Published on *The National Law Review* https://natlawreview.com

Disclosure and Vote Swamping Revisted – Has the Position Changed following the Mizen CVA Appeal?

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In two recent blog posts we discussed the challenge made to the Company Voluntary Arrangement (CVA) of Mizen Build/Design Ltd (the "**Company**") by Peabody Construction Limited ("**Peabody**") and the finding of (i) a material irregularity based on failure to disclose information to creditors in the CVA proposal, and (ii) unfair prejudice based on vote swamping.

The first instance decision was appealed by the Company, and subsequently dismissed by Sir Anthony Mann, with the original finding of material irregularity being upheld, albeit for different reasons. The finding of unfair prejudice was not decided, although was briefly touched upon at the conclusion of the judgment.

This blog considers, what the judge said on appeal, particularly in relation to the extent of disclosure required in a CVA.

Material Irregularity and Extent of Disclosure

The background to the challenge and discussion about guarantee stripping is set out in our previous blog.

By way of brief summary, the initial finding of material irregularity was based on:

- Insufficient disclosure of information relating to the Shareholder of the Company in the estimated outcome statement ("EOS") where guarantee claims against the Shareholder were being compromised in the CVA, in particular in relation to the sale of a subsidiary and consideration received;

- Insufficient information of how the class of Guarantee Creditors in the EOS of the Shareholder was made up, both in terms of identity of creditor and value of claim.

The Company's appeal was based on the face that (i) the irregularity identified by the judge was not an irregularity and the judge erred in finding that it was (indeed, there is no requirement in the legislation to disclose antecedent transactions in relation to a third party), and (ii) even if it was an

irregularity, the judge applied the wrong test for materiality because any irregularity would not affect the 75% majority supporting the proposal and was therefore not material. Both of these arguments failed, for the reasons set out below.

Subsequent to the first instance decision, the accounts of the Shareholder were signed off and filed. These accounts showed that the Company had paid a dividend to the Shareholder of circa £1.9m which was not disclosed in the EOS reviewed by creditors but upon which creditors were to make a decision of whether or not to vote in favour of the CVA. No such dividend was paid the previous year, and constituted a transaction at an undervalue, in favour of a connected person (i.e. an antecedent transaction open to challenge).

This failure to disclose was relied upon by Peabody in response to the appeal. A major purpose of the CVA was to relieve the Shareholder of its guarantee obligations and therefore the Company should have put forward the fuller picture of the possible outcome of administration of the Shareholder, including information relating to antecedent transactions which were vulnerable to challenge, the success of which could increase the asset pool of the Shareholder and return to the Guarantee Creditors.

The appeal judge made it clear that the obligation on the Company under the Insolvency Rules, and case law, was to provide sufficient information for creditors to make a reasonable judgment as to whether the proposal was in their commercial interest or not. He found that while it is unnecessary to require the level of disclosure from the Shareholder as would be provided in its own CVA, the EOS ought to have disclosed, to an appropriate extent, matters which might give rise to an antecedent transaction challenge because the possibility of such a claim could impact the EOS and the asset pool of the Shareholder, and thus the sum available to the Guarantee Creditors. On the facts, the matter is potentially significant to a voting Guarantee Creditor in the CVA of the Company.

While the judge found that the disclosure of the dividend transaction would have been relevant and significant, it also needed to be material for the challenge to succeed (and the appeal to fail) i.e. if the information had been disclosed, would this have affected the voting, a point which was not considered by the previous judge. Given that the subsequent disclosure of the dividend may have been an antecedent transaction open to challenge, the success of which would change the return to the Guarantee Creditors, the judge found that the standard for establishing that the irregularity was material had been met.

Unfair Prejudice and Vote Swamping

Our previous blog provides further detail about vote swamping, what this is and when it might be unfairly prejudicial.

The judge did not decide on arguments of unfair prejudice as he didn’t need to, however he did note that should it have mattered, it would have been difficult to follow the previous judge’s reasoning on unfair prejudice.

Notwithstanding that the judge left the point open, vote swamping remains a ground on which a CVA could be challenged for unfair prejudice, and it is a question that is likely to arise in future.

Concluding Comments

The most helpful aspect of this case concerns the level of disclosure required in a CVA.

On appeal, the judge agreed that the information disclosed about the Shareholder's position should have been more than that which was provided by the Company, but the judge did not go as far as the first instance judge in saying that disclosure should be at the level required by the Company in seeking a CVA.

Whether adequate disclosure has been made will always be a question of fact, with the key question being: Has the company provided sufficient information to creditors so that they can make an informed decision about whether or not to vote in favour of the CVA?

National Law Review, Volume XIII, Number 164