

How Hardie's spin turned to mud

June 19, 2004

*Peter Macdonald, managing director and public face of James Hardie Industries ...
"Certainly you would never consciously mislead," he told the inquiry.*

A hard-hitting inquiry has turned the carefully nurtured reputation of James Hardie's, the public face of which is managing director Peter Macdonald, from blue chip to a dark shade of mud, writes Elisabeth Sexton.

ON JUNE 7, A CAPACITY CROWD filled a cramped room in a nondescript courthouse overlooking the Goulburn Street parking station on the edge of the Sydney CBD. Sufferers of asbestos diseases, one or two with oxygen machines wheezing quietly beside them, and widows of mesothelioma victims jostled for space with stockbroking analysts and solicitors from top-tier law firms.

The attraction was the special commission of inquiry headed by David Jackson, QC, into how Australia's largest asbestos manufacturer has dealt with compensation owed to people with cancer caused by exposure to its products. After 32 days of already remarkable evidence, seats were scarce for the inevitable clash between the chief interrogator and star witness.

As counsel assisting the inquiry, John Sheahan, SC, has the role of ensuring that Jackson obtains the evidence he needs to determine whether James Hardie Industries, having profited for decades from selling asbestos products, is now deliberately avoiding honouring the financial consequences.

As Hardie's managing director, Peter Macdonald is the public face of a company under unusual siege. Unlike the massive incompetence revealed at HIH, or the breathtaking arrogance displayed at One.Tel, Hardie is a well-run, international success story.

There are no accusations here of wasting money or misjudging markets. Rather, Jackson is investigating whether there has been a cold, calculating, premeditated attempt to insulate growing shareholder wealth from the legitimate claims of people killed by products the company has known were dangerous since the 1930s.

At the heart of the matter is Hardie's corporate culture, and that is where Sheahan started when he got to his feet that morning. "I gather from documents [produced to the inquiry] that the expression 'transparent' or 'transparency' is one that has some significance for you?" he asked.

"I guess it is used synonymously as being as open as we can be," Macdonald replied.

Sheahan: Would it mean something like this: concealing nothing material, so that a full and fair picture was exposed?

Macdonald: As I said, I think it would be something like that — being as open as it is possible to be, but there are always constraints on how open you can be.

Sheahan: Those constraints being you must not mislead, obviously?

Macdonald: In terms of constraints I would have thought more of materials that might be confidential or sensitive to the company or are unable to be revealed for some

reason you judge to be against the interests of shareholders.

Sheahan: But overriding that, with an obligation not to mislead?

Macdonald: Certainly you would never consciously mislead.

When the last witness leaves the stand next Wednesday, Jackson will begin weighing the company's oft-stated case that "everything we have done has been fair, legitimate and transparent" against a now long list of allegations that it did, indeed, consciously mislead.

Time-zone hell is one of the drawbacks of running a multinational corporation. On February 25, Macdonald was in Amsterdam. The company he heads, James Hardie Industries NV, has been incorporated there since October 2001.

It doesn't do much in the Netherlands though, apart from keeping Dutch treasury officials content that it is meeting all the conditions required to take advantage of tax breaks offered to foreign companies.

Fifteen hours away in California is the operational head office. Macdonald and his family live in the comfortable new suburbs of Mission Viejo, along with the families of a small band of expatriate Hardie executives who moved to the city just south of Los Angeles in the late 1990s when Hardie's American building materials business started to go gangbusters.

Today, 76 per cent of the company's revenue is generated in the US and business is booming. In the year to March, sales there rose 19 per cent.

Nine hours from Amsterdam in the opposite direction is a city supposedly of dwindling importance to the company with global ambitions. But despite Hardie's best efforts over the past decade to entice US investors, 86 per cent of its shareholders are still Australian, so Hardie's primary stock exchange listing is in Sydney.

Australia remains significant to Hardie for another reason, which, if all had gone to plan, would be off the radar — the one Macdonald calls "legacy issues".

