Right of Inspection of Corporate Books and Records

Introduction

The Commission authorized this project to clarify a discrepancy in the statutes relating to the extent of access a shareholder of a corporation may have to corporate books and records. A recent case highlighting the issue is *Cain v. Merck & Co.*, 415 N.J. Super. 319 (App. Div. 2010). The case arose from a dispute over access to minutes from corporate meetings needed for a shareholder derivative action against Merck, then known as Schering-Plough. The trial court granted the plaintiff’s application to examine the minutes of Schering’s board and executive committee involved in the alleged wrongdoing. *Id.* at 324. Merck/Schering, on appeal, argued the statute allowed no inspection beyond the records and minutes of shareholders’ proceedings, hinging its argument on a narrow construction of “minutes.” *Id* at 324-25.

One of the major issues on appeal in the case was thus whether the reference to “minutes” in 14A:5-28(4) of the New Jersey Business Corporation Act is meant to broadly cover minutes of board and executive committee meetings or if is to be limited only to shareholder meetings. 415 N.J. Super. at 323. The New Jersey Business Corporation Act includes no definition for “minutes” in its definition section. N.J.S. 14A:1-2.1. Corporations are required to keep books, records, and minutes of the proceedings of its shareholders, board, and executive committee pursuant to N.J.S. 14A:5-28(1). The discrepancy arises in subsection (4) of 14A:5-28, which provides that a court has the power to compel production of “the books and records of account, minutes, and record of shareholders of a corporation.”

In *Merck*, the court considered the Legislature’s use of the word “minutes” in subsection (4) “to refer to the shareholder, board, and executive committee minutes referred to in subsection (1)” even though the language used in the two subsections differs. 415 N.J. Super. at 331. The Appellate Division agreed with the trial court’s grant of plaintiff’s application, disagreed with the corporation’s reading of “minutes,” and read the statute to allow a court to compel production of the “minutes” of meetings of the board, executive committee, and shareholders (the Appellate Division agreed with Schering’s other argument—that a court may circumscribe an examination of minutes to a relevant proper purpose—and reversed in part).

In analyzing the statute, the Appellate Division noted that New Jersey common law prior to the statute’s enactment recognized a shareholder’s qualified right to “examine the books and records of [a] corporation.” *Id.* at 328. The court reviewed the materials surrounding enactment, noting that the sentence at issue in the case (the first sentence of subsection (4)) has remained essentially unchanged since enactment. *Id.* at 328-29 (in 1973 “the” was substituted for “said”).

The Appellate Division looked at each subsection of the statute relative to the others. Subsection (1) of the statute references corporate records in a broad sense: “[e]ach corporation shall keep books and records of account and minutes of the proceedings of its shareholders, board and executive committee, if any.” N.J.S. 14A:5-28(1). Subsection (3), on the other hand, specifically limits shareholder access to “minutes of the proceedings of its shareholders” based on a shareholder’s percentage of holdings and longevity, but rests the burden of proof of an improper purpose on the corporation. Subsection (4), applicable to all shareholders, preserves a
court’s power to allow shareholder access to “the books and records of account, minutes, and record of shareholders of a corporation” provided the shareholder shows a proper purpose. 

_N.J.S. 14A:5-28(4)_.

The Appellate Division held, in part, that a shareholder’s right of inspection pursuant to _N.J.S. 14A:5-28(4)_ includes inspecting the minutes of the board of directors and, as applicable, the executive committee. 415 _N.J. Super._ at 323. The right of inspection is, however, limited to shareholders showing a “proper purpose” and other limitations or conditions that may be imposed within the court’s discretion, irrespective of the shareholder’s quantity of shares owned or longevity of ownership. _N.J.S. 14A:5-28(4)_.

To avoid any future confusion or misinterpretation of subsection (4)’s reference to “minutes,” Staff recommends a slight revision to clarify the statutory language. The revision below serves to ameliorate any confusion. The proposed new language in subsection (4) is lifted from subsection (1).

The extent to which a shareholder may have a right to inspect the minutes of meetings of other committees of a corporation is debatable. Pursuant to _N.J.S. 14A:6-9_, a corporation’s board of directors may form an executive committee and one or more other committees, with differing levels of authority as provided by resolution or in the corporation’s organizing and governing documents. Regardless of the amount of authority delegated to other committees, the board still retains some oversight. In particular, committee actions “shall be reported to the board” at the board’s next meeting following the committee meeting. _N.J.S. 14A:6-9(3)_. With the committee actions being reported to the board and entered into the board’s minutes (which the shareholder would have a right to inspect), it is conceivable that the statute may inadvertently apply to decisions of other committees. This is not to suggest that the language of the statute gives a shareholder the right to inspect a compensation committee’s minutes at any time. Rather it suggests that after the compensation committee has reported its discussions or decisions to the full board, the shareholder may have access to that through his or her access of the board’s minutes. The ability for a shareholder to access the reasoning or impetus behind a secondary committee’s decisions would, however, seem to be limited to what information is shared on the record with the board. Accordingly, the language from subsection (1) relating to the board and executive committee (and not to other committees) is carried forward in the revision to subsection (4). At the April meeting, the Commission inquired about the scope of access to minutes of other committees. There is support in the Model Act for allowing inspection of records of a committee beyond the executive committee. At the time of the May meeting, Staff will update the Commission with more information on the approach taken by other states on this issue.

