

# A Comparative Analysis of Shareholder Inspection Rights in India and the U.S.

By Randall Thomas, Neha Joshi & Umakanth Varottil  
10<sup>th</sup> Emerging Markets Finance Conference  
Mumbai, December 13, 2019

# Background

- Shareholder inspection rights form an important element of investor protection
- They provide shareholders with access to papers and records of a company in which they have an interest
- They help shareholders monitor management and also pursue legal claims against companies, managers or controlling shareholders

# Agency Cost Perspective on Books and Records Statutes

- The agency cost model of the corporation posits that shareholders act as monitors of corporate managers in an effort to minimize the divergences between shareholder and manager interests
- Books and records statutes have a long history of providing shareholders with access to corporate information to facilitate monitoring by addressing the information asymmetry between corporate shareholders and managers
- This is one of the few mandatory rights that shareholders have in corporate law and is statutorily protected from elimination

# Scope of the Paper and Principal Thesis

- This paper contains a comparative analysis of shareholder inspection rights in India and the U.S. (principally Delaware)
- It examines both law on the books and deployment of shareholder inspection rights in practice (i.e., law in action)
- There are some broad areas of similarity between India and Delaware, but mostly significant differences
- Shareholder inspection rights that function optimally in one jurisdiction are not suitable in others that display fundamentally different characteristics, such as shareholding structures, types of shareholders, legal systems, institutional structures and legal culture

# Shareholder Inspection Rights in India

# Emergence of Shareholder Inspection Rights in India

- Shareholder inspection rights have been available in Indian companies' legislation for more than a century
- They were transplanted from then applicable English law
- Two streams of inspection rights were available:
  - Registered shareholders could themselves inspect documents and records pertaining to a company
  - The governmental authorities (such as the Registrar of Companies) too had powers to inspect books and records
- This dual-track mechanism continues to date

# Shareholder Inspection Rights in Independent India

- Companies Act, 1956 (and amendments thereto) laid down explicit procedures for inspection by the Registrar of Companies
- This was to protect the interests of shareholders, but also other stakeholders such as employees
- This was also consistent with India's embrace of socialism during the period
- But, ...
  - Significant risk of misuse of governmental inspection powers for malevolent goals
  - This gave rise to the phenomenon of "inspector raj"

# Current Shareholder Inspection Framework in India

- Statutory provisions on inspection scattered all over the Companies Act, 2013
- Registered shareholders (i.e., members) have access to a wide variety of documents, such as:
  - Shareholder list
  - Annual return
  - Minute books of shareholders' meetings
  - Audited financial statements
  - Certain contracts



# Nature of Inspection Rights in India

- Shareholder inspection rights are both wide and narrow
- They are wide because:
  - Shareholders need not hold a minimum number of shares
  - Often, they buy a small number of shares to carry out inspection
  - They need not establish “proper purpose” or other motive for carrying out the inspection
  - On the contrary, the defendant company may be permitted to refuse inspection if it can prove a corrupt motive

# Nature of Inspection Rights in India

- Moreover, significant number of documents relating to a company available for inspection at the office of the Registrar of Companies or on the website of the Ministry of Corporate Affairs (MCA)
- Inspection denied only in exceptional cases
  - Where a shareholder insisted on obtaining documents that are readily available via the MCA website
  - Where a shareholder had the habit of seeking inspection of records from hundreds of companies where he either held a miniscule number of shares or did not hold any at all

# Inspection by Shareholder-Directors

- At the same time, shareholder inspection rights are narrow because they extend only to a limited number of documents (listed earlier)
- However, directors enjoy wider inspection rights that cover “books of account and other books and papers” such as board minutes
- Only shareholders who are also directors have access to this wider set of information
- Shareholders who are not directors must apply to the court or tribunal to exercise its inherent powers to order inspection to enable a resolution to a corporate dispute (such as an oppression claim)

# Governmental Inspection Regime

- Shareholder inspection in India must be viewed in the context of an alternative available in the form of governmental inspection
- Government's inspection rights are wider than that of individual shareholders (as they are not limited to specified documents)
- Section 206 of the Companies Act, 2013 has an elaborate process for inquiry and inspection by the Registrar of Companies
  - Companies and employees must render all assistance
  - The Registrar or inspector appointed for the purpose has search and seizure powers

# Governmental Inspection Regime

- Government has used these rights extensively, especially in high profile corporate frauds: e.g. Ketan Parekh stock market scam
- Courts have laid down guidelines regarding the exercise of power

