THE STOCKHOLDER'S RIGHT OF INSPECTION — ITS SIGNIFICANCE, EXTENT AND LIMITATIONS *

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Historically, big corporations in this country have been the business conduits either of foreign-based companies or of wealthy families and other closely-knit groups. In the last twenty years or so, however, businessmen have gradually become more aware of the advantages of the corporate structure and this has now become the most popular form of business organization today. As of November 25, 1977, there were 76,784 corporations registered with the Securities and Exchange Commission compared to only 13,414 in 1957,[1] almost a 600% increase in a period of only 10 years. Although we would venture to say that a majority of these are owned and controlled by small groups of persons bound together by blood ties or by long and close relationships in business, there has in recent years been a noticeable increase in the number of corporations in which the public has been allowed or even encouraged to participate. Public participation, however, has been limited to, and for a long time will probably remain, a minority, in so far as participation in management is concerned. And since these participants from outside the controlling group act independently of each other when they invest in the corporation, they would normally lack the unity necessary to form an effective block to check possible management abuses, although their total investment may in fact be greater than those in management.

On the other hand, the fact that a corporation is a close one does not guaranty complete harmony among stockholders. Disagreement among family members or close business associates within a corporation is not rare, and even in such a group the existence of a majority and a minority block is not unheard of.

Thus, whether in a close corporation or in a widely held one, the existence of a dissatisfied or suspicious minority is always a possibility

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[1] Information obtained from the Investments Research & Statistics Department, Securities & Exchange Commission (SEC).

which those in management will have to face. On the other hand, a minority stockholder, whether acting individually or as part of or representing a group, has to have the means to protect his investment against possible abuses or even mere negligence on the part of management. For after all, he is in fact one of the beneficial owners of the business, and management owes him the duty not only of exercising due diligence but also of acting honestly and in good faith in the running of corporate affairs. Obtaining accurate information as to whether management is living up to these responsibilities would thus be a natural desire of any concerned stockholder.

Some of the vital information he may be interested in would be available in the files of the SEC. The SEC requires all corporations to prepare at the end of each fiscal year a balance sheet and a related profit and loss statement, duly certified by a Certified Public Accountant.[2] These are filed with the SEC and are open to public inspection during reasonable hours on any business day, subject to certain specified terms and conditions.[3] Although not legally required to do so, most widely held corporations furnish their stockholders with a copy of such statements. In addition, every corporation must file with the SEC an information sheet containing the names of its elected directors and officers, as well as its capital structure.[4] Furthermore, corporations listed on the stock exchange must file with the SEC important minutes of meetings relating to change in capital structure, and documents evidencing management contracts and changes in control and ownership.[5]

The papers and records covered by these SEC requirement however may not yield the particular information which a stockholder seeks, but he may find this only in the books and records which the law and the SEC require all corporations to keep. The right to examine such corporate records is therefore significant, specially to a minority stockholder. This right is preventive as well as remedial. Preventive, because it may to a limited extent serve as deterrent to an ill-intentioned management to know that its acts may be scrutinized by "outsiders"; and remedial, because a dissatisfied stockholder may resort to the right of inspection as a preliminary step to seeking more direct remedies against abuses committed by management. It may for example be essential as a basis for a derivative suit to redress wrongs done to the corporation. Although the right of inspection may be greatly diluted by the time and expense involved in the examination

[2] SEC Rule approved March 26, 1958.
[3] SEC Rule approved May 5, 1970.
[4] SEC Rule approved March 17, 1971.
[5] SEC Rule approved August 6, 1973.

of books and records of a substantial corporation, specially where court action becomes necessary due to management's refusal to permit the inspection, its possible remedial effect cannot be ignored.

The recognition of the right of inspection is of common-law origin,[6] and is based on the stockholders' equity ownership of the corporate assets and their corresponding right as such owners to receive reliable information concerning the financial condition of the corporation and the conduct of its business affairs.[7] But since all corporate records would normally be in the physical possession of the corporation, through its incumbent officers, who may face possible removal because of information gathered from such records, enforcing the right of inspection may not in many instances, be a simple matter.

The Corporation Law recognizes this right of the stockholder in sections 51 and 52:

> Sec. 51. All business corporations shall keep and carefully preserve a record of all business transactions, and a minute of all meetings of directors, members, or stockholders, in which shall be set forth in detail the time and places of holding the meetings, how authorized, the notice given, whether the meeting was regular or special, if special, its object, those present and absent, and every act done or ordered done at the meeting. On the demand of any director, member or stockholder, the time when any director, member, or stockholder entered or left the meeting must be noted in the minutes, and on a similar demand, the yeas and nays must be taken on any motion or proposition and a record thereof carefully made. The protest of any director, member, or stockholder on any action or proposed action must be recorded in full on his demand.
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> 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."
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> Sec. 52. Business corporations must also keep a book to be known as the 'stock and transfer book' in which must be kept a record of all stock, the names of the stockholders or members alphabetically arranged, the installments paid and unpaid on all stock for which subscription has been made, and the date of payment of any installment; a statement of every alienation, sale, or transfer of stock made, the date thereof, and by and to whom made; and such other entries as the by-laws may prescribe. The stock and transfer book shall be kept in the principal office of the corporation and shall be open to the

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[6] The right was first recognized in England but was allowed only when there was a specific dispute. In the US, the right became well-established prior to the beginning of this century. See Grower, *Some Contrasts Between British & American Corporation Law*, 69 HARV. L. REV. 1369-1402, at 1380-81 (1956).

[7] Gutrrie v Harkness, 199 U.S 148, 26 S.Ct. 4, 50 L Ed. 130 (1905).

> inspection of any director, member, or stockholder of the corporation at reasonable hours: . . .

What books and records are covered

Under the aforecited provisions, the following are open for inspection of stockholders, members and directors:

(1) Records of all business transactions;

(2) Minutes of all stockholders' as well as directors' meetings; and

(3) The stock and transfer book.

