

IMPROVING SHAREHOLDER MONITORING OF CORPORATE MANAGEMENT BY EXPANDING STATUTORY ACCESS TO INFORMATION

Randall S. Thomas*

I. INTRODUCTION

A central issue in contemporary corporate law is the effectiveness of shareholders as monitors of corporate management.¹ For example, in a series of recent articles, legal scholars have debated whether the rapid growth in the equity ownership positions of institutional investors, the relative stability of their shareholdings in each company, and their increased activism in corporate governance matters, will lead to better monitoring by shareholders and improved corporate performance.² However, two predicates to effective shareholder monitoring are that dispersed investors have information about the companies they invest in and that they can communicate this information to other investors so that they can act collectively.

Good monitors need cheap and easy access to information and unimpeded, inexpensive methods of communicating to other shareholders. Investors can learn much at a low cost through informal mechanisms, such as meetings between managers and shareholders, or from examining public documents filed by reporting companies under the federal securities laws.³ These investors can also establish their own internal communication networks,

* Professor of Law, The University of Iowa College of Law; B.A., 1970, Haverford College; Ph.D., 1983, University of Michigan; J.D., 1985, University of Michigan Law School. The author acknowledges the helpful comments of Vice-Chancellor Jack B. Jacobs and Professor Elliot J. Weiss, and the research assistance of Jay Byers.

1. One recent collection of important articles on this topic is the *Cardozo Law Review's* symposium on institutional investors including articles by John Coffee, Edward Rock and Ian Ayres. See generally Symposium, *Taking Stock: Reflections on Sixty Years of Securities Regulation*, 15 CARDOZO L. REV. 837 (1994).

2. Advocates of the position that institutional investor monitoring will lead to improved corporate performance include Bernard S. Black, and Ronald J. Gilson and Reinier Kraakman. See Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992); and Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991). For more skeptical views, see John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277 (1991); Edward B. Rock, *Controlling the Dark Side of Relational Investing*, 15 CARDOZO L. REV. 987 (1994).

3. Shareholders can obtain information about some of the company's shareholders from public filings, such as the institutional shareholders' Form 13F filings. Bernard S. Black, *Disclosure, Not Censorship*, 17 J. CORP. L. 49, 68 (1991) [hereinafter Black, *Disclosure, Not Censorship*]. However, these filings are limited to those institutions with over \$100 million in stocks and are only filed on a quarterly basis. *Id.* They can also obtain a significant amount of information about registered companies from their Form 10-K and Form 10-Q filings.

as institutional investors have through organizations such as the Council of Institutional Investors.⁴

When management is hostile to the ideas that the shareholders are proposing, however, they can cut off their access to certain information. For example, suppose management opposes an acquisition offer, or a bid for board representation by a shareholder, such as Robert Monks' attempt to gain a seat on Sears' board of directors.⁵ In this situation, a corporation can refuse to give shareholders access to key information, as Sears did to Monks when it refused to provide him with a list of the names of other shareholders so that he could solicit their votes.⁶ Alternatively, management may not want shareholders to learn about corporate mismanagement or wrongdoing and may withhold vital data on these activities.⁷ If management fails, or refuses, to provide them with information, shareholders must rely on other mechanisms to get it.

This article analyzes shareholders' use of state corporate law inspection statutes as a means of prying information out of corporations. Inspection statutes permit shareholders to obtain two types of information from recalcitrant managers: the corporation's stocklist and its books and records. The stocklist gives the names and addresses of all of the corporation's current shareholders; information vital for effective intra-shareholder communications in critical situations.⁸ These communications are necessary for a shareholder

4. The Council of Institutional Investors is an organization that serves primarily as an information clearinghouse for institutional investors, Patrick J. Ryan, *Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy*, 23 GA. L. REV. 97, 157 (1988), although in recent years it has also become an umbrella organization for institutions that are interested in expanding shareholder voice. Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 569 (1990).

5. Robert A. G. Monks, *My Run for the Sears Board*, LEGAL TIMES, Aug. 12, 1991, at 20. A recent attempt by two labor unions to seat a representative on K-Mart Corporation's board of directors over management's opposition is another example. Robert Berner, *K-Mart Urges Shareholders to Reject Proposals Filed by Two Labor Unions*, WALL ST. J., Apr. 8, 1996, at A8.

6. Black, *Disclosure, Not Censorship*, *supra* note 3, at 68.

7. Although registered companies may have an obligation under the federal securities laws to report some of this information to their shareholders, they may fail to do so or may do so in a misleading manner. Furthermore, shareholders of companies that are not required to make these disclosures have no alternative method in many cases of obtaining this information.

8. For example, in a proxy contest, the stocklist is essential for mailing the solicitation materials to the shareholders once it has been decided to undertake the contest. But a stocklist now consists of much more than just a list of record shareholders with their names and addresses. Subsidiary information, such as magnetic tape compilations, breakdowns of stockholding by depository nominees, commonly referred to as CEDE breakdowns, and (where appropriate) lists of non-objecting beneficial owners of stock held by registered brokers and dealers that are available to the issuer under Rule 14b-1(c) (the "NOBO list"), and its counterpart for banks under Rule 14b-2 that hold stock for consenting beneficial owners (the "COBO list") are now considered part of the stocklist. Daily transfer sheets from the date of the list provided to the opposition shareholders, showing changes in the holdings of shareholders, will be needed up to the date of the meeting.

A CEDE breakdown is a list provided by the depository trusts of the brokers, banks and other institutions who have the company's securities registered under the name of the depositories' nominee. This information is critical for communicating with the beneficial holders of the company's stock.

In response to a stockholder's demand for a stocklist, a court will order the production of a CEDE breakdown if the corporation does not have one already prepared. *Shamrock Assoc. v. Texas Am. Energy Corp.*, 517 A.2d 658, 660-61 (Del. Ch. 1986). The Delaware court's rationale has been that these lists can be prepared within hours by the depository trusts and therefore should be considered to be in the company's possession. The CEDE breakdown

trying to convince other shareholders to vote for its proposal or hoping to solicit support against a management proposal.⁹

A shareholder seeking to uncover corporate mismanagement or fraud may need access to the company's internal files.¹⁰ It can obtain access to the corporation's books and records pursuant to a court order under an inspection statute. These statutes could authorize a court to give a shareholder any document that the corporation possesses, although typically courts limit this access to corporate minutes and accounting records.¹¹ The Delaware Supreme Court has suggested that shareholders could use these statutes to investigate potential corporate wrongdoing before seeking to file derivative lawsuits.¹² Shareholders seeking evidence of securities fraud necessary for filing a class action under the new stricter pleadings requirements imposed by the Securities Litigation Reform Act might also be interested in using corporate inspection statutes.¹³

enables dissidents to send their materials directly to the banks and brokers for forwarding to the ultimate beneficial owners.

However, the CEDE breakdown does not give a dissident stockholder the names and addresses of the beneficial holders of the company's stock. To get this information, the stockholder needs NOBO/COBO lists. NOBO/COBO lists are lists of the beneficial owners of a corporation's stock whose stock is held in record-only form by brokers and who do not object to the disclosure of NOBO's, or whose stock is held in record-only form by banks and who affirmatively consent to the disclosure of COBO's, their name and address by their broker or bank to the corporation itself for the limited purpose of facilitating direct communication on corporate matters. The federal proxy rules require registered brokers, dealers and banks that hold the company's stock in street name to compile NOBO or COBO lists at the corporation's request. See SEC Rules 14a-13 and 14b-1, 17 C.F.R. §§ 240.14a-13 and 240.14b-1 (1993). These lists must give the name, address and stock ownership of each nonobjecting, or consenting, beneficial stockholder as of the date specified in the issuer's request, and must be sent to the issuer no later than five business days after the record date or the date specified in the issuer's request. The state courts have ordered corporations to turn over NOBO/COBO lists where they are already in their possession but have split over whether a company that does not have one must obtain one when a shareholder makes a demand. Compare, *Cenergy Corp. v. Bryson Oil & Gas, P.L.C.*, 662 F. Supp. 1144, 1148 (D. Nev. 1987) (same); *Parsons v. Jefferson-Pilot Corp.*, 426 S.E.2d 685, 690-91 (N.C. 1993) (same); *RB Assocs. v. Gillette Co.*, No. 9711, 1988 WL 27731, at *7 (Del. Ch. Mar. 22, 1988) (denying shareholder request), with *Sadler v. NCR Corp.*, 928 F.2d 48, 53 (2d Cir. 1991) (ordering creation of NOBO/COBO lists).

9. These stocklists are not public information; the shareholders can only obtain one from management. If management is not willing provide this stocklist, the shareholder usually must file suit in state court to force the stocklist's production. This litigation delays the shareholder's efforts to communicate with other shareholders and costs them money, but it remains the only sure way of obtaining the stocklist.

10. The United States Supreme Court has recognized that corporate frauds may only be discoverable through the examination of corporate records by shareholders. *Guthrie v. Harkness*, 199 U.S. 148, 155 (1905).

11. The "books and records" of the corporation include appropriate corporate accounting records, minutes of all meetings of the corporation's shareholders, the board of directors or its committees, or of actions taken by written consent by the shareholders or board of directors, the stocklist materials, and copies of the corporation's certificate of incorporation, bylaws, written communications to shareholders and resolutions creating one or more classes of stock. See MODEL BUS. CORP. ACT § 16.01 (1991) [hereinafter MBCA]. See also DEL. CODE ANN. tit. 8, § 224 (1993) (records include stocklist, books of account, and minute books).

12. *Rales v. Blasband*, 634 A.2d 927, 934 n.10 (Del. 1993). See *infra* notes 143, 145-47 and accompanying text for further discussion of this case.

13. See Randall S. Thomas & Kenneth J. Martin, *Using State Inspection Statutes for Discovery in Federal Securities Fraud Class Actions* (Unpublished Working Paper, University of Iowa College of Law 1996) (copy on file with author).

Shareholders' inspection rights are qualified by the recognition that the corporation has a competing interest to be free from harassment by dissident investors.¹⁴ Shareholders seeking to disrupt the corporation's business, or misuse its proprietary information, cannot be allowed unrestrained access to corporate secrets.¹⁵ The corporation's management must balance the interests of all shareholders against those of the shareholder seeking to obtain the corporate information.

State inspection statutes attempt to protect the corporation from abusive demands by requiring that shareholders make their demands in good faith and that they state a proper purpose for seeking to obtain the information.¹⁶ The stockholder has no right to an examination if her purpose is to satisfy her curiosity, to annoy or harass the corporation with litigation, to attempt to force the corporation to buy out her interest, or to accomplish some object hostile to the corporation or detrimental to its interests.¹⁷ Proper purposes have generally been defined as including those purposes reasonably related to the stockholder's interest as a stockholder, that is, they must benefit the stockholder in her status as a stockholder.¹⁸

Scholars have yet to examine whether inspection statutes provide shareholders effective access to the information that they need to monitor managers without sacrificing the interests of the corporation.¹⁹ This article uses an empirical analysis of cases filed under the most important of the state inspection statutes, the Delaware statute, to examine whether inspection statutes facilitate shareholder communication and information collection.

This analysis shows that the Delaware inspection statute is a time consuming, expensive, but generally successful way for shareholders to obtain information about their corporation. For example, shareholders using the Delaware stocklist statute are able to obtain a stocklist in about seventy-eight

14. James L. Young, *Texas Law on Stockholders' Inspection Rights: How Does it Stack up Against Delaware Law and the Model Business Corporation Act?*, 40 SW. L.J. 845, 845-46 (1986).

15. See 2 ERNEST L. FOLK, III, ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW, § 220.5 (1993).

16. See, e.g., DEL. CODE ANN. tit. 8, § 220 (1993). The Delaware statute provides that the stockholder must make demand under oath stating a proper purpose for requesting the information. Under the terms of the statute, a proper purpose is defined as a purpose related to the stockholder's interest in the corporation.

17. 2 FOLK ET AL., *supra* note 15, § 220.7.4. Other improper purposes include seeking a stocklist to satisfy potential future needs, obtaining a list for resale to third parties, or getting the list as part of a fishing expedition.

18. In this regard, the courts have held that it is a proper purpose to ask to inspect the stock books in order to communicate with fellow shareholders and solicit proxies in opposition to the management, even if the stockholder's role is limited to supporting the contest and supplying the list to someone else, whether in connection with a proxy contest, a tender offer, or otherwise. 2 *id.* § 220.7.3. Some other examples of proper purposes include the investigation of suspected mismanagement or of the corporation's financial condition, determination of the value of one's stock, opposition to corporate plans, dissemination of information concerning a proposed merger or to aid the stockholder in ongoing litigation by inviting other shareholders to join in it. 2 *id.*

19. Similar issues under the federal proxy rules have been highlighted in the recent debate over proxy reform. See, e.g., Symposium, *Proxy Reform*, 17 J. CORP. L. 1 (1991); Bernard S. Black, *Next Steps in Proxy Reform*, 18 J. CORP. L. 1 (1992) [hereinafter Black, *Next Steps*]; John C. Coffee, *The SEC and the Institutional Investor: A Half-Time Report*, 15 CARDOZO L. REV. 837 (1994).

percent of the cases examined.²⁰ The median successful stocklist plaintiffs spend over a month in litigation, while unsuccessful plaintiffs wait significantly longer.²¹ All plaintiffs pay significant attorneys' fees to litigate these cases.

Shareholders get books and records in only slightly more than two-thirds of the inspection cases examined.²² Successful plaintiffs' median wait exceeds three months, while unsuccessful shareholders spend over eight months in litigation.²³ Once again, shareholders incur substantial attorneys' fees to get this information.

This article argues that for the Delaware inspection statute to facilitate effective shareholder monitoring, it must be significantly streamlined. The article considers a variety of possible reforms to the existing statute, such as shortening the discovery, trial and appeal processes, granting shareholders automatic access to stocklists, increasing sanctions for frivolous refusals to produce information, and attorney fee shifting provisions. This article finds that, while each of the suggested reforms would increase shareholder access to corporate information, safeguards must be kept in place to insure against abuses by unscrupulous opportunists. These safeguards are more easily implemented for stocklists than for certain types of books and records because of the highly sensitive nature of some internal corporate materials.

The article also addresses two related issues concerning inspection statutes: first, the proposed strengthening of the federal stocklist regulations which could potentially supplant the state law remedy; and second, the potential use of inspection statutes as a discovery device by shareholders to investigate corporate wrongdoing prior to filing a derivative or class action. It concludes that the SEC should amend Rule 14a-7 to provide shareholders better access to stocklists if state law is not revised. It further concludes that many plaintiffs in potential derivative and class action lawsuits are unlikely to use the Delaware inspection statute to uncover corporate wrongdoing unless there are significant changes made to its present form.

The article proceeds as follows. Section II traces the historical development of shareholder inspection rights from their traditional common law forms through their statutory codification. Section III focuses on the background of the Delaware inspection statute and its important features. Section IV presents empirical data concerning the effectiveness of the Delaware statute. It then discusses the implications of these results for the two issues mentioned above: whether the federal stocklist rules need to be strengthened and the use of the inspection statute as a discovery device. Section V looks at several possible changes to the Delaware inspection statute to determine if they would improve shareholders' access to information. The concluding section recommends that existing inspection statutes be revised to provide easier access for shareholders to stocklists and corporate books and records.

II. THE HISTORY OF SHAREHOLDER INSPECTION RIGHTS

Inspection rights have developed from two overlapping sources: a

20. See Table 1, *infra* at page 350, and text accompanying notes 114-17.

21. See Table 1, *infra* at page 350, and text accompanying notes 120-22.

22. See Table 3, *infra* at page 352, and text accompanying notes 132-34.

23. See Table 3, *infra* at page 352, and text accompanying note 134.

shareholder's property right in the corporation and the agency relationship that exists between shareholders and the corporation's management.²⁴ From the property right perspective, shareholders are entitled to inspect corporate books and records to obtain information to protect their economic interest in the corporation.²⁵ Inspection rights are based on the shareholders' underlying ownership of the corporation's assets and property, even though legal title to the assets and property is vested in the corporation.²⁶

Inspection rights are also grounded in the agency relationship between shareholders and managers of the corporation: shareholders have a right to inform themselves about how their agents are performing their duties.²⁷ The shareholders must have a means of examining the books and records under the control of the officers and other agents.²⁸ Under either perspective, inspection statutes should provide shareholders with a quick and inexpensive method of obtaining the information that they need to keep tabs on management and to communicate with other shareholders.

