

California Shareholder Demanding to Inspect Corporate Records?

You May Be Taking an Out of State Trip! – *Innes v. Diablo Controls*.

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Under California Corporations Code Section 1601, a shareholder may, upon written demand, inspect the accounting books and records and minutes of a California corporation or a foreign corporation doing business in California. Shareholder inspection demands are regularly used by California shareholders, often times in connection with ongoing, or anticipated, shareholder or shareholder derivative litigation. In *Innes v. Diablo Controls* (2016), Case No. A145528, the First District Court of Appeal addressed where that inspection may take place, and it may not be in California!

In the *Innes v. Diablo Controls* case, Diablo Controls was a California corporation whose corporate books and records were kept in Illinois. The issue on appeal was whether, under Section 1601, the corporation had to produce the records for shareholder inspection in California or could do so in Illinois where they were maintained. Relying on what can only be characterized as dicta in a 2004 case, *Jara v. Suprema Meat* (2004) 121 Cal.App.4th 1238, and noting that the statute makes no provision that the requested records be brought in state, the Court held there was no obligation on the part of the corporation to bring the requested records to California for inspection. It need only make the records available for inspection “at the office where the records are kept”; in that case, Illinois.

So, under *Innes v. Diablo Controls*, if you are a shareholder making a section 1601 demand to inspect corporate records, and those records are “kept” by the corporation at a location outside of California, you could be buying an out-of-state plane ticket. The corporation has no obligation to

produce the records for inspection at any location other than where they are “kept”. If that “kept” location is out-of-state, tough luck, you can be forced to go there to make the inspection.

**Takeaways:**

**First**, isn’t this a bit old school? Aren’t most business records maintained electronically these days, especially financial and accounting records? Aren’t most business records maintained in cloud storage? Where are such records “kept” within the meaning of section 1601? Isn’t focusing on where records are physically kept as the controlling factor for shareholder inspections a bit contrived and, frankly, silly in this day and age?

**Second**, this opinion could place substantial financial and logistical burdens on California shareholders seeking basic corporate information. One could see California corporations seeking to avoid shareholder scrutiny setting up “corporate records” offices in far away, difficult to get to, locations. *“We received your demand to inspect the company’s minute book and accounting records. Those records are kept in our “corporate records” office in Nome, Alaska. They will be made available there for your inspection on reasonable notice.”*

The case does seem to leave a little wiggle room on this issue of the burden placed upon shareholders seeking to inspect corporate records. Appellants argued that under a “no required in-state inspection” interpretation of the statute a corporation could avoid a section 1601 inspection by simply sending the records far away. The Court addressed this concern as follows:

*We agree that maintaining the records in a remote location to intentionally impede inspection would be contrary to the purpose of section 1601. However, there is no evidence of such obstruction here. To the contrary, Diablo Controls voluntarily and at its own expense transported many of the requested documents*

*to California for appellants' inspection. In addition, appellants have not alleged that requiring them to inspect the records in Illinois will preclude their ability to exercise their section 1601 inspection rights.*

This language seems to leave open the possibility that a demanding shareholder could compel production of the corporate records in state by showing that the corporation maintains records in a remote location to intentionally impede section 1601 inspections or that remote production would preclude shareholders the ability to exercise their section 1601 inspection rights. But, these may be difficult, and expensive, burdens to meet to compel an in-state section 1601 inspection.

**Third**, the California legislature should amend section 1601 to require California corporations, and out-of-state corporations doing business in California, to maintain current accounting books and records and minutes in state for inspection by shareholders. The legislature should also amend the statute to allow, as an acceptable alternative to in state production of physical records for inspection, electronic production of corporate records requested under section 1601. Corporate rights should not trump shareholder rights when it comes to the inspection of basic corporate records. It should be made easier, and not harder, for California shareholders to inspect corporate records.

**Fourth**, I just don't see this result holding up for long. It seems demonstrably unfair to generally less-powerful shareholders simply seeking to see corporate records. I suspect the California legislature will address this. It certainly should! And I suspect that subsequent decisions will open up broad judicial exceptions to a section 1601 "no required in-state inspection" rule.

But, for the time being, California Corporations Code Section 1601 inspections could require significant money and travel time to complete!