

# **JAMES HARDIE & THE FINAL FUNDING AGREEMENT**

**Lee C. Moerman**  
University of Wollongong

**Sandra L. van der Laan\***  
University of Sydney

17<sup>th</sup> May 2010

Paper prepared for presentation at APIRA 2010

**\*Corresponding Author**

Discipline of Accounting  
Faculty of Economics and Business  
The University of Sydney  
Sydney, NSW, 2006.  
Ph: +61 (0)2 9351 6431  
Fax: +61 (0)2 9351 6638

## **ABSTRACT**

Using Douglas and Wildavsky's (1982) model of culture and risk, this paper documents the role of accounting in managing, mediating and facilitating the socialisation of the risks surrounding asbestos litigation payments in Australia.

James Hardie Industries NV, the parent of former asbestos manufacturing subsidiaries in Australia, enlisted various legal arrangements in an attempt to separate its asbestos legacy from its current operations. While this separation strategy was largely unsuccessful, James Hardie through exerting its power as a market institution, has managed to mitigate its asbestos risk through 'socialising' this risk by entering an agreement to fund asbestos payments which reorients the burden of risk.

# **JAMES HARDIE & THE FINAL FUNDING AGREEMENT**

## **INTRODUCTION**

Risk, at a very basic level, is the “cost/benefit potential of uncertain circumstances” (Durkin, 1990, p.1) or the probability of deviation from an expected outcome. Risk has become the ubiquitous discourse of business as the identification and the management of risk are major components of corporate strategy. Risk, at various levels and conceptions, is also an inherent ‘way of being’ for individuals and for institutions. At an institutional level the resolution of risk, or attempts to mitigate risk, are broadly confined to market level, legal level and social level risks. Market risks tend to be resolved by mechanisms such as contracting, both explicit and implicit. Legal level risks are resolved through existing legal mechanisms and social level risks invoke higher level social resources, such as media and government-sponsored commissions of inquiry (Durkin, 1990). Accounting as a both a technology and a social practice has been studied in a plethora of market, legal and social contexts. Risk is often a factor that is connected to accounting calculations and aggregations of numerical data provide the information for stakeholders to calculate risk (Young, 2001) and rank strategic options. This paper contributes to an understanding of how accounting is implicated in the transfer of market risk to social level risk by examining the funding of asbestos litigation payments.

The phenomenon of ‘socialising’ risk in modern society is exemplified in the asbestos industry. Asbestos, a mineral once renowned for its beneficial qualities for society as a fire retardant and construction material, is potentially toxic to humans. Litigation from exposure to asbestos arises from two main sources: employment or workers’ compensation from the mining and manufacture of asbestos or allied industries; and, environmental from incidental exposure. In the US context, asbestos risk was managed through market and legal level institutions. However, since the 1970s risk management through the exploitation of the legal system has become a burden on social institutions (Durkin, 1990) as demonstrated in the overwhelming adoption of US Chapter 11 bankruptcy provisions<sup>1</sup> by former asbestos companies. In contrast, the asbestos liabilities of organisations in the UK are dealt primarily within the legal system (see Moerman and van der Laan, 2010). In Australia, the jurisdictional conditions for resolving risk related to asbestos, characterises risk resolution at all levels.

Two corporations dominate the asbestos story in Australia, CSR Ltd operated an asbestos mine in Western Australia and also manufactured asbestos products on a small scale. James Hardie Industries NV (James Hardie) was the major manufacturer of asbestos products in Australia with virtual saturation of the market until 1986 (Prince et al, 2004). To date, CSR has primarily resolved its risk at the legal level

---

<sup>1</sup> In 1994 US Chapter 11 Bankruptcy provisions were modified to include ‘Manville provisions’ which incorporate the rights of future creditors – section 524(g) (Brown, 2008).

through global settlements in both the US and Australia (Spender, 2003). James Hardie, on the other hand, faces increasing litigation beyond the realm of workers' compensation for environmental exposure to asbestos products. The most recent public attempt to resolve risk for James Hardie has occurred at the social level through the establishment of a negotiated scheme between the relevant governments, trade unions, asbestos support groups and James Hardie to pay asbestos compensation. The financial responsibility for funding the new scheme, the Asbestos Injuries Compensation Fund (AICF) rests with James Hardie and the amount of funding is explicitly calculated from the reported accounting numbers in its consolidated financial statements.

James Hardie's asbestos funding arrangements highlight the socialisation of risk arising as a legacy of the asbestos industry. This paper is an examination of the negotiation of the funding arrangements, the Final Funding Agreement (FFA) and creation of a legally separate trust, the AICF. This analysis of public decision-making, based on the risk and culture model of Douglas and Wildavsky (1982), informs the process. The model uses abstract concepts of institutions that reside in a stable centre bordered by sectarian or marginal interests that have the potential to disrupt the centre institutions. According to this model, risk is appropriately managed and contained in the centre by markets and hierarchies. However, as individuals align themselves with the border there is the potential for the risks to overwhelm the centre institutions. The interaction of centre and border institutions differs according to the jurisdictional context, with the more powerful institutions determining whether and how the risk is socialised (Durkin, 1990).

