

In the shadow of the corporate veil: James Hardie and asbestos compensation

Significant fallout is likely from the NSW inquiry into the treatment of Australian asbestos victims by James Hardie Industries ('the Hardie Group'). The NSW Special Commission will not report until 21 September this year but federal and state governments are already considering legislation to access the Hardie Group's overseas assets.¹ Construction unions in Victoria have banned James Hardie materials,² and the NSW Government may do likewise for state projects.³ And there are growing calls to 'lift the corporate veil'—fundamental to corporations law for 140 years—by restricting 'limited liability' in cases of physical injury.

The asbestos problem⁴

The Hardie Group manufactured asbestos products (cement, piping, insulation and brake linings) for over 70 years in NSW, Queensland and Western Australia.⁵ It is not alone in facing asbestos compensation claims. Estimates of Australia's total liability for future asbestos claims start around \$6 billion.⁶ Fellow corporate heavy weights CSR and BHP Billiton are targets, and federal and state governments also have substantial asbestos liabilities. Claims are not limited to those who worked in asbestos mines and factories. Former power station, shipyard and dock workers, railway labourers and members of the defence force, especially the Navy, are at significant risk from asbestos-related diseases. These diseases can take decades to develop—a

major difficulty for compensation planning. Mesothelioma (cancer of the chest cavity) can emerge 40 years after exposure. Since 1945 about 7000 Australians have died from this disease, estimated to rise to 18 000 by 2020. Other asbestos related cancers may be around 30—40 000 by the same time.

A major problem for the Hardie Group is the range of products it made with asbestos. It faces growing claims from users of these products. Over half the claims made to the NSW Dust Diseases Tribunal in 2002 were against the Hardie Group.

The James Hardie restructure

As the *Weekend Australian* noted recently:

While rival manufacturer CSR capitulated to legal and public pressure in the '90s and opted to meet victims' claims as they arose, Hardie pursued a different route.⁷

Between 1937 and 1986 asbestos products were manufactured by two subsidiaries of James Hardie Industries Limited (JHIL): now known as Amaca (building and construction products) and Amaba (brake linings).⁸ Between 1996 and 2001 the assets of Amaca and Amaba were transferred to JHIL (now 'ABN 60'), then to a Netherlands based company - James Hardie Industries NV (JHI NV). In February 2001 ownership of Amaca and Amaba was transferred to a new body, the Medical Research and Compensation Foundation ('the Foundation'), which was given \$293 million to fund asbestos injury claims.⁹ In July 2004 counsel

assisting the NSW inquiry estimated the total claim against the Hardie Group could amount to \$2.24 billion.¹⁰

In October 2001 the Hardie Group assured the NSW Supreme Court that ABN 60 could call on \$1.9 billion owed by JHI NV for partly paid shares to meet future asbestos claims. This assurance was 'pivotal to the court giving approval for the transfer of ABN 60's assets' to JHI NV in the Netherlands.¹¹ But in March 2003 ABN 60 cancelled the partly paid shares 'without informing the court or the stock exchange'.¹²

According to the Secretary of the ACTU, Greg Combet, the movement of the Hardie Group's assets overseas—out of reach of asbestos victims in this country—is 'one of the most morally and legally repugnant acts in Australian corporate history'.¹³

The Jackson Inquiry

In December 2003 the Foundation warned that it faced a serious funding shortfall. Within a few years it would be unable to pay asbestos compensation claims.¹⁴ In February 2004 NSW Premier Bob Carr appointed David Jackson QC to investigate the relationship between the funding shortfall and the Hardie Group restructure, including whether changes to corporations law were needed to ensure future claims were met.

The Hardie Group and its advisers deny any wrongdoing in relation to these events. Moreover, according to *The Age*:

... the legal structure Hardie created appears to be solid. Under the corporate law concept of the corporate veil, companies and not their shareholders are individually responsible for liabilities, even if they are part of a larger group. This means that Hardie's new, Netherlands-based, Australian-listed parent company and the old Australian parent are protected from claims against Amaca and Amaba.¹⁵

Nevertheless, counsel assisting the Jackson Inquiry identified a string of possible offences against the *Corporations Act 2001*, the *Trade Practices Act 1974* and the common law in relation to the setting up and funding of the Foundation, and the cancellation of the partly paid shares.¹⁶

