Shareholder Inspection Rights

William T. Blackburn
COMMENTS

SHAREHOLDER INSPECTION RIGHTS

The early English case of *Dominus Rex v. The Fraternity of Hostmen in Newcastle-Upon-Tyne* was one of the first cases to recognize the right of stockholders to inspect corporate books. In a dictum the court said,

It does not seem settled how far corporators have a right to apply a mandamus for a general inspection and copying of the books of the corporation. Vide *Rex v. G. Babb*, 3 Term Rep. 579. But tenants of a manor have this right as to the court rolls, &c. *Rex v. Shelly*, 3 Term Rep. 141.

The last sentence possibly indicates that the right was originally recognized upon an analogy to the old quasi-feudal right of the tenants of a manor to inspect the court rolls. Whatever may be the validity of this surmise as to the origin of the right, the common-law right became well established in this country prior to the beginning of this century. The rule was generally stated as being that the shareholder had the right to inspect the books of the corporation at reasonable times, if the inspection was in good faith and for a proper purpose. Quite a few states followed the English rule of requiring that there be a specific dispute before inspection would be granted. Many state legislatures, evidently feeling that the shareholder should have more power over that which he partially owns, enacted statutes that usually gave the shareholder an *unqualified* right to inspect the corporate books. The more recent history of the inspection right has been an effort on the part of the legislatures and the courts to put reasonable limitations upon its use, but still to allow the right to persons using it for socially desirable purposes.

For the most part this Comment will concern the law of three jurisdictions: Texas, Illinois, and Delaware. The Illinois cases are discussed because the Illinois Business Corporations Act was one of the source acts for the Texas act; and Delaware cases are discussed because of the vast number of corporations incorporated in that state.

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2 See In re *Steinway*, 159 N.Y. 250, 53 N.E. 108 (1899) and cases cited there.
THE INSPECTED BOOKS

Generally the shareholder can inspect whatever records are necessary to inform him about corporate matters in which he has a legitimate interest. Evidently the common-law right and the statutes usually cover all normally kept records, plus whatever is required to be kept by statute, for no instance has been noticed in which the scope of the examination has been objected to on the grounds that the particular records were not open to inspection under any conditions. However it has generally been held that the inspection right does not extend to records containing trade or business secrets. Such holdings should not be considered an exception to the general rule since they seem to be based on the purpose of the inspection rather than an idea that no right of inspection of these books exists. That is, it seems that if the inspection of the secrets is actually necessary, and if the inspection can be made in such a manner that it will not harm the corporation by a divulgence of the secrets, the inspection will be allowed.

Since in Texas the inspection right is statutory, the words of the statutes must be examined. Article 1, 28, which still affects many Texas corporations, requires that a record of the stock subscribed and transferred and of all business transactions be kept and that these be open to shareholder inspection. One Texas case decided under this statute held that "records, books of accounts, receipts, vouchers, bills and all other documents evidencing the financial condition" could be inspected. Otherwise the Texas decisions do not add anything to our knowledge of the permissible scope of inspection, most of the demands consisting only of requests to see "books and records," "books, records and papers," and the like.

Article 2.44 of the Texas Business Corporations Act is also ap-

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7 Tex. Bus. Corp. Act art. 9.14 (1956) sets out the corporations to which the new act applies and provides a procedure whereby existing corporations may adopt the provisions of the new act.
11 Tex. Bus. Corp. Act art. 2.44 (1956) reads as follows:

BOOKS AND RECORDS

A. Each corporation shall keep correct and complete books and records of account and shall keep minutes of the proceedings of its shareholders and board of directors, and shall keep at its registered office or principal place of business, or at the office of its transfer agent or registrar, a record of its shareholders, giving the names and addresses of all shareholders and the number and class of the shares held by each.
plicable to many Texas corporations at present." This provision concerns shareholder inspection rights and states that the shareholders may inspect the corporate "books and records of account, minutes, and record of shareholders, and shall be entitled to make extracts therefrom." There are as yet no Texas decisions under this statute and again the most persuasive precedent is that of Illinois. The Illinois decision, like the Texas decisions under article 1328, add little to the statute, the demands all being for records that are expressly mentioned in the statute. The only helpful case is Stone v. Kellog,12 which held that corporate contracts can be inspected by the shareholder. This is also the usual rule elsewhere.14

It should be noted that article 2.30 of the Texas act gives the holder of a voting trust certificate the right to inspect the counterpart of the voting agreement deposited with the corporation. It also provides that shareholders of the corporation shall have the same right of inspection of the counterpart that they have as to other books and records.

In Delaware the inspection right is derived from the common law, rather than statutory provisions, except for inspection of the stock ledgers which is provided for in section 220 of title 8 of the Delaware Code.15 The books that the court allowed to be inspected in State ex rel. Brumley v. Jessup & Moore Paper Co.,16 will illustrate the extent to which records may be examined in Delaware.

B. Any person who shall have been a shareholder of record for at least six (6) months immediately preceding his demand, or who shall be the holder of record of at least five per cent (5%) of all the outstanding shares of a corporation, upon written demand stating the purpose thereof, shall have the right to examine, in person or by agent or attorney, at any reasonable time or times, for any proper purpose, its books and records of account, minutes, and record of shareholders, and shall be entitled to make extracts therefrom.

C. Nothing herein contained shall impair the power of any court of competent jurisdiction, upon proof by a shareholder of proper purpose, irrespective of the period of time during which such shareholder shall have been a shareholder of record, and irrespective of the number of shares held by him, to compel the production, for examination by such shareholder, of the books and records of account, minutes, and record of shareholders of a corporation.

