Washington and Lee Law Review

Volume 19 | Issue 2 Article 15

Fall 9-1-1962

Director's Right to Inspect Corporate Records

courts have endeavored to decide each case upon its own merits. Nevertheless, in the absence of an express provision in the lease granting the right to strip mine, the mineral lessee has been faced with a most difficult task of providing his right to *destroy* the surface. By placing this burden upon the mineral lessee, he is denied a valuable contract right and is penalized for having failed to foresee the mining industry's unprecedented mechanization.

LEONARD SARGEANT III

DIRECTOR'S RIGHT TO INSPECT CORPORATE RECORDS

Normally a director in office has the right to examine the books and records of the corporation.[1] Whether this right may be denied or limited because the director's purposes are hostile to the corporation or because he acts in bad faith is a question that courts have not always answered consistently.

The recent Delaware case of *State ex rel. Farber v. Seiberling Rubber Co.*[2] deals with this problem. One of the directors of Seiberling Rubber Co., Eugene Farber, sought mandamus[3] to compel the officers of the corporation to provide him with a list of the stockholders or give him access to the corporate stock ledger. Seiberling answered that Farber's motive was improper; and if his petition was granted, such an inspection would be detrimental to the corporation. Farber moved to strike the answer[4] in its entirety, and the court was presented with the problem of whether or not a showing of improper motive on the part of a director is sufficient in law to deny him the right to inspect the corporate stock ledger.

The Superior Court of Delaware concluded that a director has a

---

[1]People ex rel. Bartels v. Borgstede, 169 App. Div. 421, 155 N.Y.S. 322 (2d Dep't 1915). The court conceded that the right of a director to inspect and examine the corporation books is unquestioned. In some states the right is expressly granted by statute. See Cal. Corp. Code § 3004.

[2]168 A.2d 310 (Del. Super Ct. 1961).

[3]Traditionally the proper remedy used to enforce the inspection right is a writ of mandamus. The writ requires, as a matter of pleading, that a director needs only to show that he has demanded an inspection and that the demand has been refused. See 5 Fletcher, Corporations § 2251 (Rev. Vol. 1952), and cases cited therein.

[4]He contended that under Rule 12(f) of the Superior Court of Delaware, a defense is insufficient and subject to being struck when it is not a valid defense; or where it is not germane to the issues in the case; or where it is not responsive to the claims to which it is interposed. Del. Super. Ct. (Civ.) R. 12(f). See Fowler v. Munford, 48 Del. 282, 102 A.2d 535 (1954).

right to inspect the corporate books only so long as his purpose is not adverse to the interest of the corporation. If his motives are improper then the right to inspect ceases to exist. The court denied Farber's motion to strike on the ground that it admitted his improper motive, which constitutes a sufficient defense in law to deny him the right to inspect.

At common law both the director and the stockholder were accorded the right to inspect the books, records and documents of the corporation.[5] The right of the director has often been termed an absolute and unqualified right,[6] while the right of the stockholder has been qualified.[7] Although the inspection rights of a stockholder and a director have much in common, they are based upon different principles.

The right of a stockholder to inspect the books and records is an incident of stock ownership and the corresponding interest in the assets and business of the company.[8] This equitable ownership gives

---

[5]See generally Annot., 15 A.L.R.2d 11 (1951); Annot., 174 A.L.R. 262 (1948); Annot., 80 A.L.R. 1502 (1932); Annot., 59 A.L.R. 1373 (1929); Annot., 22 A.L.R. 24 (1923).

[6]State ex rel. Watkins v. Cassell, 294 S.W.2d 647 (Mo. Ct. App. 1956); Drake v. Newton Amusement Corp., 123 N.J.L. 560, 9 A.2d 636 (Sup. Ct. 1939); Mitchell v. Rubber Reclaiming Co., 24 Atl. 407 (N.J. Ch. 1892); People ex rel. Muir v. Throop, 12 Wend. 183 (N.Y. 1834); Davis v. Keilsohn Offset Co., 273 App. Div. 695, 79 N.Y.S.2d 540 (1st Dep't 1948); State ex rel. Wilkens v. M. Ascher Silk Corp., 207 App. Div. 168, 201 N.Y.S. 739 (1st Dep't 1923), aff'd 237 N.Y. 574, 143 N.E. 748 (1924), rehearing denied 237 N.Y. 630, 143 N. E. 770 (1924); People ex rel. Leach v. Central Fish Co., 117 App. Div. 77, 101 N.Y.S. 1108 (1st Dep't 1907); Halperin v. Air King Prods. Co., 59 N.Y.S.2d 672 (Sup. Ct. 1946); Machen v. Machen & Mayer Elec. Mfg. Co., 237 Pa. 212, 85 Atl. 100 (1912); State ex rel. Aultman v. Ice, 75 W. Va. 476, 84 S.E. 181 (1915). See 5 Fletcher, Corporations § 2235 (Rev. Vol. 1952); Ballantine, Corporations § 165 (rev. ed. 1946); Annot., 15 A.L.R.2d 11, 76 (1951).

