relevant to and directly impacted upon the assessment Trowbridge was doing of James Hardie's liabilities (T722.24–.28);

(v) a person reading the last paragraph of the first page of the February Report who did not have any previous knowledge of James Hardie's claims and assumptions and figures would be entitled to conclude that Trowbridge was giving to that reader the latest up to date professional assessment of the asbestos-related numbers relating to James Hardie (T722.30–.43);

(w) in providing his expert opinion to the incoming directors he had an obligation to make clear things that were not obvious to them (T723.5–.9);

(x) if he had had the Current Data prior to February 2001 he would have adjusted the model to some extent (T724.12–.18);

(y) after he left the meeting on 13 February 2001, having made his oral presentation, he knew the incoming directors were looking to him to provide them with the latest up to date most accurate assumptions which an actuary was capable of (T724.37–.43);

(z) in circumstances where he had not reviewed the Current Data he should have made a statement in the clearest terms to the incoming directors that he was not able to confidently express and opinion that nothing since 31 March 2000 had occurred which was of significance (T725.5–11);

(aa) the qualification set out at page 4 of the February Report did not specifically highlight that matter (T725.13–.15);

(bb) there was no disclaimer in the February Report concerning the potential significance of the Current Data (T726.2–.10);

(cc) in circumstances where he knew that the incoming directors were relying on him to give an accurate opinion, there was a very serious omission in the February Report and in his oral presentation concerning the uncertainty of his opinion (T726.20–.27).

23.18 This evidence prima facie compels a conclusion that Trowbridge was negligent, and that its report was misleading.

23.19 It is necessary, however, to refer to three matters on which Trowbridge relies in answer to this.[36] The first is that the final version of the February 2001 report was amended to add the words "as at March 2001" after the reference to "our draft advice on the future cost of asbestos-related disease claims" in the first paragraph. This appears to have been the change by which Mr Minty intended to make clear that the report was not based on current data. I have difficulty accepting that he can have thought this change was adequate to achieve that end. Not only is it so subtle a change that a reader would be unlikely to notice it (and nothing was done to draw it to the readers attention in the final version[37]), it is not in truth a change which gives any information about the data used for the February 2001 report. All it does is make clear the temporal limit of the "draft advice" which was being "revisited".

23.20 The second point was that the incoming directors ought to have appreciated from the text of the report, read in light of what was said at the meeting on 13 February 2001, that the best and high estimates in the report were based on the James Hardie data used for the "Current" model, i.e., data to March 2000. However,

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[36] Trowbridge Initial Submissions, paras 138–157 and 336(a)–(e); Submissions in Reply paras 70–98, 123–134.
[37] See Ex 50, Tab 23.

even on Mr Minty's version of what was said at the meeting on 13 February 2001[38], the incoming directors would not have been deflected from the natural assumption that the Report was based on up to date data, an assumption reinforced by the language of the report itself. In Minty's account the date "March 2000" is mentioned, but only in the context of describing the data on which the "Current" model was based. That something to this effect was said is confirmed by notes made by some of those present.[39] However those notes are consistent with the incoming directors believing that the best and high estimates were based on current data. Their evidence is to the effect that was their belief as at 16 February 2001[40] and I accept that evidence.

23.21 It is significant that, having left the 13 February 2001 meeting Mr Minty was concerned that some of those present did not seem to have appreciated that the report was not based on current data.[41] Similarly Mr Robb, who was at the 13 February meeting, was under the impression that the report was based on current data.[42]

23.22 The third point relates to the purpose for which the February 2001 Trowbridge Report was being used. Trowbridge accepts, indeed asserts, that its February 2001 Report was not suitable to be used for defining the assets of a closed fund to meet Coy and Jsekarb's asbestos claims. The Report was not prepared for the purpose of estimating the likely longevity of the Foundation, and, Trowbridge says, it was not told that the Report was required for that purpose.[43]

23.23 Trowbridge's position has something to be said for it. When retained by Mr Shafron (via Allens) in January 2001 Trowbridge may have been entitled to conclude that the purpose of the exercise was to do no more than update the June 2000 report by reference to the insights of Watson and Hurst.[44] As will appear the

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[38] Ex 50, para. 44.

[39] See Ex 7, Vol 7, Tab 16, p. 308 (Cooper); Ex 29, p. 70 (Gill). The latter may be a document distributed at an earlier meeting but it seems clear that Mr Gill's notes on it were made on 13 February 2001. See also Attrill, Ex 57, Vol 4, p. 1058.

[40] Cooper, Ex 5, para. 82; Edwards, Ex 13, para. 121; Jollie, Ex 36, para. 80; Gill, Ex 29, para. 14.

[41] Minty, Ex 51, para. 13; Ex 54, para. 25; T 706.43–.46, 713.42–46, 722.51–723.3.

[42] Ex 187, para. 55.

[43] Trowbridge Initial Submissions, paras 175–178, 266–291; Submissions in Reply, paras 99–107**,**

[44] Ex 50, Tab 12, Attrill, Ex 57, Vol 4, p. 956.

real difficulty arises when regard is had to what Trowbridge learned in the course of the meeting on 13 February. However Trowbridge had, as early as 19 January, indications that this report was not concerned with the same "litigation management" or accounting provision purposes that might have applied to the earlier reports. Mr Attrill's note of the meeting on that day[45] has as its first item what appear to be Trowbridge's instructions:

> "Graph - yearly cash outflows.
>
> Readings 10 years out – cash paid
>
> – discount to NPV
>
> 15 years – "
>
> 20 years – "
>
> How much needed to last these years?
>
> Model with different earning rates: 7,8,9%.
>
> Updated with latest thinking on epidemiology."

23.24 The sentence, "how much needed to last these years" invited questions – "On what basis? With what degree of confidence?" Apparently they were not asked. Trowbridge proceeded as if it had been asked merely to update the 31 March 2000 estimate with the insights of Watson and Hurst subject to the period and discount rate parameters defined by Mr Shafron.

23.25 In fact the February 2001 report was intended to be used by the incoming directors to assess the life of the Foundation, established as a closed fund. The February 2001 report was unsuitable for that task for a number of reasons that were unlikely to have been apparent to the incoming directors, even having regard to the additional information give to them on 13 February 2001, and leaving aside the fact that it was not based on current data. Those reasons were,[46] first, that the models provided only "best estimates" which were median estimates so that they predicted outcomes that would be exceeded on 50 per cent of the plausible scenarios. Secondly, since the fund was to be closed, it was necessary to make some allowance for volatility of claim costs and investment returns. The model did not do this. Thirdly, the model made no allowance for superimposed inflation, when in truth

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[45] Ex 57, Vol 4, p. 970.

[46] See the discussion in Chapter 23.

there was a significant risk of legal and medical developments raising costs well above the rate of inflation. Fourthly, the report lacked a sensitivity analysis or any other mechanism suitable to give some concreteness to the high degree of uncertainty of the projections. Fifthly, the discount rates adopted were higher than would be employed by an actuary attempting to give reasonable confidence to a funding outcome. Sixthly, the projected claim costs and claim numbers were lower than would be adopted by an actuary attempting to give reasonable confidence to a funding outcome.

23.26 There is evidence which supports a conclusion that Trowbridge either knew, or ought to have appreciated, that its report was going to be used to assess the life of the Foundation as a closed fund.

23.27 First, Minty's notes of the meeting on 13 February[47] record the following:

> "$280M now available. Media training this morning [?] – they think not difficult to sell. Main qns are
>
> 1. was amt enough?
>
> 2. risks of everyone attacking JH for <u>all</u> asb. problems.
>
> …
>
> Phil - proj[ection] of net assets for next 20 yrs
>
> - critical assumption is cash depletion due to asb. litigation over next 15–20 yrs."

23.28 This note indicates that Mr Minty and Mr Marshall were present for the part of the meeting in which the following (relevantly) occurred:

(a) Sir Llew Edwards announced that the asset level had now increased over that previously advised, and will be some $280m.[48]

(b) James Hardie would be making an announcement about the establishment of the foundation.[49]

(c) Mr Shafron explained "set up and structural issues", and in particular, that JHIL would reduce its capital in Coy & Jsekarb to nil, that after separation there would remain a connection with JHIL

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[47] Ex 50, Tab 20.
[48] Cooper, Ex 5, para. 77; Attrill, Ex 57, Vol 4, p. 1056.
[49] Ex 57, Vol 4, p. 1056.

through the Coy loan (about $75m); that JHIL would make payments to Coy with an NPV of $70m in exchange for an indemnity from Coy.[50]

(d) Mr Robb explained the trust structure.[51]

(e) Peter Jollie raised a concern about the limited assets of Jsekarb: "If Jsekarb only lasts 5 years, we have a problem. … 3 or 4 large claims could use up Jsekarb's funds." He than asked if more of the $70m could go to Jsekarb if it needed it.[52]

(f) Mr Morley gave a presentation on financial matters and the cashflow model, in which Mr Jollie asked: "If rate falls by 1%, how much sooner will the fund run out of money?"[53]

23.29 Secondly, in the course of Minty's own presentation Mr Gill asked, "How long will $280 million last?". Minty answered:[54]

> "If you take our projections and apply discount rates in the order of 7% to 8%, a fund of around $280 million is going to last about 20 years if our medium projection plays out, and obviously it would be insufficient if the high projection is what emerges. In that case you would expect the, a fund of that size to last about 15 years. Obviously, if what we've called the current projection occurs, then $280 million would last you 20 years and maybe a few years longer depending on, among other things, investment returns. So it depends on a number of variables, many of which are quite uncertain."

It is evident that both the question and the answer proceeded on the footing that there were to be no additions to the fund in the relevant period, apart from earnings on assets.

23.30 Finally, at the end of Mr Minty's presentation, Mr Jollie said: "We intend to rely on this", and Mr Gill asked that Mr Minty send a copy of the report to the incoming directors through Mr Bancroft.[55]

23.31 In light of that material, Mr Minty's answers in cross-examination were perhaps inevitable:[56]

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[50] Ex 57, Vol 4, p. 1056.
[51] Ex 57, Vol 4, p. 1057.
[52] Ex 57, Vol 4, p. 1057.
[53] Ex 57, Vol 4, p. 1059.
[54] Ex 50, para. 45.
[55] Ex 57, Vol 4, p. 1058.
[56] T 752.39– T 755.3.

"Q. So you knew that the fund, the 280 million dollars that you have written there, was money that was being questioned and looked at as to--

A. Yes.

Q. --whether it was enough to fund future liabilities?

A. That's correct.

…

Q. If we accept what is written in your note, what I want to put to you is that you understood what James Hardie were doing was selling the sum of 280 million dollars as being enough to found James Hardie's future asbestos liabilities?

A. James Hardie were endowing the fund with 280 million dollars to that purpose, yes.

Q. You understood then on 13 February that James Hardie within a couple of days, were to announce publicly that 280 million dollars would be enough to fund their future asbestos liabilities?

A. That's correct.

Q. And you understood, I suggest, that it was your actuarial advice that was going to be used as a premise in relation to what was to be announced?

A. It would be one of the premises, yes.

…

Q. Everything recorded in your notes I suggest, indicates that what was being spoken about on 13 February was a fund that was designed to last fifteen to twenty years?

A. That's correct.

Q. And I'd also suggest that you were fully aware that the Trowbridge actuarial opinion of 13 February was fundamental to the projections over fifteen or twenty years for the fund?

A. Yes.

Q. And that you knew on 13 February that your report was being used as a basis for saying the total funding is okay?

A. It was being used as the basis for calculating the total funding, that's true.

Q. And saying that the totalling funding would meet liabilities?

A. Our report referred to liabilities out for twenty years so to that extent that would be true."

23.32 In light of this evidence I conclude that Mr Minty either knew or should have known how his report was being used. At the very least there was sufficient risk that the report would be used to set the level of funding for the Foundation that Mr Minty should have made some inquiry, or volunteered a warning as to the limits of the utility of the report. Further, it there was any room for doubt as to whether the fund would be "closed" (i.e., that there would be no right to further contributions by JHIL) that doubt would have been resolved when Mr Minty saw reports of the JHIL media releases on the 16 or 17 February.[57] His failure to warn his old client, JHIL, or his prospective client, the Foundation, that they may have proceeded on a serious misunderstanding of Trowbridge's work, is impossible to justify.

23.33 In the result, I find that Trowbridge fell below the standards of professional care and engaged in misleading conduct in permitting the incoming directors to rely on the February 2001 report without warning them of its limitations, and in particular, without warning them that it would not be appropriate to rely on its NPV estimates to assess the life of a closed fund such as the MRCF.

C. Possible Causes of Action

23.34 I do not think it necessary for me to make findings on whether causes of action are available, as opposed to findings as to the facts. However, it is appropriate briefly to identify from the submissions that have been made those claims which seem to me to be arguable, having regard to my findings.

23.35 In the case of Trowbridge, it has been suggested that Amaca and Amaba may have claims against it for damages for negligence and for damages pursuant to s 80 or s 87 of the *Trade Practices Act* for contravention of s 52.

23.36 As to negligence, there may be some difficulty in establishing a cause of action. Trowbridge[58] submits, with some force, that Coy and Jsekarb's directors, Mr Morley and Mr D Cameron could not be found reasonably to have relied on the February 2001 report in making any material decisions concerning the separation process. The matters on which Trowbridge relies are as follows:

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[57] T 736.28–738.25.
[58] Trowbridge Initial Submissions, paras 304–305.

(a) there was no reliance by Coy and Jsekarb on the February Report. Morley never read the February Report either in draft or final, other than looking at the cashflow projections contained in the Appendices, and he had not read the earlier June 2000 Report;[59]

(b) Morley, as a director of JHIL, knew:

(i) of the qualifications and limitations, and inherent uncertainty, in the June 2000 Report and the February Report;[60]

(ii) that those reports had not been prepared for the purpose of Project Green;[61]

(iii) that JHIL considered such actuarial reports unreliable and variable;[62]

(iv) that nothing had changed between June 2000 and February 2001, to improve the reliability of the actuarial reports,[63] and

(c) as a JHIL executive, he knew or should have known that the February Report, and the earlier June 2000 Report, had not been prepared for the purpose of separation (in particular, given his attendance at the August 2000 JHIL Board meeting and the meeting with Trowbridge on 19 January 2001);[64]

(d) Whilst Cameron had received and read a copy of the draft February Report (but not the final report), he had not received a copy of the letter of instructions, or the June 2000 Report, and did not request copies of those documents.[65] Cameron made no inquiries of anyone as to the terms of the instructions given to Trowbridge for the February Report, or the data and assumptions upon which it was based (although he had received independent legal advice to do so);

(e) Cameron, as company secretary of JHIL, received and had access to the JHIL Board papers including the presentation prepared for the 16 August 2001 JHIL Board meeting, which had highlighted the limitations and heavily qualified findings in the June 2000 Report;

(f) the decision by Morley and Cameron as directors of Coy and Jsekarb to enter into the DOCI on 15 February 2001, was not made in reliance upon the February Report, but rather the cashflow model

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[59] Morley: T 2160.1–.4; T 2159.20–.22; T 2237.33–.35; T 2239.27–.28.
[60] Ex 148, Vol 1, Tab 1, p. 28.
[61] Ex 61, Vol 4, Tab 33, p. 161.
[62] Ex 1, Vol 1, Tab 3, p. 43; Ex 75, Vol 8, Tab 119, p. 2767–2772; Ex 121, Vol 5, Tab 60, pp. 2239, 2247.
[63] Morley: T 2248.51–.55.
[64] Morley: T 2009.56–.57.
[65] Ex 42, paras 20–21.

prepared by Harman, which they acknowledged had significant deficiencies;[66]

(g) Morley and Cameron never told Trowbridge that they were assessing the value of the payment which Coy and Jsekarb would receive from JHIL in consideration for entry into the DOCI, or that they intended to use the February Report in connection with that business decision or any other;

(h) any assertion by Coy or Jsekarb that they relied upon the February Report for the purpose of assessing whether or not to enter into the DOCI on 15 February 2001, would not be reasonable in all the circumstances having regard to:

(i) the limited scope and purpose of the February Report which did not include, the level of "funding" required for separation;

(ii) the absence of any direct dealings in February 2001 between Trowbridge and Coy or Jsekarb;

(iii) the absence of any consent by Trowbridge to the use of the February Report by Coy and Jsekarb in a manner not made known to, or contemplated by, Trowbridge;

(iv) the nature of the February Report was such that it could not be considered in isolation from the June 2000 Report, and without sufficient regard to the qualifications and limitations and inherent uncertainty referred to in those reports, including the sensitivity analysis; and

(v) the express disclaimer in the February Report of responsibility to other persons.

23.37 These matters appear as a substantial obstacle to a negligence claim on behalf of Amaca and Amaba.

23.38 The position may be different as regards claims under the *Trade Practices Act*. It is possible to argue, by analogy with *Janssen-Cilag Pty Ltd v Pfizer Pty Ltd*[67] that Amaca and Amaba could sue on the basis that the *incoming* directors' reliance on Trowbridge caused those companies loss in that they were deprived of a valuable opportunity to achieve better separation terms from JHIL. Trowbridge relies on the recent decision of the New South Wales Court of Appeal in *Digi-Tech (Australia)*

[66] Morley: T 2260.20–.39; Cameron: T 664.39–58; T 664.58–665.9; T 651.33–.46.
[67] (1992) 37 FCR 526.

Ltd v Brand[68] to rebut this contention. *Digi-Tech*, however, may be distinguishable on the basis that in the present case the reliance by the incoming directors was a sufficient condition of the loss.

23.39 On this basis, Counsel Assisting has estimated the value of the possible claims as follows:

(a) misleading conduct as regards the currency of the data: $87m.[69]

(b) misleading conduct as regards the curve adopted: $31m.[70]

23.40 These numbers assume that if the defects in the report had been corrected JHIL would have been willing and able to provide such additional funds to Coy and Jsekarb. There may be a case for that as regards a sum of the order of $31 million,[71] but as the number increases, the prospect diminishes.

23.41 For this reason it is impossible to suggest a figure for damages attributable to Trowbridge permitting the use of its report for an inappropriate purpose. A report prepared properly for such a purpose would have been likely to estimate sums so large that JHIL would have refused or been unable to pay them.

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[68] (2004) ATPR 46–248; [2004] NSWCA 58

[69] Counsel Assisting's Initial Submissions, Section 1, para. 259.

[70] Counsel Assisting's Initial Submissions, Section 1, para. 255.

[71] See Robb, T 2952.50–2953.19; Ex 202, which suggests a willingness on JHIL's part to add up to $100m to the funds of Coy and Jsekarb, as opposed to the $70–80 million provided under the DOCI.

Chapter 24 – Was JHIL Responsible for Deficiencies in the Actuarial Advice?

A. Introduction

24.1 The February 2001 Trowbridge report was obtained by JHIL with two purposes in mind, to satisfy the incoming directors that the Foundation would have a life of at least 15-20 years, and to assist the board of JHIL to a conclusion that all the asbestos liabilities of Coy and Jsekarb would be met, i.e. that the Foundation was "fully funded".[1] Essentially these purposes were the same. The report was to be used to assess the life of the Foundation, established as a closed fund with no right to further capital from JHIL beyond that provided for by the Deed of Covenant and Indemnity.

24.2 I regard the February 2001 Report was wholly unsuitable for such use. The reasons for this, which to some extent overlap, are various. I will focus on the two that seem to be to be most significant. First, there is the fact that it was not based on current data. This resulted in lower claim costs and claim number estimates than were appropriate. Secondly, as an update of the 2000 Trowbridge Report, it was directed at purposes different from defining a closed fund. The consequence was a failure to make appropriately conservative allowances, including as regards discount rates and superimposed inflation.

24.3 The issue dealt with here is whether, and if so to what extent, JHIL was responsible for these deficiencies.

B. Omission of Current Data

24.4 There was a direct testimonial conflict on this question, one of the very few that arose in the Inquiry. On the one hand, Mr Shafron's evidence was that the JHIL asbestos claims data from 1 April to 30 December 2000 was not given to Trowbridge because they said they did not need it. On the other hand, Mr Minty's evidence was that he had asked for the data and JHIL had declined to provide it, instructing him to proceed by reference to the data as at 31 March 2000. It is necessary to resolve this conflict.

24.5 The critical conversation was on 19 January 2001. Messrs Shafron, Morley, Attrill, Minty and Marshall were present. The context was that on 16 January JHIL had retained Trowbridge to update their 2000 report to allow for Watson and Hurst, and at this meeting that retainer, and the likely impact of Watson and Hurst, were discussed.

24.6 Mr Shafron's evidence was that in the course of the meeting the following exchange occurred:

> "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.[2]

24.7 Both Mr Minty and Mr Marshall reject this version of events.[3] Mr Minty's evidence was as follows[4]:

> "'In order for us to update the March 2000 position, we're going to need James Hardie's up-to-date claims information including the number of claims reported and settled together with settlement amounts. We would also like to get any other information you have in relation to emerging trends nationally for ARD claims, including new legal precedents. We have the national experience from the November presentation, but we need to see how your data relates to that in order to calibrate the national model to reflect James Hardie's own claims.'
>
> In response, either Mr Shafron or Mr Attrill (I cannot now recall which of them) said words to the following effect:
>
> 'We're unable to get updated claims data to you in the time available.'
>
> Mr Shafron said words to the following effect:
>
> 'Anyway, we don't think there's anything in the data that would affect the results because nothing significantly different from what you projected has occurred during the period. We want you to proceed on the basis of the claims

[1] Shafron, T 1608.21-34 and 1730.45-55.
[2] Ex 17, para. 140.
[3] See Minty, Ex 51, para. 18; T 806.5-.19; Marshall, Ex 54, para. 10, substituting "140" for "138".
[4] Ex 50, para. 31.

> data you had from us and the assumptions you used in the March 2000 report, just updated with your current views on likely national experience.'"[5]

24.8 Mr Attrill's evidence of the meeting on the 19th did not shed any light on this question. His recollection was largely confined to his note of the meeting, which was not specific in this respect.[6]

24.9 Mr Morley recalled this exchange:

> "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]

24.10 Mr Morley's evidence permits acceptance of the evidence of Mr Minty that on the 19th he was told by Mr Shafron that:

> "...we don't think there's anything in the [current] data that would affect the results because nothing significantly different from what you projected has occurred during the period."[8]

Such a statement might have been expected as an explanation by Mr Shafron as to why Trowbridge should feel comfortable proceeding without the current data. Such an explanation would only be called for only by a perception that Trowbridge would otherwise prefer to do the report by reference to current data. To that extent it tends to support the evidence of Mr Minty as to the conversation which is in dispute.

24.11 However consideration of the competing accounts is insufficient to permit a confident acceptance of one version or the other, or, for that matter, of the submission of the Foundation that both should be rejected in favour of a finding that there was no discussion of the data question on 19 January.[9] It is necessary to have regard to the surrounding circumstances, in particular the events before and after which appear to be uncontentious.

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[6] Ex 57, Vol 4, pp. 970–971.
[7] Ex 121, para. 203.
[8] Ex 50, para. 31; see also the evidence of Mr Shafron at T 1709.45–50; 1713.27–38.
[9] MRCF Initial Submissions, para 30.25.

24.12 One of the matters on which JHI NV relies is evidence that Trowbridge became aware before the report was complete that the current data would show a deterioration, and did not react by asking for the data, or expressing some limitation or caveat in the report. Mr Marshall's evidence was that sometime in the period 19 January to 8 February 2001 he had a conversation with Mr Attrill to this effect:

> "A. I'm saying that the - at a general level I was made aware that the experience in the nine months to the end of 2000 was worse than it had been in previous quarters.
>
> Q. Meaning what, that there would be more claims made or more money expended or both or what?
>
> A. Based on my recollection, there were two aspects to the deterioration, an increase in the number of claims reported and a deterioration particularly in the December quarter in terms of payments.
>
> Q. But when you speak of a deterioration in claims reported, are you speaking of the number of claims, the number and type of claims that have been made on the James Hardie company?
>
> A. I'm saying the number reported based on my understanding were higher than the number we had calibrated on our model form.
>
> Q. The claims made on James Hardie companies?
>
> A. That's correct."[10]

24.13 However for present purposes I do not think this evidence has much significance. Having regard to the clear basis on which Trowbridge had been instructed to do the report, the fact that Trowbridge did not react and did not express a caveat in the February Report is not particularly surprising. The report was being done for JHIL, which had asked that it be done by reference to the March data, and was on any view aware of its own experience in the interim. It had also asked for the report to be kept brief. Trowbridge had no obligation to point out the obvious to JHIL. Moreover, the task it had been asked to do was not an irrational one, even if there had been a clear deterioration. JHIL may have wanted to see, by direct comparison with the 2000 report's outcomes, just what the effect of Watson and Hurst was, unclouded by the impact of new data. The position became different of course, on 13 February when Trowbridge became aware of the true use to which the report would be put. But I do not regard its failure to act appropriately as regards the

incoming directors in that situation as strong evidence that Mr Minty and Mr Marshall had from the outset regarded the current data as immaterial.

24.14 JHI NV also submitted that Mr Minty should be found to have had the view in February 2001 that the additional 9 months data was unlikely to make a difference, and therefore it was likely that he said something to that effect. The principal evidence for such a finding is Mr Minty's response to a question from Mr Watson SC:[11]

> "Q. When you came to considering the effect of the nine months data in August and September 2001, you in effect took the view that the data for the first six months wouldn't have made any difference, didn't you?
>
> A. That's correct.
>
> Q. And why did you do that?
>
> A. Because the two quarters had started to show a trend, were in fact higher than the averages of previous quarters, but again given the degree to which quarterly claims had fluctuated in the past, we felt that that was probably within the realms of, you know, just a normal statistical fluctuation in those numbers.
>
> Q. Now that was your view after the event, if you like?
>
> A. That's correct.
>
> Q. I suggest to you that your view before the event was to the same effect, that six to nine months data was not likely to make any difference statistically?
>
> A. It was unlikely to.
>
> Q. And that was your view as expressed in this meeting in January 2001?
>
> A. It was - yes, that's right, that it was unlikely to make an impact."

24.15 The earlier answers do suggest that Mr Minty had the view that Mr Shafron says he expressed in January 2001. This evidence has to be weighed, however, against the evidence to which I will refer later which demonstrates to my satisfaction that Mr Minty would have preferred to have the current data for the purposes of the February report.

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[10] T 866.52–867.14. I do not regard the evidence at T 890.52–891.14 as involving an acceptance by Marshall that he had been told that the half year claim costs were $16.3 m.

[11] T 806.21-46.

24.16 Perhaps the primary evidence in support of Mr Shafron's account consists of statements by him to others at around this time and subsequently in which he indicated that Trowbridge had said they did not need the current data for the purposes of the February report. This evidence has been carefully analysed in the submissions on behalf of Trowbridge.[12] In general, I accept that analysis. The paragraphs that follow adopt much of it.

C. 15 February 2001

24.17 Mr Shafron apparently told Mr Robb on 15 February 2001, when explaining why Trowbridge had not used the current data, that "Karl" had said the recent numbers were not needed because 20–30 years modelling was not impacted by 8 months claims history.[13]

24.18 There is nothing in the evidence to suggest why Marshall would have referred to "8 months claims history" in January 2001, when 9 months data after March 2000 was available and, I would add, had already been analysed by JHIL and covered in the presentation to incoming directors on 15 January.[14] Nor is the reference to "20–30 years modelling" consistent with Mr Shafron's version of Minty's statement. Mr Shafron also gave Mr Robb a further reason for why the current data was not given to Trowbridge, namely that this would extend the time required to prepare the report.[15] This explanation was unnecessary if the first reason was valid.

24.19 Mr Robb was not satisfied with Mr Shafron's explanation and discussed the matter with Mr Peter Cameron. Mr Cameron and Mr Robb then telephoned Mr Macdonald, and Mr Shafron was present with Mr Macdonald during the telephone conversation.[16]

24.20 Mr Robb's file note of the telephone conversation, the accuracy of which I accept, records Mr Macdonald saying that:[17]

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[12] Initial Submissions, paras 47–72.
[13] Ex 92; Tab 11, Ex 187, Vol 1, Tab 17, p. 65.
[14] Ex 57, Vol 4, pp. 942–953, 972–3.
[15] Ex 187, para. 58; Robb: T 2919/5–26.
[16] Robb: T 2807/45–46; T2909/22–26.
[17] Ex 187, Vol 1, Tab 17, pp. 65-66.

(a) the Trowbridge number was based on general community numbers and the March 2000 data;

(b) in the past, Trowbridge had used the complete year and the broader community (experience); and

(c) James Hardie's claim numbers reflected, and were aligned with, what was happening in the wider community.

Mr Cameron said he had been concerned to confirm the position. Mr Macdonald responded that the March 2000 data was the most recent "full" set of numbers. He noted the last quarter numbers were higher. Mr Cameron sought confirmation that there was no reason to depart from the view that the proposal was fully funded. Mr Macdonald responded "Yes, that is the case".[18]

24.21 Significantly, Mr Macdonald did not assert that Trowbridge had not used the recent data because Minty or Marshall had said that it was not needed, or it would not make any difference to the February Report. Mr Macdonald's explanation to Mr Cameron and Mr Robb was a purported justification for use of the March 2000 data, but it was not said to be based on anything Trowbridge had said to JHIL.

24.22 I would add:

(a) The statement that the March data was the latest "full" set was not correct on any view[19], and is an explanation that was unnecessary if Trowbridge did not need the data because it would not affect the results.

(b) The proposition that JHIL's data reflected the wider community experience, while a plausible justification for proceeding without the current data (given Watson and Hurst), was not accurate. As Mr Shafron knew, the precise object of the Trowbridge update was to see *how* the James Hardie data related to national material.[20] The

[18] Ex 187, Vol 1, Tab 17, p. 66.
[19] Shafron, T 1714.45–1715.30.
[20] T 1712.27–33.

graph relied on by Mr Macdonald to support a belief that that the proposition was correct in fact shows the opposite.[21]

D. JHIL February Board Meeting

24.23 There is evidence that the omission of the current data was raised at the JHIL Board meeting on 15 February 2001. Mr Macdonald said that one of the directors asked "Is there anything in these figures which causes management to reconsider its view that the proposed funding is sufficient to meet anticipated claims?" in reference to the Asbestos board paper which showed that asbestos costs for the quarter to 31 December 2000 were high.[22] Mr Macdonald said that 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" (by which Mr Macdonald said he understood Shafron to mean a curve based on 10 years of data).[23]

24.24 If Mr Shafron did say to the JHIL Board meeting on 15 February 2001 the words attributed to him by Mr Macdonald,[24] then:

(a) the statement by Mr Shafron was not correct because he had not asked Minty the question raised by the JHIL director: "is there anything in those figures" (being the asbestos costs for the December 2000 quarter, which were high), and Minty could not have answered the question without having been given the figures (which Shafron had not done);

(b) the statement attributed to Minty that "a couple of quarters of data" would not shift a 10–year curve (i.e. a curve based on 10 years of data), is different from the statement earlier attributed by Shafron to Marshall (not Minty) on that same day that "8 months claims history" was not needed.

[21] Ex 308, annexure A.
[22] Ex 148, para. 58.
[23] Ex 148, paras 58–59; Macdonald: T 2552.22-29. See also Williams, Ex 332, para. 20.
[24] Ex 148, para. 58.

E. Shafron/Robb email

24.25 The email from Shafron to Mr Robb later on 15 February 2001 (at 4.14 pm after the JHIL Board meeting earlier that day) contained three matters intended by Shafron to allay Mr Robb's concerns that the claims data used by Trowbridge was not up-to-date.[25] The email was evidently an attempt by Shafron further to justify not having provided Trowbridge with the recent claims data. Mr Robb agreed that none of the matters raised by Shafron adequately explained why Trowbridge had not used the recent data.[26] In fact they have a desperate quality about them, in my view. The three points are:

> "1. The Minty Report states in the first para that it is based on March 2000 numbers.
>
> 2. Wayne showed the potential directors the year to date numbers.
>
> 3. Harman's model uses actual and forecast numbers for the YEM 01."

24.26 The first point is true only of the altered version which Shafron caused to be sent to the incoming directors in a version in which the mark-ups to show the changes had been omitted.[27] The second point is correct, but its implication seems to be that it did not matter that the omitted data may have been significant, since the incoming directors were aware of it, at least in general terms. The third refers to the fact that the litigation cost figure in the YEM 2001 line in the model allows $16 m for the current half year, a figure based on the predicted costs to 31 March 2001. This was of no possible significance to the reliability of the Trowbridge report, which was Mr Robb's concern, but indicates that Shafron was quite aware that the current 6 months experience was much worse than Trowbridge was modelling for the future ($23m for the next full year).

24.27 Significantly, Mr Shafron did not suggest that Mr Robb should take the simple step of speaking directly with Trowbridge to confirm that the omitted data was immaterial as far as they were concerned.

24.28 I note that Mr Robb does not seem to have been persuaded at the time that Mr Shafron had acted reasonably, or even been convinced that Mr Shafron's

[25] Ex 189, Vol 1, p. 350; Ex 196.
[26] Robb: T 2796.54–2797.9; T 2909.28–33.

explanation was true. According to Mr Williams he had a conversation with Mr Robb on 23 February 2001 in which Mr Robb discussed JHIL's dealings with Trowbridge. Mr Williams says:

> "19. Mr Robb told me in substance ... that "Trowbridge were not given any extra specific JHC [Coy] figures for last 8 months" and that he (David Robb) "did not know". Mr Robb told me in substance that Trowbridge may have had the current Australian trends from their own sources. I asked in substance why the last 8 months figures had not been given. Mr Robb said in substance that he was speculating, but he mentioned 3 possibilities: that there was "no time" for James Hardie figures to be given; that the figures would have made no difference; and that the claims profile may have changed for the worse – and that James Hardie did not want the figures changed.
>
> 20. Mr Robb told me in substance that the issue had "come up at the Board meeting the Thursday before" which he attended with Peter Cameron. Mr Robb told me in substance that it had become evident to him that "the most recent claims history had not been factored in" and that he (David Robb) had taken up the issue with Peter Shafron. Mr Robb told me in substance that he had then spoken to Peter Cameron. Mr Robb told me that he had raised 4 times with James Hardie if my comments (i.e. on the draft June 2000 Trowbridge report) had been factored in, but that he had never received a satisfactory answer. Mr Robb told me in substance that Peter Cameron did not want to take it [the 8 month data issue] further, once the issue had been put to Peter Macdonald by Peter Cameron and David Robb. Mr Robb told me in substance that Mr Macdonald had acknowledged that it was James Hardie's decision, and had been told that "it will come out, perhaps in court".... Mr Robb told me in substance that he had put squarely to Peter Shafron the proposition that Allens could not now say that enough money had been put in to the trust. Mr Robb told me in substance that he had said this to Peter Shafron on the day of the Board meeting."[28]

I accept Mr Robb's account, as recorded by Mr Williams, as accurate. It accords with the burden of Mr Robb's own evidence.

F. 23 April 2001

24.29 On 23 April 2001, Mr Macdonald sent an email to Mr Shafron (copied to Mr Morley and Mr Baxter) reporting on his recent meeting with Mr Cooper, in which Mr Cooper raised the Foundation directors' concern that James Hardie had not "*properly allowed for a rapid escalation in litigation costs*" in setting up the Foundation.[29]

24.30 According to his email, Mr Macdonald did not say to Mr Cooper that the latest claims information was refused by Trowbridge, or that Trowbridge said it was

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[27] Ex 75, Vol 8, Tab 115.
[28] Ex 332, paras 19–20.
[29] Ex 150, p. 156.

not required, or that Trowbridge said it would not make any difference to their report. Rather, he had responded by saying that:

> "We had been aware of the latest information, and had encouraged Trowbridge to use the latest claims and costs data from the public record (which would include JH) to assess future costs in its update provided prior to the establishment of the foundation."[30]

It may be inferred that Mr Shafron was the source of Mr Macdonald's information for this response.[31]

G. 9 November 2001

24.31 The 9 November 2001 draft memorandum from Mr Shafron to Mr Macdonald,[32] does not state that Trowbridge said in January 2001 that the up-to-date claims information was not required, or would not make any difference to their report.

24.32 The memorandum refers to a discussion with Trowbridge – "late in calendar 2000" – concerning the data at March 2000 being "at that time more than 6 months old" and that it was unlikely that another "6 months or so of data" would make much difference to the result.[33] The context of this alleged discussion with Trowbridge is not made clear, but the time period referred to appears to be October or November 2000, because the Watson and Hurst presentation on 29 November 2000 is referred to in the following paragraph of the draft memorandum as having occurred after any such discussion.[34] Again, it is not consistent with a discussion with Trowbridge occurring in January 2001, when 9 months of data was available.

24.33 The memorandum confirms that JHIL determined the scope of the data to be used by Trowbridge in January 2001:

> "we asked Trowbridge to re-run 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

[30] Ex 150, p. 156.
[31] Mr Macdonald: T 2540.38–47.
[32] Ex 85.
[33] Ex 85, p. 3.
[34] Ex 85, p. 3; Mr Macdonald: T 2545.17–2545.54. (Mr Shafron's evidence to the contrary should not be accepted: T 1716.3–38.)

> available to the Foundation … reflected the latest Trowbridge thinking on industry claim trends".[35]

That JHIL made its own decision concerning the use of recent claims data, rather than having relied upon a statement by Minty or Marshall as to its significance, is repeated under the heading, "The most up-do-date data":

> "[W]e 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".[36]

H. March 2002

24.34 The speaking notes prepared by Mr Shafron[37] on 15 March 2002, for a meeting with the Foundation representatives on 22 March 2002,[38] record Mr Shafron's proposed response to the Foundation's letter of 24 September 2001 which had directly complained that the most recent claims data had not been provided to Trowbridge. It was:

> "figures used were most recent clean numbers; the next 6 months numbers discussed but Trowbridge relaxed, we used latest Trowbride (sic) predictions which only came to light in November/December. Next 6 months were disclosed by Wayne".[39]

The phrase"… *next 6 months numbers discussed but Trowbridge relaxed*", would seem to refer to claims up to September 2000.[40] It is not consistent with a discussion with Trowbridge in January 2001 of the 9 months claim numbers up to December 2000. Certainly, if the words were meant to convey that the data itself had been discussed with Trowbridge, the note would be false.

I. October 2003

24.35 The letter from Mr Macdonald to Sir Llewellyn Edwards dated 8 October 2003,[41] which was most likely drafted by Mr Shafron,[42] contains a lengthy and

[35] Ex 85, p. 3.
[36] Ex 85, p. 4.
[37] Macdonald, T 2413.35–55.
[38] Ex 150, pp. 215–218.
[39] Ex 150, p. 215.
[40] Mr Macdonald: T 2543.57–2544.5.
[41] Ex 3, Vol 1, Tab 29, pp. 216–221.
[42] Mr Macdonald: T 2549.30–33.

elaborate response to the suggestion that the current data had been ignored in February 2001. However, it is striking that it does not contain the assertion made by Mr Macdonald in his evidence that JHIL "offered" updated claims data, but this was "declined" by Trowbridge[43], nor the assertion by Mr Shafron in his witness statement[44] that Minty or Marshall said they did not need the recent data for their report. Rather, it suggests that the scope of the data used was JHIL's decision:

> "Trowbridge was specifically instructed to use its most up to date research, the November research, when preparing its report for the incoming directors,"[45]

and

> "[t]here was nothing to suggest that an extra 9 months' data might cause a dramatic change in Trowbridge's estimates".[46]

24.36 The above analysis casts such doubt on Mr Shafron's account that I would not be prepared to act on it. In any event, the other contemporaneous evidence strongly supports Mr Minty's account, or least, a conclusion that Mr Shafron's decision to instruct Trowbridge to proceed without the current data was not caused or influenced by any statement by Minty or Marshall to the effect that the data would be immaterial.

24.37 In particular, Mr Attrill gave evidence that tends strongly to support Mr Minty's position. His evidence was that on 16 January 2001 he had a conversation with Mr Shafron as follows:

> PJS: "Well Wayne, as you know from yesterday's meeting the Trustees will require an updated Trowbridge report."
>
> WJA: "Okay, do you need a fresh data dump for Trowbridge?"
>
> PJS: "No, that is not necessary. We will run with the data from the March 2000 report, except that we will ask Trowbridge to update the future claim numbers having regard to their presentation in November. We are going to need the report pretty quickly. Can you call David Minty and see how long it's likely to take?"[47]

[43] Mr Macdonald: T 2296.21–22; T 2548.2–2549.2.
[44] Ex 17, para. 140.
[45] Ex 3, Vol 1, Tab 29, p. 218.
[46] Ex 3, Vol 1, Tab 29, p. 218.
[47] Ex 56, para. 105.

Mr Attrill said that he particularly recalled the request, as it was unusual.[48]

24.38 The conversation is significant because it sits ill with Mr Shafron's account of the conversation on 19 January. If Mr Shafron had on 16 January decided he wanted the report done by reference to March 2000 data it is difficult to see why he would raise the issue afresh on 19 January. At the very least it indicates that he had made up his mind on the data question before any discussion with Trowbridge about it.

24.39 I accept Mr Attrill's evidence of his conversation with Mr Shafron on 16 January. While Mr Shafron did not recall the conversation, he did not deny it.[49] More importantly it is corroborated by Mr Attrill's note of a conversation with Mr Minty on 16 January 2001 in which he records this statement:

> "Can run with data we have".[50]

Mr Attrill's evidence was that this was likely to have been Mr Minty's response to Mr Attrill saying words to this effect:

> "We need a report done quickly. Peter Shafron has asked whether you could do it on the following basis – run with the March 2000 data, [and] update with the work done by Watson and Hurst?"[51]

24.40 In addition Mr Minty's evidence is supported by evidence of his statements both before and after January 19, 2001. First, in an email to Mr Marshall on 4 December 2000 he recounted a conversation that morning with Mr Attrill:

> "He asked if we could put the revised projected numbers into the valuation model and let hom (sic) know the impact. I said I would not like to do that without also reviewing the proportion of claims that we ultimately expect them to incur as a proportion of total Australian numbers since the result would also be sensitive to that. I said it would be a largely proportional increase if only the underlying model numbers changed and nothing else."[52]

24.41 Mr Minty's record of this conversation is corroborated by Mr Attrill's email to Mr Shafron of 4 December 2000, which records Mr Minty saying that he "would want to look at the proportion of claims JHC actually receives (updated from

[48] T 1009 .6–17.
[49] T 1705.42–1707.24.
[50] Ex 57, Vol 4, p. 956.
[51] T 1133.53–1134.2.
[52] Minty, Ex 50, Tab 11.

31 March 2000) as compared to the new claim projections".[53] This evidence indicates that, as at December 2000, Mr Minty regarded it as preferable to have the next 6-9 months data for the purposes of updating James Hardie's assessment to account for the new insights deriving from Watson and Hurst's paper.

24.42 Mr Minty also gave evidence that "as a normal part of our work of this nature, we like to have information which is … as up-to-date as possible."[54] Mr Marshall confirmed this.[55] I regard the evidence as inherently likely to be correct. Moreover, the particular task Trowbridge was asked to undertake made a request for current data material. Part of the exercise was to "calibrate" James Hardie's experience to the chosen model.[56] For that purpose a current picture of the James Hardie's experience was necessary, in order to "fit" it to the picture Watson and Hurst derived from the national experience.[57] Indeed, it might affect the choice of an appropriate curve – Berry medium, or Berry high.[58] Mr Shafron understood this.[59]

24.43 It is also of some slight weight that when Mr Minty and Mr Marshall attended a meeting of the Board of Amaca on 6 August 2001 they informed the Board that a request for the most current claims data (as at January 2001) had been rejected by James Hardie.[60]

J. Views

24.44 I am satisfied that the current data was withheld by Mr Shafron from Trowbridge because of a decision on his part, a decision uninfluenced by any advice by Trowbridge that the data was not required or would be unlikely to make a difference to their analysis. I find that no such advice was given by Trowbridge.

24.45 I am satisfied that Mr Shafron's decision was motivated by his desire to ensure that the process of separation kept to the timetable on which JHIL

[53] Ex 57, Vol 4, p. 801.
[54] T 813.20–23.
[55] T 871.10–19.
[56] Marshall, T 882.7–23.
[57] Marshall, T 871.20–26.
[58] See Ex 57, Vol 4, p. 971; and Ex 3, Vol 3, Tab 6, p. 470.
[59] T1703–20 - 1704.34.
[60] Ex 7, MRCF 2, p. 9.

management had settled, even though that timetable was driven by public relations concerns rather than pressing commercial need. He was content to sacrifice the accuracy and reliability of the Trowbridge report to achieve that objective. A factor too, it seems to me, was that Mr Shafron suspected that the provision of the James Hardie current data might well produce a higher figure than would result from the application of the Watson and Hurst approach to the March 2000 figures.