12 See note 7 supra.
13 165 Ill. 192, 46 N.E. 222 (1896).
15 The text of Del. Code Ann. tit. 8, § 220 (1953) is as follows:
§ 220. Stock ledger; inspection; evidence
The original or duplicate stock ledger shall be the only evidence as to who are the stockholders entitled to examine the list required by section 219 of this title or the books of the corporation, or to vote in person or by proxy at any such election. The original or duplicate stock ledger containing the names and addresses of the stockholders, and the number of shares held by them, respectively, shall, at all times, during the usual hours for business, be open to the examination of every stockholder at its principal office or place of business in this State, and said original or duplicate stock ledger shall be evidence in all courts of this State.
16 24 Del. 379, 77 Atl. 16 (1910).
The court permitted an examination of the minute books of the director's meetings for the last seven years, the books of account of the corporation that showed the amounts received from the sale of preferred stock during the last seven years and the disposition of these funds, the stock book of the preferred shareholders, the stock book of the common shareholders, the books showing the amount of business done during the last four years, and the statements submitted to the directors which showed the business done by the company, its profit and loss, and assets and liabilities, during each six-month period for the last five years. It must be remembered that the shareholder only had this broad right of inspection because the court felt that all these records were necessary for the shareholder's purposes. In Swift v. State ex rel. Richardson it was held that the shareholder could inspect pertinent contracts, conveyances of franchises and tangible property, and all records showing net earnings of the company during pertinent years. Other types of corporate records that have been held subject to inspection in other jurisdictions are correspondence relevant to the information the shareholder is seeking, and work sheets and schedules showing segregated costs of the corporation's real property.

A separate problem is presented when the shareholder seeks to inspect books of a subsidiary corporation. The rule seems to be that he can inspect the books of the subsidiary corporation if the subsidiary is dominated and controlled by the parent, the extent of the control being the determinative fact. The Delaware case of Martin v. D. B. Martin Co. held that under the facts presented that the inspection of the subsidiary's books could be obtained. A later Delaware case, State ex rel. Rogers v. Sherman Oil Co. distinguished the Martin Case on the grounds that

(1) It was in a court of equity where the principles of law are not so controlling as in this (law) court. (2) The companies that were required to produce their books and disclose the information required in connection with the charge of fraudulent mismanagement or corporate affairs, were practically one and the same in so far as management and control were concerned. . . . The president of the respondent company was president of all the allied companies but one, the respondent company owned all the shares of stock of seven of them.

17 12 Del. 338, 6 Atl. 856 (1886).
21 10 Del. Ch. 211, 88 Atl. 612 (1913).
22 31 Del. 570, 117 Atl. 122, 126 (Super. Ct. 1922).
The court also pointed out that there were interlocking directorates. The only Texas case on this point is in line with the general rule.23 Speculations as to what other corporate records are subject to inspection must be guided by the general rule that if the shareholder has a right to the knowledge he seeks, he can have access to whatever corporate records will give him the information, provided that the inspection will not result in substantial harm to the corporation. The Kentucky Court of Appeals in Otis-Hidden Co. v. Scheirich24 said, in holding certain correspondence of the corporate president to be subject to inspection:

It is a rare thing that all the transactions of a corporation are clearly shown by its records of official action. There must, of necessity, be many transactions which cannot be clearly understood except by reference to various documents, papers, and correspondence on file with the corporation. Clearly the stockholder's right to inspect his own should not be confined to official action.

Thus it would seem that the shareholder can inspect such things as tax returns and Securities and Exchange Commission Reports if he can show that they are necessary to obtaining an undistorted view of the knowledge he is seeking.25 It should be noted that in Delaware, as contrasted to Texas and Illinois, if the shareholder has been furnished in the form of regular financial reports all the information necessary for his purposes, then he cannot get mandamus for inspection.26 In Moore v. Rock Creek Oil Corp.27 the Texas Commission of Appeals held that the corporation could not defeat the shareholder's right of inspection by offering him audits and financial statements prepared at the request of the corporation. The reason for this, the court said, is that the right of inspection given by article 1328 is absolute and can not be bartered away by the officers of the corporation. The Illinois case of Furst v. W. T. Rawleigh Medical Co.28 is in accord. Both the Texas and Illinois cases just cited were decided under the older so-called absolute statutes in the respective states, but there is no apparent reason for the courts holding otherwise under the new laws. Since the Delaware court recognizes the rule that the corporation's audits and statements

24 187 Ky. 423, 219 S.W. 191 (1920).
27 59 S.W.2d 815 (Tex. Comm. App. 1933).
28 282 Ill. 366, 118 N.E. 763 (1918).
cannot be substituted for the records from which they were drawn if there is something to indicate that they are fraudulent, unreliable or inadequate, the Delaware rule seems preferable since it protects the corporation from unnecessary inspections while at the same time leaving the substantial rights of the shareholder unimpaired.

Another aspect of this problem of what books may be inspected is whether the court can order the inspection of books not located within the jurisdiction. Texas has no decisions on this problem under article 1328, and neither have any Illinois decisions been found. However a Delaware case has been found that deals with the matter. In *State ex rel. Brumley v. Jessup & Moore Paper Co.* the books which the shareholder wished to see were in Philadelphia. The court held that since the corporation was within the jurisdiction of the courts of Delaware, there was no reason it could not be compelled to discharge a legal duty resting upon it by being ordered to bring the out-of-state books for the inspection of the shareholder. This ruling seems to be correct because the jurisdiction is not being exercised on the books which are outside the jurisdiction, but on the officers of the corporation, and the corporation itself which are within the state.

