Silencing the ‘Noise’ of Corporate Responsibility: James Hardie, asbestos and strategic bankruptcy

Lee Moerman
School of Accounting and Finance
University of Wollongong
Australia

and

Sandra van der Laan
School of Business
The University of Sydney
Australia

23rd October 2006

Draft Only – Do not quote without prior consent from the authors


♠ Corresponding Author
Lee Moerman
School of Accounting and Finance
University of Wollongong
NSW 2522 AUSTRALIA
Telephone: (61 2) 4221 5575
Facsimile: (61 2) 4221 4297
Abstract

In 2004, an Inquiry into the corporate restructuring of James Hardie Industries Limited, a former asbestos manufacturer in Australia, found that the pool of funds available to asbestos litigation claimants was severely under-funded and unable to satisfy future claims. Corporate attempts to avoid social responsibility are not new, especially in the case of a long-tail tort liability such as asbestos and provide unique opportunities to examine management behaviour in times of uncertainty. In this paper we have used Delaney’s theory of strategic bankruptcy to study the creation and establishment of a limited ‘fund’ to satisfy claims and in doing so, examine how the arena of corporations law, the rhetoric of shareholder value and the social construction of the bottom-line facilitated transferring the delivery of corrective justice from tort law to a system of distributive justice under company law.
A significantly worse than expected reaction to the creation of the Foundation may require us to re-think the timing and some details of the remainder of the program...even in the face of significant “noise” about separation (Macdonald, Chairman of the Board, James Hardie Industries Limited, 15th February, 2001)

Introduction

In 2001, James Hardie Industries Limited (JHIL), the parent company of several asbestos manufacturing entities in Australia, embarked on ‘Project Green’, a “comprehensive solution” to “eliminate legacy issues that would otherwise continue to detract from value creation” (JHIL, 2001, p.1). Project Green anticipated significant adverse public reaction, or stakeholder ‘noise’, to the creation of a separate entity with a limited specific pool of assets to fund current and future liabilities arising from asbestos claims. Knowledge of the health risks associated with the extraction, fabrication and use of asbestos is relatively recent\(^1\), considering the widespread use of asbestos products both domestically and commercially since the early 1900’s. Asbestos is a mineral renowned for its strength, flexibility and fire resistant qualities which made it an excellent insulator. For this reason it was widely used in the housing and shipbuilding industries (Delaney, 1992). Not only have those working in the asbestos industry been affected, but the general public, through incidental and often unknown exposure to asbestos have suffered from diseases, ranging from asbestosis through to mesothelioma. Today asbestos, is no longer widely used in industrialized nations, however litigants are still emerging as the effects of exposure may not become apparent for several decades. For companies involved in the asbestos industry the nature of a mass long-tail tort liability creates an incentive to minimize or control their payouts to litigants (Spender, 2003). Whilst JHIL’s corporate maneuverings were lawful, the question as to whether it had a corporate responsibility beyond a responsibility only to shareholders remains.

\(^1\) A landmark study in 1964 demonstrated the link between exposure to asbestos and several types of lung cancer (Selikoff in Delaney, 1992)
Since public exposure to asbestos can be beyond the scope of workers’ compensation, arguably, the compensation for asbestos litigants becomes a broader social issue.

Theories of corporate behaviour, attempt to explain and predict management or governance bodies decision-making strategy, particularly in an environment of uncertainty. Delaney (1989; 1992) studied several corporations engaging arrangements available under the U.S Bankruptcy Code as a means to limit corporate responsibility in terms of product litigation, to terminate employment contracts or to prevent corporate takeover. One such example of ‘strategic bankruptcy’ included the Manville Corporation, a U.S. asbestos manufacturing company that employed a U.S. Chapter 11 restructuring to limit its asbestos liability payments. Manville’s strategy in this context challenged the traditional theories of bankruptcy because the company was not necessarily insolvent, but was able to allocate a specific and limited pool of funds to satisfy claims (Spender, 2003). Almost twenty years on and a similar scenario is being played out in Australia. with JHIL’s creation of a separate entity to fund litigation claims, the Medical Research and Compensation Foundation (MRCF), which was subsequently found to be incapable of satisfying future liabilities. It was only the intense trade union and media attention that provided the impetus for the Special Commission of Inquiry into the Medical Research and Compensation Foundation (referred to hereinafter as the Inquiry) and mitigated the threat of the MRCF from entering into a corporate reorganization, such as Voluntary Administration (VA)². Delaney’s theory of strategic bankruptcy, therefore provides an appropriate lens to view the actions of JHIL as it negotiated its dealings with the asbestos claimants and their supporters.

