



In the Matter of Babcock & Brown Communities Group

[2008] ATP 25

Catchwords:

*Frustrating action - agreement - implementation agreement - placement - convertible notes - management agreements
shareholder approval - listing rule 7.9 - commercial imperative - funding requirements - structure of implementation
agreement*

*Babcock & Brown Communities Group - The Prime Retirement and Aged Care Property Trust - Australian Property
Custodian Holdings Limited - Lend Lease Corporation Limited - Babcock & Brown Limited - Australian Securities
Exchange*

Corporations Act 2001 2001 (Cth) sections - 657A - 657D - 602 - 631

INTRODUCTION

1. The Panel, Hamish Douglass, Andrew Lumsden (sitting President) and Robert Sultan, declined to make a declaration of unacceptable circumstances on the basis that BBC and other parties agreed to provide an undertaking. They undertook to seek security holder approval before proceeding with stage 1 of the Lend Lease proposal if a superior proposal comes forward before 5.00 pm on 17 November 2008. This satisfied the preliminary primary concern the Panel expressed to the parties that entry into the Lend Lease proposal had a chilling effect on the auction for control of BBC.
2. Because the Panel’s preliminary primary concern was addressed by the undertaking, the Panel did not need to make a final decision in relation to the application.
3. In these reasons the following definitions apply.

Term	Meaning
BBC	Babcock & Brown Communities Group, comprising BBCL and BBCT
BBCIS	Babcock & Brown Communities Investor Services Limited, as responsible entity for BBCT
BBCL	Babcock & Brown Communities Limited
BBCM	Babcock & Brown Communities Management Pty Limited
BBCT	A managed investment scheme, Babcock & Brown Communities Trust
BBC notes	Subordinated notes issued by BBC which may be redeemed by either BBC or the holder between 5 and 10 December 2008
BNB	Babcock & Brown Limited
BNB agreement	Stapled security acquisition agreement dated 1

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Term	Meaning
	October 2008 between a subsidiary of BNB ¹ and Lend Lease for the transfer of the BNB parcel
BNB parcel	Existing BBC stapled securities held by BNB or a subsidiary comprising in total 12.45% of BBC and made up of: <ul style="list-style-type: none">- an initial parcel of 42,522,022 stapled securities and- a second parcel of 42,522,020 stapled securities
First notes	19,705,882 convertible notes issued by BBC with a 5 year term which may: <ul style="list-style-type: none">- with finance party consent, be redeemed in the first 2 years out of asset sales or- if security holders approve, be converted into BBC stapled securities
Implementation agreement	Agreement between BBCL, BBCIS as responsible entity for BBCT and Lend Lease dated 1 October 2008
Internalisation agreement	Agreement between BBCM, BBCL, BBCIS and Babcock & Brown International Pty Ltd dated 28 August 2008 under which management rights over BBC would be internalised in BBCIS (the responsible entity of BBCT)
Lend Lease	Lend Lease Corporation Limited
Management agreements	Agreements between BBCM and BBCIS (the responsible entity of BBCT), and BBCM and BBCL
Prime	The Prime Retirement and Aged Care Property Trust
RBD notes	176,470,588 convertible notes issued by BBC which are on the same terms as the First notes

4. In these proceedings the Panel:

- (a) adopted the published procedural rules and
- (b) consented to parties being represented by their commercial lawyers.

¹ Under the BNB agreement, Babcock & Brown International Pty Limited will procure the sale of the BNB Parcel.

BACKGROUND

Facts

5. On 28 August 2008, BBC announced the results of its strategic review conducted to “identify options for reducing the value gap between BBC’s underlying assets and current security price”. It outlined initiatives, including:
- price discovery process. BBC had been approached by several parties interested in acquiring BBC. With the view to soliciting proposals to acquire BBC as a whole, the directors established a process for negotiation with BBC which included a data room. Interested parties (including Prime) were invited to participate in this process. They agreed with BNB that, in the event of a recommended proposal for the acquisition of the whole of BBC, the Management agreements would either be purchased by BBC from BNB for \$17.5 million or transferred to a party that makes an offer for the whole of BBC.
 - debt reduction program. BBC would seek to lower its debt levels over the short to medium term.
6. An announcement by BNB dated 28 August 2008 provided details of the Internalisation agreement. It stated:

“To facilitate the making of offers for the whole of BBC, Babcock & Brown has agreed an arrangement with BBC’s Independent Directors under which potential bidders can engage in negotiations with the Independent Directors, with certainty that, subject to the recommendation of the Independent Directors and receipt of a superior proposal:

- *they can acquire Babcock & Brown’s rights under the existing management agreements for cash at the same price as agreed for the internalisation noted below; and*
- *Babcock & Brown intends to dispose of its holding of 64.8 million BBC securities (10% of the securities on issue) to the acquirer of those rights through a pre-bid acceptance agreement.*

BBC has agreed to pay Babcock & Brown \$17.5 million as consideration for internalising the management agreements. The acquisition price will be paid in cash or scrip at the option of BBC. If it is paid in scrip, the number of securities issued to Babcock & Brown will be based on an agreed VWAP prior to the issue of the securities.”

7. On 4 September 2008, Prime announced and lodged a bidder’s statement for a proportional (40%) takeover of BBC. Defeating conditions to its bid included:

- (a) clause 10.7(c)(iv). That clause says:

“Between the Announcement Date and the end of the Offer Period (each inclusive), neither BBC nor any subsidiary of BBC:

(iv) incurs, commits to or brings forward the time for incurring, or grants to another person a right the exercise of which would involve BBC incurring or committing to, any capital expenditure or liability, or foregoes any revenue, in respect of one or more related items of greater than \$10,000,000”

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(b) clause 10.7(e). That clause says:

“During the Bid Period, none of the following occurrences (being the prescribed occurrences listed in section 652C of the Corporations Act) happens: ...

(iv) BBC issues Securities or grants an option over its Securities, or agrees to make such an issue or grant such an option;

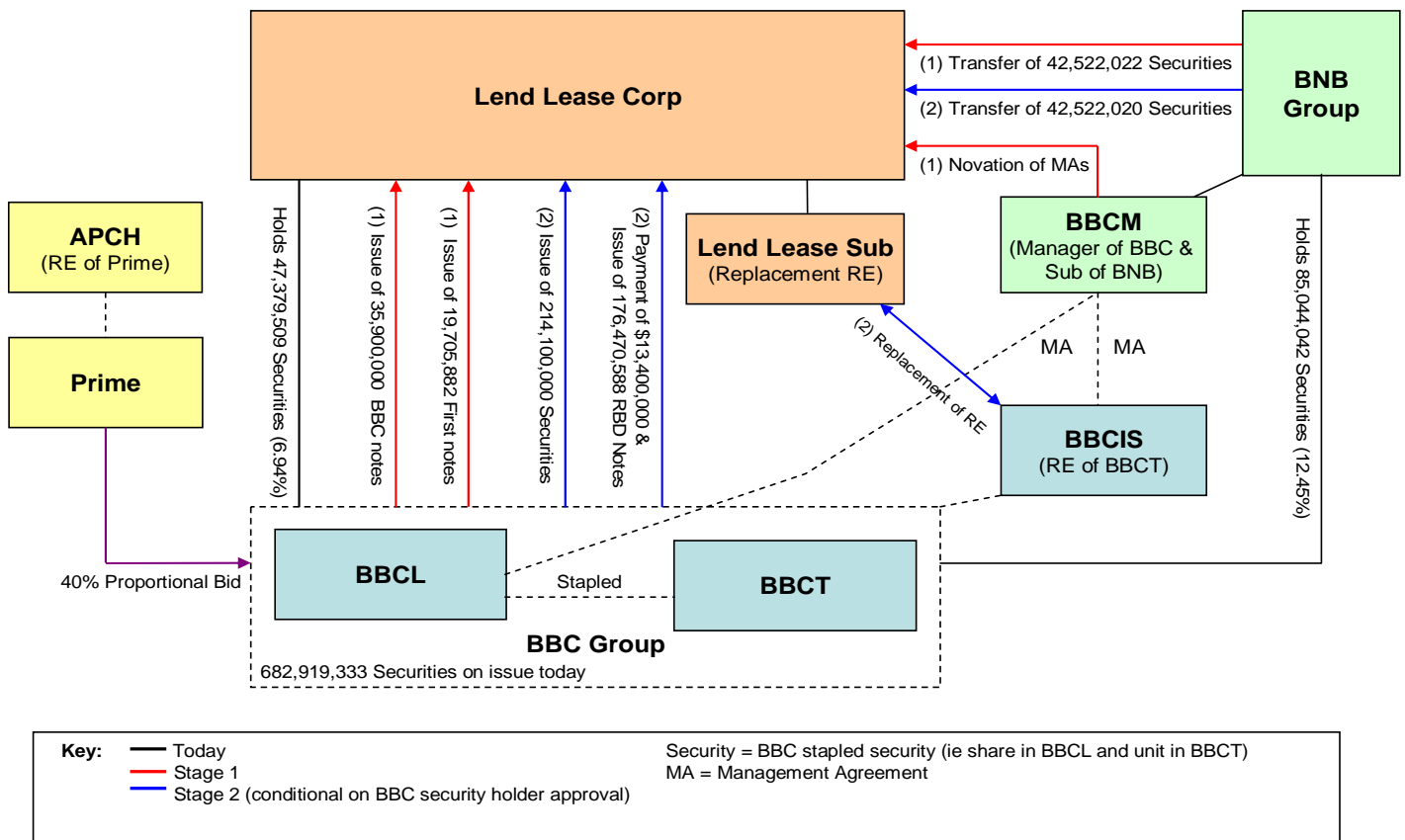
(v) BBC issues, or agrees to issue, convertible notes”.