A. The Common Law Origins of Shareholders' Inspection Rights

Before the seventeenth century, the corporation was regarded strictly as a

24. While these two interests are conceptually distinct, they overlap to such a great extent that the courts have frequently treated them together. *See, e.g.,* Shaw v. Agri-Mark, Inc., 663 A.2d 464, 467 (Del. 1995) ("[I]nspection rights have been viewed as an incident to the stockholder's ownership of corporate property....As a matter of self-protection, the stockholder was entitled to know how his agents were conducting the affairs of the corporation of which he or she was a part owner.")

25. Samuel M. Koenigsberg, *Provisions in Corporate Charters and By-Laws Governing the Inspection of Books by Stockholders*, 30 GEO. L.J. 227, 227-28 (1942); Brian C. Griffin, Note, *Shareholder's Inspection Rights*, 30 OKLA. L. REV. 616, 616 (1977); Note, *Proper Purpose for Inspection of Corporate Stock Ledger*, 1970 DUKE L.J. 393, 394 [hereinafter Note, *Proper Purpose*].

26. The legal fiction that a corporation is separate from the shareholders does not obscure the fact that the shareholders are the true owners. Graciano C. Regala, *Nature of the Rights of Stockholders to Examine the Books of the Corporation*, 21 PHIL. L.J. 74, 75 (1941). The shareholder is recognized as an equitable owner of the corporate assets through his title to the stock. RUSSELL B. STEVENSON, JR., *CORPORATIONS AND INFORMATION: SECRECY, ACCESS, AND DISCLOSURE* 152 (1980); Susan B. Hoffnagle & Jolyan A. Butler, *Shareholders' Right to Inspection of Corporate Stock Ledger*, 4 CONN. L. REV. 707, 709 (1972); 18 C.J.S. *Corporations* § 502 (1939). The shareholder's right to inspection is acknowledged as one of the rights incident to ownership in order to protect her proprietary interest and to insure the honest and diligent performance of those to whom she has entrusted to manage her investment. Hoffnagle & Butler, *supra*, at 709. A shareholder has a fundamental right to be intelligently informed about corporate matters. 5A WILLIAM M. FLETCHER, *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATION* § 2213 (perm. ed. rev. vol. 1987). However, the United States Supreme Court has stated that a shareholder's right to inspect corporate books and records is not a right which universally attaches to corporate shares. *Tcherepnin v. Knight*, 389 U.S. 332, 343-44 (1967); *see* 5A FLETCHER, *supra*, § 2213.

27. Common law inspection rights stem from the proposition that corporate officers are merely the agents, or trustees, of the real owners of the property, the shareholders. Koenigsberg, *supra* note 25, at 227; Griffin, Note, *supra* note 25, at 616; Note, *Proper Purpose*, *supra* note 25, at 394. The United States Supreme Court endorsed this position in *Guthrie v. Harkness*, 199 U.S. 148, 154-55 (1905) ("The right of inspection rests upon the proposition that those in charge of the corporation are merely the agents of the stockholders who are the real owners of the property."); 5A FLETCHER, *supra* note 26, § 2213; Regala, *supra* note 26, at 75.

28. Without shareholder inspection rights, those in charge of a corporation potentially may engage in gross incompetence or dishonesty for years. HENRY W. BALLANTINE, *BALLANTINE ON CORPORATIONS* § 159 (rev. ed. 1946); 5A FLETCHER, *supra* note 26, § 2213.

trustee holding its property for the benefit of the stockholders.²⁹ As the modern corporation developed during the industrial revolution, the English common law began to recognize a shareholder's right to inspect the books of the corporation in order to protect his property interests.³⁰

In the early 1700's, the English courts granted shareholders access to corporate books and records.³¹ The rule was well-stated by the court in *Rex v. Fraternity of Hostman*: "every member of the corporation had, as such, a right to look into the books for any matter that concerned himself, though it was in a dispute with others."³² The court went on to hold that

such books,...as are the common property of aggregate bodies acknowledged as such by our law, in which every member has an interest as being the evidence of some property or franchise being vested in him, or of his having conducted himself in the exercise of that franchise correctly. Such are corporation books with respect to corporators.³³

Today, the general rule at common law is that all stockholders of a private corporation have the right to inspect and examine the books and records of the corporation.³⁴ The common law right is not an absolute right, however, but rather a qualified one exercised only where the shareholder has established a proper purpose and proper time and place for inspection.³⁵ A proper purpose under common law has been defined as "a purpose relating to the interest that the stockholder sought to protect by seeking inspection."³⁶ As the Delaware

29. WILLIAM F. WALSH, A HISTORY OF ANGLO AMERICAN LAW 382-83 (2d ed. 1932).

30. *In re Steinway*, 53 N.E. 1103, 1105 (N.Y. 1899).

31. For example, the court in *Gery v. Hopkins* stated that "there is great reason for it, for they are books of a public company, and kept for public transactions, in which the public are concerned; and the books are the title of the buyers of stocks, by Act of Parliament." *Gery v. Hopkins*, 87 Eng. Rep. 1142 (1702).

32. *Rex v. Fraternity of Hostman*, 93 Eng. Rep. 1144 (1745).

33. *Id.* In another case, *Richards v. Pattinson*, the court granted an elector of a corporation the right to inspect the "part of the corporation-books where the names of the freemen are inrolled, and make copies at his own expense." *Richards v. Pattinson*, 94 Eng. Rep. 893 (1737).

In the 1790 case of *Rex v. Babb*, Lord Kenyon assumed "that in certain cases the members of a corporation may be permitted to inspect all papers relating to the corporation." *Rex v. Babb*, 100 Eng. Rep. 743, 744 (1790); see also *Rex v. Merchant Tailors' Co.*, 109 Eng. Rep. 1086, 1089 (1831); *Young v. Lynch*, 96 Eng. Rep. 14 (1747). In *Rex v. Babb*, the court held that if a corporator has a general right of inspection, he may apply at any time, and not wait until there is a cause in the court before he makes that the ground of his application. If a shareholder applies for a general inspection of all papers merely on the ground of his having an interest in them as a member of the corporation, he must shape his application accordingly. *Babb*, 100 Eng. Rep. at 744-45; see also *Merchant Tailors' Co.*, 109 Eng. Rep. at 1089.

34. *Guthrie v. Harkness*, 199 U.S. 148, 154 (1905); *Shaw v. Agri-Mark, Inc.*, 663 A.2d 464, 466 (Del. 1995); 5A FLETCHER, *supra* note 26, § 2214; HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS § 199 (1987). See also BALLANTINE, *supra* note 28, §§ 159, 160; GEORGE D. HORNSTEIN, CORPORATION LAW AND PRACTICE §§ 611, 612 (1959); Frank G. Newman, *Inspection of Stock Ledgers and Voting Lists*, 16 SW. L.J. 439, 440 (1962); Regala, *supra* note 26, at 75; 18A AM. JUR. 2D *Corporations* § 348 (1985); 18 C.J.S. *Corporations* § 332 (1990); Annotation, *Stockholder's Right to Inspect Books and Records of Corporation*, 22 A.L.R. 24 (1923), supplemented in 43 A.L.R. 783 (1926), 59 A.L.R. 1373 (1929), 80 A.L.R. 1502 (1932), 174 A.L.R. 262 (1948); W.E. Shipley, Annotation, *Purposes for Which Stockholder or Officer May Exercise Right to Examine Corporate Books and Records*, 15 A.L.R.2d 11 (1951).

35. *Agri-Mark, Inc.*, 663 A.2d at 466-67; Hoffnagle & Butler, *supra* note 26, at 709.

36. *Agri-Mark, Inc.*, 663 A.2d at 467.

Supreme Court recently stated: "the propriety of a demanding stockholder's purpose was measured by whether it related to the stockholder's interest qua stockholder, that is, a proper purpose in seeking inspection was viewed as a purpose germane to the petitioner's interest or status as a stockholder."³⁷

The common law form of the shareholder's right to inspection could be exercised through a variety of judicial forms: mandamus at law; mandatory injunction in equity; animation-before-trial; or discovery-and-inspection.³⁸

B. The Development of Statutory Inspection Rights

In the 1800's, firms grew larger and more complex and their shareholders became more numerous and dispersed. The shareholders' need for reliable information concerning corporate affairs expanded with the increasingly complicated problems of corporate finance and production, in addition to the rapidly expanding number of shareholders.³⁹ Shareholders were less and less likely to be involved in the corporation's management, or to have easy access to inside information about the company's business. To learn about what was happening to their investment they needed assistance to get this information and they turned to statutory corporate law to get that help.⁴⁰

Corporate law statutes in the early 1800's offered two approaches to deal with this problem: (1) declaring a right for shareholders to inspect the books and records of the corporation; and (2) requiring the corporation to make periodic reports to its shareholders. Although states consistently failed to impose effective reporting requirements through the nineteenth and mid-twentieth centuries, state statutory law concerning shareholder inspection rights was more favorable.⁴¹

For many years, the courts interpreted these statutes to impose limitations on a shareholder's inspection rights by requiring the shareholder to seek inspection in good faith and for proper purposes.⁴² A proper purpose was defined in the same manner as under the common law right: a purpose that related to the stockholder's interest in the corporation.⁴³ These limitations

37. *Id.*

38. HORNSTEIN, *supra* note 34, § 611. Generally, shareholder inspection rights are fully recognized in the absence of any constitutional or statutory provision. 5A FLETCHER, *supra* note 26, § 2214. Moreover, a shareholder is deprived of the common law right only by specific statutory terms or by some authorized provision of the corporation's articles or charter or by some valid and authorized bylaw. *Id.*

39. JAMES W. HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES, 1780-1970, at 89 (1970).

40. HURST, *supra* note 39, at 89. *See also Agri-Mark, Inc.*, 663 A.2d at 467 ("As an equitable owner of the corporation's assets, a stockholder possessed a right to reasonable information concerning the conduct of corporate management, as well as the condition of the corporation's business and affairs.").

41. HURST, *supra* note 39, at 89-90.

42. *Id.* at 90; C. Thomas Attix, Jr., Note, *Rights of Equitable Owners of Corporate Shares*, 99 U. PA. L. REV. 999, 1000 (1951) [hereinafter Attix, Note, *Rights of Equitable Owners*]; George B. Davis, Note, *Shareholder Inspection Rights*, 12 SW. L.J. 61, 61 (1958); *see, e.g., State v. Jessup & Moore Paper Co.*, 88 A. 449, 452 (Del. Super. Ct. 1913) (stating that a shareholder's right to inspection under Delaware law was conditional upon whether it was sought in good faith and for a specific and proper purpose); *In re Steinway*, 53 N.E. 1103, 1105 (N.Y. 1899) (recognizing that shareholder inspection rights under New York law were limited to a proper purpose under reasonable circumstances).

43. *See, e.g., State ex rel. Thiele v. Cities Serv. Co.*, 115 A. 773, 776 (Del. 1922):

If it appears that [the stockholder] seeks to exercise the right for some purpose

invited contests and often resulted in lengthy and costly litigation.⁴⁴

Over time the shareholders' statutory access to corporate information became unfettered.⁴⁵ By the late 1800's, state legislatures commonly encoded and extended the common law right of inspection in unqualified terms.⁴⁶ The limitations of the common law rule, the good faith and proper purpose requirements, were thought to be too restrictive. Thus the new statutes vested an absolute right in shareholders to inspect corporate books and records regardless of their purpose.⁴⁷ By the early 1900's, many state statutes also provided for punitive sanctions against a company and its officials for refusing to provide the information requested by shareholders, even where the shareholder's demands were clearly unreasonable.⁴⁸

The legislatures' and courts' recognition of an unfettered right to inspect books and records led to unfortunate consequences. For example, business competitors would purchase shares of a company to obtain unfair access to corporate information or to blackmail their competitors.⁴⁹

These abuses resulted in a legislative backlash in the 1930's and a statutory movement back toward the common law's limitations on shareholders' inspection rights.⁵⁰ Some states went beyond the common law rule to limit the

that is in no wise connected with his interest as a stockholder, but is entirely foreign to such interest, the court which is asked to issue mandamus upon the corporation to compel it to aid him in pursuing such a purpose, not only has the right under the statute to deny him the writ, but it is its duty in the exercise of a sound discretion to do so.

44. HURST, *supra* note 39, at 90.

45. Wiley B. Rutledge, Jr., *Significant Trends in Modern Incorporation Statutes*, 22 WASH. U. L.Q. 305, 331 (1937).

46. HURST, *supra* note 39, at 90; Rutledge, *supra* note 45, at 331; Note, *Proper Purpose*, *supra* note 25, at 395; Attix, Note, *Rights of Equitable Owners*, *supra* note 42, at 1000-01; Davis, Note, *Shareholder Inspection Rights*, *supra* note 42, at 61; *see, e.g.*, CODES AND STAT. OF CAL. § 5321 (1876) (requiring "[e]very corporation...keep...in a place accessible to the shareholders, and for their use...a book containing a list of all stockholders..."); N.Y. LAW ch. 564, § 29 (1890) (stating that the corporate books and stock ledger "shall daily, during business hours, be open for the inspection of shareholders..."); OHIO REV. STAT. § 3254 (1892) (maintaining that the "books and records of such corporation shall at all reasonable times, be open to the inspection of every stockholder").

47. Rutledge, *supra* note 45, at 331; Attix, Note, *Rights of Equitable Owners*, *supra* note 42, at 1000-01; Note, *Proper Purpose*, *supra* note 25, at 395; *see, e.g.*, *Furst v. Rawleigh Medical Co.*, 118 N.E. 763, 765 (Ill. 1918) (stating that the shareholder inspection rights conferred by Illinois statutory law were "unqualified and unrestricted, except, only, for the limitation that the right shall be exercised at reasonable times"); *Henry v. Babcock & Wilcox Co.*, 89 N.E. 942, 943 (N.Y. 1909) (recognizing a shareholder's absolute right of inspection and imposing an absolute duty upon the corporation to provide information under New York statutory law).

48. Rutledge, *supra* note 45, at 331. *See, e.g.*, MO. REV. STAT. § 4551 (1929) (imposing a \$250 fine on officers in charge of corporate books for refusal or neglect to grant inspection rights to shareholders); N.Y. LAW ch. 127, § 32 (1916) (imposing a \$50 fine on any corporate officer who wilfully neglected to allow the inspection of books and records).

