Financial Disclosure by Small Corporations

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FINANCIAL DISCLOSURE BY SMALL CORPORATIONS

Since the passage of federal securities legislation in the early 1930's, extensive financial disclosure has been required of large publicly-held corporations. Periodic disclosure requirements extend to all corporations which are listed on a national exchange, or have over 500 shareholders and assets of at least one million dollars, or have over 300 shareholders and have registered a security under the Securities Act of 1933. Most corporations not governed by the federal securities acts have no state statutory duty to periodically inform their shareholders of their financial condition. Presumably, the shareholders could require such periodic disclosure by resolution, but this power is nowhere expressly recognized, nor are instances of it recorded in reported cases. The corporation's only duty then is to open its books or deliver statements to shareholders upon demand.

This note will focus upon the desirability of compelling financial disclosure by corporations not subject to control under the existing federal securities legislation, which includes the vast majority of American corpo-


5 See generally part I infra.

6 In light of the principle that shareholders may take action on matters properly within their concern, see, e.g., Auer v. Dressel, 306 N.Y. 427, 118 N.E.2d 590 (1954), it would seem that the shareholders of a corporation have the power to compel disclosure through the adoption of a proper resolution at a duly called meeting. Bloomberg, The Public's "Right to Know": Disclosure in the Major American Corporation, 28 Bus. Law. 1025, 1052-53 (1973). Cf. SEC v. Transamerica Corp., 163 F.2d 511 (3d Cir. 1947), where the court found that a proposal to have a report of the proceedings at the corporation's annual meeting sent to every shareholder was a proper subject for a shareholder proposal under the SEC Proxy Rules. The court said, Certainly it is proper for the stockholders to desire and to receive a report as to what transpired at the annual meeting of their company. True it may cost Transamerica $20,000 annually, but accurate information as to what transpires respecting the corporation is an absolute necessity if stockholders are to act for their joint interest. If stockholders cannot act together they cannot act effectively.

Id. at 517-18.

7 See notes 15-17, 24 and accompanying text infra.
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While differing in degree and extent of application to corporations of varying sizes, the benefits derived from disclosure by large, widely-held corporations would also be obtained when disclosure is made by smaller, less widely-held corporations. The extension of federal or state disclosure requirements to corporations of all sizes and ownership dispersions, requiring them to place financial information before their shareholders at least once each year, is suggested.

I. EXISTING DISCLOSURE LAWS

The major source of disclosure requirements is the federal securities legislation. Because their applicability is defined in terms of corporate size, these requirements do not extend to the majority of American corporations. State statutes are generally "enabling" rather than restrictive. They permit corporations to disclose financial data, but do not require such disclosure. Only six states require that a domestic corporation send an annual financial report to its shareholders, and in three of those states some or all corporations can avoid the requirement by enacting a by-law to that effect. In two other states there is a requirement that all domestic

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8 See Conard, The Corporate Census: A Preliminary Exploration, 63 CALIF. L. REV. 440 (1975); Report of Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 3, at 19-20 (1963) [hereinafter cited as SPECIAL STUDY]. Professor Conard's statistics indicate that less than 1 percent of the corporations in the United States have sufficient shareholders to bring them within the limits of required disclosure.

9 See notes 1-4 and accompanying text supra.

10 See notes 2-4, 8 and accompanying text supra.

11 See W. CARY, CORPORATIONS 9-13 (4th ed. 1969). The deficiency of state law in the area of disclosure is pointed out by former SEC Commissioner Sommer.


corporations place a financial statement before their shareholders at annual meetings.14

Several states require a domestic corporation to prepare an annual financial statement and distribute a copy of it to any shareholder who requests one.15 Many states follow the lead of the Model Business Corporation Act,16 and require only that a corporation send copies of its "most recent" financial statements to any shareholder who requests them.17 None of the provisions which require that the shareholder request a copy of the financial statement before the corporation must disseminate it mandate that the corporation send updates of the report to the shareholder, and provisions based on the Model Act do not even require that the financial report initially sent be prepared within the past year. Several states have no requirement that domestic corporations prepare or send a financial report on its condition to shareholders or other persons requesting such information.18

When neither federal nor state law compels periodic corporate disclosure, the incidence of such action is generally low. The Report of Special Study of Securities Markets of the Securities and Exchange Commission (Special Study) found that one-fourth of the actively-traded corporations studied submitted no financial information at all to their shareholders.19