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_N.J.S. 14A:5-28. Books and records; right of inspection._

(1) Each corporation shall keep books and records of account and minutes of the proceedings of its shareholders, board and executive committee, if any. Unless otherwise provided in the bylaws, such books, records and minutes may be kept outside this State.
The corporation shall keep at its principal office, its registered office, or at the office of its transfer agent, a record or records containing the names and addresses of all shareholders, the number, class and series of shares held by each and the dates when they respectively became the owners of record thereof. Any of the foregoing books, minutes or records may be in written form or in any other form capable of being converted into readable form within a reasonable time. A corporation shall convert into readable form without charge any such records not in such form, upon the written request of any person entitled to inspect them.

(2) Upon the written request of any shareholder, the corporation shall mail to such shareholder its balance sheet as at the end of the preceding fiscal year, and its profit and loss and surplus statement for such fiscal year.

(3) Any person who shall have been a shareholder of record of a corporation for at least six months immediately preceding his demand, or any person holding, or so authorized in writing by the holders of, at least 5% of the outstanding shares of any class or series, upon at least five days' written demand shall have the right for any proper purpose to examine in person or by agent or attorney, during usual business hours, its minutes of the proceedings of its shareholders and record of shareholders and to make extracts therefrom, at the places where the same are kept pursuant to subsection 14A:5-28(1).

(4) Nothing herein contained shall impair the power of any court, upon proof by a shareholder of proper purpose, irrespective of the period of time during which the shareholder shall have been a shareholder of record, and irrespective of the number of shares held by him, to compel the production for examination by such shareholder of the books and records of account, and minutes of the proceedings of its shareholders, board and executive committee, if any, and record of shareholders of a corporation. The court may, in its discretion prescribe any limitations or conditions with reference to the inspection, or award any other or further relief as the court may deem just and proper. The court may order books, documents and records, pertinent extracts therefrom, or duly authenticated copies thereof, to be brought within this State and kept in this State upon whatever terms and conditions as the order may prescribe. In any action for inspection the court may proceed summarily.

(5) Holders of voting trust certificates representing shares of the corporation shall be regarded as shareholders for the purpose of this section.

COMMENT

The revision in subsection (4) reflects the extent to which a shareholder, who provides a proper purpose to a court, can enjoy the court's order to compel production of business records required to be kept by subsection (1). The revision codifies the reading of the statute found in Cain v. Merck & Co., 415 N.J. Super. 319 (App. Div. 2010).

New Jersey last made major revisions to the New Jersey Business Corporation Act in 1988. The revisions were based on the recommendations of the Corporation Law Revision Commission and earlier revisions were based on earlier versions of the Model Act.

In addition to clarifying the current language, the current revision also keeps New Jersey law consistent with the laws of other states as well as concepts found in the American Bar Association’s Business Corporation
Model Act,\(^1\) on which New Jersey’s enactment was partly based. See Bus. Corp. Model Act, § 16.02 (b)(1) (giving a shareholder the right to inspect and copy “excerpts from minutes of any meeting of the board of directors, records of any action of a committee of the board of directors . . . minutes of any meeting of the shareholders . . . and records of action taken by the shareholders or board of directors.”); 8 Del. Code § 220, § 224 (under Delaware law a stockholder has the right to inspect a corporation’s stock ledger, list of stockholders and books and records, and “[a]ny records maintained by a corporation in the regular course of its business, including . . . books of account, and minute books,” limited to a proper purpose.); 15 Pa. C.S.A. § 1508 (“[e]very shareholder shall . . . have a right to examine . . . the share register, books and records of account, and records of the proceedings of the incorporators, shareholders and directors”); Cal. Corp. Code § 1601 (“The accounting books and records and minutes of proceedings of the shareholders and the board and committees of the board . . . shall be open to inspection upon the written demand on the corporation of any shareholder”).

Moreover, the Model Act also provides for court-ordered inspections if a corporation refuses to grant inspection to a shareholder. And, the comments accompanying the Commission’s revisions to the statute in 1988 noted that “the Commission recognized the need not to restrict a Court’s power to order the production of corporate records in this State.” Accord N.Y. Bus. Corp. Law § 624 (“Nothing herein shall impair the power of courts to compel the production for examination of the books and records of a corporation”).

