



The shareholder's right of books and records inspection under Texas statutory and common law

Texas's statutory and common law scheme may now be of greater importance to potential plaintiffs than ever before

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In a decision that has generated widespread comment and more than a little criticism, the Texas Supreme Court in the case of *Ritchie v. Rupe* declined to recognize a Texas common law cause of action for minority shareholder oppression, and so eliminated three decades of unquestioned recognition of such a claim. In the same opinion, the Texas Supreme Court articulated those remedies that remain available to shareholders in close corporations, identifying among them the right of shareholders under Texas law to gain access to corporate books and records and the corresponding penalties associated with a corporation's failure to provide them.

While cold comfort to those who see the demise of the common law cause of action for minority shareholder oppression as a mortal blow, the fact is that the Texas statutory and common law scheme permitting shareholder access to a corporation's books and records may now be of greater importance to potential plaintiffs than ever before. The plaintiff's bar may view it as a valuable tool for the formulation and implementation of those remedies left available to minority shareholders in Texas courts, including simplified procedures for the prosecution of derivative actions and claims for accounting, breach of fiduciary duty, breach of contract, fraud and constructive fraud, conversion, fraudulent transfer, conspiracy, unjust enrichment and the like. A brief review of the Texas statutory and common law schemes permitting the examination of a corporation's books and records by a shareholder who meets the minimum standards found in the statute and common law follows below.

The statutory basis for shareholder inspection of corporate books and records is found in Section 21.218 of the Business Organization Code. Under that provision, a shareholder need only make written demand for inspection of the books and records of the corporation "stating a proper purpose," but subject to two threshold qualifications: the shareholder must have been a shareholder for at least six months preceding the demand, or the shareholder must own at least five percent of all outstanding shares of the corporation. This same provision of the Code preserves what has been referred to as the common law right of a beneficial or record holder of shares to compel production by the corporation of books and records of accounts, minutes and share transfer records. This is regardless of the length the time during which the petitioner was a beneficial or record holder of shares, and regardless of the number of shares held by that person.

Section 21.222 articulates the penalties that may be assessed a corporation for refusal to allow examination and copies of account records, minutes and share-transfer records after proper demand. That section provides that the corporation shall be liable to the shareholder for any cost or expense, including attorney's fees, incurred in enforcing the shareholder's rights under Section 21.218. Various defenses to such penalties are also articulated in Section 21.222, including a finding by the court that the petitioner was not acting in good faith or for a proper purpose in making the request for examination.

Interestingly, there remains an open question as to placement of the burden of proof of showing the presence or absence of a proper purpose. Some commentators, and some statutes, suggest that the burden of proving a proper purpose should always be on the shareholder, but it has been observed that Section 21.218 (b) requires the shareholder only to allege a proper purpose, and then requires the corporation to show the contrary. Under Section 21.218 (c), more than one commentator has suggested that the burden of proving proper purpose is always upon the shareholder. Regardless of whether it is the shareholder or the corporation that must prove proper purpose, Texas courts have taken a very liberal view of the "proper purpose" test, usually adhering to the rule that any request is proper so long as the information requested bears upon the protection of the shareholder's interest and, in some cases, the interest of other shareholders in the corporation.

One interesting and important facet of the current Texas statutory and common law scheme for a shareholder's right to inspect a corporation's books and records is that such requests are not subject to the types of objections that are conventionally asserted in litigation in response to requests for the production of documents. Predictably, however, more than one court has condemned a shareholder request for inspection as nothing more than backdoor discovery in cases where the shareholder was actively involved in litigation against the corporation, and it appeared to the court that the request for inspection was in fact being used as a tactical adjunct to discovery in that litigation. Still other cases see no conflict in this.

But we end here where we began, and that is with what may today be an even more frequent use of the shareholder right of inspection of obtain books and records before, and often in preparation of, the filing of shareholder litigation against a company. Combined with the unusual Texas provision (Rule of Procedure 202) regarding a potential litigant's right to take pre-suit deposition discovery, the shareholder right of inspection remains an important tool for utilization by minority shareholders in a close corporation as well as for shareholders in widely-held corporate entities.

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