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Silencing the noise: Asbestos liabilities, accounting and strategic bankruptcy

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ABSTRACT

The legacy of the global exploitation of asbestos provides an illustrative case to examine corporate strategy in response to the significant financial risk presented by the long-tail liability. The James Hardie group was the dominant asbestos manufacturing concern in Australia and, confronted with the uncertainties of burgeoning long-tail tort claims, embarked on a radical corporate reorganization. At the centre of the reorganization was the creation of a business unit of limited potential to separate asbestos long-tail liabilities from the profitable operations of the corporate group and locate the risk in an alternate legal arena. The strategic recognition of accounting assets and liabilities to construct a 'bottom line' and shift organizational boundaries is explored using Delaney's theory of strategic bankruptcy. This interdisciplinary and critical sociological lens highlights the power of organizations to exploit the malleability of accounting concepts to pursue their strategic goals.

1. Introduction

One of the hallmarks of the industrial exploitation of asbestos has been the complex corporate manoeuvring to attenuate the financial liabilities that arise from compensation claims for asbestos-related disease. Two notable examples in advanced legal regimes, the Manville case in the US (Delaney, 1992) and Turner & Newall in the UK (McCulloch and Tweedale, 2008; Tweedale, 2000) have demonstrated the power of organizations to exploit their regulatory context to control litigation claims, potentially casting asbestos victims adrift. The purpose of this paper is to demonstrate how the management of James Hardie Industries Limited (James Hardie) engaged legal frameworks to avoid legal and moral obligations arising from asbestos operations in Australia. In a global environment, this paper contributes to our understanding of corporate reorganizations in jurisdictionally bound legal regimes and highlights the tensions that exist between the desire for accounting to be standardized internationally and the malleability of accounting concepts in national contexts. This paradox is played out in practices such as transfer pricing, taxation and tax havens, general insolvency and also accounting for long-tail liabilities arising from exposure to toxic products.

Apart from tobacco, few mass-produced substances have proven as toxic to humans as asbestos. As a mineral renowned for its strength, flexibility and fire resistant qualities, it is still used extensively as an insulator and building material, despite

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a ban on its use or import in many countries (Moerman and van der Laan, 2013a). While the health risks associated with industrial and occupational exposure through the extraction, fabrication and use of asbestos have been documented and studied throughout the 20th century,[1] it was not until 1973 that a landmark US case highlighted the dangers to the general public from even trivial environmental exposure (Castleman, 1979). Previously confined to the domain of workers' compensation, this case expanded the reach of compensation claims for asbestos-related disease[2] into the arena of tort law. Given asbestos-related disease can manifest decades after exposure; this long latency period presents difficulties in ascertaining both the quantum and timing of tortious claims. Consequently, companies involved in the asbestos industry present a unique opportunity to examine strategic responses to the financial threat of long-tail tort liabilities[3] in the interstitial space where notions of stakeholder power, accounting representations, and the conceptual artefact of the corporate entity coalesce. This paper adopts a critical sociological approach from Delaney's theory of strategic bankruptcy to explore key aspects of the reorganization of the multinational and former Australian asbestos manufacturer, James Hardie.

While James Hardie currently produces a wide range of non-asbestos products globally, the story was quite different prior to the 1980s. As an Australian manufacturing conglomerate all James Hardie products contained asbestos and, as the Chairman, John Reid boasted in 1977:

> every time you walk into an office building, a home, a factory; every time you put your foot on the brake, ride in a train, see a bulldozer at work. . .the chances are that a product from the James Hardie group of companies has a part in it (in Peacock, 2009, p. 137)

The ubiquitous use of James Hardie asbestos products resulted in a growing financial legacy from occupational and environmental exposure which continued to plague the corporate group. In an effort to "eliminate legacy issues that would otherwise continue to detract from value creation", James Hardie embarked on 'Project Green' in 2001, a radical corporate restructure as a "comprehensive solution" (JHIL, 2001a, p. 1). This strategy involved creating a separate special purpose entity to fund current and future liabilities arising from asbestos litigation claims which threatened the availability of adequate funds to compensate a vulnerable group of stakeholders for asbestos-related disease. Burying 'toxic' balance sheet items in special purpose entities is not an unusual practice (see for example the high-profile cases of Enron in the US and Parmalat in Europe). However, this case differs in that, to enable the separation of the asbestos legacy from its core operating activities, James Hardie needed to make visible (albeit in a controlled manner) asbestos liabilities. In this case previously 'known' but incalculable future liabilities were rendered, seemingly overnight, calculable and consequently manageable. A strategic approach to bankruptcy, such as that offered by Delaney (1989, 1992), generates questions about management's power to shift organizational boundaries, their ability to determine when long-tail asbestos contingencies become *official liabilities*; as well as the organizational power embedded in social relationships to enable the construction an organizational 'bottom line' (Eckstein and Delaney, 1993).

According to Delaney (1989, 1992), management facing uncertainty from long-tail tort litigation may pursue a strategy to move into a legal arena that provides greater certainty and affords more control. The arena of corporate law provides the framework to shift organizational boundaries and create a business unit of limited potential by exploiting the technical relationship between assets and liabilities (Delaney, 1989, 1994). However, corporate reorganizations are enacted in a unique historical, regulatory and socio-political context (Eckstein and Delaney, 1993) where options are limited and contingent upon the perceived relative power of adversaries to interfere in strategic actions (Delaney, 1994)–considered by James Hardie management as 'stakeholder noise'. To explore the network of resources and constraints, we draw on prior research examining the James Hardie case. These accounts have considered: legal aspects (Dunn, 2005; Jackson, 2004; Prince et al., 2004; Spender, 2003, 2005); societal and ethical implications (Gunz and van der Laan, 2011; Haigh, 2006; Peacock, 2009); management communications (Moerman and van der Laan, 2007, 2011); and, the management of long-tail risk (Moerman and van der Laan, 2012). This paper differs from previous accounts by offering an approach that exposes accounting as a pivotal element in one of the most important events in Australian corporate history.

Organizational strategies explored from a critical sociological perspective challenge the presumption that accounting is a mere tool for economic decision-making providing the means to make economically rational decisions in an organizational context. Indeed, accounting has been portrayed as a tool of domination and oppression in a variety of contexts including slavery (see Fleischman and Tyson, 2004); the Holocaust (see Funnell, 1998); race and ethnicity (see Greer and Neu, 2009); and workers' rights (see Tinker, 1985) among others. Adopting a similar stance, this paper demonstrates how accounting concepts can be used as a hegemonic resource to recognize liabilities and construct a 'bottom line', counterintuitive to mainstream assumptions of corporate management behaviour (Delaney, 1989, 1992, 1994).

The paper begins with a description of the reorganization strategy of James Hardie. This is followed by a discussion of the challenges of interdisciplinary research and an outline of how the organizational goal of quarantining asbestos liabilities was facilitated through the strategic use of accounting concepts. A review of the institutions and networks considered to

[1] Asbestosis was listed as the cause of death for workers in the industry as early as 1931 (Tweedale, 2000). A landmark study in 1964 demonstrated the link between exposure to asbestos and several types of lung cancer (Selikoff in Delaney, 1992).

[2] Exposure to asbestos poses health risks ranging from asymptomatic calcified scarring of the lungs, through to functionally limiting conditions such as asbestosis, lung cancer and the fatal cancer of the pleural or peritoneal cavity, mesothelioma.

[3] A tort is a breach of duty of care caused by an act or failure to act which causes harm for which the remedy is damages. A long-tail tort means thet there is a long latency period between a person's use or exposure to a harmful product and the first manifestation of harm (Spender, 2003).