49. Rutledge, *supra* note 45, at 331.

50. *Id.*; Davis, Note, *Shareholder Inspection Rights*, *supra* note 42, at 61; *see, e.g.*, CAL. CIV. CODE § 355 (Deering 1931) (declaring that "[t]he share register, the book of accounts, and minutes of proceedings...shall be open to inspection upon the written demand of any...stockholder...at any reasonable time, and for a purpose reasonably related to his interests as a shareholder..."); 1933 Minn. Laws ch. 300, § 33 (stating that "[e]very shareholder shall have a right to examine...for any proper purpose...the share register, books of accounts and records..."); N.Y. LAW, ch. 641, § 10 (1933) (limiting shareholder inspection rights so "that such inspection shall not be for the purpose of communicating with stockholders in the interest

category of shareholders who were entitled to inspection rights, including the restrictions that a shareholder seeking inspection of corporate books and records must own a certain percentage of outstanding stock and must own that stock for a required minimum length of time prior to seeking inspection.⁵¹

Today, shareholders' qualified rights to obtain a stocklist and inspect corporate books and records are accepted in every state.⁵² The substance of the Model Business Corporation Act's ("MBCA") statutory provisions are typical of those used in many states. The MBCA contains provisions defining corporate records, the inspection rights of shareholders and the scope of those rights, and the procedures for court-ordered inspection.⁵³

The MBCA grants any shareholder the right to examine the books and records of the corporation upon written demand at reasonable times for a proper purpose.⁵⁴ A proper purpose is defined as a purpose that is "reasonably relevant to the demanding shareholder's interest as a shareholder."⁵⁵ If the corporation refuses the shareholder's demand, the shareholder may apply to a court for an order compelling the production of the needed books and records.⁵⁶ If the court orders production, the corporation must prove its refusal was in good faith, or it must pay the shareholder's attorneys' fees and costs of filing the suit. This statute supplements but does not supplant the shareholder's common law inspection rights.⁵⁷

III. THE DELAWARE INSPECTION STATUTE

Delaware is the preeminent state corporate law jurisdiction in the United States.⁵⁸ Its corporate code is applied by lawyers throughout the nation in deciding how to structure complex transactions. The Delaware Chancery Court decides most of the important American corporate law cases, whether they arise out of hostile acquisitions or disputes over access to stocklists and corporate books and records. Delaware corporate jurisprudence is therefore widely followed by other states' courts.

However, at the turn of twentieth century, New Jersey, not Delaware,

of a business or object other than the business of the corporation"); *see also* *Dauids v. Sillcox*, 66 N.Y.S.2d 508, 514 (N.Y. Sup. Ct. 1946) (recognizing that the proper purpose requirement under New York law included the limitations and safeguards necessary to deny judicial consideration for "[t]he blackmailer, the scandalmonger, the irresponsible busybody and trouble maker, the professed seeker of information which is really intended to be used for some ulterior purpose").

51. Rutledge, *supra* note 45, at 331-32; *see, e.g.*, LA. GEN. STAT. § 1118 (1932) (compelling ownership of at least two percent of the outstanding stock for at least six months); 1931 Mich. Pub. Acts 327, § 45 (requiring shareholders seeking inspection to own at least two percent of the outstanding capital stock for at least three months prior thereto); N.Y. LAW CH. 641, § 10 (1933) (requiring stockholders seeking inspection to be either stockholders of record for at least six months immediately preceding demand or to be owners of at least five percent of all outstanding shares of the corporation).

52. 5A FLETCHER, *supra* note 26, § 2213.

53. MBCA §§ 16.01-16.04.

54. *Id.* § 16.02. Many states restrict this right to shareholders that have held their stock for a stated period of time, usually six months, or who hold more than a specified percentage, usually five percent, of the corporation's stock.

55. *Id.* § 16.02(c), Official Commentary, at 1721.

56. *Id.* § 16.04.

57. *Id.* § 16.02, Official Commentary, at 1723.

58. ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 42 (1993).

dominated the corporate charter market.⁵⁹ In seeking to compete in the market for corporation charters, Delaware copied the New Jersey Revised Statute of 1896 essentially verbatim in 1899.⁶⁰ This included the New Jersey code's statutory inspection rights.

A. Shareholder Inspection Rights in Delaware Prior to 1967

On March 10, 1899, the Delaware legislature adopted section 17 of the Delaware General Corporation Law, the predecessor of the modern Delaware statute. The statute included the following provision codifying shareholders' right to inspect the corporate stock ledger, or stocklist:

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 of 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.⁶¹

Although the statutory provisions governing shareholders' inspection rights under the Delaware General Corporation Law were amended several times over the next fifty years, the language of this provision remained virtually untouched until the 1967 revisions of the code.⁶²

59. *Id.*

60. CHRISTOPHER GRANDY, *NEW JERSEY AND THE FISCAL ORIGINS OF MODERN CORPORATION* 76 (1993).

61. 21 Del. Laws ch. 273, § 17 (1899).

62. The statute was amended numerous times over the next 70 years. Section 17 was amended and approved as § 29 of the General Corporation Law of Delaware on March 7, 1901. The shareholders' right to inspect stock ledgers embodied in the 1899 version remained unchanged in the revised version. 22 Del. Laws ch. 167, § 29 (1901). The courts interpreted this statute to authorize shareholders to inspect the corporation's books and records, *Shaw v. Agri-Mark, Inc.*, 663 A.2d 464, 467 (Del. 1995), although this was not expressly provided for in the statutory language until the 1967 revision of the Delaware code. *See* DEL. CODE ANN. tit. 8, § 220 (1967). Furthermore, the 1901 amendment to § 29 included a provision permitting a corporation to grant bondholders the same rights as shareholders, including the right to inspect corporate books and records. 22 Del. Laws ch. 167, § 29 (1901). Although § 29 of the Delaware General Corporation Law was modified again in 1903, 1927, and 1929, the provision that embodied shareholder inspection rights remained unaltered. 22 Del. Laws ch. 394, § 29 (1903); 35 Del. Laws ch. 85, § 13 (1927); 36 Del. Laws ch. 135, § 15 (1929).

In 1949, the 115th General Assembly of Delaware created the Revised Code Commission to prepare a revised code of the general statutes of Delaware. DEL. CODE ANN. tit. 2, at ix (1953) (Report of the Revised Code Commission); 47 Del. Laws ch. 377 (1949). The governor of Delaware, Elbert N. Carvel, appointed S. Samuel Arsht, Henry J. Ridgely, and James M. Tunnell, Jr. to comprise the Revised Code Commission. DEL. CODE ANN. tit. 2, at ix (1953) (Report of the Revised Code Commission). In 1951, the Commission contracted with West Publishing Company of St. Paul, Minnesota, and Edward Thomas Company of Brooklyn, New York to prepare the revisions under the supervision of the Commission, and to print and publish the proposed Code in the revised form. DEL. CODE ANN. tit. 2, at xi (1953).

In 1953, the Delaware legislature enacted and the governor approved the new Delaware Code, the first completely modern and annotated edition of the general statutory laws in multiple volumes. DEL. CODE ANN. tit. 8, at v (1953) (publisher's preface). The new Code differed radically from all of the previous Delaware codes in the arrangement of subject matter and style of presentation. DEL. CODE ANN. tit. 2, at xi (1953) (Report of the Revised Code Commission).

The provisions containing the shareholder's right to inspect the stocklist as originally passed in 1899 remained essentially unaltered in § 220. DEL. CODE ANN. tit. 8, § 220 (1953). Section 220 of the revised Code also contained the provision from the former statute stating that the stock ledger is the only evidence as to determine the voting status of shareholders. DEL. CODE ANN. tit. 8, § 220 (1953).

Prior to the 1967 revision of the Delaware General Corporation Law, the Delaware Superior Court (not the Chancery Court) enforced shareholder inspection rights through the mandamus petition.⁶³ Mandamus is:

the name of a writ...which issues from a court of superior jurisdiction, and is directed to a private...corporation, or any of its officers...commanding the performance of a particular act therein specified, and belonging to his or their public, official, or ministerial duty, or directing the restoration of the complainant to rights or privileges of which he has been illegally deprived.⁶⁴

The pre-1967 practice of the Delaware courts in mandamus proceedings required the stockholder, called the relator through petition, to state the facts that established its legal right to the remedy sought.⁶⁵ In its answer, the defendant had to either show that it had obeyed the command of the writ or, alternatively, deny the averments of the petition in showing the stockholder to be without right to the remedy. ⁶⁶ If these denials were not unequivocal, complete and sufficient, the averments in the petition were held to be valid, and a writ of mandamus was awarded to enforce the stockholder's rights.⁶⁷

The Delaware courts interpreted the unqualified language of the statute to create a right for shareholders to inspect the stocklist.⁶⁸

Under the statute, the stockholder need only allege in the petition for a writ of mandamus: (i) that the defendant company is a corporation; (ii) that the petitioner is a stockholder of record therein; (iii) that there was a proper demand and refusal of inspection; and (iv) that the corporation failed to comply with a duty imposed by law sought to be enforced by the proceeding.⁶⁹

Thus, in a petition to compel the inspection of the stocklist under the pre-1967 version of section 220, the shareholder did not have to allege a proper purpose in the petition, as required by common law.⁷⁰ The corporation had the burden of proving that the shareholder's purpose was improper, unlawful, or in bad faith if it wanted to prevent the issuance of a writ to compel inspection of

63. 2 FOLK ET AL., *supra* note 15, § 220.2. See *Agri-Mark, Inc.*, 663 A.2d at 468 (enactment of § 220 replaced the "formalized and burdensome mandamus procedure in the Superior Court.").

64. BLACK'S LAW DICTIONARY 961 (6th ed. 1990).

65. *State ex rel. Nat'l Bank v. Jessup & Moore Paper Co.*, 88 A. 449, 451 (Del. Sup. Ct. 1913).

66. *Id.*

67. *Id.* at 451-52. Under Delaware law, the writ of mandamus was not a writ of right, but rather issued only when the facts of the case, within judicial discretion, showed that issuance was justified. Note, *Inspection of Corporate Books and Records in Delaware*, 41 VA. L. REV. 237, 238 (1955) [hereinafter Note, *Inspection of Corporate Books*]. See *State ex rel. Miller v. Loft, Inc.*, 156 A. 170, 171-72 (Del. Super. Ct. 1931). Any interest seeking to be secured or enforced by a writ of mandamus needed to "constitute a clear legal right existing in the relator at the time of the application." *State ex rel. Waldman v. Miller-Wohl Co.*, 28 A.2d 148, 152 (Del. Super. Ct. 1942). A writ of mandamus was not to be issued in doubtful cases, nor was one to be issued to enforce a right found to be in substantial dispute or a right found to be inchoate. 28 A.2d at 152.

68. Note, *Proper Purpose*, *supra* note 25, at 395-96 (discussing a shareholder's right to inspect the stock ledger under § 220, but recognizing the limitations of the mandamus proceedings).

69. *Shaw v. Agri-Mark, Inc.*, 663 A.2d 464, 467 (Del. 1995).

70. Note, *Proper Purpose*, *supra* note 25, at 396. See also Note, *Inspection of Corporate Books*, *supra* note 67, at 239.

the stocklist.⁷¹ Thus, the statutory burden of proof in an action to obtain a stocklist was not nearly as strict as under the common law.⁷²

Shareholders had both common law and statutory rights to obtain books and records from a Delaware corporation under pre-1967 Delaware law.⁷³ As with the stocklist, a shareholder made an application to the Superior Court for a writ of mandamus when an inspection of books or records had been sought and denied.⁷⁴ In a petition seeking mandamus to compel inspection of the books and records under the pre-1967 Delaware law, a stockholder had to allege a specific and proper purpose for the inspection.⁷⁵ The proper purpose had to "be alleged not by a mere bare general statement that is a proper one, but by the allegation of specific facts, from which the propriety of such purpose will appear."⁷⁶ The

71. Note, *Inspection of Corporate Books*, *supra* note 67, at 239; see *State ex rel. Foster v. Standard Oil Co.*, 18 A.2d 235, 237-38 (Del. Super. Ct. 1941).

72. Note, *Inspection of Corporate Books*, *supra* note 67, at 239. Although the statute eased the burden on the shareholder seeking inspection of the stocklist, mandamus proceedings did not create an absolute right for the stockholder to obtain the stocklist because of their peculiar pleading requirements. *Id.* at 238. Complications in the rules of mandamus resulted in further hindrance for the shareholder. Note, *Proper Purpose*, *supra* note 25, at 396.

In a mandamus proceeding, allegations in the writ that were not denied in the answer were presumed true. Note, *Proper Purpose*, *supra* note 25, at 396; see *State ex rel. Theile v. Cities Serv. Co.*, 115 A. 773, 774 (Del. 1922). However, if the defendant's answer included statements that did not conflict with the writ, then those statements in the answer were deemed conclusive and taken as true for the purpose of the case. Note, *Proper Purpose*, *supra* note 25, at 396; see *Agri-Mark, Inc.*, 663 A.2d at 467; *Theile*, 115 A. at 774. Thus, if a shareholder did not allege a proper purpose (and the statute did not require this allegation), an answer to a writ alleging that the stockholder had an improper purpose was presumed to be true, and the writ would be denied. Note, *Proper Purpose*, *supra* note 25, at 396; see *State ex rel. Linihan v. United Brokerage Co.*, 101 A. 433, 437 (Del. 1917).

A litigant could respond to this problem by including an allegation of a proper purpose in their petition and ask for the Superior Court to make a finding that it was a proper purpose. Initially, because mandamus was a summary writ, the Delaware Supreme Court reasoned that there was "no practice or procedure...whereby issues raised by the allegation in the petition and the averments in the return may be submitted upon evidence to a jury for their determination." *Linihan*, 101 A. at 437; see Note, *Proper Purpose*, *supra* note 25, at 396. However, the Delaware legislature responded by enacting an amendment to the mandamus procedure which provided that any question of fact stemming from the application for a writ of mandamus and the answer be heard and resolved by the superior court. DEL. CODE ANN. tit. 10, § 564 (1953); Note, *Proper Purpose*, *supra* note 25, at 396-97.

This meant that, as a practical matter, shareholders needed to plead a proper purpose and thus the statutory right to inspect the stocklist was not absolute.

73. *Agri-Mark, Inc.*, 663 A.2d at 467. See also *supra* note 61.

74. Note, *Inspection of Corporate Books*, *supra* note 67, at 238; see *Jefferis v. William D. Mullen Co.*, 132 A. 687, 688 (Del. Ch. 1926).

If the stockholder sought to inspect records which were in the possession of an officer or agent of the corporation, the proper practice was to petition the court for mandamus directing the custodian to allow inspection. Note, *Inspection of Corporate Books*, *supra* note 67, at 239; see *Swift v. State ex rel. Richardson*, 6 A. 856, 862 (Del. Ct. Err. & App. 1886). Where an officer or agent was not in the custody of an officer or agent, the writ was to be directed at the corporation because the corporation itself had the duty to permit the inspection demanded. Note, *Inspection of Corporate Books*, *supra* note 67, at 240; see *Bay State Gas Co. v. State ex rel. Content*, 56 A. 1114, 1119 (Del. 1904). However, the joining of an officer of a corporation as a party defendant in an alternative writ did not violate the proceedings even if the officer was not a necessary party. 56 A. at 1119.

75. Note, *Inspection of Corporate Books*, *supra* note 67, at 239; see *State ex rel. Waldman v. Miller-Wohl Co.*, 28 A.2d 148, 153 (Del. Super. Ct. 1942); *State ex rel. Miller v. Loft, Inc.*, 156 A. 170, 172 (Del. Super. Ct. 1931). As with stocklists, if the plaintiff failed to state any purpose for the inspection, the defendant could defeat the petition by alleging that the plaintiff had an improper purpose. See *supra* note 72.

76. *Loft*, 156 A. at 172.

stockholder's alleged purpose had to be proper and not adverse to the interests of the corporation, and the shareholder had the burden of proving a proper purpose.⁷⁷ Thus, the shareholder's right to inspect the books and records of the corporation through a mandamus proceeding was "in no sense an absolute right, but merely a qualified right depending upon the facts of the particular case."⁷⁸

The Chancery Court's powers under pre-1967 Delaware law were limited. It had the power to order inspection at the request of a party to a suit pending before the court if the documents at issue were in the possession of the adverse party and were material to the petitioner's allegations.⁷⁹ As a practical matter, this meant that inspection cases that were not collateral to other pending corporate disputes had to be filed in the Superior Court.

B. The 1967 Revision of Section 220 of the Delaware General Corporate Code

The 1967 revision of the Delaware General Corporation Law led to an intense debate over the proper nature of shareholders' statutory inspection rights under Delaware law. Professor Ernest Folk was the Reporter for the 1967 revision of the Delaware Corporation Code. In his 1965 Report to the Delaware Corporation Law Revision Committee (the "Committee"), Folk submitted a preliminary proposal concerning inspection rights.⁸⁰ Folk based his draft provision chiefly on section 46 of the MBCA and section 624 of the New York Business Corporations Code.⁸¹

Folk's proposed statute suggested adding several conditions to a stockholder's right to inspect.⁸² These new prerequisites included provisions

77. Note, *Inspection of Corporate Books*, *supra* note 67, at 239; see *Miller-Wohl*, 28 A.2d at 153; *Loft*, 156 A. at 172.