[7]State ex rel. Miller v. Loft, Inc., 34 Del. 538, 156 Atl. 170 (Super. Ct. 1931); News-Journal Corp. v. State ex rel. Gore, 136 Fla. 620, 187 So. 271 (1939), aff'd 1 So. 2d 559 (1941), aff'd per curiam 8 So. 2d 493 (1942); Albee v. Lamson & Hubbard Corp., 320 Mass. 421, 69 N.E.2d 811 (1946); In re Steinway, 159 N.Y. 250, 53 N.E. 1103 (1899); Tate v. Sonotone Corp., 272 App. Div. 103, 69 N.Y.S.2d 535 (1st Dep't 1947); see Miller v. Spanogle, 275 Ill. App. 335, 340 (1934) (dictum); Cravatts v. Klozo Fastner Corp., 205 Misc. 781, 133 N.Y.S.2d 235, 237 (Sup. Ct. 1954) (dictum). See Bartels and Flanagan, Inspection of Corporate Books and Records in New York by Stockholders and Directors, 38 Cornell L.Q. 289 (1953); Note, 18 La. L. Rev. 337 (1958); Note, 41 Va. L. Rev. 237 (1955).

[8]Guthrie v. Harkness, 199 U.S. 148 (1905), affirming 27 Utah 248, 75 Pac. 624 (1904); Hobbs v. Davis, 168 Cal. 556, 143 Pac. 733 (1914); State ex rel. Miller v. Loft, Inc., 34 Del. 538, 156 Atl. 170 (Super. Ct. 1931); State ex rel. De Juluecourt v. Pan American Co., 21 Del. 391, 61 Atl. 398 (Super Ct. 1904), aff'd mem. 63 Atl. 1118 (1906); Sawers v. American Phenolic Corp., 404 Ill. 440, 89 N.E. 2d 374 (1950); Wise v. H. M. Byllesby & Co., 285 Ill. App. 40, 1 N.E.2d 536 (1936); Klein v. Scranton Life Ins. Co., 137 Pa. Super 369, 11 A.2d 770 (1940); Kuhbach v. Irving Cut Glass Co., 220 Pa. 427, 69 Atl. 981 (1908). Cf., State ex rel. Dixon v. Missouri-Kansas Pipe

the shareholder the right to inspect for all "proper purposes"[9] necessary to protect his interests as a shareholder. On the other hand, a director stands in a fiduciary relation to the corporation and to its shareholders.[10] To perform properly the duties imposed by this dual relationship, a director must have a right to inspect the corporate books and records.[11] Moreover, the right of inspection is also essential in order for the director to protect himself from potential personal liability.[12] Consequently, it is apparent that a director inspects in order to perform his duties intelligently and prudently, while a stockholder inspects to protect his individual interests. Accordingly, a director generally has a wider and more extensive right of inspection.

Recognizing this distinction, it is evident that the "absolute" right of inspection enjoyed by a director, as opposed to the "qualified" right granted a stockholder, is based on the director's fiduciary function in supervising, managing and preserving the corporation.

The majority of courts, adhering to the doctrine prevailing in New York, have expressed the view that a director has an absolute and unqualified right of inspection and that his motives are immaterial.[13] The principle is stated in *State ex rel. Wilkins v. M. Ascher Silk Corp.*:[14]

Line Co., 42 Del. 423, 36 A.2d 29 (Super. Ct. 1944); State ex rel. Foster v. Standard Oil Co. of Kan., 41 Del. 172, 18 A.2d 235 (Super. Ct. 1941). See 5 Fletcher, Corporations §§ 2213-2226.4 (Rev. Vol. 1952). See also note 5 supra.

