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Owners' Rights to Inspect Management Records

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Since the Legislature gave birth to the first cooperative and condominium laws, very few issues have had as much attention and confusion as boards' concerns about the extent of unit owners' access to inspect the management books and records. Regarding cooperative buildings, many of the most prominent questions regarding these little governments have been answered. On the other hand, condominiums have been left without law or a statute to handle these questions and many times, all out civil wars ensue. Just this year, the Appellate Division, First Department handed down its first decision on the subject, albeit limited to its facts. This article will analyze the state of the law and attempt to provide guidance to the practitioner and members of boards of directors.

The Right of Analysis

Although the law on shareholders inspection rights is more developed than that of condominiums, there are still issues that arise as to the extent of books and records that shareholders are entitled to inspect.

Analysis must start with the statutory grant of power laid out in the New York Business Corporation Law (BCL). BCL §624 grants shareholders a statutory right to inspect the minutes of shareholder meetings and the record of shareholders. They also have the right, if they meet standing requirements, to receive an annual balance sheet and profit and loss statement.

In *Bohrer v. International Banknote*,¹ the First Department elaborated on the meaning of the right to inspect the records of shareholders. A shareholder sought to compel the cooperative to disclose certain shareholder records for use in soliciting proxies in connection with an election of the board of directors. Ruling for the shareholder, the court held that BCL §624 was to be liberally construed so as to facilitate communication among shareholders on issues respecting corporate affairs. Furthermore, the court reasoned that the public policy behind §624 was to put shareholders on the same or equal footing with



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the corporation when attempting to contact other shareholders in an upcoming proxy fight.

Courts have also adopted common law rights of inspection, expanding access beyond the statutory right in certain circumstances. In *Crane Co. v. Anaconda Co.*,² the Court of Appeals reaffirmed doctrines such as those found in *In re Steinway*,³ harking back to 1899, holding that shareholders have the common law right to inspect all corporate books and records where the request is made in good faith and for a proper purpose. We saw these principles applied specifically to cooperatives in *Matter of Schapira v. Grunberg*,⁴ where shareholders sought inspection of the records of a particular election, including both ballots voted for in person and by proxy. Citing *In re Steinway*⁵ and *Crane Co. v. Anaconda Co.*,⁶ the trial court held that unit owners of cooperatives have a right not only to inspect the records specified under BCL §624, but they also have the common law right to inspect other corporate records, merely by virtue of their status as corporate shareholders. *Schapira* found in these precedents a right to inspect the books and papers of a cooperative corporation for any proper purpose and under reasonable circumstances. Thus, the court ordered a hearing limited to examination of those two questions. Although the First Department mooted this rationale, finding a right of inspection already present in the corporate bylaws,⁷ it did not overturn the trial court's rationale for circumstances where there is no such explicit right. Thus, this rationale, which the Court of Appeals has applied in regards to general business corporation shareholder inspection rights, is more generally applicable to all types of shareholders including those of cooperatives.

It has clearly been established that rights of in-

spection are conditioned on shareholders showing that their demand is in good faith for a proper purpose.⁸ BCL §624(c) establishes this, stating that a shareholder must furnish an affidavit to the corporation substantiating that the inspection is not for:

a purpose which is in the interest of a business or object other than the business of the corporation and that (the shareholder) has not within five years sold or offered for sale any list of shareholders of any corporation of any type or kind, whether or not formed under the laws of this state, or aided or abetted any person in procuring any such record of shareholders for any such purpose.⁹

Upon furnishing said affidavit, the burden of proving bad faith or improper purpose is on the corporation if it wants to deny access to books and records.¹⁰ The corporation must raise a substantial question of fact as to the shareholders good faith and motives in order for the court to order a hearing on that issue.¹¹ The question of whether to hold the hearing on the good faith issue is reserved to the court's sound exercise of discretion.¹²

Generally, good faith encompasses honest intent, absence of malice, and absence of design to defraud or seek unconscionable advantage.¹³ Purposes solely based on harassing the corporation's directors or an intention to injure the corporation's pursuits would not satisfy the good faith requirement of common law inspection rights.¹⁴

Since a cooperative corporation is a corporation first and foremost, much of their common law is to be found related to actual business corporations. However, since a cooperative corporation has neither profits nor competitors, more sure analogies can be found at times in religious corporations. As for the proper purpose requirement, proper purposes for inspection of corporate records by shareholders are those reasonably related to shareholder's interest in the corporation. The information obtained through the inspection must not be used for a purpose that is in the interest of a business or object other than the business of the corporation.¹⁵

It has been held that proper purposes for inspection generally include, inter alia, to ascertain the financial condition of the corporation, to calculate stock value, to investigate management's conduct, and to obtain information in aid of legitimate litigation.¹⁶ Most improper purposes authorizing corporations to refuse to allow shareholder to inspect corporate books and records are those speaking to for-profit corporations only, but that does not mean that the peculiar world of cooperatives will never find an improper purpose.

Courts have ruled in favor of shareholder's inspection rights on several different occasions, demonstrating a lenient standard that shareholders must meet to establish good faith and proper purpose. In *Durr v. Paragon Trading*,¹⁷ the Court of Appeals held that shareholders had the right to examine corporate books to determine if its affairs were being properly managed. The court determined that based on the disputed issue of financial mismanagement, and the conceded facts that petitioners are stockholders, an examination of the books was requisite to prove the truth of the shareholders' claims.

