



Australian Government

Takeovers Panel

**Reasons for Decision
CFOAM Limited
[2020] ATP 22**

Catchwords:

Decline to conduct proceedings – effect on control – funding arrangements – need for funds - rights issue – shortfall shares – disclosure – continuous disclosure

Corporations Act 2001 (Cth), sections 611 item 10, 657A, 657C(d), 657D

Guidance Note 17: Rights Issues

Flinders Mines Limited 02 & 03 [2019] ATP 2, Warrnambool Cheese and Butter Factory Company Holdings Limited [2013] ATP 16, Magna Pacific (Holdings) Limited 05 [2007] ATP 16, Multiplex Prime Property Fund 04 [2009] ATP 21, International All Sports Ltd 01R [2009] ATP 5, Bowen Energy Ltd [2007] ATP 22, Argosy Minerals Limited [2014] ATP 7

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

INTRODUCTION

1. The Panel, Richard Hunt (sitting President), Bill Koeck and James Stewart, declined to make a declaration of unacceptable circumstances in relation to the affairs of CFOAM. The application concerned an announcement by CFOAM that it had entered into a “conditional agreement to invest A\$1,550,000 to acquire a strategic 10.24% interest in Innovaero Technologies Pty Ltd (**Innovaero**), an Australian Aerospace and Defence Technology business”, conditional (among other things) on CFOAM completing a new equity raising for a minimum of \$3,000,000 (**Innovaero Investment**) and that CFOAM would undertake the Entitlement Issue to fund the Innovaero Investment. The Panel considered (among other things) that there was no evidence that the Entitlement Issue would have or would be likely to have an effect on the control of CFOAM and delaying the Entitlement Issue could impact on CFOAM’s ability to raise funds.

2. In these reasons, the following definitions apply.

- Applicants** Jogchum Brinksma, Sydney 2000 Pty. Ltd, Brian Joseph, William Rouse, Muhammad Qubbaj, Seda Baghomian, Gregory Rubino, Toby Chandler, Vivienne Maya, Teni Zadorian and Robert Michael Reveley
- Board** board of directors of CFOAM
- Capital Contribution** has the meaning given in paragraph 4(a)
- CFOAM** CFOAM Limited
- CFOAM Corp** CFOAM corporation, a 75% subsidiary of CFOAM

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CFOAM LLC	a wholly owned subsidiary of CFOAM Corp
Entitlement Issue	4 for 3 renounceable entitlement issue at an issue price of \$0.015 per share to raise up to \$3,843,181
Entitlement Issue Prospectus	the Prospectus lodged with ASIC on 20 October 2020 which set out the terms upon which the Entitlement Issue would proceed
First Announcement	has the meaning given in paragraph 5
Innovaero Investment	has the meaning given in paragraph 1
Second Announcement	has the meaning given in paragraph 6
Shortfall Offer	the offer of Shortfall Shares on the terms and conditions set out in section 2.7 of the Entitlement Issue Prospectus
Shortfall Shares	those shares not applied for under the Entitlement Issue (if any) and offered pursuant to the Shortfall Offer

FACTS

3. CFOAM is an ASX listed company (ASX code: CFO). The Applicants have an aggregate relevant interest in 37.5% of CFOAM shares.
4. On 1 October 2020, CFOAM released its annual report for the year ended 30 June 2020. The report stated, among other things, that:
 - (a) *“the Board of CFOAM Corp (CCORP) has determined that the business of CFOAM LLC requires working capital of US\$916,532 to continue its business operations. The funds are required to be contributed on a pro rata basis being CFOAM Limited (CFO) US\$687,399 and CONSOL US\$229,133...CONSOL has agreed to contribute its pro rata share of US\$229,133 by 4 September 2020 for the issue of 4 shares and contribute US\$229,133 of CFO’s portion on or after 1 October 2020, on a short term basis, allowing CFO time to raise its allocation” (Capital Contribution)*
 - (b) *“the ability of the group to continue as a going concern is dependent on maintaining the support of its financiers...and securing additional funding through the raising of debt or equity...”*
 - (c) CFOAM intended to raise capital for its share of the Capital Contribution and set out the process for doing so
 - (d) *“There have been no significant changes in the state of affairs of the group to the date of this report, not otherwise disclosed in this report”* and
 - (e) other than the Capital Contribution *“there have been no other matters or circumstances, which have arisen since 30 June 2020 that have significantly affected or may significantly affect: a) the operations, in financial years subsequent to 30 June 2020, of the Group, or b) the results of those operations, or c) the state of affairs, in financial years subsequent to 30 June 2020, of the Group”.*