It's his shorthand for the fallout from Hardie's 70 years of making asbestos cement, piping, insulation materials and brake linings in factories in NSW, Queensland and Western Australia.

It was 5.30am — Amsterdam time — on February 25, 2004, when NSW Premier Bob Carr answered a Dorothy Dixier in Macquarie Street and began reflecting on the painful deaths in recent years of former state governor Sir David Martin and former Labor deputy premier Jack Ferguson.

Martin contracted the vicious cancer mesothelioma during his 41-year naval service from asbestos in the pipes of ships. Ferguson picked it up from six months working in an asbestos factory at Homebush as a 14-year-old.

After this personal preamble, Carr then announced the powerful inquiry into Hardie's handling of its "legacy issues" before its shift to the Netherlands in October 2001.

In February 2001, Hardie set up a charitable trust, the Medical Research and Compensation Foundation. A company press release said its starting assets of \$293 million were "sufficient funds to meet all legitimate compensation claims anticipated from people injured by asbestos products that were manufactured in the past by two former subsidiaries".

The trigger for Carr's concern was the October 2003 claim by the foundation that it faced a shortfall of \$800 million. A fresh actuarial estimate this month has put the hole

at \$1.3 billion. The new review, by KPMG Actuaries, expects another 7900 Australians to qualify for compensation from Hardie products, in addition to the 2960 already reported.

“We want to find out what James Hardie knew back in 2001 about the extent of its liabilities, and whether the firm underestimated the amount of money it set aside for dust disease claims,” Carr said.

By 10am Amsterdam time, Macdonald was hooked up to an international teleconference with stockbroking analysts and fund managers. Despite the early start, and the lack of warning of Carr’s announcement, Macdonald gave a polished performance.

He adeptly answered all the issues raised and soothed concerns that the inquiry could have any impact on the company or its shareholders. He restated the long-held view of the company’s lawyers that the parent company — the one owned by shareholders — had no legal obligation to meet the asbestos or any other liabilities of the only two companies in the group to have made asbestos products since 1937.

This was the case both before and after the two wholly owned subsidiaries were transferred to the foundation in February 2001.

The company would not meet any shortfall in the trust.

One of Macdonald’s themes during the conference call was that the Government recognised the strength of Hardie’s legal position, and the inquiry was merely a political diversion. “Various constituencies in the community that are close to the Government, such as unions and plaintiffs’ lawyers and claimants groups, have called for an inquiry into this matter,” Macdonald said.

“So there was pressure on the Government to do something ... If there was an obvious and clear legal case to be brought against the company, you would expect it to have been brought. Next question?”

The upbeat and confident chief executive who left the impression that the inquiry was a political stunt was unrecognisable from the man who left the witness box four months later on June 8.

There was no cheery request for another question by the time Macdonald had endured five gruelling days of cross-examination from less sympathetic quarters than investment analysts.

Macdonald had been grilled by barristers for the trust, for unions and asbestos victim groups and for Trowbridge Deloitte, the actuary Hardie retained in 2001 to estimate the trust’s future liabilities.

Jackson warned him several times to resist the temptation to “fight back” or “counter-punch” or “answer a different question from the one that’s been put to you”.

Having spent two days longer in the box than scheduled, Macdonald departed, still holding to his view that the company had acted legally, and that “I am not aware of any claims today that could be made against James Hardie Industries NV.”

But no one is saying now that the inquiry has had no effect on the company.

For a start, the share price has fallen 30 per cent since the trust first raised the alarm publicly in October 2003, reducing its market value from \$3.6 billion to \$2.5 billion.

Then there is the evidence from other Hardie witnesses, not least its eminent lawyers. Throughout the controversial restructure, which has “separated” shareholders

and the ongoing business from asbestos creditors, Hardie retained top-tier law firm Allens Arthur Robinson and sought advice from half a dozen leading queen's and senior counsel.

In 2001, an Allens partner, Roy Williams, took issue with Hardie's use of the firm's name to support its public assertion that the trust would have sufficient funds to meet future claims.