The term "record of all business transactions" is broad and general and could include all account books like journals, ledgers, balance sheets, profit and loss statements, financial statements, income tax reports, vouchers and receipts of all business transactions, contracts and all papers pertaining to such contracts.[8] From these records, the stockholder can find out how his investment is being used and more importantly, the actual financial condition of the corporation. Thus, he need not blindly accept the figures contained in the financial report given to him by management. As a stockholder he is entitled to know the basis for the amounts set forth therein.[9] Access to a proposed contract, however, has been held as not included within the term corporate records.[10]

The minutes of directors' meetings would inform the stockholder of all policies laid down by the board, possibly including objections of a dissenting director should the latter have demanded that they be recorded. Until the minutes have been approved, however, no stockholder may demand a copy thereof.[11]

The stock and transfer book would yield the names and addresses of all stockholders and the number of shares held by each as well as the transferees thereof, if any transfer has been made. However, unlike in some jurisdictions, the law does not make it a duty of the corporation to furnish a shareholder with a list of the names of the stockholders. The SEC has rendered an opinion that under section 52, a stockholder cannot demand that he be furnished with such list but that he should, instead, directly examine the books of the corporation. Otherwise, the corporation may be put to a great inconvenience especially when there are hundreds of stockholders.[12] Speculations as to what other corporate records are subject to inspection must be guided by the general rule that if the share-

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[8] SEC Opinion rendered on January 27, 1975, SEC Folio, 1960-1976, p. 763.
[9] Martin v. Columbia Pictures Co., 133 N.Y.S. 2d 469 (1953).
[10] Susquehiana Corp. v. General Refractories Co., 250 Fed. Supp. 767 (1966).
[11] Veraguth v. Isabela Sugar Co., 57 Phil. 266 (1932).
[12] SEC Opinion, August 11, 1972, SEC Folio, 1960-1976, p. 550.

holder has a right to the knowledge he seeks, he can have access to whatever corporate records will give the information, provided that the inspection will not result in substantial harm to the corporation.[13] In this connection, it may be mentioned that under the Secrecy of Bank Deposits Act (RA 1405), a stockholder of a banking corporation cannot have access to the records of the depositors, except upon written consent of the depositor, or in cases of impeachment, or upon order of a competent court in cases of bribery or dereliction of duty of public officials, or in cases where the money deposited or invested is the subject matter of litigation.[14]

Clearly then, under the Corporation Law, a stockholder has the means of obtaining information regarding all acts of the corporation as well as of its directors and officers as such. Considering that the records may be voluminous and that a stockholder may find it difficult to interpret them, our Supreme Court has held, citing American cases to support its view, that a stockholder may make copies, extracts, and memoranda of such records,[15] and may exercise his right either personally or through an agent, who may be a lawyer or an accountant.[16] And the corporation cannot insist that the stockholder use a company accountant since this would defeat the purpose of the examination, which is to obtain information of the corporation's affairs through an independent source, by a disinterested, expert accountant.[17]

Limitations on right

1. *Those imposed by by-laws* —

On the other hand, it is not difficult to imagine that the exercise of the right of inspection, if not subjected to some limitations, could prove extremely harrassing to the corporation, thus impairing its efficient operations. This inefficiency would ultimately prejudice the stockholder himself who is seeking to enforce the right. Thus, in the enforcement of the right, a balance must be sought between the interests of the individual stockholder as a beneficial part-owner of the corporate assets, and the interests of the corporation, as the entity responsible for making the business profitable for all the stockholders. Admittedly, therefore, there must be some limitations on the exercise of the right. May the corporate by-laws impose any such limitation? Although a corporation can prescribe rules for its government, this power is not an unlimited one. Among the recognized conditions to the validity of by-laws is that such must be reason-

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[13] OLECK, MODERN CORPORATION LAW, 607 (1960).
[14] See Rep. Act No. 1405 (1955), sec. 2.
[15] Veraguth v. Isabela Sugar Co., *supra*, note 11.
[16] See Philpotts v. Philippine Manufacturing Co. & Barry, 40 Phil. 471 (1919).
[17] Feick, Ex'x v. Hill Bread Co., 103 A. 813 (1918).

able and should not contravene the law.[18] Thus, a corporation may make reasonable regulations as to the time and manner of the inspection of its books by stockholders, but it cannot make a by-law which gives the directors absolute discretion to allow or disallow inspection.[19]

2. *Time and place* —

The Corporation Law expressly lays down at least one limitation, i.e., that it be exercised at reasonable hours. In *Pardo v. Hercules Lumber Co.,*[20] the corporate by-laws provided that: "Every shareholder may examine the books of the company and other documents pertaining to the same upon the days which the board of directors shall annually fix." Pursuant to this by-law, the board of directors passed a resolution to notify the stockholders that the books of the company would be at their disposition for ten days prior to the general meeting for that year. The Supreme Court struck down both the by-law and the resolution as invalid, being an improper restriction on the right of inspection. The Corporation Law declares that the right may be exercised at "reasonable hours", and the Court held this to mean reasonable hours on business days throughout the year, and not merely during some arbitrary period of a few days chosen by the directors. The Court however clearly admitted that corporate officers may possibly lay down some limitations and may deny inspection when sought at unusual hours or under other improper conditions. In *Veraguth v. Isabela Sugar Co.,*[21] the Board of Directors adopted a resolution providing for inspection of the books "by authority of the President of the corporation previously obtained in each case." Although the Supreme Court denied mandamus due to other grounds, it did not approve of the resolution since it was contrary to the provision of law which gives the stockholder an unqualified right of inspection at all reasonable hours. On the other hand, it is well-settled that although business hours are reasonable hours, the inspection should be made in such a manner as not to impede the efficient operations of the corporation.[22]

Another limitation laid down by the Corporation Law, although not expressed in as clear terms as the first limitation, is the place of inspection. Section 52 enjoins the corporation to keep its stock and transfer book in the principal office of the corporation. By clear implication therefore, the

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[18] See Sec. 20, Corp. Law.

[19] Klotz v. Pan-American Match Co., 108 N.E. 764 (1915); Commonwealth *ex rel.* Wilde v. Pennsylvania Silk Co., 110 A. 157 (1920); State *ex rel.* Cochran v. Penn-Beaver Oil Co., 143 A. 257 (1926)

[20] 47 Phil. 965 (1924).

[21] *Supra,* note 15.

