

Nature Of The Rights Of Stockholders To Examine The Books Of The Corporation

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THE current dispute over the Jai-Alai corporation has focused attention upon the rights of stockholders to examine the books of the corporation. Mariano Corpus, owner of five shares worth P35.00, went to the office of the corporation to examine the corporate books. The secretary refused to allow him to inspect the books of the corporation, because Corpus did not accede to the condition imposed upon him, that he would not use the data he might obtain for publicity purposes or for purposes which might prove detrimental to the corporation. Corpus, therefore, brought an action for mandamus against the corporation and its secretary, to compel them to produce the books of the corporation and let him examine the said books, without any limitations. In defense, the corporation cited Section 2, Article VII of its by-laws which reads as follows:

"Complete books of accounts of the business of the corporation shall be kept at its principal office in the City of Manila and such other place as the board of directors shall prescribe. The board of directors may determine from time to time—whether, and if allowed, when under what conditions and regulations the books and records of the corporation, or any of them shall be open to the inspection of stockholders in this respect are and shall be limited accordingly, except as otherwise

provided by statute. *Under no circumstances shall any stockholder have the right to inspect any books or records or receive any statement for an illegal and improper purpose.*" (Italics ours)

Our discussion here is confined to the last sentence of Section 2, Article VII of the by-laws of the Jai-Alai corporation. Does this condition imposed by the by-laws violate any provision of our Corporation Law? Sections 51 and 52 of our Corporation Law (Act No. 1459) provides:

"The record of all business transactions of the corporation and the minutes of any meeting shall be open to the inspection of any director, member or stockholder of the corporation at reasonable hours"; and that

"The stock and transfer books shall be open to the inspection of any director, stockholder or member of the corporation at reasonable hours."

A corporation has the power under Section 13, par. 7 of our Corporation Law to make by-laws not inconsistent with any existing law, for the fixing or changing of the number of its officers and directors within the limits prescribed by law, and for the transferring of its stocks, the administration of its corporate affairs, the management of its business, and the care, control and disposition of its property.

One of the limitations imposed by the Corporation Law is that

the by-laws must not be inconsistent with any existing law. The by-laws of a corporation must be reasonable and for a corporate purpose, and must always be within the charter limits. They must be strictly subordinate to the Constitution and the general laws of the land. They must not infringe the policy of the state, nor be hostile to the public welfare. (*Fleischer v. Botica Nolasco Co.*, 47 Phil. 590).

The by-laws of the Jai-Alai corporation refer only to stockholders, and does not include directors. This is so, because directors of a corporation have an unqualified right to have access to the books of the corporation. The duties of his position requires him to be familiar with the affairs of the company. Inspection by a stockholder is primarily for the purpose of protecting his individual interests. Inspection by a director is with a view to enable him to perform his duties intelligently. (*Ballantine's Manual of Corporation Law and Practice* p. 549)

The right of stockholders to inspect the books of the corporation rests upon the fact of ownership. The books and property of the corporation really belong to the stockholders and this reality cannot be overthrown by the fiction of law that a corporation is an artificial person or an entity apart from its members. Those in charge of the corporation are merely the agents of the stockholders, who are the real owners of the property. (*Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Ohio St. 189-201, 48 L.R.A. 732).

Our Supreme Court in the case of *Pardo vs. Ferrer* (47 Phil. 964) stated that under our law the only limitation to the right

of stockholders to inspect corporate books, is that it must be exercised at reasonable hours. This means at reasonable hours on business days throughout the year and not merely during some arbitrary period of a few days chosen by the board of directors.

Examining the provision of the by-laws of the Jai-Alai corporation, we see, that if the purpose of the stockholder in inspecting the corporate books is for an illegal and improper purpose, he will not be permitted to have access to its books. Is it necessary that before a stockholder can have access to the books, he must state its purpose to the corporation? This seems to be the logical thing to be implied from such provision, in order that the corporation may know the nature of the inspection to be made by the stockholders.

Does our Corporation Law require that the stockholder must reveal his purpose before inspecting the books of the corporation? It is submitted that it does not. In an *obiter dictum* in the case of *Pardo v. Ferrer*, our Supreme Court stated, that "generally speaking, the motive of the shareholder exercising the right is immaterial," citing *Ruling Case Law*, Vol. 7, p. 327.

In the United States, most of the decisions of the state courts maintain that the right of stockholders to examine and inspect corporate books is an absolute and not a conditional one; and courts will not inquire into the motives of the stockholders who demand the inspection. (*State ex rel. Dempsey vs. Werra Aluminum Foundry Co. et al.*, 173 Wis. 651, 22 A. L. R. 1.)

Our Corporation Law only provides that the right must be exercised at reasonable hours and no other. It grants to stockhold-

ers an absolute right to examine the books of the corporation, to enable the stockholders to know whether those in charge of the concern are doing their duties properly or not. To require every stockholder demanding inspection of the corporate books to state his motive and purpose would defeat the object intended by our Corporation Law. So long as in demanding inspection he is prompted by an honest purpose, the corporation cannot refuse to let him examine its corporate books.

