

THE NEW JERSEY SUPREME COURT TO DETERMINE THE SCOPE OF A SHAREHOLDER'S RIGHT TO INSPECT FINANCIAL AND OTHER COMPANY BOOKS AND RECORDS



By: Kenneth L. Moskowitz, Esq. and Steven R. Rowland, Esq.

On December 17, 2018, the New Jersey Supreme Court agreed to review the June 1, 2018 decision of the Appellate Division in Feuer v. Merck & Co., Inc.,¹ which narrowly interpreted the statutory right of a shareholder owning a minority interest in a public corporation to inspect the company's books and records under N.J.S.A. 14A:5-28 ("Statute") -- which sets forth the statutory inspection rights of a corporate shareholder. The Appellate Division determined that the statutory phrase "books and records of account, minutes, and record of shareholders" did not encompass the broad universe of all corporate documents, but rather only the three types of documents that are identified in the Statute, namely, "books and records of account" -- which are accounting and financial documents; "minutes," which refers to "shareholders, board and executive committee minutes...;" and, "record of shareholders" -- a list of the corporation's shareholders. In other words, the Appellate Division narrowly construed the scope of a shareholder's statutory inspection rights as including only the three categories of documents specifically referenced in the Statute, and it rejected the argument that those inspection rights should be interpreted to include other types of records not mentioned in the Statute.

The Appellate Division also rejected the shareholder's argument that, beyond the rights conferred by Statute, the court had the inherent authority under the "common law" to permit a shareholder to examine company records -- more broadly construed -- so long as the shareholder's demand for inspection was made in "good faith" and for a "proper purpose." In fact, the Appellate Division held that the common law standard -- "good faith and proper purpose" -- actually narrowed the statutory right of inspection, and that the shareholder could be required to show a "proper purpose" to support any inspection demand made under the Statute. The Appellate Division reasoned that because an ordinary managerial mistake of the type alleged in the Feuer action (i.e., that Merck overpaid for an acquisition because it performed inadequate due diligence) -- as distinguishable from a claim of self-dealing or other aggravated misconduct -- is not actionable,² the shareholder's demand in that case served no "proper purpose" and, accordingly, the shareholder was not entitled to inspect any corporate books and records.

¹ 455 N.J. Super. 69 (App. Div. June 1, 2018), certif. granted, --- N.J. --- (Dec. 17, 2018).

² The business judgment rule "protects a board of directors from being questioned or second-guessed on [the] conduct of corporate affairs, except in instances of fraud, self-dealing, or unconscionable conduct." In re PSE&G Shareholder Litigation, 173 N.J. 258, 276-77 (2002) (quoting Maul v. Kirkman, 270 N.J. Super. 596, 614 (App. Div. 1994)).

Although the Feuer decision itself concerns a large public company and a shareholder who owned a very small percentage of the company's stock, the Statute's inspection provisions are also applicable to close corporations (companies having 25 or fewer shareholders).³ That the Appellate Division has construed the scope of the statutory inspection right narrowly -- limited to the three categories of documents specified -- and limited only to those circumstances that the request was made in "good faith" and for "proper purpose," should be of great interest to all minority shareholders in both publicly traded and non-publicly traded companies, including close corporations.

Notably, the Appellate Division's ruling that Statute is the exclusive means by which a minority shareholder can obtain access to corporate books and records reflects a "minority" interpretation of the inspection provision of the Model Business Corporation Act -- the model for the Statute.⁴ Most state courts have found that the model statute intended to preserve the existing "common law" right of inspection that judges have relied upon as the basis of ordering the inspection of all corporate records by a shareholder acting in "good faith" and for a "proper purpose." However, many of the decisions that reflect the "majority" view are based on state statutory language that expressly preserves the common law right of inspection. The Appellate Division's narrow interpretation of New Jersey's Statute protects the prerogatives of management in the context of both large corporations and of the majority in a close corporation.

In the context of a close corporation, however, under New Jersey's "Shareholder Oppression Statute," N.J.S.A. 14A:12-7, a minority shareholder who alleges "oppression" as the basis of that claim may seek access to the company's books and records to vindicate the shareholder's "reasonable expectations" and to obtain the discovery relevant to the oppression claim.⁵ Unless the shareholder's Complaint is dismissed, the shareholder may be permitted to obtain through discovery the broad right to inspect the corporation's books and records relevant to the oppression claim.

The revised New Jersey Limited Liability Company Act ("Act")⁶ provides for broader statutory inspection rights than provided under the Statute. Under the Act, a member is entitled to "full information" that is "just and reasonable" so long as "the member seeks information for a purpose material to the member's interest as a member..."⁷ In other words, with respect to a

³ N.J.S.A. 14A:12-7(1)(c) (defining a "closely held" corporation as one in which there are 25 or less shareholders).

⁴ An exposition of the drafting history of the Statute may be found in Cain v. Merck & Co., Inc., 415 N.J. Super. 319, 326-330 (App. Div. 2010).

⁵ Indeed, an oppression claim could be based on the denial of access to the corporation's books and records if the minority shareholder could establish a "reasonable expectation" to participate in the management of the company and an historic practice of having access such books and records.

⁶ N.J.S.A. 42:2C-1 et seq.

⁷ N.J.S.A. 42:2C:40(b)(1)(a).

New Jersey LLC, a member's statutory right of inspection is similar to the inspection rights recognized by the common law relating to corporations.

The Supreme Court's anticipated review of the Statute should provide guidance whether the statutory right of inspection in a corporation is intended to be exclusive, i.e., the only means - outside of litigation -- available to a minority shareholder to gain access to corporate books and records. Presumably, the Court will also determine the scope of a shareholder's inspection rights, if any, under the common law, and whether the statutory right of inspection is to be limited to the three categories of documents identified in the Statute.

Pending a decision by New Jersey Supreme Court that holds to the contrary, the inspection rights of a minority shareholder in both a public company and in a close corporation are limited to the three categories of documents identified in the Statute, while members in LLC's arguably enjoy more expansive inspection rights.

©Copyright 2019, Brown Moskowitz & Kallen, P.C. All rights reserved. This article is for informational purposes only and is not intended to constitute, and does not constitute, legal advice.

For further information please feel free to contact either Kenneth L. Moskowitz, Esq. (klm@bmk-law.com) or Steven R. Rowland, Esq. (srowland @bmk-law.com), or call either at 973-376-0909.

Mr. Moskowitz is a former prosecutor and is a founding partner of Brown Moskowitz & Kallen, P.C., in Summit New Jersey. He represents clients in diverse business disputes, commercial litigation, internal investigations, "corporate divorce" matters, insurance coverage litigation and other business related disputes.

Mr. Rowland is a litigation partner at Brown Moskowitz & Kallen, P.C. He represents corporate clients in complex litigation matters including business disputes, commercial litigation, insurance coverage, and construction. He also has substantial appellate experience with numerous reported decisions.