INSPECTION OF STOCK LIST, BOOKS AND RECORDS

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(Mr. Goldman's outline on this subject appears in this issue at page 798)

MR. GOLDMAN: I would like to speak about a shareholder's right to examine stock lists as well as other books and records of a Delaware corporation. In your course materials and attached to my outline as Exhibit A, is section 220 of the Delaware Corporation Law which governs the production of both stock lists as well as other books and records.1 The mechanics of the demand are discussed in sections 'a' and 'b', and they are significant and must be followed to the letter.

First, the stockholder must have a written demand and it must be under oath.2

Second, a stockholder must make his demand in person, or by his attorney, or another agent.3 Only a stockholder of record can make the demand for stock lists or books and records.4 Many times stockholders hold their certificates in the name of their broker or nominee. In such a case the stockholder cannot demand the list or the books. His agent must do it for him. It sounds like a simple requirement, but it has been overlooked many times.

Several years ago, an attorney with one of the firms across the street from my office called me up and said, "I've got this great case for you. The complaint has already been filed, the trial is in two weeks, your new client is going to be deposed in two days, and it's all set and ready to go." So I said, "Fine", and he sent the file over. Our office had no conflict as the first firm did. I telephoned the plaintiff in Florida and my first question to him was, "How many shares do you have of record?" And he said, "None." Needless to say, we settled the action very quickly.

Recently the Delaware Court of Chancery has aided the situation somewhat in the Bear-Stearns case by ruling that a nominee can make the demand and bring the court action.5

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2. Id. § 220(b).
3. Id.
The next statutory requirement is that the stockholder state a proper purpose for looking at the list or the books. I'll expand upon that subject, subsequently.

Section 220 further provides that, where an attorney or an agent seeks the inspection, the demand under oath must be accompanied by a power of attorney or other writing authorizing the attorney or agent to act on behalf of the stockholder.

Furthermore, where a corporation is the stockholder making the demand, I think it is important that the corporation include a copy of the resolution of its board of directors authorizing a particular individual to make the demand. While our court of chancery has held that this is not a necessary item, I think you should provide it if you represent a corporate stockholder because it eliminates any issue that the defendant corporation may raise against a particular person making the demand.

Finally, the demand is to be directed to the corporation either at its registered office in Delaware, or at its principal place of business.

The main issue in the case law has been proper purpose. The statute defines it to be "a purpose reasonably related to such person's interest as a stockholder." What does that mean? Our Chancellors have said, "Almost anything." For example, a proper purpose is involved when you wish to solicit proxies. It is a proper purpose to communicate with other stockholders with regard to the settlement of a derivative suit. The cases so holding are listed in your outline.

Many cases have held that it is a proper purpose to seek a stock list in order to purchase additional shares. Therefore, if you are going to make a tender offer it is a proper purpose to obtain the stock list under section 220. Similarly, an exchange offer for stock constitutes a proper purpose.

Further, in one decision, the Bethlehem Copper case, it was held to be a proper purpose to obtain the list to determine whether you wish

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7. Id.
8. Id.
9. Id.
to communicate with other shareholders to purchase their stock. Thus, a stockholder does not even have to be committed to a tender offer. He can be at the stage in which he is trying to decide whether or not he wants to make an offer, and he is still entitled to the list.

What is an improper purpose with regard to stock lists? Almost nothing. However, several decisions have held that vague demands will not be proper. For example, in the Weisman case a demand for the list to communicate with other stockholders with respect to the management of the company and the conduct of its affairs was found to be too vague, and the list was denied. In the Northwest Industries case a purpose to communicate with reference to a special meeting of stockholders was held to be too vague and was denied. Moreover, in the ancient case, which I suppose belongs in the museum of legal antiques, as Chancellor Seitz would say, the Cities Service case, it was determined that a shareholder may not obtain the list in order to sell it for business solicitations.

Other purposes that have been held to be improper are harassment of the corporation and trying to force the corporation to purchase the shareholder's stock.

Now, our courts have held that some matters constitute harassment and some are not so much harassment. For example, in the Merritt-Chapman & Scott litigation a stockholder sued the company and its officers for fifteen straight years, and then he became ill, was tired of suing the company, and he had his wife sue the company for another few years. Then she got tired of suing the company, and they had their son sue the company. Even the son got tired of suing the company, and the family had their next door neighbor sue the company. This, said the Court, is hate and harassment. However, from time to time, one or two of these suits was successful. In such a situation, the court held it was proper to bother the company and the list must be produced for the plaintiff.