## **BACKGROUND**

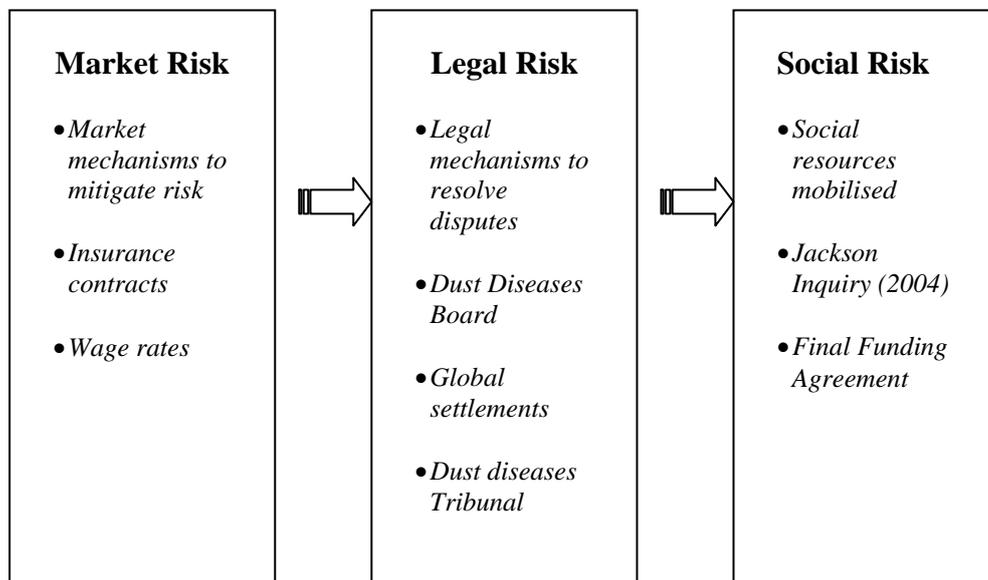
Modern society has introduced the risks that come with new technology (Douglas, 1986b) and corporate, public and government discourse is suffused with notions of risk. Beck (1999) argues that the concept of danger and the anxiety of risk associated with the environment are social constructs that do not exist independently of individuals or societies. Only when dangers to humans are identified in the public domain is the issue politicised and the risk strategically defined. Risk, it seems is a way of life and the ways in which institutions and cultures define, manage and control risk are endless.

Young (2001) analysed accounting and risk through a lens of metaphor to describe the various ways in which risk is understood in accounting standards e.g. risk as burden, a quality, a disease, an adversary and so on. These metaphors project an image of something that can be controlled, managed and indeed must be "mastered"; rather than looking at enabling alternatives such as "risk as a teacher" (Young, 2001, p. 620). Linsley and Shrivies (2009) have adopted Douglas' cultural theory of risk to analyse the role of accountants and auditors in the Enron affair. Concentrating on how accounting calculations can be used as a means of managing risk for corporations, governments and society is exemplified in the controversy over asbestos litigation funding.

Although asbestos has been used since ancient times, it was not until the era of industrialisation that products made from asbestos proliferated. Exposure to asbestos

is ongoing with the permeation of asbestos products in society. An example is the ubiquitous “fibro” house that still dominates the Australian architectural landscape. Additionally, asbestos is still mined and manufactured in many emerging economies. Exposure to asbestos causes three types of potentially fatal disease in humans: asbestosis and lung cancer which are linked to quantum of exposure and arise primarily from occupational exposure; and, the fatal cancer, mesothelioma, that can arise from only trivial exposure to asbestos. The continued presence of asbestos in the environment presents an ongoing risk to health and, coupled with the long latency period of up to forty years for the onset of mesothelioma, creates a situation of uncertainty that arises from the timing and quantum of claims for companies facing asbestos litigation claims and public institutions involved in estimating and funding litigation payments.

According to the location for resolving uncertainty, risks can be considered at market, legal or social institutional level. This location can be mapped according to the level of power of the institutions involved (Durkin, 1990). In the US asbestos became a social risk from the 1970s onwards as companies sought special legislation together with attempts to implement statutory schemes responsible for asbestos litigation for both workers’ and environmental exposure to asbestos. In the UK, the risk associated with funding asbestos-related claims has not moved beyond legal domain with the development of statutory bodies to negotiate workers’ compensation claims only (Durkin, 1990). In Australia, the scope of asbestos litigation is similar to the US experience, although the process of socialisation has been quite distinct (see Figure 1).



**Figure 1:** Levels of Risk with asbestos in Australia (adapted from Durkin (1990))

In Australia two companies dominated the asbestos industry, CSR, was involved through mining, and James Hardie with the manufacture of asbestos products. Early asbestos claims were confined to workers and employment relationships that were resolved through insurance contracts. In 1942, with the establishment of the Dust Diseases Board<sup>2</sup> the risk associated with workers' compensation claims arising from asbestosis in NSW<sup>3</sup> shifted into the legal arena. In 1989 CSR, arrived at a global settlement with their former workers and community exposed to asbestos at its mine in Wittenoom (Spender, 2003). Also, in 1989, to expedite tort claimants the Dust Diseases Tribunal was established. In contrast, James Hardie, as a product manufacturer faced increasing claims arising from environmental exposure<sup>4</sup> and in 2001 embarked on an elaborate corporate reorganisation in an attempt to socialise this risk.

The reorganisation attempted to separate asbestos liabilities from profitable operations with the establishment of a special purpose entity, the Medical Research Compensation Fund (MRCF), to pay current and future litigants. A subsequent judicial inquiry, the Jackson Inquiry (2004) determined that the MRCF was technically insolvent from its inception. The under-funded status of this entity became a major public issue resulting in an alliance of victim groups, trade unions, politicians and media lobbying for government intervention to ensure compensation payments to asbestos victims. The MRCF was ordered to recover adequate compensation for all future asbestos victims of the James Hardie group and secure additional funding<sup>5</sup> (Jackson, 2004). Subsequently, the Asbestos Industries Compensation Fund (AICF) was established as an outcome of a negotiated settlement which struck the Final Funding Agreement (FFA) between James Hardie, the NSW Government, trade unions and asbestos victim support groups<sup>6</sup>. In James Hardie's words, the FFA "is designed to be flexible by seeking to accommodate changes in the profile and quantum of asbestos claims and James Hardie's future financial performance over the term of the Final Funding Agreement" (JHI NV, 2006, p. ii). The responsibility for funding the AICF is outlined in Figure 2.