K. The Purpose of the Report

24.46 JHIL was not oblivious to the possible significance of the precise purpose for which an actuarial report is prepared. Apparently without any prompting, Mr Ashe identified as one of the points that would be used to criticise JHIL's reliance on the 2000 Trowbridge Report in a separation context that:

> "The report was not prepared for the specific purpose of determining an amount to be put aside re, separation. Would their methodology or findings change if the purpose of the assessment was more specific to separation?[61]

That question was never asked of Trowbridge. Mr Attrill's view, noted on a copy of Mr Ashe's report,[62] was that for separation purposes the Trowbridge Report should be revised so that its aim was to produce robust estimates with as little uncertainty as possible[63] – again, something which never happened.

24.47 The subject came up again when Messrs Shafron Robb and Attrill first briefed Tillinghast, the new actuaries JHIL was retaining to "handle Minty".[64] At the meeting the first thing said (according to Attrill's note) was David Robb's explaining that JHIL wanted a report addressing a different purpose from that addressed by Trowbridge. The note reads (expanding the abbreviations):

> "New purpose. Differs from [Trowbridge]. [Trowbridge] asked to prepare reports [for the purposes of] litigation. Now want a report for directors to assess the liabilities [for the purposes of] a corporate reconstruction. Intended the report would be made public."[65]

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[61] Ex 61, Vol 4, Tab 33, p.161.

[62] Ex 61, Vol 4, Tab 33, p. 161. A copy of the report with Mr Attrill's notes is also one of the annexures to Mr Shafron's statement. Ex 75, Vol 5, Tab 53.

[63] T 1188.1–1189.15.

[64] Ex 61, Vol 4, Tab 28, p. 148.

[65] Ex 61, Vol 4, Tab 50, p. 324.

24.48 It is now clear that the answer to the question posed by Mr Ashe would have been affirmative, and that the differences in the resulting report and the assessment of liabilities would have been substantial. The evidence warrants a conclusion that JHIL's relevant officers, Mr Shafron and Mr Attrill, were aware that an actuarial report for a separation exercise would be different in content from the reports that had been obtained from Trowbridge and would or at least would be likely to, result in a more conservative (i.e. higher) estimate of liabilities.

24.49 According to Mr Wilkinson, as compared to the report done by Trowbridge or even his own retrospective estimates, a report used to define an adequate fund to be set aside to pay liabilities, or to assess the adequacy of such a fund:

(a) would adopt an estimate for costs at the higher and of the range of estimates, rather than a central estimate[66],

(b) would adopt a conservative (i.e. high) rate for superimposed inflation[67],

(c) would employ a risk-free (government bond) rate as a discount rate[68],

(d) would make some allowance in the estimate to provide a "buffer" to cater for possible new areas of exposure (e.g. remediation claims)[69],

(e) at least potentially, would make some further allowance for the prospect of the emergence of third wave claims not being sufficiently allowed for by existing data and exposure models[70],

(f) potentially, would make some further allowance for the risk of further increases in propensity to sue.[71]

In fact, the February 2001 report:

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[66] T 3397.48–3398.20.
[67] T 3398.21–27.
[68] T 3398.55–3399.25.
[69] T 3399.26–3400.27.
[70] T 3400.29–49.
[71] T 3402.20–32.

(a) adopted a central estimate for claim costs,

(b) made no allowance at all for superimposed inflation,

(c) employed commercial discount rates (7–9 per cent) whereas a risk free rate would have been about 5 per cent[72],

(d), (e), (f) made no allowance for new areas of liability, additional third wave claims or increases in propensity to sue.

24.50 The incoming directors were informed of the fact that the Trowbridge estimates did not allow for possible new areas of liability. And the February 2001 report mentioned the risk of an increase in propensity to sue. However, the incoming directors were not informed of James Hardie's internal assessment of the likelihood of new areas of liability emerging in fact, and the impact they would have if they did. This had been the subject of careful analysis by Mr Attrill, and in respect of some risks, senior counsel's advice had been obtained. The picture, generally, was not encouraging.[73]

24.51 The discount rates adopted in the February report were commercial rates, at Mr Shafron's request. As I have noted elsewhere, he wanted to see if the discount rate could be "improved", so that the assessed net present value of the liabilities would be lower.[74] Mr Attrill was aware that insurers regarded even the normal Trowbridge discount rates (about 6 per cent in February 2001) were too high, something he is likely to have told Mr Shafron.[75]

24.52 As for superimposed inflation, Mr Shafron was aware that Trowbridge had made no allowance for this, having read the 2000 Report, and indeed, attempted to influence its content so far as the sensitivity for superimposed inflation was concerned. The February 2001 Report, however, did not note that there was no such allowance, and did not include a sensitivity analysis.

[72] Ex 52.
[73] Ex 7, MRCF 1, Vol 1, Tab 5, pp. 64–66.
[74] T 1759.50–1760.37.
[75] T 1190.20–49; Ex 61, Vol 4, Tab 33, p. 167.

24.53 Mr Shafron was also aware from Mr Williams's letter of 23 June 2000[76] that his lawyers regarded the failure to allow for superimposed inflation as "excessively optimistic". This is the same letter that Mr Robb asked several times to be passed on to Trowbridge, as to which he received no satisfactory response.[77]

24.54 Mr Attrill made a similar point in his review of Mr Ashe's comments on the 2000 Report. Mr Ashe refers to Trowbridge's statement that its estimates are based on a continuation of the current environment as regards legal principles and settlement practices. Mr Attrill wrote adjacent to this:

> "Need to make allowance for trends/likely developments."[78]

Mr Attrill's evidence about this was that he was conscious at the time that there were several areas in which Trowbridge did not make allowance for trends or likely developments which could have a negative impact on James Hardie, and that if a report were to be done for the purpose of assessing the adequacy of a fund to be set aside to meet future liabilities, an allowance would have to be made for this.[79]

24.55 If Mr Attrill appreciated this, it is likely Mr Shafron did as well. In any event, Mr Attrill's notes suggest that his observations were discussed among the team working on Project Green.[80]

24.56 What emerges is that when the time came to effect separation, JHIL and Mr Shafron failed to ask the first logical question – what actuarial advice do we need for a separation exercise? It failed to address the question despite Mr Ashe having flagged it a few months before. It failed even to inform Trowbridge until after the report was done of the purpose for which it would be used. These serious errors were then compounded by issuing instructions for the report to be done using high discount rates so as to bring the estimate down, and by not asking Trowbridge to include an appropriate allowance for superimposed inflation, despite being conscious that this was a problem.

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[76] Ex 61, Vol 4, Tab 13, pp. 103–105.
[77] Ex 332, para. 20.
[78] Ex 61, Vol 4, Tab 33, p. 162.
[79] T 1189.48–1190.7.
[80] T 1190.12–49.

L. Best Estimate

24.57 The significance of the purpose of an actuarial report is closely connected with the meaning of a "best estimate". More conservative allowances of the kind Mr Wilkinson would have proposed for a report directed as assessing the adequacy of a closed fund would have resulted in an estimate that was not a "best estimate" in the sense of a central estimate, with a 50 per cent chance of achievement, but an estimate with a significantly higher prospect of being achieved in reality.

24.58 The Trowbridge reports were quite uninformative, even misleading, as to what they meant by their "most likely" or "best estimates".[81] And Mr Shafron denied any appreciation that their estimates had only a 50 per cent probability of achievement.[82]

24.59 However, there is reason to conclude that Mr Shafron either did appreciate that, or ought to have.

24.60 On 7 December 2000 he met with Mr Harman and two others to discuss accounting questions. Mr Harman described the purpose of the meeting in an earlier email:[83]

> "From: Stephen Harman...
>
> Sent: ...December 05, 2000...
>
> ...
>
> A brief note to confirm that the four of us will be meeting at 8:30am this Thursday in James Hardie's offices.
>
> The purpose of the meeting is to confirm our joint understanding of the accounting treatment, and establish the required asbestos loss contingency disclosures in:
>
> (g) any US GAAP financials of JHINV
>
> (h) any 20-F document (especially risk factor section, business section, MD&A section)
>
> …

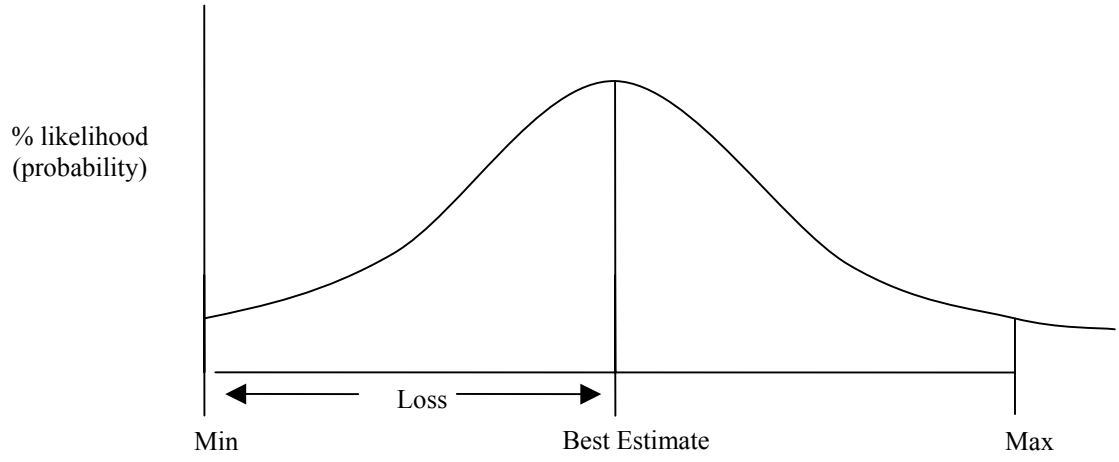
[81] See, e.g. the 2000 Report, Ex 2, Vol 4, Tab 14, p 847.
[82] Ex 309, para. 33(h).
[83] Ex 61, Vol 5, Tab 34.

> The smart money would currently be betting that the trust will get up …For Completeness, it would be useful to consider the disclosures under other two situations, if only to confirm that these are unattractive options."

24.61 Mr Shafron's notes of the meeting[84] reveal that there was detailed discussion of the operation of US accounting standards as regards estimating liabilities such as future asbestos claims. He even reproduced a graph which describes exactly what is meant by a best estimate. It is to this effect[85]:

[84] Ex 61, Vol 4, Tab 14.
[85] Ex 61, Vol 4, Tab 14, p. 109.

Best Estimate under FAS 5[86]



24.62 Mr Shafron says he did not "connect" what was discussed on this occasion with Trowbridge's use of "best estimate".[87]

24.63 This lack of comprehension is difficult to reconcile with the fact that Mr Shafron does not seem to have questioned anyone as to the meaning of the phrase "best estimate", despite dealing with Trowbridge in respect of three actuarial reports over as many years. The discussions at the meeting he attended with Tillinghast on 23 August 2000 must also be taken into account. Mr Attrill's notes record[88] the following statements by the actuaries:

> "DF: I'm more comfortable with a range, rather than a number. I'd be very edgy about picking a best estimate. That is not within actuarial capabilities.
>
> VB: In Aust., we tend to be asked to give a central estimate.
>
> DF: Actuarial standard says central estimate is usually required.
>
> VB: This study would go outside the actuarial standard.
>
> DF: This is not an appropriate context to produce a central estimate."

24.64 The point of the meeting with Tillinghast was to find means of increasing the certainty and defensibility of the actuarial projections of James Hardies liabilities. In the context of such a discussion it would be odd if Mr Shafron did not question the

[86] FAS 5 is a US accounting standard dealing with accounting for contingencies. See Ex 265.
[87] T 1779.36-1781.18; Ex 309, para. 33(h).

meaning of a "central" or "best" estimate if he was not already confident of his understanding. The actuaries were clearly treating them as terms of art.

M. The perceived limits of the Trowbridge reports

24.65 In this context it is appropriate to mention the significant body of evidence that indicates that the critical officers of JHIL, and Mr Shafron and Mr Macdonald in particular, did not regard the estimates in the Trowbridge Reports as reliable. Most of it has been referred to already in other Chapters. It is sufficient here to provide a summary:

(i) Mr Ashe's review, referred to above.

(j) Mr Williams' commentary on the 2000 Report, referred to above.

(k) The commentary on the 2000 Report in the August 2000 Project Green board presentation[89].

(l) Mr Shafron's memo to Mr Macdonald of 11 October 2000, justifying non-disclosure of the Trowbridge estimate on the grounds that it was "very imperfect… based on very uncertain epidemiological models and very uncertain predictions"[90].

(m) Mr Peter Cameron's e-mail to Mr Shafron of the same subject, comparing the 2000 Report to "information which is so speculative as to be potentially misleading"[91].

(n) The emphasis on the uncertainty of the projections in the "Q & A's" reviewed by Mr Macdonald, Mr Shafron and others in January ("the Directors are still of the view that James Hardie cannot reliably measure the liability"; No one "knows the future extent of" the asbestos-related liability, "nor is there any way to find out; "James

[88] Ex 61, Vol 4, Tab 50, p 325.
[89] Ex 148, Vol 1, Tab 1.
[90] Ex 224, Vol 1, Tab 13, p. 184.
[91] Ex 224, Vol 1, Tab 14, p. 186.

Hardie cannot make a determination as to the adequacy of funding"[92]).

(o) The similar emphasis on uncertainty in the draft Q & A materials in the January 2001 board papers[93] and the February 2001 board papers. ("We have learned that actuarial advice is not a reliable basis for assessing these kinds of liabilities"[94]).

(p) The statements in the January Board paper on separation justifying not providing additional funds to satisfy the liabilities (a position Mr Macdonald supported[95]) on the ground that "there is no reliable basis for determining what [the] amount …should be if attempting to fund all future claims. Previous indicative advice … has been quite variable and unreliable."[96]

(q) Mr Shafron's email comment to Mr Robb: "My point on T is really code for 'the thing is not that defensible'!"[97]

(r) Mr Shafron's email comment to Mr Williams: "Our approach to Trowbridge so far and going forward is not to rely too heavily on it. It is limited as you and I both know."[98]

N. A specific deficiency: mesothelioma claims had not levelled.

24.66 The significance of the general limitations of the Trowbridge Reports and of the fact that the February 2001 Report was not based on current data should have been reinforced in the minds of Mr Shafron, Mr Attrill and Mr Macdonald by two related circumstances.

24.67 The first was that the current (April to December 2000) data revealed a significant deterioration in James Hardie's claims experience. Of course, it was *possible* that this deterioration was merely an aberration. But it was equally possible

[92] Ex 61, Vol 5, Tab 43, pp. 185, and 187, 189.
[93] Ex 80, Tab 3, pp. 42, 43, 45. See also p 11.
[94] Ex 80, Tab 6, p. 111, also see pp 110 and 115.
[95] Ex 148, para. 32.
[96] Ex 80, Tab 3, p. 18, also see p.17.
[97] Ex 194, 27 March 2001.
[98] Ex 209, 8 March 2001.

that it was not, and if it was not, it was almost inevitable that the February 2001 report would be wrong.

24.68 The second point is, in effect, a particular aspect of the first. One of the key assumptions underlying the Trowbridge 2000 Report was that James Hardie mesothelioma events and claims had levelled (i.e. had reached their peak). The assumption was explicit in the report[99], and was highlighted in the August 2000 JHIL board presentation on Project Green.[100] It was restated by Mr Minty on 19 January 2001.[101] The current data suggested that the assumption may have been wrong (as indeed it was).

24.69 The propositions in the last paragraph need some elaboration, but in my opinion the evidence warrants a conclusion that JHIL's use of the Trowbridge February 2001 Report was, on the most favourable construction, careless in the extreme. I find it difficult to believe that Mr Shafron and Mr Macdonald could have had any faith in the Report as a useful tool for assessing the likely life of the Foundation, either so far as the JHIL Board or the incoming directors or outgoing directors of Coy and Jsekarb were concerned.

O. The current data disclosed a deterioration

24.70 Some of the principal information in this regard appears in Mr Attrill's Operations Plan Review for the half year to 30 September 1996. This is discussed in detail in Chapter 18. The contents of it were discussed among the management team (including Messrs Macdonald, Shafron and Morley) on 13 December 2000. Project Green was also discussed.[102]

24.71 There was other evidence, however, which confirmed the picture of deterioration.

(a) On 9 January 2001 Ms Burtmanis, who reported to Mr Attrill, sent him a "Summary of JH Litigation Trends, YEM99, YEM00 and

[99] Ex 2, Vol 4, Tab 14, pp. 864-5.
[100] Ex 148, Vol 1, Tab 1, pp. 5–6.
[101] Ex 57, Vol 4, p. 971.
[102] Ex 61, Vol 5, Tab 13 (Attrill's note).

4Q01."[103] The report refers to a "[g]eneral increase in asbestos claim numbers across the board"; "[a] noticeable increase in the number of mesothelioma and lung cancer cases"; and that "[t]he average cost to JH of each claim is increasing over time". Mr Shafron had no specific recollection of seeing the report[104], but given his responsibilities, including submitting a report to the Board on asbestos litigation, he must have at least become aware of the information it contained in the period prior to 15 February 2001.

(b) On 25 January 2001, Mr Harman sent to Messrs Macdonald, Shafron and Morley a summary of JHIL's reported asbestos costs, restated to provide a consistent basis of presentation.[105] It showed:

YEM1997	$15.2m
YEM 1998	$18.8m
YEM 1999	$18.7m
YEM 2000	$20.3m
3Q 2001	$20.0m

This summary reveals, allowing for the "plateau" over 1998 and 1999, a pattern of year on year increases, apparently accelerating in the current year, which was then expected to have a result, over four quarters, in excess of $30m.

(c) On 31 January 2001 Mr Macdonald sent an e-mail to the Project Green team with a section headed "Asbestos":

> "3. Asbestos. We have reviewed the graph below and had harboured some hope that Q4 would be significantly lower in cost, demonstrating what an outlier Q3 was. An early look at January shows costs of $3M – and we should presume that February and March (in the absence of other information) will be at a similar level. Should we proceed

[103] Ex 65.
[104] T 1747.6–8.
[105] Ex 148, Tab 18.

with the Foundation, costs in the JHIL accounts would cease as of the date that the Foundation was formed."[106]

It is likely that the graph is one of those appended to the next day's Asbestos Board paper.

(d) That Board paper[107], dated 1 February 2001 and attributed to Mr Attrill and Mr Shafron, has graphs for claim numbers and claim costs on a monthly basis. They are not all that easy to interpret, but they show clearly enough that the current year was much worse than previous years on both measures.

(e) Monthly tables headed "Asbestos litigation costs – Australia" were prepared by Mr Morley's section. The December 2000 table (dated 10 January 2001)[108] reveals:

- an increase in total costs (year to date) from $18.2m to $26.8m;
- an increase in claims settled (year to date) from 85 to 131;
- an increase in claims opened (year to date) from 116 to 236.

24.72 This was a very bleak picture. It is clear Mr Attrill was aware of it, and he thought it likely he would have sent it to Mr Shafron in the ordinary course.[109] Mr Shafron said he was "not sure" that such documents were still being sent to him as a matter of course in December 2000[110]. However, there is in evidence an email dated 10 January 2001 sending it to him and Mr Morley[111].

24.73 Mr Shafron and Mr Macdonald made a number of points in attempting to evade the impact of this evidence. One was to say that they expected that the deterioration in James Hardie's experience over the current year to be allowed for by the Trowbridge update using the insights of Watson & Hurst[112]. This was illogical. Watson & Hurst dealt with national data, and it was quite possible that James

[106] Ex 75, Vol 7, Tab 110, p. 2607.
[107] Ex 148, Vol 1, Tab 21.
[108] Ex 7, MRCF 1, Vol 2, Tab 36, p. 395. See T 1153.7–1154.20.
[109] T 1153.7–1154.20.
[110] T 1422.6–1423.23.
[111] Ex 57, Vol 4, pp. 904–906.
[112] Shafron, T 1751.12–1752.29.

Hardie's experience would be different as indeed Mr Macdonald wrote in a letter in February 2001 to a journalist[113]. More importantly, Mr Minty had made it plain to JHIL (and the information was passed to both Mr Shafron and Mr Macdonald) that for the purposes of the update he would want to look at the proportion of claims James Hardie received, updated from March 2000.[114]

24.74 Mr Macdonald was fond of saying that he believed that volatility, and in particular, a couple of quarters of data, wouldn't change a long-term trend[115]. He and Mr Shafron said, to similar effect, that James Hardie had good years and bad years, a spike one year would be followed by a trough the next.[116] None of this is consistent with the data they had. In particular, Mr Harman's summary of costs over the 1997-2001 period showed that the "trend" was of constant deterioration, and peaks were not followed by troughs[117]. The same document undermines Mr Macdonald's and Mr Shafron's resort to the proposition that they focussed on amounts paid, when confronted with information concerning claim numbers.[118] And so far as "trends" are concerned, Mr Shafron is undone by his own statement in November 2001 that reference to the data made available on 15 January 2001 showed "an upward trend in total damages payouts, a trend that appears to have commenced in 1999."[119]

24.75 Mr Shafron and Mr Macdonald said of the numerous statements emphasising that asbestos liabilities were not capable of reliable measurement that this language was referable to accounting standards, and was used "so as not to pre-empt the company's considered decision as to how to account for those liabilities"[120].

24.76 A difficulty with this explanation is that expressions of this kind occur in a range of contexts, most of them not concerned with the formal requirements of accounting standards. The statement, of which Mr Macdonald must have approved, in the January 2001 Board papers, that no additional funds should be provided because, inter alia, there is "no reliable basis" for determining an amount to fund all

[113] Ex 61, Vol 6, Tab 21, p. 108.
[114] Ex 57, Vol 4, p. 801.
[115] T 2592.38–46, 2595.50–2596.45.
[116] Shafron, T 1745.12–26. Macdonald, Ex 308, para. 33.
[117] Ex 75, Vol 7, Tab 109.
[118] Shafron, T 1743.40–1744.5; Macdonald, T 2586.36-41, 2587.26-.28.
[119] Ex 85, p. 3.
[120] Ex 308, para. 38. Ex 309, paras 26–27.

claims, and previous advice had been "quite variable and unreliable" is a case in point.[121]

24.77 The last mentioned statement in irreconcilable with another of Mr Macdonald's attempts to justify his conduct, viz. his evidence that his belief as to the suitability of the Trowbridge report was strengthened by the consistency of Trowbridge's estimates.[122]

24.78 Mr Shafron's explanation of the evidence was that his belief was that the Trowbridge estimate was uncertain, but no more than any actuarial report.[123] I do not accept that evidence.

24.79 In considering Mr Shafron's responses on this topic it is necessary to keep in mind that he was prepared to be deceitful where asbestos was concerned. In cross-examination, he admitted telling the incoming directors that the latest complete actuarial report JHIL had obtained was the 1998 report, when he was conscious that this was, in substance, false and would mislead the incoming directors.[124] He also ensured that the February 2001 report bore on its face claims for legal professional privilege that he knew could not honestly be made.[125] In addition, I do not think he could have honestly said to Mr Minty that the current data did not show anything different from what Trowbridge had projected.[126]

P. Consequences

24.80 I have not found it necessary in this context to deal with every possible basis on which JHIL's conduct in using the Trowbridge Report can be criticised.[127] The evidence discussed so far makes it, to my mind, absolutely clear that JHIL, in permitting the incoming directors and outgoing directors to rely on the Trowbridge Report, engaged in conduct that was misleading or deceptive in contravention of s 52 of the *Trade Practices Act*, because that report was wholly unsuitable to be used for

[121] Ex 148, Vol 1, Tab 5, pp. 95–96.
[122] Ex 308, para. 32.
[123] Ex 309, paras 27–29.
[124] T 1728.20–1729.2.
[125] T 1730.19–1731.36.
[126] See Ex 121, para. 203; Ex 50, para. 31.
[127] Eg. Mr Shafron's possible appreciation of the significance of a "best estimate", and his failure to give the 2000 Trowbridge Report to the incoming directors.

the purposes of assessing the likely life of the Foundation, and JHIL had no reasonable basis for implying that it was. For the same reason, Mr Shafron and Mr Macdonald have personally contravened s 42 of the *Fair Trading Act 1987* (NSW).

24.81 It is not necessary to consider any other potential causes of action. They would be unlikely to lead to any more advantageous remedy.

24.82 In so far as Mr Macdonald and Mr Shafron are concerned, in my view they breached their duties as officers of JHIL by encouraging the Board to act on the Trowbridge Report in forming a view that the Foundation would be "fully funded".

24.83 It is not clear, however, that valuable relief would be available to Amaca and Amaba on the basis of the contravention of the *Trade Practices Act* and the *Fair Trading Act* to which I have referred. The companies may have difficulty establishing a claim based on reliance by the outgoing directors, given Mr Morley's knowledge of many of the matters which tend to indicate the limitations of the Trowbridge Report, and the fact that neither he nor Mr Cameron bothered to read it. They could perhaps establish a claim based on reliance by the incoming directors, by analogy with the reasoning in *Janssen-Cilag v Pfizer Pty Ltd* (1992) 37 FCR 526. That might lead to orders under s 87 of the *Trade Practices Act* having the effect of undoing the separation.

24.84 However, Amaba and Amaca, as subsidiaries of ABN 60, would not be in a substantially better position than they are now. There might be a material improvement if they could, in *addition*, establish a claim for damages for the loss of the opportunity to pursue ABN 60 for claims arising from the transactions prior to 1999 that are discussed in relation to Term of Reference 3. However, such claims, even if established, would have no value unless ABN 60 could itself establish claims against third parties that would put it in funds to satisfy those liabilities. In practical terms, that means a claim of some kind against JHI NV in respect of the cancellation of the partly paid shares.

24.85 In short, before Amaba and Amaca could increase their funds by resort to litigation there would be many hurdles to overcome. Probably too many.

Chapter 25 – The 2001 Scheme Of Arrangement

A. Introduction

25.1 The next stage in the reconstitution of the James Hardie Group began formally when on 10 August 2001 JHIL applied to the Equity Division of the Supreme Court of New South Wales for orders convening meetings of the holders of its fully paid ordinary shares, approving an explanatory statement, and ultimately approving the scheme of arrangement proposed.[1]

25.2 "Schemes of arrangement", in relevant respects, are provided for by s 411 and s 412 of the *Corporations Act 2001*.[2]

25.3 The statutory provisions for schemes of arrangement contemplate the involvement of courts at two stages:

(a) in relation to calling meetings and approving an explanatory statement; and

(b) ultimately, in approving the scheme.

25.4 At the heart of the scheme proposed by JHIL was the notion that its shareholders would become instead the holders of shares in a Dutch company James Hardie Industries NV ("JHI NV"). JHI NV would then hold the shares in JH NV, which held the main operating assets. A "before and after" broad indication of the position is as set out in the Information Memorandum:[3]

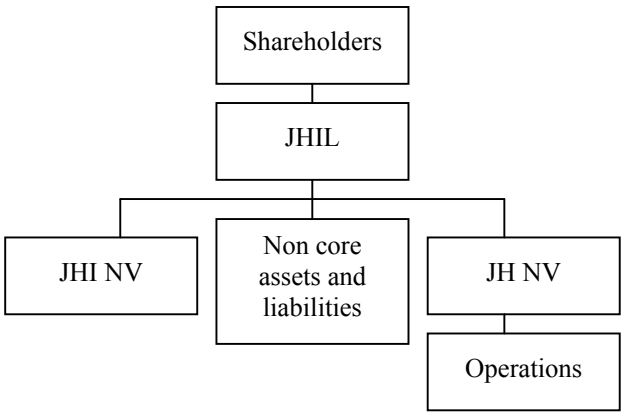
> "Simplified corporate structures before and after the Proposal is implemented are set out below:

[1] Supreme Court documents, Ex 278, Vol 1, Tab 1, p. 1.

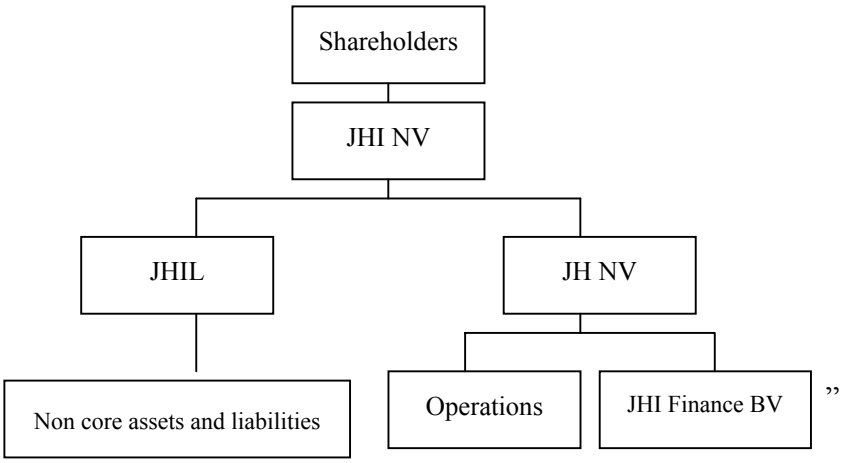
[2] On 15 July 2001 the *Corporations Act 2001* came into force as a law of the Commonwealth. It contained, as had the previous *Corporations Laws* of the States, provision for making compromises and arrangements between companies and their creditors, and between companies and the members.

[3] Ex 278, Vol 1, Tab 2, p. 33.

Before



After



”

25.5 Of course, those were not the only aspects of the Scheme. Thus Mr Donald Cameron, then JHIL's Treasurer and Company Secretary, in the principal affidavit in support of the application, set out the main features of the Scheme and the resultant reduction of capital as being that:[4]

> “(a) all members of JHIL whose address in the register of members was in Australia, New Zealand, the United Kingdom or the United States would receive an interest in shares in James Hardie Industries N.V. (“*JHI NV*”) in exchange for their shares in JHIL. The interest in JHI NV will be held in the form of CHESS Units of Foreign Securities (“*CUFS*”) to allow trading on the ASX;

[4] Ex 278, Vol 1, Tab 2, para. 14, pp. 5–6.

(b) all other members of JHIL would receive the cash proceeds from the sale of their entitlement to interests in JHI NV;[5]

(c) JHIL would become a wholly owned subsidiary of JHI NV;

(d) JHIL would transfer all its shares in JH NV, which was the owner of the operating businesses and assets of JHIL and its controlled entities, to JHI NV at market value (based on the market value of the James Hardie Group as at the record date for the Scheme);

(e) JHIL would declare and pay a dividend to JHI NV and would effect a reduction of capital pursuant to Part 2J.1 of the *Corporations Act* in respect of all its shares then held by its new parent, JHI NV, under which $775,326,261.04, or $1.72 per share, would thus be distributed to JHI NV. The reduction would be conditional on JHI NV subscribing for partly paid shares, and will be effected without cancelling any shares; and

(f) JHI NV will subscribe for partly paid shares in JHIL. Under the terms of issue of the partly paid shares, JHIL will be able to call upon JHI NV to pay any or all of the remainder of the issue price of the partly paid shares at any time in the future and from time to time. The callable amount under the partly paid shares would be equal to the market value of the James Hardie Group as at the Scheme Record Date less the subscription monies already paid up."

25.6 Mr Cameron also deposed that the directors of JHIL had resolved to approve the Scheme for reasons including:[6]

"(a) the Scheme will result in less tax being payable on international earnings, in particular by reducing US withholding tax;

(b) the Scheme will result in less corporate tax being payable in respect of group financing arrangements;

(c) the Scheme will create a structure that will be more appealing to international investors; and

(d) Grant Samuel and Associates Pty Limited, who were commissioned to complete an independent report on the Scheme (a copy of which is contained in the Information Memorandum), concluded that it is in the best interests of, and is fair and reasonable to, the Plaintiff's members."

25.7 The reasons were put more directly by Grant Samuel, retained as independent expert in support of the proposal, in the Summary of Opinion and the first of their "Key Conclusions" in their report of 10 August 2001:[7]

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[5] This was a small group of approximately 100 members with a combined holding of approximately 0.1% of JHIL's issued capital.

[6] Ex 278, Vol 1, Tab 2, para. 17, p. 6.

[7] Mr Wilson's affidavit, Ex 278, Vol 1, pp. 261–262.

"2 Summary of Opinion

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

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

3 Key Conclusions

- The increasing tax inefficiencies of the current structure of the James Hardie Group mean there is a need to restructure.

  The Australian and United States tax systems have an adverse impact on net returns to shareholders in James Hardie Industries under the present corporate structure:

  ⇒ The vast majority of income is earned in the United States where the standard corporate tax rate is 35% but, when other taxes are included (eg state taxes), the effective rate increases to almost 40%. The James Hardie Group's reported tax rate in the year ended 31 March 2001 was 23% but this rate would be 41% when adjusted for certain temporary financing measures which are not sustainable;

  ⇒ James Hardie Industries and its Australian subsidiaries have substantial carried forward tax losses which will eliminate tax payable in Australia for at least five years. Accordingly, dividends are likely to be unfranked for at least this period (in the absence of changes to tax laws or failure to meet the "continuity" tests); and

  ⇒ James Hardie Industries need to remit cash to Australia to fund dividend payments. Aggregate dividends substantially exceed after tax cash flows generated in Australia. In future, this cash will largely need to be remitted by way of dividend from offshore operations. Dividends paid out of the United States to Australia incur 15% withholding tax. The withholding tax cannot be offset against Australian income tax as dividend income from the United States is exempt income. As a result, the company's overall effective tax rate will increase to between 45% and 50%, depending on the level of internal dividends and various other factors (the pro forma accounts for the year ended 31 March 2001 show 48% when adjusted for United States withholding tax). This problem is

expected to begin to arise in the 2001/02 financial year and fully impact the following year.

Additionally, neither the United States corporate tax or withholding tax payments generate franking benefits in Australia, resulting in an effective tax rate on James Hardie Industries' United States income for Australian individual shareholders potentially up to 74% (if all income is paid out as dividends):

James Hardie Industries – Net returns to Australian shareholders	
US pre tax earnings	10.00
US corporate tax	(4.00)
US post tax earnings (paid as dividend)	6.00
Internal withholding tax (15%)	(0.90)
Distributable profits paid as dividend (unfranked)	5.10
Personal tax (48.5%)	(2.47)
Net return to Australian individual shareholder	2.63

The inefficiency is clear when it is considered that the net return to an Australian shareholder out of a similar level of Australian sourced earnings would be almost twice as high at $5.15.

These factors mean that a "do nothing" approach would ultimately have negative consequences for shareholder value. The problems are not reduced or mitigated by the sale of the US gypsum business. In short, there is a need to restructure to protect, if not enhance, shareholder returns.

- The proposed restructure is far more tax efficient

  The proposed restructure has two significant tax related benefits for the James Hardie Group:

- the effective corporate tax rate is reduced through the establishment of a financing vehicle in The Netherlands; and

- there will no longer be any requirement to remit cash from the United States to Australia (within the group) and incur the 15% withholding tax.

JHI NV will establish a Dutch finance subsidiary, James Hardie International Finance BV, which will lend funds to the group's operating subsidiaries. The effective tax shelter from the interest deductions claimed by the operating subsidiaries will be at rates between 30% and 40% depending on the country from which they are made, while the tax payable by James Hardie International Finance BV on its income will be only 15% because of the applicability of the Dutch Financial Risk Reserve ("FRR") regime. This structure therefore lowers the overall average tax rate.

In addition, as JHI NV will be listed on the NYSE and assuming it meets certain other conditions, there is no withholding tax on interest paid from the United States to The Netherlands and only 5% on dividends. The expected internal interest payments will largely meet the cash needs of JHI NV to pay dividends to shareholders.

…

> On a pro forma basis, tax expense is reduced by $31 million per annum and net cash flow is increased by an equivalent amount. The effective tax rate falls from 48% to 27% and earnings per share increases by 38%. A tax rate in the order of 27% is believed to be sustainable in the longer term. This level of benefits will continue to apply, even if the US gypsum business is sold. …"

25.8 The proposed scheme was to be implemented by steps whereby:

(a) shareholders in JHIL became shareholders in JHI NV in lieu;

(b) JHI NV became the only shareholder in JHIL;

(c) JHIL reduced its capital by passing its funds to JHI NV, and paid a dividend to JHI NV

(d) JHIL sold its shares in JH NV to JHI NV. No money actually changed hands. The purchase price was treated as a loan by JHIL to JHI NV, which was satisfied from the dividends/payment in reduction of capital to be made by JHIL to JHI NV.

25.9 The proposed scheme is of interest for two presently relevant purposes:

(a) It was a significant step on the way to cutting JHIL adrift from the James Hardie Group; and

(b) because of the position as to the partly paid shares to be issued by JHIL to JHI NV.

B. Relevant statutory provisions

25.10 The scheme of arrangement proposed was one between a company and its members and the first stage in such a scheme is provided for by s 411(1) of the *Corporations Act*:

> "(1) Where a compromise or arrangement is proposed … between a Part 5.1 body and its members … the Court may, on the application in a summary way of the body … order a meeting or meetings … of the members of the body … to be convened in such manner, and to beheld in such place or places … as the Court directs and, where the Court makes such an order, the Court may approve the explanatory statement required by paragraph 412(1)(a) to accompany notices of the meeting or meetings."

JHIL was a "Part 5.1 body".[8]

[8] See the definition in s 9.

25.11 As is apparent from s 411(1), at the initial stage the Court has three issues to determine:

(a) whether to direct a meeting or meetings of members of the company; and

(b) if so, to give directions as to the convening of such meetings; and

(c) to consider whether to approve the explanatory statement which is to accompany the notice of meeting.

25.12 The requirement for an explanatory statement is in s 412(1), which provides:

> "(1) Where a meeting is convened under section 411, the body must:
>
> (a) with every notice convening the meeting that is sent to a … member, send a statement (in this section called the explanatory statement):
>
> (i) explaining the effect of the compromise or arrangement and in particular, stating any material interests of the directors, whether as directors, as members or creditors of the body or otherwise, and the effect on those interests of the compromise or arrangement in so far as that effect is different from the effect on the like interests of other persons; and
>
> (ii) setting out such information as is prescribed and any other information that is material to the making of a decision by a … member whether or not to agree to the compromise or arrangement, being information that is within the knowledge of the directors and has not previously been disclosed to the … members; and
>
> (b) in every notice convening the meeting that is given by advertisement, include either a copy of the explanatory statement or a notification of the place at which and the manner in which … members entitled to attend the meeting may obtain copies of the explanatory statement."

25.13 The Court's power to make an order under s 411(1) is not to be exercised unless ASIC has been notified of the application and has had the opportunity to make submissions to the Court in relation to the proposed compromise or arrangement and the draft explanatory statement: s 411(2).

25.14 The second part of the Court's role derives from s 411(4). It provides that:

> "(4) A compromise or arrangement is binding … on the members .. of the body and on the body … if, and only if:

(a) at a meeting convened in accordance with an order of the Court under subsection (1) :

…

(iii) in the case of a compromise or arrangement between a body and its members or a class of members – a resolution in favour of the compromise or arrangement is:

(A) passed by a majority in number of the members, or members in that class, present and voting (either in person or by proxy); and

(B) if the body has a share capital – passed by 75% of the votes cast on the resolution; and

(d) it is approved by order of the Court."

25.15 The approval contemplated by s 411(4) may be given by the Court "subject to such alterations or conditions as it thinks just": s 411(6).

C. Proceedings in the Supreme Court of New South Wales

25.16 The proceedings first came before Santow J on 10 August 2001.[9] The draft Explanatory Statement then before him contained the following in connection with the proposed partly paid shares:[10]

> "2.3 The corporate restructuring
>
> The restructuring, if implemented, will occur by means of a New South Wales Supreme Court approved Scheme of Arrangement pursuant to the *Corporations Act 2001*.
>
> JHIL will become a wholly owned subsidiary of JHI NV as a result of the Scheme. On implementation of the Scheme, ownership of JHNV, which owns the operating assets of James Hardie, will be transferred from JHIL to JHI NV at market value (based on the market capitalisation of the James Hardie Group as at the Scheme Record Date) in order to ensure that JHI NV has direct access to the profits of its operating and financing subsidiaries thereby achieving withholding tax savings on internal dividends.
>
> Following the transfer of JHNV, JHIL will declare and pay a dividend to JHI NV, and will effect a capital reduction pursuant to Part 2J.1 of the *Corporations Act 2001* in respect of all its shares then held by its new parent, JHI NV. The reduction will be conditional on JHI NV subscribing for partly paid shares, and will be effected without cancelling any shares.
>
> Under the terms of issue of the partly paid shares, JHIL will be able to call upon JHI NV to pay any or all of the remainder of the issue price of the partly paid

[9] Supreme Court materials, Ex 278, Vol 5.
[10] Supreme Court materials, Ex 278, Vol 2, p. 44.

> shares at any time in the future and from time to time. The terms of issue of the partly paid shares are set out in Annexure 2 of the Implementation Deed at Part C of this Information Memorandum.
>
> 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.
>
> Further details of the corporate restructuring are set out in the Implementation Deed which forms Part C of this Information Memorandum.
>
> Following the structural steps described above, JHI NV will establish one of the existing Dutch subsidiaries in the group, James Hardie International Finance BV (JHI Finance BV), as the group finance company. It will operate under the provisions of the Dutch Financial Risk Reserve (FRR) regime, and will finance James Hardie's operations. JHI finance BV will be funded by equity contributions from within the Group and by borrowings under the Group's existing bank facilities."

25.17 The words quoted make it clear that JHIL had an option to call on the holder of the partly paid shares (which would be JHI NV):

> " …to pay all or any of the remainder of the issue price of the partly paid shares at any time in the future and from time to time."

There were to be 100,000 partly paid shares, issued at $50 each but each carrying a liability on the part of JHI NV to pay a much larger sum if called upon to do so by JHIL.

25.18 The sum which might be called was calculated[11] in accordance with the formula in Annexure 2 to the Implementation Deed, i.e. the last recorded sale price of a JHI NV share trading on a deferred settlement basis five days after the Scheme came into effect on the ASX, multiplied by 450,771,082. This was a sum likely to be of the order of $1.9 billion.

25.19 The role which the partly paid shares might play was adverted to on a number of occasions in connection with the hearings before Santow J.

25.20 On 9 August 2001 the Judge's Associate was sent a letter from Allens Arthur Robinson stating:[12]

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[11] Ex 278, Vol 2, p. 89, Annexure 2 to the Implementation Deed.
[12] Ex 278, Vol 3, Tab 19, p. 53.

" … The purpose of this letter is to set out the principal elements of the proposed restructuring and to highlight for His Honour's attention any significant aspects of this transaction with a view to drawing out the disclosure in the Information Memorandum in relation to those aspects.

1 …

(b) The Restructuring

Pursuant to the proposed Implementation Deed (which is set out in Part C of the Information Memorandum), JHIL and JHI NV will be required to undertake a number of other restructuring steps in conjunction with the Scheme in addition to proposing it and enabling the transactions discussed under section (a) above to be effected. Principally, the following steps are to be contemplated and are described in Part B, Section 2 of the Information Memorandum.

...

(iii) Issue of Partly Paid Shares

The reduction of capital will be conditional upon JHI NV subscribing for partly paid shares in JHIL. A total of 100,000 partly paid shares will be issued by JHIL, at a total issue price equal to the market value of the James Hardie Group as at the Scheme Record Date. The subscription price for the partly paid shares will be $50 per share, or a total of $5 million, which JHI NV will be required to pay on subscription.

JHIL will be entitled to call upon JHI NV to pay any or all of the remainder of the issue price of the partly paid shares at any time in the future and from time to time.

The terms of issue of the partly paid shares are set out in more detail in Annexure 2 of the Implementation Deed at Part C of the Information Memorandum.

...

2. Novel features of the Restructuring

Certain unusual features of the Scheme have arisen. We discuss below what we regard as those features.

...

(e) Partly Paid Shares

We discuss at Section 1(b)(iii) above the issue of partly paid shares by JHIL. The partly paid shares are to be issued by JHIL to ensure it has access to funding going forward to meet any potential liabilities. The issuing of the partly paid shares will ensure that, notwithstanding the transfer by JHIL to JHI NV of its principal operating assets, which are owned by JHNV, its net worth will remain essentially the same following implementation of the transaction.