**WHAT ASSISTANCE MAY THE SHAREHOLDER HAVE IN MAKING THE INSPECTION?**

The general rule is that the stockholder may have the help of whatever agents he wishes in inspecting the records. The specific cases have been situations either of attorneys or accountants helping the shareholder, or actually being the only ones making the inspection, the shareholder not being present while the inspection was being made; however there is no reason to think that the shareholder could not have other specialists to aid him in the inspection. This seems to be reasonable since very often the shareholder himself will not have the necessary technical knowledge to make an intelligent inspection, and to hold to the contrary would substantially divest him of this right. The Texas case holding that under article 1328 agents of the shareholder could make the inspection is *Johnson Ranch Royalty Co. v. Hickey.* The Illinois courts are in accord with this rule, but they also add to it. In *Crouse v. Rogers Park Apartments, Inc.* the shareholder demanded through his attorney to be allowed to

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29 24 Del. 379, 77 Atl. 16 (1910).
31 31 S.W.2d 150 (Tex. Civ. App. 1930) error ref.
inspect and copy the record of shareholders in order that he might offer to buy their stock. The court held that the shareholder could make the demand and inspection through his attorney, but the corporation could demand proof of the fact that the attorney actually did represent the shareholder and could deny inspection to the attorney in the absence of such proof. In a later case, Robb v. Eastgate Hotel, Inc., the court explained that though the corporation has the right to demand proof of agency from the attorney, if it does not so demand, it cannot later use this as a reason for its refusal of the inspection. Both of these decisions are very reasonable and any other holding would be surprising, but surprises of this nature are not uncommon, and so decisions on the matter are reassuring. The Delaware rule is the same.

**What Are Reasonable Times for Inspection?**

All the statutes giving the inspection right contain the proviso that the right must be exercised at a reasonable time. Under article 1328 there was some contention that the inspection had to be made at one occasion or at least on consecutive days. The Texas cases of Johnson Ranch Realty Co. v. Hickey and Smith v. Trumbull Farmers Gin Co. settled the law to be that the inspection need not be at one time or on consecutive days, and could evidently be on as many different occasions as were reasonably necessary to make the inspection. Neither does there seem to be any absolute amount of time that is the maximum allowed for the inspection. The wording of article 2.44 obviated this problem by saying that the inspection could be made at any reasonable "time or times." Evidently the only meaning of "reasonable time" is that the inspection must be made during the regular business hours of the corporation.

**What Is the Nature of the Demand and the Pleadings?**

Should the demand be in writing? Of course this is always good practice, but it is often not required. Article 2.44 of the new Texas act requires that the demand be written, but the Illinois act does not so require, nor does the wording of article 1328 of the Texas statutes or the decisions under it. Nor can any requirement of written demand be found in any of the Delaware cases, either under...
the common-law right to inspect the books or under the statutory right to inspect stock ledgers given by title 8 section 220.39

How specific should the demand be as to purpose? In the Illinois case of People ex rel. Miles v. Bowen Industries, Inc.,40 the demand simply inquired as to when it would be convenient for the shareholder to inspect the books. When the inspection was refused the shareholder sued for a writ of mandamus ordering the inspection. The court refused to issue the writ, holding that it was necessary for the shareholder, upon trial, to prove a demand which evidenced a proper purpose; that is, the demand itself should have evidenced a specific purpose and this purpose must have been a proper one. The reason for this, said the court, was that by the statute the legislature intended to protect corporations from demands for inspection that were insincere and intended only to harass. This purpose cannot be served unless the officers are informed of the reason for the inspection and given a chance to determine whether or not it is proper. The purpose of the suit for mandamus is to determine judicially whether the officers properly decided that the purpose of the inspection was improper.

A dictum in a Delaware case was to the contrary.41 The differences in the two cases can be explained by the differences in the burden of proof of proper purpose in the two states. In Illinois the burden of proof of proper purpose is on the shareholder, while in Delaware, when the stock ledger is sought to be inspected, the burden is on the corporation to prove an improper purpose on the part of the shareholder in seeking the inspection. The Delaware court reasoned: "If a stockholder need not affirmatively allege in a petition for mandamus the purpose of a desired examination, then surely he need not allege his purpose in his original request to the corporation, and thus subject himself to the examination and cross-examination of the corporate officials."42 However it must be noticed that the rule in Delaware as to the burden of proof or proper purpose is different where the general corporate books are the object of the inspection. In this latter case, therefore, it would seem that the pleadings would need to be the same as in Illinois.

What are the elements of the pleadings in a suit for mandamus? Under article 1328, the court in Moore v. Rock Creek Oil Corp.43

40 327 Ill. App. 362, 64 N.E.2d 213 (1945).
42 Id. at 36 A.2d 31.
43 59 S.W.2d 815 (Tex. Comm. App. 1933).
held that the plaintiff shareholder had made out a prima facie case by alleging and proving (1) that he was a shareholder of the corporation (2) that he made demand for inspection, and (3) that the corporation refused the demand. The rule in Delaware is substantially the same. However the Illinois rule requires in addition to these, an allegation of a specific proper purpose for the inspection, and though there have been no Texas decisions to date on this aspect of article 2.44, it may well be that Texas will follow the Illinois rule, since the wording of the two statutes in this respect is very similar.

How specific should the pleadings be as to purpose? This problem is similar to the one just discussed above concerning the problem of how specific the demand must be. However two Delaware cases deal with this problem but do not necessarily apply to the demand, and thus the topic is treated separately at this point. These Delaware cases deal with demands to see the corporate books as contrasted with demands to see the stock ledger and would probably have been decided differently if the demand had been for inspection of the latter. The cases held that the pleadings must state a specific purpose because this is part of the shareholder's prima facie case. In *State ex rel. Miller v. Loft, Inc.* the court said, "[the] purpose must not only be proved, but must, also, be alleged not by a mere general statement that it is a proper one, but by the allegation of specific facts, from which the propriety of such purpose will appear." The court went on to question whether a mere allegation that the shareholder wished to ascertain the value of his stock fulfilled this requirement, but since there was no preliminary motion to dismiss the petition, evidently waiving the matter, the court did not actually hold that the pleading was insufficient.

