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# China Media Express: The Stockholder's Right to Access Books and Records

Is your company prepared to turn over its most important financial records to stockholders within a matter of weeks? This question was recently posed to China Media Express Holdings, Inc. ("CCME"), a Delaware corporation based in Hong Kong, and its founder Mr. Zheng Cheng, who found themselves locked in a legal battle in the United States that threatens to unravel the media company. The dispute between CCME and its most important stockholders, Starr Investments Cayman II, Inc. ("Starr"), recently took a unique twist when Starr exercised its statutory right to inspect the books and records of CCME in Delaware State court, while Starr's securities fraud case against CCME was pending in Federal Court in Delaware. By adopting this dual approach, Starr significantly increased its chances of obtaining CCME's financial records in a matter of weeks rather than the months to years typically seen in federal securities litigation.

Through its subsidiaries and related entities, CCME purports to operate the largest television advertising network on inter-city and airport express buses in China. Its network of television displays is installed on buses originating in eighteen of China's regions, including the four municipalities of Beijing, Shanghai, Tianjin and Chongqing, and fourteen regions including Guangdong, Jiangsu, Jiangxi, Fujian, Sichuan, Hebei, Anhui, Hubei, Shandong, Shanxi, Inner Mongolia, Zhejiang, Hunan and Henan. CCME is traded in the United States on the NASDAQ. On October 18, 2010, Starr purchased approximately 1.5 million common shares of CCME, then worth roughly $13.5 million, making it the largest stockholder in CCME after Mr. Cheng.

Starr initially filed its federal securities action in March 2011, claiming that CCME was engaged in a scheme to commit an international fraud on the markets in both the United States and China by fraudulently inducing hundreds of millions of dollars of investments in CCME. Through its complaint, Starr alleges that Mr. Cheng intentionally misrepresented the size of the bus advertising market in China and disseminated material that significantly overstated the Company's financial results. To prevail in that litigation, Starr will need to obtain CCME internal financial records that prove a fraud occurred.

CCME will likely respond to the suit by filing a motion to dismiss. This will derail Starr's immediate efforts to obtain CCME documents, as the Private Securities Litigation Reform Act ("PSLRA") and the Securities Litigation Uniform Standards Act ("SLUSA") impose an automatic stay on all federal securities litigation discovery pending the resolution of motions to dismiss. In practical terms, when a defendant such as CCME files a motion to have the case thrown-out, a plaintiff like Starr cannot request CCME documents, including financial records, until the Court decides the motion to dismiss. It can take between 9 to 18 months for a Federal Court to decide a motion to dismiss and for discovery to proceed. There is, however, an important loophole to the PSLRA and SLUSA that Starr exploited on May 13, 2011—the stockholders' statutory right to inspect books and records pursuant to Section 220 of Delaware's General Corporation Law.

Any stockholder of a Delaware corporation may use the procedures in 8 Del. C. § 220 "to inspect for any proper purpose the corporation's stock ledger, a list of its stockholders, and its other books and records, and to make copies or extracts therefrom." Where the stockholder seeks to inspect books and records other than the stock ledger or stock list, the burden of proof is on the stockholder to establish "that the inspection he seeks is for a proper purpose." Delaware law suggests that Starr's purpose for the inspection request—the desire to investigate suspected corporate mismanagement, and to solicit the participation of other stockholders in legitimate non-derivative litigation against the defendant corporation—is a proper purpose.

In Delaware, Section 220 contemplates that corporations will promptly provide the requested information to stockholders and Delaware Courts will quickly resolve legal challenges. Complying with the requirements of Section 220, on May 2, 2011 Starr initiated its demand by serving a letter on CCME that stated under oath the purpose of the requested inspection—namely to investigate possible corporate mismanagement or wrongdoing by the present and/or former officers and directors of CCME. By law, CCME had five (5) days to respond before Starr could seek to compel the inspection by way of a summary proceeding in the Delaware Court of Chancery. CCME did not respond within the five day period and Starr filed its books and records action on May 13, 2011. Based on prior actions, the proceeding in the Court of Chancery will likely be resolved in a matter of weeks to a couple months.

Foreign companies that access the capital markets by forming or merging into a Delaware corporation and then listing on either the NASDAQ or NYSE must recognize the breadth of materials available to stockholders under Section 220, and the speed at which decisions will need to be made when stockholders make a demand. With only five days to formally respond to (an often lengthy) demand letter, detailed and written by lawyers, companies have very little time to investigate the stockholder's accusations and respond before the stockholder(s) file suit in Delaware demanding inspection. To navigate this process pre and post litigation, companies should seek the advice of legal advisors who have the experience necessary to address the legal issues, who have the geographic reach needed to respond quickly, and who know their clients. For companies based in Asia, this will often mean a law firm with a physical presence in China/ Hong Kong and the United States, and which has extensive experience before the Delaware Courts.

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