² VA is one of the options available to entities under Corporations Act 2001 (Cth) faced with the threat of insolvency.
The underlying theme in Delaney’s theory (1989; 1992) is the social construction of the ‘bottom-line’ by defining the meaning of assets and liabilities. In doing so, entities are able to create a unit with limited potential and ensure a future bankrupt\(^3\) status. JHIL made a commercial decision to use asbestos in manufacturing, even after the dangers were known and documented. In Australia, as in other jurisdictions, the tort system is the mechanism to deliver corrective justice to those affected (Spender, 2003). Since the restructuring of JHIL, the corrective justice mechanism for these mass tort claimants is effectively being contested in a system delivering only distributive justice in the arena of corporations law. This legal arena provides more certainty in the company exposure to the compensation from claims and in some cases can provide the impetus for corporations to seek strategic bankruptcy (Delaney 1989, 1992).

The asbestos industry provides a unique opportunity to study\(^4\) corporate responses to social responsibility in an environment of uncertainty where the contexts of exposure and lead time for claims are extensive. Over a period of two years from 2001-2003, JHIL completed a three-stage process to quarantine the liabilities arising from litigation claims from operating profits. The purpose of this paper is to view the first stage of corporate reorganization of JHIL and the creation of the ‘bankrupt unit’, the MRCF, through the lens of strategic bankruptcy. This examination will highlight the ability of corporations to use both legal and accounting constructs and frameworks to mitigate their social responsibility.

\(^3\) In Australia a distinction is made between the individual who is said to be bankrupt and the incorporated entity which is said to be insolvent. For the purposes of this paper these terms will be used interchangeably to mean an incorporated entity that is unable to meet debts when they fall due.

‘Strategic bankruptcy’

Delaney (1992) studied several U.S. corporations that used a U.S. Chapter 11 bankruptcy procedure to control or avoid litigation expenses, to dismiss their unionized workforce or to prevent corporate takeover. Whilst the motives may have differed, several underlying themes emerged which Delaney defines as ‘strategic bankruptcy’. Delaney (1992, p.162) views the strategic bankruptcy process,

as a political arena in which organizations invoke bankruptcy to avoid current financial burdens and shift future financial risk to other, more vulnerable parties.

By ‘strategic’, Delaney (1992) argues that large organizations invoke a bankruptcy to pursue an organizational goal that it has previously attempted outside this arena, by actively shaping and constructing a claim to insolvency. These efforts at (re)constructing assets and liabilities do not occur in organizational isolation, but instead are influenced and coincide with other powerful institutional players. For this reason, balance sheet data are said to be “socially constructed by various institutional actors” (Delaney, 1992, p. 74).

The economic rationality of an organization’s actions are embedded in social structure. The power of various actors with ties to the firm shape the very definition of what is economically rational (Delaney, 1992, p. 180).

Accounting is predicated on a belief that it is a neutral, technical practice with rules that govern the definition and measurement of the elements of financial statements. A company’s balance sheet, therefore, is perceived as an objective indicator of financial health and under company law, this data can be used as a test for solvency.