**WHO MAY MAKE INSPECTION?**

In most jurisdictions and under article 1328 of the Texas statutes the only requirement in order to have the inspection right is that the person be a shareholder (either common or preferred) of the corporation; this is usually taken to include the executor or administrator of the deceased stockholder. However, under the new

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44 Insuranshares Corp. v. Kirchner, 40 Del. 105, 5 A.2d 519 (1939).
47 34 Del. 538, 156 Atl. 170, 172 (Super. Ct. 1931).
Illinois and Texas statutes there are provisions applicable to certain types of shareholders. The Illinois act reads: "Any person who shall have been a shareholder of record . . . for at least six months . . . or who shall be the holder of record of at least five per cent of all the outstanding shares . . . shall have the right to examine . . . for any proper purpose, its [the corporation's] books and records. . . ." Later on in the same section: "Nothing herein contained shall impair the power of any court of competent jurisdiction . . . irrespective of the period of time during which such shareholder shall have been a shareholder of record, and irrespective of the number of shares held by him, to compel by mandamus or otherwise the production for examination . . . of the books. . . ." Article 2.44 of the Texas act is substantially the same. Thus to bring himself within the first provision the shareholder must prove that he has either been a shareholder of record for at least six months preceding the demand or that he owns at least five per cent of the stock. A problem concerning this came up in the Illinois case of Sawers v. American Phenolic Corp. Sawers purchased some stock of the corporation and, before six months had passed, demanded access to the books for inspection. Upon refusal of his demand, he filed suit for mandamus. Then the six-month period elapsed and Sawers again made demand for inspection. On appeal Sawers tried to relate his suit to the later demand which brought him within the class of six-month shareholders, but the court held that mandamus should not be issued because the two demands were both part of the same attempt to inspect, which had begun prior to the lapsing of the six-month period; the suit originally had been filed prior to the lapsing of the six months and the validity had to be determined as of the time it was filed. However this problem seems to be more of theoretical interest in Illinois than of practical importance since the last paragraph of the statute seems to give the same right of inspection to all the shareholders that the first paragraph of the act gives to the restricted class. For this reason there appears to be little use in attempting to qualify within the class of the first paragraph.

This has not always been true in Illinois. The last part of the act, which gives the inspection right to all shareholders, at one time did not contain the phrase "irrespective of the period of time during which such shareholder shall have been a shareholder of record, and

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404 Ill. 440, 89 N.E.2d 374 (1950).
irrespective of the number of shares held by him.” While the law
read thus, the Illinois court in *Neiman v. Templeton, Kenly & Co.* held that only shareholders who had owned stock for more than six months or owned at least five per cent of the shares could get mandamus for inspection under this statute. This was done in spite of the last paragraph of the statute which read, “Nothing herein contained shall impair the power of any court of competent juris-
diction, upon proof by a *shareholder* of proper purpose, . . . to compel . . . the production for examination . . . of the books and records . . . of a corporation.” (Emphasis added.) The court reasoned that to interpret the clause otherwise would be to nullify the re-
striction contained in the earlier part of the section, and therefore this last clause should be interpreted as extending the common-law limits of the *object* for which examination could be sought, rather than broadening the *class* of shareholders who could get inspection under the act. The later insertion of the above-quoted phrases seems to indicate an intention that the last paragraph refer to the class of shareholders who can get inspection under the statute, and to give the inspection right to all shareholders; it was not intended to apply only to the object of the inspection. That the Illinois statute now applies to all shareholders was recognized in an Illinois Supreme Court dictum in *Sawers v. American Phenolic Corp.* and would seem to be the law both under the Illinois and Texas acts.

There appear to be times when no one has the right of inspection appurtenant to certain stock. In a Louisiana case, a stockholder placed his stock in escrow pursuant to a contract of sale. A New York case had similar facts. Both courts held that the sale had been consummated and consequently the vendor, who was still the shareholder of record, had no inspection rights. On the other hand, another New York case held that one claiming to be a shareholder but who was not listed as such in the stock books of the corporation, also could not get mandamus to inspect the books. In most instances this rule will be of no importance, but if similar facts arise and the corporation wrongfully refuses to transfer the stocks on its books, the stockholder can acquire the inspection right by compelling *transference* in a proceeding for that purpose.57

53 404 Ill. 440, 89 N.E.2d 374 (1950).
54 State ex rel. Bulkley v. Whited & Wheless, Ltd., 104 La. 125, 28 So. 922 (1900).
Under the Illinois act, holders of voting trust certificates are expressly granted the same right of inspection that the shareholders have.\(^5\) In the absence of such a provision, holders of voting trust certificates are not usually given the inspection right with respect to corporate books and records.\(^6\) This would seem to be required by any statute such as the Texas one that gives the inspection right to shareholders of record. The Delaware statute granting the right of inspection of stock ledgers also limits the inspection to shareholders of record. Thus, evidently, holders of certificates cannot demand inspection but their trustees can. *State ex rel. Healy v. Superior Oil Corp.*\(^6\) held that any person who was on the stock ledger could inspect the stock ledger of the corporation, despite the fact that that person is merely a nominee. The same statute, title 8, section 220, also limits the right of inspection of the books of the corporation to the persons listed on the stock ledger, and thus again it appears that holders of voting trust certificates are left with no right to inspect corporate books. Probably the same rule would apply to holders of street certificates; *i.e.*, they would not be allowed inspection rights.\(^6\)

One other case should be noted here. Sometimes a person who at first glance seems to have lost his status as a shareholder may in reality still have it and thereby still have his inspection rights. In *State ex rel. Waldman v. Miller-Wohl Co.*\(^6\) Waldman demanded inspection of the corporate books, and the corporation replied by redeeming his stock. Waldman then filed suit for mandamus. The corporation answered that his status as a stockholder had ceased prior to the filing of the petition, leaving him no right to inspection. The court held that the redemption had been invalid and ineffective because it was not done in accordance with the provisions of the certificate of incorporation; Waldman still had the right of inspection because he was still a shareholder.

