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CORPORATIONS-RIGHT OF HOSTILE STOCKHOLDER AND DIRECTOR TO EXAMINETHE BOOKS AND RECORDS OF CORPORATION

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CORPORATIONS—RIGHT OF HOSTILE STOCKHOLDER AND DIRECTOR TO EXAMINE THE BOOKS AND RECORDS OF CORPORATION—Plaintiff was a minority stockholder and director in Pascal Company. She sought to inspect the books and records of the corporation relating to marketing practices, sales and customers, but was prevented from doing so by the defendant, who is the president and majority stockholder of the corporation. Plaintiff thereupon brought an action for a writ of mandamus to compel the defendant to permit such inspection. The defense was that plaintiff had a scheme to interfere with, harass and sabotage the business by contacting distributors and customers, and by making information regarding the business available to competitors. The lower court dismissed the action with prejudice. On appeal, *held,* affirmed. Since the plaintiff's purposes were hostile to the corporation, she had no right either as a stockholder or director to examine the books and records. *State ex rel. Paschall v. Scott,* (Wash. 1952) 247 P. (2d) 543.

At common law, the stockholder has the right to examine the books and papers of the corporation for a proper purpose and under reasonable regulations as to place and time.[1] This right is said to rest upon the ground that those in charge of the corporation are merely agents of the stockholders, who are the real owners of the property,[2] which perhaps is but another way of saying that the right is necessary to protect the stockholders' interest in the corporation.[3] In most states legislation now governs the right and in about half the states

[1] 22 A.L.R. 24 (1923). Supplementary annotations 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).

[2] Guthrie v. Harkness, 199 U.S. 148, 26 S.Ct. 4 (1905); Cincinnati Volksblatt Co. v. Hoffmeister, 62 Ohio St. 189, 56 N.E. 1033 (1900); Wight v. Heublein, 111 Md. 649, 75 A. 507 (1910).

[3] State ex rel. Weinberg v. Pacific Brewing and Malting Co., 21 Wash. 451, 58 P. 584 (1899).

merely embodies the common law rule.[4] Even in some of those states whose statutes have been interpreted as making the right absolute, the granting of the writ of mandamus, which is the ordinary method of specifically enforcing the right,[5] is held to be discretionary and will depend on a showing by the petitioner of a proper purpose.[6] A proper purpose exists whenever information concerning the management, conduct, and control of the corporation is sought for the protection of the petitioner's stock interest.[7] If the motive of the stockholder is to further some purely private interest apart from his stock interest in the corporation, his purpose is improper and, in those states following the common law rule, he will be denied relief.[8]

The right of a director to inspect the books of the corporation, like that of a stockholder, exists at common law. However, the director's right of inspection, unlike that of the stockholder, is unqualified. This is because the director must be familiar with the affairs of the corporation if he is to fulfill his managerial duties intelligently.[9] All he need show, in order to secure the aid of the court in gaining access to the books and records of the corporation, is that he is a director of the corporation, that he has demanded permission to examine the books, and that his demand has been refused.[10] The principal case and an 1890 Connecticut case stand alone in holding that a director has no right to inspect the books and records for a purpose injurious to the corporation.[11] The principal case argues that, even though the director needs the power of inspection in fulfilling his duty to look after the interests of the corporation, his purpose in inspecting the books is not to advance but to harm those interests. Therefore, the court's reasoning goes, it is not hindering the performance of his duties to prevent his inspection of the books. The difficulty with this argument is that the director may intend to fulfill his duty to the corporation except

[4] PARKER'S CORPORATION MANUAL, 1952 ed. The state statutes vary somewhat in the purpose requirement. Some require a "proper purpose," 3 MICH. COMP. LAWS (1948) §450.45, and others a "reasonable purpose," Kan. Gen. Stat. (1949) §17-3310. Another less common provision is to the effect that inspection will be denied to any stockholder who is shown to have previously sold stock lists for the purpose of circularizing stockholders. 4 N.M. Stat. (1941) §54-227.

[5] Klotz v. Pan-American Match Co., 221 Mass. 38, 108 N.E. 764 (1915); State ex rel. Cochran v. Penn-Beaver Oil Co., 34 Del. 81, 143 A. 257 (1926).

[6] Shea v. Sweetser, 119 Me. 400, 111 A. 579 (1920); Wight v. Heublein, supra note 2; State ex rel. Theile v. Cities Service Co., 31 Del. 346, 114 A. 463 (1921).

[7] Re Taylor, 117 App. Div. 348, 101 N.Y.S. 1039 (1907); State ex rel. Theile v. Cities Service Co., supra note 6.

[8] Guthrie v. Harkness, supra note 2 (to gratify idle curiosity); People ex rel. McElwee v. Produce Exchange Trust Co., 53 App. Div. 93, 65 N.Y.S. 926 (1900) (to annoy or harass the corporation); Bevier v. U.S. Wood Preserving Co., (N.J. 1908) 69 A. 1008 (to aid competitors of the corporation); Eaton v. Manter, 114 Me. 259, 95 A. 948 (1915) (to obtain lists of business prospects, advertising lists or investments).

[9] Machen v. Machen & M. Electrical Mfg. Co., 237 Pa. 212, 85 A. 100 (1912); State ex rel. Keller v. Grymes, 65 W.Va. 451, 64 S.E. 728 (1909).

[10] People ex rel. Leach v. Central Fish Co., 117 App. Div. 77, 101 N.Y.S. 1108 (1907).

[11] Hemingway v. Hemingway, 58 Conn. 443, 19 A. 766 (1890). See also BALLANTINE, CORPORATIONS, rev. ed., §165 (1946).

in the one situation which is before the court. The solution to this problem suggested by some courts following the majority rule would be to remove the director.[12] This is a workable remedy in those jurisdictions where such removal is possible. However, in the absence of statute, a director cannot be removed by the court,[13] and by the time a removal by a vote of the shareholders can be effected, the hostile director may have secured the information through the compulsive power of the courts. Nevertheless, it would appear that the rule announced by the principal case is the less desirable one. It effectively strips from the director the means of carrying out his duties while leaving him nominally in office, with the result that the stockholders and the state are deprived of the benefits of having the corporation managed by the number of directors prescribed by statute. The more appropriate remedy would appear to be through recourse to the various state legislatures to provide a method by which the courts can remove a director who has violated or threatens to violate his fiduciary duty to the corporation.

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[12] People ex rel. Leach v. Central Fish Co., supra note 10.

[13] Neall v. Hill, 16 Cal. 146, 76 Am. Dec. 508 (1860); Cella v. Davidson, 304 Pa. 389, 156 A. 99 (1931). Both of these jurisdictions now have substantially identical statutes providing for removal of directors by the courts on a showing of "fraudulent or dishonest acts or gross abuse of authority or discretion." Cal. Corp. Code Ann. (1947) §811; 15 Pa. Stat. Ann. (Purdon, 1938) §2852-405.