78. *Loft*, 156 A. at 172.

79. Note, *Inspection of Corporate Books*, *supra* note 67, at 240; see *State ex rel. Foster v. Standard Oil Co.*, 18 A.2d 235, 238 (Del. Super. Ct. 1941).

80. ERNEST L. FOLK, III, FOLK'S 1965 REPORT TO THE DELAWARE CORPORATION LAW REVISION COMMITTEE (1965) [hereinafter FOLK REPORT] (unpublished report, on file with author).

81. *Id.* at 165.

82. The full text of the proposed statute reads:

Shareholder's Right of Inspection

(a) As used in this section, a shareholder shall mean:

(1) Any person who shall have been the holder of record of shares of any class for at least six months immediately preceding his demand for inspection;

(2) Any person holding of record, or thereunto authorized in writing by the holders of record, of at least five percent of the outstanding shares of any class;

(3) Any person or persons who shall have been a holder of a voting trust certificate for at least six months immediately preceding his demand for inspection, or who holds voting trust certificates representing shares aggregating at least five percent of the outstanding shares of that class; or

(4) An attorney or other agent of any of the foregoing persons.

(b) Any such shareholder, in person or by attorney or other agent, shall, upon at least five day's written demand stating the purpose thereof, have the right during usual business hours to examine, for any specified, reasonable and proper purpose, the corporation's books and records of account, minutes of meetings of the shareholders, and record of shareholders, and to make copies or extracts therefrom. A proper purpose includes a purpose reasonably related to such person's interest as a shareholder.

(c) An inspection authorized by subsection (b) may be denied to the shareholder upon his refusal to furnish to the corporation, its transfer agent or registrar an affidavit that the shareholder does not seek inspection for an improper purpose

that: (1) the stockholder must be a stockholder of record for at least six months immediately preceding her demand for inspection; (2) the stockholder or other stockholders joining in the demand must own at least five percent of the outstanding shares of any class of stock; (3) inspection could be denied if the stockholder refused to furnish an affidavit that she did not seek the inspection for an improper purpose and that she had not sold or offered for sale any list of shareholders within five years; and (4) corporations would have the burden of establishing that the purpose for which inspection was sought was not a proper purpose.

One of the members of the Committee, Irving Morris, advocated substantial changes to Folk's draft.⁸³ Morris argued in favor of eliminating Folk's draft's requirements that shareholders hold stock for six months or have a five percent stake in the company, claiming that these conditions were both unnecessary and contrary to existing Delaware law.⁸⁴ Morris also objected to Folk's suggestion that the corporation have the burden of proof to show a stockholder had an improper purpose in all inspection cases.⁸⁵ He proposed that the revised statute place the burden on the shareholder in all cases.⁸⁶ In addition, in his proposed draft of new section 220, Morris advocated vesting exclusive jurisdiction in the Court of Chancery.⁸⁷

and that he has not within five years sold or offered for sale any list of shareholders of any domestic or foreign corporation or aided or abetted any person in procuring any record of shareholders for any such purpose.

(d) If the corporation, or an officer or agent thereof, refuses to permit an inspection permitted by subsection (b), the shareholder may apply to the Superior Court for a writ of mandamus to compel such inspection. In any such proceeding, the corporation shall have the burden of establishing that the purpose for which inspection is sought is not a proper purpose. The court may prescribe any limitations or conditions, or award such other or further relief, which to the court may seem just and proper. The court may, upon such terms and conditions as the court may prescribe, order books, documents and records, pertinent extracts therefrom, or duly authenticated copies thereof, to be brought within this State and kept in such place in this State and for such time and purposes as the order may prescribe.

(e) Nothing in this section shall impair the power of a court to compel the production for examination of the books and records of the corporation, without regard to the period of time during which the shareholder has been a shareholder or to the number of shares held by him.

Id.

83. Memorandum from Irving Morris to the Members of the Delaware Corporation Law Revision Committee (Apr. 19, 1965) (on file with author).

84. In rejecting the five percent requirement, Morris argued that "[t]he key to inspection is that the inspection be sought for a specified, reasonable and proper purpose. If a stockholder holding less than 5% of the stock meets the test so far as his purpose is concerned, it should not make any difference that his total holdings or those acting in concert with him are less than 5%." *Id.* at 2. He also saw no reason to stop a shareholder that had recently acquired stock from seeking an inspection if some event occurred which caused him concern about the company. *Id.* at 3.

85. *Id.* at 4. Morris claimed it would be a "serious error" to place the burden on the corporation in a books and records case because that would infringe on Delaware directors' responsibility to manage the corporation. *Id.* at 6.

86. Morris felt that a stockholder should have the burden of demonstrating a proper purpose in all cases because the common law placed the burden for books and records on the shareholder and that a shareholder naturally assumes the burden for demanding inspection for shareholder lists regardless of factual distinctions. *Id.* at 5.

87. *Id.* at 8.

Upon receiving suggestions from other members of the Committee,⁸⁸ Morris submitted a revised draft of the proposed statute to the Committee.⁸⁹ After a further meeting of the Committee on May 4, 1965, Morris prepared two additional drafts of his proposed section 220 addressing further concerns of the Committee's members.⁹⁰ The Delaware legislature enacted revised section 220 in 1967.⁹¹

88. Chancellor Collins J. Seitz, another member of the Committee, responded to Morris' letter by suggesting certain changes in the draft language, including that the statute should contain some language making it clear that this type of case should be given expedited treatment in the court system. Letter from Chancellor Collins J. Seitz to Irving Morris (Apr. 22, 1965) (on file with author).

89. Draft No. 2 was written in response to Chancellor Seitz's comments and attached to a Memorandum from Irving Morris to the Members of the Delaware Corporation Law Revision Committee (Apr. 27, 1965) (on file with author).

90. Memorandum from Irving Morris to the Members of the Delaware Corporation Law Revision Committee (May 6, 1965) (on file with author). Draft No. 3 provided for an equitable owner of stock as well as a legal or equitable owner of a voting trust certificate to have a right of inspection. Draft No. 4 confined the right of inspection to stockholders of record or their attorneys or agents. In his memo to the Committee, Morris indicated that he would recommend Draft No. 4. *Id.*

91. In the final version of the statute, the Legislature placed the burden of proof on the corporation to prove an improper purpose where the shareholder seeks to inspect the stocklist, and made some minor grammatical changes. The statute now provides:

(a) As used in this section, "stockholder" means a stockholder of record.

(b) Any stockholder, in person or by attorney or other agent, shall, upon written demand under oath stating the purpose thereof, have the right during the usual hours for business to inspect for any proper purpose the corporation's stock ledger, a list of its stockholders, and its other books and records, and to make copies or extracts therefrom. A proper purpose shall mean a purpose reasonably related to such person's interest as a stockholder. In every instance where an attorney or other agent shall be the person who seeks the right to inspection, the demand under oath shall be accompanied by a power of attorney or such other writing which authorizes the attorney or other agent to so act on behalf of the stockholder. The demand under oath shall be directed to the corporation at its registered office in this state or at its principal place of business.

(c) If the corporation, or an officer or agent thereof, refuses to permit an inspection sought by a stockholder or attorney or other agent acting for the stockholder pursuant to subsection (b) of this section or does not reply to the demand within 5 business days after the demand has been made, the stockholder may apply to the Court of Chancery for an order to compel such inspection. The Court of Chancery is hereby vested with exclusive jurisdiction to determine whether or not the person seeking inspection is entitled to the inspection sought. The Court may summarily order the corporation to permit the stockholder to inspect the corporation's stock ledger, an existing list of stockholders, and its other books and records, and to make copies or extracts therefrom; or the Court may order the corporation to furnish to the stockholder a list of its stockholders as of a specific date on condition that the stockholder first pay to the corporation the reasonable cost of obtaining and furnishing such list and on such other conditions as the Court deems appropriate. Where the stockholder seeks to inspect the corporation's books and records, other than its stock ledger or list of stockholders, he shall first establish (1) that he has complied with this section respecting the form and manner of making demand for inspection of such documents; and (2) that the inspection he seeks is for a proper purpose. Where the stockholder seeks to inspect the corporation's stock ledger or list of stockholders and he has complied with this section respecting the form and manner of making demand for inspection of such documents, the burden of proof shall be upon the corporation to establish that the inspection he seeks is for an improper purpose. The Court may, in its discretion, prescribe any limitations or conditions with reference to the inspection, or award such other or further relief as the Court may deem just and proper. The Court may order books, documents

C. Shareholder Inspection Rights Under Revised Section 220

The final version of section 220 transferred all inspection cases from the Superior Court to the Chancery Court.⁹² It created a summary procedure, with expedited discovery on limited issues and a quick trial.⁹³

Under the revised code, the requirements for making a valid inspection demand are straightforward. First, the shareholder making the request must be a record holder of the corporation's stock.⁹⁴ The shareholder can conduct the inspection personally or appoint an agent to do it. Second, the demand must be made under oath and delivered to the corporation's registered Delaware office or principal place of business.⁹⁵ Third, the shareholder must request inspection of the corporation's stocklist and the corporation's other books and records for a proper purpose which is reasonably related to such shareholder's interest as a shareholder.⁹⁶

If the corporation fails to produce the requested information within five business days of the shareholder's written demand,⁹⁷ Delaware law permits the shareholder to sue in the Chancery Court to compel inspection in a summary judicial proceeding.⁹⁸ The shareholder's complaint must state that the shareholder has made proper demand on the corporation, and that either the required number of days have passed without the production of the requested

and records, pertinent extracts therefrom, or duly authenticated copies thereof, to be brought within this State and kept in this State upon such terms and conditions as the order may prescribe.

(d) Any director shall have the right to examine the corporation's stock ledger, a list of its stockholders and its other books and records for a purpose reasonably related to his position as a director. The Court of Chancery is hereby vested with the exclusive jurisdiction to determine whether a director is entitled to the inspection sought. The Court may summarily order the corporation to permit the director to inspect any and all books and records, the stock ledger and the stock list and to make copies or extracts therefrom. The Court may, in its discretion, prescribe any limitations or conditions with reference to the inspection, or award such other and further relief as the Court may deem just and proper.

DEL. CODE ANN. tit. 8, § 220 (1993).

92. The Court of Chancery determines whether a stockholder may inspect and whether the court has plenary jurisdiction to grant all necessary relief in facilitating inspection. 2 FOLK ET AL., *supra* note 15, § 220.6.2.

93. DEL. CODE ANN. tit. 8, § 220 (1993); *see* 2 FOLK ET AL., *supra* note 15, § 220.2. Section 220 provides that the Chancery Court should "summarily" order relief upon proper showing on the part of party seeking inspection. Michael D. Goldman, *Delaware Corporation Law—Shareholders' Right to Make an Informed Judgment*, 32 BUS. LAW. 1805, 1814 (1977).

94. *Shaw v. Agri-Mark, Inc.*, 663 A.2d 464, 468 (Del. 1995); *Rainbow Navigation, Inc. v. Pan Ocean Navigation, Inc.*, 535 A.2d 1357, 1360 (Del. 1987). A beneficial owner may act through a record holder to obtain inspection. 2 FOLK ET AL., *supra* note 15, § 220.3.2.

95. 2 FOLK ET AL., *supra* note 15, § 220.6.1.

96. DEL. CODE ANN. tit. 8, § 220 (1993); *see* Ernest L. Folk, III, *Corporation Law Developments—1969*, 56 VA. L. REV. 755, 757 (1970). The shareholder should also offer to bear the reasonable costs incurred by the company in connection with the production of the information.

97. Pursuant to the statute, a written demand for inspection must state the purpose under oath. 2 FOLK ET AL., *supra* note 15, § 220.6.1. Written authority must be furnished if inspection is sought by an individual other than a stockholder. *Id.* The demand must be sent to the corporation's registered office or principal place of business. *Id.*

A stockholder may sue to compel inspection under § 220 if her demand is refused or not answered within five business days. *Id.* § 220.6.2. Although prior case law recognized the necessity for demand and refusal, the five day requirement has been interpreted to be a jurisdictional prerequisite. *Id.*

98. *Id.* § 220.3.

information, or that the shareholder's demand has been refused by the company.

The summary proceeding has a very narrow scope in a stocklist case. The shareholder may obtain an *ex parte* order reducing the time that the defendant has to answer the complaint and fixing an expedited trial date.⁹⁹ Generally, the answer must be filed within ten days and the trial will be set for a date a few weeks later.¹⁰⁰ The timetable is more extended in a books and records case.

Discovery is limited in an inspection case:¹⁰¹ the defendant can take the plaintiff's deposition, but the scope of this deposition is strictly limited to establishing the validity of the plaintiff's stated purpose of the demand and procedural compliance with the statute's requirements.¹⁰² Document production is also limited: the defendant may ask the plaintiff to produce documents evidencing the plaintiff's stated purpose; and to produce any corporate documents that the plaintiff already possesses.¹⁰³ The Chancery Court will not expand the defendant's discovery rights to cover other matters.¹⁰⁴

Parties normally submit briefs on the merits of the inspection demand close to the time of the hearing.¹⁰⁵ Frequently, the parties may choose to settle the case as the trial date approaches and file a stipulation of dismissal. If the case proceeds to trial, and the court grants the plaintiff's request, its order will normally grant the immediate production of the documents.¹⁰⁶ However, the court frequently imposes certain conditions on the parties. These include that the shareholder be given reasonable access to the information, usually by stating that the inspection must be conducted during regular business hours at the corporation's offices.¹⁰⁷ Furthermore, in books and records cases, the court will limit the documents provided to those which are "essential and sufficient"

99. Goldman, *supra* note 93, at 1814.

100. *Id.* at 1814. If necessary, this summary process can be shortened even further. *Id.* (noting *Sack v. Cadence Indus. Corp.*, No. 4765, 1975 WL 1962 (Del. Ch. Apr. 9, 1975), in which hearing and final decision completed within five days of filing complaint).

101. *Id.* In defining the scope of discovery inquiry into the purpose of the demand, a ruling on the merits of a proper purpose dispute may be part of a discovery decision. *Id.* at 1815 (noting *Bethlehem Copper Corp. v. Valley Camp Coal Co.*, C.A. No. 4942 (Del. Ch. 1975), unreported, in which the court held that a limited inquiry as to the status of a plaintiff's tender offer is a proper subject of discovery in investigating whether there is a proper purpose for inspection, but that an inquiry into the specific tactics of the tender offer is not).

102. *Id.* at 1814-15 (noting *General Time Corp. v. Talley Indus., Inc.*, 240 A.2d 755 (Del. Super. Ct. 1968), in which the court ruled that discovery not related to the stated purpose was irrelevant); 2 FOLK ET AL., *supra* note 15, § 220.8 (scope of deposition is limited to matters dealing with the narrow issues in the proceeding and not collateral issues).

103. Goldman, *supra* note 93, at 1815; *see, e.g.*, *State ex rel. Miller v. Loft, Inc.*, 156 A. 170 (Del. Super. Ct. 1931); *General Time Corp. v. Talley Indus., Inc.*, 240 A.2d 755 (Del. Super. Ct. 1968). *See also* 2 FOLK ET AL., *supra* note 15, § 220.8 (discovery limited to documents that will be introduced into evidence or referred to or relied on at trial).

104. Goldman, *supra* note 93, at 1815; *see Mite Corp. v. Heli-Coil Corp.*, 256 A.2d 855, 857-58 (Del. Ch. 1969) (noting that "[t]he narrow nature of [§ 220] must be kept in mind in applying the 'proper purpose' requirement. And that is important because there is a continuing tendency to use a § 220 suit for broad defensive as well as other purposes in battles over corporate control and acquisitions").