[22] Duffy v. Mutual Brewing Co., N Y L.J October 3, 1892.

inspection of this book has to take place at such office, and the Supreme Court has held that a stockholder cannot demand that he be allowed to take the corporate books out of such office for the purpose of inspecting the same.[23] Although the law does not make a similar provision in section 51 with respect to records of all business transactions and minutes of all meetings, the broad language of the Supreme Court ruling just cited clearly covers such records.

On the other hand, neither should the corporation keep its stock and transfer book in a place other than the principal office. Thus, the stockholders' right of inspection should not be made difficult by dividing the custody and control of the books between the secretary of the corporation and a transfer agent whose office is outside the corporation's principal office.[24]

3. *Purpose* —

No other limitation, express or implied, can be found in the Corporation Law. In view of such absence, would a stockholder of a Philippine corporation have the right to examine corporate books although his purpose in doing so is to prejudice the interest of the corporation? The significance of this issue is obvious, specially from the viewpoint of the corporation and its officers who may find it greatly inconvenient to grant a demand for inspection, or who refuse to open the books to a stockholder whose purpose or motive may to them seem dubious and inimical to the corporation's interests. Limiting ourselves for the time being to the decisions of our own Supreme Court, we find only three decisions which touched on this particular point. The earliest was the case of *Philpotts v. Philippine Manufacturing Co. & Barry,*[25] a mandamus proceeding to allow the stockholder's agent to examine the corporate books. In granting the writ and upholding the stockholder's contention that the right may be exercised through an agent, the Supreme Court stated that the provision of law granting the right of inspection should be liberally construed, but added as *obiter dicta*:

> In order that the rule above stated may not be taken in too sweeping a sense, we deem it advisable to say that there are some things which a corporation may undoubtedly keep secret, notwithstanding the right of inspection given by law to the stockholder; as, for instance, where a corporation, engaged in the business of manufacture, has acquired a formula or process, not generally known, which has proved of utility to it in the manufacture of its products. It is not our intention to declare that the authorities of the corporation, and more par-

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[23] Veraguth v. Isabela Sugar Co., *supra*, note 11.
[24] Hanrahan v. Puget Sound Power & Light Co., 126 N.E. 2d 499 (1955).
[25] *Supra*, note 16.

> ticularly the Board of Directors, might not adopt measures for the protection of such process from publicity. There is, however, nothing in the petition which would indicate that the petitioner in this case is seeking to discover anything which the corporation is entitled to keep secret; and if anything of the sort is involved in the case it may be brought out at a more advanced stage of the proceedings.

From this statement of the Court, these two conclusions may be drawn: first, that a stockholder may be denied access to information which the corporation is entitled to keep secret, and second, that unless the corporation can show that the stockholder is seeking to discover such kind of information, mandamus will lie to compel the corporation to allow the inspection. As to what information may be kept secret, the Court merely gives one example, i.e., a secret formula or process which has proved useful to the manufacture of the corporation's products. The clear implication, however, is that there may be matters outside a formula or process which may be kept secret in order to protect the interests of the corporation.

The second case is *Pardo v. Hercules Lumber Co.*[26] mentioned earlier, where the respondent corporation questioned the motive of the petitioner and alleged that the information the petitioner sought was to be used for an ulterior purpose, not specified, in connection with a competitive firm with which the petitioner was alleged to be connected. The corporation also argued that the petitioner wanted to obtain evidence as a basis for an action he intended to bring against the corporation. The Supreme Court brushed aside these objections in one sentence: "These suggestions are entirely apart from the issue as, generally speaking, the motive of the shareholder exercising the right is immaterial." In support of this, it merely cited 7 Ruling Case Law, p. 327. Considering that the *Pardo* case was decided later than the *Philpotts* case, and considering further that in the earlier case the court's statement was mere *obiter*, this holding in the case of *Pardo* is definitely more authoritative. Would this mean then that the two decisions are in conflict and that therefore the later case which declares the purpose immaterial should prevail? Or would it be plausible to interpret these two decisions to mean that although the purpose of the stockholder in seeking examination of the corporate books is as a general rule immaterial, he has no right of access to information which the corporation has the right to keep secret? He would, under this interpretation, have access to all other information even if his purpose is inimical to the interests of the corporation. But then, would the corporation not be entitled to keep secret information which, if disclosed to the particular stockholder

[26] *Supra*, note 20

concerned, is intended to be used by the latter to the prejudice of the corporation? If so, then it would seem that under the doctrines of these two cases, the purpose of the stockholder seeking inspection could be material. Furthermore, note that the Supreme Court in stating that the shareholder's motive is immaterial prefaced it with the words "generally speaking," thus implying that there may be exceptions to the rule.

The third case, *Grey v. Insular Lumber Co.*,[27] although it discusses the necessity of a proper purpose, was decided under the New York Law, both statutory and common-law. The parties had stipulated that said law applied to the case because the corporation although licensed to do business in the Philippines, was based in New York. The Court pointed out that under the common law applicable in New York, a stockholder has the right to inspect corporate books and records if it can be shown that he seeks information for an honest purpose, or to protect his interests as stockholder, and that said right must be exercised in good faith, for a specific and honest purpose and not to gratify curiosity, or for speculative or vexatious purposes. Since the plaintiff stockholder had neither alleged nor proved his purpose, the Court denied him the right to inspect.[28] This case merely interprets New York law. The Court's enunciations therein cannot prevail over the first two cases.

Looking beyond our very limited jurisprudence on the matter, let us now inquire into the rule in American law, for after all, our own law is derived therefrom, and it has at least persuasive influence in matters not expressly covered by our statutes. Under the common law, it is well-settled that the stockholder's purpose is material to the exercise of his right and the burden is on him to show the propriety of his purpose.[29] This would in effect mean that when he makes his demand to examine the corporate records, he has to state his purpose. Ultimately, of course, it is the court which will have to determine its propriety, should the corporate officers claim that it is improper. However, in many jurisdictions, the common law right of inspection was later expressly recognized by statute, and in these jurisdictions, the prevailing view is that unless the statute provides otherwise, a proper purpose is presumed and the burden of proving its impropriety is on the corporation.[30] In the absence of such proof, the

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[27] 67 Phil. 139 (1939).