In *Troccoli v. L&B Contract Industries*,¹⁸ the Second Department found a shareholder's desire to evaluate the worth of his shares was a demonstration of good faith and valid purpose to compel the corporation to produce its books and records that were relevant and necessary for the purpose.¹⁹ Clearly, the emerging common law of BCL §624 requires liberal construction in favor of the shareholders who have genuine issues as to their welfare as stockholders or who show genuine concern for the corporation's welfare.²⁰ The law has no such leniency in favor of mere gadflies, however.²¹

The shareholders of a corporation hold the franchise with a pecuniary interest in the corporation's appropriate administration. As such, they have the right, at common law, to examine all the books and records of the corporation. Such a right is not to be exercised to gratify curiosity or for speculative purposes, but instead should be used for good faith purposes, and where there is a particular matter in dispute, involving and seriously affecting the rights of the stockholder.²² Assuming there is good faith and proper purpose, it is in the court's discretion to exercise its authority to limit or expand the scope of the shareholder's inspection of corporate records to the material necessary to protect the interest in the corporation.²³

Condominium Records

Because most condominiums exist as unincorporated associations not subject to the business corporation law, any rights of owners as to the inspection of books and records, arise out of the building's corporate documents, the common

law and RPL §339-w which states that:

the manager or board of managers, as the case may be, shall keep detailed, accurate records, in chronological order, of the receipts and expenditures arising from the operation of the property. Such records and the vouchers authorizing the payments shall be available for examination by the unit owners at convenient hours of weekdays. A written report summarizing such receipts and expenditures shall be rendered by the board of managers to all unit owners at least once annually.²⁴

Until this year, only two lower court decisions providing mixed results gave any guidance as to condominium inspection rights.²⁵ For the first time, the First Department, in *Pomerance v. McGrath*,²⁶ recognized a common law right for an owner to have access to the "contact information for the other condominium owners in the building in written form and in any other format in which the condominium or its managing agent maintains such information...." The phrase "any other format" is important as it essentially gives access to the native computer files at least, if not to the condominium's computers.

While recognizing a common law right, the Appellate Division specifically rejected the argument that a condominium unit owner is entitled, under the BCL, to examine the books and records of the condominium, as it is not a cooperative and not an incorporated association. However, the court reasoned that:

the right of a stockholder to examine the books and records of a corporation existed at common law, and does not depend on a statute. The unit owners of a condominium collectively own the common elements thereof and are responsible for the common expenses. Thus 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.

The court continued to expand its common law development of RPL 339-w and held that the access rights should not be limited to those items specifically delineated in the statute. The court stated that the legislative history of article 9-B demonstrates that the Condominium Act should be "liberally construed." For policy reasons, the court further opined that "giving condominium unit owners the same rights as cooperative shareholder-tenants will encourage condominium ownership," a goal the court evidently felt worthy of pursuit.

While deciding that inspection rights should be liberally construed, the court made sure to mention that the rights given in this decision apply to when elections for a condominium board are concerned. It appears that the court has left the door open for future litigation to better define the common law rights of owners to inspect

and have access to condominium board records. Thus, there remains the possibility that a unit owner's rights are not ultimately going to be found to be fully coextensive with a shareholder's rights. Thus, *Pomerance* provides guidance and reason to believe in analogy, but it is not squarely on point for anything but its own facts.

While formally speaking, the law is more fully established for cooperatives, and less fully established for condominiums (especially outside the First Department), we can expect the further common law development in this field will ultimately give plenary rights of records inspection to all shareholders and unit owners, so long as the request is in good faith and for a proper purpose.

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Endnotes:

- 150 A.D.2d 196.
- 39 NY2d 14 (1976).
- 159 N.Y. 250.
- 12 Misc. 3d 1195(A), 824 N.Y.S.2d 770.
- 159 N.Y. 250.
- 39 NY2d 14 (1976).
- Matter of Schapira v. Grunberg*, 30 A.D.3d 345.
- Crane Co. v. Anaconda Co.*, supra; *Mayer v. National Arts Club*, 223 A.D.2d 440, 441 (1st Dept. 1996); *Dyer v. Indium Corp. of Am.*, 2 AD3d at 1196; *Troccoli v. L&B Contract Indus.*, supra.
- N.Y. Bus Corp Law §624(c) (McKinney).
- Crane Co. v. Anaconda Co.*, supra; *Dyer v. Indium Corp. of Am.*, supra; *Matter of Dwyer v. Di Nardo & Metschl*, 41 A.D.3d 1177 (4th Dept. 2007).
- Troccoli v. L&B Contract Indus.*, supra.
- Id.
- Cravatts v. Klozo Fastener*, 133 N.Y.S.2d 235 (Sup 1954).
- De Paula v. Memory Gardens*, 90 A.D.2d 886, 887, 456 N.Y.S.2d 522 (1982); *Smilkstein v. J. Smilkstein & Sons*, 32 Misc. 2d 882, 223 N.Y.S.2d 561 (Sup. Ct. 1961).
- N.E.P.L. §621(c); BCL §624.
- Tatko v. Tatko Bros. Slate*, 173 A.D.2d 917 (3d Dept. 1991).
- 270 N.Y. 464.
- 259 A.D.2d 754.
- Troccoli v. L&B Contract Industries*, 259 A.D.2d 754 (1999).
- Crane Co. v. Anaconda Co.*, supra.
- In re Steinway*, 45 L.R.A. 461 (1899); *Crane Co. v. Anaconda Co.*, supra.
- Id.
- Mathews v. Onondaga Co. Deputy Sheriff's*

Benevolent Assoc., 225 A.D.2d 1048, (4th Dept. 1996).

24. RPL §339-w.

25. *A&A Properties NY v. Soundings Condominium*, 1998, 177 Misc.2d 200, 675 N.Y.S.2d 853 (allowing inspection of condominium records); contra, *Mishkin v. 155 Condominium*, 2 Misc. 3d 1001(A) (Sup. Ct. 2004).

26. 2013 N.Y. App. Div. LEXIS 1423, 2013 NY Slip Op 1476 (N.Y. App. Div. 1st Dept. March 7, 2013).