---

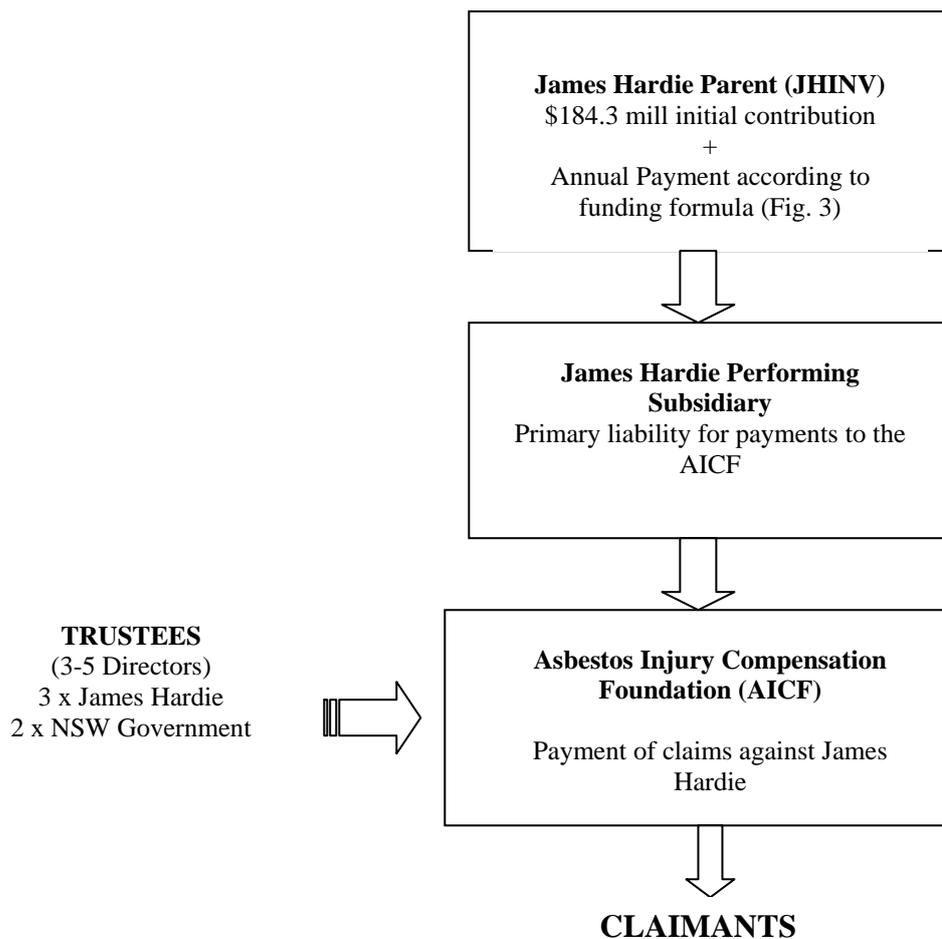
<sup>2</sup> This statutory body was established in 1942 by the NSW Government to handle workers' compensation claims arising from dust related illness, including asbestosis. While other Australian states have similar bodies, the majority of asbestos-related disease emanates from NSW production facilities.

<sup>3</sup> NSW is the 'primary' jurisdiction for asbestos claimants as the bulk of James Hardie's manufacturing facilities were in NSW. Additionally, James Hardie was incorporated in NSW.

<sup>4</sup> CSR also is often named as co-defendant in environmental suits.

<sup>5</sup> See *Second Reading James Hardie (Investigations and Proceedings) Bill 2004* (comments by Premier Mr. Bob Carr at Second Reading) <http://www.parliament.nsw.gov.au/Prod/Parlment/HansArt.nsf/V3Key/LA20041019023> last visited 24 February, 2009.

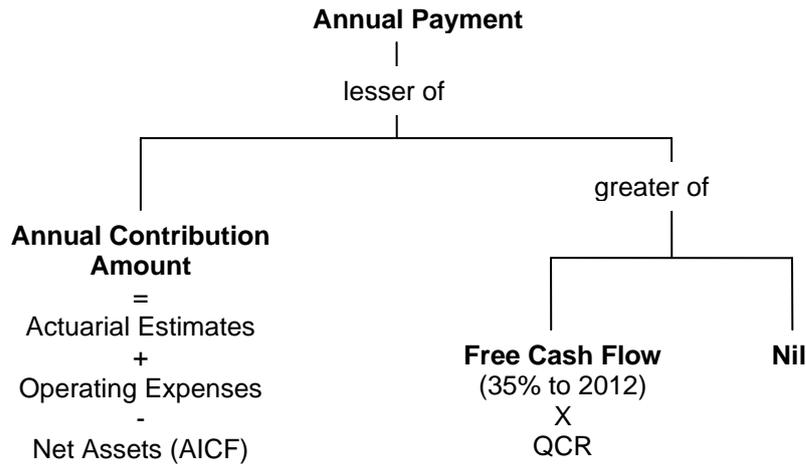
<sup>6</sup> There have been several iterations of the Final Funding Agreement. The first was executed on December 1<sup>st</sup>, 2005. The most recent revision saw an amended version released with all amendments up to and including March 31<sup>st</sup>, 2009 known as "Amended & Restated Final Funding Agreement".



**Figure 2:** Funding of AICF (adapted from FFA (2009))

The negotiated FFA outlines the funding arrangements for the AICF by James Hardie. The payments consist of an initial payment of \$184.3 million plus an ‘annual payment’. The amount of annual payment is determined from the accounting representations (derived using US GAAP) from James Hardie’s consolidated financial reports (FFA, 2009) (see Figure 3). The liability for the payment is the responsibility of a wholly-owned subsidiary of James Hardie, the Performing Subsidiary. The FFA makes detailed contingency plans in the case of insolvency or pending insolvency of this subsidiary to secure James Hardie’s continued obligation to the AICF. While James Hardie has a legal obligation to fund the AICF<sup>7</sup>, the amount of the liability is calculated from the reported financial results of the parent company and may result in nil contribution for the year, or indeed a ‘repayment’ to James Hardie. The calculation of the annual payment is outlined in Figure 3 below.