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5. On 8 October 2020, CFOAM announced the Innovaero Investment and that it would undertake the Entitlement Issue to fund the Innovaero Investment (**First Announcement**).
6. On 20 October 2020, CFOAM announced their intention to issue 256,232,035 shares under the Entitlement Issue (**Second Announcement**) and issued the Entitlement Issue Prospectus. The Entitlement Issue Prospectus disclosed that if shareholders did not participate in the Entitlement Issue, their holdings were likely to be diluted by approximately 57.14%.
7. On 21 October 2020, the Applicants (through their solicitors) sent a letter to the Board regarding the First Announcement. The letter stated that the Applicants considered the First Announcement was “*entirely contrary to matters disclosed by the Board in the financial report, some 7 days earlier*” in that the transaction must have been contemplated by the Board at 1 October 2020 and “*an investment of some A\$1,500,000 in a company, in circumstances where the Company had material working capital...obligations it is presently unable to fund, would significantly affect its operations and state of affairs in subsequent financial years*”. The letter went on to state that what the Board proposed could constitute oppressive conduct because the Entitlement Issue “*was proposed without any Shareholder consultation whatsoever*”, is significantly dilutionary and “*contrary to the interests of the shareholders as a whole*”. In respect of the Innovaero Investment, the Applicants stated that “*the acquisition appears to lack any commercial or strategic advantage to the Company*” and “*no apparent attempts were made to seek alternative funding sources*”. The Applicants were “*also concerned that this conduct could have contravened the Board’s obligations of continuous disclosure under ASX Listing Rule 3.1*”. The Applicants requested that the Board:
 - (a) immediately cease any activity which required capital to be raised for the Innovaero Investment that would result in the dilution of the existing shareholding of the Applicants and
 - (b) resign and the Applicants appoint new directors to CFOAM.
8. On 23 October 2020, the Applicants (through their solicitors) sent a further letter to the Board requesting an immediate trading halt of CFOAM as the Applicants were “*deeply concerned about the impact of the Second Announcement on the trading price*”.
9. On 26 October 2020, the Applicants (through their solicitors) again sent correspondence to the Board stating, among other things, that “*as a direct consequence of the Second Announcement (at market open), the share price dropped by 9.52% to \$0.019*” and the Board’s “*failure to accede to the requests in our 21 October 2020 correspondence will cause further loss*”.
10. On 26 October 2020, the solicitors for Gary Steinepreis and Todd Hoare (two of the directors of CFOAM) wrote to the Applicants’ solicitors stating that “*the contents of the Financial Report were accurate at the time the Financial Report was published*”, that “*the Innovaero Investment, and proposed updated funding arrangement...is in the best interests of the members of CFOAM as a whole*” and “*Your claim that ASX Listing Rule 3.1 has been contravened is similarly without merit*”.

APPLICATION

Declaration sought

11. By application dated 3 November 2020, the Applicants sought a declaration of unacceptable circumstances. The Applicants submitted (among other things) that:
 - (a) CFOAM has present working capital requirements that are unfunded and an investment of \$1,550,000 in Innovaero disregards those capital requirements, and has no discernible benefit
 - (b) the Entitlement Issue “*will allow for the acquisition of a substantial interest*” in CFOAM, is substantially dilutionary and is made at a large discount and
 - (c) the Applicants have identified an alternative source of funding for CFOAM that would be “*beneficial for all shareholders and as a result would improve the working capital position of*” CFOAM.

Interim order sought

12. The Applicants sought an interim order restraining the Entitlement Issue from proceeding pending the outcome of the application.

Final order sought

13. The Applicants sought a final order “*permanently preventing*” the Entitlement Issue.

DISCUSSION

Decision whether to conduct proceedings

14. We have considered all the material, but address specifically only that part of the material we consider necessary to explain our reasoning.
15. The Applicants submitted that the Entitlement Issue was for “*the purpose of acquiring a minority interest in another company, for which there is no apparent operational, strategic...benefit to the Company*” in circumstances “*where the Company is presently unable to fund its current working capital requirements*” and the Entitlement Issue “*will not fully address those working capital requirements*”. The Applicants also submitted that they were able to obtain funding for CFOAM from a capital advisory firm that would be beneficial for all shareholders and would improve the working capital position of CFOAM and were “*unaware of the Board having made any enquiries about alternative funding sources on more favourable terms*”.
16. CFOAM in its preliminary submissions submitted that “*prior to launching the [Entitlement Issue], the Board considered various funding alternatives available to the Company*” and the Board determined to proceed with the Entitlement Issue having regard to “*previously stated operational objectives, certainty of funding in light of these objectives and timing*”. CFOAM did not consider that the funding proposed by the Applicants was suitable for a number of reasons including that CFOAM did not have sufficient placement capacity under ASX Listing Rule 7.1 and 7.1A to complete the placement and would therefore require shareholder approval.
17. In addition CFOAM stated that “*the directors of the Company have sought to exercise their powers and discharge their duties in good faith in the best interests of the Company, and for a*

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proper purpose. In addition, the Company has at all times complied with its continuous disclosure obligations...