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\(^6\) However the court in Brentmore Estates, Inc. v. Hotel Barbizon, Inc., 263 App. Div. 389, 33 N.Y.S.2d 331 (1st Dep't 1942), set forth a dictum in which it stated that it would be possible for a stockholder to reserve the inspection right by the terms of the voting trust agreement and although this reservation would not give him an inspection right under the shareholder inspection statute because he would not be a shareholder of record, it could be enforced by mandamus under the common law right of inspection. But no later case has been found in which this has ever been attempted, much less held valid.

\(^6\) 40 Del. 460, 13 A.2d 453 (Super. Ct. 1940).

\(^6\) In a dictum in the Superior Oil Case, ibid, the court quoted with approval from Cheatham v. Wheeling & L.E. Ry., 37 F.2d 593, 596 (S.D.N.Y. 1930), which held that a holder of a street certificate is not entitled to any of the privileges of a stockholder.

\(^6\) 42 Del. 73, 28 A.2d 148 (Super. Ct. 1942).
WHAT IS A PROPER PURPOSE FOR INSPECTION?

The new Texas statute, the cases under the old Texas statute, the Illinois statute, and the Delaware cases both at common law and under the stock ledger statute require that the purpose of the inspection be proper. A good definition of proper purpose is set out in Sawers v. American Phenolic Corp.

The proper purpose required by the statute, then, is one wherein a stockholder seeks information bearing upon the protection of his interest and that of other stockholders in the corporation. He must be seeking something more than a satisfaction of his curiosity and not be conducting a general fishing expedition.

Of course the purpose is improper where it is to gain knowledge of the corporate affairs in order to aid a competitor, and the inspection will not be granted for such a purpose. Similarly, an intent to defraud the corporation has been held to be an improper purpose.

Under Texas article 1328, since proof of a proper purpose was not required of the shareholder, there is little discussion of what is a proper purpose, most of the discussion in the few cases centering on what is or is not an improper purpose. In Grayburg Oil Co. v. Jarratt the court held that it was not improper for the shareholder to seek a list of the shareholders in order to inform them about what he considered bad management practices by the officers and directors. In Moore v. Rock Creek Oil Corp. the court held that the mere fact that the shareholder and the officers of the corporation were on unfriendly terms was no proof of improper purpose. It was also ruled that it is not improper for the shareholder to hope to find something improper on the part of the management and to alarm other shareholders with his news. This is an approval of fishing expeditions by the Commission of Appeals that is in contradiction


66. 404 Ill. 440, 89 N.E.2d 374 (1950).


69. 16 S.W.2d 317 (Tex. Civ. App. 1929).

70. 59 S.W.2d 815 (Tex. Comm. App. 1933).
to the language in the above quote from the Sawers case. The Com-
mission justified its ruling by the following reasoning:

If in truth and in fact no alarming condition exists, presumably it will
not be found through any examination made by plaintiffs in error. If
there is existent anything in the financial affairs of the company which
would be reasonably calculated to alarm the stockholders in general we
see no reason why plaintiffs in error could not properly communicate
such fact to other stockholders.74

This opinion was not adopted by the Supreme Court and perhaps,
in view of the somewhat friendlier attitude towards corporations
as reflected in the new act, the Supreme Court will hold that, while
such fishing expeditions may have some value, the inconvenience
to the corporation is greater, and therefore fishing expeditions will
not be allowed.

Several Illinois cases have ruled on the propriety of the purposes
of the shareholder seeking inspection. In Wise v. H. M. Bylesby &
Co.75 the court held the following to be proper purposes: "... to
determine the true value of the company's capital stock; its pros-
spective ability to pay its secured debt in July, 1935; its ability to
pay any other matured or maturing debts or obligations; the deal-
ings between the corporation, its officers and directors, and sub-
ordinate, affiliated and controlled corporations, their officers and di-
rectors; and whether there are any liabilities to the corporation by
the officers and directors thereof, or by others, in connection with
its affairs." With regard to the specificity of the demand and al-
legations, discussed earlier, it should be noted that these purposes
above stated seem to be very specific but when examined more
closely some of them are actually localized fishing expeditions.
Another case has held that gaining outside representation on the
board of directors for minority stockholders is a proper purpose.76
Also speculation has been held a proper purpose where the president
of the corporation made offers to all the stockholders to buy their
stock and a shareholder wanted the shareholder list to enable him
to make a higher blanket offer to each.77 However, in the absence of
such justifying circumstances, speculation is an improper purpose.78
It is not necessary to show mismanagement of the corporation in
order to show a proper purpose for the inspection,79 but the share-

74 Id. at 818.
holder must show some effort on his part to determine the condition of the corporation other than the single demand to see the books and must also show that he has taken advantage of all reasonable corporate offerings of information in order to prove a proper purpose.\footnote{Sawers v. American Phenolic Corp., 404 Ill. 440, 89 N.E.2d 374 (1950).}

The Delaware courts speak in terms of "purpose connected with the shareholder's status as shareholder" as much as they do of "proper purpose" when they are discussing the merits of the purpose.\footnote{State ex rel. Theile v. Cities Service Co., 31 Del. 514, 115 Atl. 773 (1922).} One of the earliest Delaware cases on shareholder inspection rights, \textit{Swift v. State ex rel. Richardson},\footnote{12 Del. 338, 6 Atl. 856 (1886).} concerned a purpose not closely connected with the plaintiff's status as shareholder, but which was held to be proper. The shareholder incurred some debt and pledged his stock in the corporation to his sureties on the debt. The sureties were to collect not just the dividends on the stock, but a percentage of the net earnings of the stock. When the primary debt was paid, the sureties prepared to sell the stock in order to collect the net earnings to which they believed themselves to be entitled, and which had not been paid to them by the shareholder. The shareholder demanded inspection of the books in order to show that the stock had had no net earnings during the time the sureties had held the stock, and thereby prevent the sale of his stock.