---

5 U.S. Chapter 11 bankruptcy allows an out-of-court workout for firms in financial distress to restructure their debt and continue their operations (Chatterjee et al, 1996).
The case involving Manville, an asbestos manufacturer in the United States from the 1860’s, was one of the cases of interest for Delaney (1992). In 1982, whilst still having assets worth US$1 billion, the directors filed for Chapter 11 bankruptcy claiming equity insolvency. Manville’s filing for bankruptcy, however, was an end game strategy influenced by other powerful institutional players. These included a plethora of insurance companies unwilling to pay compensation; the State’s (U.S.) refusal to share in the liability for their workers in government-owned enterprises, the Financial Accounting Standards Board (FASB) and the rules of accounting for contingent liabilities and the lowering of Manville’s credit rating by Moodys. In 1981, the Manville auditors, Coopers and Lybrand, issued a qualified audit report acknowledging the potential liability of future asbestos claims on its assets. According to the auditors, the ‘liability’ did not satisfy the accounting tests of ‘probability’ and ‘measurement reliability’ and instead was presented as a footnote to the accounts. In 1982, the new CEO for Manville appointed Price Waterhouse as auditors and commissioned an epidemiological estimate of the incidence of asbestos-related disease that was subsequently estimated at a cost of approximately US$2 billion (Delaney, 1992). A reserve for this amount and equity insolvency were created simultaneously, although Manville itself and others ensured the public they were still financially strong (Delaney, 1989, 1992; Spender, 2003).

For five years the company enjoyed a period of reorganization, with a moratorium on creditor claims, including those of asbestos litigants. After this period of reorganization, creditors were paid in full, shareholders received 20% return of their capital investment and an asbestos compensation fund was established and funded through expected company profits and capped at US$2 billion for current and future victims. In this case, Delaney (1992) argues that Manville and

---

6 Equity insolvency occurs when the balance sheet liabilities exceeds assets.
its commercial creditors preferred to resolve the social issue of victim compensation through the structured arena of bankruptcy, rather than the uncertain arena of tort liability and or a statutory compensation system. Linking the funding of compensation claims to future profits effectively shifted the financial risk to the most vulnerable group. All potential insolvencies imply that a shortfall of funds exists and that some parties bear greater financial risk, including those that have advanced funds and those with an interest in an entities survival (Dal Pont & Griggs, 1994). With this in mind, we now turn to the case of JHIL and asbestos liabilities in Australia.

**James Hardie and Asbestos Liability**

As early as 1924, asbestosis was identified in workers as a disease and in 1927 to users of asbestos products, although it would be decades later that the era of the mass tort would emerge (Castleman, 1979). Asbestos related diseases can take decades to develop. As an example, cancer of the pleural lining of the chest cavity (mesothelioma) can appear up to 40 years after exposure. Some critics argue that it is this long lead time that facilitated companies in the asbestos industry to ‘ignore’ the dangers of exposure. Risk of developing asbestos-related disease is not limited to those who worked in the asbestos industry. Examples of other groups at significant risk of contracting asbestos related diseases are former shipyard and dock workers and members of defence forces, particularly the Navy. Estimates of mortality rates in Australia from asbestos exposure since 1945 are 7000 for mesothelioma. This figure is estimated to rise to a peak of 18000 by 2020 and up to 40000 from other asbestos related cancers (Hughes in Spender, 2003). Whilst JHIL is not alone in facing asbestos related compensation claims, it faces significant liability due to the range of products it manufactured with asbestos. Other large companies such
as CSR Limited\(^7\) and BHP Billiton Pty Limited, as well as state and federal governments also face future claims.

The first asbestos claim against JHIL was in 1977, however production, using asbestos, did not cease until 1987 (Spender, 2003). From 1937 until 1986 asbestos products were manufactured by two subsidiaries of James Hardie Industries Limited (JHIL) making these entities potentially liable for asbestos related claims. These entities, James Hardie & Coy (now Amaca) produced building and construction products and Jsekarb Pty Ltd (now Amaba) manufactured brake linings. Between 1996 and 2001 the majority of assets of the two subsidiaries were transferred to the parent JHIL and subsequently to an entity domiciled in the Netherlands, James Hardie Industries NV (JHI NV) while the liabilities remained in the renamed subsidiaries, Amaca and Amaba. Ownership of these two companies was subsequently transferred to the newly established MRCF with the effect of ‘separating’ JHIL from the legacy of asbestos liabilities. Following further corporate maneuvering JHIL became a subsidiary of JHI NV and in 2003, was renamed ABN 60 with ownership transferred to the ABN 60 Foundation. This sequence of events is represented diagrammatically in Figure 1.

\(^7\) In 1998 CSR was found liable for the first mesothelioma case in Australia (Spender, 2003).
Figure 1: James Hardie Industries Ltd Reorganisation.