[28] Under Section 73 of the Corporation Law, the law of the country where the corporation was organized governs relations between stockholders and the corporation. Admittedly, the exercise or refusal of the right to inspect corporate books involves the relation between stockholders and the corporation. Thus, New York and not Philippine law, was applicable.

[29] Albee v. Samson & Hubbard Corp., 320 Mass. 2121, 69 N. E. 2d 811 (1946); State *ex rel.* Miller v. Loft Inc., 34 Del. 538, 156 A. 171 (1931).

[30] Mite Corporation v. Heli-Coil Corp., 256 A. 2d 885 (1969); Ralston v. Grande Ronde Hospital, 39 P. 2d 362 (1934).

inspection will be permitted.[31] The basis of this view is that where the statute is silent as to purpose, the right of the stockholder is absolute and he can enforce his right by a mandamus proceeding. However, since the issuance of the writ is discretionary on the court, it should not be granted if the stockholder's purpose is proven to be improper.[32] Since in this jurisdiction the stockholder's right of inspection is statutory and the Corporation Law does not contain any limitation as to purpose, this prevailing view can properly apply. This means that the petitioning stockholder need allege no more than the bare essentials: that he is a stockholder in the respondent company, a proper demand, and a failure or refusal to comply with the duty imposed by law.[33] The vexing question however lies in determining whether the purpose, as stated by the stockholder or as proved by the corporation, is proper or not.

Altthough "proper purpose" is difficult of exact definition, it is usually rather broadly described as a purpose germane to the interests of the stockholder as such and not contrary to the interests of the corporation.

A stockholder may wish to examine all the records of the corporation, or may be interested only in particular books. Many times, his interest may be limited to the stock and transfer book which contains the names and addresses of the stockholders. Access to this list has been upheld for various purposes, as where the plaintiff wishes to communicate with the stockholders about the company's failure to pay dividends,[34] or to enlist their opposition to a proposed merger,[35] or for a proxy solicitation for a slate of directors in opposition to management, even if the ultimate objective is to gain control of the corporation.[36] In all these instances the purpose is reasonably related to a stockholder's interest as such.[37] Where however, the stockholder wants access to the stockholders' names and addresses merely to gratify his curiosity or for speculative use, such as to sell the list for his private profit,[38] or to use in his business,[39] the right has been denied as a purpose unrelated to the petitioner's interest as a stockholder of the corporation.

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[31] Feist v. Joseph Dixon Crucible Co., 103 A. 2d 893 (1954).

[32] See Insuranshares Corp. v. Kirchner, 40 Del. 105, 5 A. 2d 519 (1939).

[33] *Ibid.*

[34] Weber v. Continental Motors Corp., 305 F. Supp. 404 (1969).

[35] Crane v. Westinghouse Air Brake Co., 288 N.Y.S. 2d 984 (1968)

[36] State *ex rel.* G. M. Gustafson Co. v. Crookston Trust Co., 22 N.W 2d 911 (1946).

[37] See Insuranshares Corp. v. Kirchner, *supra*, note 32; Hauser v. York Water Co., 278 Pa. 387, 123 A. 330 (1924); General Time Corp. v. Talley Industries Inc., 240 A. 2d 755 (1968); Feist v. Joseph Dixon Crucible Co., *supra*, note 31; Nationwide Corp. v. Northwestern National Life Insurance Co., 87 N.W. 2d 671 (1958).

[38] See State *ex rel.* Thiele v. Cities Service Co., 115 A. 773 (1922).

[39] Charles A. Day Co. v. Booth, 123 A. 557 (1924).

In *De Rosa v. Terry Steam Turbine Co.*,[40] the petitioners were employees of the corporation who each owned one share of stock, paid for by the employees' union of which they were officers. The company's earnings had been adversely affected by a crippling five-month strike which the petitioners believed was the result of employees' dissatisfaction with the company's policies towards them. A stockholders' meeting was in the offing and the petitioners had requested the company for permission to inspect the list of the shareholders and their addresses so that petitioners could apprise them prior to the meeting "of certain facts relating to labor relations of the company which may result in the stockholders at the annual meeting recommending to management corrective action." The company refused their request on the ground that the purpose stated was not proper, arguing that there was no justification for the petitioners' criticism of management policies and that the management was justified in the position it had taken. In granting the writ of mandamus, the court held that the petitioners' wish to communicate with other shareholders in respect to matters of interest and legitimate concern to them as well as to the company is a proper purpose. In the view of the court, it was immaterial to determine whether plaintiffs' claims were justified. Relief cannot be denied merely because the company's management insists that the plaintiffs are on the wrong side of the issue in respect to the company's labor relations policies. It was not for the court to make any determination in respect to these issues, rather it was for the company's shareholders.[41]

Similarly, a corporate stockholder may have access to the list of stockholders for the purpose of purchasing their shares in the defendant corporation. The fact that such corporate stockholder bought its stocks precisely to be in a position to demand inspection of the stockholders' list does not make its purpose improper,[42] whether the sale is for cash or in exchange for the purchaser's securities.[43] And where the defendant corporation counteracts by buying shares in the plaintiff corporation in order to communicate with the stockholders of the latter in connection with the the plaintiff's offer to purchase defendant's shares, it is acting within its rights. That is a matter both of stockholder and corporate concern, and any stockholder is entitled to take the side he prefers and to seek support from fellow stockholders. It is a purpose which is germane to one's interest as a stockholder.[44]

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[40] 214 A. 2d 684 (1965).
[41] See also Trans World Airlines Inc. v. State, 183 A. 2d 174 (1962).
[42] See NVF Company v. Sharon Steel Corp., 294 F. Supp. 1091 (1969).
[43] *Ibid.*
[44] Mite Corp. v. Heli-Coil Corp., *supra*, note 30

Inspection of other records of the corporation outside of the stockholders' list would be motivated by different purposes. One common object which has been upheld as proper is to ascertain the present value of the stockholders' shares in the corporation.[45] However, although the stockholder alleges such purpose, where the corporation successfully proves that the stockholder's motive is in bad faith, the right will be denied. In *Limiban v. United Brokerage Co.*,[46] the petitioner alleged that he wanted to determine his stocks' value which was otherwise unascertainable. The corporation showed that he had misused funds of a partnership controlled by the corporation and had threatened to harrass the corporation with legal action unless it used its influence in the partnership to stop the proceedings against him. The court believed the corporation's allegation that his sole purpose for seeking examination of the books was to secure information as a basis for annoying and unsupported legal suits. The Court concluded that if the petitioner should carry out his improper threats, it could only be injurious to the defendant's business and the interest of the other stockholders. Although the purported purpose was proper, his motive was tainted with bad faith, thus mandamus was denied.