18. The Panel has historically been reluctant to involve itself in matters concerning alleged breaches of directors' duties¹ or to opine on the business or commercial judgements of directors.² As stated in *Finders Mines Limited*:³
"...It is not the Panel's role, in the ordinary course, to opine on such judgements or enforce requirements for which other regulators or the courts have primary responsibility. However, the overlap of such requirements does not prevent the Panel exercising its jurisdiction in relation to matters that do fall within its jurisdiction and role..."
19. The Applicants submitted that the Entitlement Issue would overwhelmingly dilute their shareholding but did not otherwise provide submissions on the effect the Entitlement Issue would have on the control of CFOAM.
20. We considered the large dilutionary effect of the Entitlement Issue that, if shareholders did not participate in the Entitlement Issue their holdings were likely to be diluted by approximately 57.14%. After reviewing the Entitlement Issue Prospectus and the Applicants' submissions we consider that the Applicants have not provided evidence that the Entitlement Issue will have or is likely to have an effect on the control of CFOAM. We consider that CFOAM has taken steps to mitigate the potential control effects of the Entitlement Issue including by making the Entitlement Issue renounceable and specifying in the Entitlement Issue Prospectus that, regardless of the amount raised under the Entitlement Issue, no shareholder will increase their holding to an amount in excess of 19.99%. In addition, on the basis of the allocation policy, no person would acquire, through participation in the Shortfall Offer, a holding of shares of, or increase their holding to, an amount in excess of 19.9% of all shares on issue on completion of the Entitlement Issue. We further consider that control is dispersed among shareholders and there is no evidence that the dilution of a controlling shareholder's interest would have an effect on the control of CFOAM.⁴
21. We considered the discretion given to the Board to allocate shares under the Shortfall Offer. Offering a shortfall facility under which directors exercise a discretion regarding the shortfall is a factor that the Panel will take into consideration when considering the potential unacceptable control effect of a rights issue.⁵ The Applicants did not make submissions directly on this point. However, we consider that if the directors allocate the Shortfall Shares in a manner that will have or is likely to have an effect on control then this may be grounds for a further application.

¹ For example, *Warrnambool Cheese and Butter Factory Company Holdings Limited* [2013] ATP 16, *Magna Pacific (Holdings) Limited* 05 [2007] ATP 16; *Multiplex Prime Property Fund* 04 [2009] ATP 21, *International All Sports Ltd* 01R [2009] ATP 5 and *Bowen Energy Ltd* [2007] ATP 22

² For example, *Flinders Mines Limited* 02 & 03 [2019] ATP 2

³ *Flinders Mines Limited* 02 & 03 [2019] ATP 2 at [20]. See also *Warrnambool Cheese and Butter Factory Company Holdings Limited* [2013] ATP 16

⁴ See *Argosy Minerals Limited* [2014] ATP 7 at [25]

⁵ Guidance Note 17: *Rights Issues* at [7]

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22. CFOAM submitted that the “*final orders sought by the Application are likely to have extremely prejudicial and uncertain impacts to the Company (and its shareholders). The orders will cause significant delays to the receipt of necessary funds required for the Company to meet working capital requirements*”.
23. The Panel is likely to accept directors’ decisions on funding issues if the decision appears to be reasonable and supported by rational reasons.⁶ We do not consider that the Applicants have pointed to something that suggests deeper inquiry may be warranted on CFOAM’s need for funds. Further, we consider that delaying the Entitlement Issue could impact on CFOAM’s ability to raise funds..

DECISION

24. For the reasons above, we do not consider that there is any reasonable prospect that we would make a declaration of unacceptable circumstances. Accordingly, we have decided not to conduct proceedings in relation to the application under regulation 20 of the *Australian Securities and Investments Commission Regulations 2001* (Cth).

Orders

25. Given that we have decided not to conduct proceedings, we do not (and do not need to) consider whether to make any interim or final orders.

Richard Hunt

President of the sitting Panel

Decision dated 6 November 2020

Reasons given to parties 27 November 2020

Reasons published 2 December 2020

⁶ Guidance Note 17: *Rights Issues* at [11]

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Advisers

Party	Advisers
Applicants	Mitry Lawyers
CFOAM	Steinepreis Paganin
Gary Steinepreis, Todd Hoare and Nicholas Ong	William James Lawyers