Prior to 15th February 2001

James Hardie Industries Ltd (JHIL)

James Hardie Industries NV (JHI NV)

James Hardie & Co. (NZ)

Jsekarb Pty Ltd (now Amaba)

James Hardie & Co. (now Amaca)

James Hardie Australia (JHA)

Medical Research & Compensation Foundation (MRCF)

50%

MRCF Investments

Amaca (James Hardie & Co.(Coy))

Amaba (Jsekarb Pty Ltd)

15th February 2001
Ownership of Amaba and Amaca to newly created MRCF for nil consideration.

October 2001
JHI NV becomes the holding company and shareholders of JHIL become the shareholders of JHI NV

James Hardie Industries NV (JHI NV)

James Hardie Australia (JHA)
Operating Business

JHIL $1.9 million callable on partly paid shares

March 2003
Partly paid shares are cancelled and replaced by a Deed of Covenant. JHIL ownership (now ABN 60) is transferred to the newly established ABN 60

James Hardie Industries NV (JHI NV)

James Hardie Australia (JHA)
Operating Business

Deed of Covenant of Indemnity

ABN 60 Foundation

ABN 60 (formerly JHIL)

Adapted from Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation (2004)
Whilst the information in Figure 1 is a simplification of the reorganization, ignoring the many subsidiaries of this conglomerate, it demonstrates the effect the reorganization achieved in separating the asbestos liabilities generated by their operating business to the MRCF and quarantining profits from continuing operating business to JHI NV. In anticipation of a separation of liabilities of Coy and Jsekarb, a new operating entity James Hardie Australia (JHA) was created in 1998 as a subsidiary of JHI NV. The assets of Coy and Jsekarb were transferred to this and other companies in the group from 1995-1998. On February 15\textsuperscript{th} 2001, JHIL established the MRCF and transferred ownership of Amaca (formerly Coy) and Amaba (formerly Jsekarb) for nil consideration. The net assets of these two subsidiaries at the time of transfer were recorded as AUD$214 million. JHIL, the parent company, organized a Deed of Covenant and Indemnity, in return for a further $80.3 million (discounted), over a period of time, to supplement the net assets and cover the actuarial estimates of AUD$286 million required to fund current and future claims. A donation of AUD$3 million was provided by JHIL to the MRCF to fund further research. In October 2001, JHIL entered a Scheme of Arrangement approved by the NSW Supreme Court. The shareholders of JHIL became the shareholders of JHI NV and JHIL became a wholly owned subsidiary of JHI NV. This new holding company held partly paid shares with AUD$1.9 billion callable, ostensibly to meet any future asbestos claims of JHIL. However, in March 2003 these partly paid shares were cancelled and JHIL ownership was transferred to the newly established ABN 60 Foundation. And, in return for consideration of AUD$234.150 million a Deed of Covenant and Indemnity between JHIL (ABN 60) and JHI NV effectively placed the assets of the operating business out of reach for future asbestos claims (Jackson, 2004; Prince et al., 2004). Figure 2 demonstrates the final outcome of the reorganization of JHIL, Amaca and Amaba, the two entities liable for the asbestos-related litigation claims as former operating entities and JHIL
(now ABN 60) as the former parent company are completely separated from future operating profits.

Even at this point in the proceedings there was skepticism and suspicion reported in the media about the adequacy of funding for future liabilities (Spender, 2003). And by October 2003, the MRCF was unable to meet claims beyond 2007 (Dunn, 2005). In February 2004, the Inquiry was established to report on the following terms of reference in relation to the MRCF:

- Financial position and evaluation of future ability to pay liabilities;
- The circumstances in which MRCF was separated from the James Hardie Group;
- The reorganization of JHIL and whether this contributed to a shortfall in funds or assets to meet current and future liabilities; and
Adequacy of the current corporate legislation (Corporations Act 2001 (Cth)) to manage liabilities.

The Inquiry (Jackson, 2004) expected that the MRCF will have its funds exhausted by the first half of 2007 and will no longer be able to meet the future asbestos related liabilities. It also found that while it was not possible to suggest that the reorganization directly contributed to the shortfall of funds of the MRCF, that was the effect of the reorganization. Current arrangements under the Corporation Act were also found by the Inquiry to be unable to assist the MRCF manage its liabilities.