Neither will mandamus lie where the stockholder has already received all the information he needs to ascertain the value of his stocks. In *State ex rel Miller v. Loft, Inc.*,[47] all the information necessary to determine the value of the stockholder's shares had already been released by the corporation in the form of two financial statements which had been sent to every stockholder, including petitioner. Mandamus was therefore denied since no additional information material to the evaluation of his stock could be obtained from the inspection of the corporate books.

A bona fide claim that a corporation is being mismanaged will support an order for an inspection of corporate books and records even though such inspection may ultimately establish that in fact there was no mismanagement.[48] In *Martin v. Columbia Pictures Co.*,[49] the petitioning stockholder at the commencement of the proceeding owned about $125,000 worth of stocks in defendant corporation. As the proceeding progressed, he acquired more shares until he owned and/or controlled stocks which cost him more than $830,000. He had sought to compel inspection of the corporation's records because he objected to a proposed stock option plan for employees

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[45] See National Bank of Delaware v. Jessup & Moore Paper Co., 88 A. 449 (1913) and State *ex rel.* Brumley v. Jessup & Moore Paper Co., 77 A. 16 (1910).
[46] 29 Del. 570, 101 A. 433 (1917).
[47] 34 Del. 538, 156 A. 170 (1931).
[48] Murchison v. Alleghany Corp., 210 N.Y.S. 2d 153 (1960).
[49] 133 N.Y.S. 2d 469 (1953).

and to certain corporate expenses which he considered excessive. The defendant corporation attacked plaintiff's petition by claiming that plaintiff was not in good faith and that the allegations in his complaint did not actually indicate mismanagement. The Court held however that whether or not such allegations indicate mismanagement or, for that matter, whether Columbia is in fact being mismanaged is not relevant to the issue before it. The Court observed that it was required to concern itself only with questions of whether the petitioner honestly believed the facts to be as set forth in his petition and whether he sought to protect his substantial investment in the corporation. It explained further:

> A stockholder may, in good faith, believe that the profits of a corporation, for some unknown reason, are not properly reflected by its declared dividends or in its published financial statements. While explanations therefor may be adequate and establish fully why the corporate affluence failed to reach its stockholders, such a stockholder, nevertheless, is entitled to know the underlying facts. This information can only be acquired by an examination of the records of the corporation. . . . Thus the mere fact that petitioner has not affirmatively established that the corporation is being mismanaged is insufficient basis for disputing his good faith.

Nor did the court consider as meritorious the claim that petitioner's assertions of mismanagement and inefficiency on the part of management were inconsistent with his continued purchases of Columbia's securities. The Court believed his declaration that he purchased them because of his confidence in the inherent value of the stock and his optimistic view of the future of the motion picture industry. And Columbia's assertion that what petitioner really wanted was to gain control of the corporation, even if true, is not sufficient to constitute bad faith so as to deprive him of the relief sought for.

In another case, the stockholder wanted to examine the corporation's books to ascertain the true financial condition of the company. No dividends had been declared for two years. The stockholder claimed there was an increase not only in the business but also in the income of the corporation, that salaries of officers were excessive, and that the corporation had paid exhorbitant charges to third persons. He sought information as a basis for a derivative suit which he planned to institute against management. The court granted a writ of mandamus to compel the secretary to allow him to inspect the corporate books. [50]

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[50] Rochester v. Indiana County Gas Co., 92 A. 717 (1914).

The fact that the stockholder seeking inspection is a stockholder in a competitor corporation[51] or is on unfriendly terms with its officers[52] has been held as not a justifiable ground to deny access to corporate books, if the purpose for inspection is otherwise proper. Thus, a stockholder is within his rights when his purpose is to familiarize himself with the merits of a proposed corporate transaction so that he can formulate his position and draft and circulate a proxy statement. And since the purpose is proper, the right will not be denied although the plaintiff may have an interest in a competing corporation, unless the defendant can show bad faith.[53]

Gaining control of the corporation being a proper purpose for seeking access to the stock book, the possibility that the petitioner, if successful in obtaining such control, may abuse that control is mere speculation. If such control is won and abused, the minority would anyway have its remedy in the courts.[54] Thus, where the evidence fails to prove that the purpose was to use the information in a manner inimical or detrimental to the accomplishment of the purpose for which the defendant was organized, the fact that the petitioner is a substantial shareholder in two of defendant's competitors will not deprive him of his legal right to inspect the corporate records. The presumption is that the demand is made in good faith and for an honest purpose, to protect and nurture property and for no purpose inimical to the common enterprise.[55]

In *Nationwide Corporation v. Northwestern National Life Insurance Co.*,[56] one of the defenses alleged was that the list of its policyholders was its most valuable asset and constituted a trade secret. Despite this, the court granted mandamus in favor of the defendant's majority stockholder who also owned 99% of the stock in another insurance company. However, the court enjoined the plaintiff from disclosing the names and addresses of the defendant's policyholders to other competing companies in which the plaintiff was interested. Defendant contended that there was no way of enforcing this restriction but the court refused to assume that the plaintiff would use the information to destroy its own large holdings in the defendant company.