Of course, the right may be limited by statute, but the rights of stockholders to inspect the books of the corporation may not altogether be denied them. Where the right is not limited by statute, the corporation cannot in its by-laws deny such right to its stockholders. The corporation may, however, make reasonable regulations as to the time and manner of inspection of its books by its stockholders, but it cannot make a by-law which denies or unreasonably obstructs the rights. (*Klotz v. Pan American Match Co.*, 221 Mass. 38, 108 N. E. 764; *Pardo v. Ferrer*, 47 Phil. 964.)

The remaining problem to be solved is, whether admitting that the motive of the stockholder cannot be inquired into, can a shareholder always enforce his right of inspection, even if the exercise of such right would result in serious consequences to the corporation? The by-laws of the *Jai-Alai* corporation expressly provides, that under no circumstances shall any stockholder have the right to inspect any books or receive any statement for an illegal and improper purpose. What purposes would be considered illegal and improper under its by-laws to justify the corporation to

refuse inspection of its books? Our Corporation Law does not define or provide what purposes on the part of the stockholder could make the corporation justified in refusing inspection. As was stated, the only limitation to the right of inspection is, that it must be exercised at reasonable hours. However, it could not have been intended by the legislature that the right of stockholders to demand inspection can be exercised unrestrainedly. Even a legitimate right is susceptible of being abused to such an extent that the intervention of the court is necessary for the protection of the parties concerned.

In the case of *Pardo v. Ferrer*, our Supreme Court stated that there are some matters—which a corporation may undoubtedly keep secret, notwithstanding the right of inspection given by the law to the stockholders; as for example, where a corporation engaged in the business of manufacture, has acquired a formula or process not generally known, which has proved of utility in the manufacture of its products.

From this decision it can be inferred that, although the right of inspection be absolute, there are still instances where the corporation may refuse to grant inspection.

Due to lack of Philippine judicial decisions on this point, we have to refer to decisions of state courts of the American Union where our Corporation Law was derived, for the solution of this question.

The weight of authority in the United States is that the stockholder is not entitled to an inspection, unless he seeks to learn something which he has a right to know for his protection and his application must be in good

faith and not for the purpose of injuring or annoying the corporation. (*People v. Consolidated National Bank*, 94 N. Y. Supp. 173.)

Among the lawful purposes are: (1) To ascertain the financial condition of the company; (2) or propriety of dividends; (3) or the value of the stocks; (4) or whether there has been mismanagement; (5) in anticipation of corporate meetings where important matters will be voted on; (6) in aid of a litigation with the corporation; (7) or with its officers; or to enable the plaintiff to consult with his fellow stockholders and obtain proxies to be used to an approaching election. (*Otis-Hidden Co. v. Scheirich*, 219 S. W. 191).

Refusal is proper if inspection is made for mere idle curiosity, or to fish out a defense (*Guthrie v. Harkness*, 199 U. S. 148); or to harass the corporation (*Commonwealth v. Empire*, 19 Atl. 609); or to furnish materials for a new trial of a case against the corporation (*Pratt v. Goswell*, 37 N. Y. Supp. 669); or for the purpose of establishing justification in an action against the petitioner for libel in charging the company with insolvency (*Opdyke v. Marble*, 44 N. Y. Supp. 64); or for purely speculative purposes (*State v. Pan American Co.*, 61 Atl. 398); or with the end of aiding the stockholder in his suit against the directors of the corporation for publication of false reports which induce him to purchase stocks (*Taylor v. Citizen's National Bank*, 101 N. Y. Supp. 1039); or to obtain papers concerning improper loans made by the corporation in order that proof may be used to hold the director personally liable (*People v. Products Exchange*; 65 N. Y. Supp.

926). A perusal of statutes granting in absolute terms the right of inspection, puts many writers in doubt as to whether the statute so providing take away the discretion of the court on the matter of allowing compulsory inspection; or whether upon application to the court, there is some discretion left to be exercised by the court on the case.

It is submitted that, notwithstanding the fact that the terms of a statute are absolute, courts have the power to refuse inspection to protect the interest of the corporation from a possible abuse. As has been said, in the case of *People v. American Union Life Insurance Co.*: "It would not be a wise exercise of judicial discretion to compel the company to allow the relator, who is inimical to its management, to make an unlimited inquisitorial research into the company's transactions and affairs, with leave to him and his assistants to copy all of its books and papers and make such uses thereof as he pleases particularly as he has been defeated in his action founded substantially on the same alleged grievance as is now presented."

It will be committing an act of injustice to those concerned, who may well expect protection from the court, if the court were to grant the writ, notwithstanding a clear showing that the issuance of the writ will work an incalculable injury. A stockholder who demands a right will be allowed to the extent only of not harming the rights of others, and both the claimant and the corporation may with equal force, demand protection to their respective interests in the enterprise. In the face of such "seeming conflict of interests" only the court of justice will be in a position to arbitrate.