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## Rough Times May Breed Shareholder Oppression

By **Jacqueline Bell**

*Law360, New York (April 01, 2009)* -- In an economic downturn, public companies aren't the only ones to face an increased risk of legal challenges from shareholders. Attorneys who specialize in so-called shareholder oppression suits say times of financial stress become fertile ground for shareholder disputes in private corporations.

When minority shareholders in closely-held corporations feel they are being treated unfairly, legal action is often one of the only avenues open to them. Shareholders in public companies can easily sell their stake in the company, but private company shareholders don't have that option.

"In the public context, if a minority shareholder, is unhappy, he simply sells his shares," said Erica Harris, partner at Susman Godfrey LLP. "In a closely-held company, the minority shareholder has no control and no ability to liquidate the asset at a fair market price and walk away."

And when the economy takes a turn for the worse, minority shareholders can easily find themselves in a battle stemming from a company's dwindling profits.

"In terms of creating the conditions for oppression, there's no doubt that the downturn contributes to that," said Wallace Hilke, attorney at Lindquist & Vennum PLLP and chair of the firm's shareholder disputes group. "A lot of seeds are sown for later litigation."

Eric Fryar, a Texas-based attorney who also blogs on the topic of shareholder oppression, said that while he has not yet noted a significant uptick in cases filed in the wake of the economic crisis, he has seen a marked increase in queries from minority shareholders.

Two financial states typically generate shareholder oppression disputes, according to Fryar. In a boom-time economy, when a company is doing well, a majority shareholder may decide to push for a bigger piece of the pie.

And in an economic downturn, when the size of the pie is shrinking, the majority shareholder “is tempted to use his power to keep his piece of the pie from shrinking so quickly,” Fryar said.

Power grabs by majority shareholders usually follow a particular pattern, and often involve eliminating a minority shareholder's position at the company, denying the minority shareholder a meaningful role in management, or cutting back their share of the firm's profits.

“The most common type of shareholder oppression is that the majority shareholder, either on his own or with a group of shareholders, will exercise control over the corporation to ensure that the minority shareholder receives no economic benefit,” said Erica Harris, partner at Susman Godfrey LLP. “In that context, the only recourse that minority shareholder has is to bring a lawsuit.”

Oppressive tactics can be designed to “freeze out” shareholders by essentially devaluing their ownership stake, “squeeze out” shareholders by employing methods designed to force individuals to sell their shares to the majority shareholder at a cut-rate price, or often some combination of the two.

If that happens, minority shareholders in closely held corporations can find themselves essentially trapped – tied to a company, but denied the benefit of their stake in it.

Further complicating these disputes is the fact that the roster of shareholders in closely held corporations is usually made up of family members or close friends, which can make litigation especially bitter.

“I've represented essentially every human relationship you can imagine. Siblings, grandparents, ex-wives, ex-husbands, former best friends,” said Hilke.

When a wide range of companies and industries are struggling, it can be even easier for majority shareholders intent on oppressing minority shareholders to conceal potentially abusive behavior behind the veil of the broader financial crisis.

“If you are a bad actor, it's easier to do bad things and hide it in an economic downturn. If you stop paying dividends and things are good, people say: 'What happened?' Now there are lots of reasons you can give for why you stopped paying dividends,” said Harris. “Minority shareholders are often passive investors, and not fully aware of what's going on.”

Not only can it be a challenge for minority shareholders to determine whether they're the victim of shareholder oppression, but building a court case can also be tougher in lean times.

"When the company is hurting, a lot of times it's more subtle and more difficult to prove," Fryar said.

Recessions also can affect the outcome of a shareholder oppression suit. A common remedy for shareholder oppression is a court-ordered buyout of the minority shareholder's stake in the company. That process involves a determination of the company's overall value, which in times of financial distress can be far lower than in would be in a stronger economy.

When the company's overall value drops, so too does the fair value of a minority shareholder's stake.

"The price that a court would set would be lower than in times that are better,' Fryar said.

The credit crunch may also end up affecting court-ordered buyouts of minority shareholders, according to Scott Unger, a shareholder at Stark & Stark.

"In the go-go years when banks were lending, there were adequate ways to buy a minority shareholder out of the corporation," Unger said. "But now, I think there are going to have to be more structured settlements."

Shareholder oppression suits typically end up in state court – and states have developed a variety of methods of dealing with such litigation. Because of jurisdictional differences, minority shareholder strategies may vary, but experts say in a bad economy, the worst thing minority shareholders can do is stick their heads in the sand.

"Question any changes," Harris said. "If all of a sudden there are no more dividends, question it. Get the information to which you're entitled. Get educated about the company in which you have an interest."

Minority shareholders should also reacquaint themselves with their original shareholder agreement, according to Harris.

"Most people, when they make their initial investment, put it in a file and never look at it again. Now is a good time to dust that off and know what your rights are," she said.