What defenses are there in a stock list case? Almost none. We have very imaginative counsel in our state and they have raised many defenses. Most of these have been summarily denied, primarily be-

cause of the Supreme Court’s decision in General Time Corporation v. Talley Industries, Inc., which is cited in the outline. General Time held that once a primary purpose is established, all other purposes are irrelevant. Furthermore, the Delaware Supreme Court determined in General Time that in discovery the plaintiff’s attorney can instruct the witness not to answer questions about any purpose other than the stated purpose.

Therefore, our courts have found the following allegations to be irrelevant: that a shareholder should not be permitted to get the list because he holds his stock in violation of the Federal Aviation Act; that the stockholder will get the list, win a proxy fight and commit corporate waste; that the shareholder will violate the Federal Securities Laws, the Investment Company Act, the Anti-Trust Laws, or even the Delaware Insurance Law. All of these matters are irrelevant. If the plaintiff is a record stockholder and has a proper primary purpose, that is the end of the matter.

What is the scope of production in a stock list case? First, the stockholder is not limited to his own class. A common stockholder can get both the common stock list as well as the preferred list. That was the ruling in the Western Pacific case.

Second, in Magill v. North American Refractories Co. the corporation attempted to supply a shareholder only with a list of several thousand names. The Court found that this was insufficient and required production of names, addresses and number of shares.

In addition, a stockholder is entitled to an updated, periodic list. He can even obtain the weekly transfer sheets up to a relevant date, such as the annual meeting date. The aforesaid was decided in an unreported decision which is cited in your outline, Cargill Inc. v. Missouri Portland Cement.

22. Id. at 756.
23. Id.
31. 36 Del. Ch. 185, 128 A.2d 233 (Del. 1956).
32. No. 4583 (Del. Ch., Aug. 6, 1974).
Moreover, a stockholder can obtain a beneficial owner list. If in addition to the record owner list the corporation has a list of beneficial owners, it must produce this list for the stockholder pursuant to the Bear, Stearns opinion. On the other hand, if the corporation does not have a beneficial owner list, but has the power to get it, the stockholder may not compel the corporation to get that list. He can only get what the company has. If the corporation subsequently gets it on its own volition, the stockholder is entitled to it also.

Pursuant to section 224 of our law, a corporation may store its list in a computer. It does not have to have a written list. In such a situation the stockholder can obtain a computer run if he agrees to pay the expense of that run.

The next list that we have, under section 219, which is in Appendix B to the outline, is the election list. A corporation is required ten days before any election to display a complete list of stockholders entitled to vote at the meeting arranged in alphabetical order and showing the address and number of shares of each stockholder. This list is to be exhibited ten days prior to the meeting at a place within the city limits where the meeting is to be held, and such place must be specified in the notice of the meeting. If not so specified, the list must be available at the place where the meeting is to be held.

Believe it or not, a dispute arose concerning that language because a meeting notice did not specify where the list was available for inspection in the City of Los Angeles. The corporation had exhibited the list in a building that was across the street from the meeting room. A stockholder complained and a squabble developed. The matter was settled for sufficient cab fare to enable the stockholder to cross the street.

What can a stockholder do if the corporation turns him down? This is governed by the express provisions of the Statute. If the corporation refuses the list or if it takes no action in five business days, a shareholder may bring an action in the Delaware Court of Chancery which will be tried on a summary basis, which means in a matter of weeks, or in a matter of days if necessary.

35. Id. § 219.
36. Id. § 219(a).
While the statute states that the exclusive jurisdiction is in the Delaware Court of Chancery, this is simply because in Delaware we have a split system of jurisprudence. We have the law court, the superior court, and we have the equity court, the court of chancery. The statute provides that actions can be brought only in chancery court, not in superior court. It does not mean that such actions cannot be brought in federal court, either in Delaware or in any other jurisdiction.