[9]See note 8 supra.

[10]"It is fundamental that directors stand in a fiduciary relation to the corporation and its shareholders, and that their primary duty is to deal fairly and justly." Yasik v. Watchtel, 25 Del. Ch. 247, 17 A.2d 309, 313 (1941); Drake v. Newton Amusement Corp., 123 N.J.L. 560, 9 A.2d 636 (Sup. Ct. 1939). Cf., Lebold v. Inland Steel Co., 125 F.2d 369 (7th Cir. 1941), cert. denied 316 U.S. 675 (1942) (director owed duty to minority shareholders on dissolution). See N.C. Gen. Stat. § 55-35 (Repl. Vol. 1960) (refers to directors fiduciary relation to the corporation and to its shareholders).

[11]People ex. rel. Bellman v. Standard Match Co., 208 App. Div. 4, 202 N.Y.S. 840 (2d Dep't 1924); People ex rel. Leach v. Central Fish Co., 117 App. Div. 77, 101 N.Y.S. 1108 (1st Dep't 1907); People ex rel. McInnes v. Columbia Paper Bag Co., 103 App. Div. 208, 92 N.Y.S. 1084 (1st Dep't 1905); Machen v. Machen & Mayer Elec. Mfg. Co., 237 Pa. 212, 85 Atl. 100 (1912); State ex rel. Keller v. Grymes, 65 W. Va. 451, 64 S.E. 728 (1909). See Annot., 15 A.L.R.2d 11, 41 (1951).

[12]"According to the weight of authority, it seems the directors of a corporation may be charged with negligence for a failure to inform themselves of matters shown by the books of the company, but there is respectable authority to the contrary." 3 Fletcher, Corporations § 1060 (Rev. Vol. 1947) and cases cited therein. See Ballantine, Corporations § 62 (rev. ed. 1946).

[13]See note 6 supra.

[14]207 App. Div. 168, 201 N.Y.S. 739 (1st Dep't 1923), aff'd 237 N.Y. 574, 143 N.E. 748 (1924), rehearing denied 237 N.Y. 630, 143 N.E. 770 (1924).

> "[S]o long as [he] remains a director, he is entitled to, and his duty is, to keep himself informed of the business of the corporation, irrespective of his motive; otherwise, the right of a director desiring to inspect will be dependent upon his being able to satisfy the other officers of the corporation that his motives were adequate."[15]

These jurisdictions indicate that removal from office is the appropriate remedy to use where a director's actions are hostile and inimical to the interests of the corporation.[16] Since a director's right to examine the corporate books is co-existent with his term of office, upon the expiration of that term or removal from office, he loses his right to inspect.[17]

A small minority of jurisdictions qualify the right, limiting it to inspection for "proper purposes."[18] In this form the rule closely approximates the right granted to stockholders at common law to inspect only for "proper purposes."

The rationale of the principal case and other jurisdictions qualifying the inspection right of a director is based on the reasons giving rise to the right of a director to inspect. It is inconsistent, the court says in the principal case, to say that "a director has an absolute right to inspect the records of a corporation so that he may better perform his obligations to protect the corporation, and in the next breath say this right is absolute and remains inviolate even though such exami-

---

[15]201 N.Y.S. at 740. See Javits v. Investor's League, Inc., 92 N.Y.S.2d 267 (Sup. Ct. 1943).

[16]Davis v. Keilsohn Offset Co., 273 App. Div. 695, 79 N.Y.S.2d 540 (1st Dep't 1948); People ex rel. Leach v. Central Fish Co., 117 App. Div. 77, 101 N.Y.S. 1108 (1st Dep't 1907); Halperin v. Air King Prods. Co., 59 N.Y.S.2d 672 (Sup. Ct. 1946).