"I'm a little concerned about the tone of your email," Hardie in-house general counsel Peter Shafron replied. "We kept Allens close by our side throughout this transaction and Allens' billings will reflect that."

The closeness was also emphasised last August, when former Allens partner and now investment banker Peter Cameron accepted an invitation to join the Hardie board.

The high-powered legal advice matches the status of the client. This is not a small company that might have cut a few corners struggling to establish itself or to stay afloat.

Hardie is a major blue-chip Australian stock, ranking in the top 50 listed companies. For decades it was run by one of Sydney's business dynasties. When a young Andrew Reid arrived in Australia from Glasgow in 1892, he looked up a fellow Scots emigre by the name of James Hardie.

When Hardie retired from the business they built up in 1911, Reid bought Hardie's half share. His son, Sir John Reid, held the reins and in turn handed over to his son, also John, who became a director in 1964 and was chairman for 23 years before handing over to Alan McGregor in 1995.

Reid's standing in the business community is reflected by his 25-year tenure on the BHP board until 1997, his chairmanship of the Australian Graduate School of Management and senior governing roles at the Salvation Army, the Girl Guides and the YWCA. That such a prestigious client could land one of Australia's top law firms in such hot water created a palpable tension in the hearing room on June 9.

When Allens partner David Robb took the stand Hardie's attempts to preserve its reputation took a dramatic turn for the worse.

Robb, who needed no instruction from Jackson that he was obliged to co-operate, took a deep breath when a crucial question came late in the afternoon of the next day. "I did consider whether the court had been misled and ... I drafted an opinion ... that indicated that the court may have been misled," he said.

He also thought that information sent to shareholders before the vote on the company's move to the Netherlands might have been incorrect.

His comments top the list of damaging revelations in Goulburn St. But other evidence from Hardie executives also undermines the company's formal position.

Jackson heard that Macdonald might have misled his counterpart at rival building products firm CSR, Alec Brennan, who was worried that his company might end up picking up more of the bill for asbestos compensation after the restructure.

When Hardie established the foundation in 2001, executives might have allowed Trowbridge to prepare estimates of future claims based on assumptions at odds with actual claims received by the company.

The four businessmen who signed up as directors of the foundation might have done so under the misapprehension that they had received the most up-to-date data.

Information might have been deliberately kept from the law firm giving independent advice to these directors.

Other lawyers giving arm's-length advice to Hardie executives serving as directors of the subsidiary companies with exposure to asbestos might also have been kept in the dark.

Jackson also heard of subsidiary company board minutes being altered, questionable transactions between group companies, misapprehensions by stockmarket analysts going uncorrected, briefs to external consultants made so narrow they became pointless, and press releases being issued against the advice of internal experts.

For a company so sure of its limited legal liability to compensate asbestos victims, Hardie has gone to a lot of effort in recent years to persuade the wider community of its soundness of its legal advice.

When Jackson expressed "some surprise" at the detailed PR planning which went to the Hardie board, chairman McGregor told him: "The sensitivity of these issues and the adverse publicity that invariably they attract was quite a serious issue for the company."

Macdonald also defended his PR department. "I believe the company has a requirement to firmly and fairly put its side of any story, knowing that there is a series of stakeholders who will aggressively and negatively put their side of the story."

The strategy to outwit "spoilers", as they are called in many Hardie internal documents, went much further than protecting the company's reputation in the media.

While Allens was carrying out the core legal work for the restructure, other lawyers were consulted with the specific aim of second-guessing how "stakeholders" might "interfere" in Hardie's plans to cut its ties to asbestos.

In July 2000, Hardie retained Melbourne barrister Jack Forrest, QC, to "identify and assess the likelihood of all potential legal challenges which could be made to the proposed restructuring by any party, including a plaintiffs' law firm, co-defendant in asbestos-related litigation, the Dust Diseases Board, any body claiming to represent the interest of sufferers of asbestos-related disease, a shareholder or an individual claimant".

Asked if Forrest had been chosen because he was perceived to be connected with plaintiff law firm Slater & Gordon, Hardie internal lawyer Wayne Attrill said: "I don't think that was so much consideration as that, because Jack had done work for both plaintiffs and defendants, he could bring very good perspective to bear on the proposal."