> The partly paid shares are regarded as important for the following reasons.
>
> The sale of JHNV by JHIL to JHI NV is necessary to achieve the financial benefits of the Scheme under the US-The Netherlands tax treaty, being that dividends paid by JHNV are made to another Dutch company JHI NV and are not made to an Australian company thereby attracting US withholding taxes. This sale is to be effected on loan account as an inter-company borrowing. The existence of the outstanding receivable is fiscally inefficient and so the dividend and reduction of capital by JHIL will be effected to remedy this result.
>
> The partly paid shares will have an uncalled amount equal to the market value of JHIL on implementation of the Scheme, less the subscription amount of $5 million. …"

25.21 During the initial hearing before Santow J on 10 August 2001 the Judge asked counsel for JHIL:[13]

> "What effect will this have on asbestos claims against Hardie's?"

and was answered:

> "The position is this. The claims that are on hold are not against Hardie's. They are against organisations 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 not against JIL. JIL 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."
>
> HIS HONOUR: "Subject perhaps to this: Is there any possible basis upon which a call on partly paid shares upon a Dutch company could be resisted under Dutch law? Is that dealt with in the explanatory memorandum because it is a fundamental matter. I don't know whether it is dealt with at all."
>
> HUTLEY: "I will have that checked."
>
> HIS HONOUR: "One would need to make sure every step is taken not only of disclosure but every step is taken to ensure that a call must be met. In other words, there must be the clearest possible Dutch exchange approvals require if it is possible to get them in advance in order to ensure there is no blockage in the flow of funds to Australia."

[13] Ex 278, Vol 5, pp. 23–24.

25.22 There was a further written submission on 13 August 2001 which included the following:[14]

> "As requested by his Honour, we set out below responses to each of the non-takeover matters he raised during the hearing of this matter … and regarding which he has requested submissions from Counsel.
>
> …
>
> (iv) (l) Is it possible that, if JHIL were to call for payment of the uncalled amount under the partly paid shares in full, this could technically lead to the insolvency of JHI NV?
>
> (v) …
>
> In response to his Honour's concerns, however, we propose to include the following additional term of issue of the partly paid shares (to be incorporated within Annexure 2 of the Implementation Deed at Part C of the Information Memorandum):
>
> 'Conditions to making a call:
>
> JHIL may only call for payment of an uncalled amount on the partly paid shares:
>
> (a) if the directors of JHIL form the view, after due and careful consideration, that the payment of the call is necessary to ensure that JHIL is able to pay its debts as and when they fall due; and
>
> (b) for such amount as the directors of JHIL believe is necessary to ensure that JHIL remains solvent.'
>
> …
>
> 2. Novel Features of the Proposal
>
> …
>
> (g) What effect will the Scheme, if implemented, have on asbestos claims against James Hardie?
>
> 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 Limited & Ors 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

[14] Supreme Court materials, Ex 278, Vol 3, pp. 206, 211–2.

> in the future whether in relation to asbestos-related claims or other obligations to other persons."

25.23 In the event Santow J on 23 August 2001[15] ordered the convening of a meeting of members of JHIL to be held on 28 September 2001 at the Regent Hotel, 199 George Street, Sydney.

25.24 The meeting took place at 11.00 am on that day and a very substantial majority of persons voting in person and in proxy, were in favour of the resolution. As Mr McGregor, JHIL's Chairman of Directors and the Chairman of the meeting, said in his affidavit of 28 September 2001 before the Supreme Court[16], there was a poll and the voting in favour was 97.66 per cent of votes cast.

25.25 The resolution was passed notwithstanding that much of the apparent justification for it had disappeared because of the announcement, on the evening preceding the meeting, of proposed changes to the withholding tax on dividends paid from the United States to Australia from 15 per cent to zero.[17]

25.26 The matter came back before Santow J on 8 October 2001 in the light of the new background. He decided that on the evidence there were still advantages in approving the Scheme, and did so finally on 11 October 2001, having given an opportunity for possible dissentients to be heard.

25.27 In relation to JHIL's creditors, Mr Cameron deposed to his belief that the Scheme would not materially prejudice JHIL's ability to pay its creditors.[18]

25.28 His affidavit contained one reference to the Foundation, namely to the payment of the $70m in reduction of the Foundation's loans to JHIL. That is found in paragraphs 28 and 32:[19]

> "28. … The placement of shares by the Plaintiff on 1 August 2001 (and referred to in paragraph 32 below), resulted in the receipt of $197 million and the issue of some 35 million ordinary shares. Of those proceeds, $70 million

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[15] [2001] NSWSC 741; Ex 278, Vol 4, Tab 45, p. 49.

[16] Ex 278, Vol 2, Tab 10, p. 2, para. 7.

[17] See Ex 278, Vol 3, Tab 31, p. 357; Press Release No. 74 of 27 September 2001, Protocol Amending the Australia-United States of America Double Taxation Convention: Ex 278, Vol 3, p. 254.

[18] Ex 278, Vol 1, Tab 2, para. 26, p. 7.

[19] Ex 278, Vol 1, Tab 2, p. 8, pp. 8–9.

has been paid to the Medical Research and Compensation Foundation thereby reducing the Plaintiff's Borrowings by that amount.

…

32.… There has been no material change to the financial position of the Plaintiff since this statement, other than a private equity placement of 35,000,000 fully paid ordinary shares on 1 August 2001 which raised $201,250,000 (gross) and, after deduction of the underwriting fee, $197,225,000 (net). …"

D. Matters not referred to in the proceedings

25.29 The material before Santow J did not refer to:

(a) the communications from MRCF concerning the inadequacy of its initial funding, culminating in the Foundation's letter dated 24 September 2001;

(b) the put option contained in the Deed of Covenant and Indemnity;

(c) the possibility that the partly paid shares might be cancelled at a later time.

25.30 Various submissions were put to the effect that JHIL's failure to bring all or some of these matters to the attention of Santow J or to include it in the information that was given to shareholders involved a breach of duty on its part. If there were a breach, a question also arises as to the extent to which Allens might be liable for its role in the matter.

25.31 Before turning to the facts concerning the three topics it is appropriate to say something about the sources and scope of JHIL's duties of disclosure in the context of the scheme of arrangement.

E. Duties of disclosure

25.32 The implementation of the scheme of arrangement imposed two distinct duties of disclosure on JHIL. Section 412(1)(a) of the Corporations Act required an explanatory statement or information memorandum to be sent with every notice convening a s 411 meeting that is sent to a member. An explanatory statement is one:

(i) explaining the effect of the compromise or arrangement and, in particular, stating any material interests of the directors, whether as directors, as members or creditors of the body or otherwise, and the effect on those interests of the compromise or arrangement in so far as that effect is different from the effect on the like interests of other persons; and

(ii) setting out such information as is prescribed and any other information that is material to the making of a decision by a creditor or member whether or not to agree to the compromise or arrangement, being information that is within the knowledge of the directors and has not previously been disclosed to the creditors or members.[20]

25.33 The "prescribed information" is set out in the Corporations Regulations 2001, and included:

" • particulars of the intentions of the directors of the company the subject of the Scheme regarding:

(a) the continuation of the business of the company or, if the undertaking, or any part of the undertaking of a company is to be transferred, how that undertaking or part is to be conducted in the future; and

(b) any major changes to be made to the business of the company, including any redeployment of the fixed assets of the company; and

(c) the future employment of the present employees of the company.

(Corporations Regulations 2001, Schedule 8, Part 3, Clause 8310); and

(d) information material to the making of a decision in relation to the Scheme, being information that is within the knowledge of any director of a company the subject of the Scheme."

(Corporations Regulations 2001, Schedule 8, Part 3, Clause 8302(i))."

25.34 Since the scheme in question was a members' not a creditors' scheme the primary focus of such material would be matter which bore upon the interests of members rather than matter which bore upon the interest of creditors. However, it was accepted by JHIL and its advisers that material bearing upon the impact of the

[20] Section 412(1)(a).

scheme on JHIL's creditors would be relevant to the Court both at the outset (under s 411(1)) and when considering approval (under s 411(4)(b)).

25.35 It is in this context that the second duty of disclosure arises. Since these applications were made to the Court effectively ex parte, both JHIL and its lawyers were subject to a duty of full disclosure. The content of the obligation was described by Barrett J in *Re Permanent Trustee Co Ltd* (2003) 43 ACSR 601 at 603 as follows:

> "In a technical sense, the application proceeds ex parte, which is a common enough occurrence in cases of this kind. The fact that the application is ex parte is not without some significance. The absence of any defendant or contradictor sharpens the duty of the applicant. While a case such as the present is distinguishable from one where an interlocutory injunction is sought in the absence of the defendant (in that there is here no defendant as such) I think it is fair to say that an applicant in this kind of situation, like an applicant ex parte for an injunction, carries the responsibility of bringing to the court's attention all matters that could be considered relevant to the exercise of its discretion. The principles do not need elaboration. It is sufficient to refer to the judgment of Isaacs J in *Thomas A Edison Limited v Bullock* (1912) 15 CLR 679."

25.36 Isaacs J had said (at 681–2):

> "It is the duty of a party asking for an injunction ex parte to bring under the notice of the court all facts material to the determination of his right to that injunction, that it is no excuse for him to say he was not aware of their importance. … Uberrima fides (the utmost good faith) is required and the party inducing the court to act in the absence of the other party fails in his obligations unless he supplies the place of the absent party to the extent of bringing forward all the material facts which that party would presumably have brought forward in defence of that application."

25.37 If there were any doubt as to whether JHIL and Allens had a duty of full disclosure as to matters bearing upon the impact of the scheme on creditors it would have been resolved by the questions asked by Santow J, in particular on 10 August 2001, which made clear that he regarded the practical efficacy of the partly paid shares as a protection for JHIL's creditors as an important matter. In addition JHIL's express statements on this topic, in particular as to the significance of the partly paid shares, made it necessary for JHIL to make disclosure so as to avoid what was said being misleading in any way.

25.38 I turn now to the topics as to which it has been submitted that JHIL breached a duty of disclosure.

F. Foundation funding concerns and the 24 September 2001 letter

25.39 A brief chronology of the main events is as follows:

11 April 2001	Report from Mr Attrill to Mr Cooper of claim results for the year ending March 2001. The report reveals net costs of $31.69m, before QBE receipts (compared to a $18.56m in YEM 2000) and projected similar costs for YEM 2002.[21]
19 April 2001	Cooper raises with Macdonald concern that failure to use latest claim data for Trowbridge meant MRCF was under funded. [22]
23 April 2001	Cooper reports his concerns about the new data and MRCF's likely insolvency in 10 or 11 years to the MRCF board.[23]
15 May 2001	Meeting between Sir Llew Edwards, Mr Cooper and Mr Macdonald at which funding issues are discussed.[24]
18 June 2001	Mr Cooper prepares report to the MRCF board that concludes that the YEM 2001 claims performance ($32 m before QBE) is not an aberration and represents an appropriate base level for future expectations.[25]
26 June 2001	Mr Cooper meets Mr Ashe of JHIL and says MRCF is undertaking a solvency analysis to ascertain its "real" financial position.[26]
30 July 2001	Mr Cooper tells Mr Ashe that the new Trowbridge report shows the situation to be "significantly worse than what was provided to them pre commencement." Trowbridge believe

[21] Ex 7, MRCF 1, Tab 26.
[22] Ex 150, p. 156.
[23] Cooper, Ex 5, paras 126–137.
[24] Cooper, Ex 5, paras 138–140; Ex 7, MRCF 1, Tab 33; MRCF 2, Tab 2, p. 2A.
[25] Cooper, Ex 5, para. 143.
[26] Ex 150, p. 163.

	the increase in claim costs last year will be sustained.[27]
7 August 2001	Mr Cooper tells Mr Ashe that a revised solvency model showed a dramatic change from commencement, and that Sir Llew intends to discuss it with Mr Macdonald.[28]
23 August 2001	Supreme Court orders scheme meetings.
21 September 2001	Sir Llew telephones Mr Macdonald, informs him of likelihood that MRCF will be insolvent in less than ten years, and says he will send a letter in the next few days to outline the full detail of the problem.[29]
24 September 2001	Letter from Sir Llew Edwards to Mr Macdonald.[30]

25.40 There was a dispute in the evidence as to whether the letter of 24 September 2001 was received by Mr Macdonald. The submission of the Foundation proceeded on the basis that the letter was mailed rather than faxed.[31] I shall do likewise.

25.41 Sir Llew's evidence was that the letter was sent either on or a few days after 24 September. It is clear from markings on a copy of the letter[32] that a copy signed by Sir Llew was in existence on 26 September 2001. On that day Mr Cooper sent an email to Mr Bancroft saying:

> "Following discussions with yourself yesterday and subsequent discussions between Sir Llew and the other Directors, it has been determined that we should proceed to send the letter to P Macdonald's office address in the USA. I have been asked to seek from you a communication confirming your advice to us to the effect that our interests would not be prejudiced by such action. Many thanks."[33]

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[27] Ex 150, p. 166.
[28] Ex 150, p. 167.
[29] Edwards, Ex 13, paras 145–146.
[30] Ex Ex 3, Vol 1, Tab 9.
[31] MRCF Initial Submissions, para. 48.38(a).
[32] Ex 296, Tab 3.
[33] Ex 296, Tab 2, Ex 97.

25.42 There is no evidence of the written confirmation called for by the second sentence.[34] Nevertheless, on the basis of the evidence already referred to, it is reasonable to accept that the letter was mailed on or about 26 September 2001.

25.43 When Mr Macdonald received it is another matter. His evidence was that he received Mr Shafron's memo in relation to it[35] within about two weeks of first receipt of the letter.[36] On that basis, having referred to his diary as to his movements in late September and October, he believes had did not see the letter from Sir Llew until 24 October 2001.

25.44 This evidence is in the nature of a reconstruction. I do not criticise it for that. However, that fact undermines the submission of JHI NV that "Sir Llew's unassisted memory is not a reliable basis for making a finding, especially where Mr Macdonald has given direct evidence on the point."[37] In fact, Mr Macdonald's direct evidence was that he did not specifically recall when he received the letter,[38] evidence that I found somewhat surprising given the nature of the communication and the fact that Sir Llew had warned him to expect the letter.

25.45 Having regard to the objective evidence, I think it more likely that the letter was received and read by Mr Macdonald when he was working in his office in Mission Viejo, California, by no later than 10 October 2001.[39] This would put its receipt by Mr Macdonald after the general meeting of JHIL on 28 September 2001. I cannot conclude, however, that he received it before the final court hearing in relation to the Scheme of Arrangement on 8 October 2001. There was no evidence as to when, in the ordinary course of post, a letter mailed in Brisbane or Sydney on 26 or 27 September 2001 would have been delivered in Mission Viejo. Given recent and ongoing events in the United States at that time,[40] the "ordinary" course of post may not have applied. If the letter was not delivered by 5 October 2001 Mr Macdonald would not have seen it before 10 October.

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[34] There is another responding email sent on 21 October 2001 by Ms Hunter, but it deals with a different subject Ex 296, Tab 2.
[35] Ex 85, 9 November 2001.
[36] Ex 308, paras I–3.
[37] JHI NV Submission in Reply, para. h4.10(d); see also (e).
[38] Ex 308, paras 1–3.
[39] Ex 308, para. 1.

25.46 There was much discussion in the evidence, and in submissions, as to whether the 24 September letter showed that the Foundation was making "a claim".[41] It is true that the letter does not state that the Foundation is entitled to money, or a particular sum of money. Nevertheless the letter makes it apparent enough that the directors thought they had been misled about the life of the Fund, and, in relation thereto:

(a) the basis of estimation of the asbestos liabilities;

(b) United States claims;

(c) the value of the Fund's assets.

25.47 It concluded by inviting the Hardie Group to satisfy itself as to "the validity of the information now available" and sought "an urgent meeting to discuss these matters and consider appropriate solutions". To my mind the possibility of a claim against JHIL arising from the subject matter of the letter must have been obvious. Certainly if one looks at Mr Shafron's memorandum to Mr Macdonald of 9 November 2001[42] the flavour is that the Foundation is plainly seeking more funding. The evidence of Mr Shafron was that he understood the 24 September letter to foreshadow a possible claim.[43] In April 2002 Allens took the view that these expressions of concern were "at some level a veiled threat".[44]

25.48 Even assuming the letter to have been received before 8 October 2001, the relevance of it is limited. The position appears to me to be this:

(a) Mr Cameron's affidavit had said in para. 26[45] that the Scheme would not materially prejudice the ability of JHIL to pay its creditors, and in

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[40] The September 11 attacks, and the subsequent mailing of anthrax bacteria or spores to various public figures.
[41] See eg JHI NV Submissions in Reply, paras H4.7–8; Initial Submissions paras 14.6.6, 14.7.4; MRCF Initial Submissions para. 48.28.
[42] Ex 85.
[43] Shafron, T 1371.12–22; cf McGregor, T 1511.30–35
[44] Ex 187, Vol 2, Tab 49, p. 460.
[45] Ex 278, Vol 1, Tab 2, p. 7.

paragraph 32[46] that there had been no relevant change to the financial position of JHIL since the financial statements as at 31 March 2001.[47]

(b) The existence of a possible claim by the Foundation, uncertain in amount (but unlikely to be small) and uncertain as to prospects, may not have rendered untrue the statement by Mr Cameron in paragraph 26 of his affidavit. It may also be doubtful whether it was a "material change to the financial position of" JHIL, but I think it was a factor which made the continued existence of the partly paid shares of importance. That would be the only source whereby any claim by the Foundation against ABN 60 could be met.

25.49 In my view disclosure of the 24 September letter was not necessary as regards the explanatory statement for members. The content and implications of the letter had no real relevance for members so far as their consideration of the merits of the scheme was concerned. As for the Court and its concern to see that the scheme did not adversely affect the interests of creditors, the possible claims implied by the letter were not such as to throw doubt on the adequacy of the partly paid shares as a protection for the interests of creditors. It was not suggested that in 2001 JHIL ought to have appreciated that the full liabilities of Amaca and Amaba on an undiscounted basis would exceed $1.9 billion (the amount payable on the shares).[48]

25.50 It follows that in my view disclosure of expressions of concern by MRCF prior to 24 September 2001 concerning the level of its funding was also unnecessary.

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[46] Ex 278, Vol 1, Tab 2, p. 8.

[47] Other than the private placement of 35,000,000 fully paid ordinary shares on 1 August 2001, which netted $197,225,000.

[48] Trowbridge's undiscounted estimate as at 30 June 2001 was $1.233 billion: Ex 3, Vol 3, Tab 8, p. 528.

G. The put option

25.51 The put option was found in clause 5 of the Deed of Covenant and Indemnity.[49] Clauses 5.1–5.3 provided:

> "**5.1 Covenant to acquire**
>
> Coy hereby covenants to the JHIL Shareholder that Coy shall, on receipt of a notice from JHIL Shareholder in the form of Schedule 3 (**Schedule 3 Notice**), acquire the JHIL Shares in whole and in one lot.
>
> **5.2 Exercise**
>
> The JHIL Shareholder may require Coy to acquire the JHIL Shares by giving to Coy a Schedule 3 Notice at any time during the Prescribed Period.
>
> **5.3 Sale**
>
> When the Schedule 3 Notice is given, the JHIL Shareholder shall transfer the JHIL Shares to Coy for a nominal consideration of $10.00."

[The references in cl 5.1–5.3 to "Schedule 3" should have been to "Schedule 5".]

25.52 The "JHIL Shareholder" was defined to mean the person, if any, who is the sole registered holder of the JHIL shares from time to time.[50] The "JHIL Shares" were all the issued ordinary shares in JHIL from time to time.[51] The "Prescribed Period" was 15 years from 15 February 2001.[52]

25.53 At the time the put option was created there was no "JHIL shareholder". JHIL was a company listed on the ASX and had numerous members. The put option was clearly inserted with a view to be employed if Project Green proceeded. It was Mr Macdonald who gave the instructions that there should be a put option.[53] Mr Morley's evidence was that one of Mr Macdonald's objectives was that "any company involved in asbestos manufacturing would ultimately be de-consolidated from the group".[54] The put option was a means to achieve that goal. Mr Peter Cameron gave evidence that Mr Macdonald had told him that the put option was intended to be a "marker" for the purposes of future transfer discussions with the

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[49] Ex 1, Vol 6, Tab 60, p. 2045–6.
[50] Ex 1, Vol 6, Tab 60, p. 2036.
[51] Ex 1, Vol 6, Tab 60, p. 2036.
[52] See cl 1.1: Ex 1, Vol 6, Tab 60, pp. 2036.
[53] Robb, T 2812.8–34; Macdonald, T 2386.18–24.

MRCF. This seems a little curious, but is nevertheless consistent with the connection between the put option and proposed de-consolidation of JHIL.[55]

25.54 The significance of the 2001 scheme of arrangement as regards the put option was that it would create the circumstances in which the put option might be exercised. That is, a result of the scheme was that there would be a "JHIL shareholder" for the purposes of clause 5 of the Deed of Covenant and Indemnity. In the context of the scheme of arrangement the potential significance of the put option was that the exercise of the put option would result in the transfer of the partly paid shares to Amaca (unless they had previously been cancelled), a transfer that would deprive them of any value as a protection for the creditors of JHIL. (The partly paid shares were "ordinary shares"[56]). On the other hand, a likelihood that the partly paid shares would be cancelled before the exercise of the put option would perhaps suggest that cancellation was likely, something relevant to the next topic.

25.55 In cross-examination, Mr Robb conceded that the put option should have been disclosed, and attributed the fact that it was not to the circumstance that its existence had "escaped his memory".[57] Mr Peter Cameron's evidence was consistent to the extent that he did not attribute any significance to the put option at the time.[58] His explanation, with the benefit of hindsight, as to why disclosure was unnecessary was grounded on the proposition that the Court would be so confident that JHI NV's directors would act properly, and decline to exercise the put option without catering for the interests of creditors, that the court would treat the existence of the right as immaterial.[59] I did not regard this view as persuasive.

25.56 In their submissions JHI NV and Allens relied on a range of other circumstances to support the proposition that disclosure of the put option was not necessary.

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[54] T 2172.43–49.
[55] T 3067.37–3068.2.
[56] See the implementation deed, Ex 278, Vol 2, p. 89.
[57] T 2962.1–29.
[58] T 3065.54–3066.18.
[59] T 3064.43–3065.43.

25.57 Perhaps the most significant was that by the terms of the implementation deed the JHIL Board was given an unfettered right to refuse to register a transfer of the partly paid shares.[60] It is likely that this provision was inserted to bolster the protection for creditors afforded by the partly paid shares by denying JHI NV the unilateral right to transfer them (whether by exercise of the put option or otherwise). As Allens point out in their submissions:

> "Any decision to register such a transfer had to be made consistently with the directors' fiduciary duties. As such, the directors would face a breach of their duties under ss180(1), 181(1),182 and 184 of the Corporations Act 2001 (the last of which is a criminal offence) were they to approve a transfer to a shareholder who would not reasonably be expected to be able to meet its obligations under a call in circumstances where the directors believed that the need for JHIL to make such a call was possible: Spies v The Queen (2000) 201 CLR 603 at 635 – 637. Sections 180, 181(1) and 182 are civil penalty provisions and the directors would be liable to compensation orders under the Corporations Act 2001. Further, sections 181(1) and 182 can be contravened by a person "involved" (for example, JHI NV potentially)."[61]

25.58 I accept that the terms of the implementation deed meant that it was not necessary for the put option, considered in isolation, to be disclosed to the Court.[62] It remains relevant, however, to the question whether possible cancellation of the partly paid shares had to be disclosed. I turn now to that question.

H. The possible cancellation of the party paid shares

25.59 The submissions of JHI NV on this question may be reduced to two points: first, that while it may have been necessary to disclose a firm or settled intention to cancel the shares, JHIL, particularly at Board level, had no such intention; secondly, that any lesser degree of contemplation of cancellation need not be disclosed, as the Parliament had made provision, presumably thought to be adequate, to protect the interests of creditors in the context of a reduction of capital, and the court may be taken to have been aware of the fact that the shares could be cancelled and of these provisions. Allens added that whatever JHIL's intentions had been, Allens had no reason to believe JHIL intended to cancel the shares.

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[60] Ex 278, Vol 2, Tab 11, p. 89. See Allens submissions in reply, para. 3.2.3; JHI NV Submissions in Reply, paras H2.7–.8.

[61] Submissions in reply, para. 3.2.3.

25.60 The question of the extent to which JHIL had formed the view by October 2001 that the partly paid shares would be cancelled was the subject of vigorous debate, and a great deal of evidence was canvassed. Counsel Assisting and the Foundation support a conclusion that there was at the highest levels of management of JHIL, and perhaps the Board, an expectation that JHIL would, a reasonably short time after October 2001, be deconsolidated from the Group, with a likely cancellation of the partly paid shares. In this regard the key matters and the main evidence relied on were as follows.

25.61 Since at least 1995 James Hardie had embarked on a course of separating its operating activities from any connection with asbestos liabilities. After the creation of the Foundation in February 2001, separation of JHIL was the last remaining step in that process. Consistently with this, documents going back to the original formulation of Project Chelsea treat JHIL as part of the "rump" that will have to be dealt with after the 1998 restructure. For example:

(a) Mr Pedley, 18 March 1997:

> "45. Once the asbestosis liabilities are defeased and Firmandale settled, excess cash could again be return to shareholders. Prior to this the remaining assets of JHIL could be sold in to the US group for cash. The capital return may happen immediately or after some time should cash be needed to generate income in Australia to absorb remaining tax losses. JHIL may be liquidated as a result of this process."[63]

(b) Dr Barton, 30 June 1997:

> "JHIL will have a large amount of cash and a major operational investment. Its longer term reason for being is not apparent".[64]

(c) Project Chelsea "Critical Issues Check list", 28 January 1998:

> "Rump – relationship to statements about further sell down. Need strong clear view. Key is when to deal with it. Now or next sell down?"[65]

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[62] This conclusion makes it unnecessary to consider the numerous grounds developed in oral submissions for the proposition that the put option was in truth unenforceable. (See eg JHI NV, T 3880.58–3881.57), grounds that do not seem to have appealed, or even occurred, to representatives of JHIL or JHI NV at the time.

[63] Ex 61, Vol 1, Tab 4, p. 29.

[64] Ex 61, Vol 1, Tab 8, p. 66.

[65] Ex 61, vol 1, Tab 20, p. 112 at 131.

(d) SBC Warburg Dillon Read "Project Chelsea Rump Strategy", 20 February 1998:

"Option F:

"The retained structure by JHIL (Newco Shares) will be transitory and JHIL will sell its remaining shares as and when … suitable opportunities arise.

… Subject to retaining sufficient assets to meet its liabilities … surplus capital will be returned to shareholders…"[66]

(e) Meeting notes of 25 February 1998:

"IGW [Ian Wilson – SBC Warburg Dillon Read] said we envisage a 2 stage process:

1. Successful IPO in the US as a first priority;

2. Progress the final compromise on the rump etc within a 9 to 12 month period."[67]

(f) Peter Cameron's "JHIL – Ultimate Resolution" memorandum (March 1998) canvassed a number of options for JHIL post – Chelsea, including liquidation, and transfer to an insurer.[68] He described the position expected to exist after stages 1 and 2 of Project Chelsea:

"JHIL retains (probably at the holding company level) a 25% interest in Newco valued at, say, $A400m. Its assets comfortably exceed its actual and potential liabilities; we are assuming its nett assets are of the order of $500m.

JHIL's continuing business consist predominantly of cash, assets intended for disposal, and its interest in James Hardie & Coy (Coy) which includes a number of properties (some asbestos-affected) leased to Newco.

JHIL has no real continuing corporate purpose (other than, perhaps, as a continuing holder of a minority of interest in Newco) and the directors consider there is no benefit in its pursuing new business, at least while the

[66] Ex 61, Vol 1, Tab 25, p. 169.
[67] Ex 61, Vol 1, Tab 26, p. 171.
[68] Ex 61, Vol 4, Tab 9, p. 66.

> future of any such businesses would be clouded by asbestos liabilities. For that reason, JHIL's continued listing is at risk.[69]"

25.62 It must be acknowledged that in this period there was not yet a settled view that JHIL would be separated from the Group. One proposal for "collapse of the Rump"[70] entailed separation from Coy, but JHIL remaining in existence as a holder of Newco shares. These proposals, however, do not undermine the thesis. Their premise is that the continued existence of JHIL has some value for shareholders. Under the structure adopted in the 2001 scheme of arrangement JHIL would have no utility for shareholders in JHI NV.

25.63 After Project Chelsea similar proposals for JHIL were discussed, even though Chelsea stage 2 did not occur. Mr Reg Barrett's memorandum of 27 October 1999 discussed schemes or arrangement, creation of a trust and liquidation. It includes this advice:

> "As AAH observe, there is also the point that moves to crystallise matters at the Coy level in such a way as to limit claimants' present ability to exercise their rights in an unrestricted way against Coy may result in pressure on JHIL. In other words, if the uncertainties as to the extent of future Coy pay-outs are somehow contained, the likelihood is that moves to subject JHIL itself to liability will intensify. **Any overall solution will therefore logically seek a position of finality in relation to both Coy and JHIL**."[71]

25.64 Further consideration of the fate of JHIL arose in the planning of Project Green. An issue of partly paid shares was proposed as part of the restructure,[72] and within days there was consideration of their ultimate cancellation.[73] Mr Morley agreed in cross-examination that the prospect that the partly paid shares might be cancelled by JHIL was raised as early as September 2000. In addition:

(a) A paper prepared by PwC on 6 November 2000 recorded that:

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[69] Ibid, p. 67, emphasis added. .
[70] Ex 61, Vol 2, p. 4.
[71] Ex 61, Vol 4, Tab 9, p. 76 at p. 80, emphasis added.
[72] Ex 146, email of 17 September 2000.
[73] Ex 146, email of 20 September 2000 (Shafron).

"A further major objective of Project Green has been to take Project Chelsea one stage further and to build a bridge to achieving a complete separation of James Hardie Operating companies from the product liability claim."[74]

(b) Mr Blanchard has a file note of a conference call with Mr Shafron and others on 4 January 2001 in which shows the concept of a put option was raised. Mr Blanchard records "may want to give up JHIL to T[rustee]. Make sure nothing precludes this from happening."[75]

(c) In a meeting on 1 February 2001, a JHIL representative, probably Mr Macdonald, said "[Do] want to liquidate JHIL down the line."[76]

(d) On 5 February 2001 Mr Macdonald instructed Mr Robb to include an option to "put" JHIL to Coy in the Deed of Covenant and Indemnity.[77] It is accepted by JHI NV that the exercise of the put could almost inevitably have involved the prior cancellation of the partly paid shares.[78]

(e) Michael Quinlan of Allens has a note of a conversation with Mr Robb on 5 February 2001, recording:

"liq[uidation] of JHIL within 12 months."[79]

(f) Mr Robb's note of a telephone conversation with Mr Macdonald in early February 2001, records as one item:

"Timetable to wind-up of JHIL".[80]

25.65 These deliberations were not confined to senior management. The Project Green Board Paper of 5 February 2001 considered by the JHIL Board on 15 February 2001[81] stated that management had "developed a comprehensive

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[74] Ex 168, attachment para. 23; see also paras 25–26. The email was sent to Peter Cameron, whose response is Ex 226.
[75] Ex 203.
[76] Ex 204.
[77] Ex 214.
[78] Eg, Robb, T 2848.45.
[79] Ex 193.
[80] Ex 205.
[81] Ex 75, Vol 8, Tab 119, pp. 2735–2738.

solution to critical issues that James Hardie has been facing for over 5 years […] The objective is to position James Hardie for future growth and to eliminate legacy issues […] Once fully implemented [….] legacy issues will have been removed". The Paper indicated that the elimination of "legacy" issues included the separation of JHIL from the James Hardie Group. In the section of the paper headed "alternatives considered and rejected" Mr Macdonald stated:

> "this [alternative and rejected] option would more rapidly lead to a full asbestos separation (including JHIL) […] In contrast, the recommended option initially transfers out of the ongoing structure on JH & Coy and Jsekarb, leaving JHIL in the ongoing 'new world'. It could take some months for this issue to be addressed – so there is increased exposure."

25.66 The alternative considered and rejected was a combined separation and restructure in February 2001 that would have involved separation of JHIL from the group at that time. Consistently with this, Allens' (Mr Cameron and Mr Robb) advice to the board of JHIL for the 15 February meeting included the following points in their discussion of disadvantages of the "preferred option" (ie, a staged process, rather than full separation immediately):

> "We believe a liquidation of JHIL post-implementation of the scheme will be difficult.
>
> …
>
> To vest JHIL into the trust is likely to involve a reduction of capital (presumably by cancelling the partly paid shares), which will require the directors to leave behind assets within JHIL, at least to the extent that JHIL has creditors. Those creditors will include any then current claimants, including those who may be ill but who have yet to establish the veracity of their claim.
>
> …
>
> It is likely that the scheme documents will need to disclose the directors' intentions with respect to JHIL post the reconstruction. This may involve a discussion of the liquidation and vesting options, if indeed these are in contemplation. This may be regarded as at odds with arguing that post-reconstruction JHIL's creditors' interests are not materially prejudiced. Accordingly, to the extent partly paid shares are to be used the Court may not regard them as of sufficient protection for creditors."[82]

[82] Ex 80, Tab 6, pp. 151–2.

25.67 Mr Morley said that by March 2001 the likelihood was that after the restructure had been completed, after an interval, the partly paid shares would be regarded as "an unnecessary capital lifeline" and would be likely to be cancelled.[83]

25.68 On 24 March 2001 Mr Shafron distributed by email a note on the arguments for and against partly paid shares in JHIL "post separation". Having considered options of "No additional JHIL funding" (which was likely to attract stakeholder attacks), and "Limited additional JHIL funding (likely also to attract stakeholder attacks) he turned to "Equal Additional JHIL funding", and said:

> "This option has the most cosmetic appeal but leaves in place a significant obligation between JHI NV and JHIL. It reduces completion risk but leaves in place what would be judged by the future JHIL as an altogether unnecessary capital lifeline.
>
> If JHIL is left in the same economic position after the restructure as it was in before, then stakeholders should effectively be deprived of grounds for complaint. They may argue that the asset position prior to the restructure (ownership of JHI NV) is more attractive than the asset position after the restructure (ability to call on JHI NV to pay under partly paid shares) but that may be seen as a subtlety only. They may argue that JHIL could cancel the partly paid shares shortly after the scheme was approved – to which the reply would be that the then JHIL directors are still subject to the Corporations Law and to the risk of suits if they breach their director duties involving creditors.
>
> In response to questions about the reason for the level of funding, JHIL may say that the intention was to ensure that the company remained in the same position, that the future funding requirements of JHIL could not be determined with precision so the logical solution was to ensure no change. Naturally, no guarantees could be given that the capital structure of JHIL would not be re-examined over time, but that was not a pressing issue."[84]

25.69 I find this memorandum quite significant. First, Mr Shafron's statement in the second quoted sentence was, I think, absolutely correct. JHI NV and JHIL would regard the partly paid shares as altogether unnecessary once the restructure had occurred. Mr Shafron's testimony was to the effect that the partly paid shares were really a transitional or interim measure.[85] This follows from the purpose of the partly paid shares, highlighted by the second quoted paragraph - they were a device to avoid an examination by the court of the extent of the liabilities of JHIL, that is, they

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[83] T 2263.50–2264.5.
[84] Ex 147.
[85] Ex 17, para. 222, T 1381.4–10.

were another exercise in "stakeholder management".[86] Finally the proposed defensive responses proposed by Mr Shafron have a somewhat coy quality, suggestive to my mind of an appreciation by Mr Shafron both that cancellation was the likely eventuality and that creditors at least would be likely to regard that as material.

25.70 Between March 2001 and October 2001 references to what would happen to JHIL post-restructure are few. This is equivocal. One would expect the minds of those concerned to be focussed on achieving the restructure. Mr Morley's evidence was that the idea of keeping open the option of cancelling the partly paid shares remained the position through the first half of 2001.[87]

25.71 After the restructure the evidence tends to suggest that separation of JHIL (now ABN 60) from the group had never ceased to be an objective. The most striking is that consideration of that step, including cancellation of the partly paid shares, commenced as early as March the following year. The impetus for the consideration is likely to have been the sale of the Gypsum business, announced on 13 March 2002, a sale which would realise $345m in cash.[88]

25.72 The connection between the cancellation and the sale of Gypsum is confirmed by Mr Blanchard's note of a discussion on 25 March 2002.[89] He records a discussion of two options:

> "Pay out indemnity [ie, the payments under the DOCI] now ([because] gypsum sold)."
>
> "Sell to Foundation … JHIL has partly paid shares to JHI NV [therefore] need to get rid of partly paids."[90]

25.73 There was discussion of this step being very soon after the scheme of arrangement. A question raised in that context was:

> "If had this in mind last Oct, should have disclosed?"[91]

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[86] Ex 146, email of 6 October 2000, Shafron to Robb, Cameron and others.
[87] T 2263.10–15.
[88] Ex 283, Vol 7, May 02 Tab, Part 3, p. F29.
[89] Ex 302, JRB 1.

(This question was discussed more fully on 11 April 2002 between Messrs Morley, Robb, Blanchard and others.[92])

25.74 What this suggests is that James Hardie's "contemplation" of separation from JHIL was sufficiently strong that, as soon as funds were available to permit it, it became an active project. And it had long been planned to make funds available by selling the Gypsum business.

25.75 A statutory declaration from Mr Morley, tendered too late to permit any cross examination, deals with the 25 March 2002 meeting.[93] He confirms that the Gypsum sale was the occasion for considering the transfer of JHIL and the cancellation of the partly paid shares.[94] He also says:

> "My recollection is that Mr Robb said that because there had been no reference in the scheme of arrangement documentation to an intention to transfer ABN 60 or cancel the partly paid shares, the fact that it was now proposed would raise questions as to whether such an intention existed at the earlier point in time and should have been disclosed. I recall saying in response to this suggestion that my understanding was that at the time of and prior to the scheme, it was not perceived or envisaged at all that ABN 60 would be transferred out of the James Hardie group because there was no capacity to fund such a transfer. I also said that the opportunity to pay out the indemnity only occurred when JHI NV received an offer for the purchase of the gypsum business from British Plasterboard in around February 2002. Prior to that, and prior to the scheme of arrangement, the only discussions concerning the gypsum business involved a joint venture with a different party which would not have produced any funds to James Hardie."[95]

25.76 I have difficulty accepting the second and last sentences in this evidence. Mr Morley was in attendance at the 16 January 2000 JHIL audit committee meeting and the 17 January board meeting. His own notes of the former record the "3 planks" of what seem to be JHIL's then strategy. They are:

> "1. Trust - asbestos
>
> 2. Gypsum sale
>
> 3. Green restructure.

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[90] Ibid.
[91] Ibid, JRB 2.
[92] Ibid, JRB 3–5; Ex 187, Vol 2, Tab 49.
[93] Ex 307.
[94] Ex 307, para. 3.
[95] Ex 307, para. 4 (c) (ii)

> The only question was, "what order/sequence".[96]

25.77 The slide presentation for the January board meeting includes several references to the intended sale of the Gypsum business, in the context of it being a means of raising cash for the group.[97] Under the heading "Next Steps" the first item is:

> "Focus on Gypsum sale as highest priority."[98]

25.78 The slide show also lists the "Post Trust, Post Green options for JHIL." Four of the five options involve the transfer or liquidation of JHIL.[99]

25.79 Finally, there is Mr Shafron's email of 13 February 2003. Mr Shafron edited a draft letter to the MRCF to delete references to the cancellation of the partly paid shares and forwarded the draft to Messrs Macdonald and Morley for approval. In the covering email [100] Mr Shafron wrote (referring to the separation of JHIL and the cancellation of the partly paid shares), "this is not a conspiracy – it is the working through of an arrangement which has been in contemplation since the beginning".

25.80 The evidence I have outlined suggests that even if the management and board had not formed a fixed intention that JHIL would, post restructure, be separated from the group, nevertheless it was, in effect, the "operating assumption" on which both management and the board were proceeding that separation of JHIL by a mechanism that would probably involve the cancellation of the partly paid shares would occur within a year or so of the restructure.

25.81 Against this conclusion JHI NV and Allens rely primarily on the following matters (I quote from Allens's submissions):

> "[All] relevant written evidence from around 27 March 2001 (when the scheme implementation began (Ex 187, para. 66) indicates that there was no such intention:
>
> (a) the memorandum from Mr Shafron to Mr Macdonald dated 23 March 2001 presents arguments for the existence of or the

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[96] Ex 121, Vol 6, Tab 85, p. 2494.
[97] Ex 121, Vol 6, Tab 88, pp. 2526–2530: See also his notes of the board meeting, behind Tab 87, at p. 2498.
[98] Ex 121, Vol 6, Tab 88, p. 2531.
[99] Ex 121, Vol 6, Tab 88, p. 2518.
[100] Ex 317.

amount of any callable amount under the partly paid shares (Ex 147). The detailed memorandum does not give any indication of an intention to exercise the put option, liquidate JHIL or cancel the partly paid shares … ;

(b) the Q&A attached to Mr Shafron's email of 15 May 2001 (Ex 224, tab 40) confirmed that the partly paid shares would continue to be available to meet existing and future obligations and liabilities of JHIL;

(c) the file notes of David Robb of a James Hardie conference call of 22 May 2001 (Ex 187, tab 27) included a discussion of what quantum the callable amount of the partly paid shares should be. Mr Macdonald is recorded as saying that he would need to get approval of the Board if the partly paid shares were to be issued at market value rather than the lesser book value. If senior management or the Board of JHIL held an intention to cancel the shares, it would be of no concern to them as to the quantum of the callable amount. That concern can only arise if they held the view that the shares were to remain on issue into the future;

(d) the July 2001 Board paper, which confirmed that JHIL would be funded for the transfer of JHI NV by partly paid shares in order to provide funding if required, gave no indication of any intention to cancel (Ex 224, tab 41);

(e) the Information Memorandum which was considered on more than one occasion by the Board and which was approved by the Board at its July meeting evidenced no such intention (Ex 17, tab 148); and

(f) the minutes of the directors' meeting of 23 July 2001 record that JHIL "would continue to have capital to the market value of JHNV" (Ex 187, tab 34)."[101]

25.82 These submissions inappropriately confine the area of inquiry to the period from March 2001. That said:

(a) Mr Shafron's memo is significant because once it was decided that there would be partly paid shares, at full value, the conclusion followed that they would be regarded as an unnecessary capital lifeline;

(b) (d), (e) and (f) These are consistent with the Board of JHIL regarding their post-restructure plans for JHIL as something that did not need to be disclosed, consistently with the submissions made to

[101] Allens Initial Submissions, para. 3.3.2. See also JHI NV Initial Submissions, section 14.4.

this Inquiry on their behalf. They are not a basis for concluding that they had no such plans.

(c) Mr Macdonald's observation implies that JHIL did not intend to cancel the partly paid shares immediately after the restructure. However it is consistent with the view I have formed that cancellation in a year or so was very likely.

25.83 The question then is whether this is something that ought to have been disclosed. At this point the submission of Allens and JHI NV is that all share capital is cancellable, the *Corporations Act* provides a mechanism for it to occur and Santow J may be taken to have been aware of this.

25.84 These propositions may be accepted.

25.85 On the other hand, Counsel Assisting submitted that the protections in the *Corporations Act* in the case of cancellation under s 256B are, from a creditor's point of view, less than perfectly adequate. Injunctive relief, even relying on s 1324 (1B), would only rarely be available, as notice to creditors is unnecessary. Failure to have proper regard to the interests of creditors in contravention of s 256B(1)(b) would not invalidate the cancellation (s 256D(2)). Persons involved in the breach would be liable to be sued for damages (s 256D(3)), but in a case such as this a personal claim against Mr Morley and Mr Salter would not be not an adequate substitute for access to $1.9 billion in assets. Moreover, "involved" in s 256D(3) picks up the definition in s 79, which imports, in effect, knowing involvement or something akin to fraud. This has consequences both for what has to be proved, and as to what may be recovered by resort to policies of insurance.

25.86 These submissions have some force. However, it is not necessary for to form a view on them. The circumstances here throw up the question of disclosure in a factual context where JHIL was saying, explicitly, that the partly paid shares would be available in the future and from time to time, and in which the judge made it clear that the efficacy of that "capital lifeline" was a matter of concern.

25.87 In these circumstances it seems to me that JHIL's plans for itself after the re-structure ought to have been disclosed. Those plans went beyond mere consideration of the theoretical possibilities in my view. The circumstances

were such that anyone familiar with JHIL's internal strategic planning over the 1998–2001 period and with knowledge of the true purpose of the partly paid shares (ie, stakeholder management) would have formed the view that their cancellation was almost inevitable. The JHIL board, senior management, and Allens were all so placed.

25.88 It is inappropriate for me to attempt to say what the Supreme Court would have done if such disclosure had occurred.

25.89 However it is appropriate to say that, in my view, the Court could have required JHIL to alter the constitution of JHIL so as to restrict its powers[102] under s 256B, e.g. by requiring as a precondition that independent advice be obtained that the proposed cancellation would not materially prejudice the interests of creditors.