15 GA. CODE ANN. § 22-613 (1970); ILL. REV. STAT. ch. 32, § 157.45 (1973); LA. REV. STAT. § 12:102 (1969); ME. REV. STAT. ANN. tit 13A, §§ 625(3), 626(8) (1974) (applicable to corporations with more than twenty shareholders); N.J. STAT. ANN. § 14A:5-28 (1969); N.Y. BUS. CORP. LAW § 624(e) (McKinney 1963) (limited to persons who have been shareholders for six months or who are, or have authorization from, holders of at least 5 percent of any class of outstanding shares); N.C. GEN. STAT. § 55-37(a)(4) (1965); OHIO REV. CODE ANN. § 1701.38 (Page Supp. 1974) (with time limitation relating to the annual meeting); S.C. CODE ANN. § 12-16.25(c) (Supp. 1974); TENN. CODE ANN. § 48-716 (Supp. 1974); TEX. BUS. CORP. ACT ANN. art. 2.44(E) (Supp. 1974); WIS. STAT. ANN. § 180.43(1) (Supp. 1975).

16 ABA-ALI MODEL BUS. CORP. ACT § 52 (1971).


18 These states are Delaware, Florida, Idaho, Kansas, Missouri, Nevada, and New Hampshire.

19 SPECIAL STUDY, supra note 8, pt. 3, at 10-12. The Special Study drew its sample only from corporations in which some trading interest had been shown. Hence, the corporations represented in the sample had a greater average number of shareholders than if they had been chosen without this qualification. Moreover, according to Singhvi & Desai, An Empirical Analysis of the Quality of Corporate Financial Disclosure, 46 ACCOUNTING REV. 129, 132 (1971), there is a significant relationship between the number of shareholders in a corporation and the quality of disclosure made by that corporation. This would suggest that if the sample had been drawn from all corporations the percentage of corporations which report no financial information would be greater.
York state study of intrastate offerings by corporations which had an average of one hundred shareholders revealed that only one-fourth of them sent financial reports to their shareholders.  

Most states require domestic corporations to hold an annual shareholders' meeting, but Delaware authorizes the elimination of the meeting if the holders of sufficient stock to take any action which is proposed to be taken at the meeting consent to such action in writing. The elimination of the annual meeting deprives shareholders of an opportunity to question management and thereby gain insights into the financial condition of the corporation.

Shareholders do enjoy a common law right, often codified by statute, to examine the books and records of a company in which they own shares. This common law right is a qualified right. The demand by the shareholder must be for inspection at a reasonable time and place and for a proper purpose.

There is a growing trend toward greater disclosure from a larger number of corporations. Recent actions by the Congress and the SEC, by the organized bar, and by the corporations themselves have all expanded


With the Securities Acts Amendments of 1964, Congress extended the authority of the SEC in terms of both the number of firms required to file, and the quality of disclosure required. The SEC has also enhanced the quality of disclosure required through its rulemaking power. In addition to the Special Study, supra note 8, the SEC completed another extensive study of disclosure requirements in 1969. U.S. Securities & Exchange Commission, Disclosure to Investors: A Reappraisal of Administrative Policy Under the '33 and '34 Acts (1969) [hereinafter cited as Wheat Report]. Most of the recommended changes from the study, conducted under the direction of SEC Commissioner Francis M. Wheat, deal with the quality and content of disclosure, but at least one writer feels that the response to the Wheat Report portends further changes.

There is every indication that these changes [in response to the Wheat Report] are only the beginning of what will be one of the major efforts of the Commission in the years ahead. The ultimate goal is to drastically increase the amount of information a company must disclose on a continuing basis, the dissemination of the information, and the numbers of companies required to make that disclosure.


The American Law Institute has proposed a securities code which would require registration and annual reporting by any corporation with 300 shareholders and one million dollars in assets. ALI Fed. Securities Code §§ 401, 601 (Tent. Draft Nos. 1-3, 1974).

Some corporations have undertaken greater disclosure than presently required by law. For example, corporations which have chosen to have their shares listed on the New York Stock Exchange are subject to the regulations of the Exchange as well as those of the SEC. See NYSE Company Manual 18-34, 64-73, 89-104.
the scope of disclosure by corporations. There is no indication, however, that this trend is likely to extend to all corporations regardless of size unless legislative action is taken.