105. Goldman, *supra* note 93, at 1816.

106. *Id.*

107. The Delaware statute expressly provides that "any stockholder [of record]...shall, upon written demand under oath...have the right during the usual hours of business to inspect for any proper purpose to inspect the corporation's stock ledger...." DEL. CODE ANN. tit. 8, § 220 (1993).

to satisfy the shareholder's stated purpose.¹⁰⁸ This restriction protects the corporation's sensitive business information from disclosure and stops potential abuses by shareholders. The court may also require the shareholder to execute a confidentiality agreement before permitting him access to corporate documents.

Since the 1967 revision, the only substantive change in section 220 was made in 1981 with the addition of subsection (d) to the statute. This amendment codified the common law right of a director of a Delaware corporation to inspect the stocklist and books and records. The statute now permits a director to obtain summary relief in the Court of Chancery to enforce her rights.¹⁰⁹

IV. DOES DELAWARE'S INSPECTION STATUTE WORK FOR MONITORING SHAREHOLDERS?

Shareholders that seek to monitor management performance need to get information about their company in a quick and inexpensive fashion. Can they use the Delaware inspection statute to get this information cheaply and on a timely basis?

Suppose that dissident shareholders decide to challenge incumbent management in a proxy contest and request a list of the company's shareholders. The corporation's management can choose from a number of alternative courses of action. It could provide the stocklist. However, if it does not want to do so, it will resist the shareholder's demand and force the shareholder to follow the statutory procedures to obtain the stocklist.¹¹⁰

If the shareholder seeks the stocklist under the inspection statute, the corporation can still refuse to produce the stocklist by claiming that the stockholder has not stated a proper purpose or that the stockholder has failed to comply with the other statutory requirements. Now, the shareholder must resort to court proceedings to secure the stocklist. If the corporation denies the validity of the shareholder's stated purpose, the shareholder will seek an expedited trial on this issue.

In the meantime, the shareholder is delayed in starting its proxy solicitation and the incumbent management has more time to formulate its own plans and strategy. In addition, the shareholder is required to spend time and money on these judicial proceedings. In a proxy contest for corporate control, all of these factors work to the incumbent management's advantage in the solicitation.¹¹¹

108. 2 FOLK ET AL., *supra* note 15, § 220.5.

109. 2 *id.* § 220.1; H.R. 16, 131st Gen. Assembly 10, 63 Del. Laws ch. 25, § 9 (1981).

110. In a proxy contest for corporate control, this is almost invariably management's response. James B. Watson, *Protecting the Shareholders' Right to Inspect the Share Register in Corporate Proxy Contests for the Election of Directors*, 50 S. CAL. L. REV. 1273, 1273 (1977).

111. *Id.* at 1277. If the corporation chooses to engage in stall tactics, the corporation runs the risk that a successful shareholder will attack its reputation.

Table 1

Descriptive Statistics of Variables Associated With
Request for Stockholder List by Outcome
(Dismissals Without Further Information are considered unsuccessful)

Variable ^a	Mean	Standard Deviation	Minimum	Median	Maximum
<i>Panel A: Plaintiff Obtains Stockholder List (N = 71)</i>					
DELAY	111.9	168.4	9	43	980
PLTPAGES	81.1	111.9	4	39	700
DEFPAGES	56.7	91.2	0	18	500
TOTPAGES	137.8	187.9	8	66	1,200
PLTTOTAL	68.4%	22.6%	6.0%	71.4%	100.0%
INDADJROA ^b	-9.3%	38.0%	-203.3%	0.5%	24.4%
<i>Panel B: Plaintiff Does Not Obtain Stockholder List (N = 20)</i>					
DELAY	187.2	256.5	9	70	876
PLTPAGES	128.1	344.5	4	19	1,550
DEFPAGES	79.7	177.6	0	5	600
TOTPAGES	207.8	493.9	7	26	2,150
PLTTOTAL	70.3%	31.4%	6.3%	74.8%	100.0%
INDADJROA ^b	0.8%	9.2%	-22.3%	1.7%	16.0%
<i>Panel C: t-statistics for Tests of Differences in Means and Wilcoxon Z-statistics for Tests of Differences in Medians Between Panels A and B</i>					
Variable	t-statistic		Wilcoxon Z-statistic		
DELAY	1.24		1.02		
PLTPAGES	0.60		2.56***		
DEFPAGES	0.56		1.55		
TOTPAGES	0.62		1.83*		
PLTTOTAL	0.25		0.95		
INDADJROA	1.69*		0.36		

*** The variables in panels A and B are statistically different at the .01 level.

* The variables in Panels A and B are statistically different at the .10 level.

a Variable definitions are as follows:

DELAY Number of days between demand and outcome dates

PLTPAGES Number of pages filed by plaintiff.

DEFPAGES Number of pages filed by defendant.

TOTPAGES Total number of pages filed by plaintiff and defendant.

PLTTOTAL Percentage of total litigation pages filed by plaintiff.

INDADJROA Industry-adjusted return on assets. Return on assets is calculated as operating income before depreciation and taxes (COMPUSTAT item 13) divided by total assets (COMPUSTAT item 6). INDADJROA is calculated as the firm's return on assets minus the average for the industry based on the firm's 2-digit SIC code.

b Due to unavailable accounting data, the subsample for INDADJROA contains only 47 observations in panel A and 15 observations in panel B.

Table 2

Frequency Distribution of Stated Purposes for Use of Stockholder List

	<i>Plaintiff Obtains List</i>		<i>Plaintiff Does Not Obtain List</i>		Dismissal without Further Information
	Decision in Favor of Plaintiff	Dismissal With List	Decision Against Plaintiff	Dismissal Without List	
1. To value the firm's stock	4	8	0	2	4
2. To contact shareholders about soliciting proxies or written consents	13	23	2	1	3
3. To contact shareholders about a tender offer	5	10	0	1	3
4. To investigate whether management is breaching its fiduciary duty to shareholders through mismanagement, negligence, waste, fraud, self-dealing, etc.	2	9	1	2	0
5. To communicate with other shareholders regarding proposals by management or proposals to be voted on at the annual meeting	3	4	1	0	1
6. To fulfill fiduciary duty as a member of the Board of Directors	1	1	0	0	1
7. Miscellaneous	2	3	0	2	1
8. Not stated	0	1	0	0	0
Total ^a	30	59	4	8	13

a Total exceeds total number of filings from Table 1 (91) due to multiple purposes given.

Table 3

Descriptive Statistics of Variables Associated With
Request for Books and Records by Outcome
(Dismissals Without Further Information are considered unsuccessful)

Variable ^a	Mean	Standard Deviation	Minimum	Median	Maximum
<i>Panel A: Plaintiff Obtains Stockholder List (N = 36)</i>					
DELAY	210.7	242.4	9	109	980
PLTPAGES	93.3	219.3	6	35	1,342
DEFPAGES	55.6	85.4	0	13	341
TOTPAGES	148.9	277.8	8	61	1,648
PLTTOTAL	70.0%	25.3%	20.0%	74.5%	100.0%
INDADJROA ^b	1.4%	13.8%	-38.1%	0.8%	21.9%

<i>Panel B: Plaintiff Does Not Obtain Stockholder List (N = 17)</i>					
DELAY	347.8	275.6	27	259	876
PLTPAGES	86.8	171.1	4	25	700
DEFPAGES	59.5	119.7	0	19	500
TOTPAGES	146.4	288.7	6	46	1,200
PLTTOTAL	67.5%	27.4%	6.3%	72.7%	100.0%
INDADJROA ^b	-1.2%	11.0%	-22.3%	1.7%	7.2%

*Panel C: t-statistics for Tests of Differences in Means
and Wilcoxon Z-statistics for Tests of Differences in Medians Between Panels A and B*

Variable	t-statistic	Wilcoxon Z-statistic
DELAY	1.84*	2.00**
PLTPAGES	0.11	1.19
DEFPAGES	0.12	0.07
TOTPAGES	0.03	0.51
PLTTOTAL	0.34	0.29
INDADJROA	0.40	0.27

*** The variables in panels A and B are statistically different at the .05 level.

* The variables in Panels A and B are statistically different at the .10 level.

a Variable definitions are as follows:

DELAY Number of days between demand and outcome dates
 PLTPAGES Number of pages filed by plaintiff.
 DEFPAGES Number of pages filed by defendant.
 TOTPAGES Total number of pages filed by plaintiff and defendant.
 PLTTOTAL Percentage of total litigation pages filed by plaintiff.
 INDADJROA Industry-adjusted return on assets. Return on assets is calculated as operating income before depreciation and taxes (COMPUSTAT item 13) divided by total assets (COMPUSTAT item 6). INDADJROA is calculated as the firm's return on assets minus the average for the industry based on the firm's 2-digit SIC code.

b Due to unavailable accounting data, the subsample for INDADJROA contains only 15 observations in panel A and 6 observations in panel B.

Table 4

Frequency Distribution of Stated Purposes for Use of Books and Records (B&R)

	<i>Plaintiff Obtains B&R</i>		<i>Plaintiff Does Not Obtain B&R</i>		<i>Dismissal Without Further Information</i>
	<i>Decision in Favor of Plaintiff</i>	<i>Dismissal With B&R</i>	<i>Decision Against Plaintiff</i>	<i>Dismissal Without B&R</i>	
1. To value the firm's stock	6	11	0	2	10
2. To contact shareholders about soliciting proxies or written consents	2	6	2	0	0
3. To contact shareholders about a tender offer	0	2	1	0	0
4. To investigate whether management is breaching its fiduciary duty to shareholders through mismanagement, negligence, waste, fraud, self-dealing, etc.	5	11	1	2	4
5. To communicate with other shareholders regarding proposals by management or proposals to be voted on at the annual meeting	0	2	1	0	0
6. To fulfill fiduciary duty as a member of the Board of Directors	2	2	0	0	1
7. Miscellaneous	1	3	0	2	1
Total ^a	16	37	5	6	16

^a Total exceeds total number of filings from Table 3 (53) due to multiple purposes given.

If the shareholder's purpose in requesting the inspection was to obtain a stocklist in order to communicate with the shareholders to seek their proxies to oust the management, the Chancery Court will order its production.¹¹² The corporation then can attempt to secure a stay of execution of the order by filing an appeal from the Chancery Court's decision.

A. The Costs, Delays and Success of Shareholders Under the Delaware Inspection Statute

Litigation takes time and costs money. A recent empirical study of cases filed under the Delaware inspection statute examined stockholders' success in obtaining stocklists and books and records, the delays associated with these cases and their cost.¹¹³ The analysis of the stocklist statute used data from a sample of ninety-one cases filed under section 220 in the Delaware Chancery Court during the period 1982–1994.¹¹⁴ Plaintiffs obtained the stocklist in seventy-one of ninety-one, or seventy-eight percent, of the cases reported.¹¹⁵ Of these seventy-one cases, the court entered a decision in favor of the plaintiff in twenty-five cases, while in the remaining forty-six cases, the litigation was dismissed with the plaintiff receiving the stocklist.¹¹⁶

Plaintiffs did not receive the stocklist in twenty, or twenty-two percent, of the cases included in the sample.¹¹⁷ Of these cases, the court denied the shareholders' request for a stocklist four times. In the other sixteen cases, the litigation was dismissed without providing for the shareholders to receive the stocklist.¹¹⁸ Thus, while this article cannot conclude, as some scholars have claimed,¹¹⁹ that shareholders obtain a stocklist in all cases filed under stocklist statutes, it seems apparent that they get them in a very high percentage of cases.

Table 1 gives descriptive statistics for the variables included in the study.¹²⁰ The first variable, DELAY, is the number of days between outcome

112. In these circumstances, the incumbent management may suffer a public relations defeat in the eyes of the company's shareholders because the opposition shareholder group will undoubtedly paint their defeat as evidence that they are not acting in shareholders' best interests.

113. Thomas & Martin, *supra* note 13.

114. *Id.* at 6. The data for this study were compiled by searching the public records of the Court of Chancery for New Castle County in the State of Delaware. Initially, the researchers identified approximately 250 cases filed under the Delaware inspection statutes. Researchers gathered data on all of these cases. Those cases for which complete data were unavailable were discarded from the sample. The remaining 91 cases were used in the study. *Id.*

115. See Table 1, *supra* at page 350.

116. See Thomas & Martin, *supra* note 13, at Table 1.

117. See Table 1, *supra* at page 350.

118. See Thomas & Martin, *supra* note 13, at Table 1. In all 16 of these cases, the litigation was dismissed and a stipulation of dismissal was filed that did not provide for the production of the stocklist. The author contacted the attorneys of record in all of these cases to inquire whether a stocklist had been produced despite the silence of the stipulation of dismissal. In four cases, the attorneys recalled that no stocklist had been produced. In the remaining 12 cases, the attorneys did not remember a stocklist being produced. *Id.*

119. See, e.g., Black, *Next Steps*, *supra* note 19, at 31 ("The state courts *always* order the company to turn over the list.").

120. Because the sample includes substantial outliers for some variables, it is more informative to compare medians rather than means, although both are shown in the table for completeness. Panel A presents summary statistics for those cases where the plaintiff obtained the stocklist, while Panel B provides the same statistics for those cases where the plaintiff did not get a stocklist. Panel C shows t-statistics for differences in the variable means and Wilcoxon

and demand dates. It measures the length of time that it takes for a plaintiff's demand to be resolved.¹²¹ The median (mean) delay for shareholders obtaining the stocklist is forty-three days (112 days), while the median (mean) delay for shareholders not obtaining the stocklist is seventy days (187 days).¹²²

The next three variables shown in Table 1 measure the number of pages of litigation materials filed in the lawsuit. The number of pages of litigation filings is used as a proxy for the cost of the lawsuit—the more pages filed, the greater the legal expenses incurred.¹²³ This is consistent with anecdotal evidence from practicing Delaware attorneys. The attorneys interviewed estimated that a simple stocklist case would cost \$10,000 to \$25,000 to bring to trial, but that this cost would go up sharply if the demand was strongly resisted.¹²⁴

This variable is then broken into pages filed by the plaintiff (PLTPAGES), pages filed by the defendant (DEFPAGES) and the total number of pages filed by both parties (TOTPAGES). The mean levels of these variables are influenced by large outliers, making the median levels of the variables likely to be more informative. Unsuccessful shareholders have slightly (but insignificantly) higher mean numbers of pages filed for all three categories of variables.¹²⁵ Looking at the medians, however, this pattern is reversed: the median number of pages filed is significantly higher (for two of the three categories) in cases where plaintiffs succeed in obtaining the stocklist.¹²⁶ This result is consistent with the intuition that increasing the number of pages filed should increase the likelihood that the plaintiff will obtain the stocklist.¹²⁷

Table 1 also presents data on the operating return on assets adjusted for two-digit SIC code industry means (INDADJROA) for the fiscal year just prior to the year in which the stocklist demand was made for the sixty-two firms that were publicly traded and for which data was available.¹²⁸ As shown on Table 1,

Z-statistics for differences in the variable medians.

121. The demand date is the date on which the plaintiff made its written demand on the corporation to provide a stocklist. This date is taken from the demand letter sent to the corporation by the shareholder that is attached to the shareholder's complaint when it is filed with the Chancery Court.

The outcome date is taken from the court's order or the parties' stipulation. If the case is decided by court order in favor of the plaintiff, we used the date for production of the stocklist as the outcome date. If the request was denied, we used the date of the court's order as the outcome date. For stipulations, we used the date of entry of the stipulation as the outcome date for denials of the stocklist. Where the parties agreed to the production of the stocklist, we used the date of production in the stipulation as the outcome date.

122. The differences between the two groups are not significantly different at the .05 level.

123. Obviously, there are other expenses involved in litigating any lawsuit. However, it is reasonable to assume that the cost of the litigation will increase as the number of pages of materials increases.