<sup>7</sup> The AICF is a creditor of the Performing Subsidiary not the James Hardie parent company (FFA, para.4.2(a))



**Figure 3:** Calculation of AICF payments (adapted from FFA (2009))

The simplified rules for calculating the Annual Payment to the AICF is as follows:

The James Hardie group pays the *lesser* of

- a) the actuarial estimates (past year and next two years) plus a reasonable amount for operating expenses less the net assets (total book value of assets less the total book value of liabilities) of the AICF; and
- b) the *greater* of:
  - a. 35%<sup>8</sup> of free cash flow (adjusted by a qualifying capital ratio); and
  - b. NIL

Therefore, if the free cash flow (an adjusted net cash from operations figure according to US GAAP) is negative then James Hardie is not required to make a payment to the AICF. However, if the Annual Contribution Amount is negative, the AICF is required to 'repay' that amount to James Hardie. As an example: for the 2008 payment the Annual Contribution Amount was AUD\$121.2 million and 35% of the free cash flow was calculated as AUD\$114.7, therefore James Hardie contributed the lesser of those two amounts.

These arrangements for funding asbestos however do not alter the financial reporting arrangements for the James Hardie group, which in 2009 reported a balance sheet liability of \$1.2billion which resulted in negative equity or a 'shareholder's deficit, despite reporting an accounting profit. Additionally, in the event of a shortfall in available AICF funds to pay claimants, James Hardie bears no responsibility to increase the contribution beyond the Annual Payment. This was the case in 2009 when James Hardie, citing decreased profitability from the US housing market, was unable to contribute (JHI NV, 2009a). As a consequence, the NSW and Commonwealth government contributed \$320 million to a loan facility to ensure the ongoing financial viability of the AICF (JHI NV, 2009b).

<sup>8</sup> This 35% proportion is the maximum proportion of free cash flows to be contributed and set to diminish over the life of the agreement.

## **THEORETICAL FRAMEWORK**

Douglas and Wildavsky (1982) propose a risk and culture model to analyse public decision-making in a technological era. Culture has been defined as “actively invoked conventional wisdom” or as a “publicly shared collection of principles and values used at any one time to justify behaviour” (Douglas, 1986b, p.67). Between private, subjective perception and public, physical science there lies culture, a middle area of shared beliefs and values” (Douglas and Wildavsky, 1982, p. 194) that are channelled into public institutions and “uphold the forms of institutional life” (Douglas, 1986b, p.67). In particular, the public reaction to institutional policies directed to mitigate risk is determined by public ideas about justice, or what is the correct way to achieve right or wrong in society so that, the idea of ‘acceptable risk’ is a matter of judgement and judgements differ (Douglas, 1986b). Culture provides what Douglas (1986b, p. 68) refers to as a “coding principle by which hazards are recognized” and culture, therefore, provides the standards for what is proper and, conversely, improper.

Since this life takes place in a given environment, with given physical resources and techniques of exploitation and political pressures, the culture of a time and place speaks for the current solutions to political and environmental issues. In a strong sense, it represents the cost-benefit analyses which balance all individual’s interests as agents dependent on the decisions of others (Douglas, 1986b, p. 67-68).

The model relies on the notion that institutions ‘think’ and the idea a collective worldview exists (Douglas, 1986a). Social artefacts produced by an institution are an appropriate representation of collective thought (Mannheim, 1972). An institution arises from a convention whereby individuals share a belief in a common set of rules that ensures coordination among its members (Douglas, 1986a). Once this “parallel cognitive convention” becomes a site where members rely on the legitimacy of the convention to sustain their views, it is an institution (Douglas, 1986a, p.46). Thus, institutions gain legitimacy by “affording members a set of analogies and justify naturalness and reasonableness of the institution” (Douglas, 1986a, p.122). The social institution is founded in the legitimation of a social convention and, in turn, provides the basis for the cognitive processes of the individual.

Social institutions are able to make decisions on “automatic pilot” based on past experience which “is encapsulated in an institution’s rules so that it acts as a guide to what to expect in the future” (Douglas, 1986a, p. 46 & 48), thereby reducing uncertainty or risk:

Any institution that is going to keep its shape needs to gain legitimacy by distinctive grounding in nature and in reason: then it affords to its members a set of analogies with which to explore the world and with which to justify the naturalness and reasonableness of the instituted rules (Douglas, 1986a, p.112).

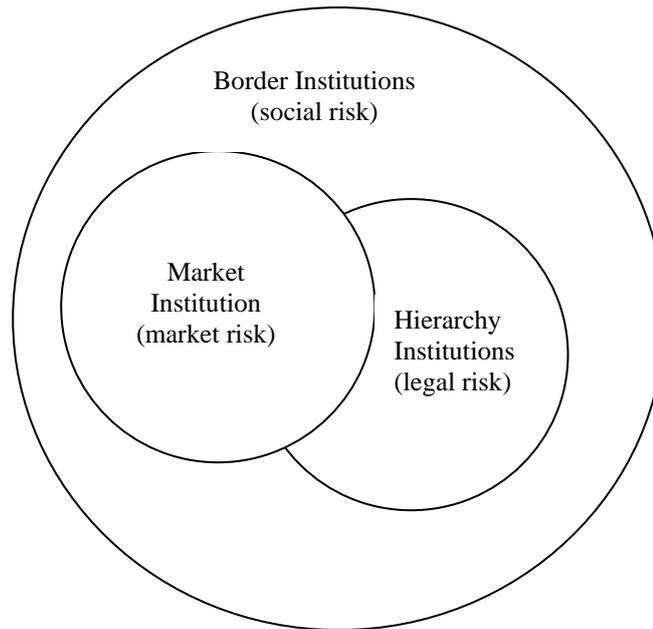
Predefined codes or “conceptual schemes” facilitate decisions about new phenomena. And institutions rely on a common set of meaning which “stand immune to the new

inflections” (Douglas, 1986a, p.63). Therefore, communication between institutions and society relies on a discourse of agreed predefined categories (Douglas, 1986a).