In \textit{State ex rel. Brumley v. Jessup & Moore Paper Co.}\footnote{24 Del. 379, 77 Atl. 16 (1910).} the shareholder stated his purposes to be the following: to obtain evidence as to actual value of his stock, his stock constituting a substantial percentage of the outstanding shares; to ascertain whether illegally issued preferred stock was issued below par; to determine under what unlawful contracts the corporation was conducting its business; to determine the assets and liabilities of the corporation and its earning power. These purposes were held to be proper.

Another Delaware case, \textit{State ex rel. Nat'l Bank v. Jessup & Moore Paper Co.},\footnote{27 Del. 248, 88 Atl. 449 (Super. Ct. 1913).} held that neither failure of the shareholder to vote at a shareholders' meeting nor his failure to be present at a shareholders' meeting where some of the books were open to inspection showed an improper purpose. This seems to be in conflict with the Illinois rule mentioned above. The only possible distinguishing factor might be that here the shareholder was itself a corporation,
and, with the division of responsibility, would be more likely to miss the inspection at the meeting by an oversight, especially if it did not for policy reasons take a regular part in the control of the corporation.

*State ex rel. Foster v. Standard Oil Co.* was a case in which the shareholder was engaging in a derivative suit against the corporation and wanted a list of the shareholders for the purpose of mailing them a summary of the pleadings in the pending litigation, seeing if any of the other shareholders wished to join him in conducting the suit, and soliciting proxies for the purpose of changing the personnel of the board of directors. The first and third purposes were held proper, but the second was held to be inappropriate. The court said that there was no public policy against acquainting the real owners of the corporation with the circumstances surrounding a derivative suit against the corporation; in fact the public policy was on the side of the shareholders receiving the knowledge.

In *State ex rel. Theile v. Cities Service Co.* the shareholder wanted the stock lists to use in his business of selling stock lists for profit. The court held that such a purpose would not sustain a suit for mandamus because it was in no way connected with the shareholder's status as a shareholder.

**Who Has the Burden of Proving Proper Purpose?**

In Texas, under article 1328, the burden of proving proper purpose is not on the shareholder; rather the burden is on the corporation to prove an improper purpose. In *Moore v. Rock Creek Oil Corp.*, the Commission of Appeals said:

> Where a stockholder seeks to enforce by mandamus the statutory right of inspection, he has made a prima facie case when he alleges his interest as a stockholder and the refusal of the corporation to grant him such right of inspection after proper demand therefor. It is not essential that he allege or prove that in seeking the issuance of such writ he is acting in good faith and for an honest purpose. . . . But when the corporation pleads, and is able to establish by proof, a state of facts sufficient to convince the court that the stockholder is not seeking the information . . . for the protection of his interest as a stockholder, or that of the corporation, but that he is actuated by corrupt or unlawful motives, the court will not, by the issuance of its writ of mandamus, aid him to consummate such corrupt and unlawful purposes.

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82 41 Del. 172, 18 A.2d 235 (Super. Ct. 1941).
83 31 Del. 514, 113 Atl. 773 (1922).
In Illinois, under section 45 of the Business Corporations Act, the Supreme Court of that state has held that the burden of proof of proper purpose is always on the shareholder. It must be remembered that the statute divides the shareholders into two classes (general shareholders and those that have either owned stock for more than six months or own at least five per cent of the stock), but still the Illinois rule is that both classes have the burden of proving proper purpose. The leading case is *Morris v. Broadview, Inc.* The opinion starts out with statements of general rules of statutory interpretation, such as "the entire section must be read together and so construed, as to make it harmonious and consistent in all its parts" and "if possible we must give meaning to each word, clause and sentence" and "the section should be so construed that no clause, sentence or word should be superfluous." Then the court goes into the historical background and shows that the prior statutes gave an almost absolute right of inspection to the shareholder. It was clear that the legislature by the new act intended to restrict the shareholder's inspection rights. The court said:

Considering the change in the statute clearly abrogating the absolute right of shareholders to a definitely limited right of inspection, the only reasonable interpretation that will afford meaning to every clause and word of the section in question is that the legislative intent was to limit the right of examination to an allegation and proof of a specified purpose which is proper and legitimate, for the protection of the stockholder's investment."

The opinion continued:

What then was the legislative intent expressed in the amendment of 1941, which gives to any stockholder, irrespective of time of ownership or amount, the remedy of mandamus to compel access to the records, upon proof by the shareholder of proper purpose? The clause for "proper purpose" appears in each paragraph of section 45. It is inconceivable that, by the amendment of 1941, the legislature intended to render the clause referred to as superfluous in the first paragraph, as appellee would have us do. Such an interpretation would contravene one of the above mentioned primary rules of construction. It is equally inconceivable that the legislative intent was to give such effect to the 1941 amendment as to completely nullify the limitations and classification of shareholders mentioned in the first paragraph. To leave in the act a limitation in one paragraph and to completely nullify it in another would create an absurdity which we cannot assume was intended.

Thus it will be seen that the main argument the court has for

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86 385 Ill. 228, 52 N.E.2d 769 (1944).
87 52 N.E.2d at 771-72.
holding as it did is that to hold otherwise would make the section internally inconsistent and nullify part of it. There is no basis whatsoever for this contention; rather it is the strained construction of the court which nullifies, and renders superfluous part of the section. To use the phraseology of the last above-quoted sentence, to create in the act a right for a sub-class in one paragraph and to create the same right for the whole class in another would create an absurdity which we cannot assume was intended. Under the Illinois rule the first right would be superfluous because entirely enveloped by the second.