25.90 At the very least this would foreclose the risk of someone later acting on the basis contended for by JHI NV at one point in the Inquiry, namely, that in the case of partly paid shares cancelled for no payment, JHIL did not have to consider the interest of creditors at all.[103]

I. Conclusions

25.91 The conclusions I draw in relation to the issues expressed above are:

(a) By failing to disclose that the separation of JHIL, and consequent cancellation of the partly paid shares, was likely in the short to medium term, Allens and JHIL were in breach of their duty of disclosure in the proceedings before Santow J.

(b) The failure to make such disclosure was not deliberate.

(c) In the circumstances, Allens is likely to have been breach of its duty of care to JHIL, but it is not clear that any such breach caused JHIL loss. Nor is it clear that if disclosure had been made, subsequent events would have turned out differently.

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[102] See *Corporations Act* s 125.

(d) I reject the submissions that JHIL or Allens contravened s 52 of the *Trade Practices Act 1974* (Cth), that they attempted to pervert the cause of justice, and that the orders of Santow J were procured by fraud.

[103] JHI NV Initial Submissions, para. 16.1.3. The Submissions was disavowed in final, oral submissions. But in fact it was in mind as arguable at the time of cancellation.

Chapter 26 – Discontent Following Separation

A. The Foundation's funds appear inadequate

26.1 After the approval of the Scheme, the first financial reports of the Foundation, Amaca and Amaba were prepared. Amaca, they showed, had paid out $37.66m in settlement of claims for the 15 months to 30 June 2001, compared with $18.362m for the 12 months to 31 March 2000.[1] There followed a growing awareness on the part of the Foundation that its initial funding had been inadequate, and a series of communications with JHIL, and then JHI NV, about that subject.

26.2 Those communications started on 19 April 2001 when Mr Macdonald had a brief discussion with Mr Cooper. Mr Macdonald summarised the issues they discussed in an email sent to Mr Shafron on 24 April 2001. Two issues of particular relevance were included in the summary: [2]

> "5. **Earnings Rate**. Dennis says the Foundation is obviously earning at below its long term target rate in the current interest rate environment (around 5%). We agreed that this was a short term situation and would not be a matter of concern unless it persisted for some time. In the meantime, the Foundation was very well placed to enter the equity markets when it judged the timing to be appropriate.
>
> 6**. Foundation Provision.** Dennis had a "sensitive issue" to discuss. 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 underprovision. He said that FY '01 costs would be well in excess of the $22M that had been expected – and this would be a problem if the trend continued. He said he and Sir Llew felt that this was sufficiently "sensitive" that it should be raised by Sir Llew to me rather than by "official" Foundation communication.
>
> I responded that we would want to make sure there were no "errors" in the way we had accounted for the Foundation. We had been aware of the latest information, and had encouraged Trowbridge to use the latest claims and cost data from the public record (which would include JH) to assess future costs in its update provided prior to the establishment of the Foundation. We were cognizant of the fact that it would take several quarters (most likely years) of a significantly different trend line to markedly shift the provision numbers. We had taken great comfort from the consistency that had been displayed over more than 6 years that Trowbridge had been reviewing the situation on behalf of the company.

[1] Ex 3, Vol 2, Tab 5, p. 309.
[2] Ex 122, Vol 1, Tab 8, pp. 48–49.

> Dennis said that the Foundation would be working hard on containing all its costs – but felt that litigation costs would only escalate in one direction. I noted that we had allowed for a steady escalation in such costs.
>
> I don't anticipate taking any action on this conversation. I will wait to see if Sir Llew follows up with me. I will be seeing Sir Llew at his JHIL Board farewell dinner on Tuesday 15 May in Sydney. It may be that Dennis and the Foundation have decided to press on all possible fronts (including coming back to JHIL) to attempt to improve the situation of the Foundation".

26.3 Despite what Mr Macdonald recorded in the first sentence of the third paragraph, JHIL did not then or subsequently make any attempt to ensure there were no errors in the way they had accounted for the Foundation.

26.4 On 23 April 2001 Mr Cooper reported to the Executive Committee of Amaca with regard to his first "findings and concerns" in relation to projected budget figures showing increased claims costs.[3]

26.5 At about that time Sir Llew Edwards was also endeavouring to meet with Mr Macdonald[4] with a view to informing him about the difference between the forecast model for net settlement costs in the Trowbridge Report, the actual outcome for the year ended 31 March 2001 and the impact it might have on the economic life of the Foundation.[5]

26.6 Sir Llew Edwards and Mr Cooper eventually met with Mr Macdonald[6] on 15 May 2001. The meeting lasted only 10–15 minutes. Sir Llew Edwards raised the Foundation's "extreme concerns" in relation to increased claims and settlement costs beyond those originally anticipated.[7] He continued:[8]

> "… settlement is far in excess of what was predicted. This may in part be a result of the migration of interstate cases into the Dust Diseases Tribunal but the basic cause of our concern is the increased number of cases and the increased amount of the payments being made beyond what was predicted. If this continues we are going to be out of business in a very short time. I hope that all the facts which went into your officers calculations of the figures and the predictions have been made available to us. Peter, to be quite frank this is a mess. I would now like to ask Dennis to take you

[3] Cooper, Ex 5, p. 31, para. 135; See extract of minutes, Ex 7, MRCF 2, Tab 1, p. 1.

[4] This meeting was the result of a number of discussions between Sir Llew Edwards, Mr Cooper and other Foundation Board members. Sir Llew Edwards's recollection is that the decision to approach Mr Macdonald was made at an Amaca Board meeting on 23 April 2001. Edwards, Ex 13, p. 34, para. 133.

[5] Cooper, Ex 5, p. 31, para. 135.

[6] Mr Cooper's notes of the meeting are in Ex 7, MRCF 2, Tab 2, p. 2A. Sir Llew Edwards stated these notes were an accurate account; Ex 13, p. 35, para. 134.

[7] Edwards, Ex 13, p. 35, para. 135.

[8] Ex 13, p. 35, para. 135.

> through the detail of these figures to give you the full story. As you know he is always across the figures and he can best explain them to you. We also have some information here that we would like to leave with you."

26.7 Mr Cooper endeavoured to hand Mr Macdonald a document, however, Mr Macdonald refused to accept it. He went on to say: [9]

> "I am not prepared to accept any documents. The decision to set up the Foundation was made in good faith. There are no more funds available. We cannot and will not provide any more funds".

26.8 Mr Macdonald's explanation for his behaviour in refusing to accept the document was that he "did not want to have detailed information of the Foundation's internal and confidential information".[10] He said he wanted to preserve the apparent independence of the Foundation from JHIL.[11]

26.9 Mr Macdonald's explanation is curious. The dealings between the Foundation and Mr Macdonald and other JHIL executives, including Mr Shafron, Mr Morley and Mr Ashe were coloured with considerable ambiguity. On the one hand they claimed no further responsibility on the part of JHIL/JHI NV for Amaca and Amaba, whilst on the other hand they sought to maintain an apparently sympathetic relationship with Mr Cooper and to a lesser extent Sir Llew Edwards, with a view to maintaining accurate intelligence on the activities and financial circumstances of the Foundation.

26.10 In that regard, Mr Cooper's file note of the meeting with Mr Macdonald, in part, records:

> "P Macdonald … was pleased to receive information related to our concerns and would want to be kept informed if, following more extensive experience, our concerns remained.
>
> …
>
> Sir Llew Edwards advised in relation to the series of political and union meetings which had commenced and the generally positive outcomes experienced so far. He also advised in relation to the medical research and forthcoming appointment of a specialist retained role within the Foundation who could advise in relation to directing future funding. P Macdonald indicated that they would potentially directly fund any initiative to better co-ordinate multiple research efforts".[12]

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[9] Edwards, Ex 13, pp. 35–36, para. 135.
[10] Macdonald, T 2376.25–32.
[11] Macdonald, T 2376.34–2377.4.
[12] Ex 7, MRCF 2, Tab 2, p. 2A.

26.11 Mr Cooper met with Mr Shafron on 17 May 2001. It was agreed that the due diligence material provided to the directors prior to the establishment of the Foundation would be available to the Foundation Directors.[13] Nonetheless, Mr Cooper continued to press Mr Shafron for various material. An email to Mr Shafron dated 24 June 2001 from Mr Cooper included the following request:

> "I need to update progress on the various matters outstanding. In particular, the other Directors are keen to receive the material which I confirmed would be provided following my meeting with you some 5 weeks ago".[14] The material included the Trowbridge Report to prospective Directors of 13 February 2001.

26.12 Mr Shafron forwarded the report, together with other documents to Mr Cooper by way of email attachment on 26 June 2001. He informed Mr Cooper:

> "… With the exception of the extra letter (T2) indicating that the Foundation directors could rely on the information, this is the same material that was distributed and discussed by David Minty at the February 13 meeting. We would still maintain our claim for confidence and privilege and according ask – as before – that you limit distribution to Foundation directors".[15]

26.13 Mr Shafron was not being scrupulous with the truth. As I note elsewhere, he knew no valid claim to privilege could be made. In addition, the attachment was not in fact the letter discussed by Mr Minty at the 13 February Meeting, but rather the final version of the letter which was sent to Mr Shafron by Mr Minty on 14 February 2001.[16]

26.14 Mr Ashe met with Mr Cooper on 26 June 2001 for a "general update". Mr Ashe forwarded his notes of the meeting to Mr Macdonald, Mr Shafron, Mr Morley and Mr Baxter.[17]

26.15 Two of the four items summarised by Mr Ashe were "Research" and "Meetings with Della Bosca's office and the DDB". The other items dealt with were:[18]

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[13] Ex 7, MRCF 1, Tab 37, p. 405.
[14] Ex 7, MRCF 1, Tab 38, p. 406.
[15] Ex 7, MRCF 1, Tab 38, pp. 406–407.
[16] Minty, Ex 50, Tab 22.
[17] Ex 150, pp. 162–164.
[18] Ex 150, pp. 162–164.

"**Solvency Analysis**

The Foundation is undertaking a solvency analysis to ascertain its "real" financial position. This involves:

- New estimates from Trowbridge on future claim numbers and costs
- Review of investment earnings
- Review of property holdings (hold v sell)

Dennis indicated that the returns the Foundation is getting are well under 11% (property about 2.8%, loan accounts 6%, securities 5%).

He had a dig at us over the indemnity payments, noting that there are 42 payments over an 8 year period, with the flexibility to cut this down to one payment per year. His point being that together with the other loan repayments that they really didn't have $293m to invest, "they were really just being drip fed" by us.

…

Media

No claims over the last couple of months have received media attention. However, there is a strong possibility of media attention for a Jsekarb claim scheduled to commence in about 3 weeks (AGM time). It is a South Australian claim and Tanya Segalov [sic] of Turner Freeman is involved. The claimant is a motor mechanic in his early 40s with about 2 mths exposure only. He has mesothelioma and Tanya is seeking about $1.2m.

I have arranged to meet with Dennis, Wayne and the Foundation's media adviser next week to discuss strategy."

26.16 This level of "interest" on the part of JHIL is somewhat at odds with the position Mr Macdonald put to Sir Llew Edwards and Mr Cooper on 15 May 2001.

26.17 Mr Macdonald responded by email dated 27 June "I know Phil M (Mr Morley) is going to respond to Dennis (Mr Cooper) on the many inaccuracies, in his statement to you".[19]

26.18 JHIL's approach to managing the relationship with Mr Cooper is demonstrated in Mr Ashe's reply:[20]

"Peter

Think if Phil goes direct to Dennis, Dennis is likely to cut the open dialogue he and I currently have. To preserve this, it might be better that I let him know in our next catch up meeting that I looked into his concerns and found that … (per the fact sheet that is being prepared). If he continues with the inaccuracies we then call in Phil?"

[19] Ex 189, Vol 2, p. 417.
[20] Ex 189, Vol 2, p. 417.

26.19 Mr Ashe met with Mr Cooper again on 30 July 2001 and forwarded his notes of the meeting by email to Mr Baxter and Mr Morley with a copy to Mr Macdonald. The notes outlined matters relating to the funding of Amaba and then continued: [21]

> "2. He also advised that Trowbridge has completed their report and that it shows the situation to be significantly worse than what was provided to them pre commencement. They have also received updated information from Towers Perrin and the Foundation will soon complete their solvency model. According to Dennis it won't look good. They intend briefing Peter M on the model outcomes.
>
> Apparently Trowbridge haven't interpreted the increase in claim costs last year as a blip. They believe it will be sustained".

26.20 Mr Ashe spoke to Mr Cooper on 7 August 2001 and reported the same day to Mr Shafron by email with copies to Mr Macdonald, Mr Baxter and Mr Morley. Mr Ashe reported the following matters "of interest": [22]

> "he is aware about the income stream to AMABA (which he noted was about $270k per year). His concern over solvency is if they get another sizeable claim or a number of claims in the short term in particular. He said he was liaising with you on this and had provided you with a copy of the Mallesons advice.
>
> he mentioned that one of the considerations re loans from AMACA to AMABA is whether it is expected that AMACA will become insolvent. He said it is the Foundation's view that based on the information provided at commencement, funding would last 15 to 20 years only. I noted that based on the best advice available at the time it was our view that it was fully funded. He said 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.
>
> The revised solvency model (post Trowbridge and Towers Perrin input) was presented to the Board on Monday and it reaffirmed that there is a dramatic change from the position at commencement. In his words "the directors are all walking around with very long faces". Apparently Trowbridge relies more heavily on the last 18mths claims data. Again he said that Sir Llew intends to discuss the latest solvency position with Peter M.
>
> He mentioned their political strategy to influence changes to the system – as Peter M discussed with us last week. Of concern though, is the possibility that they may use their new solvency model to demonstrate the need for change".

26.21 During July and August of 2001 Amaba was the subject of a significant claim, which raised issues as to its solvency. Advice from Mallesons, Stephen Jaques questioned the ability of the directors of Amaca to provide funds to Amaba, notwithstanding that the Deed of Covenant and Indemnity contained a provision

[21] Ex 189, Vol 2, p. 420.
[22] Ex 189, Vol 2, p. 437.

which permitted such a transfer. The problem was eventually addressed by JHIL agreeing to an acceleration of payments under the Deed of Covenant and Indemnity.[23]

26.22 Whilst this matter, of itself, is of no significance to the Inquiry, some aspects of the matter are of relevance:

(a) In the course of the transaction Mr Robb and Mr Williams, of Allen Allen & Hemsley, provided an advice dated 15 August 2001 to Mr Shafron on the Deed of Covenant and Indemnity. Mr Shafron provided Mr Cooper with a copy of the advice.[24] The "Factual Background" set out in the advice contained the following:

> "The recollection of those lawyers at this firm who were involved in the relevant discussions is that one of the principal and earliest concerns of the incoming directors was that the Foundation's subsidiaries would have sufficient assets so that they did not become insolvent within the first 5–10 years of establishment. This 5–10 year period was the length of time originally specified and later on this specification was extended to them having a 10–20 year life.
>
> While we are not aware of the particular reasons that the incoming directors had that underlay this concern, it is our understanding of the negotiations that this concern was strongly held and led to amendments to the commercial arrangements and the terms of the Deed.
>
> Firstly, that concern led to JHIL agreeing to contribute a substantial cash sum under the Deed.
>
> Secondly, the indemnity payment schedule was divided into payments to the two companies based on their historic claims profile. This had the purpose of seeking to ensure that, as best as could be determined, the two companies would have a similar fund life.
>
> Thirdly and more pertinently for the purposes of this note, it is our recollection that Peter Jolly, one of the incoming directors, raised the point during negotiations that it would not be possible to predict which, if either, of Amaba and Amaca would exhaust its assets first (noting that the amount payable under the indemnity was ultimately calculated with the aim of giving the companies sufficient assets to meet all expected future claim amounts). JHIL and the directors of Amaba and Amaca could see the logic of Peter Jolly's point and agreed with his idea that the two companies agree to indemnify each other to better secure their mutual (as opposed to respective) futures".[25]

(b) JHIL was anxious to avoid any insolvency on the part of Amaba. In cross-examination Mr Macdonald accepted that it would have been a "serious

[23] Cooper, T 24.58–25.21. See also Williams, Ex 332, p. 9, paras 24–28.
[24] Ex 7, MRCF 1, Tab 40, pp. 417–424.
[25] Ex 7, MRCF 1, Tab 40, p. 419.

matter had Amaba not been able to meet" the claims.[26] Nevertheless, it appears that Mr Macdonald did not draw the matter to the attention of the JHIL Board, though he said in evidence that he would probably have raised the matter with Mr McGregor.[27]

26.23 Mr Cooper sent an email to Mr Macdonald on 22 August 2001 advising that Sir Llew Edwards was endeavouring to contact Mr Macdonald regarding the potential appointment of an administrator to Amaba.[28]

26.24 An exchange of email correspondence occurred on 24 and 25 August 2001 involving Mr Ashe, Mr Morley and Mr Macdonald. Mr Morley advised Mr Ashe:

> "In your discussions with Dennis (Mr Cooper) I would just listen to what he has to say".[29]

Mr Macdonald observed to Mr Morley:

> "It would seem Dennis is continuing to play a fairly "hard game" with Steve Ashe".[30]

Mr Macdonald advised Mr Ashe:

> "As Phil says, it would be good to just absorb what Dennis has to say – I don't think the Foundation will do anything precipitous".[31]

26.25 In any event, for the time being at least, the problems in respect of Amaba's solvency were satisfactorily addressed.

26.26 The Trowbridge August 2001 report and explanatory correspondence were discussed at the Executive Meeting of Amaca/Amaba on 3 September 2001. As a result of that discussion it was suggested that Sir Llew Edwards "make another attempt to contact Mr Macdonald". He was not able to do so until 21 September 2001.[32]

26.27 Sir Llew Edwards described the telephone conversation:[33]

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[26] Macdonald, T 2390.20–24.
[27] Macdonald, T 2390.56–2391.12.
[28] Ex 189, Vol 2, p. 488.
[29] Ex 189, Vol 2, p. 502.
[30] Ex 189, Vol 2, p. 502.
[31] Ex 189, Vol 2, p. 502.
[32] Edwards, Ex 13, p. 38, paras 144–145.
[33] Edwards, Ex 13, pp. 38–39, para. 146.

> "Peter, the Foundation now has more information further to the conversation that you and I had in May. There is no doubt now that the Foundation has a very limited life. We believe that we could well be insolvent in less than 10 years. Our current estimated value of future claims could be as high as about $600 million. What is happening is there has been a great increase in the frequency and settlement value of claims. Our present experience shows continuing increases and the next study may well show an even worse position. We are either going to be short of money in the medium term, or are you able to do something about it?".
>
> Macdonald: We cannot do anything about it. In light of all the information we had available to us at the time we believe we provided adequate funds to the Foundation.
>
> It was either in this telephone conversation or in one of the few contracts that I had with him after that he raised the issue of the Foundation's legal costs in words to the following effect:
>
> Macdonald: You should be looking at your legal expenses. Perhaps you could look at those. You may be spending too much on them.
>
> Myself: Peter, that is peanuts compared to the size of the overall problem that we are dealing with. Peter, I am going to send you a letter anyway. I will outline the full detail of the problem in the letter. I will send it to you in the next few days.
>
> To the best of my recollection that was the end of the conversation".

The Board of Amaca/Amaba met on 18 September 2001. The minutes record: [34]

> "Trowbridge had provided additional information showing that some $100m of the increased asbestos liability projections (per Trowbridge Report 13 August 2001) could have been identified in February had the calendar 2000 information been processed.
>
> D Cooper tabled a draft letter appraising JHIL of the new projections. This was agreed to be reviewed and forwarded by the Chairman in advance of a direct meeting to discuss the position".

26.28 In view of the unsatisfactory nature of that conversation Sir Llew Edwards wrote a letter dated 24 September 2001 to Mr Macdonald outlining various concerns and seeking a meeting with Mr Macdonald.[35] Questions as to the timing of the sending and receipt of the letter are discussed in Chapter 25. It is sufficient here to note that there was no immediate response to the letter.[36]

26.29 However, Sir Llew Edwards and Mr Cooper met with Mr Macdonald on 20 November 2001 at Mr Macdonald's request.[37] In Mr Cooper's view, although

[34] Ex 7, MRCF 2, Tab 2, p. 16.
[35] Ex 3, Vol 1, Tab 9, pp. 129–131; Cooper, Ex 5, p. 36, para. 159.
[36] Edwards, Ex 13, p. 39, para. 148.
[37] Cooper, Ex 5, p. 36, paras 161–162.

Mr Macdonald was polite, he was "annoyed" that the 24 September 2001 letter had been sent. Mr Macdonald said:

> "Now that you have written this letter we have a problem and it needs to be responded to. I suggest that you consider withdrawing the letter. The quantum of funds in Amaca and Amaba that were vested to the Foundation was entirely the decision of JHIL".

26.30 Mr Cooper made notes of the meeting.[38] In his oral evidence Mr Macdonald claimed, somewhat unconvincingly, that he could not recall the meeting in any detail but accepted that Mr Cooper's notes were probably a fair summary of what happened at the meeting.[39] When pressed, Mr Macdonald further accepted that he "initiated the idea of the withdrawal of the letter".[40]

26.31 Mr Cooper's notes record relevantly:

> "The discussion consisted of Amaca reviewing and expanding the points made in the letter while P Macdonald (PM) responded in accord with the following summary statements –
>
> The extent of assets transferred was purely a matter for JHIL. Despite having no legal liability for ongoing claims (per Putt), the Board nevertheless transferred all assets for Coy and Jsekarb (rather than liquidating them) and provided additional funding. The role of new directors was to utilise those assets as effectively as possible to meet claims. Amaca's views were that this goal is a subset only and that we wanted to meet all claims or 20 year's worth which was our expectation.
>
> Re the projections, PM argued that the normal process was a Trowbridge analysis each 2 years based on year end data (to March). A report was then provided by August in that year. This was done in 2000 with a report issued in August 2000. As a result of an industry survey and conference convened by Trowbridge in November, it was determined that the 2000 JH report should be updated to reflect the epidemiological trends. To have "re-calibrated" based on JH data post March 2000 was seen to be impractical due to timing and unnecessary due to the unlikelihood of post March data having any significant effect on long term trends.
>
> While accepting the rapidly rising trends and the effect on long term projections, PM felt that more time was required to validate. He indicated that he would be prepared to have further informal discussions followed by formal ones if required however we had to allow more time to assess the trends – there could be a fall off. He re-iterated that the February 2001 forecasts were done in good faith and while he was disappointed with the actual claims experience, it was not reasonable to expect that there could have been a significant revision at that time.

[38] Ex 7, MRCF 2, Tab 11, pp. 16B–16C. Sir Llew Edwards considered the file note to be "an accurate and full account" of the meeting. Edwards, Ex 13, p. 39, para. 149.

[39] Macdonald, T 2402.33–35.

[40] Mr McGregor's evidence was that Mr Macdonald did not discuss this request for withdrawal of the letter with him prior to it being made by Mr Macdonald. McGregor, T 1511.10–13.

> In relation to the actual claims experience for year end March 2001, which were clearly able to be forecast in February and which were significantly greater than the projections, PM claimed that this information was given to us. This point was contested.
>
> …
>
> Re the letter, PM stated that he had a problem. This letter must be responded to and he would do so with a strong rebuttal of all points. He expected this would become a "pissing" contest which would be unproductive and not conducive to an ongoing co-operative relationship and future opportunities to explore these matters. He asked that we consider withdrawing the letter since at this stage he has shared its contents only with counsel. We responded that the Board saw this letter as a duty once we had become aware of the gravity of the position and the variance in expected life from that represented to us.
>
> We would put all matters to our Board for discussion and determination".[41]

26.32 Mr McGregor did not see the Foundation's letter of 24 September 2001 until shortly before him giving evidence to the Inquiry.[42] He was unable to recall when Mr Macdonald first made him aware of the existence of the letter but "expected that it would have been shortly after its receipt". Further that "it's highly likely and most probable that it was 2001".[43]

26.33 It appears that JHI NV was made aware of Sir Llew Edwards's letter no later than the JHI NV Board Meeting on 13 February 2002.[44] Mr McGregor's evidence was to the effect that when the matter was reported to the Board it left Mr Macdonald "to continue to manage it as he was doing".[45] Mr McGregor also recalled that Mr Macdonald had "indicated that at the meeting he had with Sir Llew there had been a rather less forceful position being taken than would appear from this letter".[46]

26.34 The attitude of the JHIL/JHI NV Board with regard to the payment of any more money following separation was canvassed in the cross-examination of Mr McGregor. According to Mr McGregor the Board had not agreed to pay any more money to the Foundation at any stage. This was decided "… early on, when these

[41] Ex 7, MRCF 2, Tab 11, pp. 16B–16C.
[42] McGregor, T 1504.53–54.
[43] McGregor, T 1504.56–1505.12.
[44] Ex 153; Macdonald, T 2403.47–2404.3.
[45] McGregor, T 1506.22–32.
[46] McGregor, T 1506.42–51.

claims were being made, and that remains the position at this time".[47] When pressed as to the meaning of "early on" Mr McGregor replied:

> "I suspect soon after receipt of the letter and subsequent requests, claims, whatever they might be categorised as, that occurred in following periods".[48]

26.35 Mr Shafron prepared a draft internal memorandum addressed to Mr Macdonald dated 9 November 2001 in which he made detailed comments regarding the Foundation's letter of 24 September 2001. Mr Shafron's recollection of the purpose of the memorandum "… was to set out our responses to the various allegations and possibly provide a basis for a reply that might be made to the Foundation to their letter".[49] Mr Shafron acknowledged that a reply was not sent for another 11 months.[50] Mr Shafron subsequently sent a copy of his memorandum to Allens Arthur Robinson and thought he would have "discussed it with that firm".[51] Mr Shafron understood that Mr Macdonald was going to meet with Sir Llew Edwards to discuss the matters raised by the memorandum.[52] A copy of the memorandum is at Annexure "Q".

26.36 The meeting of 20 November 2001 was discussed at the Amaca Executive Meeting on 26 November 2000. The minutes record:

> "… It was agreed that the matters raised in Chairman (sic) correspondence to P Macdonald of 24 September were legitimate and would stand. The Board re-iterated that the communication to James Hardie was meant to be informative not provocative and was vital since the information on future claims was at variance to P Macdonald's public comments at the time of Amaca's transfer. It was noted that the expert consultant was the same as that used in previous James Hardie studies. In the discussions with P Macdonald, it was indicated that Directors had received information on actual claims experience and also on US exposure. This was at variance to the recollection of Directors, who will review the supplied material accordingly. In addition, Mallesons will be approached in this regard. It was resolved that Sir Llew Edwards would communicate further to P Macdonald confirming the above discussion and encouraging constructive dialogue".[53]

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[47] McGregor, T 1506.53–1507.16.
[48] McGregor, T 1507.18–22.
[49] Shafron, T 1591.28–34.
[50] Shafron, T 1591.36–39.
[51] Shafron, T 1591.46–50.
[52] Shafron, T 1592.8–11.
[53] Ex 7, MRCF 2, Tab 11, p. 16A.

26.37 Mr Cooper's monthly report to the Amaca Board in January 2002 records, under the heading "Strategy Issues":[54]

> "JHIL Funding – P Shafron has been directly appraised of the issues and objectives relating to liability projections as per Sir Llew's letter. It was asserted that delays have resulted from unintended communication problems and that they are not attempting to ignore or otherwise stonewall. P Macdonald has subsequently confirmed with Sir Llew his willingness to meet the Board and to personally address all issues".

B. Funding Shortfall – The Revelation by Trowbridge

26.38 The course of dealings between the Foundation and JHIL post-separation must be considered in the context of the Foundation's directors becoming increasingly aware of the funding shortfall.

26.39 Mr Minty and Mr Marshall first met with Mr Cooper in March 2001 to discuss the possibility of Trowbridge providing services to the Foundation.[55] A letter of engagement was eventually sent by Mr Minty to Mr Cooper on 3 May 2001.[56] Mr Cooper's Managing Director's Monthly Report to the Board – June 2001, included:[57]

> "2. Claims & Litigation
>
> Preliminary outputs from the Trowbridge study have been reviewed and are being validated pending a report and presentation scheduled for the Executive Committee meeting of 6 August. It is clear that the actual claims performance for year ended March 2001 of $32m (net of QBE recovery) is not an aberration and represents an appropriate base level for future claims expectations. The previous study, as provided to Directors as part of due diligence, has been received from P Shafron and will be tabled at the Board. Trowbridge advised that this report was based on their previous report to Hardies covering 1999/2000 updated to reflect inflation and latest population claims expectations, but not including the most recent actual claims experience".

26.40 The Minute of the Executive Committee for 18 June 2001 under the item "Matters Arising from Board Minutes" records:[58]

> "D Cooper will provide outstanding James Hardie action list and will follow up directly in relation to provision of the Trowbridge report as referred to prospective

[54] Ex 7, MRCF 2, Tab 12, p. 18.
[55] Minty, Ex 50, p. 12, para. 54.
[56] Minty, Ex 50, p. 13, para. 57; Ex 50, Tab 28, pp. 232–240.
[57] Ex 7, MRCF 2, Tab 3, p. 3.
[58] Ex 7, MRCF 2, Tab 4, p. 4.

Directors on 12 February 2001. Sir Llew Edwards to be appraised in order to take up with P Macdonald as appropriate".

26.41 A draft report was provided to Mr Cooper on 5 August 2001. Mr Minty presented the draft report to the Amaca Board on 6 August 2001.[59] The minutes of the Amaca Board Meeting record:

> "Trowbridge had been commissioned to prepare an actuarial report of litigation outflows based on most current Amaca data and disease trends. This report was presented by David Minty and Karl Marshall who joined the meeting. This showed the total projected net cost of claims to be $574m and expected net outflows in year ending March 2002 of $37.5m. Directors highlighted the significant discrepancies between this latest Trowbridge report and that of February which was provided to prospective directors by James Hardie. The February report showed $294m for cost of claims and $23m for expected outflows in year ending March 2002. Trowbridge advised that their request for the most current claims data was rejected by James Hardie. Therefore, the February report was not calibrated by this latest claims experience. This actual claims performance so excluded revealed significant increases in mesothelioma claims such as provides the basis for the trend demonstrated in the current report. In addition, the previous report failed to update cost per claim data. Trowbridge would be asked to prepare figures based on data to December 2000 to gauge the extent of error caused by this lack of calibration".[60]

26.42 According to Sir Llew Edwards the Trowbridge presentation provoked "intense discussions within the Foundation Board".[61] Following the meeting the Board "sought a written explanation from Trowbridge for the movement in its projection of the potential future claims liabilities of Amaca and Amaba from that set out in its February Report".[62]

26.43 The adequacy of assets available to the Foundation was discussed at a meeting on 20 August 2000.[63]

> "**Background**
>
> 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.
>
> The key information provided by James Hardie upon which Directors relied was –
>
> - Trowbridge Report of February 13 showing litigation outflows;

[59] Minty, Ex 50, p. 13, para. 60; Tab 31, pp. 251–260.
[60] Ex 7, MRCF 2, Tab 5, p. 9.
[61] Edwards, Ex 13, p. 36, para. 137.
[62] Cooper, Ex 5, pp. 33–34, para. 148.
[63] Mr Cooper described this as a Board Meeting. Ex 5, p. 34, para. 150. The minutes at Ex 7, MRCF 2, Tab 6, pp. 10, 10A–10B are headed minute of Executive Meeting. In any event the Executive Committee, according to Mr Cooper is "in effect the Board". Ex 5, p. 31, para. 135.

- The James Hardie cash flow model incorporating the above plus investment returns and assumed operating costs.

Expert reports recently commissioned by the Foundation suggest that, contrary to Director's expectations, fund assets will last no more than 9 years and that a further $216m would be required to achieve the asset life of 20 years as originally proposed by James Hardie." [64]

26.44 Explanations were provided by Trowbridge in two letters dated 29 August 2001. Mr Minty described the 29 August 2001 letters as:[65]

"(a) a letter briefly explaining the reasons for the movement in our projections of the future exposure of Amaca and Amaba from that set out in the 13 February 2001 Report; and

(b) a letter concerning the effect that the availability of additional claim data from the Group may have had on our assessment of potential ARD claim exposure in our 13 February 2001 Report".

26.45 Mr Cooper[66] said that when he received the 29 August 2001 letter from Trowbridge he noted, in particular, the following comments which were made in the first letter: [67]

"In preparing our letter of 13 February, we were asked to revisit the claim number assumptions that we adopted in our draft advice on the future cost of asbestos-related disease claims as at 31 March 2000. This was to take into account revised estimates for the future emergence of asbestos-related personal injury claims in Australia developed by our colleagues at Trowbridge Consulting, Bruce Watson and Mark Hurst, whose findings were presented to the Accident Compensation Seminar of the Institute of Actuaries of Australia in November 2000.

Our letter of 13 February was otherwise based on the work we had done using James Hardie's own claim data to 31 March 2000 …".

26.46 Following receipt of those letters, Trowbridge was instructed to "estimate the impact that the availability of additional data as at 31 December 2000 may have had on Trowbridge's assessment of potential asbestos related liabilities from that set out in the February Report".[68]

[64] Ex 7, MRCF 2, p. 10A.
[65] Minty, Ex 50, p. 13, para. 63.
[66] Cooper, Ex 5, pp. 34–35, para. 152.
[67] Ex 3, Vol 3, Tab 4, pp. 464–466 at p. 464.
[68] Cooper, Ex 5, p. 35, para. 153.

26.47 Mr Cooper's evidence provided his perspective of developments in the six months following February 2001.[69]

> "During the 6 months following the establishment of the Foundation I had become progressively aware that Amaca and Amaba were likely to have insufficient assets to meet claims for compensation. This had become clear as a result of the actual YEM 2001 results, the latest actuarial data and the solvency analysis. I was still shattered to learn that the February Report had materially understated the potential asbestos-related liabilities of Amaca and Amaba.
> …
> It was all confirmed in the Trowbridge reports of 29 August 2001 when it noted that in preparing its February Report Trowbridge had not taken into account the most recent data which was available, the so called 'additional nine months data'".

26.48 Mr Cooper's recollection is that he learned of the failure to include the latest data in the February 2001 Trowbridge Report "first with Mr Attrill" and then he "raised the subject with Mr Minty".[70]

26.49 For Sir Llew Edwards the "concrete problem" was that "unless substantial additional funds were made available to the Foundation it was unlikely to achieve life of 20 years".[71]

26.50 Trowbridge issued a further report on 26 September 2001,[72] which incorporated the revised projections as at February 2001, based on the Amaca data to 31 December 2001. Mr Cooper said that "among other things" he noted in the report:[73]

> "(a) that data up to 31 December 2000 would have been the most up to date information that could have been made available to Trowbridge at the time that the firm prepared the February Report;
>
> (b) that with the benefit of the additional nine months' data to 31 December 2000 Trowbridge would probably have made material changes to the assumptions adopted in the February Report;
>
> (c) the material changes to the assumptions that they would probably have made had the additional nine months data been available to them in February 2001".

26.51 Mr Minty maintains that he requested up-to-date data from JHIL prior to preparation of Trowbridge's February Report.[74]

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[69] Ex 5, p. 35, para. 154.
[70] Ex 6, p. 2, para. 7.
[71] Edwards, Ex 13, p. 36, para. 136.
[72] Ex 3, Vol 1, Tab 9, pp. 469–474.
[73] Cooper, Ex 5, p. 36, para. 160.

26.52 On 18 January 2002 Mr Robb and Mr Peter Cameron[75] discussed the Foundation's position, in particular the letter dated 24 September 2001, with Mr Shafron. It was noted that the figure for settlements might be $40m in the current year and that the last 12 months had the Foundation "really worried". Mr Shafron said, in relation to the letter that: "we did not give any guarantees about the fund".[76]

26.53 A response to the Foundation's letter was apparently in contemplation and on 23 January 2002 Mr Robb emailed Mr Shafron saying that:[77]

> "It seems to me that the two main issues are (1) reliance/representation questions and (2) currency of data. The first is a question of the history of the negotiations and the second may result in the Foundation seeking confirmation of your position by Trowbridge."

As to the second of these issues he said:

> "(2) I think we need to focus on the conclusion at page 4 of your briefing note to Peter Macdonald that the combination of 10 years' data and the most recent industry figures means that the "Trowbridge numbers were as reliable an input model as was likely to be available at that time" – this is consistent with what you and Peter Macdonald told us at the time. We may need to discuss with you how Trowbridge confirmed at your meeting that if it had the most recent numbers it would not have affected their model. If Peter makes such a statement in the letter you run the risk that the Foundation will ask Trowbridge to confirm what is said – the Foundation will ask from two angles – did Trowbridge say this to you and, even if it did, if Trowbridge had have had the actual numbers at the time would it have affected the model – were the industry numbers sufficient for the purpose. This latter question may not be relevant from a legal perspective, depending on the outcome to (1) and given Trowbridge's advice to you that the most recent numbers would not have made any difference, but the Foundation is likely to ask anyway. Now that Trowbridge seems to be advising the Foundation are we comfortable that Trowbridge will back this up if asked?"

26.54 On the next day, 24 January 2002, in response to a question from Mr Shafron: "For now, are you able to confirm that we have no current disclosure obligation?", Mr Robb advised that disclosure was unnecessary under the ASX Listing Rules.[78] Among his reasons were:

> "Secondly, the discussion in the letter does not make any defined requests from JHIL that necessarily involve JHIL spending money (what are "necessary actions"?) or make any clear allegation – the nature of the Foundation's thinking is somewhat unclear from the letter. There may be insinuations but until we

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[74] See, for example, Minty, Ex 50, pp. 6–7, para. 31.
[75] Ex 189, Vol 2, p. 594.
[76] Ex 189, Vol 2, p. 595.
[77] Ex 207, p. 1.
[78] Ex 150, p. 206.

> understand more about them or if our own due diligence causes us to be concerned about our position such that JHIL believes that it may well have to provide a material amount of money to the Foundation, then there is simply insufficient certainty. Provided JHIL knows no more of the Foundation's thinking or intentions than is in the letter then the issue is insufficiently definitive to warrant disclosure."

26.55 Again, on 30 January 2002 a further telephone conference took place between Mr Robb, Mr Shafron and Mr Morley. Mr Robb suggested that there was a need for a reply on the merits to the Foundation's letter of 24 September 2001. No decision to that end appears to have been arrived at.

26.56 On 7 February 2002 Mr Robb emailed Mr Shafron as to discussions he had had with Mr Ball, a senior litigation partner at Allens.[79] In summary, Mr Ball agreed with the approach previously discussed (a form of letter was attached) and advised against taking witness statements at that time, especially since the Foundation's complaints were unclear.

26.57 The draft letter referred to in the second paragraph of Mr Robb's email was addressed to Sir Llew Edwards and, after referring to his letter of 24 September 2001, said: [80]

> "We have considered your letter and do not believe that any action by us or, more particularly, JHC Pty Limited (formerly James Hardie Industries Limited) is necessary or warranted.
>
> I understand [from conversations between us and between Peter Shafron and Dennis Cooper,] that you are not seeking [any action nor] a detailed response from us.
>
> I trust that this accords with your understanding.
>
> I note in passing that you have addressed your letter to me as Managing Director of James Hardie Inc. In responding to your letter, I have assumed that the letter was meant to be addressed to James Hardie Industries NV, noting that this company was not involved in the establishment of the Foundation".

26.58 It was proposed that the draft be signed by Mr Macdonald. The question of a reply to the letter of 24 September 2001 was apparently raised at the JHI NV board meeting held on 13 February 2002.[81] There is no reference to the subject in the minutes, [82] but Mr Macdonald's draft speaking notes for his CEO Report for the February 2002 Board Meeting refer to the September letter from the Foundation, and

[79] Ex 189, Vol 2, p. 591.
[80] Ex 189, Vol 2, p. 593.
[81] See McGregor, T 1506.13–26.
[82] Ex 283, Vol 7, April 2002 Tab.

Mr Macdonald's discussions with the Foundation.[83] The marked-up notes include the following:

> "it may be desirable to respond to the Foundation so that it is clearly understood James Hardie does not agree with much of the content of the letter from the Foundation. PJS to add any comments? (I would say that Allens advise to reply briefly …)" [84]

The Foundation's letter of 24 September 2001 was not replied to at this time.[85]

26.59 On 15 March 2002 a meeting was held at the Qantas Club Lounge at Qantas Domestic at Sydney Airport. There were differences of view on the agenda. In the event what took place at the meeting, so far as presently relevant, is summarised in Ex 150:[86]

> "Present:
> Peter McDonald
> Phillip Morley
> Peter Shafron
> Sir Llew Edwards
> Dennis Cooper
> Peter Jollie
> Michael Gill
>
> Opening
>
> Sir Llew Edwards
>
> Sir Llew opened with a thank you to all for attending.
>
> Wanted to tell you of trends causing concern
>
> Our learning curve
>
> Now on top of where we are heading and what we face
>
> Want to share with you and see if there is a way we can face this together
>
> Claims increasing dramatically — both numbers and average cost.
>
> We see it as a vastly different situation to what we expected 12 months ago
>
> D.D.T, USA and other issues are of concern.
>
> Questions about property values, leases and contamination
>
> Need to have this discussion so you can appreciate what we may need to do and why
>
> Reference to discussions with Government and the meetings with Insurers etc
>
> What we have done re research; some detail of progress in that area

[83] Ex 153, pp. 1–2. To the best of Mr Macdonald's recollection the draft speaking notes were a good summary of what he said. Macdonald, T 2403.53–56; see also, McGregor, T 1506.13–26.
[84] Ex 153, at p. 2.
[85] A brief letter of reply dated 15 October 2002 was subsequently sent by Mr Macdonald; Ex 3, Vol 12, p. 136.
[86] Ex 150, pp. 210–212.

Out of businesses in 5/6 years or maybe little longer

Michael Gill/Peter Jollie spoke briefly at Sir Llew's invitation

Peter Macdonald

Thanks for what you are doing

James Hardie carries responsibility for adequacy or otherwise of the original funding

James Hardie must remain independent

We can get too close; we don't need to know and can't get into the detail

Sale of Gypsum gives us an opportunity to take some initiatives — will talk about that today.

USA discussion re exaggerated claims and potential tort reform; Amaca has had small number of claims and should be able to maintain at low level

Dennis Cooper presentation

Trowbridge projections as provided 13 February were compared with those showing complete data to December 2000 and with those prepared for June 2001. Actuals to March 2001 and to February 2002 were also presented (see attached)

General discussion about the Trowbridge work in 2000 and early 2001 showing major shortfalls based on differing information

Specific Issues

Peter Macdonald

Now financially able to do something

Company did all it could last year; Almost breached covenants at the time

Should get entire cash proceeds from Gypsum sale next month

Intend to bring forward all indemnity payments forthwith

Peter & Phil will work with Dennis to see if that can be delivered efficiently

Have created the ability to deliver some millions more than that to the Foundation - more than $10m; delivery options to be explored

James Hardie can't take action that may need to be the subject of public disclosure of ongoing funding or commitment in the future

Net effect of all that: will try to cover off the differences from last year

What happens with JHIL? Won't strike without our agreement. Will want to talk to us. Will come with assets

These should be progressed in a matter of weeks; may take a little longer

Peter Macdonald

Leases

To be put on a fair and commercial basis

Maintenance issues will be addressed to the benefit of the Foundation including Meeandah drain

Goal of securitisation to be primary driver

> Peter Shafron to take responsibility for working out a settlement with Dennis Cooper
>
> **Non Asbestos Liabilities**
>
> No intention for MRCF to have liability for non-asbestos product claims
>
> Workers comp. claims should be the subject of an insurance claim; if no insurance, Hardie will cover
>
> **Covenant and Indemnity**
>
> The accounting treatment will be solved by the cash settlement …"

26.60 At about this time JHI NV commenced consideration of the cancellation of the partly paid shares issued by ABN 60 to JHI NV.

26.61 Mr Julian Blanchard, a Senior Associate at Allens from September 2000 until January 2004, was in the period March to July 2002:[87]

> " … part of the Allens' team which advised on the preferred method of transferring control of ABN 60 to the Medical Research and Compensation Foundation (***MRCF***) (the ***Transaction***). I worked under the supervision of David Robb who was, and is, a partner of the firm. In this capacity, I attended a number of internal meetings at Allens, and other meetings or teleconferences involving Allens' lawyers and representatives of JHI NV."

26.62 In the course of so doing he made notes of a number of meetings at Allens dealing with the Transaction as so defined.

26.63 The first such meeting was on 25 March 2002. This appears to have been an occasion when Mr Robb was briefing him on what was under consideration. One of the possibilities then mentioned was a sale of JHIL to the Foundation. It was noted that:[88]

> "JHIL has partly paid shares to JHI NV
>
> ∴ need to get rid of partly paids"

26.64 A question also raised was noted by Mr Blanchard as:

> "By 30 June, less than 1 year from scheme. What does IM[89] say"

26.65 It was noted that this was a question for counsel and the issue was raised:[90]

> "If had this in mind last Oct, should have disclosed?".

