

# Commercial division update: Shareholder inspections of corporate books and records

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On suspicion of corporate misconduct or mismanagement, shareholders of a corporation will often begin their investigation by seeking the books and records of the corporation to determine whether they have a valid claim. In New York, shareholders have both statutory and common law rights to inspect their corporation's books and records as long as they do so in good faith and for a valid purpose, which has historically been found to include "efforts to ascertain the financial condition of the corporation, to learn the propriety of dividend distribution, to calculate the value of stock, to investigate management's conduct, and to obtain information in aid of legitimate litigation." *Matter of Tatko v. Tatko Bros. Slate*, 173 A.D.2d 917, 918 (3d Dep't 1991). The New York Business Corporation Law (BCL) provides that any shareholder of record, by written demand, may examine any minutes from shareholder proceedings or shareholder records, as well as certain financial records, that are reasonably related to that person's interest as a shareholder. BCL Section 624(b), (e). In contrast, the common law right to inspection can extend to all corporate books and records that are relevant to an investigation or dispute.

## The evolution of the inspection right

Although the common law and statutory rights of inspection have existed in some form in New York law since the 19th century, they were not seen as particularly effective until relatively recently, owing to a 2014 First Department decision that overturned the dismissal of a pension fund's petition for the books and records of McGraw-Hill, as part of an investigation of possible mismanagement and breaches of fiduciary duty by its board. McGraw-Hill had moved to dismiss on the grounds that petitioners had failed to identify specific wrongdoing, and thus there could be no valid purpose to the inspection. In granting dismissal, Justice Jeffrey K. Oing of the New York County Commercial Division expressed concerns that petitioners were essentially seeking to subject McGraw-Hill to pre-litigation discovery in order to avoid the evidentiary protections that would be available in litigation. This logic essentially crippled the common law right to inspection

in New York because an inspection is intended, at least in part, to be a means by which a shareholder could determine if a viable claim even existed. The Appellate Division reversed, holding that "investigating alleged misconduct by management and obtaining information are, in fact, proper purposes for a BCL Section 624 request, even if the inspection ultimately establishes that the board had engaged in no wrongdoing." *Ret. Plan for Gen. Emps. of City of N. Miami Beach v. McGraw-Hill Companies*, 120 A.D.3d 1052, 1056 (1st Dep't 2014).

The statutory right to inspection also has been created for LLC members under N.Y. LLC Law Section 1102, which grants members access to lists of managers and members of the LLC with their addresses and contributions, the articles of organization, the operating agreement, and the LLC's tax documents for the three most recent fiscal years. The common law right to inspect has been extended to LLC members for documents beyond the scope of Section 1102. *Lark Duane LLC v. Swig*, No.

652466/2020, 2020 WL 5644861, at \*1 (N.Y. Co. Sep. 16, 2020). Similarly, New York courts have held that “the rationale that existed for a shareholder to examine a corporation’s books and records at common law applies equally to a unit owner vis-à-vis a condominium,” thus granting unit owners the common law right to inspect their condominiums records for a proper purpose. *Pomerance v. McGrath*, 104 A.D.3d 440, 441 (1st Dep’t 2013).

In practice, shareholders frequently rely on the common law right to inspection in tandem with the statutory right, because the scope of the common law right is broader than that under the BCL. This, in turn, requires the shareholder to demonstrate a valid purpose and that the records requested beyond the scope of the BCL are related to that purpose. Courts have used these requirements, especially in defining proper purpose, to place restrictions on grants of shareholder inspection. This column examines these limitations and recent applications in greater depth.

## Limitations on inspection rights

New York courts have found inspection requests to be illegitimate where not made in good faith or, where other related litigation involving the parties is already pending, the request is used to circumvent the discovery limitations available in that case. Prior to joining the New York County Commercial Division, Justice Nancy Bannon oversaw a case wherein a shareholder in a residential cooperative sought to prove that the board was rejecting applications to purchase his apartment due to a 20-year-old vendetta against him by the president. The court held that petitioner’s request was purely speculative and not made in good faith, and was “premised upon his presumption that the entire board of the respondent corporation is acting at the behest of [the president] who petitioner believes has, for decades, maintained a bias and vendetta” arising from an old bidding war over maid’s quarters. *Cayne v. 510 Park Ave.*, No. 654916/2019, 2020 WL 5819742, at \*3 (N.Y. Co. May 11, 2020). Moreover, the court found the scope of the request improper because “a shareholder may not engage in ‘an intrusive probe into the confidential financial records’ of other shareholders, let alone attempt to delve into a prospective purchaser’s finances well beyond the contemplated scope of BCL Section 624.”