# Data on Inspection Regime in India

- Study of inspection cases in India from 2004-2018 is still work in progress
- We hope to discern trends in these cases and analyse reasons for the same
- Empirical data regarding inquiries and inspections carried out by the Government are available through the MCA website

# Shareholder Inspection Rights in Delaware

# Basic Rules for Delaware Books and Records

- Statutory right for shareholders to obtain stocklist and books and records of the company
- Shareholder must make a demand on the company to provide the information, and if the company refuses, shareholder may file suit seeking information
- Shareholder must state a proper purpose for wanting the documents, one that relates to their economic interest in the company
- Examples: investigating corporate wrongdoing (books/records) or seeking to communicate about a pending tender offer (stocklist)



# Traditional Limitations on Shareholder Inspection Rights

- Plaintiff need only demonstrate some credible evidence of possible mismanagement - much lower standard than in a motion to dismiss
- No fishing expeditions: must identify with “rifled precision” the documents sought
- Confidentiality restrictions often imposed
- A variety of other restrictions can also be imposed by the court, such as, only using the documents produced in filing of a subsequent lawsuit in Delaware

# Evolution of Delaware Inspection Statute: First Empirical Study

- Prior to 1993, Delaware's inspection statute, contained in section 220 of the Delaware corporate code, was primarily used in corporate control contests as a mechanism for obtaining the corporate stocklist which a hostile bidder/proxy contest dissident needed in order to communicate with the target's shareholders
- In a pair of earlier articles, one of the authors conducted research on this statute and found that during the 14 year period from 1981-1994, plaintiffs filed a total of 53 section 220 cases and were generally successful in obtaining the stocklist (and books and records as well if they were requested)

# Derivative Litigation

- At that time, the books and records statutes seem interesting only to corporate law scholars, but soon the courts found a novel use for the statute in improving the quality of derivative litigation
- Derivative lawsuits are representative litigation initiated by the shareholder in the name of the corporation typically alleging that the directors/officers of the company have breached their fiduciary duties to the firm and harmed it
- The board is generally empowered to determine if the corporation should initiate litigation to pursue the alleged wrongdoers and hence the shareholders must make demand on the board to take action unless doing so would be futile (the “demand futility” requirement)

# Concerns about Derivative Litigation lead to Discovery Stay

- Establishing demand futility requires the shareholder to allege facts that create a reasonable doubt that a majority of the board of directors is not independent, or has made an uninformed decision, or has committed waste
- Because of concerns about frivolous derivative lawsuits, Delaware law evolved so that plaintiffs in such a suit were not entitled to discovery to assist them in pleading demand futility
- This is a difficult burden to meet for plaintiffs using solely public information leading to concerns that many high-quality derivative suits were being dismissed prematurely

# Delaware Supreme Court creates the Tools at Hand doctrine

- In *Rales v. Blasband* (1993), the Delaware Supreme Court endorsed using section 220 as a pre-filing discovery device for shareholder derivative actions as a means to improve the quality of this form of shareholder litigation – the so-called “tools at hand” doctrine
- Plaintiffs’ lawyers resisted filing these actions as they had to bear all of the costs of the 220 action themselves and would only be rewarded if they filed a successful subsequent derivative lawsuit
- The Delaware Supreme Court was persistent, however, issuing a series of decisions dismissing derivative cases with scolding footnotes admonishing the plaintiffs’ bar to use section 220 before filing their derivative suits

# Tools at Hand Doctrine Spreads to Class Action M&A Litigation

- In 2000's, most class action litigation in Delaware invokes plaintiff-friendly standards of review that make it difficult for defendants to get rid of these cases so many settlements
- By 2013, 96% of large deals attract merger litigation
- As deal litigation explodes, pressure built on Delaware courts to rein in private enforcement of fiduciary duties

# Revlon Gets Cut Back in Corwin

- Beginning in 1985, plaintiff friendly Revlon doctrine applies in sale of control cases to provide enhanced judicial scrutiny of directors' actions when they are selling the firm
- As the amount of Revlon litigation increases, in Corwin v. KKR (2015), Delaware Supreme Court decides that a fully informed, uncoerced shareholder vote approving the transaction will result in dismissal of the case
- Subsequently that court decides that if defendants in a Corwin action move to dismiss a case, the plaintiffs do not get to engage in discovery (Singh v. Attenborough)