The Douglas and Wildavsky (1982) model presents the abstract notions of a centre and a border where typologies of institutions exist: the hierarchical and market comprise the centre; and, the sectarian represents the border institutions. Each institution emerges from different interests and either exerts power or monitors those with power. Members uphold the beliefs and values of their affiliated institutions whereby “each is only strong enough to blind its adherents to the virtues of other ways” (Douglas and Wildavsky, 1982, p. 175). The basic principles that bind the group form the premise for intellectual coherence and thus the basis for everyday decision making.

In domestic rituals (as well as in public affairs), they provide the stuff from which letters of condolence are drawn, and the source of sentiments for speeches at weddings, funerals, presentation ceremonies, and addresses of welcome and farewell. But their ritual uses are the surface functions of these basic principles. More profoundly, they serve as strings of control, credible supports for threats and promises and techniques of moral coercion (Douglas and Wildavsky, 1982, p. 175).

Linsley and Shives (2009, p.495) describe Douglas’ typologies in a two-by-two “grid-group model” focussing on how the types of social structure impact on an individual’s perception of risk. In their analysis of Enron, accountants and auditors are presented as marginal players, non-conforming to the market individualist worldview of Enron’s employees or the manipulative efforts by management. This paper, on the other hand, focuses on the institutional level of risk management and examines how particular accounting technologies facilitate the socialising of risk. The relationships between border and centre institutions are demonstrated in Figure 4 below:



**Figure 4:** Centre and Border Institutions

The margins of the institutions are fluid, not static; abstract, not defined and institutions will draw on the support of other institutions to further the interests of the members (Douglas, 1986b; Douglas and Wildavsky, 1982). As centre institutions, the market and hierarchy wield power and influence in society and become a formidable force when their interests intersect (Linsley and Shrives, 2009). However, markets and border institutions may seek the control given to hierarchies to dominate political debate and stabilise wealth and the allocation of resources (Douglas and Wildavsky, 1982).

The centre institutions are the institutions of the market and hierarchy. The market relies on implicit controls dependent on means-end rationality as one of “the fundamental condition of industrial society” (Douglas, 1986b, p.87). Market institutions have clear, rank-able goals and facilitate decision-making by cost/benefit analyses dependent on standardised measurement practices protected by regulation (Douglas and Wildavsky, 1982), such as that provided by accounting. Despite, an emphasis on self-regulation and individualistic nature of market institutions, collaboration with other institutions will occur if it results in gains (Douglas 1986b), such as: the fair play of an exchange system; standard measures for quantification; and, the protection afforded by contracts (Douglas and Wildavsky, 1982). However, markets are not necessarily negative as opportunities reside in risk (Linsley and Shrives, 2009). Market institutions have a short term view and will “manipulate the time dimension, pushing repayments into some calculable but distant future” (Douglas and Wildavsky, 1982, p.96). Market institutions favour the notion of rules of fair play to facilitate but stipulate action for the individualistic behaviour of its members.

Hierarchies, characterised by large organisations, are oriented towards the system as a whole whereby process is perpetuated by instruction (Douglas and Wildavsky, 1982). Bureaucracies, such as state organisations and instrumentalities fit within this definition of hierarchies. Hierarchies have arisen from “high culture” and rely on explicit controls flowing from procedural rules for members (Douglas, 1986b, p.87). Hierarchies have well defined boundaries and set limits on member actions according to prescribed rules. Internal boundaries are strictly adhered to by custom and tradition and the penalties for transgression are clearly articulated to members. Hierarchies are said to exhibit collectivised responsibility as roles are anonymous and individuals are not “seen” to make decisions (Douglas and Wildavsky, 1982, p.91). Attempts to negotiate or reach a compromise are made according to fixed instructions and processes. Hierarchies tend to have multiple and vague goals, rather than a single overriding objective and use this to facilitate a type of retrospective legitimacy for decisions resulting in the ability to avoid prior commitments. Risks manifest as threats to the boundaries of influence, and hierarchies generally rely on advice from experts on risk management (Linsley and Shrives, 2009). Decision making about risk is incremental, remedial and serial. The process develops a solution to a problem that is “realistically feasible” (Douglas and Wildavsky, 1982, p.93). Hierarchies tend to formalise procedures in an attempt to control the future and this institutional process of decision making tends to make them unreceptive to the unexpected.

The border institutions embody sectarian interests. The sect, as a border institution, derives its existence from a “stable, opposing” centre from which it can expand and guarantee its ideals (Douglas and Wildavsky, 1982, p. 177). The members of border institutions are “predisposed towards idealism, and equality and justice” (Linsley and Shrives, 2009, p. 496). Therefore, risk arises from the centre institutions maintaining the status quo and adhering to the structures that perpetuate inequality or injustice. Sectarians, however, in repudiating centre institutions may be blinded to the necessity of a stable centre to implement their view of society (Douglas and Wildavsky, 1982). The sectarian institution also questions the status of professional experts (Linsley and Shrives, 2009).

Institutions set up decision processes according to their typology, filtering and sometimes hiding, risk from members (Douglas, 1986b). Therefore there is a moral dimension to this cultural theory of risk. Accordingly, risk is used to “mobilize moral communities for dealing with danger in particular ways, and to force accountability” (Ericson and Doyle in Linsley and Shrives, 2009, p.496).

The argument to be developed is that the institutional filter through which risks are perceived imposes a consistent distortion upon the probabilities. To say that the institutional lens obscures the risk issues is partly true. It also uses the risk issues to clarify another set of problems. It is more illumination to regard the risks as a lens for sharpening the focus on the social organization itself. Institutions use the risk issue to control uncertainty about human behavior, to reinforce norms, and to facilitate coordination (Douglas, 1986b, p.92).

In addition, institutional risk is controlled through a temporal dimension whereby;

The social past and social future are like a balance: if one is long, the other must be just as long; if the future is too heavy, the past must be equally so. This is not a mystical announcement but a straight sociological inference. The vista of the future is made of claims of one generation against the next: from one standpoint the claims stretch forward; from the other they stretch back. The converse holds: a future that only has a short term is unmortgaged; its past has not been allowed to stake forward claims. Living in the present means inventing cutout mechanisms which prevent the future from being cluttered with a load of obligations (Douglas and Wildavsky, 1982, p.87).

