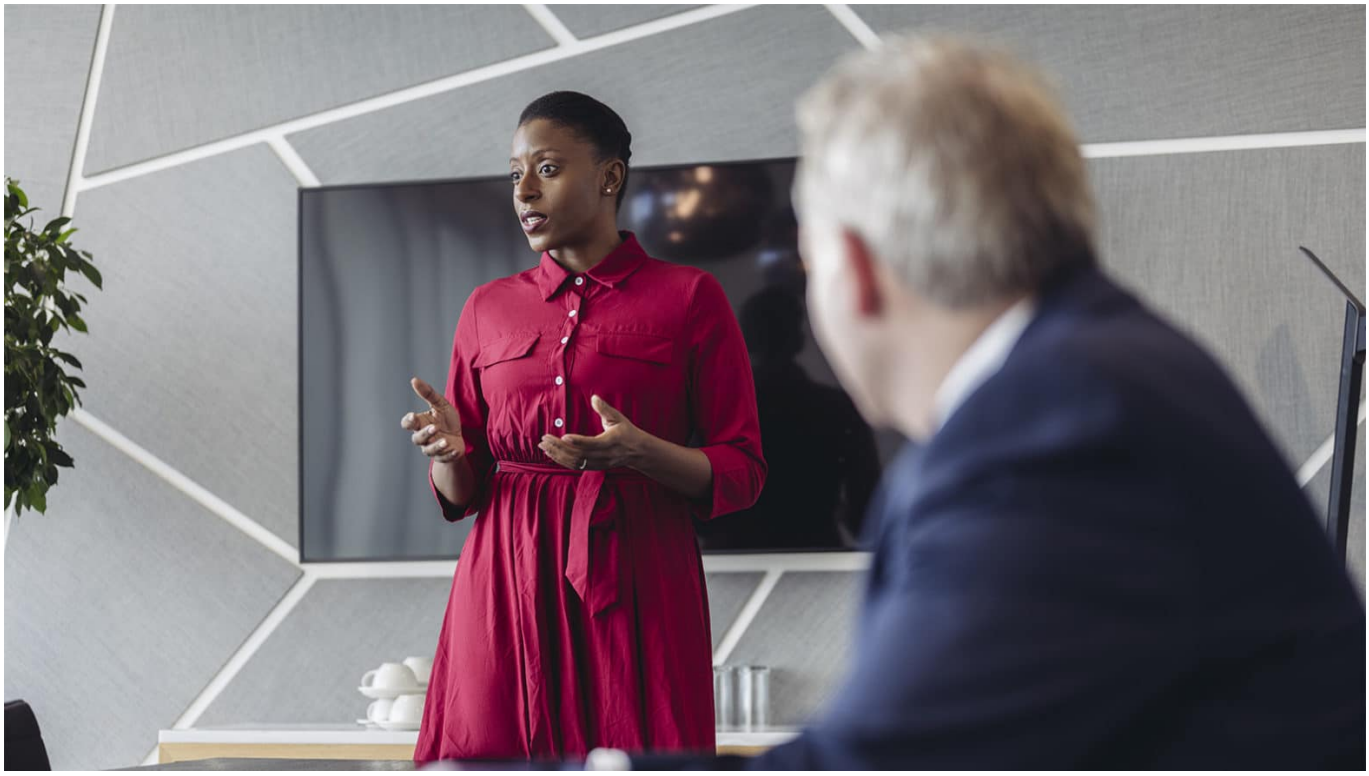
Dilution of shares was unfair but not unfairly prejudicial



One of the mechanisms that can be deployed by a majority shareholder at war with a minority shareholder is the dilution of their shares. For example, new shares may be issued at a price or in a quantity that the minority shareholder cannot afford. Even if they can afford it the minority shareholder may quite reasonably not want to put any more money into the company.

The risk

The risk for the majority shareholder is that if it is not a genuine commercial exercise and the goal is simply to dilute the minority shareholder then it may be held to be unfairly prejudicial.

This gives the minority shareholder the right to claim relief under s.994 of the Companies Act 2006. The usual relief sought being that the majority shareholder buys out the minority shareholder at a fair value, potentially on an undiluted basis.

Example case

This scenario was looked at in some detail in the case of Isaac v Tan (Cardiff City Football Club) [2022] EWHC 2023 (Ch). Mr Isaac was the minority shareholder (petitioner) and Mr Tan the majority shareholder (respondent).

There was a long history of animosity between Mr Isaac and Mr Tan culminating in the dilution of Mr Isaac's shares in 2018 from 3.87% to 1.29%. At that time the 3.87% shareholding had a pro rata value of around £1m.

The dilution was as the result of a rights issue, shares being allotted in consideration for the conversion of a loan from Mr Tan to the company. In the course of evidence it became clear that a significant motivation for Mr Tan was diluting Mr Isaac's shareholding and he used his controlling shareholding to push the dilution through.

This feels unfair and Mr Isaac petitioned the court accordingly. However, the case was not successful, the outcome being effectively summarised in this extract from the judgment.

"In his submissions on behalf of Mr Isaac, Mr Reade QC pressed me to accept that what Mr Tan did was unfair. I agree it was unfair in the moral sense. Based on my findings above, it seems to me it was vindictive and unpleasant behaviour, and is to be deprecated. But to say something is unfair in that sense is not the same as saying it is unfair or unconscionable in the legal sense, because one can behave unpleasantly and unfairly (and people often do) without behaving unlawfully."

In this case what Mr Tan did was found not to be unlawful because the unfair prejudice alleged needed to relate to the conduct of the company's affairs and the Judge held that it did not do so for two reasons:

- Mr Tan was entitled to exercise commercial pressure on the board in his position as creditor and was acting on his own account in this respect, not in the conduct of the company's affairs; and
- Even if Mr Tan was motivated by personal vindictiveness the dilution itself was capable of being objectively justified and there was no agreement or understanding between Mr Tan and Mr Isaac that he would not exercise his legal rights in this way.

Mr Isaac's fall-back claim was against the board of directors who were alleged to have breached their fiduciary duties by simply rubber stamping what Mr Tan wanted. Unfortunately for Mr Isaac this claim also failed.

This case is a stark illustration of the principle that even blatantly unfair behaviour towards a minority shareholder will not necessarily form the basis of a successful claim under s.994 of the Companies Act 2006. It is always necessary to establish the ingredients that make such unfair behaviour unlawful.

How we can help

Our commercial disputes team is here to help should you need help with this topic or anything similar. Please get in touch with us.

Written by

Ed Weeks

Partner