124. While this is significantly lower than the estimates generated by other scholars, compare, Black, *Disclosure, Not Censorship*, *supra* note 3, at 68 (cost of stocklist litigation is "a few hundred thousand dollars"), it is still a substantial cost for many shareholders.

125. See Table 1, *supra* at page 350.

126. See Table 1, *supra* at page 350.

127. The percentage of the total number of pages filed by the defendant measures the relative burdens on the parties of litigating these cases (DEFTOTAL). The hypothesis was that a higher proportion of pages filed by the defendant should be observed in cases where the plaintiff does not obtain the stocklist. However, as shown in Panel C, only the univariate test for the medians demonstrates such a relationship.

128. This measure has been used in numerous studies recently in the accounting and

in the cases where the plaintiff obtains the stocklist, the average INDADJROA is (9.3)% compared to +0.9% for the sample in which the plaintiff fails to get the stocklist.¹²⁹

Table 2 gives statistics on shareholders' stated purposes for demanding the stocklist. As noted above, under Delaware law, a shareholder must state a lawful and germane purpose for wanting to obtain the stocklist, the proper purpose requirement. The proper purpose requirement is intended to weed out unwarranted demands for stocklists by screening out improper demands.

Purposes 2, 3 and 5 are directly related to intra-shareholder communications and accounted for sixty-one percent of the stated purposes.¹³⁰ Shareholders stating one of these three purposes succeeded over eighty-three percent of the time in obtaining the stocklist, while other shareholders were successful seventy percent of the time.¹³¹ Thus, shareholders demanding a stocklist to communicate with other shareholders were successful more frequently than others, but still failed to obtain the stocklist in seventeen percent of the cases filed.

Table 3 presents summary statistics concerning fifty-three cases filed under the books and records statute during the same time period.¹³² Plaintiffs succeeded in obtaining books and records in about sixty-eight percent (thirty-six of fifty-three) of the cases filed.¹³³ Of these successes, thirteen were by court order and twenty-three by agreement of the parties. In the seventeen cases where the shareholders failed to obtain the books and records, three were by court order and the remaining fourteen were through dismissals without obtaining the information.¹³⁴

As in the stocklist study, DELAY is defined as the number of days between outcome and demand dates. It measures the length of time that it takes for a plaintiff's demand to be resolved. The median (mean) delay for shareholders obtaining books and records is 109 days (210 days), while the median (mean) delay for shareholders not obtaining books and records is 259 days (348 days).¹³⁵ The median and mean differences between the two groups are significantly different.

The next three variables shown in Table 3 measure the number of pages of litigation materials filed in the lawsuit. Delaware attorneys interviewed estimated that a simple books and records case would cost \$25,000 to \$50,000

finance literature. See Thomas & Martin, *supra* note 13, at 11.

129. While the averages are statistically significant at the 10% level, the medians are not significantly different. See Table 1, *supra* at page 350.

130. See Table 2, *supra* at page 351.

131. These differences were not statistically significant at the 10% level. See Thomas & Martin, *supra* note 13, at 17.

132. Thomas & Martin, *supra* note 13, at 6. In Table 3, panel A presents summary statistics for those cases where the plaintiff obtained books and records, while panel B provides the same statistics for those cases where the plaintiff did not get the books and records. Panel C shows t-statistics for differences in the variable means and Wilcoxon Z-statistics for differences in the variable medians.

133. See Table 3, *supra* at page 352.

134. See Thomas & Martin, *supra* note 13, at 12. The author contacted the attorneys of record in the cases where the dismissals filed did not provide for the production of the books and records. In 12 of the 14 dismissals by the parties, the attorneys did not recall that books and records had been produced. *Id.*

135. See Table 3, *supra* at page 352.

to bring to trial, but that this cost would go up sharply if the demand was strongly resisted.¹³⁶

As in the stocklist study, this variable is broken into pages filed by the plaintiff (PLTPAGES), pages filed by the defendant (DEFPAGES) and the total number of pages filed by both parties (TOTPAGES). The mean levels of these variables are influenced by large outliers, making the median levels of the variables likely to be more informative. Unsuccessful shareholders have lower (insignificantly) mean and median numbers of pages filed for two of the three categories of variables.¹³⁷

Table 3 further presents data on the operating return on assets adjusted for two-digit SIC code industry means (INDADJROA) for the fiscal year just prior to the year in which the books and records demand was made for the twenty-one firms that were publicly traded and for which data was available.¹³⁸ In the cases where the plaintiff obtains the books and records, the average INDADJROA is +1.4% compared to (1.2)% for the sample in which the plaintiff fails to get the books and records.¹³⁹

Table 4 presents a frequency distribution by outcome of shareholders' stated purposes for demanding books and records. Purposes 4 and 6 are related to shareholders' investigation of corporate mismanagement or their fulfillment of their fiduciary duties as directors. These are the types of purposes that would be stated by shareholder monitors of potential corporate wrongdoing. These cases accounted for thirty-five percent of the stated purposes. Shareholders that gave one of these two purposes succeeded 71.5% of the time in obtaining books and records, while shareholders stating other purposes succeeded about 63.5% of the time.¹⁴⁰

What are the implications of these results for shareholders seeking to use these statutes to obtain information about their company? First, it is apparent that shareholders are not always successful in obtaining the information they desire through the use of the inspection statute, especially if they are seeking books and records. Second, shareholders seeking books and records under these statutes must be prepared to wait months for a result, with the delays being substantially longer than in stocklist cases.

In both kinds of cases, they will pay substantial attorneys' fees to litigate their case. Delaware attorneys estimated that these fees would run \$10,000 to \$25,000 for simple stocklist cases and \$20,000 to \$50,000 for straightforward books and records cases.¹⁴¹ In more complex, contested cases, these costs would be significantly greater.

136. See Thomas & Martin, *supra* note 13, at 14.

137. The percentage of the total number of pages filed by the defendant is a measure of relative burdens on the parties of litigating these cases (DEFTOTAL). The study hypothesized that a higher proportion of pages filed by the defendant should be observed in cases where the plaintiff does not obtain books and records. However, as indicated in panel C, both univariate tests fail to show such a relationship.

138. This measure has been used in numerous studies recently in the accounting and finance literature. See Thomas & Martin, *supra* note 13, at 11.

139. These differences are not statistically different for either the means or the medians. See Table 3, *supra* at page 352.

140. See Table 4, *supra* at page 353.

141. These fees would escalate if the cases were seriously contested by the corporation, particularly for books and records cases.

B. Should Shareholder Plaintiffs Bring a Books and Records Case Before Filing a Derivative or Class Action?

Shareholders file derivative lawsuits when they believe that there has been corporate wrongdoing and the corporation has not acted to stop it. However, the shareholder must make "demand" on the corporation's board of directors to weigh the asserted allegations and exercise their discretion under the business judgment rule to decide whether to file a claim on behalf of the corporation.¹⁴² A shareholder's right to bring this type of action "is limited to situations where the stockholder has demanded that the directors pursue the corporate claim and they have wrongfully refused to do so or where demand is excused because the directors are incapable of making an impartial decision regarding such litigation."¹⁴³ The complaint must plead particularized facts showing a wrongful refusal of demand, or that demand was futile, in order to survive a motion to dismiss.

In almost every derivative action, the defendants will file a motion to dismiss the complaint under Rule 23.1 claiming that it fails to allege facts sufficient to establish wrongful refusal or excusal of demand. In Delaware, a shareholder plaintiff is not entitled to discovery prior to responding to a Rule 23.1 motion to dismiss.¹⁴⁴ Shareholders must rely solely on the allegations of their complaint.¹⁴⁵

The potential use of the books and records prong of the Delaware inspection statute as a discovery device in shareholder derivative actions was highlighted by the Delaware Supreme Court in *Rales v. Blasband*.¹⁴⁶ There, the court observed that "[s]urprisingly, little use has been made of section 220 as an information-gathering tool in the derivative context."¹⁴⁷ It suggested that shareholders should employ section 220 to conduct a "deliberate and thorough"

142. 3 FOLK ET AL., *supra* note 15, § 327.4; see *Schick Inc. v. Amalgamated Clothing & Textile Workers Union*, 511 A.2d 1235, 1240 (Del. Ch. 1987). The business judgment rule is "a presumption that in making a business decision, the directors of a corporation acted on an informed basis in good faith and in the honest belief that the action was taken in the best interests of the company." ROBERT C. CLARK, *CORPORATE LAW* 123-24 (1986) (quoting *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)).

143. *Rales v. Blasband*, 634 A.2d 927, 932 (Del. 1993) (quoting *Levine v. Smith*, 591 A.2d 194, 200 (Del. 1991)); see generally *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984); *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981).

144. See *Levine v. Smith*, 591 A.2d 194, 208 (Del. 1991). But see *Zapata*, 430 A.2d at 788 (recognizing that a court has the right to order limited discovery where a board has delegated its power to dismiss a derivative suit to a special litigation committee, and that committee moves for dismissal or summary judgment). See also Note, *Discovery in Federal Demand-Refused Derivative Litigation*, 105 HARV. L. REV. 1025, 1029 (1992) (arguing that in derivative actions in federal court, Federal Rule of Procedure 23.1 does not block discovery because it does not require shareholder plaintiffs to plead wrongful demand refusals with a high degree of specificity).

A plaintiff shareholder's burden under a Rule 23.1 motion to dismiss is more arduous than that required to withstand a 12(b)(6) motion. 3 FOLK ET AL., *supra* note 15, § 327.4; see *Levine*, 591 A.2d at 207. However, "plaintiffs are not required to plead evidence inasmuch as discovery is foreclosed." 3 FOLK ET AL., *supra* note 15, § 327.4.

145. Although derivative plaintiffs have a formidable burden to meet at the pleading stage without the benefit of discovery, there are additional avenues to obtain information relating to the subject of their claims. *Rales*, 634 A.2d at 934-35 n.10. Details of a corporate act may be discoverable through a variety of public sources of information, including the media and government agencies such as the Securities Exchange Commission. *Id.*

146. *Id.* at 934 n.10.

147. *Id.*

investigation prior to filing a complaint alleging director misconduct.

The idea of using section 220 in this manner is appealing. It gives derivative plaintiffs an avenue to obtain discovery before filing their suits which could lead to a reduction in the number of frivolous derivative suits. A section 220 action also alleviates the unfairness of forcing shareholders to respond to a motion to dismiss based on the substance of their complaint without the benefit of discovery. Furthermore, even if Delaware were to permit discovery in responding to a motion to dismiss under Rule 23.1, shareholders should get the same corporate records faster through the inspection statutes than the regular discovery process because cases filed under the inspection statutes are expedited.¹⁴⁸

Plaintiffs in securities fraud class actions might also consider using the Delaware inspection statute as a method of obtaining information.¹⁴⁹ This potential use has become particularly important in light of the stricter fraud pleading requirements imposed by the Private Securities Litigation Reform Act legislation passed by Congress. Under the new pleading requirements, plaintiffs must allege sufficient facts showing fraud to create a strong inference that the defendant acted with the requisite state of mind.¹⁵⁰ If these pleading requirements are not met, the new legislation creates a presumption that the defendants are entitled to an award of their attorneys' fees and costs incurred in defending the action.¹⁵¹

A plaintiff seeking to use the Delaware inspection statute to uncover evidence to bolster a securities fraud case would need to allege a proper purpose, one reasonably related to its interest in the corporation and not adverse to the company.¹⁵² This purpose could include inspecting the company's books and records to determine if fraud or mismanagement are occurring, or continuing, where there is a pending action against the company.¹⁵³ This purpose would be proper even if the inspection would lead to increased damages being awarded against the company because the company has no legitimate interest in avoiding payment of compensatory damages which it may owe to its owners.¹⁵⁴

What implications do the empirical results discussed above have for the future of the Delaware books and records statute as a pre-suit discovery device for plaintiffs in derivative and class actions? In cases where plaintiffs have strong reasons to suspect corporate wrongdoing, and enough evidence to establish demand futility, or plead fraud with particularity, they will not wait

148. 5A FLETCHER, *supra* note 26, § 2213. A shareholder who demands inspection is not precluded from enforcing her right simply because she has another suit pending against the corporation and could obtain the same books and records through discovery. *Id.* Where a proper purpose is shown, a shareholder's right to inspect books and records under § 220 of the Delaware Corporate Code is absolute and apart from litigation. *Estate of Polin v. Diamond State Poultry Co.*, No. 6374, 1981 WL 7612, at *2 (Del. Ch. Apr. 14, 1981). *Cf.* *Lipman v. National Med. Waste, Inc.*, C.A. No. 12260 (Del. Ch. May 4, 1992), slip op. at 3 (§ 220 action is not a substitute for discovery in a civil action).

149. See *Thomas & Martin*, *supra* note 13.

150. See Conference Report on Private Securities Litigation Reform Act, 1995 DER 231 d99, available in LEXIS, at *13-14.

151. *Id.*

152. See *Compaq Computer Corp. v. Horton*, 631 A.2d 1, 5 (Del. 1993).

153. *Id.* at 7.

154. *Id.* at 9.

the additional four to six months necessary to win a books and records case before filing their derivative action. However, in cases where the shareholder is uncertain they will be able to establish that demand is excused, or that they have sufficient basis for believing that corporate wrongdoing has occurred, they might consider using section 220 as a discovery device.

A plaintiff in this position should consider several negative factors before filing a books and records action. First, filing litigation under section 220 does not guarantee a shareholder access to corporate books and records. In roughly one-third of the books and records cases filed under the statute, the plaintiff does not obtain any documents.¹⁵⁵ Second, a plaintiff will face substantial delays and significant costs, at least \$10,000 to \$25,000, in litigating its books and records case before even determining if they should file a derivative action.¹⁵⁶ Finally, plaintiffs seeking to uncover corporate wrongdoing do not appear to enjoy any higher rate of success than other plaintiffs in books and records actions.

The plaintiff must weigh against these costs the potential benefits of examining the corporation's books and records. These benefits will be particularly significant for plaintiffs suing nonregistered companies for which there may be few alternative public sources of information.¹⁵⁷ Even with registered companies, a successful books and records case will give the plaintiff access to otherwise unavailable internal company documents, such as corporate minutes and by-laws.¹⁵⁸ This information might be crucial to providing a basis for adequately pleading demand excusal in a derivative action, or pleading fraud with particularity in a securities fraud action. Furthermore, if after examination of the corporation's books and records, plaintiffs could not find enough evidence of wrongdoing to warrant pursuing their derivative or securities fraud claims, they could dismiss those cases and save themselves further expense.

On balance, while the idea of utilizing the Delaware books and records statute as a means of pre-suit discovery for derivative and class plaintiffs has intuitive appeal, and could lead to the dismissal of some weak cases, many plaintiffs will be reluctant to rely on such an uncertain, lengthy, and costly procedure to learn if they should bring an action for corporate wrongdoing. If Delaware wants to provide shareholder plaintiffs with a better system of pre-suit discovery through its books and records statute, it should streamline the existing statutory procedure. In Section V, this article examines the arguments in favor of amending the Delaware inspection statute to provide for quicker trials, attorney fee awards against defendants that unjustifiably resist legitimate demands by shareholders and a more liberal access for plaintiffs.

155. Those plaintiffs that do obtain documents will only get those documents that are "essential and sufficient" to accomplish their stated purpose. 2 FOLK ET AL., *supra* note 15, § 220.5. These documents may also be subject to a confidentiality agreement. *Id.*

156. Of course, if a plaintiff must incur these costs in order to find out if it has a sufficient basis for a lawsuit, this will discourage the filing of frivolous lawsuits.

157. Section 12 of the 1934 Exchange Act requires any company which has a class of securities traded on a national securities exchange to register with the SEC. In addition, § 12(g) and Rule 12g-1 require companies with more than 500 shareholders and \$5 million or more in total assets to register with the SEC. Registered companies must file mandatory disclosure statements with the SEC. These documents are a source of information about the company.