But where it is admitted or shown that the motive of the stockholder is clearly inimical to the interests of the defendant corporation and that the information is desired for the purpose of crippling the business of

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[51] E. L. Bruce Company v. State of Delaware, 144 A. 2d 533 (1958).
[52] Veraguth v. Isabela Sugar Co., *supra*, note 11.
[53] Susquehana Corp. v. General Refractories Co., 250 Fed. Supp. 767 (1966).
[54] E. L. Bruce Co. v. State of Delaware, *supra*, note 51.
[55] Mayer v. Cincinnati Economy Drug Co., 103 N.E. 2d 1 (1951).
[56] 87 N.W. 2d 671 (1958).

the corporation for the benefit of a business rival, the right to inspect will be denied.[57] In *Slay v. Polonia Publishing Co.*,[58] the petitioner bought one share of stock in the defendant corporation as a dummy for the controlling stockholder of a competitor corporation. He did not deny that his purpose in seeking inspection was to prejudice the interests of the corporation by using the information to be obtained by him to try to dissuade its advertisers from continuing their patronage of the defendant corporation. The court refused to grant mandamus and dismissed the petition.

A comparatively recent issue that has faced American courts is whether the right of inspection could be used to further a stockholder's social and political beliefs. In *State ex rel. Pillsbury v. Honeywell, Inc.*,[59] the petitioner, who had opposed American involvement in the Vietnam war, was a shareholder in defendant corporation, which was engaged in the production of war materials. He had bought his shares solely to gain a voice in the corporation's affairs. He sought inspection of the stockholders' list for the purpose of soliciting proxies and thereby effectuate a change in the board of directors that would lead to a reduction in the production of war materials. In dismissing the petition for a writ of mandamus, the Supreme Court of Minnesota held that the stockholder was motivated solely by social and political beliefs and not by a concern for the economic well being of the corporation, and could therefore not compel production of the stockholders' list. The court conceded that obtaining information for use in an election of directors is normally a proper purpose and that neither animosity toward management[60] nor a desire to gain control of the corporation in order to improve its economic position would be justifiable reason to deny his right. However, the Court rejected the argument that a mere desire to communicate with other stockholders is *per se* a proper purpose. The court in effect held that it could scrutinize the motive behind the solicitation of proxies and if the motive was not proper, it would deny mandamus. The Court considered that the petitioner did not have a bona fide investment interest relevant to his position as stockholder and therefore did not have a proper purpose.

This last decision seems to run counter to the modern concept that a corporation, just like any citizen or member of the community, has certain social responsibilities. The traditional theory demands that managers

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[57] See State v. St. Cloud Milk Producers Assn., 273 N.W. 603 (1937).
[58] 229 N.W. 434 (1930).
[59] 191 N.W. 2d 406 (1971).
[60] See also Veraguth v. Isabela Sugar C., *supra*, note 11.

operate a business with a view only to profit-seeking, and that they should leave it to the market place to develop moral and social judgments.[61] This theory has been seriously questioned and at least one court has upheld the right of a group of stockholders to present to the other stockholders the question of whether they wish to have their assets used in a manner which they believe to be more socially responsible but possibly less profitable than that which is dictated by present company policy.[62] The court in that case stated:

> We think that there is a clear and compelling distinction between management's legitimate need for freedom to apply expertise in matters of day-to-day judgment, and management's patently illegitimate claim of power to treat modern corporations with their vast resources as personal satrapies implementing personal political or moral predelictions.

Who may exercise right

The Corporation Law states that the right of inspection belongs to every "stockholder, member or director." What does "stockholder" mean — only a stockholder of record or does it include the equitable owner of shares like a voting trust certificate holder? Section 36 of the Corporation Law which recognizes the validity of voting trust agreements, requires that the stocks must be transferred to the voting trustee and that the transfer should be recorded in the books of the corporation. The trustee thus becomes the stockholder of record, and the transferring stockholder merely holds a voting trust certificate. Section 36 also provides in part:

> The trustee or trustees shall possess all voting and other rights pertaining to the shares so transferred and registered in his or their names, subject to the terms and conditions of and for the period specified in said agreement.

Under this provision, it is clear that the voting trustee has all the rights of a stockholder, including the right of inspection unless the voting trust agreement otherwise withholds such right from him. Does this necessarily mean that the transferring stockholder who has ceased to be the stockholder of record and is now merely the holder of a voting trust certificate, can no longer have access to the corporate books? Of course, the voting trust agreement may expressly reserve the right of inspection in favor of the

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[61] See Schwartz, *The Public Interest Proxy Contest: Reflections on Campaign GM*, 69 MICH. L. RECH. 421, 463 (1971).

[62] Medical Committee for Human Rights v. SEC, 432 F. 2d 659 (1970).

voting trust certificate holder. In the absence of such a reservation, however, there is a conflict of opinion as to whether the voting trust certificate holder retains the right of inspection. [63] The case of *Everett v. Asia Banking Corp.* [64] however, is a clear example of why the right should be recognized in favor of a voting trust certificate holder. The stockholders of Teal Motor Co. in that case, at the instance and due to the prodding of Asia Banking, one of its creditors, entered into a voting trust agreement with Asia Banking. They transferred all their stocks to the latter as voting trustee who took over completely the management of the company. All the old directors were replaced by men under the complete control of Asia Banking. Faithful employees of the company were gradually eased out. The voting trustee, without anyone left to check its actions, succeeded in turning over all of Teal Motor Co.'s assets to another company it had organized for the purpose, without the knowledge and to the prejudice of the original stockholders, who were now merely holders of voting trust certificates. The fraud was made possible partly because the voting trust certificate holders were refused access to the corporate records. Had they been able to check the records of the company, they could have prevented or at least minimized the adverse effects of the fraud perpetrated by the voting trustee.

Considering that our law, unlike in some jurisdictions, does not definitely state that the right of inspection belongs only to stockholders of record, it is possible to adopt an interpretation that the word "stockholder" as used in Sections 51 and 52 includes an "equitable stockholder." Otherwise, how could a voting trust certificate holder ascertain whether his beneficial interest in the corporation is properly safeguarded? This should be a reasonable interpretation particularly because of the provision which limits voting trust agreements to only five years. [65] This interpretation finds support in a decision of the Supreme Court of South Dakota where the trustee appointed under a will, and who was not the stockholder of record, was allowed to inspect the books of the corporation. The court refused to uphold the argument of the corporation that the inspection of its books by a non-stockholder constitutes an infringement of its constitutional right of freedom from unreasonable search. It held that although the trustee was not a stockholder of record, yet as equitable owner of one

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[63] See State *ex rel.* Crowder v. Sperry Corp., 15 A. 2d 661 (1940), where mandamus was denied in the absence of showing that the voting trust agreement did not recognize the right of the voting trust certificate holder to inspect the corporate books. For a contrary opinion, see Baezkowska v. Operating Corp., 109 N.E. 2d 470 (1952).

