

Increase of Share Capital — A Case for Oppression?

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It has been more than a year since COVID-19 first surfaced. The ongoing pandemic continues to take its toll on many industries and businesses both locally and abroad. Many ailing businesses are still struggling to ensure they remain a going concern.

In order to maintain a healthy cash flow and liquidity, many private limited companies are resorting to increasing their share capital. The injection of capital by subscription of the companies' newly issued shares will provide a much-needed lifeline to them.

Unless otherwise provided by the constitution of a company limited by shares, each existing shareholder is entitled to subscribe to the newly issued shares proportionate to his respective shareholding. If, however, the offer to subscribe to the new shares is not accepted by the existing shareholders, the company can then dispose of those shares to interested third parties. By doing so, the shareholding of the existing shareholders who refuse to subscribe to the company's new shares will be diluted, and, in some instances, can even prompt a shift of power in the company.



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Oppression?

The pressing question is whether a shareholder can argue a case for oppression, in that the increase of the company's share capital is conducted in a manner oppressive, unfairly discriminatory, prejudicial to, or in disregard of, his interest as a shareholder of the company.

In the following instances, the courts have ruled that an increase of the company's share capital does not amount to oppressive conduct:

- (a) To ensure the company's solvency following a financial crisis:¹

During the Asian financial crisis in 1997, the respondent company was in dire need of an injection of funds to ensure its future solvency. To overcome the financial difficulty, the respondent company increased its share capital by RM20 million. However, the petitioner refused to subscribe to the allotment of shares, citing the respondent company's bleak financial forecast. The petitioner's refusal resulted in the dilution

of its shareholding in the respondent company from 20% to 8%, one which formed part of its complaint of being oppressed. In dismissing the claim, the court placed emphasis on the unchallenged evidence by the respondent company in respect of its financial status at that material time. The petitioner also conceded, under cross-examination, that the dilution of its shareholding was but a natural consequence of its decision not to subscribe to the respondent company's shares.

(b) To overcome large liabilities coupled with a recession:²

Due to the respondent company's large liabilities and banking requirement at the material time, the respondent company increased its share capital by converting debts owed to various creditors. Then, the respondent company further increased its share capital following a recession. The petitioners cried foul and alleged that the increase in share capital was reflective of oppressive conduct. It is noteworthy that although the court allowed the petitioners' claim under various other grounds, the court found nothing irregular and oppressive in the respondent company's decision to increase its share capital as it was justified and duly passed by the board.

(c) To finance for business expansion plan:³

In order to obtain financing for the respondent company's expansion plan, its share capital was increased from RM350,000 to RM5 million. A resolution was also passed to set off the directors' fees due by allotting new shares to all the shareholders. This was done to preserve the cash flow of the respondent company in view of the impending expansion plan. In dismissing the petitioner's appeal, the court remarked that the petitioner's rights as a shareholder were not prejudiced as such an exercise would collectively affect all the shareholders of the respondent company.

If, however, the issuance and allotment of shares in a company to a particular shareholder were surreptitiously carried out in breach of the director's fiduciary duty and with the intention to achieve a collateral purpose in diluting the shareholding of a majority shareholder, the court may find that a case for oppression has been made up.⁴

² *Chiew Sze Sun & Anor v Cast Iron Products Sdn Bhd & Ors* [1993] MLJU 115 (HC)
³ *Soh Jiun Jen v Advance Colour Laboratory Sdn Bhd & Ors* [2010] 5 MLJ 342 (CA)
⁴ *Re a Company (No. 005134 of 1986), Ex parte Harries* [1989] BCLC 383;
Seah Eng Toh Daniel & Anor v Kingsley Khoo Hoi Leng & 3 Ors [2015] MLJU 2353 (HC)



Authors' comments

The courts are generally slow in interfering with the internal management of a company.⁵ Thus, the burden weighs heavily on a petitioner to show that an exercise to increase the company's share capital was carried out in a manner oppressive and prejudicial to his rights as a shareholder. Shareholders must always be on the lookout to ensure their interest in the company is safeguarded.

On the flipside, shareholders who are running the company must ensure an exercise to increase its share capital is premised on sound business judgment. As noted by the English court:⁶

“A power to issue shares in a limited company given to directors for the purpose of enabling them to raise capital when required for the purpose of the company is a fiduciary power to be exercised by them *bona fide* for the general advantage of the company, and when the company is in no need of further capital, directors are not entitled to use their power of issuing shares merely for the purpose of maintaining their control, or the control of themselves and their friends, over the affairs of the company, or merely for the purpose of defeating the wishes of the existing majority of shareholders.”

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⁵ *Howard Smith Ltd v Ampol Petroleum Ltd & Ors* [1974] AC 821
⁶ *Piercy v S Mills & Co* [1920] 1 Ch 77

