

Stockholder Discovery Rights: Nevada Vs. Delaware

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Prelitigation discovery is a novelty in the law. For example, in a contract dispute, a potential plaintiff cannot demand that the other party produce documents for use in evaluating and designing the plaintiff's claims. A stockholder who is considering suing the directors or officers of a corporation, however, can, in certain circumstances, engage in prelitigation discovery. This article compares Nevada's clear and easily applied statutory stockholder discovery rights with the broadly worded Delaware statute that a recent Chancery Court interpretation expanded further.



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In Nevada, by statute, that right is limited only to significant stockholders and only to certain information. Additionally, as a practical matter, the right only exists when the information is not already available in public filings.

In Delaware, by contrast, that right is open to any stockholder, the right is broad by statute, and, according to the recent interpretation of Vice Chancellor J. Travis Laster, the right extends to electronically stored documents, including emails.

Outside of litigation or any applicable federal securities law, a Nevada stockholder's right to information about the corporation's business is established in Nevada Revised Statutes (NRS) 78.105 and NRS 78.257. Pursuant to NRS 78.105, a stockholder who has been a stockholder for at least six months and who controls at least 5 percent of the outstanding shares (or who is authorized by the holders of at least 5 percent of the outstanding shares) may request copies of the documents held by the registered agent of the corporation. These documents are (1) the articles of incorporation and all amendments thereto, (2) the bylaws and all amendments thereto and (3) a stock ledger (or a duplicate stock ledger), revised annually, containing the names, alphabetically arranged, of all persons who are stockholders, showing their places of residence, if known, and the number of shares they respectively hold.

The NRS 78.105 demand must give the corporation at least five days' notice to produce the documents for copying and, while the demand need not be under oath, pursuant to NRS 78.107, the corporation may demand an affidavit from the stockholder stating that the information is not desired for a purpose other than the business of the corporation and that the stockholder or other person has not at any time sold or offered for sale any list of stockholders of any domestic or foreign corporation or aided or abetted any person in procuring any such record of stockholders for any such purpose. The corporation may also impose a reasonable charge for copies. Notably, the articles and bylaws can also be requested from the Nevada secretary of state by anyone, regardless of their stock ownership.

For a deeper dive into a Nevada corporation's records, NRS 78.257 permits an inspection and audit of the corporation's "books of account" and "financial records." The rights granted under NRS 78.257, however, are limited to stockholders owning or representing at least 15 percent of the corporation's issued and outstanding shares. Additionally, the rights authorized in NRS 78.257 are unavailable to a stockholder who refuses to provide the corporation an affidavit that such inspection, copies or audit is not desired for any purpose not related to his or her interest in the corporation as a stockholder. Thus, Nevada law (1) provides for access to financial and accounting information, (2) mandates that the stockholder own (or represent) significant ownership of the corporation, and (3) requires the stockholder to affirm that the information is sought solely for a purpose related to the stockholder's interest in the corporation.

Furthermore, the provisions of NRS 78.257 do not apply to any corporation that (a) furnishes to its stockholders a detailed, annual financial statement, or (b) has filed during the preceding 12 months all reports required to be filed pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934. In other words, a publicly traded corporation that is complying with its SEC reporting requirements, or a corporation that provides an annual financial statement to its stockholders, is not subject to a demand under NRS 78.257.

Nevada's clear and comprehensive statutes are in stark contrast to Section 220 of the Delaware General Corporation Law, 8 Del. C. § 220 ("Section 220") and the interpretation of Section 220 by Delaware's Court of Chancery. Section 220 provides:

Any stockholder, in person or by attorney or other agent, shall, upon written demand under oath stating the purpose thereof, have the right during the usual hours for business to inspect for any proper purpose, and to make copies and extracts from:

(1) The corporation's stock ledger, a list of its stockholders, and its other books and records ...

Demands under Section 220, therefore, are not limited to stockholders owning their shares for a meaningful period of time or owning or representing a significant percentage of shares. Section 220 demands are also unbounded by the fact that publicly traded corporations already disclose significant information to comply with federal securities laws or that the corporation may already provide its stockholders with detailed financial information on an annual basis. Instead, Delaware permits any stockholder to seek discovery under Section 220 as long as the stockholder can attest to a "proper purpose."

Moreover, Section 220's "other books and records" language has been interpreted broadly. In a recent opinion, Vice Chancellor Laster noted that a stockholder "can obtain books and records that address the crux of the shareholder's purpose ... if that information is unavailable from another source." *Amalgamated Bank v. Yahoo! Inc.*, C.A. No. 10774-VCL, slip op. at 52 (Del. Ch. Feb. 2, 2016) (internal quotations and citations omitted). Further, rejecting an argument promoted by Yahoo, Vice Chancellor Laster held that the information available under the "other books and records" language of Section 220 includes "email and other documents, which count as corporate records." *Id.* at 60. Notably, the records Vice Chancellor Laster ordered Yahoo to produce included the emails of its CEO related to the hiring and subsequent termination of Yahoo's chief operating officer, demonstrating that the documents subject to Section 220 are not limited to those presented to the board of directors. As if that were not broad enough, even attorney-client and work-product privileged documents are subject to a Section 220 demand, though, in the Yahoo opinion, only a privilege log was required unless the stockholder could

show further need for the privileged documents. Id. at 67.

This expansive view of “other books and records” is made exponentially broader by the fact that a “proper purpose” under Section 220 includes “a stockholder’s desire to investigate wrongdoing or mismanagement.” *Steinfeld v. Verizon Communications Inc.*, 909 A.2d 117, 121 (Del. 2006). The stockholder need not show that the perceived wrongdoing is either established or sufficient to state a claim or even that the potential claim is not barred by statutory exculpation. Yahoo opinion pp. 37, 49-50. Instead, the stockholder “need only show, by a preponderance of the evidence, a credible basis from which the Court of Chancery can infer there is possible mismanagement that would warrant further investigation.” *Steinfeld*, 909 A.2d at 123.

In other words, the holder of a single share of stock in a Delaware corporation may subject that corporation to discovery — paid for by all the stockholders of the corporation — because one particular stockholder has some judicially rationalized “credible basis” to conclude that a transaction (likely disclosed by the corporation in its SEC filings) may have resulted from “wrongdoing or mismanagement.” Again, this discovery is permitted prior to filing litigation and establishing a claim upon which relief may be granted. Such broad prelitigation discovery is indeed unique in the law.

In comparison, from a policy perspective, Nevada’s corporate statutes maintain reasonable deference to the directors and officers of the corporation, while still balancing the right of significant stockholders to seek information about the corporation’s finances, if the company is either not subject to, or not complying with, the extensive disclosure requirements of the federal securities laws. As demonstrated by Vice Chancellor Laster’s recent opinion, Delaware’s Section 220, on the other hand, demonstrates no deference to the directors and officers of the corporation and empowers any stockholder to demand production of a broad range of records if the stockholder has any expressible concern regarding the management of the corporation — whether or not that concern could be maintained as a complaint in litigation.

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