158. See *supra* note 11, for further explanation of what constitutes a corporation's books and records.

C. Should the Federal Stocklist Rule Be Strengthened?

Shareholders seeking to obtain the corporation's stocklist can try to obtain it under federal law using Rule 14a-7.¹⁵⁹ However, Rule 14a-7 has the disadvantage from a shareholder's perspective that it does not require a corporation to furnish a stocklist to the requesting shareholder. Rather, Rule 14a-7 gives the corporation the election either to furnish the stocklist or to mail, at the expense of the requesting stockholder, copies of any proxy statement, form of proxy, or other communication furnished by the stockholder. This has led legal commentators to nickname Rule 14a-7, "The SEC's Useless Disclose or Mail Rule."¹⁶⁰

The corporation invariably elects the second option and mails the dissident stockholder's proxy materials. Corporate incumbents prefer to mail the stockholder's materials because this permits the corporation to retain exclusive possession of the stocklist. Without a stocklist, the shareholders cannot personally lobby all of the shareholders and must rely on the corporation to make any future mailings, too. Moreover, this option prevents shareholders from launching a "first strike" because the corporation controls the timing of the mailing and has prior knowledge of the contents of the materials to be mailed. As a practical matter, Rule 14a-7's ineffectiveness has meant that shareholders use state, rather than federal, law to obtain stocklists.

In a 1991 rulemaking proposal, the SEC noted that Rule 14a-7 did little to insure shareholders of access to a stocklist.¹⁶¹ In its release, the SEC proposed:

to amend the registrant's existing choice to mail a requesting securityholder's proxy material rather than produce a securityholder list upon request, and to transfer that choice to the requesting securityholder. Moreover, the proposed amendment would expand the scope of the list to encompass the names, addresses and securities holdings of both record and nonobjecting beneficial owners ("NOBO's") or consenting beneficial owners ("COBO's").¹⁶²

The SEC also solicited public comment on numerous other changes to the old rule.¹⁶³

If this proposal had been adopted, shareholders would have had an absolute right to obtain a stocklist under federal law at little cost and within a few days of making their demand.¹⁶⁴ A vigorous debate ensued over the necessity of amending this rule. On one side of the debate were the defenders of the status quo, led primarily by incumbent corporate management.¹⁶⁵ This group believed the federal proxy system and related state laws regulating

159. SEC Rule 14a-7, 17 C.F.R. § 240.14a-7 (1991).

160. Black, *Disclosure, Not Censorship*, *supra* note 3, at 69.

161. Exchange Act Release No. 29315 (June 17, 1991). *See generally*, Black, *Disclosure, Not Censorship*, *supra* note 3.

162. Black, *Disclosure, Not Censorship*, *supra* note 3, at 65-67 (quoting text of SEC proposal).

163. For a summary of the various changes proposed in the initial release, see *id.* at 65-75.

164. Under Rule 14a-7, the defendants cannot claim that the shareholder is seeking the stocklist for an improper purpose as a basis for obtaining judicial review. This makes it harder for the corporation to justify delaying producing the stocklist.

165. Robert D. Rosenbaum, *Foundations of Sand: The Weak Premises Underlying the Current Push for Proxy Rule Changes*, 17 J. CORP. L. 163 (1991).

communication worked very well for shareholders, and that the SEC lacked jurisdiction to enact a broader rule.¹⁶⁶

The advocates of change argued that Rule 14a-7 chilled the ability and willingness of shareholders to effectively launch a proxy campaign and to exercise their voting rights in an informed manner.¹⁶⁷ They claimed that the rule undercut Congressional intent, as reflected in section 14(a), to preserve stockholder voting as a meaningful check on corporate managers. They also claimed that the SEC could expand Rule 14a-7 without fear of overstepping its jurisdiction.¹⁶⁸

The SEC accepted the argument that the state stocklist laws work well for shareholders in making its revisions to Rule 14a-7. Although the revised Rule 14a-7 cures several of the problems in the prior rule, it continues to give management the option either to provide the stockholder with a stocklist or to mail the shareholder's materials for it.¹⁶⁹ For that reason, the new rule is likely to remain largely unused by shareholders.¹⁷⁰

166. Black, *Next Steps*, *supra* note 19, at 31 (quoting Regulation of Communication among Securityholders, Exchange Act Release No. 30,849 [1992 Transfer binder] Fed. Sec. L. Rep. (CCH) ¶ 85,002 (June 24, 1992), at 82,833).

167. *Id.*

168. *Id.*

169. In two limited cases, the corporation may no longer choose whether to send the stockholder's proxy materials or to provide them with a stockholder list. These are when the corporation is soliciting or intends to solicit with respect to a roll-up transaction or a transaction subject to the Commission's going private rule. *Id.* In these two instances, the requesting stockholder determines whether the corporation shall furnish a list of stockholders or shall mail their materials.

170. Several important changes, however, were made to the rule. For example, it now permits beneficial holders, as well as record holders, to make a stockholder list request. *Id.* at 38. The rule requires a beneficial owner to provide the corporation with a statement confirming its beneficial ownership of the company's stock. Furthermore, the new rule allows a stockholder request "[i]f the registrant has made or intends to make a proxy solicitation in connection with a security holder meeting or action by consent or authorization." 17 C.F.R. § 240.14a-7(a) (1993). This language makes the rule available when the company engages in a written consent solicitation.

Numerous requirements were added to Rule 14a-7 that stockholders must comply with when making a request. The revised rule requires the requesting stockholder to provide the corporation with an affidavit identifying the proposal or other action for which the corporation is soliciting or intends to solicit which is the subject of their solicitation or communication. 17 C.F.R. § 240.14a-7(c)(2). The stockholder must attest that they will not use the information provided by the corporation for any purpose other than solicitation of stockholders regarding the proposal or corporate action specified. 17 C.F.R. § 240.14a-7(c)(2)(i). Stockholders must also attest that they "will not disclose such information to any person other than a beneficial owner for whom the request was made and an employee or agent to the extent necessary to effectuate the communication or solicitation." 17 C.F.R. § 240.14a-7(c)(2)(ii). Finally, if provided with a stockholder list, the stockholder must return the list and not retain any copies of it or any information derived from it after the termination of the solicitation. 240 C.F.R. § 240.14a-7(d). All of these changes are designed to ensure proper use of the stockholder list and to protect the confidentiality of stockholder information.

The revised rule tightens the time periods during which a corporation must respond to a Rule 14a-7 request. A corporation now must "[d]eliver [a response to a request]...within five business days after receipt." 17 C.F.R. § 240.14a-7(a)(1). This five business day limitation applies even if the corporation elects to provide a stockholder list. As a result, corporate incumbents have very little discretion in determining when to respond to a request.

The revised rule further requires the corporation when furnishing a stockholder list to provide the requesting stockholder with the approximate number of record and beneficial holders. 17 C.F.R. § 240.14a-7(a)(1)(ii). These numbers must be separated by type of holder and class of security. *Id.* This change enables stockholders to concentrate their solicitation

What implications do the statistics concerning the Delaware statute have for the debate over reforming federal law? First, shareholders generally get a stocklist when they file litigation under the Delaware statute.¹⁷¹ In over seventy-eight percent of the cases studied, shareholders get a stocklist. Furthermore, only a few "failures," less than five percent, result from a state court judgment denying the shareholders' request for a stocklist.

Some caution must be taken in interpreting these results. First, they do not indicate how many times companies refuse to turn over the stocklist and the shareholder does not file litigation either because of the cost or because litigation will not lead to timely access to the stocklist.¹⁷² Furthermore, in some of these cases, the shareholders may be using the suit as a means to get other relief and may therefore be satisfied to drop the case without obtaining the stocklist.

Taking these caveats into account, it appears that the Delaware courts are granting most shareholders' claims for stocklists. Nevertheless, even for successful litigants, the state court procedure entails substantial delays and significant costs.¹⁷³ Unsuccessful litigants incur similar costs and wait even longer for a result.¹⁷⁴ By comparison, if Rule 14a-7 had been amended in the manner the SEC originally proposed in 1991, shareholders using the rule would have been able to obtain a stocklist with little delay or cost.

In short, the empirical research on the Delaware statute supports shareholders' claims that federal law could be revised to provide them with a less expensive, quicker method for obtaining a stocklist.¹⁷⁵ However, it also shows that the Delaware courts are weeding out a small number of unwarranted stocklist demands. Any reform of federal law, or existing Delaware law, that removes the courts from the process risks increasing the number of

efforts on the larger stockholders while also conducting a modest solicitation of smaller stockholders. However, stockholders' ability to obtain information about "any more limited group of such holders designated by the security holder" is restricted to information "available or retrievable under the registrant's or its transfer agent's security holder data system." *Id.*

If the issuer elects to provide the stockholder list, the revised rule requires it to furnish, in addition to the list of record holders, a NOBO/COBO list if the corporation has obtained or obtains such a list for its own use prior to the stockholder meeting or other stockholder action. Thus, whenever the corporation elects to provide the list, the corporation and the stockholder will have equal access to the NOBO/COBO list to disseminate proxy materials directly to the beneficial owner. Black, *Next Steps*, *supra* note 19, at 38.

The revised rule is ambiguous as to whether the stockholders can get a CEDE breakdown. But the SEC's comments to the revised rule state that the list information must include "the names, addresses, and security positions of record holders, including banks, brokers and similar intermediaries." 17 C.F.R. § 240.14a-7(a)(2)(ii). It therefore seems likely that the stockholders are assured continued access to a CEDE breakdown.

171. See Table 1, *supra* at page 350, and accompanying text.

172. However, some shareholders also will get stocklists from companies without having to file an action under the inspection statutes because the company knows that the court will almost certainly order production. See Thomas & Martin, *supra* note 13, at 19. Companies do not generally report stockholder requests for stocklists in their SEC or other public filings so the author has been unable to determine the frequency with which these different events occur.

173. See Table 1, *supra* at page 350, and accompanying text.

174. See Table 1, *supra* at page 350, and accompanying text. This suggests that at least part of the existing delays and costs may be a necessary part of differentiating between legitimate and illegitimate requests for stocklists.

175. See Black, *Disclosure, Not Censorship*, *supra* note 3, at 75 (Rule 14a-7 should be amended to provide shareholders with "quick, cheap, automatic access to the stocklist without the need for a court fight.").

unjustifiable demands for stocklists. The next section addresses the question of how to reform the existing laws to reconcile shareholders' desire to obtain information with the need to safeguard corporations against improper demands.

V. EVALUATING POLICY ALTERNATIVES FOR IMPROVING INSPECTION STATUTES

This article argues that the Delaware inspection statute, or federal Rule 14a-7, should be modified to provide shareholders with faster and cheaper access to information that they need to monitor corporate managers and to communicate amongst themselves.¹⁷⁶ Any such reforms, however, would need to protect the corporation's sensitive business information and trade secrets and to prevent harassment of the corporation by dissident shareholders.¹⁷⁷ This section analyzes three possible types of reforms before setting forth the author's proposals.

A. Expedited Court Proceedings

Virtually every major state's corporate codes provide for an expedited review of a corporation's rejection of a shareholder's inspection request.¹⁷⁸ The expedited hearing procedure is intended to safeguard a shareholder's inspection right, while providing management a reasonable opportunity to object to

176. Several commentators have offered suggestions about how to revise inspection statutes so that they better accomplish their purpose. See, e.g., Kenneth W. Starr & Terrance E. Schmidt, *Inspection Rights of Corporate Stockholders: Toward a More Effective Statutory Model*, 26 U. FLA. L. REV. 173, 189 (1974); Watson, *supra* note 110, at 1296; Young, *supra* note 14, at 877.

Starr and Schmidt argue for a non-penalty inspection scheme with four characteristics: (1) the establishment of a reasonable time period during which management can consider the request for inspection; (2) a provision that provides for expedited court proceedings on management's refusal to permit inspection; (3) the allowance of reasonable attorneys' fees to shareholders with a proper purpose who are forced into judicial proceedings to enforce their rights; and (4) the elimination of the corporation as a defendant in inspection suits, while providing corporate indemnification to officers who deny a proper inspection request in good faith. Starr & Schmidt, *supra*, at 184. Watson's proposal for improving shareholder access to the share register suggests the following modifications for respective state statutes: (1) repudiating management's improper purpose defense; (2) requiring management to supply a completed copy of the list and updates upon the request of a shareholder; and (3) establishing an effective remedy for wrongful refusals. Watson would institute a comprehensive summary trial and appeal scheme, supplemented by the award of attorneys' fees and a substantial statutory penalty. Watson, *supra* note 110, at 1300-01. Appellate procedures would either grant corporate inspection demands priority on appeal or make the issuance of a stay discretionary, with a presumption against issuance. *Id.* at 1300-01.

Young maintains that the Delaware statute reflects a clear bias toward management in that only record holders of stock are allowed to inspect, management is not penalized for wrongfully denying a demand for inspection, and it is tolerant of attempts by management to limit stockholders from exercising their inspection rights. Young argues that the Delaware courts will more often than not exercise their discretion in favor of management. Young, *supra* note 14, at 867-68. Young proposes that an approach like that of the Model Business Corporation Act should be implemented. *Id.* at 867-68.

177. In particular, the historical experiences of the 1930's recounted in § 220 suggest that giving shareholders an absolute right to all corporate information is a mistake. For example, the corporation's interests in preserving trade secrets and other valuable information from disclosure to competitors suggest that some mechanism must be incorporated to stop rogue shareholders from blackmailing and harassing the company.

178. See Randall S. Thomas & Catherine Dixon, *Proxy Contests for Corporate Control* (forthcoming 1996) (manuscript at Chapter 3, on file with author).

unwarranted requests.¹⁷⁹ However, in numerous instances, managers have delayed the production of stocklists and books and records, forcing shareholders to make important decisions without the benefit of these documents.¹⁸⁰

Critics of summary hearing procedures, such as section 220, argue that they give management an incentive to refuse legitimate requests for inspection for two reasons. First, management can delay the stockholder from obtaining the information requested by forcing them commence litigation.¹⁸¹ Second, if the shareholder knows it will need to bring suit, it may be deterred from seeking the documents by the significant expenses in this litigation.¹⁸² Furthermore, although statutes that expedite procedures reduce the time for a trial, some of these statutes still permit the defendant to delay the enforcement of the trial court's order pending an appeal.¹⁸³

Delaware's courts expedite the treatment of cases filed under the inspection statute, particularly stocklist cases. However, as shown in Tables 1 and 3, these summary proceedings still delay the successful plaintiff for a lengthy period of time. The shareholders must also incur significant attorneys' fees in pursuing this litigation. This empirical evidence supports critics' claims that, even with expedited proceedings, management's refusal to provide information causes the shareholder substantial delay and expense.

A statutory scheme that provides for expedited hearings should minimize the delay and expense incurred by shareholders with meritorious inspection requests. Appellate courts should deny a stay pending appeal, or at least make the issuance of a stay discretionary so that frivolous appeals will not deny shareholders an effective remedy. This is particularly important for requests where time is of the essence, such as a request for a stocklist in a proxy contest, or in a solicitation in opposition to a management proposal. In these situations, a court must provide relief within a few weeks for it to be effective.

B. Bad Faith Refusals: Deterrence or Compensation?

Expedited hearing procedures alone will not stop companies from forcing shareholders to obtain a court order if they wish to inspect corporate documents. Corporate management can benefit from the delay resulting from the hearing (and possible appeals) if there are no adverse consequences stemming from an improper refusal to provide shareholders with the requested information. States have responded in different ways to this problem. Several states have enacted compensatory statutory provisions that assess attorneys' fees against the corporation for a bad faith refusal to permit a shareholder to inspect corporate records.¹⁸⁴ Some other states have enacted deterrent-type statutes

179. Starr & Schmidt, *supra* note 176, at 186.

180. For a partial list of these cases, see Black, *Next Steps*, *supra* note 19, at 31-32; Black, *Disclosure, Not Censorship*, *supra* note 3, at 68-69.