**James Hardie & strategic bankruptcy**

The JHIL rationale for separating the asbestos liabilities was to improve shareholder value and position “James Hardie for future growth” (JHIL, 2001, p.1). The restructuring was aimed to achieve the twin goals of separating the parent company from asbestos liabilities and to increase shareholder returns through taxation benefits of listing on the New York Stock Exchange (NYSE). Delaney (1989; 1992) argues that companies restructuring to achieve an organizational goal such as limiting or mitigating product liability are constrained by powerful institutional actors. In the case of JHIL the corporate maneuvering was conducted in a structured and purposeful manner. ‘Project Green’, was presented to the Board of Directors in February 2001 outlining the rationales for the restructuring, the process, consideration of alternatives and a risk analysis. There is no doubt that the outcome was achieved after careful consideration of the likely response to the creation of the MRCF by many powerful stakeholders.
Institutional Stakeholders

New York Stock Exchange

In 1998 James Hardie Australia (JHA) was established as a new operating entity and subsidiary of JHI NV. JHI NV attempted a partial listing on NYSE, however a weak demand for shares and the issue of liability made the company a less desirable investment (Spender, 2003) and the proposal was “aborted” (Jackson, 2004, p. 23). By 2001, around 80-90% of profits were being generated in the U.S. and shareholder returns were being eroded by tax regulations. The tax implications arising from profit repatriation to Australia created a further incentive for JHIL to domicile their holding company in the Netherlands and list JHI NV on NYSE. Listing in the U.S. also requires compliance with US GAAP, in particular FAS 5 that mandates the undiscounted disclosure of contingent liabilities of all companies in a group. These circumstances made the two-stage restructure that effectively quarantined the liabilities from former operations from the new holding company JHI NV and facilitated listing on NYSE without the stigma of asbestos liabilities from the balance sheet the most attractive option (JHIL, 2001).

“The Corporate Veil” – Corporations Law

The principle of the separate legal entity arose from the watershed Salomon\(^8\) decision almost 100 years ago and, in Australian corporate jurisdictions, the notion of ‘lifting the corporate veil’ has been a topic of debate in many cases involving the restructuring of insolvent units. Several submissions were made to the Inquiry in regards to the separate legal entity doctrine and its application to the corporate restructuring of JHIL (Harris, 2005). This issue of implied agency occurs when a subsidiary is considered to be acting for and representing the principal and this issue was raised in relation to JHIL and the two subsidiaries, Coy and Jsekarb. Although other

---

\(^8\) Salomon v Salomon & Co Ltd [1897] AC 22
jurisdictions, notably in the U.S., there exists several doctrines that allow the corporate veil to be lifted between members of a corporate group, the Australian courts have been reluctant to do so on the basis of control or dominion. (Harris, 2005).

The restructuring was founded on the premise that JHIL had no legal liability for the former subsidiaries’ asbestos claims (JHIL, 2001). However, previous litigation claims involving a New Zealand subsidiary9 and concerns raised about future tortious claims in Australia in relation to the ‘corporate veil’, the separation of Amaca and Amaba was accompanied by a Deed of Covenant of Indemnity in return for a total AUD $234.150 million (undiscounted over a period from 2001 to 2042) . This stream of future payments was represented as an asset on the balance sheets of the subsidiaries in the form of a receivable. The Deeds of Covenant effectively indemnified JHIL for not only asbestos liabilities, but also for past dividends10, management fees and distributions (Jackson, 2004, p. 331). These additional items covered under the Deed of Covenant comprised assets that were transferred as inter-company payments in the process of reorganization which may have been at risk if the corporate veil was lifted under insolvent trading provisions. The Deed however was only effective as long as all parties were viable entities and able to indemnify JHIL. To cover this contingency a put option allowed any future parent of JHIL to compel Amaca to purchase all the shares of JHIL for AUD$10/share, resulting in JHIL the former parent becoming the subsidiary of Amaca.