8. Prime’s offer is scheduled to close at 7.00 pm on 28 November 2008.
9. On 1 October 2008 BBC and Lend Lease announced that they had entered into a proposal which comprised the Implementation agreement and the BNB agreement. The combined effect would result in Lend Lease holding approximately 41% of BBC.
10. The proposal was structured to be implemented in two stages:
 - (a) Stage 1 -
 - 50% of the BNB parcel is sold to Lend Lease
 - BBC issues 35,900,000 stapled securities or BBC notes to Lend Lease for \$24,412,000 depending on whether ASX granted a waiver from Listing Rule 7.9
 - BBC issues 19,705,882 First notes to Lend Lease for \$13,400,000 and
 - the Management agreements are novated to Lend Lease for payment of \$17,500,000 to BBCM.
 - (b) Stage 2 (subject to security holder approval) -
 - the remaining 50% of the BNB parcel is sold to Lend Lease
 - BBC issues 214,100,000 BBC securities to Lend Lease for \$145,588,000
 - BBC issues 176,470,588 RBD notes to Lend Lease and pays Lend Lease \$13.4 million cash in exchange for 7 retirement villages and an aged care facility owned by Lend Lease and
 - a subsidiary of Lend Lease replaces the current responsible entity of BBCT.
11. The relevant transactions contemplated by the Implementation agreement and the BNB agreement are summarised in the following diagram:

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12. The issue of, or agreement to issue, the stapled securities to Lend Lease required security holder approval under ASX Listing Rule 7.9.² BBC sought a waiver, which was refused by ASX on 13 October 2008. Therefore, under the Implementation agreement the BBC notes are to be issued to Lend Lease instead of stapled securities. By their terms the conversion rights in the BBC notes are subject to security holder approval (as were all the transactions in stage 2). The Implementation agreement has since been amended so that the BBC notes will not be convertible and will thus not be put to security holders for approval.

Application

13. By application dated 10 October 2008, Prime sought a declaration of unacceptable circumstances. Prime submitted that entry into and giving effect to the

² ASX listing rule 7.9 says that subject to exceptions not relevant here, "an entity must not issue or agree to issue equity securities, without the approval of holders of ordinary securities, for 3 months after it is told in writing that a person is making, or proposes to make, a takeover for securities in it". By listing rule 19.12, an equity security includes a convertible security.