# Weinberger is Modified in MFW

- Since 1983, *Weinberger v. UOP* had resulted in enhanced judicial review under the entire fairness standard for controlling shareholder squeezeouts --plaintiff friendly standard of review
- In *Kahn v. MFW* (2014), the Delaware Supreme Court decides that an empowered, active special committee plus an uncoerced, fully informed majority of the minority vote will lead to the application of the business judgment rule
- This standard is applied to dismiss a shareholder suit without providing the plaintiffs discovery (*In re Books-A-Million*)



# Books and Records Cases Become Common Pre-Filing Discovery in Class Actions

- Plaintiff shareholders need to find an alternative method of contesting the adequacy of defendants' disclosures for Corwin and MFW cases to avoid dismissal
- Delaware Supreme Court endorses the tools at hand doctrine in cases where the defendants employed a Corwin or MFW defense
- Delaware's "tools at hand" doctrine has become a method for plaintiffs to obtain corporate books and records as a pre-filing discovery technique for both class actions and derivative suits

# Second Empirical Study – What's Changed?

- Collect data on all inspection actions filed from 2004 to 2018
- Code a variety of variables by hand
- Also collect data on all subsequently filed lawsuits
- Important to remember that many books and records demands may result in the production of information without litigation: defendants say this is common, while plaintiffs disagree
- Also unclear whether information is produced in cases that are voluntarily dismissed without saying anything about documents

# Section 220 Corporate Filings: 2004-2018

Year Filed	Number of Cases	Stocklist Only	Books and Records Only	Both Stocklist & Books and Records
2004	49	2	30	17
2005	57	0	37	20
2006	40	3	27	10
2007	34	0	21	13
2008	33	1	20	12
2009	29	1	23	5
2010	35	1	20	14
2011	38	0	27	11
2012	38	0	31	7
2013	56	0	47	9
2014	67	0	51	16
2015	48	0	39	9
2016	52	0	36	16
2017	61	0	48	13
2018	62	0	53	9
Total	699	8	510	181

# Overview of the Corporate Cases (2004-2018)

- Thirteen-fold increase in the number of books and records cases filed during the second time period – 699 corporate inspection cases
- Stocklist only cases are rare with only 8 cases in the sample period
- Books and records only cases become the dominant form of section 220 case with 510 filed during the 15 years

# Corporate Filings Activity: 2004-2018

Variable	Mean	Standard Deviation	Minimum	Median	Maximum
DELAY	312	367.01	0	193	2,666
PLTPAGES	182	288.9	7	77	2,597
DEFPAGES	152	315.8	0	32	3192
COURTPAGES	46	78.1	0	18	579
TOTPAGES	380	593.2	9	144	5,781
PLT%TOTAL	58.1%	21.1%	7.7%	59.0%	100.0%

## Variable definitions are as follows:

DELAY	Number of days between demand and outcome dates.
PLTPAGES	Number of pages filed by plaintiff.
DEFPAGES	Number of pages filed by defendant.
COURTPAGES	Number of pages filed by the court.
TOTPAGES	Total number of pages filed by the plaintiff + defendant + court.
PLT%TOTAL	Percentage of total pages filed by plaintiff.

# Main Points on Filing Activity

- In multijurisdictional litigation, delay generally favors defendants as they may be able to negotiate a better deal with plaintiffs in another jurisdiction
- Delay = an average of around 10 months, and in some cases numerous years, which is hardly a summary proceeding
- Pages filed by the parties and the court are significant, with some cases producing more than 5000 pages in total – full blown litigation!
- Average page filings by plaintiff are twice the level in the prior study and defendant page filings are three times as high

## Frequency Distribution by Year of Section 220 Cases Where a Subsequent Case Is Filed by Plaintiff

	All subsequent related suits	Derivative suits	Class actions	Individual actions	Receiver appointment actions	Appraisal suits
<b>2004</b>	16	13	6	3	0	0
<b>2005</b>	20	12	11	3	0	0
<b>2006</b>	2	0	0	1	1	0
<b>2007</b>	3	2	1	1	0	0
<b>2008</b>	7	4	1	3	0	0
<b>2009</b>	4	3	1	1	0	0
<b>2010</b>	3	1	0	1	1	0
<b>2011</b>	11	5	1	5	1	0
<b>2012</b>	7	4	3	1	0	0
<b>2013</b>	12	8	2	3	0	0
<b>2014</b>	16	13	5	2	0	1
<b>2015</b>	12	9	3	2	1	0
<b>2016</b>	7	3	1	2	0	1
<b>2017</b>	10	5	4	2	0	0
<b>2018</b>	3	1	1	1	0	0
<b>Totals</b>	133	83	40	31	4	2