The British experience in this area is of interest since British corporate law made a significant step in the direction of disclosure in 1967. Formerly, small English corporations which attained the status of an "exempt private company" were excused from making financial disclosure to their shareholders. In 1962, a parliamentary committee which had been studying the corporate law recommended a series of amendments to corporate law, expanding company disclosure requirements. After considering the arguments in favor of maintaining the exemption from disclosure for small companies, the committee recommended the abolition of the status of "exempt private company," in effect removing this exemption.

In 1967, Parliament adopted this recommendation and the status of "exempt private company" was eliminated. At present, all companies, regardless of size, must make a detailed annual report to their shareholders. In this report, they are required to disclose both financial and nonfinancial information.

Many corporations are voluntarily going beyond the requirements of both the Exchange and the SEC. See Gillis, Trends in Disclosure, 142 FIN. ANAL. J. 11 (1975); Big Board Chairman Recommends More Corporate Disclosure, 93 PUB. UTIL. FORT., Jan. 17, 1974, at 41. The reported instances of voluntary disclosure all involve corporations already subject to some required disclosure.


Companies Act 1948, 11 & 12 Geo. 6, c. 38, § 129.

REPORT OF THE COMPANY LAW COMMITTEE, CMND. 1749 (1962) [hereinafter cited as JENKINS REPORT].

Pickering, supra note 29, at 402, concludes that the principal features of the report fall within the four categories, extension of company disclosure requirements, a substantial widening of the powers to check fraud, a new system of insurance business supervision, and the abolition of the privileges which have been enjoyed by the small companies.

JENKINS REPORT, supra note 31, § 59, at 20.

Id. § 63, at 22. See also id. § 15, at 3.

Companies Act 1967, c. 81, § 2.

English companies are required to place a profit and loss statement and a directors' report before their shareholders at least once a year. Section 16 of the 1967 Act requires that the report contain information on the directors, their holdings, and contracts with the corporations in which they have an interest. This section also requires that the report contain information on the activities and assets of the company. The report must also include information on average employment of the company and aggregate compensation (§ 18), political and charitable contributions over £50 (§ 19), and disclosure of facts on exports (§ 20). The corporation must also disclose reimbursement paid to directors (§ 6) and salaries of officers who receive more than £10,000 (§ 8).

See Pickering, supra note 29, at 388-92. One fact mentioned by the JENKINS REPORT, supra note 31, § 57, at 19, which may have influenced the decision of the committee to recommend the abolition of the exemption from disclosure is that over 70 percent of the private companies in England had attained the status of "exempt private company," thereby removing themselves from disclosure requirements. According to the report some of these companies were "not very small in
II. PURPOSES AND BENEFITS OF DISCLOSURE

Several benefits are achieved by disclosure requirements. Publicity resulting from disclosure has an obvious deterrent effect on the conduct of management. Management's knowledge that its actions will be open to scrutiny will have a beneficial effect on the character of those actions. In the absence of disclosure nonmanaging shareholders are susceptible to mismanagement and fraud perpetrated by those who are in active control of the corporation. A vivid example is found in *Holi-Rest, Inc. v. Treloar*, where the plaintiff was induced by her employer to purchase 160 shares in a corporation he had organized to own and operate a restaurant. Plaintiff managed the restaurant for three years, all of which were very profitable, and was compensated through wages and distribution of residual earnings of the corporation. She then quit her job as manager. The defendant hired a replacement, and also began drawing a salary himself. The net income of the corporation dropped, and small losses were sustained in two of the next four years.

The court found the defendant accountable to the corporation for damages caused by the use of corporate funds to repay personal debts, the withdrawal and pocketing of corporate funds without formal shareholder authorization, self-dealing contracts with other businesses in which he had an interest, and drawing an excessive salary for himself. The court stated that the defendant had "breached his fiduciary duty in several ways, and operated the corporate affairs solely for his own benefit and not that of Holi-Rest or its stockholders." In addition, the court castigated the defendant for attempting to buy out the plaintiff's interest in what the court termed a "freeze-out." Various types of shareholder victimization are demonstrated by this and similar cases. Such abuses include excessive compensation paid without

37 WHEAT REPORT, supra note 26, at 10-11; Schoenbaum, supra note 26, at 575-78.

Years before the enactment of federal securities legislation, Justice Brandeis recognized the value of disclosure in improving the character of men's actions.

