

CORPORATIONS QUESTION

A shareholder owns 100 shares of MEGA Inc., a publicly traded corporation. MEGA is incorporated in State A, which has adopted the Model Business Corporation Act (MBCA).

The shareholder read a news story in a leading financial newspaper reporting that MEGA had entered into agreements to open new factories in Country X. According to the story, MEGA had paid large bribes to Country X government officials to seal the deals. If made, these bribes would be illegal under U.S. law, exposing MEGA to significant civil and criminal penalties.

On May 1, the shareholder sent a letter to MEGA asking to inspect the minutes of meetings of MEGA's board of directors relating to the Country X factories mentioned in the news story, along with any accounting records not publicly available relevant to the alleged foreign bribes. The shareholder explained that she was seeking the information to decide whether to sue MEGA's directors for permitting such possible illegal conduct.

In her letter, the shareholder also demanded that the MEGA board investigate the possible illegal bribes described in the news story and take corrective measures if any illegality had occurred.

On June 1, MEGA responded to the shareholder in a letter, which stated in relevant part:

The corporation will not give you access to any corporate documents or take any action regarding the matters raised in your letter. We cannot satisfy the whim of every MEGA shareholder based on unsubstantiated news stories. Furthermore, given our continuing operations in Country X, the board of directors will not investigate or take any other action regarding the matters raised in your letter because doing so would not be in the best interest of the corporation.

On October 1, the shareholder filed a lawsuit in a State A court. Her petition includes (1) a claim against MEGA seeking inspection of the documents previously requested and (2) a derivative claim against all of the MEGA directors alleging a breach of their fiduciary duties for failing to investigate and take action concerning the alleged foreign bribes.

MEGA's board has asked the corporation's general counsel the following questions:

- (1) Is the shareholder entitled to inspect the documents she requested?
- (2) May the board obtain dismissal of the shareholder's derivative claim if the board concludes that it is not in the corporation's best interest to continue the lawsuit, even though the board has not investigated the allegations of illegal foreign bribes?
- (3) Is the board's decision not to investigate or take further action with respect to alleged illegal foreign bribes consistent with the directors' duty to act in good faith, and is that decision protected by the business judgment rule?

How should the general counsel answer these questions? Explain.

Question Presented

A shareholder of MEGA Inc. (publicly traded, MBCA) read a newspaper report that MEGA paid illegal foreign bribes to seal factory deals, exposing it to civil and criminal penalties.

← credible basis of possible corporate illegality

She demanded to inspect the board minutes and accounting records about the bribes, to decide whether to sue the directors, and demanded the board investigate.

← proper purpose = investigate suspected wrongdoing

The board refused everything: it would not investigate or act, without any inquiry, calling that not in the corporation's best interest given its Country X operations.

← no reasonable inquiry → cannot win dismissal

The board never denied the report and chose to continue in the face of the alleged illegality.

← condoning illegal conduct → not good faith; BJR won't protect

1. Is the shareholder entitled to inspect the documents she requested?

← → proper purpose

2. May the board dismiss the derivative claim without investigating?

← → reasonable inquiry required

3. Is the refusal to investigate consistent with good faith and protected by the business judgment rule?

← → duty of good faith / oversight

Question 1: Shareholder Inspection Rights

Issue. Whether the shareholder is entitled to inspect MEGA's board minutes and accounting records.

Does she have a right to these documents?

Rule. A shareholder may inspect board minutes and accounting records upon a written demand made in good faith, for a proper purpose reasonably related to her interest as a shareholder,

Inspect minutes/accounting records for a proper purpose + credible basis; limited to records tied to that purpose.

described with reasonable particularity and supported by a credible basis. Investigating suspected mismanagement or illegality in order to decide whether to sue is a proper purpose. Inspection is limited to records directly connected to that purpose.

Analysis. Here, the shareholder seeks minutes and accounting records to decide whether to sue over the alleged illegal bribes, a proper purpose tied to protecting her economic interest in MEGA. The newspaper report, plus the board's refusal to deny it, supplies a credible basis of possible illegality. She is entitled to the relevant excerpts and accounting records, though the corporation may withhold unrelated, non-financial documents.

Conclusion. Therefore, the shareholder is entitled to inspect the board minutes and accounting records related to the bribes.

*Deciding whether to sue over illegality
= proper purpose; report + non-denial
= credible basis.*

Yes: entitled to the related records.

Question 2: Dismissal of the Derivative Claim

Issue. Whether the board may obtain dismissal of the derivative claim without having investigated the allegations.

Rule. A board may obtain dismissal of a derivative suit only if a majority of its qualified (disinterested) directors determine, in good faith and after a reasonable inquiry on which the conclusion is based, that continuing the suit is contrary to the corporation's best interest.

Analysis. Here, the board made no inquiry at all before declaring the suit not in MEGA's best interest, so its conclusion rests on no investigation and fails the good-faith, reasonable-inquiry requirement. A failure to investigate credible allegations of illegality is itself a lack of good faith.

Conclusion. Therefore, the board cannot obtain dismissal, and the derivative claim may proceed.

Can the board end the suit on its own say-so?

Dismissal needs qualified directors + good faith + a reasonable inquiry supporting the conclusion.

Zero investigation → conclusion unsupported → requirement not met.

No: the claim survives.

Question 3: Duty of Good Faith and the Business Judgment Rule

Issue. Whether the board's refusal to investigate or act is consistent with the directors' duty of good faith and protected by the business judgment rule.

Rule. Directors owe a duty to act in good faith, which includes an obligation not to condone illegal corporate conduct and to investigate credible evidence of it. The business judgment rule protects informed, good-faith decisions, but it does not protect a

Is inaction on illegality protected?

Good faith bars condoning illegality; the BJR does not protect ignoring credible red flags.

decision to disregard or condone illegal conduct, even if that conduct is profitable.

Analysis. Here, faced with a **credible report of illegal bribery that it did not deny**, the board refused to investigate and chose to continue, reasoning that inquiry was not in MEGA's interest given its Country X operations. Consciously disregarding credible evidence of illegality is not good faith, and the business judgment rule does not shield a decision to condone illegal conduct.

Conclusion. Therefore, the board's decision is not consistent with the duty of good faith and is not protected by the business judgment rule.

Ignoring credible illegality for profit = bad faith; outside the BJR.

Not good faith; not BJR-protected.

Step-by-Step: Inspection, Derivative Dismissal & Oversight

Three separate tests: the shareholder's access, the board's power to end the suit, and the directors' duty when illegality surfaces.

1. Shareholder inspection: a proper purpose (with a credible basis), seeking records directly connected to it?

→ Investigating suspected wrongdoing to decide whether to sue = proper purpose → **inspection granted**. **Q1: minutes + accounting records**



2. Board seeking dismissal of a derivative suit: qualified directors, in good faith, after a reasonable inquiry, find continuation contrary to the corporation's interest?

→ No inquiry → **no dismissal**; the claim proceeds. **Q2: board did not investigate**



3. Directors' duty of good faith: does the decision condone or disregard illegal conduct?

→ Refusing to investigate credible illegality = bad faith; the **BJR does not protect it**. **Q3: refusal to investigate bribery**