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[87] Ex 302, para. 11.
[88] Ex 302, JRB 1.
[89] Obviously a reference to the 2001 Information Memorandum.
[90] Ex 302, JRB 2.

26.66 A telephone conference took place on 11 April 2002, the participants being Mr Robb, Ms Priestley and Mr Blanchard on behalf of Allens, Mr Sheppard and Mr Sandow on behalf of PricewaterhouseCoopers and Mr Morley. Various options were discussed, and Ms Priestley's note the next day records those ultimately identified as:[91]

> "Options
> - Appears to be four main options that should all be canvassed as possibilities to determine positives and negatives:
>   (a) Transfer of the shares in JHIL
>   (b) Give the Foundation more cash now up the tax losses incurred – no tax leakage
>   (c) Give the Foundation more cash now – irrespective of tax leakage
>   (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.
> - Another possibility is to commence some form of insolvency procedure for JHIL, but given it involves a solvency declaration is unlikely to be available."

Mr Blanchard's note is to the same effect.[92]

26.67 Mr Morley's evidence[93] was to the effect that as he was in Australia at that time he had been asked by Mr Macdonald to attend the meeting on 11 April 2002. This was in the context of the impending settlement of the sale of JHI NV's United States based Gypsum business to British Plasterboard for US$345m. The surplus proceeds would allow repayment of up to A$100m to satisfy JHIL's outstanding liability under the Deed of Covenant and Indemnity.

> "… The tax effective way of paying those funds to the Foundation was by transferring ABN 60 rather than making payments. My recollection is that the tax consolidation legislation which made it possible to transfer ABN 60 with the funds in it without the Foundation incurring any tax liability was to be introduced with effect from 30 June 2002. When I went to this meeting I understood that Allens had been instructed, either by Peter Macdonald or Peter Shafron, to advise on the possibility of a transaction involving the transfer of ABN 60 to the Foundation. I understood that this was the first meeting at which that proposal was to be discussed".[94]

26.68 In the course of the meeting a matter discussed was the reputation of JHIL and, I should think, JHI NV in cancelling the partly paid shares so soon after having

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[91] Robb, Ex 303, Tab 4, p. 461.

[92] Ex 302, p. JRB5.

[93] Mr Morley addressed this and other issues in a statutory declaration dated 16 July 2004 he provided to the Commission after completion of his oral evidence.

[94] Morley, Ex 307, p. 1, para. 3.

obtained approval for a scheme which made no mention of cancellation of those shares. Ms Priestley's note of this aspect was:[95]

> "• ***Reputation of Company***
>
> • ***Acting soon after the Scheme***
>
> • This is all very soon after having been to the market with a scheme booklet which did not state that reduction of the partly paid shares was part of the intentions for JHIL.
> • Selling JHIL, cancelling the partly paid shares that have only just been issued etc would all be a change in direction
> • ASIC may also take an interest and choose to investigate
> • Liquidation in particular, so soon after the scheme may raise too many questions (getting Michael Ball and/or Tim L'Estrange to look at this as required)."

26.69 Mr Blanchard's note was to the same effect,[96] but he also noted:

> "→ reputation
> → short time after scheme
> Scheme spoke of intentions →
> 1. Then directors of JHIL confirm that what they said reflected their honest belief
> Open to risk that ASIC will enquire.
> Cameron – too soon."

26.70 The reference to "Cameron – too soon" was apparently to a view expressed by Mr Peter Cameron to Mr Robb to the effect that insufficient time had elapsed between the approval of the scheme of arrangement and the cancellation of the partly paid shares.[97]

26.71 I would note in passing that it was suggested that Mr Blanchard's note – in referring to the directors of JHIL confirming that what they said (no doubt in the Information Memorandum and in the statements made to the Supreme Court) reflected their honest belief at that time – was a part (or the start) of a form of conspiracy on the part of Allens (and JHI NV) to manufacture an excuse for the failure to refer to the possibility of cancellation of the partly paid shares at the time of the approval of the scheme of arrangement. I do not agree with this contention. In my view what was being done was simply to say to JHIL (per Mr Morley) that if the partly paid shares were to be cancelled so soon after the approval of the scheme of arrangement, the directors of JHIL at the time of the scheme might be called on to

[95] Ex 303, Tab 4, p. 460.
[96] Ex 302, p. JRB4.

justify their statements in the Information Memorandum and the statements made to the Court as being their then honest belief.

26.72 Although Mr Morley did not have a clear recollection of this meeting he was, with the assistance of Mr Blanchard's file notes,[98] able to comment on several aspects of the notes which he considered to be consistent with his recollection. I have commented on one aspect of his recollection in the previous chapter.

26.73 He also recalled that at the end of the meeting an attempt was made to summarise the possible options available:

> "… The first option was to transfer ABN 60. The second option was to make payments to the Foundation up to the amount of the tax losses available so that those payments were not the subject of income tax in the Foundation's hands. The third was to pay all of the money now with the consequence that at lease some part of it would have been the subject of income tax in the Foundation's hands. The fourth was proposed by Mr Sheppard. He suggested that a new company be formed as a subsidiary of ABN 60 and that it be funded to the maximum amount of the liability prior to that subsidiary being transferred to the Foundation".[99]

26.74 These deliberations occurred with the Foundation being informed to some extent. The minutes of the meeting of the Executive Committee of Amaca on 11 June 2001 record under the item "James Hardie Update":

> "Sir Llew Edwards reported that there had been no substantive communication with P Macdonald despite attempts to do so. David Fairlie of Malleson's had been briefed and will address the Board at a meeting to be convened in the following week. D Cooper reported that P Shafron had advised that it would not be possible to effect the proposed transaction priuor (sic) end June and had confirmed the two options being considered for early repayment of C&I receivable. On the basis that one option being considered was the "JHIL option" (Clause 5 of C&I Deed), this provision was to be included in the brief to D Fairlie. Sir Llew Edwards and D Cooper were to advise P Macdonald and P Shafron respectively of the Board's continued disappointment at the lack of apparent concern and urgency in addressing the issues".[100]

26.75 Mr Cooper then proposed a draft meeting strategy for a further meeting[101] with James Hardie in July 2002. In that document Mr Cooper summarised his view of the position to date:

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[97] Blanchard, T 3536.32–38.
[98] The note is reproduced in Blanchard, Ex 302, Tab 1, pp. JRB 3–5.
[99] Morley, Ex 307, pp. 2–3, para. 4(e).
[100] Ex 7, MRCF 2, Tab 21, p. 27.
[101] Ex 7, MRCF 1, Tab 46, pp. 488–490.

"**The Background**

A funding shortfall was identified in 2001 and advised by letter 21 [sic] September 2001 and at a meeting 22 March 2002. This shortfall was quantified in a revised Trowbridge projection which used actual JH experience data which was ignored by JH in their representations of February 2001 to prospective directors and the public at large. The key statements were that the Foundation is "fully funded" and that "the funds are sufficient to meet all anticipated future claims".

The Foundation has offered JH the opportunity to "make good" the promises by making a further contribution of funds. The meeting of 22 March left Foundation directors with the impression that such sufficient funds would be forthcoming which could meet the shortfall.

In a follow up meeting, P Morley advised D Cooper that the quantum of funds which may be made available (complementing the early payout of C&I receivable) would be in the order of $10–15m. ("that's all there is"). Since this response does not accord with director's expectations and is, in any event, totally inadequate, a meeting has been convened at the request of the Foundation to allow full understanding, to present a further opportunity for satisfactory response to funding and to communicate to JH the forward program for the Foundation including, particularly, the impacts of the JH funding decision."

He also offered a bleak description of the Foundation's future:

"**The Future**

The table below summarises key outputs from Trowbridge -

Measure	Projection 13 Feb 2001	Projection 13 Feb 2001 as revised in Sept 2001 by inclusion of calendar 2000 experience data	Latest Projection 11 July 2002
20-Year Expected Future Claims	310	404	693
Total Expected Future Claims	355	486	810

[Figures in $'m]

Our present expectation is that Foundation assets will be exhausted in approximately 4 to 5 years. In 2 years, from June 2004, our contingent liabilities for notified claims (preliminary estimate of $70m in the June 2002 accounts) will require monthly assessment (as is now done for Amaba as a matter of course) ahead of the appointment of a receiver which is likely to be required in 2004–5 tax year. We are moving promptly now to commence the process of selling those properties currently leased to JHA following completion of reworking of the leases as agreed with JH."

26.76 The meeting took place on 16 July 2002, Mr Cooper's notes of that meeting[102] recording the attendance as being:

[102] Ex 7, MRCF1, Tab 47, pp. 504–505.

"Attendees:	Sir Llew Edwards (LE)	Peter Macdonald (PMC)
	Peter Jollie (PJ)	Phillip Morley (PMO)
	Dennis Cooper (DC)	Peter Shafron (PS)
Apologies:	M Gill"	

26.77 During the meeting Mr Macdonald stated that the funding provided to the Foundation "was entirely a decision of JH". Mr Morley then set out the outline of a proposal to provide another $15m to the Foundation. Under that proposal a total of $91m would have been provided, being the payments under the Deed of Covenant and Indemnity, plus $15m. ABN 60 would be transferred to Amaca.

Mr Jollie observed that:

> " … this sounded interesting but as MG had said to Foundation directors we would have to fully understand what is involved."

Mr Cooper:

> " … noted the latest projections and commented that the additional amount provided would not assist significantly in extending the Foundation life which now was less than 5 years and maybe only 2 to 3 before and [sic] administrator would be called in."

Mr Macdonald:

> " … commented that they fully understood this and that the outcome seemed inevitable whether 3 months, 3 years or 6 years. Both parties would have to deal with that situation whenever it happens and defend their own positions."

26.78 A discussion then ensued on the calculation of the funding which had been initially provided. Mr Cooper recorded Mr Jollie as saying that he recognised that James Hardie had not known the higher current projections:

> " … however there was available data at the time of the transfer to the Foundation which would have produced a claims expectation of around $200m more than that which was provided and that they may wish to address this."

26.79 In response Mr Shafron "commented that they see this differently to the Foundation" and Mr Cooper's notes proceed:

> "PMC said that the Board were in possession of all the independent expert advice and that they had been doing the projections for some 5 years and the total did not vary dramatically around the $300m plus. PMC said if they had made an error in the amount provided then they would have to explain that in dealing with their

position. PJ said that they should review their advice as Trowbridge may not be supportive of that (error) argument as they had not used the most up-to-date information available. PMC said that maybe this means the error was in timing. They would review their position.

LE quoted from PMC press releases re the extent of funding and the ability of the fund to meet anticipated future claims. PS reiterated that they provided all the funding possible and were close to covenant limits. PMC said it would be totally inappropriate and improper for JH to provide continuing support for the Foundation and could not be done in a transparent way. PJ felt that there were two issues; one the amount at $200 million and secondly the method of providing it without creating an unwelcome precedent. PJ believed that the method of provision issue may well be solvable if it was felt important enough, ahead of what will be a difficult time particularly from a PR perspective."

26.80 The meeting concluded with Mr Macdonald saying that he:

> " … was pleased to have a dialogue with us and would certainly report back to the Board on the Foundations expected future and the views of Foundation directors."

26.81 On the next day a meeting took place between Mr Robb and Mr Blanchard, and Mr Michael Ball. Mr Blanchard said that the purpose of the meeting was to obtain "high level input" from Mr Ball, who was very highly regarded within Allens "as an analytical thinker".[103] Mr Ball's possible involvement had been foreshadowed at the meeting on 12 April 2002.

26.82 A great deal was sought to be made of Mr Blanchard's notes of this discussion.[104] In particular, submissions have been made to the effect that Mr Blanchard's notes of this meeting suggest that at that time the notion was developed that – whatever might have been the true situation – the directors of JHIL should seek to justify the cancellation of the partly paid shares (together with the absence of any references to that possibility at the time of the scheme of arrangement) by saying that they had no intention to cancel those shares at that time.

26.83 This is a view with which I do not agree. The events at the meeting of Messrs Ball, Robb and Blanchard may, I think, be summarised as follows:

(a) After some introduction, Mr Robb said that there were five questions:

> "(1) timing after scheme
> (2) creditors of JHIL
> (3) control of docs
> (4) US/Dutch law

[103] Ex 302, para. 24; Blanchard, T 3537.24–31.
[104] Ex 302, pp. JRB6–JRB13.

(5) JHI NV pre accounts prepared in US GAAP recognised for full undiscounted amount. Foundation expecting to receive discounted amount if receive early. JHIL accounts in AUS GAAP show discounted amount. May want to pay undiscounted amount."

(b) As to "Timing", the notes describe the discussion as follows:

"

(i) Timing
JHIL's future intentions at scheme – no mention of this.
What would discovery reveal? What would witnesses say? What explanation given for change of timing? Last q. we have the $ now. Put option not disclosed in scheme, b/c it is not relevant. Scheme to secure tax benefits, no change to business/shareholders etc."[105]

This reflects no more than that there had been no intimation, at the time of the scheme of arrangement, of any intention to cancel the partly paid shares, and an explanation may well be necessary to explain or justify the change of view.

(c) It was also discussed, in relation to cancellation of the partly paid shares:

> "If cancelled, at instigation of JHI NV or dir[ector]s of JHIL, with no cash
> For "no consideration", interests of creditors not relevant.
> But court may think otherwise.
> If have regard to creditors, who are they?
> Current & future? How quantify? Actuarial Assessment. But have indemnity from Coy.
> Process, of actuarial assessment, valuing indemnity, may not want to"

A discussion then ensued about the classes of persons who might be "creditors".

(d) After debate on other topics, the question of "timing" was revisited:

> "Timing
> Factual question. Whatever misleading conduct that may be alleged has already occurred.
> What did they intend by the Put at the time? Did they intend that they were worth $1.8 billion. At time of Foundation, scheme was in contemplation.
> Reason for partly paids. Not willing to justify to court that creditors interests not affected.
> Proposed reduction. Doesn't have to be approved by court. […]
> Critical q, at time of scheme, we had intention to cancel these partly paid shares?
> But is that material to shareholders.
> But only req, do stat req to disclose intentions.
> Who might object?

[105] Mr Blanchard's evidence was q=question, $=money, b/c=because. Blanchard, T 3538.35.38.

> If had int. cancel pp shares, or t/f pursuant to the put option then misleading not to include in scheme docs
> Existence of pp shares to overcome concerns court may have in massive red^{n} of capital.
> But apart from that, can't see any concern. Just becomes creditor question.
> What relevance of partly paids if there is no creditor question. What would court have done. If satisfied, then no loss.
> In an ideal world, better to t/f pp shares
> Let Foundation deal with them
> Not a timing question. Could the put be exercised.
> Any extra $ that goes across it ameliorates any concerns may be raised.
> No other creditors in JHIL other than asbestos claimants …"

(e) In the end the view expressed, perhaps arrived at, was:

> "Best position:
> →cancel partly paids
> →t/f ordinary shares
> Say, no int. to t/f at time of scheme.
> Didn't cross anybody's mind to do this.
> Reason had partly paids was to have greater flexibility.
> Had an int. to deal with it later.
> Going to be weaker than what can be said for a t/f"

26.84 The contention which is advanced is that the note: "Say, no int. to t/f at time of scheme. Didn't cross anybody's mind to do this" records a decision to present this view as having been the fact at the time of the scheme of arrangement. Mr Blanchard in his oral evidence said[106] that when he used the word "Say" in his note, he was intending to convey that the word was used in the sense of "assume". That appeared to be virtually the only part of the events in which Mr Blanchard was relevantly involved of which he claimed to have any recollection other than what was recorded in his notes. [107] Nonetheless, I think that it reflects the sense of the notes. I reject the suggestion that the solicitors were making up a story for JHIL.

26.85 Mr Shafron participated in a conference call with Mr Robb and Mr Blanchard on 25 July 2002.[108] Mr Shafron reported on the meeting he had

[106] Blanchard, T 3527.34–57; see also, Blanchard, T 3550.16–39.
[107] An approach which I had some difficulty in accepting.
[108] Blanchard, Ex 302, p. 5, paras 36–38; Robb, Ex 303, paras 29–37.

previously attended with representative of the Foundation on 16 July 2002.[109] There was also further discussion of the proposed transfer of ABN 60 to the Foundation.

26.86 Mr Blanchard's note of the conference call included:[110]

> "...
> JHIL transfer
> Discussed meeting with Michael Ball.
> Creditors for Dirs of JHIL, only people with claim or who threatened a claim. Future potential claimants not creditors for that purpose.
> $17m shouldn't be an issue. Cost of doing business.
> Didn't see timing as presenting a legal risk.
> Each step, proper ∴ timing should not make a difference.
> JHIL may have shorter life in Foundation's hands.
> Could still be a decent period of time.
> JHIL – had subsid with assets.
> Existing JHIL directors could cancel partly paids
> cf t/f → not disclosed to market put option,
> did not in scheme indicate what it might do with the partly paids.
> Technical req of dirs of JHIL, what their future intentions were.
> Risk/arg, hard to believe we didn't had (sic) the int.
> Put in place before Scheme → hard to say was relevant.
> Or just generally misleading.
> Advantage of reduction – following due process.
> If done with clean bill of health.
> Since then – sold Gypsum
> – Foundation's position changed.
> If misleading, who suffered a loss b/c creditors interests taken into account.
>
> PS – don't like idea of handing Foundation partly paids. Can be painted in very bad light.
> ...
> Timing not an issue, b/c already sent out Info Memo.
> But, inference that they don't believe you. Courts influenced by subsequent conduct.
> How much cash to leave behind in JHIL.
> Risk, not against JHIL. If anybody, against JHIL's directors.
> JHI NV should not be at risk (subject to Dutch law q)
> No $ value shifting to date until cancellation of partly paid shares".

26.87 Mr Shafron's reference here to the partly paid shares is to be understood as his expression of a preference for cancelling the shares prior to exercising the put option, or otherwise transferring ABN 60 to the Foundation. The topic of the cancellation of the partly paid shares is the focus of the next chapter.

[109] It is not apparent that there was any reference to the put option or cancellation of the partly paid shares at that meeting.

[110] Ex 302, Tab 1, pp. JRB 14–18.

Chapter 27 – Separation of ABN 60 and the Cancellation of the Partly Paid Shares

A Cancellation of the Partly Paid Shares

27.1 As mentioned in the previous Chapter, in July 2002 consideration was being given to the possible exercise of the put option (Clause 5 of the Deed of Covenant and Indemnity between JHIL, Amaca and Amaba). On 11 July 2002 Mr Shafron sent an email to Mr Salter and Ms Marchione on the subject of "JHIL to Foundation". He said:

> "We are still thinking about putting JHIL to the Foundation, and will mention it to them next Tuesday when we meet with them.
> There are a bunch of issues, including:
> 1. the tax audit/carve out
> 2. stamp duty claw back
> 3. moving the subs out of the structure
> 4. bringing the company into compliance with our doc. retention policy
> 5. an indemnity for non asbestos matters
> 6. the partly paids
> 7. indemnities and agreements.
>
> Can you think of anything else?
> Other comments?"[1]

27.2 Mr Morley and Mr Salter were the directors of ABN 60 at this time.[2] In or around July or August 2002 Mr Morley participated in discussions with Mr Macdonald and Mr Shafron relating to the availability of funds in the order of US$50m expected to be received by JHI NV in March 2003 upon completion of the proposed sale of a mine site in Las Vegas, Nevada. According to Mr Morley:

> "… The availability of those funds would enable ABN 60's liability under the indemnity to Amaca and Amaba to be funded within ABN 60 by a payment of cash. If ABN 60 was then transferred to the same group (that is, the Foundation) the payments subsequently made by ABN 60 to Amaca and Amaba under the indemnity would not be taxable because of the tax consolidation legislation. At around this time, in these discussions, it was decided to explore the possibility of exercising the "put" option".[3]

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[1] Ex 118, Tab 6, p. 3.

[2] Ex 276, Tab 6, p.3. Mr Salter was the Tax Manager for the James Hardie Group in Australia. He reported to Mr Morley. He had joined James Hardie in 1975, initially as a cost accountant with Coy. Salter, Ex 103, p. 1, para. 1. Mr Morley and Mr Salter were appointed directors on 19 October 2001, following approval of the Scheme of Arrangement. They resigned on 31 March 2003.

[3] Morley, Ex 122, p. 7, para. 33.

27.3 Mallesons Stephen Jaques provided advice to Mr Cooper on 16 August 2002 in relation to the JHI put option. Preliminary views were provided by Mallesons Stephen Jaques on:

> "1. The likelihood of asbestos claims succeeding against JHIL;
>
> 2. The consequences of agreeing or not agreeing to the JHIL option for you as directors of Amaca; and
>
> 3. The mechanics of exercising the JHIL option".[4]

27.4 The Board papers for the Meeting of the JHI NV Board held on 18 September 2002 included a paper dated 5 September 2002 from Mr Shafron, dealing with the "Foundation and Related Matters". The recommended action sought by management was:

> "Recommended Action
>
> 1. To note this paper and discuss any issues.
>
> 2. Approve further work by management in relation to the steps discussed.
>
> 3. To make a final decision on: request to cancel partly paid shares; capital structure of ABN 60; and transfer of control of ABN 60 later this year once the board receives final external legal advice".[5]

27.5 The minutes of the JHI NV Board Meeting confirm that Mr Morley and Mr Shafron reported on the viability of ceding control of ABN 60 to the Foundation.[6]

27.6 On 17 October 2002 Allens Arthur Robinson, on instructions from JHI NV, wrote to Mallesons Stephen Jaques, the solicitors for the Foundation.[7] The letter outlined a proposal by JHI NV for change of control of ABN 60 from JHI NV to the Foundation. The letter advised:

> "Our client understands that the Foundation's management wishes to focus its attention on the proper management of the asbestos claims that are brought against its subsidiaries. Accordingly, the arrangements proposed in this letter have had regard to such concerns as best understood by our client.

[4] Ex 296, Tab 8.
[5] Ex 283, Vol 8, Tab Sep. 02; see also Ex 121, Tab 136, p. 3251.
[6] Ex 283, Vol 8. Tab Nov. 02.
[7] Ex 187, Vol 2, Tab 50, p. 462.

In light of this proposal, our client has formally responded to a letter of Sir Llew Edwards to Peter Macdonald of 27 September 2001. We enclose a copy of a letter from Peter Macdonald.

We are instructed to let you know that JHI NV believes that the broad theme of this proposal is consistent with recent discussions our respective clients have held".

The proposal was to:

"
- transfer from ABN 60 to JHI NV all of ABN 60's non-cash assets and liabilities at their approximate fair market value;
- provide ABN 60 with approximately $91 million in cash assets which is in excess of the present value of the amount payable for the covenant and indemnity pursuant to the existing deed of covenant and indemnity dated February 2001 between ABN 60, Amaca and Amaba (as amended on 10 September 2001) (**Existing Deed**);
- JHI NV considers that after the transfer of control of ABN 60 to the Foundation that the payments contemplated by the Existing Deed should be made (and the Proposed Deed requires this to happen). This is consistent with the original intent of ABN 60 at the time of entering into the Existing Deed; and
- cancel the partly paid shares of ABN 60 before effecting the transfer of control and execution of the Proposed Deed. ABN 60 currently has on issue 270 ordinary fully paid shares and 100,000 partly paid ordinary shares."[8]

27.7 The alternative to the proposal was noted as being the formal exercise of "the put option that exists under the terms of the Existing Deed".[9]

27.8 A draft Deed of Covenant, Indemnity and Access was enclosed with the letter.

27.9 The Foundation directors had briefed Mr Fairlie of Mallesons Stephen Jaques as to the position of the Foundation in or around June 2001.[10] Preliminary views were provided by Mr Fairlie to the Amaca Board on 19 June 2002[11] in relation to the "likely shortfall in funds" available to Amaca and Amaba. A formal summary advice dated 3 July 2002 was subsequently provided. Whilst identifying possible actions for misleading conduct, the issue of appropriate and practical remedies was considered to

[8] Ex 187, Vol 2, Tab 50, pp. 462–463.
[9] Ex 187, Vol 2, Tab 50, p. 463.
[10] Ex 7, MRCF 2, Tab 21, p. 27.
[11] Ex 327, Tab 5.

be more difficult. Mr Walker SC's advice in conference on 5 July 2002 was even less encouraging.[12]

27.10 Without wishing to canvass the details of the legal advice given to the Foundation it is in my view important to appreciate the tenor of the advice. This is particularly so insofar as the advice impacts on the manner in which the Foundation dealt with JHIL at this time. This is illustrated in an email Mr Cooper sent to Mr Bancroft of Mallesons Stephen Jaques on 19 October 2001:

> **"2. <u>JHIL Response to our letter advising of Upward Revision of Claims Estimates</u>**
>
> …
>
> The key question upon which we seek your advice is an extension of the previous, namely, are the Amaca Directors prejudicing the company's interests by not pressing JHIL on this matter, irrespective of whether JHIL need to address it formally as a claim.
>
> Of consideration is the fact that we did not believe that our letter could have been considered as a "claim", rather a provision of information and request for a meeting. We had received your earlier preliminary advice that we had very weak legal grounds upon which to build a case for more funding or related action against JHIL.
>
> We seek to ensure the best result for our constituents which probably falls to the "persuasion" / risk of negative publicity etc rather than legal "pressure"." [13]

27.11 When Mr Cooper received the first draft of the proposed Deed of Covenant, Indemnity and Access from Mr Shafron in late October[14] he "read the document thoroughly" and concluded that the covenants contained in the deed "were broader than those in the Original Deed".[15]

27.12 Receipt of the new Deed of Covenant, Indemnity and Access was noted at a meeting of the directors of Amaca on 24 October 2002 and advice sought so that "the Board may be fully appraised of the specific provisions including any variations from the Deed currently in place".[16]

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[12] Ex 296, Last Tab 14.
[13] Ex 327, Tab 2, p. 2.
[14] Cooper, Ex 5, p. 40, para. 182.
[15] Cooper, Ex 5, p. 40, para. 183.
[16] Ex 7, MRCF 2, Tab 25, p. 34; Cooper, Ex 5, p. 40, para. 183.

27.13 Advice was subsequently received from Mallesons Stephen Jaques.[17] This advice was considered at the meeting of the directors of Amaca on 27 November 2002:

> "A letter of advice from Mallesons of 22 November summarising key provisions of the proposed ABN60 deed was tabled. It was RESOLVED that, under the proposed Deed, the Board has no way of assessing the value of the ABN60 assets as proposed as against the extensive set of liabilities and commitments required of the Board and prospective future directors of ABN60. It was noted that the provisions of the Deed contain significantly extended indemnities over the existing deed. It was also noted that the response to the Board concerns re extent of assets as per Board letter of 26 September 2001 was unsatisfactory. D Cooper was instructed to advise James Hardie and our legal representatives that the proposed Deed is unacceptable and the Board remains disappointed with the lack of response to our letter of 26 September 2001".[18]

27.14 Mr Cooper telephoned Mr Shafron on 2 December 2002 and informed him of the Board's decision to reject the Deed.[19] JHIL requested a meeting with Sir Llew Edwards and Mr Cooper for 16 December 2002.[20]

27.15 The concerns that Mr Cooper expressed to Mr Shafron are summarised in an email Mr Shafron sent to Mr Robb on 5 December 2002. That email was then forwarded by Mr Robb to Mr Bancroft and Ms Hunter at Mallesons Stephen Jaques.[21]

27.16 Sir Llew Edwards and Mr Cooper met with Mr Macdonald on 16 December 2002. Mr Cooper prepared a file note of the meeting.[22] The file note was tabled and the meeting discussed by the Amaca Board on 17 December 2002.[23]

> "… it was RESOLVED that a revised deed embodying the principle espoused by P Macdonald, namely, that no new commitments be required of Amaca, would be considered by Directors".[24]

27.17 Mr Gill resigned as a director of MRCF and all subsidiaries on 30 January 2003.[25]

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[17] Cooper, Ex 5, p. 40, para. 184; Ex 327, Tab 9.
[18] Ex 7, MRCF 2, Tab 27, p. 37.
[19] Cooper, Ex 5, p. 40, para. 186.
[20] Cooper, Ex 5, pp. 40–41, para. 187.
[21] Ex 7, MRCF 1, Vol 2, Tab 52, p. 553.
[22] Cooper, Ex 5, p. 41, para. 189; Ex 7, MRCF 1, Tab 53, p. 556.
[23] Ex 5, p. 41, para. 190.
[24] Ex 7, MRCF 2, Tab 29, p. 39.
[25] Ex 276; Tab 5, p.2; Ex 7, MRCF 1, Tab 54, p. 558.

27.18 Mr Cooper met with Mr Morley and Mr Shafron on 21 January 2003 to discuss the Deed of Covenant, Indemnity and Access.[26] Mr Cooper informed Mr Morley and Mr Shafron that the replacement deed did not meet the requirement for no new commitments on the part of Amaca and its directors. Mr Cooper also indicated the shortfall of funds to meet future claims was $500m. Mr Morley and Mr Shafron indicated they were determined to transfer ABN 60. Mr Cooper prepared a file note. Part of the note reads:

> "To my questions – they say they cannot meet requirements for additional funds; would "blow apart" the separation. They again "defended" the extent of assets originally provided, despite non-use of latest data. To my assertion that this affected the support of Directors, they re-iterated that they could do nothing and that they were responsible for the funding and would be required to defend it. They confirmed that they are concerned about the PR risk to them but, again, say they cannot do anything".[27]

27.19 It also appears that JHI NV's intentions were "flagged" to put ABN 60 to Amaca by "end March (or 14 days from 19 February) should negotiations on a deed not be successful".[28]

27.20 Mr Shafron's board paper dated 3 February 2003 provided:

> " 1. **Background and overview**
>
> For reasons previously discussed with the Board and more fully set out below, it would seem to make sense – for both JHI NV 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

[26] Cooper, Ex 5, p. 41, para. 191.
[27] Ex 7, MRCF 1, Tab 55, p. 559.
[28] Ex 7, MRCF 2, Tab 30.

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".[29]

27.21 Mr Shafron's paper included comments on the Foundation, which reflected the then perceived commercial reality of any association with asbestos albeit even one distanced by the corporate veil.

"5. **US debt market experience**

The Foundation was set up to be independent of the JHI NV group and that is how it has operated since its inception. An extract from our FY02 accounts sets out the position:

> *The Foundation is managed by independent trustees and operates entirely independently of James Hardie. James Hardie does not control the activities of the Foundation in any way and, effective from February 16, 2001, does not own or control the activities of JH & Coy or Jsekarb. In particular, the trustees are responsible for the effective management of claims against JH & Coy and Jsekarb, and for the investment of their assets. James Hardie has no economic interest in the Foundation, JH & Coy or Jsekarb; it has no right to dividends or capital distributions, nor will it benefit in the event that there is ultimately a surplus of funds in the Foundation, JH & Coy or Jsekarb following satisfaction of all asbestos-related liabilities.*

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

The note's renegotiation was seriously delayed by the Foundation issue and at worst it would seem as though the renegotiated terms were substantially less favourable than they would have been without the connection to the Foundation. (The delay in renegotiation saw interest rates fall and cost James Hardie around USD4M.) A note from Peter Walraven, debt specialist with JP Morgan, substantiates this concern in Annexure F.

[29] Ex 121, Vol 8, Tab 136, pp. 3243–3249 at 3243–3244.

> Other recent transactions, such as the attempted sale (by Cemplank to a third party) and lease back (to JH US) of industrial land connected with the acquisition of the two Cemplank fiber cement sites in December 2001, were also adversely impacted by the Company's former subsidiaries' liabilities and the ongoing connection to the Foundation (according to CRIC, the lead investor engaged to put the financial aspects of the transaction together). That deal was delayed to the point where it could not go forward and the land was not transferred in the manner planned".[30]

27.22 Sir Llew Edwards wrote to Mr Macdonald on 10 February 2003.[31] The letter referred to discussions over the previous two years with Mr Macdonald and his executive team in relation to the inadequacy of funding to meet future claims. Observations in the letter included:

> "…contrary to the indications given to ourselves, the government and to the community in public statements, our assets are expected to last only some four to five years, with some 80% of future victims being unlikely to have their claims considered let alone met.
>
> …
>
> Amaca will meet its legal obligations under the original deed, however, no Foundation director is presently prepared to become a director of ABN60. The acquisition of ABN60 by the Foundation effectively divests from the new James Hardie Group that company which itself manufactured asbestos products and was the holding company for Amaca over that company's years of involvement in asbestos manufacture. We are advised there may be some $25m of additional assets accompanying ABN60 however, given the changed liability profile, this amount appears to be grossly inadequate to deal with the currently expected level of future claims.
>
> We note with interest the AFR article of February 3 wherein you are quoted in relation to a possible capital return to shareholders. We believe that your Board would share our view that issues of corporate social responsibility are critical in today's environment of triple bottom line reporting. We strongly believe that you should give serious consideration to now making further funds available to compensate future victims of asbestos disease arising from the James Hardie organisation's corporate stewardship over some 65 years and of the attendant dividends and capital growth for shareholders over that period.
>
> …
>
> James Hardie may assert that in 2001 it took account of expected future claims in establishing the Foundation and transferring the previous asbestos producing subsidiaries to that entity. In 2003, James Hardie wishes to similarly transfer the major corporate vehicle of those asbestos producing years to the Foundation. However, in so doing, it has apparently chosen not to take account of the current

[30] Ex 121, Vol 8, Tab 136, pp. 3245–3246; See also the email from Mr Walraven, the managing director of JP Morgan Securities "The Debt Renegotiation Foundation Implications"; Ex 121, Vol 8, Tab 137, p. 3382.

[31] Ex 3, Vol 1, Tab 13, pp. 137–138.

forecast of expected future claims, nor of earlier forecast deficiencies which have previously been pointed out by the Foundation".[32]

27.23 The Board of JHI NV met in New Zealand on 12 February 2003. The Board Papers included various papers and advice from Allens Arthur Robinson; Mr Archibald QC, Dutch lawyers De Braw Blackstone Westbrook draft resolutions, the latest draft of the Deed of Covenant, Indemnity and Access, and a report on asbestos-related litigation involving ABN 60 from Mr Attrill's Litigation Management Group.[33]

The relevant Board minute notes:

"FOUNDATION Mr D Robb (Allen Arthur Robinson) joined the meeting.

Mr PG Morley provided background and overview concerning the possible ABN transfer and Mr PJ Shafron spoke to his paper.

Mr Macdonald discussed recent communications with the Medical Research and Compensation Foundation. The board discussed each of the issues associated with a transfer of ABN 60 and the cancellation of partly paid shares. It instructed management to continue discussions with the Foundation and to report again upon further developments".[34]

27.24 A meeting was held with Mr Macdonald on 13 February 2003. Mr Morley, Sir Llew Edwards, Mr Jollie and Mr Cooper were also present.[35] Mr Macdonald acknowledged receipt of Amaca's letter of 10 February 2003 and confirmed that the letter had been discussed at the JHI NV Board and "resulted in robust debate on the issues". Mr Macdonald stated that they wished "to repay the funds due and an additional $20m surplus on a tax and friction free basis". He stated that "JH companies" had no liability and it would be against shareholders' interests to provide funds.

27.25 Mr Jollie put forward various reasons as to why payment could be justified, including the risk of litigation. Mr Macdonald replied:

[32] Ex 3, Vol 1, Tab 13, pp. 137–138.
[33] Ex 121, Vol 8, Tab 136.
[34] Ex 121, Vol 8, Tab 135, p. 3241.
[35] Mr Cooper prepared a file note of the meeting; Ex 7, MRCF 1, Tab 56, p. 560–561.

> "… that he regarded this as a well considered response and together with his Chairman and advisers would assess this prospect though he stated his initial feeling that this may be a difficult proposition. He gave a different reason for the "difficulty" by referring to the need to support his previous and current market statements..
>
> PMacd indicated that we would receive a letter relating to the proposed Deed which we may find challenging but which is meant to propose a rationale as to why the execution of the Deed by Amaca should be perceived as being in the interest of that Company".[36]

27.26 JHI NV responded to Amaca's letter of 10 February 2003 by letter dated 19 February 2003.[37] The letter stated that Amaca's letter was discussed at the JHI NV Board meeting on 12 February 2003. The letter advised that JHI NV was not "able to make additional funds available to the Foundation".[38]

27.27 The letter was considered by the Amaca Board at a meeting on 26 February 2003. The Amaca Board Meeting was also attended by Mr Bancroft and Mr Gill.[39]

27.28 Amaca responded to JHI NV by letter dated 3 March 2003.[40] The letter briefly dealt with funding and sought various amendments to the Deed of Covenant, Indemnity and Access. The letter also complained that the "deadline" was unrealistic and unreasonable.[41] The letter concluded:

> "Should you decide for whatever reason to put ABN60 with a lesser level of cash assets, potential liabilities for non-asbestos claims and with the unanticipated adverse financial consequences for the Foundation and its stakeholders, then this will clearly have adverse implications for all parties".[42]

27.29 JHI NV replied by letter dated 4 March 2003 indicating various amendments.[43] The matter was considered by the Amaca Board at a meeting on 12 March 2003.[44] The Board determined that the Deed was still unacceptable. On 12 March 2003 Mr Shafron reported by email to Mr Macdonald and Mr Morley on a meeting with Mr Cooper and Mr Bancroft. He described the meeting as "encouraging". He said:

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[36] Ex 7, MRCF 1,Tab 56, p. 561.
[37] Ex 3, Vol 1, Tab 15, pp. 141–145.
[38] Ex 3, Vol 1, Tab 15, p. 142.
[39] Ex 7, MRCF 2, Tab 33.
[40] Ex 3, Vol 1, Tab 16, pp. 146–148.
[41] Ex 3, Vol 1, Tab 16, p. 148.
[42] Ex 3, Vol 1, Tab 16, p. 148.
[43] Ex 3, Vol 1, Tab 17, pp. 149–150.
[44] This meeting is referred to in the Amaca Minutes of the Meeting of Directors on 17 March 2003. Ex 7, MRCF 2, Tab 35, p. 47.

> "…we made some of the small concessions (D&O, separate deeds, covenant not to sue on the partly paids) but reserved on the middle (arbitration, confidentiality of disputes) and big points (document confidentiality, balance sheet warranty, covenant not to sue on the establishment of the Foundation)".[45]

27.30 Under the heading "Issues", he observed:

> "They have sought and I think we will need to give a warranty that the balance sheet has been prepared in accordance with current accounting standards.
>
> In addition I plan to concede, if necessary, on: arbitration and confidentiality of disputes. I don't intent to concede on document confidentiality and covenant not to sue on establishment of the Foundation".[46]

27.31 The Amaca Board met again on 17 March 2003 (Mr Bancroft was in attendance).[47] The Board resolved:

> "that Mallesons should advise Allens of the Board's rejection of these deeds and put JHINV on notice in relation to any agreements entered into prior to exercising a "put option" alternative".[48]

27.32 On 17 March Mallesons Stephen Jaques wrote to Mr Robb at Allens Arthur Robinson advising that the Foundation was not prepared to accept the proposal to transfer control of ABN 60 on the terms set out in the proposed Deed.[49] The letter concluded by requesting 48 hours notice of any action to exercise the "put option". Mr Macdonald responded in a letter to the Amaca Board on 20 March 2003, expressing his disappointment with the decision of the Amaca Board and confirming agreement with a 48 hour notification prior to exercise of the option.[50]

27.33 Sir Llew Edwards wrote to Mr Macdonald on 25 March 2003 acknowledging Mr Macdonald's agreement to the provision of 48 hours notice and also seeking that notice to apply to any related action, namely:

> "any agreement or other transaction undertaken by ABN 60 of a nature similar to that proposed during our discussions on a negotiated deed".[51]

27.34 On 2 April 2003 Mr Macdonald wrote to the directors of Amaca advising them that JHI NV had reconsidered its position and transferred ABN 60 to a new

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[45] Ex 122, Vol 1, Tab 13, p. 94.
[46] Ex 122, Vol 1, Tab 13, p. 94.
[47] Mr Hutchinson had joined the Board on 26 February 2003: Ex 276, Tab 5, Ex 7, MRCF2, Tab 35.
[48] Ex 7, MRCF 2, Tab 35, p. 48; Cooper, Ex 5, p. 42, para. 200.
[49] Ex 187, Vol 3, Tab 70, p. 711.
[50] Ex 3, Vol 1, Tab 19, p. 152.
[51] Ex 3, Vol 1, Tab 20, p. 153.

foundation.[52] Mr Macdonald proposed a meeting on 22 May to explain the development in more detail.[53] At this stage the Foundation was unaware that the partly paids had already been cancelled (on 15 March) and ABN 60 transferred to a new Foundation (on 31 March).

The role of Mr Morley and Mr Salter

27.35 In or about August 2002 Mr Salter became aware that Messrs Macdonald, Shafron and Morley, together with other members of JHIL management, were considering the possibility of transferring "… ABN 60 to Amaca, possibly by exercising the put option contained in the Deed of Covenant and Indemnity …".[54]

27.36 "From around September 2002 to March 2003 …" Mr Salter "participated in regular meetings and telephone calls involving JHIL management and JHIL's external advisers, including Allens Arthur Robinson and PricewaterhouseCoopers".[55] Mr Salter also said:

> "As far as I can recall, all preparations for the transfer of ABN 60 to Amaca proceeded on the basis that the partly paid shares held by James Hardie Industries NV (**JHINV**) in ABN 60 would be cancelled prior to its transfer".[56]

27.37 There were a number of legal, accounting and administrative aspects of the proposed transfer of ABN 60 to the Foundation. This is illustrated by reference to one of the several iterations of the so called "step plan", identifying various issues and actions required in relation to the proposal[57] which was circulated to Mr Salter and others as an email attachment on 29 August 2002.[58] The "Step plan" specifically identified cancellation of the partly paid shares as one of the actions required. Step 5 under the heading "Issue" read:

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[52] Ex 3, Vol 1, Tab 21, pp. 154–155.
[53] Ex 3, Vol 1, Tab 21, p. 155.
[54] Salter, Ex 103, p. 8, para. 39.
[55] Salter, Ex 103, p. 8, para. 40.
[56] Salter, Ex 103, p. 8, para. 41.
[57] There are earlier versions of the plan, for example, Ex 119. These plans were part of an iterative process involving JHIL management and its advisors. Mr Salter briefly described the process in his oral evidence; see Salter, T 1993.7–29.
[58] Ex 116.

"**Cancel partly paid shares**

ABN 60 has on issue 100,000 Partly Paid shares paid to $50.00 each with uncalled of $19,603.62 each. This call potential from JHINV will not be available to the MRCF".[59]

27.38 The proposed transfer also involved consideration of ABN 60's liabilities, in that "… ABN 60 would have to be capitalised to the extent of those liabilities with that capital replacing the partly paid shares which would be cancelled".[60] The liabilities in question included those arising out of asbestos litigation. On 9 August 2002 Mr Morley instructed Mr Attrill to provide him with "a report on all asbestos litigation involving ABN 60".[61] Mr Attrill provided the report on 18 October 2002.[62]

27.39 Mr Velez of the legal firm Watson Mangioni was retained in or about August 2002 to advise Mr Morley and Mr Salter in their capacity as directors of ABN 60 in relation to any decision concerning the cancellation of the partly paid shares.[63] The evidence is not entirely clear as to the course of dealings with Mr Velez but it seems that Mr Morley met with Mr Velez at least twice around this time and Mr Salter attended one meeting with Mr Velez, Mr Robb and Mr Blanchard.[64] .

27.41 Mr Velez provided Mr Morley with a draft advice by email on 19 November 2002.[65] Mr Velez also sent a copy of the draft advice to Mr Oakes SC for his review and comment. Mr Morley forwarded the advice to Mr Salter on 21 November 2002. Mr Velez's advice included a summary:

"1. ABN 60 may implement the proposed reduction of share capital if, among other things, the reduction does not materially prejudice ABN 60's ability to pay its creditors.

2. We consider the better view is that "creditor" includes a person who may bring a claim against ABN 60 with respect to asbestos-related diseases where

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[59] Ex 116.

[60] Morley, Ex 122, p. 7, para. 34.

[61] Morley, Ex 122, p. 7, para. 34; Morley, Ex 122, Vol 1, Tab 9, p. 50.

[62] Morley, Ex 122, Vol 1, Tab 10, p. 54.

[63] Morley, Ex 122, p. 7, para. 36; Salter, Ex 103, p. 8, paras 42–43.