Implementation agreement constituted frustrating action in relation to the Prime offer and should be subject to security holder approval.

14. Prime further submitted that failure to obtain security holder approval for entry into the Implementation agreement offended the principle in section 602(c)³ as the Implementation agreement deprived BBC security holders, including Prime, of a reasonable and equal opportunity to participate in the benefits accruing to BNB through Lend Lease's acquisition of a substantial interest in BBC.

Orders Sought

15. Prime sought the following final orders:
- (a) BBC be required to seek security holder approval for entry into and giving effect to the Implementation agreement
 - (b) Unless security holder approval is obtained:
 - (i) BBC not consent to the novation of the Management agreements to Lend Lease
 - (ii) BBC not issue stapled securities or BBC notes to Lend Lease and
 - (iii) Lend Lease not acquire the BNB parcel pursuant to the Implementation agreement and
 - (c) If security holder approval is not obtained, the Implementation agreement be cancelled with immediate effect.

DISCUSSION

The Lend Lease proposal

16. The Implementation agreement, according to its recitals, says that subject to obtaining the consent of the finance parties:
- (a) Lend Lease wishes to
 - (i) acquire the management rights under the Management agreements
 - (ii) replace BBCIS as the responsible entity of BBCT
 - (iii) acquire the BNB parcel
 - (iv) subscribe for stapled securities or BBC notes and
 - (v) sell its 'Retirement By Design' business⁴ to BBC and
 - (b) BBC has agreed to:
 - (i) consent to the novation of the Management agreements to Lend Lease

³ References are to sections of the Corporations Act 2001 (Cth) unless stated otherwise. Section 602(c) says: "as far as practicable, the holders of the relevant class of voting shares or interest all have a reasonable and equal opportunity to participate in any benefits accruing to the holders through any proposal under which a person would acquire a substantial interest in the company, body or scheme"

⁴ Essentially, retirement villages operated by Lend Lease

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- (ii) issue stapled securities or BBC notes to Lend Lease and
 - (iii) negotiate in respect of the acquisition of the 'Retirement By Design' business.
17. BBC sought to characterise the elements of the Lend Lease proposal as separate transactions. We do not share that view. In our opinion, the proposal is or should be treated as a single transaction with different elements.
18. It is important that the Panel consider the substance of the transaction and not merely its legal form. Its legal form involves separate agreements with different parties. Its substance involves BNB quitting its interests in BBC in favour of Lend Lease. These interests include stapled securities in BBC, management rights and control of the responsible entity. Lend Lease is also subscribing for securities in BBC and vending into BBC some retirement village assets.
19. There are a number of additional factors that support our interpretation of the proposal as a single transaction. For example, in its announcements BBC described the transactions as a single proposal. Further, the agreements⁵ are interlocking and were executed on the same day.
20. Accordingly the separate agreements, which involve significant control implications for BBC, "*in substance and for practical purposes ... were interdependent and had been designed as integrated parts of a single transaction*": Becker Group 01⁶.
21. Stage 2 of the transaction (see paragraph 10(b)) will be subject to security holder approval. We are concerned with stage 1 (see paragraph 10(a)).
22. There are two elements of stage 1 of the transaction that concerned the Panel:
- (a) issue of the BBC notes and the First notes and
 - (b) novation of the Management agreements.

Issue of the BBC notes and the First notes

23. BBC submitted that the First notes and the BBC notes were loan notes unless and until BBC security holders approved convertibility. This was on the basis that the right of conversion in the terms of those notes did not exist until the condition precedent to the conversion rights (namely, security holder approval) was satisfied.
24. Clause 4.1(f) of the Implementation agreement was significant. It provided as a condition of completion of stage 1:
- "if the First Tranche is BBC Notes, receipt by BBC on or before the First Completion Date from Lend Lease of an application to subscribe for 35,900,000 Stapled Securities at \$0.68 per Stapled Security which only becomes effective if the holders of Stapled Securities do not approve the Conversion Rights at the Annual General Meeting and pursuant to which Lend Lease agrees that if it has requested redemption of the BBC Notes, the proceeds of*

⁵ Stapled security acquisition agreement dated 1 October 2008 and implementation agreement dated 1 October 2008. The transfer and RE replacement agreement, referred to in schedule 1 of the implementation agreement, was not provided to the Panel

⁶ [2007] ATP 13 at [39]

redemption may be applied in satisfying the payment of subscription monies under the application."