As the planning intensified during 2000, Hardie contemplated how to deal with a risk potentially more serious than a court challenge: that the NSW Government might legislate to thwart its plans.

The board papers for a Hardie meeting in January 2001 said the Government could either declare the parent company or a "sister" company liable for all of the asbestos-related liabilities of the group, or freeze NSW assets pending undertakings to meet all future liabilities.

Such actions "could be constitutionally valid and relatively simple to achieve from a legislative drafting point of view", the board was told.

"The Government would seek to characterise such conduct as special to the asbestos issue and not a matter for general business concern."

Lobbyist and former Labor powerbroker Stephen Loosley was brought in to advise on reducing this risk.

These careful preparations were initially successful, but the "spoilers" are now

having a field day.

Hardie has put a lot of faith in its lawyers and their opinions that the parent company has not been liable since 1937 to pay asbestos compensation and that the elaborate restructuring of recent years has not changed that.

Jackson will be the first to review whether such faith is justified in his report, due in September. Court challenges by the foundation have already been foreshadowed, regulatory authorities are hovering and it's safe to assume Bob Carr will closely read the report he commissioned.

But even the company itself acknowledges that technical legal compliance is not the only the only benchmark it has to meet. Its last annual report says: "We think it is important that our behaviour reflects the spirit, as well as the letter, of the law and we aim to govern the company in a way that meets or exceeds appropriate community expectations."

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A case of who knew what, when

By Elisabeth Sexton
June 19, 2004

In the late 1990s, James Hardie Industries considered many different ways to “separate” the group’s ongoing businesses from its obligation to compensate for past asbestos manufacturing.

The reams of legal advice it obtained made frequent references to what might happen if a strategy was chosen which required court approval or triggered a court challenge.

“The court has broad discretion ... and it would understandably be hesitant to take any step which might result in sufferers of asbestos-related illnesses not being compensated for their injuries,” advised Allens Arthur Robinson partner Peter Cameron in 2000.

In February 2001, the board chose a structure which did not require approaching the court. It set up a charitable trust to house the two wholly owned subsidiaries which had made asbestos products.

Eight months later, when Hardie was planning to switch its seat of incorporation from Australia to the Netherlands, the approval of the NSW Supreme Court was necessary.

The company told Justice Kim Santow that the creation of a new Dutch parent would not disadvantage any creditors of the former Australian parent company, including asbestos victims.

The new parent would ensure the Australian shell, left with net assets of \$20 million had “access to funding ... to meet any potential liabilities”.

“Its net worth will remain essentially the same,” Hardie’s lawyer, Allens partner David Robb, told Justice Santow.

The company proposed a “lifeline” that would be available to asbestos victims. The mechanism used was an issue of partly paid shares. These shares gave the Australian company the right to call on funds up to the value of its market capitalisation in October 2001 — \$1.9 billion.

The lifeline was quietly severed by Hardie in March 2003. Justice Santow was not told. Hardie shareholders were not told. The Australian Stock Exchange was not told. The group most likely to try to use the lifeline, the directors of the charitable trust, were not told.

The shares were cancelled at a private board meeting.

Did anyone have misgivings? On June 10, the special commission of inquiry was told that the lawyer most closely involved in the transaction was concerned when he learned in October 2002 his client was considering cancelling the partly paid shares.

“I did consider whether the court had been misled, and, in response to this question, I drafted an opinion ... that indicated that the court may have been misled,” Robb said.

Because the company believed the old Australian parent did not have any legal liability to meet asbestos claims since it set up a subsidiary to make asbestos cement in

1937, it contended that the potential liabilities were less than the shell company's \$20 million in net assets.

The key issue in Robb's mind was whether Hardie knew when he went to court in 2001 that it might cancel the partly paid shares. Court papers said the shares would be available "at any time in the future and from time to time".

Hardie executives were alerted to his opinion. But Allens did not inquire about their intentions in 2001.