Clarifying the Meaning of 'Stockholder' for a Section 220 Action

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In a decision with facts egregious enough to justify two references to the definition of "chutzpah," Vice Chancellor Sam Glasscock III of the Delaware Court of Chancery provided helpful guidance on how to establish and refute "stockholder" status for purposes of bringing an action to inspect corporate books and records under 8 Del. C. Section 220, in *Pogue v. Hybrid Energy*, C.A. No. 11563-VCG (Del. Ch. Ct. Aug. 5). The vice chancellor held that "inclusion on a stock ledger is prima facie evidence of stock ownership but ... the corporate defendant may rebut that presumption by clear and convincing evidence."

Section 220 allows a stockholder to make a demand to inspect the books and records of the corporation so long as it is for a "proper purpose," which the statute defines as being "a purpose reasonably related to such person's interest as a stockholder." The corporation has five days to respond to such a demand once it has been made. If the corporation does not respond within that time or if in its response it refuses to allow a books-and-records inspection, then the stockholder may bring an action to compel production of those records in the Delaware Court of Chancery. Of particular relevance here is the statutory requirement that a Section 220 demand—and any action based on the refusal of that demand—must be brought by "a stockholder." The issue of whether one who claims to be a stockholder is truly a stockholder for Section 220 purposes was presented front and center in *Pogue*.

Pogue arose out of a dispute between an employer (Hybrid Energy Inc.) and a former employee (James Pogue). Upon being hired by Hybrid, Pogue was issued a stock certificate representing 1 million shares of Hybrid stock. Pogue was also listed on Hybrid's stock ledger as a stockholder of the company. Later, according to the complaint, Hybrid issued to him a revised stock certificate, paid him dividends on his shares, and issued to him an IRS form for the reporting of those dividends for tax purposes. The problem was that Hybrid's corporate charter only authorized 1,500 shares of stock, all of which were outstanding and owned by Thomas Lull, Hybrid's president, CEO and secretary. Consequently, Hybrid did not have, and never had, 1 million shares to issue to Pogue, and the certificate Pogue received evidencing 1 million shares was invalid. The parties thus agreed, for the purpose of the Section 220 action, that the issuance of stock to Pogue was void ab initio. Pogue, by now a former employee, made a demand for books and records under Section 220. When Hybrid did not respond to that demand, Pogue filed an action seeking to compel access to those records.

Pogue claimed that the fact that he was listed as a stockholder on Hybrid's stock ledger conclusively established that he was a stockholder for Section 220 purposes. Hybrid responded that because Pogue's stock certificate was demonstrably void, he was not a stockholder and therefore lacked standing to demand books and records under that statute. Hybrid then moved for summary judgment offering into evidence the company's charter and other documents supporting the fact that the stock issuance was void. Glasscock sagely observed that "a company that issues a void stock certificate to an employee to defraud him of his services, [and then] defending a books-and-records request on the ground that said the employee is no stockholder" is a paradigm example of chutzpah. Nonetheless, the court concluded that it was required to grant summary judgment to Hybrid.

In so ruling, the court looked to the purpose of the statute, which "is to provide corporate records necessary to a stockholder's interests 'as a stockholder.'" Given that purpose, the vice chancellor concluded that someone who was listed on the stock ledger solely by reason of typographical error would not have a proper stockholder interest in the books and records of the corporation. Similarly, someone listed on the ledger by fraud (her own or someone else's) would have no interest as a stockholder in receiving the corporation's books and records—since that person would demonstrably not be a stockholder. Thus, the court held that although inclusion in a stock ledger was prima facie evidence of being a stockholder for purposes of Section 220, that evidence could be (and in this case was) rebutted.

The court took pains to note that Pogue was not without remedies. Clearly he had alleged wrongs that could be addressed in a fraud or contract action (and perhaps even a derivative action under an estoppel

theory), but those wrongs, however sympathetic they might be, were not legally sufficient to establish standing as a shareholder under Section 220 based on a concededly void stock certificate. Once the corporation had demonstrated that Pogue was not a valid stockholder, and consequently had no ownership interest in the company, Pogue lacked standing to proceed under Section 220. The court held that "to find standing to vindicate such a nonexistent interest would not advance the purpose of the statute."

Ultimately, *Pogue* allows a corporation to properly deny access to its books and records to someone listed improperly on its stock ledger (for example, a shareholder who has subsequently sold her stock, a disgruntled employee who left before her shares actually vested, or a stockholder whose shares were acquired in a merger). In those cases, there is no legally culpable conduct on the corporation's part. But, even a corporation that fraudulently lists a person on its stock ledger may deny access to its books and records under Section 220. While the former situation is the one more likely to occur, in both such cases *Pogue* permits the corporation to protect its books and records and avoid the expense of reviewing and producing them.

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