Australian Government

Takeovers Panel

Reasons for Decision
Quantum Graphite Limited (subject to Deed of Company Arrangement)
[2018] ATP 1

Catchwords:

Company under administration – deed of company arrangement – association – disclosure – share issue – substantial holding – effect on control – decline to make a declaration

Corporations Act 2001 (Cth), sections 602, 606, 611, 657A and Part 5.3A

ASX Listing Rules 7.1, 7.1A and 7.4

Financial Resources Limited [2007] ATP 27; Pasminco Ltd (Administrators Appointed) [2002] ATP 6

Interim order	IO undertaking	Conduct	Declaration	Final order	Undertaking
NO	NO	YES	NO	NO	NO

INTRODUCTION

1. The Panel, Yasmin Allen, Robert McKenzie and Sophie Mitchell (sitting President), declined to make a declaration of unacceptable circumstances in relation to the affairs of Quantum Graphite Limited (subject to Deed of Company Arrangement). The application concerned a placement of shares in Quantum and resolutions passed at Quantum's annual general meeting to approve the issue of shares and unlisted options, in accordance with a deed of company arrangement, for the purposes of ASX Listing Rule 7.1. The Panel was not satisfied that the circumstances were unacceptable.

2. In these reasons, the following definitions apply.

Chimaera	Chimaera Capital Limited
Deed Administrators	Mr Laurence Andrew Fitzgerald and Mr Michael James Humphris of William Buck
DOCA	Deed of Company Arrangement entered into by the Deed Administrators, Quantum (then known as Valence Industries Limited), Quantum Graphite Operations Pty Ltd (then known as Valence Industries Operations Pty Ltd) and Chimaera dated 17 November 2016, as varied by the Deed of Variation dated 22 December 2016 and the Second Deed of Variation dated 20 October 2017
SER	Strategic Energy Resources Limited
Quantum	Quantum Graphite Limited (subject to Deed of Company Arrangement)

FACTS

3. Quantum is an ASX listed company (ASX code: QGL). It is suspended from trading.

4. On 15 July 2016, Quantum was placed into administration by the board of Quantum and the Deed Administrators were appointed as joint and several administrators of Quantum. Quantum subsequently entered into the DOCA.[1]

5. On 17 November 2017, Quantum lodged an Appendix 3B disclosing the issue of 29,852,400 Quantum shares (amounting to just under 15% of the issued capital) issued as consideration for services provided in connection with the Uley Mine and other services.

6. On 17 November 2017, Quantum also released a Notice of Annual General Meeting (**Notice of Meeting**) for an annual general meeting to be held on 18 December 2017 to consider:

   (a) resolutions relating to the ordinary business of Quantum required to be conducted at the 2016 annual general meeting, including the adoption of accounts and the remuneration report and the election of directors

   (b) resolutions giving effect to the DOCA, namely, for the issue of shares to unsecured creditors and the issue of shares and unlisted options to the secured creditor beneficiaries

   (c) a resolution for the issue of shares to the directors in lieu of director's fees and

   (d) a resolution for subsequent approval under ASX Listing Rule 7.4 of securities issued under ASX Listing Rules 7.1 and 7.1A (to reset Quantum's placement capacity), specifically, the issue of the following shares on 29 September 2017 each at a deemed price of $0.0252 per share:

      (i) 24,877,000 shares to Mr Tony Harbrow (or his nominee) and

      (ii) 2,985,240 shares to Thornton Group (Australia) Pty Ltd (or its nominee)

      (iii) 1,990,160 shares to Mr Robert Mencel.

7. On 20 December 2017, Quantum announced the results of the annual general meeting. All resolutions were carried except for the resolution described in paragraph 6(d).

APPLICATION

Declaration sought

8. By application made on 16 January 2018, SER sought a declaration of unacceptable circumstances. SER was the largest shareholder of Quantum with approximately 10.95% of Quantum shares prior to the issue of shares to Mr Harbrow. At the time of the annual general meeting, SER held 9.52%, and Mr Harbrow held 10.87%, of Quantum shares.

[1] The Deed of Company Arrangement was subsequently varied by a Deed of Variation dated 22 December 2016 and a Second Deed of Variation dated 20 October 2017

9. SER sought a declaration of unacceptable circumstances, submitting that (among other things):

   (a) Mr Harbrow voted in favour of all resolutions (other than the resolution described in paragraph 6(d) on which he was precluded from voting) and his vote was determinative of the final outcome of all the resolutions carried

   (b) the issue to Mr Harbrow was not a genuine commercial transaction but rather was an issue to an associate of Chimaera for the purposes of affecting control of Quantum, ensuring the passing of the resolutions at the annual general meeting

   (c) as a result of the resolutions passed to give effect to the DOCA, Chimaera[2] was likely to be issued with shares equivalent to 19.5% of Quantum together with unlisted zero-strike price options equivalent to a 1.13% interest in Quantum, taking Chimaera's direct interest in Quantum over 20% on exercise of the options

   (d) given the zero strike price, Chimaera would be able to exercise the options six months after their issue in reliance on the 3% creep rule (in item 9 of section 611)[3] and was likely to do so, as no other course of action was commercially reasonable

   (e) the structure of the transaction shows a clear intention to subvert the proper operation of Chapter 6 (noting that the Second Deed of Variation dated 20 October 2017 to the DOCA effecting the change in the structure of the transaction avoided the necessity of complying with item 7 of section 611)

   (f) there were deficiencies in the Notice of Meeting and the conduct of the annual general meeting and

   (g) no initial substantial holder notice had been given by Mr Harbrow, despite the issue to him of more than 10% of Quantum shares.

10. SER submitted that the effect of the circumstances was to subvert the principles in section 602, including that the acquisition of control take place in an efficient, competitive and informed market.