[64] Salter, T 1996.24–45. A letter from Mr Blanchard of Allens Arthur Robinson dated 5 September 2002 to Mr Velez refers to a meeting involving Mr Velez, Mr Morley, Mr Salter and a representative of Allens, on 21 August 2002. The letter forwarded a number of documents to Mr Velez by way of background information. Ex 103, Vol 1, Tab 17, p. 84. Mr Salter provided further information to Mr Velez on 25 September 2002. Ex 103,Vol 1, Tab 18, p. 861.

[65] Ex 103, Vol 1, Tab 24, pp. 110–123.

the act or omission by ABN 60 giving that person the right to bring a claim occurred prior to the reduction of capital even if ABN has no notice of that claim at the time of the reduction.

3. A reduction of capital undertaken by ABN 60 without regard to the impact of the reduction on potential claimants for asbestos-related diseases may expose the directors to claims for compensation for insolvent trading, civil penalties and disqualification from managing a corporation.

4. In the current circumstances of ABN 60, it is strongly advisable that the directors of ABN 60 commission an actuarial analysis to quantify the potential liability of ABN 60 to claims in relation to asbestos-related diseases before implementing the proposed reduction".

27.42 ABN 60's power to reduce its share capital derives from s 256B of the *Corporations Act 2001* (Cth). Section 256B provides:

"**SECTION 256B COMPANY MAY MAKE REDUCTION NOT OTHERWISE AUTHORISED**

256b(1)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.

Note 1: One of the ways in which a company might reduce its share capital is cancelling uncalled capital …"

27.43 I note that there was some advice given to JHI NV at this time by Allens Arthur Robinson to the effect that if the partly paid shares were cancelled for no consideration, that s 256B(1)(b) of the *Corporations Act 2001* (Cth) would not apply. This view was for a time also propounded in the submissions on behalf of JHI NV.[66] Mr Bathurst QC in an oral submission on behalf of Allens Arthur Robinson noted that it was not a proposition put on behalf of Allens Arthur Robinson or one that was "sustainable on a proper construction of the section".[67] I agree with this view. Further, Mr Meagher SC appeared to adopt a similar view in his oral submissions.[68]

[66] JHI NV Initial Submissions on Terms of Reference 2 and 3, p. 201, para. 16.1.4; see also JHI NV Submissions in Reply on Terms of Reference 1 to 3, p. 68, para. I3.9.

[67] Bathurst, T 3871.17–33.

[68] Meagher, T 3880.27–43.

In any event, for all practical purposes, the matter proceeded on the basis that s 256B(1) did apply.

27.44 To that end, on 10 December 2002, Allens Arthur Robinson forwarded an advice with the subject of "ABN 60 Creditor Analysis" to Mr Shafron. The advice dealt with the question of who could properly be considered a creditor for the purposes of s 256B of the *Corporations Act 2001* (Cth).[69]

> " 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 purposes 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".

27.45 Mr Archibald QC was also briefed to advise on the issue.[70] In a written advice dated 20 December 2002, he concluded:

> "It is likely, in my view, that the expression "creditors" in s. 256B is to be construed in a broad rather than a narrow fashion. Such an approach is consistent with (but not yoked inexorably to) the concept of creditor as employed in s. 195 of the Corporations Law. Such an approach would also be in harmony with the expansion of the class of persons capable of proving in a winding up effected by s. 553. It would meet, at least to some extent, the public interest considerations which were relevant under the previous legislation to the exercise by a court of its function of

[69] Ex 187, Vol 2, Tab 51, pp. 492–513 at pp. 505–506.
[70] Ex 187, Vol 2, Tab 52, pp. 514–518.

determining whether to confirm a reduction of capital. The position of "future creditors" was part of that public interest concern".[71]

"17. The consequence of the foregoing is that "creditors" of ABN 60 will include persons who, at the time of which the directors of ABN are deliberating under question whether to proceed with the capital reduction –

(a) have an enforceable entitlement to be paid a sum of money by ABN 60 (for example, pursuant to a final judgement of a court in relation to an asbestos related injury);

(b) a person who has instituted a legal proceeding against the company in respect of such a claim, but that proceeding has not reached the stage of final determination;

(c) a person who has conveyed to ABN 60 an intention to institute proceeding in respect of such an injury;

(d) a person who, by reason of prior events, is reasonably likely to have, and to make, such a claim but who has not yet communicated to the company to ABN 60 an intention to make such a claim".[72]

He went on to say:

"Further I consider for like reasons, that persons who, by reason of prior exposure to asbestos, are reasonably likely to manifest such symptoms at a later time, and who have not instituted a claim or indicated an intention to institute a claim, are also included in that category. The existence of a real likelihood that a prospective liability will be established has been employed in cognate areas. See, for example, Re Saebar, (1971) 18 FLR 317. Clearly, it may be very difficult to identify the individual persons who would constitute such "creditors". However, statistics may assist in establishing the likely number of claimants and the likely nature of their alleged injuries, as would (no doubt) reference to information as to the period of time within which symptoms of asbestos related diseases would manifest themselves. Assessment of the strength and likely success of such claims will of course be difficult but actuarial and like analysis will probably be capable of yielding some measure of quantification that will assist the Board in this respect. The matter should, in my view, be approached in a commercial and realistic way. This is consonant with a view that claims that are predictable and reasonably likely to emerge (but which have not yet emerged) ought to be taken into account in the way that an insurer does".[73]

27.46 On 31 January 2003 Allens Arthur Robinson provided an advice to the directors of JHI NV with regard to the proposed transfer of JHI NV to the Foundation. Amongst other matters, that advice dealt with "Who are the creditors of ABN 60?"[74] and attached the advice from Mr Archibald.

[71] Ex 187, Vol 2, Tab 52, pp. 523–524.
[72] Ex 187, Vol 2, Tab 53, p. 525.
[73] Ex 187, Vol 2, Tab 53, p. 526.
[74] Ex 187, Vol 2, Tab 57, pp. 535–557 at 541–543.

27.47 It is necessary to provide some detail of this advice in order that the actions of JHI NV, ABN 60 and its directors and JHI NV can be properly understood.

27.48 In the advice Allens Arthur Robinson agreed with Mr Archibald's view that "creditors" was likely to be interpreted broadly in the context of s 256B of the *Corporations Act 2001* (Cth). On that basis, pre-1937 claimants against ABN 60 should be included as creditors and appropriate amendments made and sufficient assets retained. The advice also noted:

> "The advice that ABN 60 has received from us is that it is more likely than not that claims arising out of the events of the 1970s and 1980s, if they are brought, will fail. In those circumstances, we think the better view is that the relevant claimants are not "creditors".
>
> Although, as we have said, there are some statements which suggest that a lower threshold may be applicable, none of those statements has been made in a context which addresses the question whether a greater than 50% chance of success is necessary. Rather, they have been made in a context where the expectation is that a claim by an identifiable person will be made and will succeed. In our view, it is not consistent with the purpose of s 256B to require a company to consider a claim and make some allowance for it where the expectation is that it will fail. To require a company to do that would be to require the company to disregard what would be in the interests of shareholders in favour of persons who are not expected to exist.
>
> Notwithstanding the views that we have expressed, there remains a real risk that a court will reach the opposite conclusion. Obviously, that risk could be reduced if ABN 60 retains sufficient capital to satisfy those claims or has adequate insurance coverage from a well rated insurer.
>
> The most conservative approach would be to attempt to quantify the liability of Amaca and Amaba for post mid-1970s claims and to assume that those claims will also succeed against ABN 60, applying appropriate discounts having regard to factors such as the apportionment of responsibility between Amaca and Amaba on the one hand and ABN 60 on the other. However, we think the better approach would be to limit the analysis to claims that might be brought by employees. Although the reasoning in *Wren's* case is not expressly limited to claims by employees, that was the relationship in that case. Moreover, in reaching its conclusion, the majority of the Court in *Wren's* case relied on the fact that the class of potential claimants resulting from its judgment was not indeterminate. In addition, we think that there are good reasons for distinguishing the position of employees from other claimants. Typically, the law imposes more onerous obligations in relation to employees than it imposes in respect of others. Moreover, in *Wren's* case, there was a direct relationship between the employees of CSR and the employee of its subsidiary to whom it was held to owe a duty. That direct relationship is unlikely to exist between third parties and ABN 60 employees who worked for Amaba and Amaca. For these reasons, we think a successful claim by third persons who are not employees is sufficiently remote to be able to say that there is not a "real likelihood" of liability being established, even on a broad interpretation of that expression.

> We advise separately on the question of how to quantify the potential value of such claims".[75]

27.49 On 31 January 2003 Allens Arthur Robinson also provided an advice addressed to Mr Shafron and Mr Morley on the merits of a claim being brought by the Foundation, or its subsidiaries, or any of their directors against ABN 60 or JHI NV in connection with the establishment of the Foundation.[76]

27.50 The advice proceeded on the assumption, the validity of which it did not examine, that in the establishment of the Foundation JHIL had engaged in misleading or deceptive conduct. The focus of the opinion was on what remedies might flow on that premise. Allens concluded that "it will be very difficult for the directors to establish that they or Amaca or Amaba have a right to a substantial remedy".[77] The reasoning was as follows:

> "(e) On the other hand, 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. Two possible arguments are available to them.
>
> First, they might argue that they would never have entered into the transaction if the assumed misrepresentation had not been made. We do not believe a rescission-type claim could succeed, as the directors and Amaca and Amaba have effectively confirmed the transfer by proceeding since sending this letter on the basis that the contracted arrangements are in force.
>
> Secondly, it is difficult to see how the directors or Amaca and Amaba have suffered any loss. (1) It may be that the directors would never have been directors. But it is difficult to see what loss they have suffered by becoming directors. (2) If the transaction had never occurred Amaca and Amaba are likely to have been worse off. It is true that they would never have given the indemnity to ABN 60. But nor would they have received the capital that they did. That is likely to be substantially more valuable to Amaca and Amaba than the indemnity is to ABN 60.
>
> Consequently, those companies have not suffered any loss either".

[75] Ex 187, Vol 2, Tab 57, pp. 535–546 at 542–543.

[76] Ex 187, Vol 2, Tab 57, pp. 557–560.

[77] Ex 187, Vol 2, Tab 57, p. 559. This advice is consistent with the advice the Foundation received from Mallesons Stephen Jaques and Mr Walker SC: See for example, Ex 327, Tab 5; Ex 296, Last Tab 14.

27.51 As I have said, the advice assumes that the claims which might have been available to Coy or Jsekarb in respect of dividend payments and management fees were less valuable than the payments to be made under the Deed of Covenant and Indemnity. No formal examination of that question ever occurred. Mr Robb offered to provide a detailed advice, in late 2000 and early 2001, but JHIL decided not to obtain one. The advice goes on to suggest an alternative remedial theory:

> "(g) The alternative argument available to the directors is an argument that, if the assumed misrepresentation had not been made, they would have put pressure on ABN 60 to contribute additional capital and it would have done so so that Amaca and Amaba's loss is to be measured by the amount of additional capital. In order to make out this case, however, the directors would need to prove that they would have insisted on an additional capital contribution and ABN 60 would have agreed to make that contribution. We think that would be a difficult thing to prove. Moreover, any damages claim would be limited to the additional amount of capital that the directors can prove ABN 60 would have contributed at that time".

27.52 This approach was the subject of no further comment or consideration, it appears. In fact, as I discuss elsewhere, there is good reason to think that JHIL may have been prepared to pay some more to achieve separation (although certainly not the sort of amounts that would have been necessary to justify a statement that the Foundation was "fully funded").

27.53 Nevertheless, Mr Morley's interpretation of this advice was that there was no compensable claim:[78]

> "By early February 2003 I 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 to which Sir Llew's letter related".[79]

Mr Salter apparently held a similar view, although his reasons are less clear in that he appears to have assumed, wrongly, that a claim in relation to the establishment of the Foundation was precluded by the "indemnities that were already in place between Amaca and Amaba and ABN 60".[80]

[78] Morley, T 2053.14–19.
[79] Morley, Ex 122, p. 7, para. 37.
[80] Salter, T 1945.11–32.

27.54 Mr Morley endeavoured to assess ABN 60's liability for workers compensation claims. Via Mr Shafron he had received advice from insurance brokers JLT[81] on this issue.

27.55 On 7 March 2003 Mr Robb forwarded a "revised note" to Mr Macdonald and Mr Shafron. This advice followed on from the advice given by Allens Arthur Robinson on 31 January 2002 on "Change of Control of ABN 60" and dealt with the valuation of claims against ABN 60 relating to the "*Wren* period". (The period from the mid to late 1970s to 1987 when it is suggested ABN 60 had some employees who to some extent supervised the manufacturing activities of Amaca and Amaba).[82]

27.56 On 7 March 2003 by memorandum to Board members, Mr Macdonald "confirmed a board teleconference to approve the cancellation of the partly paid shares in ABN 60 (formerly JHIL) and the payment of outstanding sums to the Medical Research and Compensation Foundation". The meeting was held by teleconference on 11 March 2003 (Sydney time).[83] The directors of JHI NV resolved:

(a) to transfer control of ABN 60 to Amaca and Amaba either by agreement or by exercise of the put option; and

(b) to require ABN 60 to cancel the partly paid shares.

27.57 These resolutions were subject to approval of a committee of the Joint Board "to consider further advice and analysis and, if thought appropriate, to approve each of the transactions".[84]

27.58 At this time JHI NV and its advisors were anticipating that the proposed transfer of ABN 60 to the Foundation would proceed[85] and Mr Robb was expecting preliminary comment from Mr Bancroft on the most recent documentation on

[81] Morley, Ex 122, Tab 12A, pp. 88–99, Tab 12B, pp. 92–93.
[82] Ex 187, Vol 2, Tab 58, pp. 562–569.
[83] Ex 121, Vol 8, Tab 138, pp. 3408–3411.
[84] Ex 121, Vol 8, Tab 138, p. 3410.
[85] See, for example, Mr Shafron's email of 13 March 2003 to Mr Macdonald and Mr Morley; Ex 187, Vol 2, Tab 60, p. 572.

Monday 17 March 2003.[86] This did not occur, instead he received the letter from Mr Bancroft saying that the Foundation would not execute the "negotiated transfer".[87]

27.59 In the interim, Mr Morley was continuing with his endeavours to quantify ABN 60's potential asbestos related liabilities.[88] He recalled:

> "1. In around March I had one or two telephone conversations with Mr Velez plus an exchange of emails in which I sent him the calculations which I had been doing concerning ABN 60's potential liability. In one or other of those conversations he told me that he would finalise the earlier draft advice and send a copy to Mr Salter. I have a vague recollection that I met Mr Velez in February with Mr Salter in relation to this same subject.
>
> 2. By the middle of March 2003 I understood that I had to address the question whether ABN 60 should cancel the partly paid shares and enter into the proposed Deed of Covenant, Indemnity and Access by reference to the interests of that company.
>
> 3. On 13 March 2003 (California time), I provided Mr Shafron with some preliminary calculations taking into account the Trowbridge March 1998 Report, verbal representations from the Foundation of a total asbestos liability at February 2003 of $650 million (net present value) and a revised advice from Allens on the Wren Period dated 14 March 2003 at (Sydney time) (attached to my email of 15 March 2003 at Tab 17). A copy of the email containing these calculations and Mr Shafron's response is at Tab 14.
>
> 4. By letter dated 14 March 2003, JHI NV requested that the directors of ABN 60 cancel the partly paid shares for no consideration. A copy of the letter is at Tab 15.
>
> 5. On 14 March 2003 at 4.34pm (California time), I circulated, by email, to Messrs Salter, Shafron and Robb:
>
> (a) a draft of a memorandum of an analysis I had prepared of potential workers compensation claims against ABN 60 for the Wren Period;
>
> (b) Allens draft advice dated 14 March 2003;
>
> (c) advice from JLT by email dated 10 February 2003;
>
> (d) a draft advice from Watson Mangioni; and
>
> (e) an email from Mr Shafron dated 13 March 2003.
>
> A copy of this email dated 15 March 2003 (Sydney time) is at Tab 16.
>
> 6. On 15 March 2003 at 6.42pm (California time), I re-circulated a further email attaching my slightly amended memorandum which analysed workers

[86] Robb, Ex 187, p. 17, paras 112–113; Ex 187, Vol 3, Tab 70, p. 711.
[87] Ex 187, Vol 3, Tab 70, p. 711.
[88] Ex 122, Vol 8, pp. 8-9.

compensation claims against ABN 60 during the Wren Period. A copy of this email is at Tab 17.

7. At 10.31pm (California time) Mr Macdonald responded to my analysis, commenting that the calculations did not account for a growth in the $20 million surplus without deduction for some years before claims would be made against ABN 60. A copy of that email by Mr Macdonald is at Tab 18.

8. On 15 March 2003 at approximately 1.00pm (California time), a meeting of directors of ABN 60 occurred. I was in California and Mr Salter was on the telephone from Sydney. We resolved to cancel the partly paid shares for no consideration. A copy of the minutes of the meeting signed by me is at Tab 19. Before that meeting I sent Mr Salter the copies of the various advices which had been received which addressed, in my view, ABN 60's potential liability in respect of asbestos claims. At the same time I was aware of the earlier advice to ABN 60 concerning its possible liability to the Foundation. Taking into account all of those matters it was my view that the amount of money which was to be left in ABN 60 (then approximately $20 million in net assets) was in excess of the funds which would be required to meet any liabilities it had. During the telephone meeting with Mr Salter on 15 March I discussed these matters and my views with him. He indicated that he was of the same view. He told me that he was not aware of any other liabilities which ABN 60 had. After that we resolved in accordance with the minutes".[89]

27.60 Mr Morley used the Allens Arthur Robinson advice of 14 March 2003 to further refine his calculations on providing for ABN 60's asbestos liabilities. Mr Morley's statement of 5 April 2004 describes the exercise in some detail.[90]

27.61 Mr Morley and Mr Salter did not follow Mr Velez's advice to commission an actuarial analysis to quantify the potential liability of ABN 60 to claimants in relation to asbestos related diseases before implementing the proposed cancellation.[91]

27.62 In this context several aspects of Mr Morley's oral evidence should be noted. Mr Morley admitted that the Trowbridge information that he relied on was out of date.[92] Mr Morley said he relied on the figures because they were consistent with prior Trowbridge reports. He had looked at the June 1998 report and was able to update this by reference to the current data provided by Mr Attrill to Mr Shafron.[93]

[89] Ex 122, pp. 8–9, paras 41–49.
[90] Morley, Ex 121, pp. 46–49, paras 307–323.
[91] Ex 103, Vol 1, Tab 24, pp. 110–111; Morley, T 2057.30–33.
[92] Morley, T 2117.21–33.
[93] Morley, T 2118.19–25; see also Morley, Ex 121, p. 47, para. 311.

Mr Morley recalled that method of calculation had been discussed "with Allens, our lawyers, that were working on this with me, and calculated it on that basis".[94]

27.63 Further, Mr Morley was aware that Amaca faced insolvency within nine years and had allowed for three, five and seven year insolvency in his calculation.[95]

27.64 Mr Morley did not have the latest information on claims figures but had been "told … a figure of 600 to 650 million".[96] Mr Morley's belief at the time was that the calculation was generous. He said:

> "…I used the information that was available to me. I spoke to Allens, the lawyers, and they analysed the workers compensation experience and I put it all together and calculated, I think, a number of about 11 million dollars".[97]

27.65 Mr Morley did not provide Mr Salter with a copy of any advice from Allens Arthur Robinson dealing with possible liability to the Foundation arising out of the separation in February 2001, he assumed such advice would have been provided to Mr Salter by Allens Arthur Robinson.[98] Nor did he discuss this advice with Mr Salter at any time.[99]

27.66 In cross-examination Mr Morley was unable to recall why he had not discussed a possible claim by the Foundation with the only other director of ABN 60, however, he claimed that this was not because he had already made up his mind to cancel the partly paid shares.[100] He said:

> "… I discussed these matters and my views with Salter on the 15th, so I would have discussed that advice as regards to the no claim. We both went through the workers compensation claims. We had an indemnity from JHI NV and we also had an indemnity at the time of setting up the Foundation from Amaca and Amaba for asbestos claims coming up to ABN 60". [101]

27.67 In fact, at the date of cancellation, ABN 60 had no such indemnity from JHI NV. In addition, Mr Morley was forced to acknowledge that the indemnity from

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[94] Morley, T 2118.25–27.
[95] Morley, T 2119.31–38.
[96] Morley, T 2119.25–29.
[97] Morley, T 2119.55–T 2120.1.
[98] Morley, T 2124.18–57.
[99] Morley, T 2124.40–41.
[100] Morley, T 2125.4–21.
[101] Morley, T 2125.5–21..

JHI NV did not apply to a claim from the Foundation.[102] He says he relied on the advice from Allens Arthur Robinson that "any potential claim from the Foundation was not compensable".[103] Mr Morley accepted that by cancelling the partly paid shares ABN 60 was giving up recourse to $1.9 billion.[104] Throughout cross-examination Mr Morley persisted with the view that appropriate advice had been taken and on the basis of that advice there was sufficient "cash" left in ABN 60 to meet all liabilities.[105]

27.68 Mr Morley agreed he was aware that when the partly paid shares were cancelled on 15 March 2003 that JHI NV was still negotiating with the Foundation with a view to transferring ABN 60 to the Foundation and his expectation was that the transaction would proceed and there would be a covenant not to sue in relation to asbestos claims.[106]

27.69 Two days later, Mr Morley participated in a conference in which Mr Ball cast doubt on the effectiveness of the Deed of Covenant and Indemnity as an answer to claims in respect of dividend payments and management fees.[107] It does not seem to have occurred to him, or to anyone else on the JHI NV/ABN 60 side, that this might require further consideration to be given to the extent of the creditors of ABN 60.

Mr Salter

27.70 On 15 March 2003 Mr Salter had an expectation that ABN 60 would be transferred to Amaca on 17 March 2003.[108] He reviewed the various advices including Mr Morley's "Qualification Memorandum" of 14 March 2003[109] prior to resolving to proceed with the cancellation of the partly paid shares.

27.71 In cross-examination Mr Salter acknowledged that he had always proceeded on the basis that the partly paid shares would be cancelled prior to transfer because

[102] Morley, T 2125.35–41.
[103] Morley, T 2125.43–49.
[104] Morley, T 2126.12–15.
[105] Morley, T 2126.21–27.
[106] Morley, T 2264.11–30.
[107] Ex 112; Morley, T 2267.38–2268.30.
[108] Salter, Ex 103, p. 10, para. 55.
[109] Ex 103, pp. 9–10, paras 51–54.

Mr Shafron had instructed him to operate on that basis.[110] Indeed, he was not asked to consider any other scenario,[111] did not question these instructions and accepted that the cancellation was part of the "game plan".[112]

27.72 Mr Salter said that he was in no doubt that the partly paid shares were a very valuable right from ABN 60's perspective which would not be given up without full and proper consideration.[113] Further, he acknowledged that the outcome of $22m net assets was an outcome that Mr Morley wanted.[114] Mr Salter agreed that he had not been released from his duties as an employee of the JHI NV group "to the extent that there might be a conflict" with his duties as a director of ABN 60.[115]

27.73 Although he was informed that an indemnity was going to be put in place as a substitute for the partly paid shares, there was no discussion on the precise terms of the indemnity.[116] By contrast he did, however, have considerable involvement in the tax implications of the cancellation, especially in relation to the tax consequences for JHI NV.[117] Other than taxation issues he did not recall any particular concerns as to any adverse consequence for ABN 60 regarding the cancellation.[118]

27.74 Mr Salter accepted that he gave no consideration to not agreeing to the cancellation of the partly paid shares.[119] Further, Mr Salter understood from the advice of Mr Oakes SC that "a court would be likely to do everything possible to construe an asbestos-related claimant to be a creditor for the purpose of section 256B".[120]

27.75 In addition, Mr Salter was aware of the letter of 21 September 2001 from Sir Llew Edwards "certainly before Christmas 2002".[121] However, as the correspondence was with JHI NV he did not understand this correspondence to involve a claim against

[110] Salter, T 1925.26–52.
[111] Salter, T 1926.1–3.
[112] Salter, T 1926.27–30.
[113] Salter, T 1928.49–57.
[114] Salter, T 1929.30–36.
[115] Salter, T 1930.14–21.
[116] Salter, T 1930.46–56.
[117] Salter, T 1932.19–24.
[118] Salter, T 1932.32–44.
[119] Salter, T 1933.1–36.
[120] Salter, T 1935.41–51.
[121] Salter, T 1936.41–58.

ABN 60.[122] He was confident that he would have been informed if the Foundation intended to pursue the matter[123] but understood that the Deed of Covenant, Indemnity and Access under consideration at that time did not provide any indemnity for a claim by the Foundation.[124]

27.76 He also realised that cancellation of the partly paid shares brought to an end the substantial means of satisfying a claim in respect of dividends paid by Amaca.[125] I note that Mr Salter received the final version of the quantification memorandum on 25 April 2003 and Mr Velez's advice on or around 28 March 2003,[126] both after the shares had been cancelled.

Submissions

27.77 A number of submissions have been made by parties in relation to the cancellation of the partly paid shares and the actions of JHI NV and its officers, and in particular Mr Morley and Mr Cameron.

27.78 To the extent that these submissions involve adverse contentions, the burden of rebuttal has fallen primarily on JHI NV. The submissions in reply on behalf of JHI NV conveniently summarise the various themes that emerged from the submissions of other parties.

> (a) Who is a creditor under s256B of the *Corporations Act*, and who were ABN 60's creditors when the partly paid shares were cancelled?
>
> (b) Were Amaca and Amaba creditors of ABN 60 at the time of cancellation?
>
> (c) Was JHI NV a shadow director of ABN 60 in relation to the cancellation?
>
> (d) Did Mr Morley and Mr Salter breach any of the duties that each of them owed under the *Corporations Act*?
>
> (e) Did the cancellation occur to defeat the MRCF's rights upon a winding up?
>
> (f) What are the consequences of any breach of the *Corporations Act*?"[127]

[122] Salter, T 1937.13–19.
[123] Salter, T 1938.40–49.
[124] Salter, T 1945.19–22.
[125] Salter, T 1975.46–1976.3.
[126] Salter, Ex 103, p. 10, para. 56.
[127] JHI NV Submissions in Reply on Terms of Reference 2 and 3, p. 64, para. I1.3.

27.79 I should also note that one of the threshold considerations to bear in mind in the present context is that the agitation with regard to whether there has been a failure to comply with the provisions of s 256B of the *Corporations Act 2001* (Cth) to some extent diverts attention from the merits of the actual decision to cancel the partly paid shares.

27.80 Although the advice from Allens Arthur Robinson would permit the conclusion that any claims against ABN 60 were speculative, no advantages to ABN 60 were apparent. Relevantly, JHI NV still sought the benefit of the Deed of Covenant, Indemnity and Access against the risk of such claims. Arguably, if the issue was material to JHI NV, it must also have been material to the interests of ABN 60. Further, whilst Mr Morley undertook various calculations, it is not apparent that any consideration was given to creditors in the event that his calculations or the advice given to him was incorrect. Arguably, these claims were not amenable to precise calculation. There was also a possibility that ABN 60 might not be able to rely on the original Deed of Covenant and Indemnity in respect of claims arising out of the establishment of the Foundation.[128] Accordingly, it is extremely difficult to identify how the interests of ABN 60 were being served.

27.81 In my view, the issue is not whether the directors of ABN 60 had the power to cancel the partly paid shares pursuant to s 256B of the Corporations Act, but did their actions in March 2003 contravene s 180(1) and/or 181(1) of the *Corporations Act 2001* (Cth).

27.82 As to the first question, the meaning of the word "creditor" for the purposes of s 256B of the *Corporations Act 2001* (Cth) is a matter of some complexity. However, for present purposes it is sufficient for me to proceed on the basis that Mr Archibald's opinion is sound, a view with which I have considerable sympathy.

27.83 As to the second issue, one of the difficulties confronting the Foundation is the lack of clarity of the claims possibly foreshadowed during its dealings with JHIL/ABN 60 and JHI NV following separation in February 2001. In this context I also note the advice given to the Foundation by its own legal advisors at the relevant time. JHI NV's submissions make the point that it would be harsh to criticise

[128] See Mr Lawrance's File Note of 17 March 2003, Ex 112.

ABN 60's directors for not treating Amaca and Amaba as creditors, having regard to the advice those companies had as to the value of the claims against ABN 60.

27.84 As to the issue of shadow or de facto directorship, I find it difficult to conclude, for example, that Mr Salter did not simply follow instructions. For his part, Mr Morley endeavours to estimate ABN 60's liabilities were at one level well intentioned but nonetheless unquestioning of a predetermined objective to achieve separation of ABN 60, which of necessity must be preceded by cancellation of the partly paid shares.

27.85 Accordingly, in my view, it may be open to conclude that JHI NV was a shadow director of ABN 60.

27.86 As to the fourth issue, as I have indicated earlier, in my view, s 256B(1)(b) of the *Corporations Act 2001* (Cth) applied to the cancellation of the partly paid shares. Numerous submissions were made as to claims that might arise against the directors of ABN 60, JHI NV, officers of JHI NV and Allens in respect of the cancellation of the partly paid shares.

27.87 It is convenient to focus on the position of the directors of ABN 60. I say this because the circumstances give rise to a reasonable case for the proposition that JHI NV was a de facto or shadow director of ABN 60.[129] If there were such a finding, *and* a case of breach of directors' duties could be made out, it might be that the cancellation of the shares could be set aside.

27.88 As for whether the directors of ABN 60 breached their duties, it must be conceded that a considerable body of evidence supports a view that they acted with good faith[130] and care and diligence.[131]

27.89 They had the benefit, directly or indirectly, of the advice of Mr Archibald QC, Allens (as to both the cancellation process generally and the possibility of a claim by the Foundation), their own independent solicitors, who had in turn obtained advice from Mr Oakes SC, a specialist in corporate law matters. In large measure, this

[129] The relevant matters were summarised in Counsel Assisting's Initial Submissions, Section 4, paras 13–23.
[130] *Corporations Act*, s 181(1).
[130] *Corporations Act*, s 180(1).

advice was followed. Contrary to the submissions of the Foundation, I do not believe that Mr Morley's attempts to estimate the liabilities of ABN 60 was a sham. Whatever its flaws, it seems to me to have been a genuine exercise, and reasonably rational and appropriate.

27.90 Nevertheless, it is difficult to avoid having reservations about what occurred. Mr Salter appears not to have given any real, independent consideration to the transaction. In truth, he merely did as he was told. Mr Morley was more actively involved, and no doubt considered the various advices more carefully. However, he did not follow it in all respects. For example, he did not follow the advice of his independent solicitors and obtain an actuarial assessment. And he does not seem to have questioned whether the *possibility* of a successful claim by the Foundation not entirely excluded by the Allens advice warranted some allowance, or even further consideration. Finally, there is his willingness, almost enthusiasm for the project, in circumstances where:

(a) cancellation of the shares achieved no useful object for ABN 60, considered separately from JHI NV;

(b) the main impact of it was to destroy any hope for recovery on behalf of asbestos claimants, if, contrary to the advice of Allens, non-employees might have claims in respect of the "*Wren*" period, or the Foundation might have claims against ABN 60.

27.91 On the evidence before me, I would not be prepared to find that the directors of ABN 60 breached their duty in cancelling the partly paid shares, notwithstanding a lingering lack of enthusiasm for the commercial morality of the transaction.

27.92 The submissions made on behalf of the Unions and Asbestos Support Groups are critical of Mallesons Stephen Jaques with regard to their alleged failure to advise the Foundation of the serious implications of the cancellation of the partly paid shares.

The submissions have no substance. The Unions and Asbestos Support Groups are also critical of the advice given by Mallesons Stephen Jaques with regard to any claims relating to the establishment of the Foundation. The evidence does not support the criticisms, especially given the advice sought by the Foundation from Mr Walker SC, and the limited information available to the Foundation compared to that known as a result of this Inquiry.

B. The Establishment of the ABN 60 Foundation

27.93 As previously noted, on 17 March 2003 Mallesons, on behalf of the Foundation wrote to Allens rejecting the proposal that control of ABN 60 be transferred to the MRCF. Mr Bancroft said:[132]

> "Foundation Entities
>
> We refer to previous discussions and correspondence concerning the proposed negotiated transfer of control of ABN 60 ("Negotiated Proposal").
>
> The Foundation Entities Boards met this afternoon to discuss the Negotiated Proposal and have instructed us to advise you that they are not prepared to accept the Negotiated Proposal on the terms set out in the Proposed Deed.
>
> The Directors have carefully and thoroughly considered the issues and have formed the view that the Negotiated Proposal is not in the best interests of the Foundation Entities' stakeholders. In particular, the restraints imposed on Amaca and Amaba by the Proposed Deed are unacceptable when balanced against the additional benefits this provides.
>
> In this regard our clients have asked that we advise you that if your client seeks to exercise the put option under the Existing Deed then the Foundation Entities will very carefully scrutinize any actions taken by ABN 60 prior to that time (including entering into a Deed of Covenant and Indemnity along the lines of the draft provided over the weekend) to ensure that such actions are in the best interests of all relevant parties, including Amaca, as a future member of ABN 60.
>
> Accordingly, we request that you notify us at least 48 hours in advance of any such action so that our clients can take advice prior to taking any necessary steps to protect their interests."

27.94 Mr Macdonald emailed the Mallesons letter to Mr McGregor adding:[133]

> "We were not able to get the transaction done yesterday. The MRCF has informed us by letter (see below) that it is not minded to accept a negotiated outcome or the put. In fact, Sir Llew Edwards has confirmed in a telephone conversation that certain directors of the Foundation are adamant that they will not accept any negotiated outcome or put."

[132] Ex 77, Vol 2, Tab 17, pp. 405–406.
[133] Ex 77, Vol 2, Tab 17, p. 405.

and:

> "Accordingly, we have developed a new next best alternative the details of which are spelt out in the attached draft paper. So far, the potential of this alternative has proved out in preliminary reviews with our advisors. We are working very hard to finalize details in the next couple of days, with a target of completion by year end, so that it can be a management recommendation to the JHI NV board
>
> I will call after I have sent this email to discuss its contents with you."

27.95 Following receipt of Mr Bancroft's letter Mr Shafron prepared a decision table analysing the various options available to JHI NV including a negotiated outcome with the Foundation and the establishment of a separate and independent trust to receive ABN 60.[134]

27.96 According to Mr Morley, by 18 March JHI NV management had made a decision to pursue the alternative of a new Foundation (Foundation II) to manage ABN 60 for the benefit of the MRCF.[135] Mr Macdonald and Mr Morley worked jointly on analysis of that concept based on Mr Shafron's decision table. A telephone conference was held involving Mr Macdonald, Mr Morley, Mr Shafron, Mr Robb and Mr Blanchard on the morning of 18 March 2003 (Sydney time). It was decided that the current Deed of Covenant, Indemnity and Access would be amended and used as a basis for Foundation II.[136]

27.97 Although Mr Salter did not participate in these deliberations, it seems that he was aware of the proposal for Foundation II.[137]

27.98 On 18 March 2003 Mr Macdonald emailed Mr Shafron and Mr Morley, with copies to Messrs Robb and Baxter, stating that:[138]

> "I spoke with Alan and he supports proceeding with the recommended option forthwith.
>
> No communication with the MRCF for now.
>
> Let's circle back when Peter and David are in the office tomorrow morning. I would like us to review a detailed check list of tasks to be completed and issues to be addressed to get the proposal up in a timely fashion."

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[134] Morley, Ex 122, p. 10, para. 53. The table was circulated to Mr Robb, Mr Macdonald, Mr Morley, Mr Blanchard and Mr Baxter.
[135] Morley, Ex 122, p. 10, para. 54.
[136] Morley, Ex 122, p. 10, para. 55–56.
[137] Salter, Ex 103, p. 10, para. 57.
[138] Ex 187, Vol 3, Tab 72, pp. 717–718.

27.99 The "option" to which Mr Macdonald's email referred was to create Foundation II. His paper of 17 March 2003 was attached to his email to Mr McGregor. That paper said:[139]

> "JHI NV is now a focused fiber cement business It is the sole shareholder in two legacy companies (ABN 60 and Studorp) and seeks to determine the best process by which these companies should be managed in the future."

27.100 As to ABN 60, the paper commenced by noting that "We have completed a major review of ABN 60", and had "determined that here (sic) is no ongoing purpose, or necessity, for ABN 60 to remain within the JHI NV group". He then proceeded:

> "JHI NV would be advantaged by removing ANB 60 from the JHI NV Group as it would make even clearer the separation of JHI NV from any asbestos legacy of ANB 60's former subsidiaries (Amaca and Amaba). The review also enabled the directors of ABN 60 to cancel the partly paid shares which it held and that were callable against JHI NV."

27.101 The paper proceeded:

> "The next step in our review of ABN 60 is to locate it appropriately to enable it to carry out its future purposes. We have attempted to negotiate with the MRCF so as to place ABN 60 within the MRCF Group This cannot be achieved.
>
> ABN 60 is a non operating company with gross assets of AUD94M, an indemnity payment obligation to the MRCF of NPV AUD75.705M and net worth of around AUD18M. JHI NV wishes to ensure that the net assets of ABN 60 are fully and effectively provided to the MRCF despite its unwillingness to take ABN 60 directly. Given this, the primary purpose of ABN 60 should be:
>
> - To properly manage its assets to meet its obligation to make future indemnity payments to the MRCF. This obligation consists of making annual payments of AUD5.498M for the next 4 years (total AUD21.992M) then a balloon payment in 2008 of AUD73M. …
>
> - To invest its surplus funds and use the income from its surplus funds (and the principal if necessary) to cover any costs of ABN 60 prior to returning any surplus to the MRCF.
>
> The best option to achieve the above purposes is to create an independent foundation that would take on responsibility for managing ABN 60 to achieve the above two purposes. Don Cameron has already indicated willingness to become a director of ABN 60. He would be a very strong executive director of ABN 60. It would be highly desirable to appoint another 1–2 directors before implementing the proposed new foundation. The quality and availability of independent directors will be a key determinant as to whether we can achieve a year end implementation, and as to the quality of the future management of the new foundation.

[139] Ex 77, Vol 2, Tab 17, p. 407–408 at p. 407.

The table below analyses alternative options and concludes that the creation of a foundation is materially more attractive than the next best option."

27.102 The reference to locating ABN 60 "appropriately" must be read in a context where the aim was to remove it from the James Hardie Group.

27.103 So far as Studorp was concerned, the proposal was simply:

"Studorp is a non operating NZ corporation in which RCI Corporation is the sole shareholder. It has assets (land and buildings) that are leased to JHI NV's NZ operating subsidiary. It is, in many respects, the same as Amaca and Amaba before they were granted to the MRCF. While there is a no-fault compensation system that operates in NZ that covers the costs of anyone injured through exposure to asbestos, it is still the former operating vehicle that owned the NZ operations when they used asbestos. Studorp serves no purpose within the JHI NV Group and JHI NV would benefit from the same separation perception that would be a benefit in the case of ABN 60. Studorp should be included in the proposed foundation that would be created to take ABN 60.

Next Steps.

1. Roll Studorp under ABN 60. This is a task completely within the control of JHI NV and should be able to be completed within 14 days.
2. Create a foundation to take ABN 60. This is a task completely within the control of JHI NV and can be completed within 14 days, however appointing a suitable slate of directors may delay us past this point."

27.104 The "Conclusion" arrived at in the paper was that:

"We should recommend to the directors of JHI NV that:

1. Studorp be made a subsidiary of ABN 60.
2. A foundation be created to take ABN 60.
3. The charter of the foundation to be to ensure ABN 60:

- properly manages its assets to meet its obligation to make future indemnity payments to the MRCF
- invests its surplus funds and uses the income from its surplus funds (and the principal if necessary) to cover any costs of ABN 60 prior to returning any surplus to the MRCF

4. That these tasks be completed before 31 March 2003 with a rider that delay may be necessary to ensure appropriate quality directors are available."

27.105 The "table" analysing alternative options was as follows:

"

Options for Disposition of ABN 60							
		Put to MRCF	**Negotiated Placement to MRCF**	**Liquidate within JHI NV**	**Retain within JHI NV**	**Sell 3rd Party**	**Create New Foundation**
Objectives	*Weighting*						
ABN leaves group	3	Y	Y	N	N	Y	Y
MRCF gets maximum cash	3	Y	Y	N	Y	N	Y
JH avoids public clash	2	N	Y	N	Y	Y	Y
No breach of debt covenants	1	Y	Y	N	Y	N	N
Documents secured	1	N	N	N	Y	Y	Y
Speed of resolution	1	Y	Y	N	Y	N	N
Likelihood of completion	2	N	N	N	Y	N	Y
Collateral benefits	2	N	N	N	N	N	Y
JH protections	2	N	N	N	Y	Y	Y
Debt/equity market upside	3	N	Y	N	N	Y	Y
Score	*20*	*8*	*13*	*0*	*12*	*11*	*18*
Notes:							
"Negotiated Placement to MRCF" option assumes no protections and no confidentiality guarantees – we have been told that the MRCF will not accept this option, so its score should really be 0. This is also the only option that requires an independent audit before completion.							
"Create New Foundation" means a new Foundation with ABN and Studorp.							
"No breach of debt covenants" means that there would be no need to obtain noteholder extension or equivalent.							

"

27.106 On 21 March 2003 Mr Macdonald circulated a memorandum to the directors of JHI NV on the subject of "Proposed ABN 60 Foundation". He described the Key Objectives of the Foundation:

> "• To properly manage its assets to meet its obligation to make future indemnity payments to the MRCF. This obligation consists of making annual payments of AUD5.498M for the next 4 years (total AUD21.992M) then a balloon payment in 2008 of AUD73M. This could be achieved by ABN 60 self managing (investing) its funds and making the payments over time.
>
> • To invest its surplus funds and use the income from its surplus funds (and the principal if necessary) to cover any costs of ABN 60 prior to returning any surplus either to the MRCF subsidiaries (if they require further cash) or to the MRCF to fund asbestos medical research".[140]

27.107 He noted that Mr Don Cameron, the recently retired JHI NV treasurer was willing to become an executive director of ABN 60. Draft resolutions were attached. Mr Macdonald recommended approval of the resolutions.

[140] Ex 121, Vol 8, Tab 149, pp. 3456–3460 at p. 3456.

27.108 By late February or early March 2003 Mr Don Cameron became aware of the proposed transfer ("put") of ABN 60 to MRCF. This knowledge came through discussions with Mr Shafron or Mr Morley. Mr Shafron had subsequently indicated that consideration was also being given to establishing a new foundation. Mr Shafron asked Mr Cameron whether he would be interested in managing the new foundation, briefly explaining that it would have sufficient funds to meet its liabilities to Amaca and Amaba. Mr Cameron indicated an interest.[141]

27.109 On or around 21 March 2003 Mr Morley received a telephone call from Mr Don Cameron concerning an invitation to him to act as a director of Foundation II. Mr Morley explained the composition of ABN 60's balance sheet to Mr Cameron and "reminded [him] of the indemnity agreement with Amaca and Amaba and said that all other liabilities except for asbestos claims and the creation of the Foundation would be covered by JHI NV".[142]

27.110 In the period after 21 March 2003 Mr Don Cameron received a draft copy of his employment contract.[143]

27.111 Drafts of the Deed of Covenant, Indemnity and Access were circulated at the time.[144] This issue is considered elsewhere in the Report.

27.112 At about that time, Mr Macphillamy was approached by Mr McGregor with regard to whether he "would be interested in becoming a director of one of the companies in the James Hardie Group".[145] Mr McGregor had been the Chairman and Mr Macphillamy a director of a company unrelated to JHI NV.[146]

27.113 Mr Macphillamy attended a meeting in Sydney with Mr McGregor and was briefed by Mr McGregor. Mr Macphillamy recalled:

> "Mr McGregor explained that ABN 60 was to be separated from the James Hardie group, primarily to address a negative perception in the market and among investors that members of the James Hardie group had asbestos-related liabilities. Mr McGregor outlined in general terms the establishment of the Medical Research

[141] Cameron, Ex 42, p. 15, paras 101–103.
[142] Morley, Ex 122, p. 11, para. 61.
[143] D Cameron, Ex 42, p. 16, para. 105.
[144] Ex 122, Vol 1, Tab 28, pp. 163–217.
[145] Macphillamy, Ex 173, p. 1, para. 4.
[146] Macphillamy, T 2667.25–45.