Publicity is justly commended as a remedy for social and industrial disease. Sunlight is said to be the best of disinfectants; electric lights the most efficient policeman.

L. BRANDEIS, OTHER PEOPLE'S MONEY 92 (1914).

38 Blumberg, supra note 6, at 1026; Cary, Corporate Standards and Legal Rules, 50 CALIF. L. REV. 408, 419 (1962).


40 Defendant Treloar retained 600 shares and it appears from the record that there may have been eight other small shareholders. —Iowa at —, 217 N.W.2d at 520. It does not appear that these other shareholders had any part in this action or that they still held these shares.

41 —Iowa at —, 217 N.W.2d at 525.

42 *Id.* A freezeout is the elimination of some of the shareholders from the enterprise by those in control through the manipulative use of their superior position. See F.H. O'Neal & J. Derwin, EXPULSION OR OPPRESSION OF BUSINESS ASSOCIATES § 1.01, at 3 (1961); 2 F.H. O'Neal, CLOSE CORPORATIONS § 8.07, at 43 (1971).
shareholder knowledge, improper failure to declare dividends, self-dealing with the corporation, and attempts to induce purchases or sales of shares at inadequate or excessive prices. The comparatively small number of appellate decisions, coupled with the potential for abuse, suggest that these problems may be widespread but as yet undiscovered. All of these activities rely upon concealment for their success because an informed shareholder could seek judicial relief to curtail these practices. Should deterrence ultimately fail, disclosure at least benefits those who seek to put a halt to prohibited activities through legal action. These activities will often be revealed, either directly or indirectly, through required disclosures.

Disclosure also may forestall fraud perpetrated by management and other

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43 See, e.g., Teren v. Howard, 322 F.2d 949 (9th Cir. 1963); Smith v. Dunlap, 269 Ala. 97, 111 So. 2d 1 (1959); Hackley v. Oltz, 105 So. 2d 20 (Fla. 1958); Fendelman v. Fenco Handbag Mfg., 482 S.W.2d 461 (Mo. 1972).

INT. REV. CODE OF 1954, § 162(a)(1) allows deduction as a business expense only of "a reasonable allowance for salaries or other compensation for personal services actually rendered." Arguably, this provides some protection for outside shareholders since corporate management will be reluctant to withdraw money under the guise of compensation without the corresponding benefit of a tax deduction. However, the Treasury Regulations recognize that disallowance of a deduction for an amount paid out does not necessarily result in the return of the payment to the corporation. Treas. Reg. § 1.162-8 (1958). Moreover, in the absence of required disclosure by the corporation, there does not appear to be any method by which shareholders are assured of learning of the disallowance of any deduction.


In a small corporation, where the officers are often directors and substantial shareholders, there is a conflict of interest between insiders (officers and directors) and outsiders caused by the differences in tax treatment afforded to salaries and dividends. Reasonable salaries are a deductible expense of the corporation. INT. REV. CODE OF 1954, § 162. Thus, salaries are paid for with "before tax" dollars. On the other hand, dividends are not deductible by the corporation and, hence, must be paid out of "after tax" dollars. INT. REV. CODE OF 1954, § 161. Moreover, the maximum tax rate applied to salaries is 50 percent, while the tax rate on dividends may be as high as 70 percent. INT. REV. CODE OF 1954, § 1348.

Management will seek to obtain as much return on its investment as possible in the form of salaries, both for tax reasons and because salaries are a legitimate means of discriminating between insiders and outsiders. If the managing shareholders are content with the return on their investment taken in the form of salaries, they will be less likely to declare dividends which would benefit all of the shareholders. See generally 2 F.H. O'NEAL, CLOSE CORPORATION, supra note 42, § 8.08, at 58.


47 One of the prime problems for a shareholder seeking to bring an action for fraud or mismanagement against management is lack of evidence. Hale, Prevention by a Minority Shareholder of Waste and Mismanagement by the Majority, 33 Wis. B. BULL. 15 (June 1960).

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insiders in the purchase and sale of shares of stock. This rationale underlies the Securities Act of 1933’s provision for the registration of securities prior to sale and the Securities Exchange Act of 1934’s regulation of sales and purchases by the corporation, officers, directors, controlling persons, and other insiders. Disclosure puts the parties to a transaction on equal footing with regard to information material to that transaction.