It has been suggested to the inquiry that:

- the managing director of the Hardie Group could be prosecuted over a 2001 statement that the Foundation could meet all future claims
- legal adviser to the Hardie Group, Allens Arthur Robinson, may have breached its 'duty of care' in relation to the restructure and the cancellation of partly paid shares, and
- actuarial adviser Trowbridge may have been negligent in underestimating the Foundation's future funding needs¹⁷

Counsel assisting the inquiry also suggested that the cancellation of partly paid shares was 'unconscionable', and that the Supreme Court's approval for the transfer of Hardie Group assets to the Netherlands could be rescinded because the court was misled.¹⁸

Recovering overseas assets

Given the shortfall facing the Foundation, an important issue is the extent to which liability from any prosecutions could be traceable to the Hardie Group's overseas assets, including those of Netherlands-based parent JHI NV.

Despite the above view in *The Age* about the solidity of the restructure, counsel assisting the inquiry suggested that JHI NV was a 'shadow director' of Australian company ABN 60.¹⁹ So successful claims in Australia against ABN 60 may be enforceable against JHI NV. If, for example, JHI NV and/or its directors contravened the Corporations Act in relation to the cancellation of partly paid shares:

a court may order the contravenor to compensate ABN 60 for damage suffered by reason of the contravention ... Damage would arise, for instance, if a claim were made against ABN 60 which it could not meet, but would have been able to meet had the partly paid shares not been cancelled. In such a case, it would be arguable that ABN 60 could seek to recover from the contravenor the amount of the liability it is unable to meet.²⁰

Even if an Australian court found JHI NV or its directors liable, however, gaining access to James Hardie's Netherlands based assets would be difficult. Under the *Foreign Judgments Act 1991*, 'money judgments' of Australian courts can be enforced overseas if Australia has a reciprocal agreement with a particular country.²¹ Australia has no agreement with the Netherlands. After a request from the ACTU to the Prime Minister,²² the Federal Government announced that new approaches had been made to the Dutch government. As a spokesman for the Attorney-General said, however, 'we aren't expecting an answer quickly'. Referring to the Netherlands' obligations to the European Union, he noted that negotiations could take years.²³

However JHI NV also has substantial assets in other countries. Its operational head office is in California, it is registered in Delaware and most of its revenue is generated in the United States, where 'business is booming'.²⁴ While Australia also has no agreement with the United States

for reciprocal enforcement of judgments,²⁵ negotiating agreements with the US would not appear to involve the same obstacles as with the Netherlands.

If 'statutory' action under the Foreign Judgments Act is not available, action could also be taken overseas at 'common law' against JHI NV. But as a Government spokesman said:

What in effect would have to happen is that if there was a judgment here, they would virtually have to part-hear it again to make sure it complied with their laws ... Either way you are talking many years.²⁶

In addition, in the case of the United States, foreign plaintiffs seeking damages from US-based defendants for personal injuries face a restrictive *forum non conveniens* doctrine, under which a US court will refuse to hear a matter if most of the circumstances of the case involve a foreign country.²⁷

If the current inquiry leads to successful criminal prosecutions, the *Mutual Assistance in Criminal Matters Act 1987* could be used to access overseas property and other assets. Australia has agreements with both the Netherlands and the United States in relation to this Act.

Lifting the corporate veil

The term 'corporate veil' refers to the protection given by the principle of 'limited liability'. Under this principle, companies are legal entities separate and distinct from their individual members. Hence liability to a company's creditors is limited to the *company's* assets and does not extend to the *personal* assets of company members. Counsel assisting the Jackson Inquiry explains that:

Applied to corporate groups, the principle means that they can determine the size and choose the limits of their legal responsibilities by the relatively simple mechanism of making one company (the 'parent' or 'holding' company) a member of

another company or companies (the 'subsidiary'/ 'subsidiaries') in the group. In economic terms, companies may by this technique externalise the risk of their operations by exposing third parties to the risk of compensated losses where the subsidiary's assets are insufficient to satisfy its liabilities.²⁸