*Trade Unions*

9 James Hardie & Coy Pty Ltd v Putt (1998) 43 NSWLR 554
10 A dividend of AUD$43.5 million had been paid by Coy to JHIL in 1996. This dividend was considered by the Inquiry as a doubtful intercompany transaction.
In the context of the Australian workplace trade union involvement has always been prominent. Unions have had a positive role to play in some highly public cases of corporate or pending corporate insolvency to protect the rights of workers and their entitlements (Floyd, 2005). A case in point is that of Patricks\textsuperscript{11}, a company that attempted ‘strategic bankruptcy’ to dismiss their unionized workforce by constructing an insolvent labour hire company\textsuperscript{12} (O’Neill, 1998). In a corporate situation where liabilities are under-funded, workers require a collective voice or union to advocate and act on their particular interests. In the case of JHIL they became the voice for social issues as they advocated for those affected by asbestos-related illnesses and were seen as a risk factor in the reorganization.

A history of skepticism by trade unions in relation to JHIL and asbestos exists. They were suspicious of the motivations of company attempts to fund asbestos initiatives as a smoke screen for a “hidden agenda” (JHIL, 2001, p.21). JHIL management assessed the risk of a “vocal and negative response” by unions to the creation of MRCF as “medium”, however the fact that union shareholding via superannuation funds\textsuperscript{13} is less than 1%, actual intervention in company affairs was regarded as insignificant (JHIL, 2001, p.21). Any trade union instigated ‘noise’ could only be a rearguard action as public knowledge of the reorganization and the establishment of the MRCF became apparent after the fact. Subsequent trade union action did however, direct the attention of the nation to the problem and ensured an “in-principal” solution was reached that would benefit workers not be just a corporate punishment for wrongdoers (Floyd, 2005, p. 158).

\textsuperscript{11} Waterfront Union of Australia & Others v Patrick Stevedores No. 1 Pty Ltd (under administration) & Others [1998] 378 FCA
\textsuperscript{12} Interestingly, Greg Combet, the Secretary of the Australian Council of Trade Unions (ACTU), was a prominent union figure in the case of Patricks and James Hardie.
\textsuperscript{13} Superannuation funds is the term given to pension funds in Australia.
**Governments**

*The easiest practical option for the NSW Government would be to ‘flick-pass’[14]’ the issue to the Federal Government and ask that they deal with it as an issue of Corporations Law (JHIL, 2001, p.19)*

The risk of government intervention was considered “low on legal and commercial grounds”, however it could not “be ruled out on political grounds” (JHIL, 2001, p. 16). Various levels of government in Australia are involved in a myriad of ways in the asbestos issue. State governments (particularly in New South Wales) have the responsibility for worker’s compensation. In the Manville case, as in Australia, many workers exposed to asbestos were employed by the government, particularly the defence force. In both cases, although it could be argued that the government should share the burden of liability, the governments were reluctant to establish a statutory scheme for dealing with claims (Harris, 2005). Both Manville and JHIL sought to address the asbestos problem in an alternate legal arena. The NSW Dust Diseases Board (DDB) funds research into asbestos related disease and were expected to influence the NSW Government’s views on the creation of the MRCF as the vehicle for funding compensation. JHIL had mooted the idea of an Asbestosis Disease Research Institute with the NSW government with funding of AUD$4 million. Funding would guarantee JHIL’s involvement in the planning of an institute, a role that would “help keep JH ‘in the loop’ and able to maintain and monitor relationships” and allow them to “continually reinforce the positives of establishing the Foundation and understand any ongoing opposition from opponents” (JHIL, 2001, p.24).

---

14 A ‘flick pass’ is a sporting term mainly used in games such as Rugby Union and Rugby League. It means a short sharp pass (usually behind the back) to a member of your own team resulting in a change of direction or point of attack.
The successful establishment of the MRCF set the scene for the second stage of the reorganization strategy. The Scheme of Arrangement allowing the redistribution of shares and transfer of the former parent (JHIL) to a holding company in the Netherlands (JHI NV) required sanction from the NSW Supreme Court. Prior to approval certain agreements were made to satisfy the court that the interests of stakeholders were not compromised in the restructure. In particular 100,000 partly paid ordinary shares ensured that JHIL had the ability to call approximately AUD$1.9 billion to satisfy any asbestos-related liabilities (Jackson, 2004, p.34). These shares were subsequently cancelled and JHIL’s (renamed ABN 60) ownership was transferred to the ABN 60 Foundation in exchange for another Deed of Covenant and Indemnity (see Figures 1 and 2) to indemnify JNI NV from the liabilities of JHIL. Although, the corporate regulator, the Australian Securities and Investment Commission (ASIC), was informed, the cancellation of the shares was not announced to the public (Jackson, 2004).