> and Compensation Foundation (***MRCF***). Mr McGregor explained that, under existing arrangements, ABN 60 was required to make regular payments to Amaca Pty Limited (***Amaca***) and Amaba Pty Limited (***Amaba***), which were both former subsidiaries of ABN 60 but were now subsidiaries, ultimately, of MRCF. It was my understanding that it would not have been tax efficient for ABN 60 to pay the monies owed in a lump sum. Mr McGregor said that ABN 60 would have about $90 million to be managed in order to meet its existing obligations".[147]

27.114 On 25 March 2003 (Sydney time) the directors of JHI NV resolved to establish the ABN 60 Foundation:

> "The ABN 60 Foundation Trust Deed, as proposed to be executed by the Company and the ABN 60 Foundation, was tabled and discussed. The establishment of the ABN 60 Foundation was considered to be in the best interests of the Company as it was a necessary initial step to effect the ABN 60 Separation.
>
> **Resolved** that the Company's execution of the ABN 60 Foundation Trust Deed and settlement of AUS$2,000 in the ABN 60 Foundation, be approved, subject to any additions or changes that a committee of the board as designated below (*Board Committee*) approve". [148]

27.115 Various other resolutions were passed facilitating the establishment of the ABN 60 Foundation.

27.116 On 26 March 2003 Mr Cameron and Mr Macphillamy met at the offices of Allens Arthur Robinson with Mr Robb and Mr Blanchard. Mr Robb explained the transaction. Mr Macphillamy recalled the events:

> "… Mr Robb explained that JHI NV proposed to establish a new independent foundation (***ABN 60 Foundation***) which would hold all the shares in ABN 60. ABN 60 would continue to make payments to Amaca and Amaba as it was obliged to do, with any surplus to go to those companies if they needed the funds to make payments to claimants. If Amaca and Amaba did not require the surplus for that purpose, the surplus was to be given to the ABN 60 Foundation to be used for medical research.
>
> Mr Robb also explained that part of the transaction was an indemnity from JHI NV to ABN 60 in relation to certain claims, particularly non-asbestos-related claims. I recall that I expressed concern about the scope of the indemnity being offered. I wanted to make sure that ABN 60 and the directors would be indemnified for all claims other than those related to asbestos. I was principally concerned that claims may arise as a result of a tax audit, which I understood was a possibility at that time.
>
> I recall that Mr Robb gave me a bundle of documents to read. One of the documents in this bundle was a copy of a balance sheet of ABN 60 as at 25 March 2003. The balance sheet shows a projected surplus of approximately $19 million. I was satisfied that ABN 60 was solvent and would be in a position to meet its obligations towards Amaca and Amaba.

[147] Macphillamy, Ex 173, p. 1, para. 5.
[148] Ex 121, Vol 8, Tab 148, p. 3452.

> Following this meeting with Mr Robb, I recall that I had a discussion with Mr Cameron in which Mr Cameron briefly explained some of the background to ABN 60 and James Hardie generally. Because of my concern about the proposed indemnity, I remember saying to Mr Cameron that we should get independent legal advice. I recall that there was some discussion about whether we should approach a barrister directly or a solicitor. We decided to approach Andrew Stevenson, of Corrs Chambers Westgarth (***Corrs***), for advice.
>
> I was aware that, in the period following the meeting with Mr Robb, AAR provided documents, including a draft Deed of Covenant, Indemnity and Access (***Deed***), to Mr Stevenson. It is my understanding that discussions took place between Mr Robb and Mr Stevenson about the wording of the indemnity. However, I am not aware of the details of those discussions. It is my recollection that I had further discussions with Mr Robb about the transaction generally but I do not presently recall when these conversations took place, nor do I recall the details of those conversations.
>
> On 31 March 2003, I attended a meeting at the offices of AAR where the transaction was to be finalised. I recall that I had a further discussion with Mr Stevenson and Mr Cameron. Mr Stevenson provided us with a draft advice. Mr Stevenson also advised us orally. In substance, Mr Stevenson said that it was OK for Mr Cameron and I to go ahead and become directors of ABN 60. This was because the indemnity in the Deed covered ABN 60 and the directors for claims by third parties against ABN 60. This addressed my concerns about potential liability arising from a tax audit.
>
> …
>
> At the time the ABN 60 Foundation was established, it was my understanding that the purpose of the Deed was that JHI NV would indemnify ABN 60 in relation to all claims by third parties other than those related to asbestos or by Amaca and Amaba. This understanding was based on my discussions with Mr Robb and my own reading of the Deed".[149]

27.117 Mr Don Cameron met with Mr Macphillamy for about one hour on 27 or 28 March 2003. Mr Cameron explained what he knew about ABN 60.[150] Mr Shafron had also suggested that Mr Cameron and Mr Macphillamy receive independent legal advice. According to Mr Cameron, "Mr Macphillamy said he knew Andrew Stevenson, a partner at Corrs Chambers Westgarth", and a decision was made to approach Mr Stevenson for advice.[151]

27.118 A meeting with Mr Stevenson took place on 31 March 2003 at 12.00pm. Mr Macphillamy said:

> "… At the meeting, I recall that Mr Stevenson focussed particularly on a proposed Deed of Covenant and Indemnity. I recall that, in substance, he said that, in his opinion, the proposed indemnity was valid and that it appeared to achieve what the

[149] Macphillamy, Ex 173, pp. 2–3, paras 6–13.
[150] D Cameron, Ex 42, p. 16, para. 106.
[151] D Cameron, Ex 42, p. 16, para. 107.

> Allens summary document (see Tab 35) said it did. He also said that, in his view, the proposed deeds of access were appropriate.
>
> I recall that this meeting lasted about 30 minutes. I did not make any notes of this meeting.
>
> As an incoming director, I was also given a copy of a management accounts balance sheet for ABN 60 as at 1 March 2003. A copy is at Tab 36. When I was given a copy of the balance sheet, I was told that the figure for the net asset position was not final and could change but that it would be of the same order as that shown in the balance sheet. Tab 37 is a copy of a management accounts balance sheet for ABN 60 as at 31 March 2003 dated 1 April 2003.
>
> Following the advice from Mr Stevenson and my assessment of the ABN 60's financial position, I was happy to consent to becoming a director of ABN 60.
>
> After the meeting with Mr Stevenson concluded, I sat with Mr Macphillamy, Mr Stevenson and Mr Blanchard of Allens and we signed the documents that we were required to sign to become directors of the ABN 60 Foundation. I recall that this took about an hour".[152]

27.119 On 28 March 2003 Mr Robb provided to Mr Shafron and Mr Morley final advices in relation to the change of control of ABN 60.[153]

27.120 On the afternoon of 31 March 2003 Mr Robb in response to Mr Macdonald's email of earlier that day concerning Mr McGregor's contact with Mr Macphillamy, reported:

> "All signed – well pretty much all. All will be signed before the close of business. A few late changes and no major concessions. Andrew Stevenson was only reasonable.
>
> Congratulations".[154]

27.121 Some submissions were directed to claims that might be made against the directors of ABN 60, Allens and JHI NV in relation to the execution of the Deed of Covenant, Indemnity and Access, and the creation of the ABN 60 Foundation. It seems to me that these submissions were misconceived. If it is kept in mind that the partly paid shares were cancelled on 15 March 2003, the Deed of Covenant, Indemnity and Access can be seen, whatever its imperfections, to have been an entirely advantageous transaction from ABN 60's point of view, creating valuable rights of indemnity that would not otherwise exist. The creation of the ABN 60 Foundation considered separately from the Deed of Covenant, Indemnity and Access,

[152] Ex 42, p. 16, paras 108–112.
[153] Ex 187, Vol 3, Tab 86, pp. 923–931.
[154] Ex 187, Vol 3, Tab 87, p. 932.

had no impact on its financial position. It simply replaced one shareholder with another.

27.122 In the event JHIL also was removed from the James Hardie Group. It is now a wholly owned subsidiary of a foundation, the ABN 60 Foundation. That Foundation is also a company limited by guarantee, the guarantors being Mr T.J.C. Macphillamy, Mr Donald Cameron and Mr D.B. Treback. [155]

[155] Ex 276, Tab 5.

Chapter 28 - The Deed of Covenant, Indemnity and Access of 31 March 2003 and the Deed of Rectification of 3 February 2004

A. Introduction

28.1 With the establishment of the ABN 60 Foundation on 31 March 2003, a Deed of Covenant, Indemnity and Access was executed on behalf of JHI NV by Mr Robb under a power of attorney and by ABN 60 by Mr Salter signing as director and Mr Kneeshaw as secretary.[1]

28.2 Upon completion of these transactions, it appeared that JHI NV had finally achieved a full separation from the "legacy" issues associated with the James Hardie Group's asbestos related-liabilities.

28.3 That hope proved short lived. Mr Robb of Allens, in a meeting with Mr Blanchard and Mr Ball on 17 June 2003, appears to have been the first to realise that that the Deed operated in a manner contrary to his understanding of that which was intended, in that it included an indemnity in respect of the establishment of the Foundation.[2]

28.4 Ultimately, the Deed of Covenant, Indemnity and Access was amended, at the request of JHI NV, by a Deed of Rectification on 3 February 2004, executed by Mr Macdonald and Mr Shafron for JHI NV and Mr Donald Cameron and Mr Macphillamy for ABN 60.[3]

28.5 The Deed of Covenant, Indemnity and Access had as its model the Deed of Covenant and Indemnity of February 2001[4] which had been adapted to form part of the package of documents prepared for the proposed execution by the Foundation on 17 October 2002.[5]

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[1] Robb, Ex 187, Tab 88, pp. 935–958.
[2] Ex 187, para. 134.
[3] See Macphillamy, Ex 173, Tab 8; D. Cameron, Ex 42, Tab 39; Morley, Ex 122, Tab 62.
[4] Morley, Ex 122, paras 56, 68.
[5] Robb, Ex 187, Vol 2, Tab 50; Morley, Ex 122, Tab 28.

28.6 The draft deed underwent a number of revisions in the period from 18 March 2003 said to be consistent with the new stand alone proposal.[6] The correspondence concerning the numerous drafting changes are adequately summarised in the submissions of JHI NV[7]; I refer to some of them below.

28.7 Again, solicitors were retained to provide legal advice to the outgoing directors; this time Mr Velez of Watson Mangioni. However, he took no role in the deed's negotiation on behalf of ABN 60,[8] and no submission was made challenging his conduct.

B. Terms of the Deed of Covenant, Indemnity and Access

28.8 The final form of Deed contained obligations by ABN 60 in favour of JHI NV, and vice versa.

28.9 *First*, ABN 60 was required by clause 2.3 to comply with the terms of the 16 February 2001 Deed of Covenant and Indemnity[9] between itself, Amaca and Amaba. Those obligations included, importantly, the obligation to make the monthly payments to Amaca and Amaba which it was obliged to make under the earlier Deed.

28.10 *Secondly*, by clause 2.1 ABN 60 covenanted to not *make* any "Claim"[10] against a "JHI NV Party"[11] except for amounts payable by JHI NV pursuant to the

---

[6] See Robb, Ex 187, Tabs 54–57.

[7] JHI NV Initial Submissions, paras 17.1.7–17.1.23.

[8] Shafron T 1404.11-13; T 1406.23-26.

[9] The "existing Deed": see clause 1.1.

[10] A "Claim" was defined by clause 1.1 to mean:

> "… any:
> (a) allegation, claim, demand, action, cause of action, investigation by a Government Agency or proceeding; or
> (b) allegation, claim, demand, notice, threat, assessment or reassessment of or for Tax, GST or Duty under any Tax Law,
> whether based in contract, tort, statute, at law or otherwise howsoever, whether arising in Australia or in any other part of the world and whether or not substantiated;".

[11] "JH NV Party" was defined by clause 1.1 to mean:

> "… each member of the JH NV Group and each of their respective present or past directors, officers and employees and any of the directors, officers and employees of Amaca and Amaba who held that position prior to 16 February 2001;"

indemnity to which I refer below, or non-asbestos Claims arising "in the performance of any of the terms of any Subsisting (General) Contracts".[12]

28.11 *Thirdly*, by clause 2.2 ABN 60 was required to indemnify each JHI NVParty for any "Loss"[13] incurred in respect of Claims made against or Losses suffered or incurred by such JHI NVParty in respect of acts or omissions occurring before "Completion", a term defined by clause 1.1 to mean:

> "… completion of the change in control of ABN 60 from JHI NV to ABN 60 Foundation to be effected on or about the date of this Deed."

Not all such "Losses", however, were the subject of ABN 60's indemnity, but only those involving acts by, undertakings of, omissions of ABN 60 or any of its directors or officers in connection with or incidental to any Asbestos Claim or Asbestos Liability.[14]

28.12 *Fourthly*, JHI NV by clause 4.1 covenanted not to:

---

[12] "Subsisting (General) Contracts" were those set out in Part A of Schedule 1, namely:

"1. Queensland Business Acquisition Agreement Between James & Coy Pty Ltd, James Hardie U.S. Investments Carson Inc. and James Hardie Industries Ltd dated 28 October 1998
2. Business Acquisition Agreement between James Hardie & Coy Pty Ltd, James Hardie Australia Pty Ltd and James Hardie Industries Ltd dated 28 October 1998.
3. Queensland Business Acquisition Agreement between James Hardie U.S. Investments Carson Inc., James Hardie Australia Pty Ltd and James Hardie Industries Ltd dated 28 October 1998.
4. Agreement of Sale and Purchase of Business between James Hardie Building Products Ltd, James Hardie New Zealand Ltd and James Hardie Industries Ltd dated 2 November 1998.
5. Share Acquisition Agreement between James Hardie Industries Ltd and James Hardie Australia Pty Ltd dated 28 October 1998.
6. Deed of Adherence between Pine Waters Pty Ltd, ABN 60 000 009 263 Pty Ltd and Amaca Pty Ltd dated 6 November 2000."

[13] Very widely defined by clause 1.1 to mean:

> "… any loss, liability, cost (whether or not the subject of a court order), expense or damage and includes, without limitation, any lost salary or wages or any order for compensation, damages, aggravated damages, exemplary carnage or legal costs made by a court, tribunal or any other body with authority to do so;"

[14] Terms defined by cl 1.1 as follows:

"*Asbestos Claim* means any Claim, whenever arising, concerning or alleged to concern any Asbestos Liability;

Asbestos Liability means any liability (including any fine or penalty), whenever arising, in connection with, arising from or incidental to, whether directly or indirectly:

(a) the marketing, manufacture, processing disposal, removal, purchase, sale, distribution, importation, or exportation of asbestos or products containing asbestos;
(b) the ownership, occupation or the holding of any other interest in land where asbestos or products containing asbestos are or were present, manufactured, processed, distributed, removed or stored; or
(c) being the holding company, directly or indirectly, of companies that undertook the activities described in para. (a) or (b)."

"(a) make any Claim, whenever arising, against ABN 60 in respect of any Intragroup Claim; or

(b) assign, novate, encumber or otherwise dispose with its right to make any such Claim."

The concept of "Intragroup Claim" was itself widely defined, clause 1.1 providing:

"*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 JHI NVGroup, 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 control of ABN 60 by it and all matters incidental thereto;

(c) the cancellation of all the ABN 60 Party 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;"

Of some importance was the reference in para (a) of the definition of Intragroup Claim to the "JHI NVGroup". That term was defined by clause 1.1 as follows:

"*JHI NVGroup* 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);" (Emphasis added).

28.13 *Fifthly*, clause 5.1 contained an indemnity by JHI NV in favour of each "ABN 60 Party".[15] The indemnity was relevantly in two parts. In the first place there was a covenant by JHI NV:

"…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 …"

Then there was an exception:

"… 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."

[15] That is, ABN 60 itself, and its post-Completion directors and officers: clause 1, definition of "ABN 60 Party".

28.14 The exclusion from the definition of "JHI NVGroup" of Amaca and Amaba had a number of effects. It meant that Amaca and Amaba were not within the definition of "JHI NVParty". Accordingly clause 2.1 did not itself prevent ABN 60 from making "Claims" against Amaca and Amaba.

28.15 For similar reasons the indemnity given by ABN 60 pursuant to clause 2.2 would not extend to loss sustained by Amaca or Amaba. Because Amaca and Amaba were excluded from the definition of JHI NVGroup in para (a) of the definition of Intragroup Claim, the covenant given by JHI NV by clause 4.1 not to make a Claim against ABN 60 in respect of Intragroup Claims did not prevent it from making a Claim against ABN 60 in respect of a matter concerning Amaca or Amaba.[16]

28.16 Most importantly, claims by Amaca and Amaba would not be caught by the "Intragroup Claims" exception from indemnity provided for by clause 5.1, because Amaca and Amaba were not part of the JHI NVGroup as defined.

C. Terms of the Deed of Rectification

28.17 The Deed of Rectification varied the Deed of Covenant Indemnity and Access, which it described as the "Original Deed", in three respects, as set out in clause 2.1:

> "The Original Deed is amended as follows:
>
> (a) Paragraph (a) of the definition of Intragroup Claim is deleted.
>
> (b) The following paragraph is inserted after paragraph (a) of clause 4.1:
>
> > "(ab) make any Claim, whenever arising, against ABN 60 in connection with, arising from or incidental to, whether directly or indirectly, any transaction effected between ABN 60 and any of the other members of the JHI NVGroup, whether by way of dividend, distribution, management fees or otherwise; or"
>
> (c) The words "or Intragroup Claim" in clause 5.1 are removed and replaced with the words "Intragroup Claim or Claim by Amaca or Amaba"."

28.18 The amendments were to take effect retrospectively as from the date of execution of the Original Deed: clause 2.2.

28.19 The first amendment deleted para (a) of the definition of "Intragroup Claim". As a result, that term no longer covered a claim in connection with a

[16] Although it may be difficult to identify what such a Claim might be.

transaction effected between ABN 60 and another member of the JHI NVGroup (other than Amaca or Amaba).

28.20 This amendment would have meant that JHI NV's covenant not to sue did not relate to any claim in connection with a transaction between ABN 60 and another member of the JHI NVGroup. In other words, the covenant not to sue would have been narrower than it was originally. Standing on its own, the amendment was to the benefit of ABN 60.[17]

28.21 However, a further amendment inserted a new clause 4.1(ab) into JHI NV's covenant not to sue. This clause extended the covenant to any claim in connection with a transaction between ABN 60 and any other member of the JHI NVGroup. The new paragraph was the same as para (a) of the definition of "Intragroup Claim", which had been deleted. Accordingly, the Deed of Rectification – by deleting part of the definition of "Intragroup Claim" and incorporating it as a separate paragraph within the body of the covenant not to sue – preserved for that covenant effectively the same operation as it had originally. That is, this amendment was essentially neutral.[18]

28.22 The amendment to the definition of "Intragroup Claim", standing on its own, would have broadened the scope of the indemnity given by JHI NV under clause 5.1 of the Deed of Covenant, Indemnity and Access. Instead of excluding from the indemnity all claims in connection with transactions between ABN 60 and any member of the JHI NVGroup except Amaca or Amaba, the amendment would have had the effect that extending the indemnity to cover all such claims. However, the Deed of Rectification also amended the concluding words of the indemnity so that it excluded any claim by Amaca or Amaba. The "carve out" in clause 5.1 was changed to read "Intragroup Claim or Claim by Amaca or Amaba" instead of simply "or Intragroup Claim." This amendment was to the benefit of JHI NV.

[17] Cf JHI NV Initial Submission, para. 18.2.19.
[18] JHI NV Initial Submission, para. 18.2.21.

D. Basis for rectifying the Deed of Covenant, Access and Indemnity

28.23 On 12 November 2003, Mr Shafron sent an email to Mr Ball and Mr Lawrence of Allens concerning the Deed of Covenant, Indemnity and Access in which he said,[19]:

> "I am not sure that the definition of "Intragroup Claim" and "JHI NV Group" is right. It seems to me that the intention behind "JHI NV 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."

The evidence does not satisfactorily explain why the matter received apparently urgent attention from this time, although it may have been related to the release by the Foundation of its financial statements to the market on 29 October 2003[20], to which JHI NV responded with its own media release.[21]

28.24 The issue was addressed at a meeting on 17 November 2003 between Mr Shafron and Mr Morley, and Mr Ball, Mr Robb and Mr Lawrence.[22] Mr Morley describes the substance of those discussions on that occasion as being[23]:

> "that the Deed of Covenant, Access and Indemnity [sic] had the inadvertent effect of:
>
> (a) Failing to clearly reflect the intention of the parties that the indemnity granted by JHI NV excluded claims arising from the establishment of the Foundation.
>
> (b) Failing to protect ABN 60 against claims relating to dividends and management fees by former subsidiaries which had left the group before 31 March 2003."

Mr Morley's note of that meeting was as follows:[24]

> "INDEMNITY – By agreement could get rectification
>
> …
>
> Address/Location of ABN 60/Don Cameron
>
> Intention not sufficiently precise, clear to overcome what is a fairly high burden for the Courts to overturn
>
> – assumption behind rectification is words do not reflect agreement

[19] Ex 77, Tab 38.

[20] Ex 2, Vol 1, Tab 3, pp. 6–7.

[21] Ex 158.

[22] Morley, Ex 122, para. 90.

[23] Ex 122, para. 90, Tab 53, pp. 400–401.

[24] Ex 122, Tab 53, p. 400. In Mr Morley's note of that meeting, elements (i) and (ii) were joined with parentheses and an arrow leading to the words *"go hand in hand"*.

– one or two areas
(i) did it cover establishment of MRCF – easy to draft
(ii) inter company – not easy to draft"

28.25 The Allens advice appeared to focus upon which elements of the changes could readily be drafted into an amendment that could be the subject of a rectification order. Allens advice at the conference, reflected in its subsequent written advice,[25] was consistent with a recognition that the equitable remedy of rectification is available in limited circumstances and can be difficult to obtain.[26]

28.26 On 18 November 2003, Allens circulated a draft without prejudice letter to be sent by Mr Macdonald to Mr Cameron on behalf of ABN 60.[27] The letter was forwarded to Mr Don Cameron by Mr Shafron by email on 23 November 2003. In his cover email, Mr Shafron said:

> "As we discussed earlier this week, the indemnity document – for reasons of speed in preparation – does not really reflect the split of responsibilities between ABN 60 and JHI NV that we intended.
>
> As it is written now, and as I see it, ABN 60 is theoretically on the hook for ABN 60 vis-à-vis operating company transactions (e.g. ABN 60 guarantees on asset sales) and yet not for ABN 60 vis-à-vis Amaca transactions.
>
> I attach a letter that Allens wrote that you might want to discuss with your board and get advice (from Corrs?) on.
>
> I look forward to hearing from you."

The text of the attached letter was:[28]

> "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 JHI NVGroup" 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.

[25] Letter of 17 December 2003: see Ex 122, Tab 59, p. 419.
[26] See authorities gathered at MRCF Initial Submissions, para. 63.54.
[27] Ex 122, Tab 54, pp. 402-404.
[28] Ex 122, para. 92, Tab 55 (emphasis as shown).

> 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."

28.27 A draft deed was circulated on 1 December 2003 by Allens to Mr Shafron and Mr Morley, and to Mr Cameron. The letter was subsequently addressed and dated 9 December 2003, and sent to Mr Cameron, who sent it, with the draft deed, by email to Corrs.[29]

28.28 On 16 December 2003, Mr Cameron met with Mr Morley, Mr Ball and Mr Lawrence, at which Mr Cameron apparently queried the effect of the proposed amendments and the benefit to ABN 60.[30] On 17 December, Allens discussed these concerns in an email to Mr Macdonald, Mr Shafron and Mr Morley, attaching a draft letter to ABN 60 that responded to Mr Cameron's query.[31] As Allens explained to the JHI NV executives:

> "The availability of rectification as a remedy does not depend on the rectifying amendments providing some benefit to both parties. An alternative approach to that taken in the attached draft would be to make this point. **However, given the difficulty we think JHI would have in establishing the terms which were actually agreed, we think it is best not to take that approach**. [emphasis added]
>
> We suggest we make a time to discuss the draft once Peter returns. We should also mention that, although the attached letter identifies a benefit to ABN 60 in rectifying the Deed, we still think it is unlikely that any solicitor will advise ABN 60 to execute the proposed Deed of Rectification without some further benefit to ABN 60. Did the letter which Peter Macdonald send to ABN 60 include the offer to pay ABN 60's costs? If not, we think it is likely that that offer will need to be put at some stage.

28.29 On 19 December 2003, Mr Macdonald sent a letter to Mr Cameron seeking to explain the operation and intended operation of the Deed of Covenant, Indemnity

[29] Ex 173, Tab C.
[30] Ex 122, para. 96.
[31] Ex 122, Tab 59.

and Access.[32] Mr Macphillamy's evidence was that he recalled seeing this letter and it was likely that he was given a copy of it around that date.[33]

28.30 It was submitted by JHI NV and ABN 60 that the unintended operation arose by reason of an error by Mr Blanchard on 21 March 2003 when he amended the draft Deed of Covenant, Indemnity and Access to exclude claims by the Foundation against ABN 60[34] "which error was perpetuated" when Mr Robb suggested an alteration to the draft Deed of Covenant, Indemnity and Access "which did not achieve what was intended".[35] No dispute was made of this analysis. In the context of a possible rectification suit, the question was whether that mistake failed to reflect the common intention of the parties at the time of execution.

28.31 The position of JHI NV and ABN 60 was and is that "as a matter of fact, both ABN 60 and JHI NV had a common intention" when the Deed of Covenant, Indemnity and Access was entered into, which was not reflected in the Deed of Covenant, Indemnity and Access.[36] It was said that the evidence demonstrates that each of Mr Morley, Mr Salter, Mr Macdonald and Mr Shafron intended that JHI NV would indemnify ABN 60 in respect of transactions effected between ABN 60 and any other of the members of the JHI NV group but would not indemnity ABN 60 in respect of claims (of any kind) by Amaca or Amaba.[37]

28.32 Principal among the evidence advanced to support the existence of a common intention in terms of the rectified deed is an email from Ms Joanne Marchione of James Hardie to Mr Blanchard dated 27 March 2003,[38] in which she noted

> "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".

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[32] Ex 124, Tab E.

[33] Ex 173, para. 15, Tab 5, pp. 14–16.

[34] Ex 122, Tab 36.

[35] Robb, Ex 122, Tab 50, Ex 187, Tab 85: see JHI NV Submissions, paras. 18.2.22, 17.1.12, 17.1.14, 17.1.18.

[36] JHI NV Submissions, para. 18.2.15.

[37] JHI NV Submissions, para. 17.1.24 and 18.1.4.

[38] Ex 122, Tab 39. Ms Marchione was not called as a witness.

Mr Robb responded on the following day (copied to Mr Shafron, Mr Morley and Mr Kneeshaw), commenting that the point made good sense.[39] 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.

28.33 A number of witnesses gave evidence supporting the existence of that common intention, including Mr Shafron (whose evidence on this point is corroborated by his email in reply to that sent by Ms Marchione),[40] and Mr Morley gave evidence that he did not understand or intend that the Deed of Covenant, Indemnity and Access would indemnify ABN 60 for claims in respect of the establishment of the Foundation.[41] Mr Salter, who executed the Deed of Covenant, Indemnity and Access on behalf of ABN 60, gave similar evidence[42] (although notably he was not consulted at the time of the Deed of Rectification to confirm this[43]). Mr Kneeshaw, who also executed the original deed as company secretary of ABN 60, gave evidence that he did not have a belief one way or the other about whether the indemnity covered claims arising from the establishment of the Foundation.[44]

28.34 The Foundation submitted that the Marchione email is a "flawed basis for rectification"[45], on the basis that Mr Morley and Mr Salter never jointly considered the substance of the amendment proposed by Ms Marchione, the JHI NV board was never told of the effect of the proposed amendment, and the incoming directors were not aware of the clause 5.1 carve out. In my opinion, it is not necessary for me to decide whether there was a proper basis for a possible rectification suit. Ultimately, what actually occurred seems more likely a variation, not a rectification, of the initial bargain made on 31 March 2003. Indeed, perhaps unsurprisingly, this became common ground between the Foundation and JHI NV & ABN 60 by the end of this Inquiry.[46]

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[39] Ex 122, Tab 40.
[40] Shafron, Ex 76, para. 34, Tab 28.
[41] Morley, Ex 122, paras. 61 and 71.
[42] Salter, Ex 103, para. 67.
[43] T 1948.40.
[44] Kneeshaw, Ex 101, para. 30.
[45] MRCF Initial Submissions, para. 63.56.
[46] See MRCF Initial Submissions, para. 62.48; JHI NV Initial Submissions, para. 18.3.1.

28.35 The rectification in question was being sought by JHI NV and was, on its face, in the interests of JHI NV. Notwithstanding that internal legal advice tended rather to the contrary, JHI NV's correspondence implied that there was evidence that an agreement of this kind was reached in March 2003. Similarly, the draft deeds circulated by JHI NV included the statement in Recital B:

> "JHI NV and ABN 60 have become aware that the Original Deed does not accurately reflect the agreement reached between them at the time the Original Deed was executed"

28.36 The recital tended to convey the impression that there was certainty as to the agreement and indeed that the remedy of rectification would follow as of course. Since neither Mr Cameron or Mr Macphillamy was a director of ABN 60 at the time of execution of the Deed of Covenant Indemnity and Access, given the incomplete documentary trail, the situation required them to rely upon the recollections of former or current JHI NV employees.

E. Possible Causes of Action

Conduct of Mr Cameron and Mr Macphillamy

28.37 It was contended that the proposed rectification was a serious matter, because its effect was to deprive ABN 60 of the right to be indemnified by JHI NV in respect of claims in connection with transactions between ABN 60 and Amaca or Amaba. These would seem to include claims in connection with the creation of the Foundation, the execution of the Deed of Covenant and Indemnity of February 2001, and payment of management fees and dividends by Coy (now Amaca) and Jsekarb (now Amaba) to JHIL (now ABN 60). In particular, it would remove the right of indemnity in respect of a potentially substantial claim that had been threatened by the Foundation on behalf of Amaca and Amaba in a letter from Clayton Utz dated 18 September 2003.[47]

28.38 Of course, the change would not appear to have had any effect on a claim made by Amaca or Amaba against ABN 60 in connection with cancellation of the partly paid shares held by JHI NV of 15 March 2003. Such claims were excluded

[47] Ex 3, Vol. 1, Tab 26.

from the scope of the indemnity, both before and after it was varied, by reason of para (c) of the definition of "Intragroup Claim".

28.39 Counsel Assisting submitted that fully informed directors of ABN 60 would have had to be persuaded to agree to reduce the scope of an indemnity which presently responded to Amaca and Amaba's claim against ABN 60. This would have provided Mr Cameron and Mr Macphillamy with the opportunity to seek to negotiate for the receipt of further benefits for ABN 60 as the price of agreeing to the amendments. If entry into the rectified deed was not in the best interests of ABN 60, then Mr Cameron and Mr Macphillamy may have breached their duties of care and diligence to ABN 60.

28.40 The Foundation has suggested that it may be inferred that JHI NV sought to rely and play upon its "ally"[48] in Mr Cameron in persuading ABN 60 to the rectified deed. I formed a view that Mr Cameron seemed quite too willing to co-operate, given that he agreed with the proposal for a rectified deed[49] before receiving a draft[50] or obtaining any advice from Mr Stevenson, [51] nor, as the evidence disclosed, had he consulted with his co-director, Mr Macphillamy, when he again declared this intention on behalf of ABN 60.[52]

28.41 I think, it is plain that he simply accepted, without questioning it, JHI NV's assertion that the Deed of Covenant, Indemnity and Access did not reflect the intentions of the parties and deed to be rectified to do so.[53] The same appears to be true of Mr Macphillamy, who was prepared to rely upon Mr Morley's advice to Mr Cameron and the correspondence on behalf of JHI NV. Neither director appears to have appreciated that rectification of the deed, in one respect, reduced the breadth of the indemnity from JHI NV to ABN 60 or to have made a serious attempt to understand the effect of the rectification.[54]

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[48] MRCF Initial Submissions, paras 63.28, 63.107
[49] Ex 122, Tab 57.
[50] Ex 122, Tab 58.
[51] Ex 126.
[52] Ex 124, Tab C.
[53] Cameron T 574.10-15; Macphillamy T 575.10–35.
[54] T 2677.15–35.

28.42 Of course, had the officers of ABN 60 fully investigated the proposition that the rectified deed reflected the common intention of JHI NV and ABN 60 from March 2003, they may well have been satisfied that this was the recollection of the various participants at that point.

28.43 Against that is the desirability for them to have given due weight to the fact that the directors of ABN 60, at the time of the original deed, had been and were still senior employees of JHI NV. This was not done. Moreover, none of the individuals to whom I have referred expressed a view as to the question of whether claims against ABN 60 in respect of dividends or management fees paid by Amaca or Amaba were to be covered by or excluded from the indemnity. Yet, in the original form of the Deed of Covenant, Indemnity and Access such claims were indemnified; now that the deed has been rectified they are not. Assuming these matters in favour of Mr Cameron and Mr Macphillamy, it could be said that it was reasonable for them to accept what they were told about the common intention of the parties, and rely upon it in executing the rectified deed.

Conduct of Mr Stevenson

28.44 An issue was raised by Counsel Assisting,[55] taken up rather vigorously in submissions by the Foundation[56] and the Unions[57], that Mr Stevenson may have been negligent in his advice to ABN 60 concerning the entry into the Deed of Rectification by ABN 60. It was contended on behalf of Mr Stevenson that issue 49 is outside the Terms of Reference of the Commission.[58] I was satisfied that it was relevant in the sense that it went ultimately to the current financial situation of Amaca and Amaba.

28.45 I accept that the scope of Corrs' instructions, in relation to the Deed of Rectification, is not entirely clear.[59] Although Mr Stevenson understood his instructions to be confined to advising the directors personally as to their own position[60] there was some (albeit slight) evidence to suggest that Corrs was now

[55] Issue 49: see Annexure _
[56] MRCF Initial Submissions, paras 63.69–63.85.
[57] UASG Initial Submissions, paras 10.6–10.8.
[58] Stevenson Initial Submissions, paras 8–9.
[59] Stevenson T 2072.22–24; 2072.34–36; see Initial Submissions of Counsel Assisting, Sect. 3, para 100
[60] T 2068.5; T 2061.33; T 2071.40–2072 hafron T 1402.5–13.

retained by, or owed a duty of care, to ABN 60.[61] It probably is not necessary to resolve this question, because I accept that Mr Stevenson could perform his duty to safeguard the interests of Messrs Cameron and Macphillamy in the transaction only by ensuring that they were well placed to safeguard the interests of the company.[62]

28.46 That said, I do not accept that, as the Foundation contends, that Mr Stevenson exhibited a "readiness to go through the motions and a failure to consider the real legal issues".[63] Mr Stevenson met Mr Cameron on two occasions (on 16 December[64] and 13 January 2004[65]) and with Mr Cameron and Mr Macphillamy on 15 January 2004[66] for the purposes of providing advice on the proposed amendments, and provided some written advice.[67] Although Mr Stevenson's evidence was that he assumed Mr Cameron had enquired of Mr Morley as to the relevant intention at the time of execution,[68] the evidence tends to support the proposition that Mr Stevenson explained to Mr Cameron at their first meeting the critical issue from the perspective of ABN 60 (and thereby its directors): that he ought to consider whether this was in truth a case for rectification based on a mistaken expression of a common intention, or in truth a "supplement" by way of amendment to the existing deed sought by JHI NV for some presently unknown commercial consideration.[69] Mr Cameron appears to have followed Mr Stevenson's advice, although, as I observed above, rather uncritically.

28.47 Ultimately Mr Stevenson advised Messrs Cameron and Macphillamy that if they were satisfied that the parties had a common intention when the initial deed was entered into, which was not reflected in that deed, then it was in order to rectify the deed by entering into the Deed of Rectification.[70] It was quite reasonable for him to do so.

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[61] Ex 127 (with notation "client: ABN 60"); Corrs invoice was issued to and paid by ABN 60: Stevenson, Ex 124, para.17; Stevenson T 2082.4-29.
[62] Submissions in Reply of Counsel Assisting, para. 3.25.
[63] MRCF Initial Submissions, para. 63.78.
[64] Ex 127.
[65] Ex 129.
[66] Ex 130; Ex 124, para. 16.
[67] Ex 124, Tab E.
[68] T 085.6-28
[69] See the file note of that meeting by Ms Saltos of Corrs in Ex 127; See also Ex 124, paras 12, 15. Stevenson T 2070.57 – 2071.11; 2071.52 – 2072.18. Ms Saltos was not called as a witness.
[70] Ex 124, para. 16.

Possible Causes of Action against JHI NV

28.48 It was contended by the Foundation that the Deed of Rectification is liable to be set aside as having been executed as a result of breaches of the *Corporations Act*, as a result of misleading or deceptive conduct by JHI NV and as a result of unconscionable conduct by JHI NV.[71] It was said that Allens and JHI NV engaged in conduct which was apt to represent to Mr Cameron, Mr Macphillamy and Mr Stevenson that there was a sound rectification case based upon common mistake when in truth, Allens and JHI NV knew that rectification of the Deed of Covenant, Indemnity and Access was unlikely to be successfully obtained through the courts. If that were true, the amendments effected by the Deed of Rectification are liable to be set aside. Amaca and Amaba could then seek to enforce the unamended Deed of Covenant, Access and Indemnity on the basis that on its true construction, by clause 5.1 JHI NV indemnifies ABN 60 against the claims made by Amaca and Amaba in their letter of 18 September 2003.[72]

28.49 In my opinion these are rather far fetched. In addition to the usual hurdles in successfully pursuing such actions, it would be necessary to prove reliance of Mr Macphillamy and Mr Cameron, and perhaps Mr Stevenson, on JHI NV for information about whether there were imminent claims against ABN 60 for which it would no longer be indemnified under the original deed if a deed of rectification were executed. I also doubt that it could be said to be misleading conduct contrary to section 52 of the *Trade Practices Act 1952* (Cth) for JHI NV not to reveal to ABN 60 any doubts that it had about whether a court would order rectification of the original deed in circumstances where ABN 60 (or, at the very least, its directors) had legal advice and JHI NV was proposing to "rectify" the deed by agreement between the parties rather than to seek a formal court order.

28.50 I would add one further matter. It would be difficult to establish what would have happened if JHI NV had disclosed such doubts to ABN 60's directors; it is not entirely clear whether the Deed of Rectification would not have been executed at all, whether it would have been executed as in fact it was, or whether it would have been executed in an amended form.

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[71] MRCF Initial Submissions, para. 63.35(a) for the reasons set out at paras 63.103–63.105.
[72] MRCF Initial Submissions, paras 63.35–63.36.

Chapter 29 – Some Concluding Observations

29.1 In arriving at the views expressed in this Part I have considered many documents and heard a great deal of oral evidence. Whilst there have been few direct conflicts of evidence on basic facts, the complexion to be placed on the events, and motivations, of those involved has been affected by the manner in which the principal witnesses gave their oral evidence, some for quite some days.

29.2 The directors of the Foundation, other than Mr Hutchinson, were the subject of considerable attack for not having undertaken more "due diligence" at the time of separation in February 2001. No doubt they could have done more, but they were not obliged to do anything, and they were entitled to assume that what they were told was a reasonable representation of the actual situation.

29.3 I have criticised a situation where the evidence suggested that no director of JHIL had ever read any of the Trowbridge reports. I include Sir Llew Edwards as a subject of that criticism, but I would reject the contention that he was in any way involved in a conspiracy or scheme to "hive off" the asbestos liabilities to an underfunded body. Nor do I think that Mr Cooper was part of any such plan. He impressed me as a frank, honest and diligent man, against whom the only criticism could be that he treated the JHIL employees, after separation, as people in whom he might confide, when they were using him as a source of information. Mr Jollie, I thought, presented as an entirely honest witness.

29.4 My impression of the incoming directors was that, no doubt to varying degrees, each regarded becoming a director of the Foundation as involving an element of service to the public. They were to be paid, of course, but I do not think that was a dominant consideration. Mr Hutchinson, who replaced Mr Gill, has devoted much time to the Foundation's work.

29.5 I regret to say that I was unable to form so benign a view of the credibility, or motivations, of the principal participants on behalf of the James Hardie interests.

29.6 The principal witnesses were Mr Macdonald, Mr Shafron and Mr Morley, all three of whom are clearly intelligent and capable people.

29.7 Mr Macdonald appears to have conducted the Group's North American operations very successfully before succeeding Dr Barton as Chief Executive Officer in November 1999. As Chief Executive Officer he also appears to have been very effective in carrying out the functions of that office.

29.8 But Mr Macdonald's evidence on so many matters was so difficult to accept. He had obviously read and pondered over every document that it was thought might possibly be put to him, and had identified, and was ready with, the explanation of it which he thought might most advance his company's case, or his own position, whatever might be the true situation. So much of his oral evidence was the presentation of an advocate rather than a witness, that it is only on very few issues that I have been prepared to accept his evidence, including that given in Exhibit 308. A particularly unattractive feature was his unwillingness to accept personal responsibility for matters in which he was obviously personally engaged.

29.9 I had much difficulty too in accepting Mr Shafron's evidence about matters which occurred at and prior to the separation of Coy and Jsekarb from JHIL. Mr Shafron was a man who seemed determined to control the course of events, and the activities of the participants. At relevant times he was, to the greatest extent possible, very aware of the detail of matters. His endeavours, after the event, to explain away what had taken place, appeared contrived. His evidence too, I think, was tailored to a result, though not to the same extent as that of Mr Macdonald.

29.10 Mr Morley presented rather differently. Although I have not accepted his evidence in a number of respects, I thought he was a fundamentally honest man. I have made some comments in relation to Mr Harman in dealing with the Twelfth Cash Flow Model.

29.11 Mr Attrill's conduct and credibility was also attacked. He had suffered the difficulty in late 2000/early 2001 of being an employee of JHIL who might become a contractor to the Foundation. By the time he gave evidence he was a contractor to the Foundation who was justifying his performance when an employee of JHIL. In each instance he reflected the discomfort occasioned by sitting on a fence. But I found Mr Attrill an honest witness, doing his best to answer truthfully the questions he was

asked. No doubt he might have been more forthcoming at the time of the events leading to separation, but the relationship between him and Mr Shafron (his then superior) was, it seems to me, a reflection of Mr Shafron's personality, and Mr Attrill would not convey outside JHIL information to third parties without Mr Shafron's prior agreement or instruction.

29.12 The last JHIL officer I mention is Mr McGregor, the Chairman of Directors during the periods principally in question. Mr McGregor was a sick man, in the sense of undergoing serious treatment at the time when he gave evidence. He did his best, I thought, to give an honest account of events but much of what he said was a repetition of what others had communicated to him, and a substantial part, I thought, was reconstruction. There are, however, some aspects of his evidence which I have specifically accepted.

29.13 I have dealt in previous Chapters with my view of the evidence of the Trowbridge actuaries Mr Minty and Mr Marshall.

29.14 There is a disturbing feature in the events which took place leading to the February separation. It is why no one, of the many advisers which JHIL had in relation to Project Green and separation, ever appears to have said – once the trust scheme was settled upon in late 2000 – that separation was unlikely to be successful unless the Foundation *was* fully funded, and that this was required to be rigorously checked. The exception to that was on 15 February 2001 when Mr Robb of Allens spoke to Mr Shafron and Mr Cameron spoke to Mr Macdonald and were assured that it was.

29.15 It was obvious from Mr Robb's evidence that he had a consciousness of the need for the actuarial figures to be up to date, but at the time the principal at Allens dealing with the matter was Mr Cameron. Both these men had been involved to a considerable degree in the lead up to separation, and I remain surprised, a matter which I foreshadowed at the hearing, that the question of the adequacy of the funding at separation was not raised by them earlier. It may well be, however, that this was a case where the JHIL management were determined, so far as possible, to deal with the matter in-house as far as possible and that outside advice touching the merits of the proposal was

unwelcome. It may well be also that the engagement of Trowbridge was thought sufficient.

29.16 What is also disturbing, however, is that with solicitors acting for JHIL, for the outgoing directors of Coy and Jsekarb, and for the incoming directors, no one expressed any view on the merits of the underlying transactions. The nature of directors' duties was discussed at length, the subjects to which the duties relate were not.

Part 5 – Term of Reference 4

Chapter 30 – The Future

A. Introduction

30.1 This Chapter discusses Term of Reference 4:

> "The adequacy of current arrangements available to MRCF under the *Corporations Act* to assist MRCF to manage its liabilities, and whether reform is desirable to those arrangements to assist MRCF to manage its obligations to current and future claimants."

Two points are involved:

(a) the adequacy of current arrangements under the Corporations Act; and

(b) possible reform to those arrangements.

B. Adequacy of Current Arrangements

30.2 This aspect may be dealt with briefly.

30.3 All parties to the Commission were agreed that the current arrangements available to the Foundation under the *Corporations Act* to manage its liabilities are inadequate.[1] The essential difficulty is that none of the external administration mechanisms under the Act[2] recognises the position of persons in the category of unascertained, future creditors, such as future claimants in respect of asbestos disease for which Amaca and Amaba will be liable.