The principle has a number of benefits, not least promoting 'entrepreneurial risk taking which encourages economic growth'.²⁹ Its downside, however—highlighted starkly by the James Hardie imbroglio—is that in some cases creditors will be unable to recover the amount they are owed. This is the prospect facing Australian asbestos victims seeking compensation from the Foundation – despite its association with the 'booming' James Hardie business. Some exceptions to the limited liability principle already exist, but they 'do not provide adequate protection for victims of torts committed by insolvent subsidiaries of wealthy holding companies'.³⁰ John Gordon from the Australian Plaintiff Lawyers Association says it is clear that the principle of limited liability needs to be reconsidered, and he is blunt about who is to blame. In his view, the concept:

needs a very thorough review and corporate Australia will have James Hardie to thank if that protection is lost in the future.³¹

Counsel assisting the Jackson Inquiry suggests that where death or personal injury is caused by a company that is part of a larger corporate group, the limited liability principle should be restricted to members of the ultimate holding company.³² If applied to the James Hardie case, this would mean the personal assets of JHI NV members would still be protected, but the company's assets would be available to asbestos compensation claimants.

Such a proposal is controversial. The Law Council of Australia is opposed to the idea:

The Law Council does not believe that a response by the Commonwealth to permit 'lifting the corporate veil' is an appropriate response to the issues raised by this inquiry, particularly given the uncertainty and risk of claimants successfully recovering compensation against James Hardie group companies outside Australian jurisdictions.³³

In 2000 the Companies and Securities Advisory Committee (CASAC) rejected proposals for the imposition of general liability for parent companies in corporate groups for personal injuries and other legal 'torts'. CASAC did however recommend that:

...this area could be dealt with by specific legislation where the extension of liability beyond the tortfeasor company is desirable in the public interest.³⁴

Even if the Corporations Act was amended to 'lift the corporate veil' in cases of personal injury—requiring JHI NV to compensate Australian asbestos victims – there would remain the problem discussed above of accessing the foreign assets held by the company.

Statutory compensation

JHI NV has offered to provide an unspecified amount of money for compensating Australian asbestos victims if the NSW Government establishes a statutory compensation scheme. Details of how that scheme would work are not yet available. However it is likely to involve caps on award payouts and a cap on JHI NV's own liability under the scheme. The ACTU has rejected the proposal, calling it 'an attempt to blackmail the dying'.³⁵

A similar scheme was established in France in 2002, financed by the employment and social security ministries.³⁶ A proposal for a statutory scheme is also being debated in the United States. The

US proposal is for a 'privately funded, publicly run' process for compensating asbestos victims. Asbestos defendants and insurance companies would contribute to a compensation fund, with assets from existing asbestos compensation trusts being transferred to the fund. Defendants would pay either a proportion of their revenue or a flat dollar amount to the fund each year, with the amount depending on the defendant's size and past liabilities. For insurers, a commission would determine individual companies' contributions depending on past exposure to asbestos liabilities.³⁷

The US proposal has stalled over disagreements about the amount of contributions, the level of compensation, and the adequacy of the fund.³⁸

A statutory scheme would 'cut out the lawyers'.³⁹ The Hardie Group has calculated that this could reduce its future asbestos compensation bill by \$430 million.⁴⁰ John Gordon, on the other hand, says that:

there is no evidence that a statutory scheme would be quicker than what's currently available and certainly the benefits would be less. Today someone could be diagnosed one day, see a lawyer the next day and the next day they ought to be able to receive compensation for an amount that the courts have determined is equitable. There's no reason why that should be changed just because James Hardie has taken their assets offshore.⁴¹

ANU Reader in Law and corporate liability specialist Peta Spender states that:

The case studies reveal that the creation of a limited fund generally results in the under-compensation of tort victims, particularly future claimants. This may be acceptable upon a genuine insolvency, but not by unilateral acts of the corporate defendant.⁴²

Other proposals

The Law Council of Australia has proposed the creation under State

legislation of a 'nominal defendant' to handle asbestos claims, funded by levies on relevant insurance policies such as workers compensation and occupiers' liability. The nominal defendant would be able to pursue claims against other entities, and would add any recovered amounts to the compensation fund. The claims work could be outsourced to an insurance company.⁴³

Alternatively, the Law Council proposes amending Commonwealth legislation to allow 'anticipated but as yet unascertained claims' to be brought against an insolvent company. As the Council notes:

Unascertained future claims [are] a particularly acute problem in relation to asbestos liabilities given the long latency periods and short life expectancies of sufferers ...⁴⁴