Interim order sought

11. SER sought an interim order that no action be taken to issue shares pursuant to the resolutions passed at the meeting pending determination of its application. The Deed Administrators advised that the expected date for the share issue was 16 February 2018 and agreed to give at least 48 hours' notice before any share issue. In the light of that, the Panel did not consider it necessary to make an interim order.

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[2] We assume the basis for this submission was the fact that the Notice of Meeting contemplated that beneficiaries of the VXL General Liquidity Trust (of which Chimaera was trustee) might be entitled to shares exceeding 19.5%, in which case any entitlement above 19.5% would be received as unlisted options rather than shares

[3] Unless otherwise specified, all statutory references are to the *Corporations Act 2001* (Cth) (as modified by ASIC) and all terms used in Chapter 6 or 6C have the meaning given in the relevant Chapter

Final orders sought

12. SER sought final orders to divest the shares issued to Mr Harbrow, prevent the issue of shares pursuant to the resolutions passed at the meeting and declare all resolutions passed at the meeting invalid.

DISCUSSION

13. The Deed Administrators made a preliminary submission that the Panel should not conduct proceedings as:

    (a) it was inappropriate to conduct proceedings in relation to a company that is the subject of a deed of company arrangement

    (b) SER had put forward insufficient evidence and ignored relevant materials

    (c) there was no meaningful remedy available as, if the application succeeded, the DOCA would fail and Quantum would be placed into liquidation and

    (d) the application was vexatious and made with the intent of subverting implementation of the DOCA.

14. We were mindful that the purposes of Chapter 6 may have limited relevance where a company is insolvent and no equity value remains in the shares.[4] We were also concerned not to inappropriately obstruct action by the administrator to bring the company back to solvent operation.[5] However, as was noted in *Pasminco Ltd (Administrators Appointed)*, there is no exception from section 606 for deeds of company arrangement and calls for an exception were rejected by CASAC in its 1998 report.[6] No change was made in that respect when Parliament "fine-tuned" Part 5.3A in 2007.[7] It follows that the requirements of Chapter 6 must not be ignored.

15. It may be that the Panel will not often conduct proceedings on an application concerning the affairs of a company that is subject to a deed of company arrangement. We decided to conduct proceedings in this case as:

    (a) The application contained credible allegations of potentially serious unacceptable circumstances on matters squarely within the Panel's jurisdiction, including:

        (i) resolutions contemplating the possible issue of shares carrying voting power of 19.5% as well as zero-strike price options guaranteeing the ability to creep above 20%

        (ii) an allegation that a placement of more than 10% ensured (and was made to facilitate) approval of the resolutions in (i) and

        (iii) the lack of any substantial holder disclosure in relation to the placement in (ii).

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[4] *Pasminco Ltd (Administrators Appointed)* [2002] ATP 6 at [130]-[131]

[5] *Financial Resources Limited* [2007] ATP 27 at [45]

[6] [2002] ATP 6 at [81]-[88]. See Legal Committee of The Companies and Securities Advisory Committee, *Corporate Voluntary Administration* 1998 Chapter 9, recommendation 57

[7] *Corporations Amendment (Insolvency) Act 2007* (Cth). The Explanatory Memorandum does not discuss recommendation 57 but refers to and implements other recommendations in the 1998 CASAC report

(b) It was not clear to the Panel that Quantum shares had no value (and limited disclosure by Quantum and changes in commodity prices made this difficult to assess).

(c) We did not have sufficient material to assess the Deed Administrators' submissions that the application was vexatious and made to subvert implementation of the DOCA.

16. We requested further information and relevant documentation and invited submissions and rebuttals from the parties and ASIC in relation to the timing and purpose of the application, implementation of the DOCA and the issue of shares to Mr Harbrow.

17. We continued to have concerns, despite the responses received, about matters including the adequacy of disclosure in the Notice of Meeting[8] and the failure of Mr Harbrow to lodge a Notice of Initial Substantial Holder. In other circumstances, we would have made further enquiries on these issues. However, the additional material provided persuaded us, on balance, that making a declaration under section 657A would be against the public interest, having regard to:

(a) the object of Part 5.3A

(b) the matters in section 657A(3)

(c) the potential prejudice to creditors and shareholders if the DOCA did not proceed as a result of making a declaration (including as a result of the likely exercise of rights by the secured creditor and probable liquidation of the company) and

(d) the potential advantages to creditors and shareholders if the DOCA is fully implemented and Quantum's shares recommence trading on ASX.

18. Given that conclusion, we did not need to decide whether the application was made for a collateral purpose. However we note that, in our view, SER had time to make an alternative proposal regarding Quantum to the Deed Administrators and had delayed in making its application. In addition, SER appears to have more appropriate forums available to it (including the courts) to address its claims.

DECISION

19. For the reasons above, we declined to make a declaration of unacceptable circumstances. We consider that it is not against the public interest to decline to make a declaration and we had regard to the matters in s657A(3).

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[8] We were concerned about this for a number of reasons, including because the Notice of Meeting did not:
a) disclose the persons proposed to be issued shares under the resolutions described in paragraph 6(b)
b) disclose the named persons who would be excluded from voting on each resolution
c) include information regarding the terms of the "Unlisted Options" proposed to be issued or
d) include adequate information regarding the process for, and status of, implementing the DOCA / restructuring and recapitalising the company (including the likely effect on existing shareholders)

Orders

20. Given that we made no declaration of unacceptable circumstances, we make no final orders, including as to costs.

Sophie Mitchell
President of the sitting Panel
Decision dated 1 February 2018
Reasons given to parties 14 February 2018
Reasons published 16 February 2018

Advisers

Party	Advisers
SER	Grillo Higgins
Deed Administrators	Holding Redlich