[17]Overland v. Le Roy Foods, Inc., 279 App. Div. 876, 110 N.Y.S.2d 578 (2d Dep't 1952) aff'd mem. 304 N.Y. 573, 107 N.E.2d 74 (1952) (director removed); Cravatts v. Klozo Fastner Corp., 205 Misc. 781, 133 N.Y.S.2d 235 (Sup. Ct. 1954) (director resigned); Hymes v. Riveredge Printers, Inc., 131 N.Y.S.2d 200 (Sup. Ct. 1954) (director removed). But see Cohen v. Cocaline Prods., 309 N.Y. 119, 127 N.E.2d 906 (1955) (director failing to be re-elected has a qualified right to inspect the books covering the period of his directorship); Application of La Vin, 37 N.Y.S.2d 161 (Sup. Ct. 1942) (ex-director entitled to examine the books up to the date of his removal from office).

Removal as a remedy presents practical difficulties and is not always effective. The remedy is criticized in Bartels & Flanagan, Inspection of Corporate Books and Records in New York by Stockholders and Directors, 38 Cornell L.Q. 289, 314 (1953).

[18]Hemingway v. Hemingway, 58 Conn. 443, 19 Atl. 766 (1890); State ex rel. Paschall v. Scott, 41 Wash. 2d 71, 247 P.2d 543 (1952). See Stone v. Kellogg, 165 Ill. 192, 46 N.E. 222 (1896) (dictum); Strassburger v. Philadelphia Record Co., 335 Pa. 485, 6 A.2d 922, 924 (1939) (dictum). See 5 Fletcher, Corporations § 2235, (Rev. Vol. 1952); 13 Am. Jur. Corporations § 1025 (1938). See also note 25 infra.

nation is conducted for an improper purpose hostile to the interests of the corporation."[19] Similar reasoning is used in *State ex rel. Paschall v. Scott*:[20]

> "[W]hen a director, driven by hostile and improper motives, seeks to examine corporate books and records, he cannot do so under a claim of duty. On the contrary, his purposes and action are entirely inconsistent with such duty. The basis of the right which a director has to examine corporate records—the performance of corporate duties—is then wholly lacking, and thus the right itself no longer exists."[21]

The minority rule seems to be founded upon sound reasoning. If a director cannot sustain the burden of showing that inspection is for a proper purpose and is not hostile or inimical to the interest of the corporation he should be denied the right to inspect. As asserted in *Davis v. Keilsohn Offset Co.*[22] in a concurring opinion:

> "[A] person ought not to receive the aid of a court order for an inspection of the books and records of a corporation as a director, if it be established that he has disqualified himself from continuing to act in that fiduciary capacity toward the corporation."[23]

Delaware, in adopting the minority rule, goes as far as any jurisdiction has in qualifying a director's right, and this may be indicative of a current trend. Apparently even the New York courts, as indicated in *Gresov v. Shattuck Denn Mining Corp.*,[24] have recognized that there

---

[19] 168 A.2d 310, 312 (Del. Super. Ct. 1961).

[20] 41 Wash. 2d 71, 247 P.2d 543 (1952).

[21] 247 P.2d at 549.

[22] 273 App. Div. 695, 79 N.Y.S.2d 540 (1st Dep't 1948).

[23] 79 N.Y.S.2d at 542.

[24] 29 Misc.2d 324, 215 N.Y.S.2d 98 (Sup. Ct. 1961). In holding that a director of a foreign corporation doing business in New York "has an absolute, unqualified right to inspect its books and records," the court states, "Respondent's contention that this rule is inapplicable where inspection is sought for purposes inimical to the interest of the corporation is not questioned." The court held that an inspection sought for the apparent purpose of ousting present management is not considered to be an act of bad faith detrimental to the corporation. 215 N.Y.S.2d at 99.

In certain unusual circumstances the right has been restricted by the New York courts. Posen v. United Aircraft Prods. Co., 201 Misc. 260, 111 N.Y.S.2d 261 (Sup. Ct. 1952) (inspection denied where director engaged in national defense work did not have federal security clearance); People ex rel. Bellman v. Standard Match Co., 208 App. Div. 4, 202 N.Y.S. 840 (2d Dep't 1924) (former director of dissolved corporation denied the right to inspect). Cf., Javits v. Investor's League, Inc., 92 N.Y.S.2d 267 (Sup. Ct. 1949) (membership list denied).

See Melup v. Rubber Corp. of America, 181 Misc. 826, 43 N.Y.S.2d 444 (Sup. Ct. 1943) (while describing the right as absolute the court admitted there must be exceptions to it.) See also Ballantine, Corporations § 165 (rev. ed. 1946) (the view