Disclosure is essential to producing a market value for a share of stock which approximates as nearly as possible its intrinsic value. Securities do not have a readily apparent value. Rather, the price at which they are bought or sold depends upon investors’ estimates of the future earnings of the corporation, and such estimates are meaningful only when made by a person fully informed about all relevant factors. The more information that is available about the corporation, the closer the market price will be to the intrinsic value.

Disclosure aids in ensuring the efficient allocation of capital resources. Availability of information is a basic prerequisite to the optimal operation

49 Blumberg, supra note 6, at 1038; Knauss, A Reappraisal of the Role of Disclosure, 62 Mich. L. Rev. 607, 613-14 (1964); Schoenbaum, supra note 26, at 575-78.

50 Professor Francis defines “intrinsic value” as the true economic worth of a financial asset. This true economic worth depends on the earnings prospects of the firm, in light of anticipated economic conditions. It is the “true value” of the security and is unaffected by accounting variations or market disequilibriums (that is, temporarily inflated or deflated security prices).


Congress had this purpose in mind when it enacted the Securities Exchange Act of 1934.

No investor, no speculator, can safely buy and sell securities upon the exchanges without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells. The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings about a situation where the market price reflects as nearly as possible a just price. Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstructs the operation of the markets as indices of real value. There cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy. The disclosure of information materially important to investors may not instantaneously be reflected in market value, but despite the intricacies of security values truth does find relatively quick acceptance on the market.

H.R. Rep. No. 1383, 73d Cong., 2d Sess. 11 (1934). See also Knauss, supra note 49, at 613-14; Schoenbaum, supra note 26, at 575-78.


52 Knauss, supra note 49, at 610.

The value of the SEC and its disclosure requirements has been questioned by certain economists who feel that because of the timing and the type of disclosure insisted upon, with its emphasis on conservative accounting principles, the SEC has had no important effect on the quality of the securities on the market. See, e.g., Benston, The Effectiveness and Effects of the SEC’s Disclosure Requirements, in Economic Policy and the Regulation of Corporate Securities 23 (H. Manne ed. 1969); Stigler, Public Regulation of the Securities Market, 37 J. Bus. 117 (1964).
of the market in allocating capital throughout the economy. Moreover, in order for investors to allocate their savings efficiently, the parties to a transaction must have extensive information on securities offered and traded in order to assess available investment opportunities.\textsuperscript{53}

As the notion of corporate social responsibility gains greater recognition,\textsuperscript{54} it is also noteworthy that disclosure serves to trigger investor and public pressure with regard to such obligations.\textsuperscript{55} With this realization of the impact of corporations on American life has come a greater demand for disclosure of information.\textsuperscript{56}

III. EXTENSION OF DISCLOSURE TO SMALL CORPORATIONS

A. Benefits

Since the passage of federal securities legislation, the incidence of abuse by management tends to be concentrated in corporations which do not

\textsuperscript{53} See generally W. Baumol, The Stock Market and Economic Efficiency (1965); J. Francis, supra note 50, at 52-54; J. Van Horne, The Function and Analysis of Capital Market Rates 3-10 (1970). In this sense disclosure has a more profound effect where the capital to be accumulated or invested is substantial. However, in order to achieve true allocative efficiency, it is necessary to be concerned with the allocation of resources for even the smallest investors and corporations.

\textsuperscript{54} See generally W. Cary, supra note 11, at 237-43; Blumberg, supra; note 6; Schwartz, Towards New Corporate Goals, Co-Existence with Society, 60 Geo. L.J. 57 (1971).

\textsuperscript{55} Blumberg, supra note 6, at 1025-26; Knauss, supra note 49, at 647-48; Comment, supra note 48, at 1273-75.

Speaking of the role of disclosure as both a deterrent and a trigger for public pressure, Blumberg says,

Conduct that will prove embarrassing, if disclosed, is avoided; the possibility of future disclosure constitutes a major element in shaping prudent current decision. Further, greater dissemination of the facts inevitably leads to the development of more informed public opinion and more effective public pressures. Disclosure is not only a preventive but is an essential element in the public evaluation of corporate performance and in the determination of appropriate objectives for reform.

Blumberg, supra note 6, at 1026.