The court points out that the phrase "proper purpose" occurs in each of the paragraphs and says that its construction of the statute does not nullify the phrase in the first paragraph, implying that any other interpretation would nullify the phrase. The fact that "proper purpose" is a requirement of both paragraphs tends to indicate that the court's construction is erroneous, for the words "upon proof of a shareholder of" precede the phrase "proper purpose" only in the last paragraph. If the legislative intent was identical in each paragraph as to the placing of the burden of proof, it would take some cogent reason to explain why the language was not identical; and the court offers none.

It would seem that the only way to give full effect to each "word, clause, and sentence" of the section is to construe the statute as giving the inspection right to all shareholders upon proof of proper purpose, and further giving the inspection right to the select subclass of shareholders without proof of proper purpose, the propriety of the purpose being a defensive matter to be pleaded and proved by the corporation.

The court gave one further reason for its construction. The Illinois act contained a penalty provision applicable to any person or corporation that would not allow the inspection "for any proper purpose." Thus the phraseology of the "proper purpose" requirement was identical in this and the first paragraph. The court said: "Clearly the clause has the same meaning in both paragraphs and it could hardly be contended that a suit for a recovery of the penalty could be maintained without allegation and proof of a proper purpose for the demand." Whatever the merits of this argument in Illinois,\(^8\) it has no merit in Texas for the corresponding Texas pro-

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\(^8\) Laws Ill. 325 (1919), the Illinois statute which immediately preceded the present inspection statute, contained a penal clause similar to the one now in force; it was interpreted in Morris v. Broadview, Inc. There was no mention of proper purpose anywhere in this statute. In Babcock v. Harrsch, 310 Ill. 413, 141 N.E. 701 (1923), this penal provision was held not to be violative of the due process clause of the Illinois Constitu-
vision article 2.44 has no such penalty provision and there is no comparable provision in any other Texas statute.

It is submitted that article 2.44 of the Texas Business Corporations Act should not be construed in accordance with the Illinois authority, because the validity of the reasoning of such authority is doubtful in Illinois and nonexistent in Texas. The construction of the statute contrary to the Illinois authority would be consonant with the apparent legislative intent to protect the corporations from needless and vexatious inspections, and would place the conflicting interests of corporate efficiency and shareholder rights in better balance.

In Delaware the burden of proof is on the shareholder in one instance and on the corporation in the other. In suits to inspect the stock ledger under title 8, section 220 of the Delaware Code, the shareholder does not have to prove proper purpose; the corporation has the burden of proving an improper purpose in order to defeat the inspection. However, when the shareholder is suing on his common law right to inspect the books of the corporation, he must allege and prove proper purpose. A recent case by the Delaware Supreme Court throws a slight shadow of doubt on this rule, for the court seemed to go out of its way to state that, for the purposes of the opinion, it was assuming rather than holding that the burden of proof of proper purpose is on the shareholder; this was done in a situation in which courts commonly dicta as though they were rulings of the case.

ARE FOREIGN CORPORATIONS SUBJECT TO INSPECTION?

Inspection of the books of foreign corporations is generally allowed, subject of course to the requirement that the corporation must be doing business within the state. The Illinois case of Wise v. H. M. Byllesby & Co. held that section 103 of the Illinois statutes required foreign corporations to have the same duty of allowing in-

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inspection as domestic corporations. Article 8.02 of the Texas act is substantially the same and presumably would have the same result. This rule also is in effect in Delaware. 8

HOW THE RIGHT MAY BE ENFORCED

As indicated in the above-quoted dictum from Rex v. The Fraternity of Hostmen, the remedy from the earliest times has generally been in the nature of a writ of mandamus ordering the custodian of the books to allow the shareholder to inspect them. This has generally been true in the various jurisdictions throughout the United States. Texas has followed this accepted method of enforcing shareholder inspection rights in the past and will presumably do so in the future. Under article 1328 of the Revised Civil Statutes of Texas, the right given has consistently been enforced by mandamus. 9 The form of the remedy seems to have affected the substantive law of inspection in Texas, or at least allowed the Commission of Appeals to rationalize its decision in Moore v. Rock Creek Oil Corp., 10 for it held that the right of inspection under article 1328 was absolute but that since the general rules applicable to the issuance of a writ of mandamus required that it not be issued to perpetrate a wrong, the absolute legal right would not be enforced unless the shareholder had a proper purpose in seeking the inspection. The court said:

It must be borne in mind that the enforcement of the right is by mandamus. Such a writ is not issued as a matter of right, but in the exercise of a sound judicial discretion which allows the court to view other considerations than the mere legal right of the relator. 11

It is presumed that the enforcement of the right in Texas will still be by mandamus under the new provision of the Texas Business Corporations Act which concerns the inspection right of shareholders, article 2.44. 12 There are no cases yet in which enforcement of the right has been sought, but the strongest precedents for the Texas courts outside of the decisions under article 1328, are the

12 59 S.W.2d 815 (Tex. Comm. App. 1933).
13 Id. at 817.
14 For text of this statute, see note 11 supra.
Illinois decisions; and the right is customarily enforced in Illinois by writ of mandamus.\textsuperscript{101}

In Delaware, also, mandamus is the usual method of enforcing the inspection right,\textsuperscript{102} but it would seem possible that the right can also be enforced by an action in equity when the rights of the person suing for inspection are not cognizable in a court of law. In \textit{Parrish v. Commonwealth Trust Co.}\textsuperscript{103} the Court of Chancery of Delaware held that a court of equity had no power to order an inspection by a stockholder of corporate books as a matter of primary and independent relief, even though the stockholder was not of record but was only a holder of a voting trust certificate (and thus a person whose interest as a shareholder was cognizable only in a court of equity). However a later lower court holding in \textit{State ex rel. Crowder v. Sperry Corp.}\textsuperscript{104} explained that the holding in the \textit{Parrish Case} was not as strong as it seemed:

The decision, however, does not justify the conclusion that the Court of Chancery will, in no circumstances, afford to a holder of a voting trust certificate the relief of an order of inspection.\textsuperscript{105}

The court also said that the voting trust certificate holder, who was seeking inspection by mandamus, had possibly mistaken his forum, implying that he might have been successful had he sought to enforce his inspection right by injunction. It is not clear from this opinion under what circumstances a court of equity will order inspection, but a later lower court case\textsuperscript{106} seems to return to the \textit{Parrish} rule that a court of equity cannot order inspection as a matter of independent relief but can only do so when the information is necessary and relevant to the issues of pending litigation to which the corporation is a party. Thus, in its present state, the Delaware law is unclear as to whether the inspection right can be enforced by an independent suit in equity. On the other hand, a federal district court case in Pennsylvania, \textit{Steinberg v. American Bantam Car Co.},\textsuperscript{107} indicates that an injunction probably will be issued to enjoin corporate action if the action was such as required shareholder approval and the shareholder can show that, if he had been

\begin{footnotes}
\textsuperscript{101} E.g., see \textit{Morris v. Brodview, Inc.}, 385 Ill. 228, 52 N.E.2d 769 (1944); \textit{Hohman v. Illinois-Iowa Power Co.}, 305 Ill. App. 17, 26 N.E.2d 420 (1940); \textit{Neiman v. Templeton, Kenley & Co.}, 294 Ill. App. 45, 13 N.E.2d 290 (1938).
\textsuperscript{102} E.g., see \textit{State ex rel. Brumley v. Jessup & Moore Paper Co.}, 24 Del. 379, 77 Atl. 16 (1910); \textit{Swift v. State ex rel. Richardson}, 12 Del. 379, 6 Atl. 856 (1886).
\textsuperscript{103} 21 Del. Ch. 121, 181 Atl. 658 (Ch. 1935).
\textsuperscript{104} 41 Del. 84, 15 A.2d 661 (Super. Ct. 1940).
\textsuperscript{105} Id. at 664.
\textsuperscript{106} \textit{State ex rel. Foster v. Standard Oil Co.}, 41 Del. 172, 18 A.2d 235 (Super Ct. 1941).
\textsuperscript{107} 76 F. Supp. 426 (W.D. Pa. 1948).
\end{footnotes}
allowed access to corporate records, the action could well have taken a different course. However the law on this point is in an undeveloped state. In the Bantam Car Co. case Steinberg, the plaintiff, sued as a shareholder to enjoin a shareholders meeting in order to enable him and his fellow shareholders to solicit proxies adverse to management. The need for additional time was created by the inaction of the corporation. The court held that “where the stockholders are unable to investigate the affairs of a corporation a sufficient length of time prior to the annual meeting of the stockholders, so as to secure the will of all before the election of directors, . . . a court of equity should exercise its undoubted authority to supervise and control the corporate election with reasonable limitations.”

It went on to say the irreparable loss that Steinberg would suffer in the absence of an injunction would be the loss of his right to inspect and copy the shareholder lists sufficiently in advance of the shareholders meeting to enable him to communicate with other shareholders regarding the condition of the company. A case of complete denial of access to stock lists would seem to be an even stronger case for the shareholder seeking an injunction.

The Illinois act has a provision which assesses a penalty of ten...
per cent of the value of the shares owned by the shareholder against any officer, agent or corporation which refuses to allow an inspection founded on a proper purpose. It seems that this provision persuades the officers of the corporation to grant the inspection in all cases except where they are certain that the purpose is improper and they can establish that fact in court. Thus the penalty provision may tend to cause improper inspections to be allowed by officers for the sole reason that the officers are fearful of the penalty they will have to pay if they are not successful in court. The Texas act has no penalty provision and there is none at common law in Delaware.

**Conclusion**

Generally the statutes and decisions of the jurisdictions covered in this Comment seem to cope intelligently with the problems of granting inspection rights to a shareholder in such a manner as to strike a fair balance between the intrinsic rights of inspection of the shareholder, which flow from his beneficial ownership, and the right of the officials of the company to protect the efficient management of the corporation for the benefit of all the shareholders. The only exception to this is the holding of the Illinois court that the burden of proof of proper purpose is on the shareholder regardless of his having owned stock for more than six months or his owning at least five per cent of the stock. This seems to put an undue burden on the shareholders who are most likely to have a proper purpose for making an inspection and ignores a distinction which seems to have been intended by the legislature. On the other hand the statutes themselves are not perfect. The six-months time qualification for stock ownership seems to be insufficient and should probably be increased to one year, in order to more nearly assure that stockholders who meet this qualification have a proper purpose in seeking the inspection. However it would be a waste of time for the legislature to make such a change in Illinois or Texas while the *Morris* case is controlling, for under it the qualifications of five per cent and six months are merely worthless verbage.

The only way for the legislatures to make an informed judgment of the inspection statutes would be to make a factual study of the expense and inconvenience caused to corporations by inspections, and the frequency with which inspections have been made in the number of shares held by him, to compel by mandamus or otherwise the production for examination by such shareholder of the books and records of account, minutes, and record of shareholders of a corporation.
past. These factors should be considered in the light of the extent to which the inspection right allows the shareholders to perform "watch dog" duties on improper action by corporate officials and the weight which should be given to the time-honored feeling that the shareholders should have some inspection right since they are the beneficial owners of the corporation. Only by accurately determining these facts can the legislatures evaluate their past work and determine what improvements are needed.

William T. Blackburn