25. We were subsequently advised that BBC and Lend Lease had agreed the BBC notes will not be convertible at all and that clause 4.1(f) of the Implementation agreement has been amended to delete the words "*which only becomes effective if the holders of Stapled Securities do not approve the Conversion Rights at the Annual General Meeting*". Nevertheless we considered that the commercial substance of issuing the BBC notes as redeemable notes combined with the application for subscription in clause 4.1(f) of the Implementation agreement (as amended) was effectively the same as issuing convertible notes.
26. We were of the preliminary view that the issue of the notes triggered the defeating condition in clause 10.7(e)(v) of the bidder's statement as convertible notes, and clause 10.7(c)(iv) as loan notes.⁷
27. However, we did not need to finalise our preliminary view because our concerns were addressed by the undertaking.
28. The triggering of defeating conditions may constitute a frustrating action. This would be so if there was no commercial imperative for issuing the notes or if it was accepted that the issue of the notes had a material impact on the Prime bid and BBC itself. However, we did not need to make a finding on this issue.

Novation of the Management agreements

29. Novation does not trigger a defeating condition of the Prime bid, so it cannot be considered to be a frustrating action as contemplated by Guidance Note 12. The Prime bid and the Lend Lease proposal can run in parallel: the Prime bid (as currently formulated) can run its course uninterrupted and security holders can decide whether or not to accept the offer.
30. In our view, however, novation is likely to preclude the auction for control of BBC (whether the Prime bid or otherwise) from running its course.
31. Notwithstanding that Prime did not make its bid conditional on the Internalisation agreement going ahead, it submitted in substance that novation had effectively locked out the possibility, or substantially reduced the likelihood, of an ongoing auction for BBC. We agree. This was so notwithstanding the price discovery process which had been conducted by BBC. The management rights are valuable and important.
32. While the management rights are an asset of BNB, novation can only proceed with BBC's consent, and the BBC board agreed to provide that consent without reserving their rights if a superior proposal were to emerge. It is hard to imagine a person making a bid for the whole of BBC if the novation proceeds. It also seems unlikely that Prime would increase its offer. In *Consolidated Minerals 03*⁸ the Panel found an action by a bidder that had a chilling effect on the auction process unacceptable and ordered that it be undone. The policy underpinning this decision extends equally to

⁷ Clause 10.7(e)(iv) is triggered if BBC incurs or commits to a liability of over \$10m

⁸ *Consolidated Minerals 03* [2007] ATP 25

the conduct of target directors or, with necessary adaptation, a responsible entity for a managed investment scheme.

33. It is material that a takeover was on foot at the time BBC agreed to the novation. While it may have been appropriate for BBC to enter the proposal with Lend Lease and consent to novation before any takeover had been made (perhaps even then a fiduciary carve-out would be required), the situation was different once Prime had announced its bid.
34. BBC responded that the market for bidders for BBC has been tested. However it is possible that Prime (or another potential bidder) may be willing to offer more in light of the competing proposal with Lend Lease.
35. BBC and Lend Lease each made submissions to the effect that transfer of the management rights was not a control transaction: *Bowen Energy*.⁹ However, we consider the situation more like *AMP 01*.¹⁰ In that case, pre-emptive rights in co-owners of some of the assets of the trust meant that, if after a takeover the responsible entity was changed, assets of significant value might be sold out of the trust. The Panel was satisfied, among other things, that the effect of the (previously undisclosed) pre-emptive rights on the possibility of a takeover bid was inconsistent with an efficient competitive and informed market in units of the trust. In this case, we are not concerned with who controls BBC but with the effect of the transfer of the Management agreements on control transactions (or potential control transactions) in BBC securities.
36. For the above reasons we had the preliminary concern that the auction for control of BBC may not be taking place in an efficient, competitive and informed market. However, we did not need to finalise our preliminary view because our concerns were addressed by the undertaking.