\textsuperscript{56} See Blumberg, supra note 6. This demand has been for information of both a financial and nonfinancial character.
disclose financial information on a regular basis.\textsuperscript{57} If these corporations were required to make disclosure to their shareholders, this incidence presumably would be lessened because there is little to indicate that disclosure requirements would not be as beneficial in deterring dishonest conduct in small corporations as it has been in larger corporations.\textsuperscript{58} In addition, the process of preparing and disseminating financial information to the shareholders each year serves as a reminder to corporate managers that they are the agents and fiduciaries of the corporation and of all the shareholders.\textsuperscript{59}

The absence of widespread markets for the shares of small corporations,\textsuperscript{60} restricts the opportunity for the shareholder of such a corporation to divest himself of his shares if the corporation pursues financial policies with which he is dissatisfied.\textsuperscript{61} To sell his interest, he must often make a financial sacrifice.\textsuperscript{62} Moreover, many shareholders in both large and small corporations are dependent upon the corporation in which they have invested for employment,\textsuperscript{63} but shareholders in small corporations often have a relatively larger personal stake in the venture than do shareholders in large corporations.\textsuperscript{64} Due to their greater stake and the lack of a ready

\textsuperscript{57} Special Study, supra note 8, pt. 3, at 10. The Special Study surveyed every reported case of fraud prosecuted under either securities act for a period of eighteen months subsequent to January 1961. Of the 107 corporations against which actions were brought, ninety-nine were corporations not subject to continuous reporting requirements and sixty-five of these had never submitted anything to the SEC.

\textsuperscript{58} Cf. Special Study, supra note 8, pt. 3, at 7-10.

\textsuperscript{59} Often in close corporations management tends to disregard the corporation as a distinct entity. See generally 2 F.H. O'Neal, Close Corporations, supra note 42, § 8.02, at 2. In Holi-Rest, Inc. v. Treloar, -Iowa-, 217 N.W.2d 517, 521 (1974), the court reports that Treloar testified,

\begin{quote}
Since the inception of this business, I have thought of this business as being my own and have pretty well dealt with it as my own. See also Baker v. Cohn, 42 N.Y.S.2d 159, 167 (Sup. Ct. 1942). This type of attitude can result in disregard of shareholders' interests.
\end{quote}

\textsuperscript{60} See generally 1 F.H. O'Neal, Close Corporations, supra note 42, § 1.07, at 22. See also Schwingle, Valuation of Closely Held Stocks, 100 Trusts & Estates 555, 557 (1961).

\textsuperscript{61} Schulman, supra note 12, at 599.

\textsuperscript{62} 1 F.H. O'Neal, Close Corporations, supra note 42, § 1.07, at 22. In part this is due to the lesser demand for shares of small corporations, both because cautious investors will be reluctant to invest in an enterprise without a market in which to divest themselves of their shares, and because small corporations tend to be less well-known than their larger counterparts.

\textsuperscript{63} See, e.g., Clark v. Dodge, 269 N.Y. 410, 199 N.E. 641 (1936) (upholding shareholders' agreement requiring plaintiff to be retained as general manager). See generally 1 F.H. O'Neal, Close Corporations, supra note 42, ch. 6.

\textsuperscript{64} In Galler v. Galler, 32 Ill. 2d 16, 27, 203 N.E.2d 577, 583-84 (1964), the court, speaking of a close corporation (which it defined as a corporation with few shareholders and little or no trading) said:

\begin{quote}
While the shareholder of a public issue corporation may readily sell his shares on the open market should management fail to use, in his opinion, sound business judgment his counterpart of the close corporation often has a large total of his entire capital invested in the business and has no ready market for his shares should he desire to sell. He feels, understandably, that he is more than a mere investor and that his voice should be heard concerning all corporate activity.
\end{quote}

See also 1 F.H. O'Neal, Close Corporations, supra note 42, § 1.07, at 21; Han-
market in which to dispose of their shares, many shareholders in a small
corporation have a more compelling need for corporate disclosure than do
shareholders of widely-held corporations.  

Disclosure breeds overall investor confidence, and aids in the formation
of capital. Small as well as large corporations benefit from securities
markets in which people have confidence that their investments will be
managed responsibly and that the results of the corporation's operations
will be reported to them. Reporting, in this sense, becomes more vital for
small corporations attempting to instill investor confidence because in-
vestors are faced with a diversity of choice among small corporations when
making investment decisions. Some of these are successful, well-managed
corporations, but are unknown to the investing public. Disclosure will make
investment decisions regarding these corporations easier.