*Actuarial Estimates of Contingent Liabilities*

As with Manville, the estimation of contingent liabilities was a pivotal issue in JHIL’s strategy. In 2000, prior to the establishment of the MRCF, Trowbridge Consulting, an actuarial firm, estimated the medium future cost of asbestos liabilities as Net Present Value\(^{15}\) (NPV) AUD$284 million. This estimate was described as the “most likely” or “best estimate” cost of current and future claims. In 2004, the Inquiry found that these original estimates left the MRCF under-funded and unable to provide compensation beyond mid 2007.

*Accounting Rules*

\(^{15}\) Based on discount rate of 7% and a time period of 20 years, net of insurance recovery.
In October 2001, AASB 1044 Provisions, Contingent Liabilities and Contingent Assets was issued by the Australian Accounting Standards Board. Prior to the promulgation of this standard Australia did not have a standard for these issues and in preparation and comment the AASB published ED 88 Provisions and Contingencies for comment (Thomson, 2001). ED 88 outlined the proposals for a provision method of accounting for liabilities that were probable and could be measured reliably. A provision is a subset of liabilities “for which the amount or timing of the future sacrifice of economic benefits that will be made is uncertain” (Thomson, 2001, p.7). The obligations arising from the provision should be carried at the present value the ‘best estimate’ of discounted future cash flows if they can be measured reliably. For liabilities failing the recognition criteria of a provision for liabilities they could be disclosed as contingent liabilities. When JHIL presented ‘Project Green’ to the Board, the spectre of this standard was a consideration in the timing of the establishment of the MRCF. In the concluding comments by the incumbent Chairman, Peter Macdonald he states that

[d]elaying creation of a Foundation past financial year end significantly increases the risk of ED 88 complications. Latest intelligence is that ED 88 will be promulgated before the end of this financial year and that CSR will significantly increase its provisioning by early adopting ED 88 (JHIL, 2001, p. 4).

JHIL had previously recorded a contingent liability of AUD$43 million in respect of the known asbestos claims of the manufacturing subsidiaries. Future claims, according to the accounting firm PricewaterhouseCoopers “cannot reliably be measured at the present time” (in Jackson, 2004, p.26). Paradoxically, JHIL were caught between the expert actuarial estimates of future liabilities to justify the creation of the MRCF with net assets of AUD$296 million and the imminent requirements of AASB 1044 to disclose in a provision these estimates of AUD$284 million.
Silencing the ‘Noise’

Separating the potential asbestos liabilities from the operational businesses was seen by the JHIL Board as integral to their future growth strategy and a number of options were canvassed (JHIL, 2001). The restructuring option with the establishment of a foundation was preferred, on a costs-benefits basis, and was timed to minimise adverse stakeholder reaction – “noise” (JHIL, 2001). Possible trade union, media and other stakeholder outcry (‘noise’) contributed to speed and stealth by which the reorganization was effected. The ‘private and confidential’ Project Green Board paper was tabled and discussed on February 15th 2001. By the next morning, a media release coinciding with quarterly results announced the creation of the MRCF as providing “certainty for people with a legitimate claim against the former James Hardie companies which manufactured asbestos” and has “sufficient funds to meet all legitimate compensation claims anticipated” (Media Release in Jackson, 2004, p.29).