It appears that the Model Act and other states approach the issue in the same way the court in *Cain v. Merck* did. That is, when “minutes” is limited to minutes of shareholder meetings as in subsection 3 of 14A:5-28, the board and executive minutes are not included. But, when access to “minutes” is open to all shareholders with a qualification of showing a proper purpose, the term refers to the minutes of proceedings a corporation keeps as required by law. Because New Jersey corporations are required by 14A:5-28(1) to keep “books and records of account and minutes of the proceedings of its shareholders, board and executive committee,” it seems consistent with both the Model Act and other states’ laws that the “minutes” referred to in subsection 4 applies to all the minutes a corporation keeps by law.

The right of inspection under 14A:5-26 applies to shareholders and not to the general public. Throughout the statute the term “shareholder” is used consistently and nowhere are rights of the general public to demand business records from a corporation mentioned. It appears unlikely that the Legislature intended to extend the right of inspection to any member of the general public, but instead reserves that right for shareholders of a corporation.

No change has been made to the idea that the shareholder’s right is qualified by the requirement that a proper purpose be shown. A shareholder’s purpose may be found to be improper where the shareholder acts in bad faith, with ulterior motives, or with intent to destroy the corporation. See *Feist v. Joseph Dixon Crucible Co.* 30 N.J. Super. 153, 157 (App. Div. 1954). A proper purpose has also been described as a “purpose germane to the applicant’s status or proprietary interest as a member or stockholder.” *Siena v. Grand Lodge of N.J., Order Sons of Italy in America*, 11 N.J. Super. 507, 511 (App. Div. 1951). A showing of a proper purpose will be a credible showing of legitimate issues of wrongdoing on the part of the corporation’s directors and officers. *Cain v. Merck*, 415 N.J.Super at 332 (quoting *Seinfeld v. Verizon Comms Inc.*, 909 A.2d 117, 123 (Del. 2006). However, mere “fishing expedition[s] based on general and unsupported allegations of mismanagement” do not evince a proper purpose. *Id.* Therefore, if a shareholder meets a court’s satisfaction of proving a proper purpose under subsection 4, the court shall compel production of the records for inspection. *Wyckoff v. Hardware Supply Co.* 134 N.J.L. 172, 173-74 (1946) (“a common stockholder has the right of inspection of the books and records of a corporation to determine whether there has been proper management of the business”).

Left unchanged also is the statute’s apparent application to holders of both voting and non-voting shares of stock. Subsection 4 merely refers to “a shareholder” and “a shareholder of record” without any qualification on the shareholder’s voting rights within the corporation. 14A:5-28(4). This section of statutes contains no other mention of division of shares. However, the NJ Business Corporation Act elsewhere addresses the division of shares into

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\(^1\) The American Bar Association has promulgated a Model Business Corporation Act. The Act was first promulgated in 1950 and has undergone periodic updates and revisions since then, with a complete revision made in 1984. At least 30 states have incorporated some of the Model Act into their statutes, including New Jersey.
classes and series. For example, in its certificate of incorporation, a corporation is to specify if shares will be divided, the designation of classes and series, and the relative rights, preferences and limitations of the divided shares. *N.J.S. 14A:2-7 (1)(d); 14A:7-2 (1)* (allowing for changes to divisions through amendments to original certificate of incorporation). A corporation is able to include provisions in its certificate of incorporation so long as the provision is not inconsistent with other provisions of the Business Corporation Act or any other NJ statute. *N.J.S. 14A:2-7 (1)(f).* The court’s power to compel inspection under subsection 4 seems unimpaired by anything but the requirements that (1) a request be made by a shareholder (2) showing a proper purpose. Thus, it appears a corporation cannot limit a shareholder’s right to inspect based on the class or series of the shares held.

In addition, the right of inspection is held by the beneficial or equitable holder of shares of stock. *N.J.S. 14A:1-2.1(l)* defines “Shareholder” as “one who is a holder of record of shares in a corporation.” In addition, the definition section of 14A defines “authorized shares” to mean “shares of all classes and series which the corporation is authorized to issue.” *14A:1-2.1(c).* The statute applies to the beneficial holder of the shares of stock. A beneficial holder is the holder of equitable title to the stock. *Black’s Law Dictionary* (9th Ed.). The “shareholder” under the statutes is the one who receives notice of shareholder meetings, the one who may be entitled to vote at such meetings, the one who may arrange for proxy or group voting, among other rights. *See N.J.S. 14A:5-4, 14A:5-10, and 14A:5-19.* In none of these sections does a street name holder or stock broker have the power to act in ways statutorily reserved to a shareholder. It follows that the reference to “shareholder” throughout 14A:5-28 should refer to the beneficial holder of the stock because the right of inspection is aligned with the other rights specified elsewhere in the statute. Because each section of 14A should be read in union with the others unless otherwise noted, it seems unlikely the Legislature intended, without explicit mention, that the term “shareholder” should be read differently here.

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