



# 'Absolute' Right of Directors to Inspect Corporate Documents Not So Absolute

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Corporations should be aware of circumstances under which they may not be required to provide their directors with unlimited access to all of the corporation's records; in fact, there are circumstances under which they should not do so. Although Section 1602 of the California Corporations Code (the "Corporations Code") provides that the directors of a corporation have the "absolute right" to inspect and copy all of the corporation's books and records, the California Court of Appeal, Fourth Appellate District, recently held that this "absolute right" is subject to certain necessary exceptions.

The Court of Appeal, in *Tritek Telecom, Inc. v. Superior Court of San Diego County* (January 7, 2009, D053073) \_\_\_ Cal.App.4th \_\_\_ ("*Tritek*"), held that a director of a corporation, who was also one of the corporation's shareholders, does not have the right to inspect the corporation's documents that are covered by the attorney-client privilege and were generated in defense of a lawsuit filed against the corporation by the director in his capacity as a shareholder of the corporation. The court found that the director's inspection rights could properly be limited because the lawsuit caused his loyalties to be divided, and any documents obtained by the director in his capacity as a director could be used to advance the director's personal interest in his litigation with the corporation.

## The Decision

In *Tritek*, Chik-Lun Mak ("Mak"), a disgruntled director and shareholder of Tritek Telecom, Inc., a California corporation (the "Corporation"), sued the Corporation and its other director in his individual capacity as a shareholder of the Corporation under various causes of action. In a separate action, Mak filed a petition under Section 1603 of the Corporations Code, pursuant to which the trial court ordered the Corporation to allow Mak to inspect all of the Corporation's relevant books and records. The Corporation sought review of the lower court's ruling in the Section 1603 action, arguing that the trial court abused its discretion by ordering disclosure of documents covered by the attorney-client privilege and work product doctrine. The

Court of Appeal agreed with the Corporation, finding that:

- Mak's filing of the shareholder action made him the Corporation's adversary;
- Mak's inspection rights could properly be limited because the documents he sought in his capacity as a director could be used to advance his personal interest in his litigation with the Corporation; and
- enforcing Mak's "absolute" inspection rights would give him access to documents he could not obtain via discovery in the shareholder action.

### **The Background**

The Corporation had two equal shareholders: Andre Rerolle ("Rerolle") and Prospect Development, Inc. ("Prospect"), a company solely owned by Mak. In May 2007, Rerolle and Mak hired L. Michael Wilson ("Wilson") of the Apollo Law Group to act as the Corporation's corporate counsel.

In June 2007, conflicts arose between Rerolle and Mak regarding the operation of the Corporation and management responsibilities. Mak and Prospect sued the Corporation, Rerolle and others, alleging various causes of action and seeking return of their investment in the Corporation and damages against all defendants (the "Shareholder Action").

In a separate action, Mak filed a petition under Section 1603 of the Corporations Code against the Corporation, Rerolle and Wilson, seeking to enforce his right as a director to inspect the Corporation's books and records. The trial court granted the petition and ordered the Corporation to produce: (1) the entire content of the Apollo Law Group case files relating to the Shareholder Action and any other matters for which Apollo Law Group had been consulted or employed by the Corporation; (2) all communications between Apollo Law Group and any officer, director or employee of the Corporation; and (3) any case files evidencing the Corporation's involvement in any litigation.

### **The Rationale**

On appeal, the Court of Appeal noted that the Corporation did not dispute Mak's right to inspect general corporate documents, but rather contended that the trial court's ruling was overbroad in allowing the inspection of documents protected by the attorney-client privilege. The court concluded that Mak's inspection rights could properly be limited because his loyalties were divided and the privileged documents obtained in his capacity as a director of the Corporation could be used by him in the Shareholder Action. In its decision, the court acknowledged that allowing Mak to inspect such privileged documents would give him access to documents he could not obtain through discovery in the Shareholder Action.

The Court of Appeal explained that although Section 1602 of the Corporations Code grants corporate directors the "absolute right" at any reasonable time to inspect and copy all corporate books, records and documents of every kind, Section 1603 of the Corporations Code qualifies this "absolute right" by providing that a court may enforce this right "with just and proper conditions." Furthermore, the Court of Appeal noted that the "absolute right" of inspection is subject to exceptions and may be denied where a disgruntled director "announces his or her intention to violate his or her fiduciary duties to the corporation" such as when, for example, the inspection rights are used by the director to obtain trade secrets to enable him to compete with the corporation.

Since Mak filed suit against the Corporation in his individual capacity as a shareholder, the Court of Appeal held that he did not have the right to inspect those books, records or documents of the Corporation that are

covered by the attorney-client privilege and were generated in defense of the Shareholder Action. *Tritek* does not address the situation where a director seeks access to the corporation's books, records or documents for a purpose adverse to the corporation *prior to* disclosing his or her intentions or taking action from which such intentions could be discerned by the corporation. For example, if Mak had attempted to exercise his inspection rights under Section 1602 to inspect privileged documents that were generated as a result of the dispute between Mak and the Corporation's other director *before* Mak filed the Shareholder Action against the Corporation, it is unclear whether Mak would have been permitted to inspect those documents.

Corporations receiving requests from their directors seeking to inspect the corporation's books and records should not automatically comply; instead, management should evaluate whether conflicting considerations could be involved and consult their counsel as appropriate.