181. Watson, *supra* note 110, at 1294.

182. *Id.*

183. *Id. Compare* E.L. Bruce Co. v. State, 144 A.2d 533 (Del. 1958) (stay pending appeal in a stocklist case should be denied); *Odysey Partners v. Trans World Corp.*, No. 7125, slip op. at 6-7 (Del. Ch. Sept. 29, 1983) (same).

184. Under the MBCA, the court may order the corporation to pay the plaintiff's costs, including attorneys' fees, unless the corporation can prove that it acted reasonably. MBCA § 16.04(c).

with penalties that are imposed on individual corporate officers for any refusal.¹⁸⁵ California has given five percent shareholders, or one percent shareholders soliciting proxies under the federal proxy rules, the right to obtain an order postponing any shareholders' meeting previously noticed for a period of time equal to the number of days that the company delays in producing the stocklist.¹⁸⁶

Deterrent statutes provide shareholders with an absolute right to inspect and assess penalties to stop corporations from improperly refusing shareholder inspection requests.¹⁸⁷ However, the statutory penalties should not be so onerous that they inhibit a corporate official from denying bad faith requests.¹⁸⁸

The courts have historically been reluctant to enforce penalty statutes unless the corporation's refusal to provide the information was in bad faith.¹⁸⁹ Furthermore, courts have refused to enforce penalty statutes where the shareholder seeking inspection has stated an improper purpose, even where the language of the statutes would appear to give shareholders an absolute right to inspection.¹⁹⁰

Some penalty statutes provide that the corporation must pay the shareholders' attorneys' fees where the corporation's refusal to permit inspection is made in bad faith. These statutes are intended to compensate the plaintiff for the expenses they incurred in enforcing their rights. This type of statute has the advantage of tying the dollar amount assessed against the corporation to the out-of-pocket costs incurred by the shareholder. Although the Delaware inspection statute does not include such a provision, a recent Chancery Court decision suggests that Delaware is moving toward granting attorney fee awards for bad faith refusals.¹⁹¹

The problem with the compensatory standard is that in many situations, such as when a shareholder vote is going to be held and timely access to the stocklist is crucial, the assessment of a relatively small amount of attorney fees will not deter a corporation from acting in bad faith to deny inspection. Furthermore, if the shareholder bears the burden of proving that the corporation's refusal was in bad faith, it will be difficult for the shareholder to recover its expenses.

A well-drafted statute should function to deter wrongful refusals and to compensate shareholders who incur needless expense in litigation. One potential

185. *Id.* §16.04. See also Starr & Schmidt, *supra* note 176, at 176-77.

186. CAL. CORP. CODE § 1600 (West 1995).

187. Starr & Schmidt, *supra* note 176, at 177-78. One commentator has argued that an award of attorneys' fees and payment of a fixed statutory penalty against individual officers and directors while prohibiting indemnification by the corporation may solve this problem. Watson, *supra* note 110, at 1302. If this award of attorneys' fees falls below the amount necessary for deterrent purposes, a fixed penalty could be added to it.

188. Starr & Schmidt, *supra* note 176, at 177-78; MBCA § 16.02, Official Commentary, at 1725.

189. Starr & Schmidt, *supra* note 176, at 177 (citing cases). Mandatory penalties were found to be unsatisfactory because they exposed corporate officers to potentially extensive personal liability if they denied the request of a shareholder whose intent was to harm the corporation.

190. *Id.*

191. *Ostrow v. Bonney Forge Corp.*, No. 13270, 1994 WL 114807, at *13 (Del. Ch. Apr. 6, 1994).

solution is to allow the shareholder to sue the corporate officer responsible for denying the inspection request in his individual capacity and to forbid corporate indemnification for an officer's bad faith refusal.¹⁹² However, as noted above, corporate officers may grant undesirable applications if they face a threat of personal liability.

If the corporation alone is the defendant, then the penalties assessed would have to be very substantial to achieve effective deterrence. The shareholder would need complete relief, not just payment of attorneys' fees, to obtain adequate compensation. In a proxy contest, or other shareholder solicitation, this could require a court order postponing the shareholder vote until the court-ordered information was provided and the shareholder had sufficient time to use it effectively.¹⁹³

C. Eliminating the Improper Purpose Defense

The corporation's traditional defense to a shareholder's inspection demand is that the shareholder has failed to state a proper purpose.¹⁹⁴ To state a proper purpose, a shareholder must claim that it wishes to examine the corporate information for a reason that relates to its investment in the corporation. The courts have tried to interpret the proper purpose requirement to balance the requesting stockholder's interest in obtaining information against the corporation's interest in protecting itself and other shareholders from harmful or disruptive inspections.¹⁹⁵

When the corporation raises the defense that the shareholder has failed to state a proper purpose, it can force a trial (and in many states, if it loses at trial, an appeal) on the issue, thereby delaying the production of the stocklist.¹⁹⁶ At trial, in a Delaware proceeding to obtain a stocklist, the corporation has the burden of showing the shareholder's purpose is wrongful or improper.¹⁹⁷ By contrast, the shareholder has the burden of proving a proper purpose as to all books and records other than the stocklist.¹⁹⁸

Should the improper purpose defense be eliminated? The case for abolition is strongest where a stockholder is demanding a stocklist. In a stocklist case, the "proprietary" information that management seeks to protect through the assertion of the proper purpose defense is nothing more than the names and addresses of the record holders of its stock. Shareholders who do not wish to have this information made available can choose to hold their shares through a bank or broker, that is in "street" name, and thus avoid direct contact with a soliciting shareholder.¹⁹⁹

192. See Starr & Schmidt, *supra* note 176, at 188; Watson, *supra* note 110, at 1301.

193. See CAL. CORP. CODE § 1600 (providing for delay in holding any stockholder meeting where the corporation has delayed production of a stocklist to a five percent stockholder or a one percent stockholder that is engaged in a solicitation).

194. See 2 FOLK ET AL., *supra* note 15, § 220.7.

195. Young, *supra* note 14, at 856.

196. Watson, *supra* note 110, at 1290.

197. It is not enough for the corporation to show that the stockholder has an improper secondary purpose if the stockholder has a proper primary purpose. 2 FOLK ET AL., *supra* note 15, § 220.7. This burden-shifting does not, however, obviate the necessity for non-management shareholders, in requesting a list, to satisfy the statutory requirements.

198. 2 FOLK ET AL., *supra* note 15, § 220.7.5.

199. See Thomas & Dixon, *supra* note 178 (manuscript at Chapter 5). Shareholders that do not wish to have their identities known have a variety of options to conceal them.

The potential abuse of this right by direct mail solicitors, or "crank" shareholders, could be remedied in a variety of ways.²⁰⁰ Perhaps the most expedient and complete solution would be to establish a standard agreement about the production of the stocklist, limiting its use to communication with other shareholders about corporate matters, or the solicitation of proxies.²⁰¹ Shareholders would agree to abide by these restrictions and post a bond to insure their compliance.²⁰² Corporations could file suit if a violation occurred and ask that the offender be fined and barred from obtaining any other stocklist for a number of years.

All of these arguments support eliminating the proper purpose requirement and automatically granting shareholders access to stocklists. This is especially true for institutional shareholders that are not involved in control contests and for shareholder solicitations in opposition to management solicitations. In these instances, shareholders should be entitled to immediate and unencumbered access to the shareholder list.²⁰³

The justification for the proper purpose requirement is stronger where a court is protecting sensitive corporate information whose release might competitively disadvantage the corporation. Even here though, the proper purpose requirement's utility is limited. A shareholder need only to carry its burden of stating a valid primary purpose—the corporation cannot defeat the demand simply by showing an invalid secondary purpose.²⁰⁴ A well-advised shareholder generally should be able to state a valid purpose for obtaining many types of books and records.²⁰⁵

The second argument for eliminating the proper purpose requirement even for books and records is that for most types of information that shareholders interested in monitoring management would want, confidentiality restrictions backed by financial requirements are adequate to protect the corporation's interest in its business information. For example, where shareholders are concerned about management fraud or wrongdoing, details of internal investigations by attorneys and accountants should be made available to the shareholders without protracted litigation, subject to confidentiality

Shareholders who hold their stock through a bank or broker will not have their names on the company's list of recordholders. If the company attempts to learn this information through Rules 14b-1 or 14b-2, the stockholder can object to this disclosure and remain anonymous. For a more complete discussion of this question, see *id.*

200. Some inspection statutes attempt to limit harassment by requiring that shareholders own a minimum of five percent of the companies' stock or have owned the companies' stock for a minimum of six months. See Young, *supra* note 14, at 852-53.

201. Courts have the power to place reasonable limitations and restrictions on the stockholder's use and dissemination of information gained in the course of examination to protect the corporation from potential harm. MBCA § 16.04(d); see Young, *supra* note 14, at 851 n.41. If they sought the stocklist for other reasons, shareholders would need to make application to the court.

202. The amount of the bond should be sufficient to cover the corporation's costs of filing suit if a violation occurred.

203. Cf. Black, *Next Steps*, *supra* note 19, at 33 (SEC should consider further revisions of Rule 14a-7 to provide shareholders access to stocklist for a solicitation in opposition to a management proposal).

204. 2 FOLK ET AL., *supra* note 15, § 220.7.3.

205. However, even where the shareholder states a proper purpose, the Delaware courts will protect the corporation's sensitive business information from discovery by restricting the information produced to those documents that "essential and sufficient" to achieving the shareholder's stated purpose. See *id.* § 220.5 for a discussion of this requirement.

agreements. Institutional investors that are actively monitoring their long term investments in the corporation will almost certainly abide by such agreements.

Undoubtedly, there are limitations on the use of confidentiality agreements. Proprietary business information, such as secret production processes or customer lists, cannot be adequately safeguarded with confidentiality agreements without onerous bond requirements. Furthermore, requests by certain types of shareholders, particularly those actively seeking control of the corporation, should be subjected to judicial scrutiny before any information is produced.²⁰⁶

VI. POLICY RECOMMENDATIONS AND CONCLUSIONS

Shareholders' inspection rights are fundamental to their ability to monitor effectively corporate management in situations where management tries to block shareholders from obtaining information about the corporation. In times of crisis, inspection statutes that give management too much control over information may be misused. At the same time, corporate managers are well-positioned to stop abuses of shareholder inspection rights by opportunistic competitors or corporate gadflies.

This conflict can be minimized by two revisions in inspection statutes: automatic access to information for certain types of shareholders, and further streamlining the existing inspection process for all other requests. Inspection statutes should provide for automatic access to the corporation's stocklist and limited types of nonsensitive corporate books and records, for certain classes of shareholders, such as long term institutional shareholders, where the dangers to corporate policy are minimal, and for all shareholder demands related to communicating about pending shareholder votes, where any harm to the corporation is far outweighed by the benefits of informing shareholders.

The dual objectives of informed shareholder voting, and equal access for both management and shareholders that are soliciting voters,²⁰⁷ lead to the conclusion that stocklists should be made available whenever a shareholder vote is pending, either as part of a proxy contest, or as a countersolicitation in opposition to a management proposal. In fact, a strong argument can be made that shareholders should have an absolute right to the corporation's stocklist in all circumstances. The corporation's interests in protecting its shareholders from harassment by maintaining shareholders' privacy are adequately served by requiring any shareholder requesting the stocklist to execute appropriate confidentiality agreements with adequate bond provisions.²⁰⁸

Large institutional investors that are actively monitoring corporate management should be provided with immediate access to most corporate books and records provided that they agree to execute confidentiality agreements and post an appropriate bond. The statute must be carefully drafted to protect the

206. See *Thomas S. Betts Corp. v. Leviton Mfg. Co., Inc.*, 1995 Del. Ch. LEXIS (Dec. 19, 1995) (denying those portions of a shareholder's books and records request that related to its interest in acquiring the company in a hostile transaction).

207. See Black, *Disclosure, Not Censorship*, *supra* note 3, at 67.

208. Shareholders that are particularly sensitive about having other shareholders learn their identities can still keep this information secret by holding their stock in street name and refusing to consent to disclosure of their identities under Rules 14b-1 and 14b-2. See Thomas & Dixon, *supra* note 178 (manuscript at Chapter 5).

corporation against the shareholder's misuse of the corporation's proprietary secrets. First of all, only shareholders that are not seeking control,²⁰⁹ nor actively competing with the corporation, nor involved in labor negotiations with the corporation,²¹⁰ should benefit from an automatic access rule for books and records. These restrictions would reduce the risk of shareholder misuse of corporate documents. Furthermore, trade secrets and other confidential business information should not generally be provided to shareholders. As noted above, confidentiality agreements may not provide sufficient protection for the corporation with respect to these materials.

For the remaining demands, inspection statutes should be revised to streamline shareholder access to information and deter frivolous refusals. These revisions could take three forms: shortening the time required to complete an inspection case; reducing the cost to the plaintiff of fighting these cases; and increasing the plaintiff's likelihood of success.

The time it takes to handle an inspection case could be shortened in several ways. One possibility is to eliminate a stay pending appeal. This would mean that if the corporation loses in the trial court, it cannot delay execution of the court's order by seeking appellate review. This would make the most sense for stocklist cases, where the potential harm to the corporation from an incorrect trial court decision is limited. In books and records cases, the stay could be discretionary but with a substantial bond required so that an appellate court might in an important case weigh the possible harm to the corporation from the disclosure of the information before determining whether to permit immediate examination.

The time and the cost of inspection cases could be reduced by further limiting the issues and the discovery process in inspection cases. Most importantly, the proper purpose requirement could be eliminated for stocklist cases and most types of books and records cases. A standard confidentiality agreement that would cover most contingencies could be generated for use in stocklist cases. This could be coupled with a bond requirement in an amount sufficient to deter abuses.

Plaintiffs' expected costs for inspection cases could be lowered by insuring that they are compensated if the corporation's refusal is frivolous.²¹¹ The key is that the court award the shareholders complete relief, not just the amount of their attorneys' fees. Complete relief may require the court to order a delay in the corporate vote so the shareholders will have enough time to use the information they obtain from their inspection demand.²¹² Adopting such a

209. Thus, for example, if a shareholder had filed a Schedule 13D stating that they intended to try to gain control of the target company, it would be barred from obtaining its books and records in this manner.

210. These institutions may have interests that are at odds with those of other investors because they have dual interests as both capital and labor. For a further discussion of these issues, see Randall S. Thomas & Kenneth Martin, *An Empirical Analysis of Labor Unions' Use of the Shareholder Proposal Rule* (Unpublished Working Paper, University of Iowa College of Law 1996) (copy on file with author).

211. The more likely the court is to grant reimbursement, the lower the plaintiff's expected costs. At a very simple level, the plaintiff's expected costs of filing a lawsuit are the out-of-pocket cost of the suit times the probability of being reimbursed for these costs. For example, if the cost of the inspection case is \$20,000, and the probability of being reimbursed is 50%, then the plaintiff's expected cost is \$10,000.

212. See CAL. CORP. CODE § 1600.

policy would also deter wrongful refusals because corporations would know that delay would be of little or no benefit to them.

Finally, the inspection statutes could be revised to improve the plaintiff's likelihood of success. The Delaware statute already shifts the burden of proof onto the defendant corporation in stocklist cases to show that the plaintiff has not established a proper purpose. This shifting of the burden of proof could be extended to books and records cases in instances where the information sought is neither trade secrets nor other sensitive proprietary data. Furthermore, the other changes outlined above would increase the likelihood that shareholders will succeed in their inspection demands. These proposals would also lower the costs of, and time taken, resolving an inspection case.

Delaware should revise its inspection statute to provide shareholders with faster and cheaper statutory access to stocklists and books and records. The policy recommendations in this article are incremental ones, intended to preserve needed protections for the corporation's interests and deter abuses by destructive shareholders. At the same time, Delaware corporations could benefit from encouraging shareholder monitoring. One small step in that direction is to provide shareholders access to the data that they need to become better monitors of corporate management. If Delaware is unwilling to make these changes, then shareholders should ask the SEC to reopen the issue of revising Rule 14a-7 to provide shareholders with better access to the information that they need to monitor corporate management.