Therefore, issues of risk are culturally defined through institutions and differ according to 'what's at stake' and have a temporal aspect. Accountability mechanisms are used to gain institutional legitimacy by mitigating the threat of risk and preserve a sense of fairness or equity for members. Different institutions invoke a time frame to manage risk characteristic of their underlying beliefs about risk. Therefore, the cultural risk model identifies three factors used by institutions to estimate both the quantum and probability of risk. The "editing out of losses", a "confidence in assessment procedures" and the sense of "future time" all contribute to the institutional management of risk (Douglas and Wildavsky, 1982, p. 89).

The cultural foundations form the basis of why societies select the dangers to concentrate on while ignoring others (Douglas and Wildavsky, 1982), in other words risk. Cultural analysis relies on the researcher to "keep looking for the rules into which a vision of the good life can be effectively translated and for the possibilities of praise and censure that can commit members" (Douglas and Wildavsky, 1982, p. 175). Cultural analysis based on Douglas and Wildavsky (1982, p. 176) requires an understanding of the foundations that inform the "hopeful expectations that could be realized if certain rules were kept and would be jeopardized if they were broken". Consequently, there is the obverse of failure and suffering if the cultural bias is not upheld.

Institutions bind members through social norms and the social artefacts produced by institutions, including legal agreements, represent the collective consciousness of an institution. This paper uses the Final Funding Agreement to analyse the cultural foundations of the three institutions represented by the negotiating parties. In doing so, it demonstrates how accounting technology has been used to facilitate the move from sectarian border interests to the centre.

## **FINAL FUNDING AGREEMENT**

Durkin (1990) investigated the reasons why the US asbestos crisis had become a social risk. In the US context, the powerful actors are the asbestos producers and insurers, both centre institutions. According to the risk and culture model, the socialisation of asbestos risk should have come from powerful border actors, claimants and activists. Durkin (1990, p. 19) concludes that asbestos-related disease risk in the US is the result of "different social locations of risk are due to different

organizational choices, battles, coalitions and interactions”. Australia and the FFA provide another case study to test the theory of culture and risk.

Three institutions are represented in the Initial Negotiating Party of the FFA (FFA, 2009, p.6). James Hardie represents the market institution. As a large organisation it also demonstrates characteristics of a hierarchy, but in this case it clearly demonstrated the individualistic overriding goal of maximising shareholder wealth. The hierarchy is comprised the NSW and Commonwealth governments that represent the rights of the current and future claimants to payments from James Hardie. The sectarian or border interests are proposed by the trade unions peak bodies, ACTU, Unions NSW and Bernie Banton. The trade unions represent the interests of workers’ rights in Australia and Bernie Banton, an asbestos and mesothelioma sufferer, was “the designated representative of the Asbestos Support Groups<sup>9</sup>” (FFA, 2009, p.12).

The border institution played an instrumental role in socialising risk by directing media attention to the creation of the MRCF, and its questionable solvency, following the redomiciling of the James Hardie parent company to the Netherlands in 2003. Indeed, “it has suffered damage to business operations and sales from boycotts and other actions in relation to the distribution and sales of its products in Australia and in other places throughout the world” (FFA, 2009, p.7). This border noise secured the not only support of the public and media, but also the hierarchy. The risk to James Hardie cannot be understated, as their share price fell 18.67% in the period from 29 October 2003 to 20 December 2004 in a market where comparable stocks increased by 32.6% (LEA, 2006). In the May 2005 issue of Shares magazine, investors were advised that an “*important drag on James Hardie stock has been the uncertainty and adverse publicity linked to the settlement of its asbestos-related liabilities in Australia*” (LEA, 2006, p.144, italics in original).

Both hierarchy and market institutions give priority to threats to the system and are sensitive to changes in the “public confidence that maintains it” (Douglas and Wildavsky, 1982, p.97). The James Hardie group faced increasing threats from the hierarchy as asserted that the principal purpose of the JHINV Group entering into this deed is to avert threats from the NSW government, the federal government and other state and territorial governments...to legislatively impose liability upon one or more members of the JHINV Group in relation to Asbestos-related personal injury liabilities...in excess of the available assets” (FFA, 2009, p.7). In fact, in 2004 the NSW government proposed to “*wind back James Hardie’s corporate restructure*” and the federal government proposed to “*consider options for legislative reform*” (FFA, 2009, p.7 & 8, italics in original). This legislation, if enacted, would likely have an “adverse effect on the profitability, financial position or reputation” on the parent or members of the group (FFA, 2009, p. 8). The threat of the hierarchy changing the rules to ensure James Hardie’s willingness to negotiate and the cost/benefit analysis of risks motivated James Hardie to participate in the FFA.

As Douglas and Wildavsky (1982) argue, institutions will collaborate to further their own interests and securing continued payments relied on upholding the market institution’s access to profitability While both border and hierarchy institutions

---

<sup>9</sup> Asbestos Support Groups refers to the various asbestos-related associations in Australia (FFA, 2009, p.11)

desired full compensation from James Hardie they also recognised that their success was inextricably linked to the continued successful operations of James Hardie. “[I]t is in the mutual interests of the Parties and the Claimants that the JHINV remain profitable and financially viable and is able to continue to grow its business in a competitive environment, retain the support of debt and equity markets and is able to meet all of its current and future financial commitments” (FFA, 2009, p.7).

Both the market and hierarchy are interested in universal rules, the market desires rules of fair play while the hierarchy seeks rules of process or instruction (Douglas and Wildavsky, 1982). The hierarchy institution seeks to mitigate risk through the use of legal processes. The accounting calculation of an annual payment ensures that James Hardie remains a viable entity able to participate successfully in the market. James Hardie also collaborates with the hierarchy through the governance of the AICF. The FFA requires a board of trustees to oversee the AICF comprising 3-5 directors. James Hardie is “entitled to appoint a majority of the Directors...and to designate one of those Directors to be Chairman” (FFA, 2009, p. 50). The remaining Directors are appointed by the NSW Government.

