Watchdog didn't even sniff Babcock

By Ian Verrender for The Sydney Morning Herald, September 1, 2011

IT WAS the nation's biggest ever corporate collapse, with losses totalling upwards of $10 billion. But those responsible for the debacle that was Babcock & Brown are now in the process of buying their way out of trouble.

Less than a fortnight ago, liquidators of the once high-flying investment group launched legal action against the directors and its auditors, Ernst & Young, to recover $160 million in damages. It appears a settlement between the aggrieved parties is already afoot. If accepted, this could potentially bring to a close one of the most shameful periods in Australian corporate history.

Launched on the stock exchange as an investment vehicle in late 2004, Babcock & Brown soared from day one, its $5 shares peaking at close to $32 on the promise that it would rival Maquarie Group. But the onset of the financial crisis in late 2007 exposed the group for what it was; a poorly managed operation with an enormous and ultimately unsustainable debt burden. When disaster struck in 2008, its banking syndicate quickly took control and ousted those who had created the debacle as its share price crashed into penny dreadful territory.

Unlike insurance group HIH, the collapse of which a decade ago sparked a royal commission, there was never any public inquiry by the corporate regulator or any other government authority into the activities of Babcock & Brown. Instead it was left to the liquidator, Deloitte, to last year conduct public hearings which honed in on rather narrow allegations against the investment group; that it had paid dividends out of debt rather than earnings, and in so doing had prejudiced its own shareholders over those of subsidiaries. That narrow view of damages was taken on behalf of the few remaining debt holders in B&B's main operational subsidiary, Babcock & Brown International, who still had a claim.

Frustrated by inaction from the Australian Securities and Investments Commission, Deloitte a fortnight ago decided to go it alone. The liquidator's damages claim may be paltry when compared with the group's overall losses, but employed the only ammunition it had in the absence of any action by the corporate regulator.

The defendants in its action were former chairman Jim Babcock, former managing director and chief executive Phil Green (pictured), former deputy chair Elizabeth Ann Nosworthy, and former directors Geoffrey Martin, Dieter Rampl, Joe Roby, Martin Rey, James Fantaci, Michael Sharpe, and auditors Ernst & Young.

In what must have been one of its best investments, Babcock & Brown took out premium insurance policies for its directors in the event they would ever be sued. And it appears they will now walk away from the ruins of the collapsed group financially unscathed.

Babcock & Brown these days has just one director and is run out of a tiny downtown office with a laptop and a computer by Michael Larkin. He is the sole remaining local employee, along with a handful of administration people overseas. Most of the banks that had secured debt to the stricken group sold out as Babcock was imploding two years ago. The new holders of the debt are understood to have paid an average of about 17¢ in the dollar and expect to make a modest profit when the remaining assets are liquidated. Not that there is a great deal left.

Apart from minority stakes in some offshore shopping centres, some American ethanol operations and some British and German commercial real estate, most of the group has already been busted up.

Among those who have bought the original business activities are former senior employees of the group. Rob Topfer bought control of stockbroking firm Tricom for a fraction of the amount tipped in by his employer. In the chaos of the early days of the financial crisis in 2008, Tricom - Babcock & Brown's house broker - came close to collapse, threatening to destabilise the entire Australian sharemarket when the extent of its stock lending and short-selling facilities became apparent.

Another to benefit from the collapse was Eric Lucas, the former head of Babcock's Japan operation who bought out the group's Japanese property funds management business.

But the greatest survivor was Phil Green. The driving force behind Babcock & Brown, Green reportedly left the group with more than $30 million intact and has since gone from strength to strength. Now running a private operation, Alceon, he has been in the business of buying distressed debt since his Babcock days, rather than applying for debt. He first bought out a portion of GMAC's residential mortgage book, picked over some of the carcass of the Allco group and has since emerged as a big shareholder in the collapsed RAMS home loan business.

Former B&B chairman Jim Babcock, meanwhile, returned to San Francisco with some $100 million from the halcyon days to build a magnificent new home.

Corporate collapse is more often the result of incompetence or poor judgment rather than wrongdoing. But the reluctance of Australian regulators to even investigate the collapse of Babcock & Brown in a public forum smacks of a greater failure.

It was Green who called your columnist in February 2008 to complain of ''rumourtrage'' - those who profit by spreading nasty rumours and short-selling the shares - and implored regulators to take drastic action. In the next breath, he confidently predicted B&B would deliver a $750 million profit that year. He was a tad shy of the mark. Accounts filed long after Green left the group show it lost $5.2 billion that financial year.

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