# Subsequent Litigation Filings

- For all 220 actions, search for subsequently filed cases that have the same parties, or just the same defendants with a mention of the 220 case in the complaint
- 133 later cases out of 699 total cases = 19% subsequent litigation rate
- Some cases contain both derivative and class action allegations
- Taking that into account, 62% of cases contain derivative allegations, while 30% contain class action allegations and 23% have individual claims
- Comparing these results to those of an earlier study of the Delaware Chancery Court's case load, it appears a higher percentage of derivative cases have 220 actions associated with them than do class actions (which used to be filed quickly after deal announcement so as to get an injunction)



# Outcomes of Subsequent Litigation Filed after Section 220 Action

Outcome in Inspection Action	Number of Subsequent Actions with Known Outcome	Subsequent Plaintiffs voluntarily dismiss Merits-Based Action	Subsequent Plaintiffs win Merits-Based Action	Defendants win Merits-Based Action
Plaintiffs voluntarily dismisses inspection action	19	5	9	5
Plaintiffs win 220 Action	81	16	42	23
Defendants win 220 action	8	0	2	6

# Outcomes of Subsequent Litigation

- Plaintiffs that win Section 220 litigation and file subsequent litigation are frequently successful (42 out of 81 cases)
- Defendants win a significant number of these cases (23 out of 81)
- Plaintiffs voluntarily dismiss their cases (perhaps for a settlement) in the remainder of the cases
- Defendants win a small number of 220 actions where the plaintiff files subsequent litigation, and win 6 out of 8 of the subsequent cases filed
- When plaintiffs voluntarily dismiss the 220 action, and yet still file subsequent litigation, they win the follow up case about half the time

# Comparative Analysis and Policy Implications

# Scope of Inspection Rights

- Shareholder inspection rights are both wide and narrow in India as compared to Delaware
- In India, there is no requirement to establish “proper purpose”
- On the contrary, it is for the companies to claim and establish a corrupt purpose
- Moreover, a number of corporate records of Indian companies are publicly available on the MCA website

# Scope of Inspection Rights

- At the same time, shareholders of Indian companies have access only to a limited number of documents
- Unless they are also directors, they cannot enjoy access to internal documents of the company, thereby operating as a disincentive to exercise of the rights
- On the other hand, once shareholders in Delaware companies are able to discharge the burden of establishing “proper purpose”, they enjoy broader scope of inspection

# Inspection Rights and Types of Enforcement

- Under Delaware law, inspection rights are a tool to seek remedies from insiders, e.g. for breach of fiduciary duties
- They operate largely in the realm of private enforcement
- But, in India, direct shareholder inspection as a matter of private enforcement fulfils a partial role
- This is be contrasted with governmental inspection, which involves public enforcement of corporate law by the state
  - The advantage is that shareholders do not need to incur the cost, time and effort in pursuing litigation

# Inspection Rights and Types of Enforcement

- Public enforcement continues to play a role in India due to legal, structural and institutional reasons
  - Well-known delays in civil litigation (mitigated to some extent by the establishment of the National Company Law Tribunal)
  - Prohibitive costs in bringing legal action
  - Lack of appropriate incentives, such as contingency fees that are disallowed
- The situation is rather different in Delaware, which has a robust corporate law regime and an effective private enforcement machinery through its courts

# Other Differences

- Inspection rights are fragmented under the Indian Companies Act, while they are consolidated in Delaware in the form of section 220 of the DGCL
- The multiplicity of statutory provisions and courts and authorities involved in India make the implementation of shareholder inspection rights much less clear
- The Indian regime relies largely on a statutorily prescriptive regime with limited discretion to courts, while the Delaware position confers discretion on the judges to use a more standards-based approach



# Lessons and Conclusion

- Even though the paper examines a specific issue of shareholder inspection rights, the significant differences in the regimes between India and Delaware are not altogether surprising
- This is attributable to the differences in the corporate governance set up (e.g. dispersed shareholder vs. concentrated shareholding) and in the legal system and institutions (e.g. private enforcement vs. public enforcement)
- It also tells us something about the impact of legal rights and the use of the legal system towards minority shareholder protection and ultimately the shape of the corporate governance system