

BOOKS & RECORDS REQUESTS

A 19th Century Request Becomes a 21st Century Litigation Tool

BY JON OEBKER

In the 1800s, if you held shares in an Ohio company, you had a right to inspect its corporate books and records. It's not hard to imagine a shareholder making the journey by horse and buggy to downtown Cleveland to visit the corporate offices on Public Square and paging through the leather-bound corporate ledger of the company. This right of a shareholder to review the corporate books has since been codified in Ohio law and endures to this day; however, what began as a basic right to monitor an investment has evolved into a 21st century harbinger and tool of corporate litigation.

Ohio common law has long recognized that the right of a shareholder to inspect the "books and records" of a corporation is a fundamental "incident to ownership of stock" and rests "upon the broad ground that the business of the corporation is not the business of the officers exclusively, but is the business of the stockholders." *Cincinnati Volksblatt Co. v. Hoffmeister* (1900), 62 Ohio St. 189, 199. Ohio codified this common law right in Ohio Revised Code § 1701.37.

Different states have different rules as to which shareholders are entitled to request inspection. For example, in Nevada, the shareholder must own at least 15% of the stock, and Maryland requires at least 5% ownership. In California, only a shareholder of record has the right to inspect corporate books, while in contrast, Delaware extends the right of inspection to beneficial owners if they produce documentary evidence of ownership. The Ohio statute, which simply refers to "any shareholder," does not limit the right to record shareholders or have a minimum ownership requirement.

While the right of a shareholder to inspect the corporate books is well established, a shareholder still must have a valid reason for the request. In Ohio, a shareholder must have a "reasonable and proper purpose" to justify

the request. R.C. 1701.37. This hurdle is easily satisfied. The Ohio Supreme Court explained that, in order for a shareholder to exercise his right of inspection, "[n]othing more is required than that, acting in good faith for the protection of the interests of the corporation and his own interests, he desires to ascertain the condition of the corporation's business." *Lake v. Buckeye Steel Castings Co.* (1965), 2 Ohio St.2d 101, 104. Examples of reasonable proper purposes include investigating suspected corporate mismanagement and ascertaining the financial health of the corporation. Notably, even a competitor who holds stock in a company can have access to a company's books and records as long as the demand presents a reasonable and proper purpose. *Celina Mut. Ins. Co. v. Am. Druggists Ins. Co.* (1977), 52 Ohio App. 2d 304, 308 (competitor of Am. Druggist Ins. (ADI) who also owned stock in ADI made a reasonable and proper demand to inspect ADI records in order to determine whether the competitor wished to purchase more stock in ADI). The committee notes to R.C. 1701.37 further explain there is a presumption that a shareholder's written statement of purpose has been made in good faith and the corporation has the burden of rebutting the presumption by proving that the shareholder's actual purpose is improper or unreasonable. In order to carry its burden to establish that a shareholder inspection request is improper, a corporation opposing a shareholder request must establish the request is made in a "capricious, irresponsible or hostile way or in such a manner as to depreciate the assets of the company and the value of the stock of the other shareholders." *Celina Mut. Ins. Co.*, 52 Ohio App. 2d at 310.

While a shareholder's right to inspect has existed for well over a century, the items available and format for the production to

shareholders have predictably evolved. The early versions of these requests often simply sought access to corporate ledgers and lists of fellow shareholders. Upon codification, the Ohio statute allowed shareholder access to the following items specifically listed in the statute: articles of the corporation, regulations, books and records of account, minutes, records of shareholders, and voting trust agreements. Over time, courts have permitted shareholder access to an increasing list of items under the category of "books and records of account." For example, a recent appellate case permitted shareholder access to the following: ledgers; journals; payroll ledgers; contracts, including employment and consulting contracts; financial statements and reports; leases; securities and other investments of the company; guarantees; expense reports; records of salaries; records of transfers or loans; employee expenses requested and expenses paid by the company; and loan applications. *No-Burn, Inc. v. Murati*, 2011-Ohio-5635. And in addition to the growing list of corporate records available to shareholders, Ohio follows the majority rule allowing shareholders to inspect the records of a wholly owned subsidiary of the corporation in which they own stock when the parent corporation "so controls and dominates the subsidiary that the separate corporate existence of the subsidiary should be disregarded." *Danziger v. Luse*, 2004-Ohio-5227, ¶ 20. Finally, the shareholder's right to the "records of shareholders" under the statute includes the so-called "NOBO" list (non-objecting beneficial owners who own the stock through a brokerage, but do not object to the release of their names to the company upon request) as long as the list already exists. *Luxottica Grp. S.p.A. v. U.S. Shoe Corp.*, 919 F. Supp. 1091, 1092 (S.D. Ohio 1995).

In light of the fact that Ohio corporate law tends to follow trends from Delaware, recent rulings from the Court of Chancery foreshadow an expanding list of items available in a books and records request. For example, recent Delaware cases have ordered the production of corporate documents containing attorney-client privilege and work product information, *Wal-Mart Stores, Inc. v. Indiana Electrical Workers Pension Trust Fund IBEW*, 95 A.3d 1264 (Del. 2014), and corporate emails, *Amalgamated Bank v. Yahoo! Inc.*, 132 A.3d 752, 763 (Del. Ch. 2016). When faced with such broad requests, corporate counsel are wise to consider whether the items requested in the books and records request are overly broad and unrelated to the stated proper purpose. *Khanna v. Covad Communications Group, Inc.*, No. 20481, 2004 WL 187274 (Del. Ch. 2004) (rejecting a shareholder request to produce all e-mails, letters and communications between the stockholder and the company and between the company's directors because the request was "overly broad," "excessive," and the plaintiff had not shown any necessity for the information. *Id.* at *9).

While the litigation over books and records requests can be innocuous, they are often harbingers of larger disputes and more litigation. While it is not uncommon for shareholders contemplating a proxy dispute to use a books and records request to obtain a corporation's list of shareholders, the Delaware Supreme Court has gone further and recognized that books and records requests are "an important part of the corporate governance landscape" and a "tool" that should be employed before filing a derivative action. *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 120 (Del. 2006).

Because these requests are so closely tied to future litigation, the corporation's directors and officers liability insurance carrier should be informed as soon as a books and records request is received. In fact, while D&O insurance traditionally does not cover books and records requests because the insurer views the costs as a corporate operating expense, the prevalence of books and records requests as a precursor to litigation has resulted in some carriers being willing to cover the expense of a books and records request as a defense expense or at least to amend their policies to provide coverage for

such requests. *Kevin LaCroix, D&O Insurance: Securing Coverage for Books and Records Requests, The D&O Diary, July 20, 2017.*

Indeed, while corporate records are now held electronically instead of within dusty leather-bound ledgers, a shareholder's fundamental right to review corporate records has essentially remained unchanged for over a century. But while the right to this information existed before the advent of the automobile, the corporate information available and the use of these requests as a litigation tool are much more modern.



Jon Oebker is Counsel with Tucker Ellis LLP, where he is a member of the firm's Business Litigation Group.

A former Ohio Assistant Attorney General and Assistant Cuyahoga County Prosecutor, Jon has handled more than 200 cases in state and federal courts and argued over a dozen cases before the Ohio Supreme Court. He has been a CMBA member since 1999. He can be reached at (216) 592-5000 or jon.oebker@tuckerellis.com.