“When institutions present choices to their members, they may present either the loss or the gain as the dominant element, according to the kind of institution” (Douglas and Wildavsky, 1982, p.89). The market institution generally states problems as quantifications. James Hardie outcomes demonstrated the characteristics of a market institution in the FFA. As corporate regulation requires shareholder and creditor approval, James Hardie sought this prior to ratifying the FFA. The shareholders’ ratification of the FFA demonstrates the market institution’s perception of the individualistic, utility-maximising behaviour of its members.

All parties involved in the negotiations recognise the benefits of aligning the interests of James Hardie shareholders and people who have certain personal injury claims against the former James Hardie subsidiaries with the future success of James Hardie over the period of the Final Funding Agreement (JHI NV, 2006, p.ii)

The market institution also prefers a short time frame to mitigate risk and this risk of timing and amount of payment is calculated on an annual basis from historical yearly data. The short future obligation matches the backward looking time frame consistent with the Douglas and Wildavsky (1982) hypothesis of institutional risk. The hierarchy, on the other hand tends towards a longer time frame and using the law to ensure compliance, the FFA “is and is intended to be legally binding on all Parties hereto and to be enforceable at a law and equity” (FFA, 2009, p.32).

According to Douglas and Wildavsky (1982) the hierarchy relies on the advice of experts in how to manage risk. The FFA uses a plethora of experts to both calculate and audit. These experts are both independent, such as: “a reputable independent valuer of shares or businesses who has the requisite financial expertise” (FFA, 2009, p.73); the appointment of an “Approved Actuary” (FFA, 2009, p.37) to calculate present and future claims; and, the appointment of an “Approved Auditor” (FFA, 2009, p.53) to audit the financial statements of the AICF. In addition, the FFA (2009, p. 53) authorises “the President of the Institute of Chartered Accountants of Australia”

to have “the sole power to determine an available auditor” in the event that an auditor suitably independent cannot be found. The hierarchy also used its own experts such as the NSW Government Auditor to “conduct a general or more limited audit of the activities, affairs and financial position” of the AICF (FFA, 2009, p. 54). As Beck (1999, p. 51) points out when experts become involved in the calculation of risk it “permits a type of “technological mobilization” which no longer employ moral and ethical imperatives directly”.

Table 1 below demonstrates how the risks relating to asbestos payments have been ‘socialised’ in terms of the Douglas and Wildavsky (1982) framework.

**Table 1: Risks Characteristics of Centre and Border Institutions**

<b>Risk Characteristic</b>	<b>Market James Hardie</b>	<b>Hierarchy Government Representatives</b>	<b>Border Trade Union &amp; Asbestos Support Groups</b>
Editing out losses	<ul style="list-style-type: none"> <li>• Creation of AICF as separate entity</li> <li>• AICF, not James Hardie has responsibility for payments to asbestos claimants.</li> <li>• James Hardie indemnified</li> </ul>	<ul style="list-style-type: none"> <li>• \$320 million loan to ensure viability of AICF</li> <li>• Contingency plans in the event of insolvency of the various entities involved in payments to claimants</li> </ul>	<ul style="list-style-type: none"> <li>• Explicit link to James Hardie operations to ensure viability of James Hardie and AICF</li> <li>• Contingency plans in the event of insolvency of the various entities involved in payments to claimants</li> </ul>
Confidence in Assessment	<ul style="list-style-type: none"> <li>• Annual Payment calculated using James Hardie consolidated financial reports.</li> </ul>	<ul style="list-style-type: none"> <li>• Reliance on experts and audited financial statements</li> <li>• NSW Government Auditor</li> <li>• FFA is a deed legally binding all parties</li> </ul>	<ul style="list-style-type: none"> <li>• Little confidence in experts</li> <li>• Reliance on independent experts for actuarial estimates</li> </ul>
Future time-frame	<ul style="list-style-type: none"> <li>• Annual Payment based on historical 12month data</li> <li>• Payment related to actuarial estimates projected for 3 years</li> <li>• Capped amount so risk of quantum is related to business operations</li> </ul>	<ul style="list-style-type: none"> <li>• Time-frame for funding obligation is until 2045 linked to long latency period for onset of mesothelioma</li> </ul>	<ul style="list-style-type: none"> <li>• Ensure continued payments for future asbestos claimants</li> <li>• Final Payment must be agreed or FFA extended</li> </ul>

The term of the FFA extends to 31<sup>st</sup> March 2045. At that time James Hardie has the right, but not the obligation, to estimate a “Final Payment”. All parties to the FFA must be in agreement on the terms of the payment, otherwise the term will automatically be extended by 10 years (FFA, 2009, p. 97-98).

Douglas and Wildavsky (1982, p. 101) suggest that leaving the future to centre institutions will only serve to maintain the status quo. And while the border may be restless with dire predictions about the future, both the market and hierarchy may appear to be complacent. An individualist society based on market institutional rationality will ignore those who cannot participate in exchange. “Its risk portfolio does not carry heavy fixed liabilities for pensioners, widows and orphans” (Douglas and Wildavsky, 1982, p. 101). On the other hand, hierarchies are often maintain the system above the needs of the few and in its bureaucratic form is often too slow to respond to new information and only accept risks if they appear “on the horizon beyond its institutional threshold of concern” (Douglas and Wildavsky, 1982, p. 101). Therefore, risks are often left to the border institutions to raise public awareness and instigate change. In the case of funding asbestos by James Hardie, the sectarian interests raised by asbestos victim groups and trade unions, representing workers’ rights socialised the risk of asbestos funding previously confined to the centre market and hierarchy institutions and forced these centre institutions to collaborate a negotiated outcome. The negotiations also secured payments for the Baryulgil aboriginal community (see Moerman and van der Laan, 2010), previously excluded from the scope of the MRCF on legal grounds, within the scope of the FFA (FFA, 2009, p.9) Accounting technology through the funding formula operationalised the legal and moral responsibility for payments.