[64] 49 Phil. 512 (1926).

[65] See Sec. 36, CORPORATION LAW.

third of the preferred stock, the books were as much hers as they were the property of any stockholder, and she had an equitable right to examine the same to determine her interest in the corporation. [66]

Whether the stockholder of a parent corporation has the right to examine the books of its subsidiary depends on whether the two corporations have been operated as legally separate and independent entities. If so, the right is denied. [67] However, if the corporations are practically one and the same in so far as management and control are concerned, and the inspection is demanded because of gross mismanagement of the subsidiary by the parent's directors, who are also directors of the subsidiary, then the latter will be treated as a mere agent or instrumentality of the respondent parent corporation, and the latter may be compelled to open the subsidiary's books to its stockholders. [68] Unless the legal fiction of distinct corporate entities is disregarded, the injuries suffered by the parent's stockholders will not be righted.

A majority of American decisions gives the director a more extensive right of inspection than a stockholder, and his right cannot be defeated by showing a hostile purpose. [69] The reason most often given is that a director is under duty to keep himself informed of the company's affairs, and should therefore have an unqualified right to inspect corporate records. [70] Sections 51 and 52 of our Corporation Law however, make no distinction between a director and a stockholder, as far as the right of inspection is concerned. In the absence of any such distinction, would the limitations applicable to the stockholder's right operate similarly on a director? As far as the limitations on time and place of inspection are concerned, they would because these are expressly laid down by the law. But would the requirement of proper purpose also apply considering that it is not imposed by statute but by the courts? In other words, if a director's motive in inspecting the corporate books is shown to be prejudicial to the corporation, should his duty and right to keep himself informed of corporate affairs override the overall interests of the corporation? A director's right of inspection is admittedly more extensive than that of a mere stockholder. For example, a stockholder may be refused inspection if his purpose is merely to gratify his idle curiosity because this could lead to undue inconvenience and strain to the efficient operations of the corporation. A director's mere

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[66] See McNeary v. Brown, 122 N.W. 605 (1909).
[67] State *ex rel.* Rogers v. Sherman Oil Co., 117 A. 122 (1922).
[68] Martin v. Martin, 88 A. 612 (1913).
[69] Machen v. Machen & Mayer Electrical Manufacturing Co., 85 A. 100 (1912); State *ex rel.* Aultman v. Ice, 84 S.E. 181 (1915).
[70] *Ibid.*

curiosity however, is sufficient basis to demand inspection because it is his duty to be curious and his curiosity cannot be labelled as "idle". However, to say that a director's right of inspection is more extensive than that of a stockholder is not the same as to state that the director's right is absolute and unqualified as to motive. If it is clearly shown that his motive is to destroy the corporation, no court should give him the license to do so under the guise of his duty to keep himself informed of corporate affairs. At the very least, such ulterior motive would be completely inconsistent with his fiduciary duties as a director.[71] It would perhaps be safe to conjecture however, that the when the petitioner is a director, the court, under normal circumstances, will require much stronger evidence to rebut the presumption of propriety of purpose than when the petitioner is a mere stockholder.

Statutes in some jurisdictions give the right of inspection only to those who own a prescribed minimum percentage of shares and/or to a stockholder who has been owner of the stocks for at least a prescribed minimum period.[72] These limitations are not found in the Corporation Law. The proposed Corporation Code treats holders of more than 5% of the stocks and one who has been a stockholder for more than three months differently from other stockholders. In such cases, the stockholder is presumed to have a legitimate purpose for seeking inspection. If he owns less than 5% and has not been a stockholder for at least three months, he must seek judicial relief and prove that his purpose is legitimate.[73] This proposed provision obviously tries to balance the interests of an individual stockholder with those of the corporation as a whole and raises presumptions accordingly.

Remedies of stockholder.

The existence of a right would be useless if the exercise thereof cannot be enforced effectively. Statutes in some jurisdictions impose on corporations and their officers who wilfully refuse to comply with the stockholder's statutory right to inspect a penalty of 10% of the value of the shares of the demanding stockholder.[74] Such a remedy however is not available under our Corporation Law. In this jurisdiction, as in most other jurisdictions, the proper remedy available for the enforcement of the right

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[71] State *ex rel.* Paschall v. Scott, 241 P. 2d 543 (1952).

[72] NY law, cited in Grey v. Insular Lumber Co., *supra*, note 27, requires ownership of 3% of shares. Louisiana law requires 2% ownership and 6 months as stockholder of record.

[73] See Sections 104 & 108 of Proposed Corporation Code.

[74] See for example, Sec. 52, U.S. Model Business Corp. Act. Among the jurisdictions whose statute contains such a penalty clause are Alabama, Alaska, Colorado, Mississippi, Illinois, Nebraska, Vermont, Washington, Utah and Wyoming.

of inspection is undoubtedly mandamus.[75] However, under the Rules of Court, the writ will be granted only if the court is satisfied that justice so requires.[76] In issuing the writ the court should exercise its sound discretion and grant the right under proper safeguards to protect the interests of all concerned.[77] Thus, as we have earlier noted, mandamus should not issue where it is shown that the petitioner's purpose is improper and inimical to the interests of the corporation. The writ should not be used to require defendant to perform an act which of itself is legal, if the ultimate object of the plaintiff in seeking the writ is the accomplishment of an illegal act.[78]

Where mandamus is proper under the circumstances, the writ should be directed against the corporation,[79] but the secretary thereof may be joined as party defendant since he is customarily charged with the custody of all corporate records, and is presumably the person against whom the orders of the court would be made effective in case mandamus is granted. And even the President may be made a respondent if necessary to the effectuation of the order of the court.[80]

Where mandamus is inadequate to prevent injustice to the plaintiff, injunction may give the desired relief. In one case, a stockholder's meeting had been called by management to discuss a particular transaction. The plaintiff, a minority stockholder, wanted to warn the other stockholders about such transaction before the meeting. He demanded to see the stockholders' list so that he could communicate with them, but was refused. Since the date of the meeting was fast approaching, he sought relief from the court. Injunction was granted enjoining the holding of the meeting until the plaintiff could have reasonable time to contact the stockholders and give them the information which will enable them to evaluate the wisdom of the proposed act or transaction.[81]

Aside from mandamus and injunction, the Civil Code makes it possible for the stockholder who has been wrongfully refused access to corporate records to bring an action for damages.[82] Although no actual damages are

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[75] See Sec. 3, Rule 65, RULES OF COURT; See also Philpotts v. Phil. Manufacturing Co., *supra*, note 16.