Undertaking

37. While the issue of the notes may have constituted a frustrating action in relation to the Prime bid, we did not think that there was a likelihood of unacceptable circumstances for that reason alone. However we were concerned with the risk of the novation of the Management agreements having a chilling effect on the auction for control of BBC.
38. GN 12.50 states:

“The Panel has wide powers to make orders under section 657D if it finds that triggering action by target directors gives rise to unacceptable circumstances. This includes preventing an action or transaction from proceeding or requiring the target to seek shareholders’ approval of the action or transaction in general meeting. It also includes unraveling an action or transaction that has already occurred.”
39. An undertaking to expose the Lend Lease proposal to any superior proposal would effectively unravel the effect of the novation because a superior proposal may emerge. BBC was willing to undertake not to proceed with stage 1 for a period of 10

⁹ *Bowen Energy Ltd* [2007] ATP 22 at [32]

¹⁰ *AMP Shopping Centre Trust 01* [2003] ATP 21

days so that a superior proposal¹¹ would have a chance to emerge (from Prime or another bidder). If a superior proposal did emerge, BBC, BNB and Lend Lease were willing to undertake not to proceed with stage 1 before obtaining security holder approval.

40. We consider that this has the effect of remedying the chilling effect that novation has had, or is likely to have, on the auction process for control of BBC.

DECISION

41. We were satisfied that the undertaking remedied the primary concern that might have led to a declaration of unacceptable circumstances, namely the chilling effect that the novation has had, or is likely to have, on the auction process for control of BBC.
42. We are therefore satisfied that it is not against the public interest to decline to make a declaration. As we declined to make a declaration we did not make any final orders, including any costs orders.
43. A copy of the undertaking is in the annexure.

Andrew Lumsden

President of the Sitting Panel

Decision dated 31 October 2008

Reasons published 11 November 2008

¹¹ A proposal is a superior proposal if the independent directors form the opinion, reasonably formed in good faith and for a proper purpose based on their fiduciary duties, that it is a superior proposal to the Lend Lease Proposal.



Annexure

Section 201A of the Australian Securities & Investments Commission Act (Cth)

Undertakings

In the matter of Babcock & Brown Communities Group

Pursuant to section 201A of the *Australian Securities & Investments Commission Act 2001* (Cth):

1. Each of BBC, BNB and Lend Lease undertakes to the Panel that, before 5:00pm on Monday 17 November 2008, they will not:

- (a) issue to Lend Lease the First Notes or the BBC Notes
- (b) consent to the novation of the Management Agreements
- (c) agree to terminate the Internalisation Agreement
- (d) issue securities under any application referred to in clause 4.1(f) of the Implementation Agreement; or
- (e) acquire the Initial BNB Parcel.

2. Each of BBC, BNB and Lend Lease undertakes to the Panel that if, before 5.00pm on Monday 17 November 2008, a superior proposal has been made or announced, they will amend the terms of the Implementation Agreement, the Stapled Security Acquisition Agreement and the Transfer and RE Replacement Agreement to require security holder approval before BBC, BNB or Lend Lease takes any of the steps referred to in (1).

3 Each of BBC, BNB and Lend Lease undertakes to the Panel to confirm in writing to the Panel when it has satisfied its obligations under this undertaking.

In this undertaking:

Terms have the same meaning as in the Implementation Agreement dated 1 October 2008

BBC comprises Babcock & Brown Communities Limited and Babcock & Brown Communities Trust (the responsible entity for which is Babcock & Brown Communities Investor Services Limited)

Lend Lease means Lend Lease Corporation Limited

A proposal is a superior proposal if the independent directors form the opinion, reasonably formed in good faith and for a proper purpose based on their fiduciary duties, that it is a superior proposal to the Lend Lease proposal announced on 1 October 2008.

[Signed on behalf of Babcock & Brown Communities Group, Lend Lease Corporation Limited, Babcock & Brown International Pty Limited]

Dated 31 October 2008