The law in this area has developed in a case by case basis, and as might be expected because the proceedings are accelerated, the parties often partake in expedited discovery. Many times the 220 action is part of a series of cases which might include a tender offer case in Delaware as well as federal suits in other jurisdictions and the discovery for all suits will be combined. If discovery is taken in another city, the question has arisen as to what occurs when you are in a deposition room and the witness is instructed not to answer? This has given rise to a situation which I call the “squawk box argument.” Counsel asking the question states that he wants to telephone the judge because there is not sufficient time to make a formal presentation to the court. Then the attorneys will gather around a telephone speaker phone in the deposition room, and call the Chancellor in Delaware. The first argument of any squawk box argument is whether the court is going to allow the squawk box argument. The Chancellors usually do, although they do not care much for such proceedings.

Moreover, the situation can get out of hand. In a recent action we were taking depositions in New York City during evening hours. At around 8:00 o'clock p.m. I instructed my witness not to answer a question. Counsel for the other side jumped up and said I was unreasonable and so forth, and that he wanted to talk to the court right away. I said, “The court is closed.” He said, “Well, I'll call him at home.” I said, “I oppose.” He said, “Well, I'm going to call anyway.”

The attorney then called the Vice Chancellor on the squawk box. As luck would have it, the Vice Chancellor was not at home, but his wife was there. She said, “The Vice Chancellor is out fishing and I don't know what time he's going to be home.” But that didn't stop my opponent. He said, “Please, Madam, this is very important. A very important issue has arisen. Please have him call us at this office in New York City. Here's the number, and we're all set to go.”

She said, “He may not be back for a while,” and he said, “Well, look, please tell him that this is the issue,” and he told her what the

39. Id.
issue was. Now, that didn't stop him. He said, "As long as you are going to tell him what the issue is, please tell him, it's really a simple matter, and these are my arguments." And he gave her his arguments.

He then said to her, "Madam this is not fair. I shouldn't just give you my arguments. These are Mr. Goldman's arguments." And so he gave her what he said were my arguments. Now as any good trial lawyer knows, those were not my arguments, so I had to give her my arguments, and I did.

My opponent still wasn't satisfied. So he summed up and he asked the wife of the Vice Chancellor to rule on the matter, which she did not. However, to this day she is known to the members of the Delaware Bar as "the Vice Chancelloress."

Next I would like to cover the law with regard to the production of books and records. The books and records situation differs from the stock list situation. In a stock list case the corporation has the burden to demonstrate that the purpose of the stockholder is improper. In a books and records hearing, the burden is upon the stockholder to establish his purpose. This is very significant, and was overlooked in a recent decision in which a corporate stockholder plaintiff sought books and records to value its stock interest in the defendant corporation. The only witness produced at trial in the Maurlee Modular case was the accountant. The accountant testified that he needed to look at this book and that book in order to determine the value of the stock. However, he was not able to testify from first hand information as to what the purpose was. The case was dismissed.

Evaluation of corporate stock is a proper purpose to examine the books and records. However, the stockholder must establish that he has no other means of valuation. If the company is a listed company, then he cannot obtain the books to value his stock. He must demonstrate that the stock has no market value. Furthermore, even if he does that, the corporation can defend on the ground it has already given the stockholder sufficient financial information to value the stock. The courts will not permit a shareholder to inspect every financial record in the company in order to value his securities.

40. Id.
41. Id.
42. No. 4488 (Del. Ch., April 16, 1975).
Another proper purpose is the investigation of an improper transaction.\textsuperscript{47} The Courts have held, and the cases are cited in the article in Appendix C of the outline, that a shareholder cannot conduct a fishing expedition.\textsuperscript{48} Stockholders must list specific transactions that they want to investigate. For example, in the Nodana case\textsuperscript{49} a stockholder filed a demand under oath that he wanted to investigate improper transactions in general. The Court held that this was improper. Subsequently, he wrote a letter stating three specific transactions that he was interested in. The Court found that this cured the demand, and allowed the inspection.