[76] RULES OF COURT, Rule 65, Sec. 8.

[77] Guthrie v. Harkness, *supra*, note 7.

[78] Nationwide Corp. v. Northwestern National Life Ins. Co., *supra*, note 37

[79] See RULES OF COURT, Rule 65, Sec. 3.

[80] Philpotts v. Phil. Manuf. Co., *supra*, note 16.

[81] See also Bourdette v. Seward, 31 S. 630 (1902).

[82] See CIVIL CODE, Articles 2195-2235.

proven, the stockholder would be entitled to least nominal damages.[83] Against whom may he recover damages, from the corporation or from the officer who refused his rightful demand? In *Legendre et al v. New Orleans Brewing Association,*[84] the plaintiff sought inspection of the corporate books but the secretary refused. Subsequently, the value of the stocks depreciated from $131 to $115 per share. Plaintiff claimed that if they had been allowed to inspect the books, they would have found out the financial status of the corporation and that it was being mismanaged. Had they known this, they would have sold their shares before they had depreciated in value. An action for damages was brought against the corporation instead of the secretary. Although the Court admitted that corporate officers who prevent the lawful exercise of the right of inspection may be liable for damages, it held that the corporation itself could not be liable in this case. An error of an officer in a subordinate position in refusing to permit inspection of books is not *per se* such an error as will expose the company to the payment of damages. A corporation is not responsible for the unlawful act of its officers, unless it was expressly authorized or the act was adopted or ratified by the corporation. The defendant company was not placed in default by an informal request made of the secretary, whose act is not absolutely binding upon the corporation even in the matter of inspection of books.[85]

Conclusion

In view of the well-recognized rule that a stockholder may be denied inspection of corporate records if his purpose is shown to be improper, it would not be surprising if many corporations, specially widely-held ones, should make it a policy to uniformly deny demands for inspection until a court order is obtained. Even if the court should subsequently compel inspection, at the very least, the corporation will have succeeded in delaying it. And in many cases, even mere delay in the exercise of the right renders such right of little value. More significantly, the expense and time involved in judicial proceedings will definitely discourage many stockholders from enforcing their right, although their purposes in seeking inspection may in fact be proper and honest. This would particularly be true of stockholders whose holdings are not too substantial. This reluctance of the minority to seek judicial relief may in turn embolden a dishonest management in continuing its fraudulent practices.

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[83] CIVIL CODE, Art. 2221. See also Nationwide Corp. v. Northwestern National Life Ins. Co., *supra*, note 37.

[84] 12 S. 837 (1893).

[85] See Susquehana Corp. v. General Refractories Co., *supra*, note 53; see also Campbell v. Leow's, Inc., 134 A. 2d 852 (1957).

Thus, despite the apparently liberal provisions of sections 51 and 52, perhaps some changes should be introduced in our statute aimed, on the one hand, at deterring corporations from refusing any and all demands for inspection, and on the other, discouraging demands in bad faith.

As noted earlier, statutes in some jurisdictions impose a penalty of 10% of the value of the stocks of the shareholder on the officer or corporation improperly denying inspection. This penalty clause however, many times defeats its purpose because a corporate officer who is faced with an inspection demand from a large shareholder with questionable purposes, may choose to grant the demand rather than expose himself to heavy personal liability On the other hand, it does not encourage the small shareholder because the cost of judicial proceedings may be entirely disproportional to 10% of his holdings.

A summary proceeding would greatly reduce costs and will thus encourage dissatisfied stockholders to seek relief. At the same time, it will give management a reasonable opportunity to voice its objections. Under Presidential Decree No. 902-A granting exclusive jurisdiction to the SEC over intracorporate matters, such a summary proceeding can easily be adopted and justified.

To discourage a corporation from adopting a policy of uniform denial of inspection demands, reasonable attorney's fees should be granted as of right to a successful plaintiff-stockholder, although the corporation's refusal to allow inspection may have been in good faith. This will deter the corporation from dilatory tactics, without imposing too heavy a liability as to unduly coerce management to permit questionable inspections. On the other hand, it will encourage honest demands by a small-stockholder as his right to damages will not be measured by his holdings, unlike the 10% penalty clause found in some statutes. Should the refusal of a corporate officer be found to be in good faith, although the right to inspect is granted because it is in fact proper, such officer may be sufficiently protected by a provision requiring the corporation to indemnify him if he has been made to answer to the complaining stockholder for reasonable attorney's fees.

Finally, to protect a corporation from unfair competition, provisions may be included in its by-laws designed to prevent information obtained by an inspecting shareholder from being used to the detriment of the corporation. For example, a provision may be inserted to the effect that a shareholder shall not have the right to examine or receive information on patents, inventions, formulas, processes and the like. In addition, the by-laws may set up as a condition to the inspection an undertaking by the stockholder to indemnify the corporation for losses suffered from improper

disclosure of information obtained in the course of inspection. Although liability may possibly be imposed even without such a clause, such an express provision in the by-laws can have a psychologically deterrent effect on an ill-intentioned stockholder. On the other hand, a stockholder with an honest purpose will in all probabilities be more willing to agree to such an undertaking than to incur the delay, not to mention the costs, of a judicial proceeding.

With these recommended safeguards, a minority stockholder would have in his right of inspection an effective and reliable measure of protection against abuses of management, without at the same time exposing an honestly and efficiently managed corporation to undue inconvenience and harrassment