30.4 Some of the difficulties were discussed by the New South Wales Court of Appeal in proceedings brought by the present directors of the Foundation.[3] They had sought relief that, in practical terms, would permit them for a few months more to continue to pay claimants in full, even though it is a virtual certainty that the present assets of Amaca and Amaba will prove to be insufficient to meet all future claims. The

[1] Initial Submissions of Counsel Assisting, Section 5, para. 1–5; JHI NV Initial Submissions on Term of Reference 4, pp. 5–20; MRCF Initial Submissions: pp. 663–680; UASG Initial Submissions para. 11.19–11.23; LCA Initial Submissions, p. 6.
[2] Schemes of arrangement, voluntary administration and liquidation.
[3] *Edwards v Attorney General (NSW)* [2004] NSWCA 272.

current dilemma facing the Foundation was described by Young CJ in Eq. (Spigelman CJ and Mason P agreeing): [4]

> 58 On current authority, persons injured through exposure to asbestos manufactured or supplied by Amaca or Amaba do not have a completed cause of action until damage is suffered and that usually involves manifestation of the disease: *Orica Ltd v CGU Insurance Ltd* [2003] NSWCA 331; 13 ANZ Insurances Cases 61-596. Indeed, some of the future claimants could be in the more extreme category where the people concerned have not yet been exposed to the asbestos such as home renovators doing future renovations or may even be people not yet born who might be involved in demolishing an asbestos ridden building somewhere in 2030. No-one can currently know the identity of the future claimant.
>
> 59 This type of liability must be distinguished from the case of a contingent creditor. A contingent creditor is a person to whom a corporation owes an existing obligation out of which a liability on its part to pay a sum of money will arise in a future event, whether that event be one which must happen or only an event which may happen: *Community Development Pty Ltd v Engwirda Construction Co* (1969) 120 CLR 455; *Re International Harvester Australia* (1983) 1 ACLC 700 at 703. Again, the liabilities in this case must be distinguished from the case of a prospective creditor, a prospective creditor being one who is owed a sum of money not immediately payable but which will certainly become due in the future either on some date which has already been determined, or on some date determinable by reference to future events: *Stonegate Securities Ltd v Gregory* [1980] Ch 576; *Commissioner of Taxation v Simionato Holdings Pty Ltd* (1997) 15 ACLC 477.
>
> 60 The distinction is vital because whilst contingent or prospective creditors are taken into account in assessing solvency, possible future claims that might crystallise are not. The great probabilities are that if Amaca and Amaba were to go into provisional liquidation now, then the only claims that would be paid by the liquidator would be those which have crystallised and, after paying the doubtless heavy expenses of liquidation, there would be a distribution of surplus funds to the shareholder MRCF which would be used for the purpose of the alleged charitable fund. The future creditors would get nothing and this may very well be the case even if the claim matured the day after the liquidation commenced.
>
> 61 Accordingly, the choice between continuing to pay claims at present and going into liquidation will not advantage the future claimants one whit. Moreover, going into liquidation would preclude any possibility of further funds being injected into the pool to meet future claims. The material before the Court shows that there is at the very least a realistic possibility that there might be a further injection of funds into the pool.
>
> 62 It is very difficult to see any other course that could be taken other than liquidation or continuing to go on as usual. Of course, some completely unanticipated event might occur such as the large injection of funds or special legislation, but at least, short of this, there is no way in which any alternative method can protect the future claimants.[5]

[4] Schemes of arrangement, voluntary administration and liquidation.

[5] *Edwards v Attorney General (NSW)* [2004] NSWCA 272 at paras 58–62. See also paras 62–66.

C. Proposals for Reform

Background

30.5 The Terms of Reference refer specifically only to the reform of arrangements available under the *Corporations Act* but I have assumed, and the various submissions made also assume, that the Term of Reference does not confine consideration to proposals to amend that Act. In any event the availability of other forms of reform would be germane to whether reform of the *Corporations Act* were "desirable". Accordingly I shall deal with the various proposals advanced.

30.6 I turn *first* to the current financial position of Amaca and Amaba, a topic dealt with in detail in Chapter 3. If left to their existing resources they will be insolvent in about three years.

30.7 A great deal of attention in the Inquiry was spent, particularly by the Foundation, in endeavours to demonstrate the existence of causes of action which would enable either recovery of additional monies from ABN 60 or JHI NV, or other persons, or would result in the separation of February 2001 being set aside. If it were apparent that Amaca, Amaba or the Foundation had valuable claims against possible defendants the value of the causes of action would properly be taken into account in determining the assets of those bodies. But, as I have indicated in various Chapters, any claims which might be made seem unlikely to result in damages which would have a very significant effect on the likely life of the Foundation.

30.8 More specifically, any ultimate recovery would depend on the success of claims relating to the intra-group payments (dividends and management fees) and asset transfers in the 1995 to 1998 period, together with any additional remedy that might be obtained in respect of the events relating to separation in February 2001 ("primary claims"). On established measures of loss, even if all these claims succeeded the damages would be unlikely to be sufficient to prevent the ultimate insolvency of Amaca and Amaba. Moreover, claims in respect of the intra-group payments would be barred by the Deed of Covenant and Indemnity, so that they would have no value unless there was also a cause of action in relation to the Deed which, in one way or another, would nullify it or its effect.

30.9 There is also the question of the ability of any defendant to satisfy a judgment. Insofar as the claims are against natural persons, prospects of recovery would be limited to their personal assets and the proceeds of any enforceable policy of liability insurance that answered the claim. Insofar as the claims were against ABN 60, that company now has assets which are negligible compared to the claims that might be made. Relief other than damages might be awarded of course, and the Foundation in particular appears to advocate an outcome in which the separation was undone, leaving Amaca and Amaba as ABN 60 subsidiaries. On its own, however, such relief would be of little assistance to claimants against Amaca and Amaba.

30.10 Thus, even if there were substantial success in primary claims, effective recovery might be very limited unless there were also substantial success in secondary claims, principally, claims by ABN 60 against JHI NV either to have the partly paid shares (or their value) restored or to have the Deed of Rectification of the Deed of Covenant, Indemnity and Access set aside, or treated as inapplicable at relevant times.

30.11 It is probably an understatement to say that none of the proposed claims (primary or secondary) could be regarded as straightforward. Some seemed speculative indeed, requiring change in the law or rather radical adaptation of the its presently perceived application.

30.12 Finally, even assuming success in primary *and* secondary claims, issues of enforcement would arise, given that JHI NV has limited assets in this jurisdiction. However these difficulties should not be overestimated. Conventional Australian court judgments (that is, judgements that did not depend on legislation specifically directed at JHI NV, or affect its right to due process, and were not punitive or retrospective) would be likely to be enforced both in the Netherlands[6] and the United States[7], even in the absence of a treaty.

30.13 A *second matter* is the capacity of the Parliaments of New South Wales and the Commonwealth to legislate so as to improve the ability of Amaca and Amaba to pay all their creditors. A number of proposals for legislation are discussed later in this Chapter.

[6] See Rosner, "The Requirements for Execution of Foreign Money Judgments in the Netherlands Absent of Treaty", http://www.llrx.com/features/novel.htm (2 Jan 2003).
[7] See UASG Initial Submissions, paras 11.37–11.41.

Among the more extreme would be legislation that retrospectively removed the corporate veil between Amaca and Amaba and their former parent ABN 60 and then restored the partly paid shares that were held by JHI NV in ABN 60. Such legislation would probably face constitutional challenges of one kind or another.[8] If the challenges failed, there would then arise a difficult question as to whether such laws, or judgments based on them, would be enforced in the United States or the Netherlands.[9] Nevertheless, from JHI NV's point of view, such legislation, if valid and effective, would have the consequence of making available to Amaca and Amaba, as and when needed, the $1.9 billion unpaid on the shares.

30.14 The *third matter* is an economic consideration that may reinforce a moral judgment that companies in the position of JHI NV should not deny assistance to the victims of Amaca and Amaba. JHIL, and JHI NV as the successor to its assets, have received very substantial benefits from the business activities of Amaba and Amaca, including activities in the period in which those companies were dealing in asbestos so as to cause the diseases which now and in the future will give rise to claims. The present value of dividends paid by Amaca to JHIL or subsidiaries of JHIL is very substantial. The dividends from 1969–1997 alone have a present value (calculated at 10 year Commonwealth bond rates plus 1 per cent, compounded 6 monthly) of $1,073 million on an after tax basis and $2,433 million on a before tax basis. To put it directly, JHI NV still has in its pockets the profits made by dealing in asbestos, and those profits are large enough to satisfy most, perhaps all, of the claims of victims of James Hardie asbestos. And, as I have said in other Chapters, the causes of actions now arising are by reason of negligent conduct which took place during the period when profits were being made from asbestos.

The essential feature

30.15 It is worthwhile to seek to identify the nature of the problem which exists for the Foundation and claimants. It is simply that:

[8] See Submissions of JHI NV in reply on Term of Reference 4, para. 5.3.1, para. 5.4.
[9] See Submissions of JHI NV in reply on Term of Reference 4, Annexure B.

(a) The Foundation is faced, month by month, year by year, with claims which it has to meet.

(b) Its funds are diminishing steadily. They will be exhausted in 2007.

(c) Once that occurs, claimants will be unable to recover from the Foundation, Amaca or Amaba.

(d) To alleviate that situation the need, of course, is more money.

30.16 There is no imperative that the Foundation should be continued as a body with a large fund to invest. What is needed, as a minimum, is that the Foundation have sufficient funds:

(a) to investigate, deal with and pay claims as and when they are made and are liable to be paid, and

(b) to cover its other operating costs.

Other outgoings might be added but the only one I would regard as essential is that the funds available to the Foundation should allow it to investigate also how claims could be dealt with more efficiently and expeditiously in the interests of all parties involved. Other matters, such as funds for research into asbestos related diseases, may be a bonus.

30.17 It would follow that I do regard it as essential for the Foundation to have a large asset base. It does not need, assuming it were available, $1.5 billion or $2 billion to invest. What it would need is sufficient funds in hand year by year to meet the expenses to which I have referred in the previous paragraph. It needs to have the money available in advance of the outgoings, and it needs to know that the money will be there in the future.

30.18 Those are basic considerations. A more basic consideration is that whilst Term of Reference 4 treats the Foundation as a continuing body, it is not essential that *the Foundation* be the body which is responsible for the administration of claims against Amaca and Amaba. (That is not to suggest that it has not done so satisfactorily in the past. The evidence suggests that it conducts its affairs efficiently and effectively. I simply make the point that it is not essential.)

30.19 I turn now to the various reform proposals. I commence with that of JHI NV, the obvious source of funds.

D. The JHI NV Proposal

A Change of Heart

30.20 On 14 July 2004 JHI NV made an announcement to the Australian Stock Exchange in which it said:

> "The Board of James Hardie announced today that it would recommend that shareholders approve the provision of additional funding to enable an effective statutory scheme to be established to compensate all future claimants for asbestos-related injuries caused by former James Hardie subsidiary companies."[10]

30.21 This announcement represented a radical departure from the position taken by JHI NV at the commencement of the Inquiry. On 25 February 2004 it issued a media release that quoted Mr Macdonald:

> "We welcome the Commission and the opportunity it provides the clear up misconceptions and explore the broader issue of asbestos liability, but it in no way alters the company's well-established position on this issue," Mr Macdonald said."[11]

30.22 The company's "well-established position" was no doubt a reference to the position explicitly adopted in response to the Foundation's disclosure only a few months before of the difficulties of its financial position.[12] The Foundation's media release had said:

> "Sir Llew said the Foundation had approached James Hardie seeking additional funding to meet the expected liabilities. However, the Foundation had been told that no additional monies were available."

JHI NV's media release on the same day was unequivocal: [13]

> "James Hardie reaffirms its previous guidance that there can be no legal or other legitimate basis on which shareholder's funds could be used to provide additional funds to the Foundation and the duties of the company's directors would preclude them from doing so."

[10] Ex 340.
[11] Ex 87.
[12] Ex 154, 29.10.03.
[13] Ex 158.

Outline of the Proposal

30.23 The JHI NV proposal in its ultimate form essentially consists of this, that the present board of JHI NV would support a resolution of the members of the company approving contribution of company funds to a New South Wales statutory scheme designed to ensure compensation, preserved at current levels in real terms, for all those with legitimate claims against Amaca, Amaba or ABN 60, *provided* that the scheme conformed to certain criteria.

30.24 The criteria were not defined explicitly, but are implicit in the "proposed key principles for Scheme structure":[14]

> "In order to achieve the desired outcome, the proposed elements of the statutory scheme include:
>
> [1] speedy, fair and equitable compensation for all existing and future claimants; the method of distributing the scheme funds, including the level and type of monetary benefit paid or other benefit received, determined having regard to an independent assessment of the medical condition of the claimant and other objective criteria (thereby reducing superimposed or judicial inflation);
>
> [2] independent administration of the scheme to maximise efficiency for the benefit of all parties;
>
> [3] determination of contributions to be made in a manner which provides certainty to:
>
> [a] claimants as to their entitlement
>
> [b] the scheme administrator as to the amount available for distribution; and
>
> [c] the contributors as to the ultimate amount of their contribution to the scheme;
>
> [4] significant reduction in legal costs via the removal of the requirements for litigation, achieved through conditions which need to be satisfied to access the scheme, which should be clear and should not involve potential for significant legal dispute;
>
> [5] limitation of legal avenues outside of the scheme;
>
> [6] provisions to protect liquidity to ensure payments to claimants, such as periodic and defined step-ups in annual contributions to the scheme (as well as later step downs, if appropriate), more extended payment periods, or a combination of both mechanisms;
>
> [7] the assignment to, or subrogation of, the scheme to any rights which a participating claimant may otherwise have against any other party (eg. Insurance);

[14] JHI NV Initial Submissions on Term of Reference 4, pp. 3–4. See also Submissions in Reply on Term of Reference 4, para. 2.1.

[8] administration and maintenance of the scheme by the NSW Government in line with other statutory compensation schemes or mechanisms (eg. workers compensation and dust diseases tribunal and/or board);

[9] protection of the scheme against costs arising from future legislative change; and

[10] defined adjustments to payment schedules based on claimants' ability to seek redress from those other interested parties which would encourage participation of other parties in the scheme and ensure an equitable outcome for all sufferers of asbestos related illnesses."

30.25 These ten "key principles" left much room for elaboration and further definition. In one respect the detail was filled in a little. In oral submissions JHI NV's counsel indicated that JHI NV's proposal called for:

> "a scheme which would provide compensation to the number of claimants assumed by KPMG in arriving at its central estimate calculation as at 30 June 2003 and at the levels of compensation current at that time."[15]

30.26 Described in this way, the JHI NV scheme provided for a clear limit on the number of victims who would be compensated. This problem, and consequential difficulties, were flagged by Counsel Assisting in their submissions,[16] attracting this response from JHI NV's counsel in reply.

> "Meagher: Could I get to the heart of the matter, Commissioner. The point which Mr Sheahan refers to, that is, the problem which arises if the number of claimants exceeds ultimately, as a matter of fact, the KPMG central estimate, is a problem which my clients can see going forward and they accept that any scheme will have to accommodate that possibility and that those claims would have to be funded and they would expect that that question would be addressed in the discussions which would take place in the working out of the scheme and, in that context, my clients accept that they may have to fund those claimants."[17]

30.27 This seems to involve willingness, in principle, on the part of JHI NV to accept responsibility for compensating all Amaba and Amaca claimants without limit as to number. This, it must be emphasised, remains a conditional willingness, and is without admission of any legal liability.

30.28 The scheme is proposed as a State-legislated scheme of arrangement pursuant to s 5G of the *Corporations Act* for administration of the assets of Amaca, Amaba and ABN 60.

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[15] Meagher SC, T 4010.44–.47.
[16] T 4034.20–4035.3.
[17] T 4041.1–.12.

Key elements of the JHI NV proposal

30.29 The "key principles" are, if I may say so, in some respects stated almost as slogans but, as I understand the concept, it involves centrally the following:

(a) The New South Wales legislature establishes a scheme whereby asbestos disease sufferers ("claimants") make a claim in respect of their injury to a statutory authority: Element 8.

(b) No claim by a claimant may be made outside the scheme: Element 5. That means, no doubt, that a claimant could not sue in a court for damages as is now the case.

(c) The amount which a claimant would be entitled to receive would be determined "having regard to an independent assessment of the medical condition of the claimant and other objective criteria": Element 1. The intended meaning is a little elusive. I assume it is intended that there will be amounts fixed as the maximum available for particular conditions, and that a claimant will recover a proportion of that amount based on a medical assessment of the relative seriousness of the case. For example, 50, 75 or 100 per cent of a "worst case". "Other objective criteria", I assume, refers to the amounts available for what otherwise would be heads of damage involving actual or notional economic loss.

(d) The proposal appears to assume that asbestos defendants, in addition to former James Hardie companies may be parties to the scheme, with each making contributions: Element 3, particularly 3c. Element 10 suggests that participation by non-James Hardie asbestos defendants is voluntary.

(e) The scheme would be funded by periodical contributions: Items 3 and 6. I assume that the reference to "ultimate amount of their contribution" should be read subject to the statement to which I have referred in paragraph 30.26.

(f) The amount to which claimants would be entitled is reduced to the extent to which the claimant might also have claimed against, presumably, an asbestos defendant not a participant in the scheme.

(g) It is not clear whether the proposal involves strict liability, i.e. that a claimant will not have to prove negligence, breach of contract or breach of statutory duty by a participant, but will only have to prove exposure to the participant's asbestos fibres.

(h) Element 10 refers to protection of the scheme "against costs arising from future legislative change". The scheme, as conveyed to me, involved initially a money limit overall based on Mr Wilkinson's assessment of future liabilities as at 2003, and also maintaining the levels of compensation as at that time. The first limitation has gone. I understood the second to mean maintaining the 2003 levels, but altered to reflect the same amount in real terms of the day.

E. Views on the JHI NV proposal

30.30 As a very broad proposition, the JHI NV proposal could provide the basis for a scheme for dealing with asbestos liabilities in the future. It is a legitimate political choice to provide for an administrative rather than a court-based scheme for compensation. New South Wales has recently adopted such a mechanism for workers' compensation claims, in lieu of a court based process.[18]

30.31 There are difficulties, however, in expressing any more concluded view on the proposal because it is in such an embryonic and tentative state, but I will make the following observations.

30.32 *First* the scheme, proposed as it is as a State-legislated scheme of arrangement pursuant to s 5G of the *Corporations Act* for the administration of the assets of Amaca, Amaba and ABN 60, does not sit well with the contemplated provisions for other asbestos defendants to be part of the scheme.

[18] *Compensation Court Repeal Act 2002* (NSW).

30.33 The *second* point is in relation to "cross-claims" against Amaca, Amaba and ABN 60.

30.34 Such claims typically arise where employees suffer an asbestos-related disease contracted in their employment, and the asbestos in question has been acquired by the employer from James Hardie.[19] The scheme will need to provide for such claims. If the scheme is structured simply as a statutory administration of the assets and liabilities of the three companies, there would not seem to be any basis for limiting the rights of claimants to sue other persons in the ordinary way. There also may not be a strong case for limiting the rights of other defendants to pursue Amaba, Amaca and ABN 60 for contribution, particularly if they have already satisfied a plaintiff's claim.

30.35 On the other hand, the JHI NV proposed scheme may not achieve the efficiencies that are desired if claims such as these are dealt with outside the scheme. This problem is likely to be exacerbated if the scheme is perceived not to operate fairly or efficiently, or not to offer compensation as full as available otherwise.

30.36 This gives rise to the *third point*. JHI NV's tenth "key principle" calls for:

> "defined adjustments to payment schedules based on claimants' ability to seek redress from those other interested parties which would encourage participation of other parties in the scheme and ensure an equitable outcome for all sufferers of asbestos related illnesses."

30.37 The first part of that principle would impose on some claimants the burden of both pursuing claims under the scheme and pursuing claims against others who may be liable. To that extent it would be open to criticism. This would amount to a kind of proportionate liability. Legislation in New South Wales has recognised the undesirability of extending notions of proportionate liability to personal injury claims.[20] It would also seem quite unfair to burden claimants with the need to duplicate the claim process or to take the risk of insolvency of the other potential defendant.

30.38 *Fourthly*, it is a legitimate legislative choice to fix the maximum amounts and heads of compensation available. Some principles laid down by courts in regard to injury compensation are of debatable merit, something recognised by recent reforms in New

[19] See, e.g., the various claims described in *Amaca Pty Ltd v New South Wales* (2003) 199 ALR 596, [2003] HCA 44.
[20] *Civil Liability Amendment Act 2003* (NSW) Schedule 2, clause 1.

South Wales and other States.[21] It might be thought that an onus should lie on those contending that reforms judged appropriate for the compensation of tort victims generally are not appropriate to be applied to asbestos claimants, to make out that case. It must be acknowledged, however, that to date dust diseases claims have been exempted from the civil liability reforms. Whether the JHI NV proposal contemplates doing that is not entirely clear; it would not sit well with preserving the current levels of compensation in real terms. It would be essential in determining whether to adopt such a scheme to identify precisely what is proposed.

30.39 *Fifthly*, it is generally thought that in fault based compensation schemes, a court-based system better ensures the procedural rights of both parties to an independent arbiter, and to a fair process. If strict liability were to be adopted, a non-curial process would be less unattractive. I would note, however, that the proportion of cases in which liability is now put in issue by Amaca and Amaba is probably low, and so the gains by having strict liability may not be great.

30.40 *Sixthly*, the view was strongly advanced on behalf of the UASG that claimants should not be denied the benefits of legal representation.[22] Strictly speaking the JHI NV proposal may not require that claimants do not have the benefit of legal representation. The opportunity for an effective right of review or appeal, which JHI NV appears to concede[23] (rightly, in my view), implies the prospect of legal representation at that stage at least. However, it does seem to require that the costs of any legal representation will be either reduced (presumably because the process is streamlined so that there is less work for lawyers to do), or borne to a greater extent than at present by claimants themselves.[24]

30.41 Speaking a little more generally, if strict liability were accepted by JHI NV, the residual issues and assessment of loss would remain to be dealt with. They can involve issues of some complexity. The proposition that these issues can be determined with both speed and fairness in an administrative system at a cost significantly less than a

[21] See in particular the *Civil Liability Act 2002* (NSW).
[22] T 4027.32–4028.7.
[23] T 4013.17–20.
[24] It must be kept in mind that in the present system successful claimants do not recover all their costs from the other side.

court-based system is one that has to be demonstrated, rather than merely assumed. The defendant will almost certainly have legal representation of some kind. And the Dust Diseases Tribunal in New South Wales already has procedures that achieve significant efficiencies compared to conventional adversarial processes.[25] In addition, the Foundation and the UASG have agreed to support measures further to promote the efficiency of existing procedures. What they have said is this:

> "5. In the time available MRCF and UASG have been able to identify some common proposals for the more efficient management of the MRCF's future liabilities. The MRCF and UASG each identify the principal driver of the cost (both administrative and legal) of bringing asbestos related claims at present is delay between claim notification and claim resolution. Each of the MRCF and UASG submit that changes to procedure can bring substantial savings in legal costs. No claims resolution scheme will ever be cost free. However, appropriate reforms can encourage early, efficient and cost effective resolution of claims, through court supervised mechanisms. The changes the MRCF and the UASG identify include –
>
> a) early notification of claims;
>
> b) the earliest practicable resolution of liability questions and, following an admission of liability, the immediate payment of certain expenses as and when they are incurred (eg medical costs);
>
> c) requiring early and full cooperation by plaintiffs in the provision of information about their claims sufficient to permit rapid and effective evaluation of claims by the MRCF.
>
> 6. One approach to encourage early resolution of claims, which the MRCF and UASG each advance, is the following procedure –
>
> a) provision by plaintiffs of an affidavit together with medical evidence confirming diagnosis and particulars relevant to other issues such as causation and damage;
>
> b) early mediation/expert assessment conducted by an experienced solicitor or barrister with relevant asbestos claims experience. The individual or individuals who fulfil this role could be agreed by representative of plaintiffs and representatives of Amaca/Amaba and/or any other defendants who are interested in participating in the facility –
>
> i) at an early stage, the mediator/assessor would convene a meeting of the plaintiff, plaintiff's representatives and the defendant's representatives and explore whether any agreed resolution is possible. In the event that an agreed resolution is not achieved, the mediator/assessor would determine an amount, which he or

[25] See s11A of the *Dust Diseases Tribunal Act 1989* (NSW), which provides for the award of provisional (as opposed to once-and-for-all) damages; s 25(3), which permits the use of historical and general medical evidence from one trial in another trial; s 25A, which permits discovered documents and answers to interrogatories from one case to be used in other cases; and s 25B, which prevents the relitigation, without leave, of issues of a general nature determined in earlier proceedings.

she considers to be an appropriate aware in all of the circumstances;

ii) such a procedure could be enshrined in legislation, or subordinate legislation. But it is also possible that it could operate on a voluntary basis. In any event, it will be the subject of ongoing dialogue.

7. Other matters which are supported by each of the MRCF and UASG include compulsory court supervised procedures to facilitate early settlements (eg Conciliation and mediation) and ongoing oversight of claims resolution processes."[26]

30.42 Such measures may have a significant impact on legal costs, even within the current court-based scheme.

30.43 The *seventh point* is a contention that the JHI NV proposal does not explain how it will deal with the rights of claimants outside New South Wales. Again, however, consideration of the mechanism proposed by JHI NV (i.e., a state legislated scheme of arrangement under s 5G of the *Corporations Act*) suggests an answer. So long as the assets of the companies in question are situated in New South Wales, claimants would be compelled to come to New South Wales to enforce any claim or judgment. In New South Wales the claimant would be bound by the provisions of the scheme legislation, which could define the means by which claims could be admitted, and the extent. There would be unlikely to be any objection to a provision in the scheme statute that any claim to payment for compensation from Scheme funds would be recognised only if the amount of compensation was certified or approved pursuant to the scheme and in accordance with its provisions. Such a provision would not prevent claimants suing elsewhere, but it would deprive them of any incentive to do so. There is a partial analogy with companies in liquidation. Even where a creditor has the benefit of a judgment against the company, the liquidator can, in certain cases, "go behind the judgment" when it comes to admitting the claims to proof.[27] And even if the judgment debt is confirmed by the liquidator, the creditor's rights are limited by the provisions of the *Corporations Act* to a right to share in distributions in accordance with statutory priorities. Those priorities may result in other unsecured creditors being paid in full, though the judgement creditor receives only a dividend, or nothing at all.

[26] Joint submission of MRCF/UASG, 11 August 2004.
[27] *Tanning Research Laboratories Inc v O'Brien* (1990) 169 CLR 332 at 341.

30.44 As I have said, however, the "key principles" seem to contemplate the participation of bodies other than Amaca, Amaba and the Foundation. This would have to be clarified.

30.45 The *eighth point* concerns the rights which Amaca, Amaba and ABN 60 themselves would have *against* third parties, and which it would be appropriate to enforce. Claims against insurers and cross-claims for contributions are in this category. Presumably the scheme would provide for the rights of the companies to be enforced in the ordinary way by the scheme administrator on behalf of the companies.

30.46 JHI NV would want different provision to be made for claims that might be made against it by the scheme companies. Presumably its obligations to contribute to the scheme would go in satisfaction of any such claim or liability. Similar considerations may arise in the case of possible claims by Amaca, Amaba and ABN 60 against their present or former directors, officers or external consultants such as solicitors or actuaries. JHI NV may have a legitimate concern that the agitation of such claims would be likely to embroil it in litigation, as the defendants may seek indemnity or contribution from it or from its present officers. It may be said that the more complete JHI NV's obligation to fund claims is, the better its position to bargain for a release of claims of this kind against third parties.

30.47 The *ninth point* is securing payment. This is a critical matter. As it develops, the JHI NV proposal is likely to involve a system of ongoing contributions by JHI NV rather than a very substantial "up front" payment. If so, the scheme will have to address two risks. One is that JHI NV in the future undergoes a change of heart, and resolves no longer to cooperate in funding the scheme. This might occur, eg, if the company were taken over, in particular by a non-Australian entity. In that situation, issues of international enforcement of civil obligations might become critical. A measure of protection might be afforded by imposing, by statute, an equivalent obligation to pay on the directors of the company, if the company itself did not pay, such as was done as regards shareholders by the *Taxation (Unpaid Company Tax) Assessment Act 1982* (Cth) (See *MacCormick v Federal Commissioner of Taxation* (1984) 158 CLR 622). However,

such a provision might not encourage compliance by directors who were not residents of Australia and had no assets here.

30.48 A more effective device, as regards international enforcement, would be to base the scheme on a covenant, contractual promise, or other voluntary commitment by JHI NV that is enforceable as an ordinary civil obligation. Such obligations, and judgments of Australian courts giving effect to them, would have a strong chance of being recognised and enforced in jurisdictions such as the Netherlands and the United States.

30.49 The second performance risk relates to the ordinary commercial risk of JHI NV becoming unable to meet its obligations to the scheme, through a change in its fortunes or otherwise. This may be thought to suggest that JHI NV's obligations should be secured in some way. (There are, of course, the usual commercial possibilities, bank bonds and the like.)

30.50 Some may not think the argument for security compelling. Victims of torts are generally subject to the risk of the insolvency of the tortfeasor. If an insolvent tortfeasor is uninsured, then, absent a publicly funded scheme for compensation, the victim has no recourse. Further, requiring security from JHI NV could impose a significant burden on it, in particular, by limiting its ability to raise capital, or significantly raising the cost of doing so. To this extent requiring security may be counter-productive, since the best ultimate assurance that JHI NV will be able to meet its obligations under the scheme is its continuing prosperity and business success.

30.51 Nevertheless, it may be appropriate to consider a system of funding for the scheme that keeps it in funds for, say, three years' anticipated payments on an ongoing basis. So far as possible there should be no question of the scheme having to operate at any time under circumstances of financial stringency, irrespective of short term difficulties in payment by JHI NV.

30.52 The *tenth point* concerns superimposed inflation. There is an element of ambiguity about this in the JHI NV proposal that it will be important to resolve. It may be a legitimate goal of such a scheme to reduce or eliminate inflation of awards insofar as this is due to the changing disposition of judges over time ("judicial inflation").

30.53 However, superimposed inflation is also caused by other factors, including changes in medical knowledge, leading to new treatments and longer life expectancy. These may increase damages at a rate higher than ordinary inflation. It would be inappropriate to shift the burden of those costs from JHI NV to claimants.

Conclusion

30.54 The points discussed so far by no means exhaust the issues that will have to be resolved if the JHI NV proposal is to reach fruition. They are sufficient to indicate that much work would need to be done to fill in, and develop, the details of the proposal. It was beyond the capacity of the Inquiry to attempt such a task independently, and none of the parties suggested it should have done so.

30.55 The JHI NV proposal, however, holds out a prospect for a solution of the impending rather disastrous situation facing claimants against Amaca, Amaba and JHI NV.

F. The Foundation Proposal

30.56 The Foundation agrees that the best potential remedy for Amaca is a special legislative enactment.[28] It has proposed such arrangements in quite some detail. It has also proposed a "cut down" version as a type of interim scheme that might be put in place pending another solution or a substantial increase in the funds of the Foundation. A copy of this proposal is Annexure S. These schemes are, however, only aimed at creating a mechanism for balancing the rights of present and future claimants in a reasonably fair and efficient way, assuming that Amaca and Amaba will or may not be able to pay all present and future claimants. If a proposal along the lines of the JHI NV scheme comes to fruition, all claimants should be compensated making a scheme of the kind proposed by the Foundation unnecessary.

30.57 However, if the circumstances were such that a shortfall was anticipated, a scheme generally along the lines proposed by the Foundation would be worth of consideration.

[28] MRCF Initial Submissions, para. 65.1.

G. A Special Prosecutor: The UASG Proposal

30.58 The UASG proposal is predicated upon their confidence that numerous claims are available against JHI NV "flowing from its involvement in JHIL's 2001 application for approval of a scheme or arrangement and the March 2003 cancellation of the partly paid shares.[29] Their proposal is as follows:

> "A proposal to achieve speedy and effective recovery is that legislation be enacted by the NSW Government whereby:
>
> (a) there would be established a statutory office of the James Hardie Special Prosecutor ("the JHSP");
>
> (b) the JHSP would have as its sole function the pursuit of claims against James Hardie and third parties on behalf of the MRCF, Amaca and Amaba;
>
> (c) there would be vested in the JHSP all choses in action held by the MRCF, Amaca and Amaba to enable the JHSP to pursue such claims;
>
> (d) the JHSP would pay all damages recovered into the Fund;
>
> (e) the Fund would continue to be conducted by the MRCF under new management;
>
> (f) the litigation in connection with such claims would be managed by the Crown Solicitor's Office."[30]

30.59 A similar proposal was advanced on behalf of the Law Council of Australia ("LCA"), in it that its proposed "nominal defendant" would be entitled to pursue claims on behalf of Amaca and Amaba.[31]

30.60 The main potential advantage of these proposals is that they shift the immediate cost of pursuing claims from the Foundation to the government; not surprisingly the Foundation supported the proposal. Another advantage, it was said, was that time and costs would be saved because "Those at the Crown Solicitor's office would already be seized of all relevant facts."[32] This overlooks two things. The first is that the Inquiry has not been conducted with a large team of solicitors from the Crown Solicitor's office. I have had the assistance of one permanent and one temporary solicitor. Moreover, in proceedings of the kind in contemplation, the fact that the Commission's staff have had access to the parties' privileged material may preclude their involvement in subsequent litigation.

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[29] UASG Submissions in Reply, para. 2.17.
[30] UASG Submissions in Reply, para. 2.19.
[31] LCA Initial Submission (14 July 2004), p 2.
[32] UASG Submissions in Reply, para. 2.20(d).

30.61 A potential disadvantage of the "special prosecutor" proposal is that it divorces the control of asset recovery litigation from the responsibility for the funds of the Foundation, Amaca and Amaba. Such a division of responsibility seems prima facie undesirable.

30.62 In this context it may be appropriate to mention some suggestions of the Foundation. With a view to making the litigation of such claims more efficient the Foundation suggests that there be special legislation with:

(a) provisions for the admissibility of evidence and findings in the Commission in any subsequent proceedings;

(b) provisions dealing with the release from confidentiality and privilege of all documents produced to the Commission;

(c) a provision that in any proceedings after the Commission has been completed there is a reversal of the onus of proof in relation to any findings of the Commission so that findings of the Commission are prima facie evidence of those facts. This might be facilitated by an amendment to the Special Commission of Inquiry Act allowing the Commissioner to provide a certificate in relation to certain findings. Alternatively, the Act could be amended to provide that the Commissioner's report will be prima facie evidence of its findings in any subsequent proceedings involving parties authorised to appear before the Commission;

(d) possible adoption of the US bond system which requires a foreign defendant to file a bond before they can defend litigation in certain circumstances. In this situation, the legislation might provide that where there have been findings of misleading conduct by the Commission that in addition to those findings being prima facie evidence of the facts, if a defendant wants to dispute those findings the plaintiff can apply for an

order requiring the defendant to post a bond before the defendant can file a defence.[33]

30.63 The problem with all this, however, lies in the starting point. It assumes that there are numerous claims available to the Special Prosecutor, or to be litigated arising out of the events earlier referred to. In the light of the views expressed earlier in relation to the merits of the various causes of action available, I am unable to agree.

H. Limitation Periods Reform

30.64 Both UASG[34] and MRCF[35] contend that special legislation should remove any time bar on the prosecution of claims against JHI NV and parties related to it arising from matters canvassed in this Inquiry. Of particular concern are claims that might be made by Amaca in respect of dividend payments and management fees paid prior to 1998.[36]

30.65 The views I have expressed on the merits of such claims militate against any such reform.

I. Reform of the Law Concerning the Corporate Veil

30.66 Some submissions urged the consideration of law reform that would operate generally, rather than merely being focussed on the particular problems of the Foundation and its subsidiaries. Such proposals suffer the difficulty that they would require legislation on the part of the Commonwealth in order to be effective. In addition, because of their general operation they would raise public interest considerations of a wider and more complex kind than it would have been possible or appropriate to consider in the course of this Inquiry.

30.67 Nevertheless, the circumstances that have been considered by this Inquiry suggest there are significant deficiencies in Australian corporate law. In particular, it has been made clear that current laws do not make adequate provisions for commercial insolvency

[33] MRCF Initial Submissions, para. 66.8. The MRCF also suggested in this context that I be appointed an acting judge of the Supreme Court of New South Wales to resolve the claims. There are insuperable practical and legal obstacles to such a course.

[34] UASG Initial Submissions, pp. 136–138.

[35] MRCF Initial Submissions, para. 66.14.

[36] All other claims would appear to be within time, though claims in respect of asset transfers in 1998 may become time barred or shortly after publication of this report. There is, generally, a six year limitation period.

where there are substantial long-tail liabilities.[37] In addition, the circumstances have raised in a pointed way the question whether existing laws concerning the operation of limited liability or the "corporate veil" within corporate groups adequately reflect contemporary public expectations and standards.

30.68 In the circumstances I have mentioned, I do not express any concluded view on these topics. However it is appropriate to highlight the main matters raised by the submissions, given their importance.

30.69 The most wide-ranging reform suggested would have imposed limits on the operation of the doctrine of limited liability.[38] In a detailed submission Counsel Assisting recommended reform of the *Corporations Act* so as to restrict the application of the limited liability principle, in respect of claims for damages for personal injury or death, to members of the ultimate holding company. Rather than attempt to summarise it, I reproduce it in Annexure T.[39] The Australian Plaintiff Lawyers Association made a submission to similar effect.

30.70 These submissions were opposed by JHI NV and the Law Council of Australia. These submissions placed particular weight on the fact that the Corporations and Securities Advisory Committee ("CASAC") had considered the question of limited liability for torts in its final report on corporate groups published in May 2000.[40] The Report made this recommendation:

> "The existing principles of tort liability should not be changed for corporate groups. The imposition of additional tort liability on parent companies of corporate groups should be left to specific statutes and general common law principles".[41]

30.71 In any ultimate consideration of these issues it would need to be kept in mind that the reform proposed is more limited in its scope than that considered by CASAC, since it was confined to liability for personal injury or death. Tort liability is a much wider category. In addition, claims in respect of personal injury or death are commonly

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[37] That is, liabilities which arise many years after the events or transactions which give rise to them.

[38] A corollary of the principle that a company is a legal entity separate from its member, this doctrine limits the liability of members of the company, as members, to the amounts they have agreed to subscribe by way of capital to the company.

[39] Initial Submissions of Counsel Assisting, Section 5, paras 41–68.

[40] Chapters 1 and 4 of the Report were themselves made a submission to the Inquiry by the Corporations and Markets Advisory Committee, as CASAC now is.

[41] CASAC, Corporate Groups Final Report, p. 12, para. 4.22.

protected by policies of insurance. Finally, public disapproval would be particularly strong in the case of a parent company failing to meet the obligations of an insolvent subsidiary to such claimants. Taken together these factors suggest that the proposed reform may have a limited impact on corporate liability in practical terms.

30.72 In addition, the proposed reform is limited in that it does not seek to remove limited liability from all shareholders, only from parent companies. It would, therefore, have no impact on the liability of individual investors (whether corporations or natural persons), and should not impact on their willingness to pool their investment capital by resort to incorporation. The submissions of the Law Council in this respect may be misdirected.[42]

30.73 Finally, it will be necessary to keep in mind that, contrary to the submissions of JHI NV,[43] the submissions considered by CASAC for the purposes of its report were not wide ranging. On this issue in particular, those who supported the full retention of limited liability consisted of some major corporations, a commercial lawyer, and the Australian Institute of Company Directors.[44] It is no criticism of CASAC to observe that this is not a wide ranging survey of relevant opinion.

J. Chapter 11 Procedures

30.74 Counsel assisting advanced a submission that consideration should be given to introducing insolvency mechanisms along the lines of Chapter 11 of the United States' *Bankruptcy Code*.[45] Again, the submission was confined, in this case, that such procedures should be available to companies for which other forms of external administration are inappropriate because of the existence of substantial long tail liabilities.

30.75 So confined, many of the disadvantages of Chapter 11 procedures are substantially reduced in significance. These have been the subject of recent, detailed consideration in this country, in particular, by CAMAC in its discussion paper,

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[42] LCA Supplementary Submissions, p. 3.
[43] JHI NV Submissions in Reply, para. 5.3.
[44] CASAC, Corporate Groups Final Report, p. 121, n 432.
[45] Initial Submissions of Counsel Assisting, Section 5, paras 10–34; Submissions in Reply of Counsel Assisting, paras 5.3–5.8.

Rehabilitating Large and Complex Enterprises in Financial Difficulties,[46] and by the Federal Parliamentary Joint Committee on Corporations and Financial Services in its *Corporate Insolvency Laws: a Stocktake*.[47] The principal objection to Chapter 11 has been that it leaves the company in the control of the existing directors and management ("debtor in possession"). This is less of an issue in the cases under consideration since those whose conduct gave rise to the long tail liabilities are less likely still to be involved with the company.

30.76 The Parliamentary Joint Committee however, did recommend an adjustment of the threshold test for the commencement of a voluntary administration:

> "The Committee recommends that the threshold test permitting directors to make the initial appointment of an administrator under the voluntary administration procedure be revised in order to alleviate perceptions that the VA procedure is only available to insolvent companies. The Committee notes the suggestion that the test be reworded to read 'the company is insolvent or may become insolvent'."[48]

30.77 In conjunction with such a change it may be useful to make clear that, for the purposes of assessing solvency in this context, regard should be had to debts and liabilities which are wholly prospective, but which are reasonably likely to arise. Such changes would enable the appointment of administrator to companies in the position of Amaca and Amaba. There would then arise the possibility of the Court's powers under s. 447A being utilized to create a scheme that did adjust the rights of present and future creditors in an appropriate way. In that context, some of the mechanisms employed in Chapter 11 proceedings, in particular, the appointment of a future claimants' representative, may have some merit. It may also be necessary, to require administrators to have regard to the interests of future claimants, to ensure that steps of this kind were taken. Otherwise the assets of the company may simply be distributed among existing creditors.

30.78 For reasons already given, it is not appropriate that I make any recommendations in this regard. However I can say that unless some general reform is enacted that permits

[46] September 2003.
[47] June 2004, and in particular, Ch 5.
[48] At p. 84, para. 5.52.

external administration to deal with long tail liabilities, future cases will arise that will have to be the subject of ad hoc legislative solution, if serious injustice is to be avoided.

K. Under-Capitalisation

30.79 The Foundation advanced a submission, based on a paper by Professor Ian Ramsay, that the *Corporations Act* should be amended to permit the corporate veil to be pierced in cases of "under-capitalisation". [49] This refers to a United States doctrine described by the Supreme Court as follows:

> "An obvious inadequacy of capital, measured by the nature and magnitude of the corporate undertaking, has frequently been an important factor in cases denying stockholders their defense of limited liability."[50]

30.80 The doctrine aims at what might be characterised as a form of deceptive conduct, misleading creditors. So characterised it may be thought to have little relevance to the circumstances of Amaca and Amaba, whose liabilities are mostly in tort rather than contract, arising in circumstances where reliance on capitalisation was not a relevant circumstance.

30.81 Whatever may be the merits of this doctrine otherwise, it has not been shown to be of relevance to the issues raised for this Inquiry, save in one respect. The existence of the doctrine in the United States suggests that significant inroads can be made into the corporate veil doctrine without undermining international competitiveness.

L. Views overall

30.82 Of the proposals which have been advanced the JHI NV proposal seems the most suitable in the long term. But it does need a lot of further definition.

30.83 I would simply add that if JHI NV is prepared to make periodical payments over years to a scheme of the nature it proposes, that seems to indicate that the spectre of asbestos liabilities may not be as significant as had been thought.

30.84 JHI NV's proposal involves it making periodical payments to fund the scheme. An alternative would be simply to provide for the shortfalls occurring as the Foundation

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[49] MRFC Initial Submissions, para. 67.1(a) and Attachment A.
[50] *Anderson v Abbott* (1944) 321 US 349 at pp. 467–468.

administers the affairs of Amaca and Amaba. I suspect that the amounts involved would not be very different.

30.85 If that course were adopted, it leaves it perfectly open to JHI NV (or, of course, the Foundation) to make out a case to the Government that damages in asbestos related cases should be assessed on the same bases as adopted in relation to other classes of personal injury litigation. The Unions and Asbestos Support Groups would oppose such changes, of course, but they recognise that JHI NV would be entitled to seek them. It would also leave it open for JHI NV, perhaps in collaboration with other asbestos defendants, to put together a developed, and thought through, scheme for the permanent resolution of claims of this kind.