In a very recent case, a shareholder of American Express (AmEx) demanded the inspection of books and records in response to a series of Wall Street Journal (WSJ) articles regarding an AmEx marketing campaign to retain Costco credit card customers after

AmEx’s partnership with Costco for use of AmEx credit cards had ended. Known as “Project Lincoln,” the project allegedly offered high commissions to salespeople for successfully converting Costco cardholders to AmEx cards and incentivized poor sales practices, such as misrepresenting AmEx card rewards and fees and even issuing cards that had not actually been requested. The WSJ articles emphasized the negative effects of these practices on small business credit cardholders, as did the multiple agency investigations that followed. AmEx agreed to provide the shareholder records related to the 2015–21 period relevant to Project Lincoln, but the shareholders’ demand covered more general information related to AmEx’s credit card practices going back as far as 2003, citing various regulatory settlements from 2012, 2013, and 2018 for violations unrelated to Project Lincoln.

Justice Margaret Chan of the New York Commercial Division granted AmEx’s motion for summary judgment and dismissed the shareholder’s complaint, holding that the “separate violations do not give plaintiff free reign to inspect all of AmEx’s documents for a 20-year period. Plaintiff cannot string together different conduct in different parts of defendant’s business across several decades to try manufacture [sic] a basis for broad inspection.” *Hafeez v. American Express*, No. 656656/2022, 2024 WL 2188864, at \*4 (N.Y. Co. May 15, 2024). The court found that the plaintiff’s only proper purpose could be to investigate mismanagement directly related to Project Lincoln and its aftermath, and that the demand for documents beyond this scope was no more than speculative fishing for additional claims against AmEx.

In 2023, Justice Andrea Masley of the New York County Commercial Division oversaw a case against General Electric Company (GE), where the plaintiff shareholders had previously intervened in a derivative action against GE before filing this separate suit seeking to inspect its books and records under common law. Plaintiffs had previously received some materials from GE under a confidentiality agreement, but complained that those documents were insufficient. Plaintiffs admitted that they intended to use information gathered through the inspection to strengthen the complaint in the derivative action. In light of the pending litigation between the parties, the court granted GE’s motion to dismiss the books and records case, finding that the “common law right of inspection cannot be used to circumvent limitations on the scope or timing of disclosure in pending litigation.” *Burden v. General Elec.*, No. 652991/2021, 2023 WL 4464097 (N.Y. Co. July 11, 2023) (quoting *Galasso v. Cobleskill Stone Products*, 73 Misc. 3d 1231(A), 156 N.Y.S. 3d 715, at \*3 (Albany Co. Dec. 14, 2021)).

## Statutory rights

While the common law right to inspection is considered to be broader than the statutory right, courts have found a lower burden of proof applies to establish the statutory right on BCL Section 624. A recent case granted inspection to petitioners who had inherited an interest in a construction equipment contracting firm through a trust created by their father. Petitioners had demanded documents for the purposes of evaluating the corporation's financial condition, calculating the value of their own shares, and investigating managerial conduct. The company had previously provided petitioners with a stock ledger and history dating back to 1987 pursuant to BCL Section 624, and contended that petitioners' request for further information had been made in bad faith. Justice Joseph Risi of the Queens County Commercial Division disagreed, writing that "the burden of proof is less onerous when seeking the statutory remedy since the [bona fide intentions] of a shareholder who satisfies the statutory criteria and pleads them in an enforcement proceeding will be assumed," and finding further that the petitioners had demonstrated proper purpose under common law. *Lobosco v. Chas. Lobosco & Son*, No. 722589/2022, 2023 WL 4305315, at \*2 (Queens Co. May 4, 2023).

Courts have further distinguished between requests under subsection (b) of BCL Section 624 (shareholder proceedings and records of shareholders) and subsection (e) (financial records), subsection (e) having fewer requirements for access to certain financial statements than subsection (b) for shareholder information. In a dispute over a request for the financial statements of a construction services corporation, the corporation challenged the shareholder's request on the grounds that the financial statements requested under subsection (e) were irrelevant to the shareholder's purpose of valuing their shares, and further that the request had been made in bad faith because ample discovery on the value of shares had already been provided in separate actions pending before the court. Justice Richard Platkin of the Albany County Commercial Division disagreed, explaining "there is nothing in the text of BCL Section 624(e) that expressly requires the shareholder to demonstrate that he or she is acting in good faith and for a proper purpose. This is in contrast to BCL Section 624(b), governing access to the minutes of shareholder meetings and the shareholder list, which does require such a showing." *Galasso v. Cobleskill Stone Products*, 73 Misc. 3d 1231(A) (Albany Co. Dec. 14, 2021).

## Conclusion

The right to shareholder inspection of a company's books and records can be a powerful tool for minority shareholders to assess the financial state of the company and to investigate suspected misconduct. New York courts have been careful to avoid allowing inspections that are overly broad, speculative or made in bad faith, or, when other litigation is pending, that appear to bypass the discovery protections that would otherwise be afforded in the discovery process in that pending case. Unsurprisingly, the courts' decisions usually turn on the scope of the request and whether that scope is tied to a good faith purpose. As such, parties should be careful to understand the statutory and common law definitions of proper purpose and relevance, and whether and how they apply to specific categories of documents in a given request for inspection; petitioners, so that they may avoid the appearance of attempting to obtain information by underhanded means, and respondents, so that they may properly protect confidential information about their finances, practices, and management where possible.

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