Delaney’s (1989) strategic bankruptcy theory model of creating a ‘bankrupt unit’ to forestall or limit claims demonstrates how accounting definitions and measurements are implicated. The MRCF was constructed as a legal entity with the sole purpose of funding claims and research from the assets of its subsidiaries, Amaca and Amaba. As events unfolded, there is no doubt that the MRCF had only a limited ability to satisfy claims, despite expert claims to the contrary. Since 1995, JHIL had embarked on a process of asset shifting by transferring operating assets of Coy and Jsekarb to other operating companies in the group and transferring cash through the inter-
company transfer of excessive management fees, loans and improper dividends (Dunn, 2005). In 2001, the net assets of Amaca and Amaba available to the MRCF included leases arising from real estate leased to other James Hardie operating companies, loans to James Hardie companies, the future amounts receivable under the Deed of Indemnity and a contingent amount expected upon the settlement of a claim with QBE Insurance. The amount of cash and cash equivalents totaled AUD$47.6 million (Jackson, 2001, p.43). These ‘assets’ largely comprised receivables due from other James Hardie entities. The liability of AUD$43 million consisted of only notified claims, in other words claims that satisfied extant accounting definition. The media release proudly refers and directs stakeholders to the pool of assets available on the balance sheet. These figures were accepted as an objective representation of financial health and ability to ‘fund’ claims, especially when supported by the advice and recommendations of experts.

The process of valuation also plays an important role in the construction of the ‘bottom-line’ (Delaney, 1992). The compounded use of unknown variables obscures any meaning of the final numbers created. This is seen particularly in the actuarial estimates and calculations using discounted future amounts. The best estimate of future liabilities in 2001 calculated by the actuarial firm served to legitimize the establishment of the MRCF as the vehicle to satisfy James Hardie’s corporate social responsibility. The balance sheet assets of Amaca and Amaba almost exclusively consist of discounted cash flows in the form of leases and other receivables. The investments held by MRCF were estimated using a constant earnings rate of 11.7% pa over 50 years. The Inquiry found that rate was “selected simply to achieve the result that the model showed significant surpluses of funds over its life” (Jackson, 2004, p.9).
The corporate maneuverings of JHIL serve to highlight how ‘crucial’ social issues are resolved in corporate frameworks designed for the operation of corporations in the market. In an effort to sever “troublesome ties” and avoid current financial burden, reorganizations shift future financial risk to vulnerable parties (Delaney, 1992, p. 179). In an environment where the corporation and doctrine of limited liability underpin resource allocation in market economies, notions of survival and efficiency legitimise unethical managerial behaviour (Salem & Opal-Dawn, 1994). Corporate attempts to avoid social responsibility are not new, especially in the case of a long-tail tort liability such as asbestos and provide unique opportunities to examine management behaviour in times of uncertainty. In this paper we have used Delaney’s theory of strategic bankruptcy to study the creation and establishment of a limited ‘fund’ to satisfy claims and in doing so, examined how the arena of corporations law, the rhetoric of shareholder value and the social construction of the bottom-line facilitated transferring corrective justice from tort law to company law.

Conclusion

Asbestos related liability is a social issue and provides an opportunity to study how a corporation dealt with its corporate social responsibility by using an elaborate corporate restructuring to separate its former operating companies through the creation of a ‘fund’. The objective of separation, as articulated by the incumbent management, was the creation of shareholder value (JHIL, 2001, p.1). The optimization of shareholder wealth unequivocally meant that JHIL would need to eliminate its legacy issues by quarantining and limiting its future asbestos liabilities from its source of future profits: its current operating businesses. Corporations law regulates the
incorporation and establishment of the vehicles for capital and resource allocations. The notion of limited liability and separate legal entity doctrine permit companies to create a limited pool of funds available for allocation. Using the rhetoric of shareholder value, JHIL created such a unit, the MRCF. Arguably, the profits of the formerly successful asbestos manufacturing entities Coy and Jsekarb were transferred to the parent, JHIL, and therefore JHIL should bear the responsibility for the inadequacy, however it has used the corporate form as a vehicle in a strategic manner to confine and limit social responsibility.

Whilst the reorganization “raised important questions about continued community acceptance of a legal doctrine which suspends the natural consequences of tort law in favour of companies and their shareholders to the detriment of involuntary tort creditors” (Dunn, 2005, p. 340), it also raises issues of accounting and its role in the social construction of the ‘bottom-line’. Delaney argues that management, faced with the uncertainties of tortious litigation prefer to conduct their ‘business’ in the arena of corporations law and will use both legal and accounting constructs to define the ‘unit’ of business to deal with claims. This management strategy, however is not conducted in an organizational vacuum, other powerful institutional stakeholders create ‘noise’ which serves to constrain and shape, as well as facilitate the options available to management.
References:

Thomson, A. (Ed.) *Transparency*, Australian Accounting Standards Board (AASB)