Investigation of executive compensation is a very pertinent issue today. Stockholders may examine the books for this purpose.\textsuperscript{50} They must show several matters. They must establish that the published material is insufficient, and secondly, they must demonstrate that there is some reasonable basis to question the compensation of the executives. Examples of such would be a showing that executives have been paid high salaries and bonuses at a time when the corporation is losing money, or that the corporation has maintained an unnecessary staff during a time of liquidation.\textsuperscript{51}

Other cases have held that it is proper to inspect the books to examine the representations of management in selling stock and to aid in the prosecution or evaluation of another legal action, even in another jurisdiction.\textsuperscript{52} Delaware pioneered this area as early as 1885.\textsuperscript{53} At that time, of course, the discovery processes were very conservative, and therefore one of the few available means of examining the books was a 220 action. Subsequently, however, with the advent of modern discovery, our courts have indicated that if the court in the other jurisdiction can provide full and complete discovery, the Delaware Court of Chancery probably will not allow production in a 220 action.\textsuperscript{54}

However, in the Sack v. Cadence case,\textsuperscript{55} the shareholders of a Delaware corporation were invited to a New York derivative suit hearing to present evidence as to a proposed settlement. A stockholder

\textsuperscript{47} Nodana Petroleum Corp. v. State ex rel. Brennan, 50 Del. 76, 123 A.2d 243 (1956).
\textsuperscript{48} Business Capital Corp. v. Interphoto Corp., No. 3616 (Del. Ch., June 3, 1971).
\textsuperscript{49} 50 Del. 76, 123 A.2d 243 (1956).
\textsuperscript{51} Id.
\textsuperscript{52} Id.
\textsuperscript{53} State ex rel. Richardson v. Swift, 12 Del. (7 Houst.) 137, 30 A. 781 (Super. Ct. 1885).
\textsuperscript{55} No. 4747 (Del. Ch., Feb. 28, 1975).
attempted to intervene in the New York action to obtain discovery in order to present evidence at the settlement hearing. He was not allowed to intervene. Subsequently, he filed suit in the Court of Chancery and asked to examine the books and records in order to value the New York settlement. This production was permitted by the Court.

What are improper purposes preventing the inspection of books and records? In addition to the ones already mentioned, with regard to production of the stock list, the cases have held that if you are a competitor you cannot buy stock in another corporation and acquire facts that would aid you in competing with the corporate defendant. However, even if the stockholder is in the same type of business as the corporation, our courts will allow production of the books where (1) the stockholder is not in direct competition, and (2) the plaintiff has shown genuine concern as a shareholder of the defendant. Thus the courts have held that the very fact that a stockholder was in the same field of business as the corporation particularly imbued it with the qualifications to question the propriety of the activities of the corporation.

What is the scope of production of books and records? Early decisions are not helpful. They simply required production of "all books necessary to accomplish the particular purpose." Recent cases, which are cited in the outline, hold that the order will be tailored to fit the facts of the particular case. For example, in the Business Capital decision, a stockholder wanted to value its security interest and to investigate a takeover. Purpose one was denied because the defendant was a listed company. Purpose two, the takeover, was approved. The plaintiff was permitted to examine contractual agreements, the corporate minutes, and supporting papers which specifically related to the takeover.

In addition, where a stockholder alleges many improper transactions, and there is a likelihood of general corporate mismanagement, the stockholder will not be limited to the specific transactions cited, but will be permitted to examine the financial records in general.

This brings me to the final point of subsidiary books. I believe that it was in 1912 that the Martin case was decided. In that case the corporation had seven subsidiaries. The same individual was

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59. Skoglund, 372 A.2d 204.
president of all the companies. The eight corporations had common bank accounts, common officers and common directors. The Chancellor ruled that the seven subsidiaries were alter egos of the parent. Therefore, a stockholder in the parent could examine the books of the subsidiaries as well.

Several years later, inspection was denied in the case of a 94% Oklahoma subsidiary. The parent never voted its 94% interest. In addition, there were no common officers and no common directors. Therefore the Delaware corporation was not in a position to be able to produce the books of its subsidiary.61

This was followed by the Sack case 62 in which the plaintiff asserted improper perquisites and executive compensation in the main company and thirty-one subsidiaries. The Court required production of the records of all thirty-two companies.

Finally, last year, the Skouras case 63 was determined. I would suggest to you that it's a very unusual case and should be limited to its facts. In that case the Court held that in order to look at the subsidiary's books the plaintiff would have to show either fraud or an alter ego situation. However, the Court also specifically cited harassment as well as the fact that the plaintiff was a former director and could have looked at the books while he was a director, but did not. Therefore, I feel that in situations where wrong-doing is alleged to have occurred in a wholly-owned Delaware subsidiary, a stockholder should and will be permitted to examine the books of the subsidiary.