If the Foundation or other James Hardie entities went into liquidation because of insufficient funds, 'many potential claimants could be left with no compensation at all'.⁴⁵

The Law Council proposes a quasi-judicial tribunal to assess unascertained future claims, together with amendments to the Corporations Act and the *Bankruptcy Act 1966* concerning the liability of holding companies and individuals for the debts of insolvent corporations. Changes to these laws would also be needed to prevent companies making agreements intended to defeat future as well as current entitlements.⁴⁶

An interesting idea comes from the Foundation itself, which proposes adopting the US doctrine of 'undercapitalisation'. It suggests a new provision in the Corporations Act imposing liability for the debts of a company *set up with inadequate funds* on those who created it where such people have engaged in misleading conduct in relation to the firm's capitalisation.⁴⁷

Further reading:

See endnote 42 below for Peta Spender's article discussing appropriate legal responses to situations of 'mass tort liability'.

1. *Sydney Morning Herald*, 30.7.04, p. 7.
2. *The Age*, 30.7.04, p. 1.
3. *The Australian*, 3.8.04, p. 5.
4. Source: Beth Quinlaven, 'Asbestos: Powder traces', *Business Review Weekly*, 2 June 2004.
5. *Sydney Morning Herald*, 19.6.04, p. 45.
6. Quinlaven, *op. cit.*
7. *Weekend Australian*, 3.7.04, p. 27.
8. *The Age*, 31.7.04, Business 1.
9. *Weekend Australian*, 3.7.04, p. 27; *The Age*, 31.7.04, Business 1–2.
10. *The Age*, 30.7.04, p. 1.
11. *Weekend Australian*, 3.7.04, p. 27.
12. *The Australian*, 3.8.04, p. 5.
13. Transcript, *7.30 Report*, 28.7.04.
14. *The Age*, 31.7.04, Business 1.
15. *ibid.*
16. Submissions of Counsel assisting the Special Commission of Inquiry, see e.g. pp. 1–28 and 2–58.
17. *The Age*, 31.7.04, Business 2; *Weekend Australian*, 3.7.04, p. 27.
18. *The Age*, 31.7.04, Business 2.
19. Submissions of Counsel assisting, *op. cit.*, pp. 3–16.
20. *ibid.*, pp. 3–22, 23.
21. *Foreign Judgments Act 1991*, section 5.
22. Transcript, *7.30 Report*, 28.7.04.
23. AAP, 'Fed: Govt approaches Netherlands over reciprocal court case deal', 4.8.04.
24. *Sydney Morning Herald*, 19.6.04, p. 45.
25. See schedule to *Foreign Judgments Regulations 1992*.
26. AAP, *op. cit.*, 4.8.04.
27. See Peter Prince, 'Bhopal, Bougainville and Ok Tedi: Why Australia's *Forum Non Conveniens* Approach is Better', 1998 *International and Comparative Law Quarterly* 47, 573–598.
28. Submissions of Counsel assisting, *op. cit.*, 5–15.
29. *ibid.*
30. *ibid.*, pp. 5–17.
31. Transcript, *Business Sunday*, 1.8.04.
32. *ibid.*
33. Law Council of Australia, 'Submission to the Special Commission', p. 2.
34. Companies and Securities Advisory Committee, *Corporate Groups, Final Report*, May 2000, p. 122.
35. *The Australian*, 29 July 2004.
36. Salvatore, Santino and Michaels, 'Asbestos: The current situation in Europe', <http://www.astin2003.de/img/papers/santoni.pdf>
37. Submissions of Counsel assisting *op. cit.*, p. 5–14.
38. *ibid.*
39. *The Age*, 31.7.04, Business 1.
40. *ibid.*
41. Transcript, *7.30 Report*, 28.7.04
42. Peta Spender, 'Blue Asbestos and Golden Eggs: Evaluating Bankruptcy and Class Actions as Just Responses to Mass Tort Liability', 25 *Sydney Law Review*, 223 at 254.
43. Law Council of Australia, *op. cit.*, p. 2.
44. *ibid.*, p. 6.
45. *ibid.*
46. *ibid.*, pp. 6–7.
47. MCRF, Attachment A to submission to Special Commission of Inquiry.

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