## CONCLUSIONS

The debate about funding asbestos “victims” by James Hardie is no longer an “imaginary state of nature”, instead the institutions have “arrived at a point at which moral problems about social inequality have been satisfactorily settled” (Douglas and Wildavsky, 1982, p. 177). Thus, the three institutions, market, hierarchy and border are at a “place where each is fully subscribing to democratic principles and the rule of law” (Douglas and Wildavsky, 1982, p. 177) and whereby the actors are interacting through the process of establishment of an agreement for current and future asbestos compensation payments to manage risk.

In the case of the FFA, the three ‘institutions’ represented demonstrate the centre and border-type institution characteristics. Interactions between border and centre institutions have been mediated by both legal and accounting concepts. Additionally, accounting technologies, such as valuation and audit, have played a central role in managing and socialising the risk. Accounting technology is at the crux of the negotiated outcome of the FFA. The market institution, James Hardie, has limited and managed the uncertainty of the timing and quantum of compensation payments by shifting their responsibility for funding to the AICF. James Hardie’s responsibility is merely to provide contributions to the AICF. And, this responsibility is explicitly derived from accounting calculations represented in published financial statements. The hierarchy, has also limited and managed risk of government responsibility for compensation payments through a legal arrangement establishing the AICF and providing loans to foster the long-term financial viability of James Hardie. The border institution, representing the sectarian interests of asbestos litigants, has collaborated with the centre institutions, initially by co-opting the hierarchy to support its disruption of the market following the restructure of James Hardie. Subsequently, the border has aligned with the centre through the FFA and its negotiated outcome

allowing the centre to regain stability and contain risk thus socialising the risk of asbestos compensation funding and ultimately shifting to the centre.

Globally, the asbestos compensation issue is far from resolved. Risks associated with asbestos compensation have been 'socialised' in a number of jurisdictions where asbestos has been banned. However this does not mitigate future risks. Asbestos is still mined and manufactured lengthening the horizon of asbestos-related disease and adding to the uncertainty of timing and quantum of claims. Additionally, former mining subsidiaries of western parent companies are creating new border institutions to represent sectarian interests. The risk and culture model provides a lens which emphasises the power of various interests and analyses the location and management of risk and how technology, in this case accounting technology, is pivotal in the conceptualisation of the socialisation of risk.

## References

- Beck, U. (1999), *World Risk Society*, Polity Press, Cambridge.
- Brown, S. (2008), Section 524 (g) “Without Compromise: Voting Rights and the Asbestos Bankruptcy Paradox”, *Columbia Business Law Review*, Vol.3, pp. 841 - 933.
- Douglas, M. (1986a), *How Institutions Think*, Syracuse University Press, New York.
- Douglas, M. (1986b), *Risk Acceptability According to the Social Sciences*, Routledge & Kegan Paul, London.
- Douglas, M., and Wildavsky A. (1982), *Risk and Culture: An Essay on the Selection of Technical and Environmental Dangers*, University of California Press, California.
- Durkin, T. (1990), *How Do Risks Become Social?* ABF Working Paper #900, American Bar Foundation, University of Chicago.
- Linsley, P. and Shrives, P. (2009), “Mary Douglas, risk and accounting failures”, *Critical Perspectives on Accounting*, Vol. 20, pp. 492-508.
- Lonergan, Edwards and Associates Ltd (LEA) (2006), *Independent Experts Report*, James Hardie Industries.
- Mannheim, K. (1972), *Essays on the Sociology of Knowledge*, Routledge & Kegan Paul Ltd, London.
- Moerman, L. and van der Laan, S. (2007), “Pursuing Shareholder Value: The Rhetoric of James Hardie”, *Accounting Forum*, Vol. 31, No. 4, pp. 354 - 369.
- Moerman, L. and van der Laan S. (2009), “Strategic Bankruptcy: The case of James Hardie”, paper presented at *Interdisciplinary Perspectives on Accounting Conference*, Innsbruck, 9-11<sup>th</sup> July.
- Moerman, L. and van der Laan, S. (2010), “Funding Asbestos Liabilities – An Investigation of Corporate and Regulatory Responses”, paper presented at the European Accounting Association Conference, Istanbul, 19–21<sup>st</sup> May.
- JHI NV (2006), “Proposal to provide long-term funding for compensating Australian asbestos-related personal injury claims against certain former James Hardie companies”, *Explanatory Memorandum*, 12<sup>th</sup> December, available at: <http://www.ir.jameshardie.com.au>, accessed 15<sup>th</sup> February 2010.
- JHI NV (2009a), *AICF issues notice to James Hardie and NSW Government*, 23<sup>rd</sup> April 2009, available at: <http://www.ir.jameshardie.com.au>, accessed 15<sup>th</sup> February 2010.
- JHI NV (2009b), *James Hardie acknowledges government assistance and reconfirms commitment to AICF*, 7<sup>th</sup> November 2009, available at: <http://www.ir.jameshardie.com.au>, accessed 15<sup>th</sup> February 2010.
- Final Funding Agreement (FFA) (2009), *Amended Final Funding Agreement*, 31<sup>st</sup> March 2009, available at: <http://www.ir.jameshardie.com.au>, accessed 7<sup>th</sup> May, 2009.
- Jackson, D.F. (Commissioner) (2004), *Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation*, Commonwealth of Australia, Canberra.
- Prince, P., Davidson J. and Dudley, S. (2004), “In the Shadow of the Corporate Veil: James Hardie and asbestos compensation”, *Research Note No. 12*, 10 August, Parliamentary Library, Commonwealth of Australia.

- Spender, P. (2003), "Blue Asbestos and Golden Eggs: Evaluating Bankruptcy and Class Actions as Just Responses to Mass Tort Liability", *Sydney Law Review*, Vol. 25, pp. 223-254.
- Young, J. (2001), "Risk(ing) Metaphors", *Critical Perspectives on Accounting*, Vol. 12, pp.607-625.