Ascertaining the value of a share of stock through an examination of the
issuing corporation is a problem which faces those who trade in the shares
of either small or large corporations. Before the extension of federal dis-
closure requirements to unlisted securities, it was recognized by both the

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65 Cf. Schulman, supra note 12, at 599.

The argument that shareholders in small corporations lack access to markets in
which to divest themselves of their investment is not inconsistent with the argument
that sufficient trading goes on in the shares of some small corporations to justify
extension of disclosure on the rationale that it is necessary to protect those who
trade in such securities. See notes 70-75 and accompanying text infra.

In some corporations both of these characteristics are present. A significant amount
of trading exists, but not enough to ensure an escape route for dissatisfied share-
holders. Even in corporations where only one of these rationales applies, there is
still ample justification for requiring that disclosure be made to shareholders. Almost
by definition, every corporation, regardless of size, falls into one of these two
categories.

66 Feuerstein, The Corporation's Obligations of Disclosure Under the Federal
Securities Law When It is Not Trading in Its Stock, 15 N.Y.L.F. 385, 403-04 (1969);
Manning, Response in Economic Policy and the Regulation of Corporate Sec-

Dean Manning's view is that in enacting the federal securities laws, Congress
may have been seeking to restore lost public confidence in the securities markets
and that all other rationales may have been secondary to this purpose. Manning,
supra at 85.

67 Feuerstein, supra note 66, at 403-04.

68 Arguably, in a small enterprise all the investors either know each other or
realize that they should be on the alert before and after investing. It seems unrealistic
to assume, however, that all the shareholders of any but the most closely held
corporations will be familiar with those who control the corporation. Moreover, the
more widespread are investor interest and confidence, the easier it will be to attract
capital.

69 SPECIAL STUDY, supra note 8, pt. 3, at 7-10.

70 Congress extended disclosure requirements to securities of corporations having
more than 500 shareholders and one million dollars in assets which are traded over
the counter through passage of the Securities Acts Amendments of 1964, Act of
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Special Study \(^{71}\) and commentators \(^{72}\) that the value achieved by disclosure in market trading of shares listed on the national exchanges could also be achieved in trading of unlisted shares. \(^{73}\) Whenever a share of stock is traded at least two parties must in effect compute the value of the corporation, \(^{74}\) whether the corporation is large or small. Moreover, many small companies are actively traded, \(^{75}\) and even when a corporation's stock is inactively traded, ready availability of information is necessary if trades are to be made efficiently.

The social responsibilities of small corporations are not as commonly recognized as those of larger corporations. There are corporations not presently subject to disclosure, however, which strongly influence the economic and social climate of this country. \(^{76}\) The Special Study found that, especially in corporations with a small number of shareholders, there is no significant relationship between number of shareholders and asset size. \(^{77}\) In fact, there are a significant number of large, well-known companies with a sufficiently small number of shareholders to exempt them from required

\(^{71}\) The Special Study said,

The basic principles which impelled Congress to establish the disclosure, proxy, and insider-trading protections for investors in listed securities are equally applicable to the over-the-counter market. There is nothing in the mechanics of the market place which calls for protection in one case and not in the other. The need for accurate information as a basis for investment decisions and as a bulwark against fraud and manipulation, the desirability of providing a basis for at least minimum corporate democracy, and the dangers of misuse by insiders of confidential corporate information are as great in one as in the other.

\(^{72}\) See, e.g., Knauss, supra note 49, at 626.

\(^{73}\) Some indication that disclosure of financial information is beneficial in assessing the value of shares of stock can be drawn from the fact that the ascertainment of such value is considered a proper purpose for inspection of the corporation's books and records. See, e.g., State ex rel. Rogers v. Sherman Oil Co., 31 Del. 570, 117 A. 122 (Sup. Ct. 1922).

\(^{74}\) Cf. Knauss, supra note 49, at 626.

\(^{75}\) One of the inquiries of the Special Study, supra note 8, pt. 3, at 20-23, was the extent of trading in stock of corporations with varying numbers of shareholders. Lacking more reliable data, the study used as its indicator of trading activity the number of recorded transfers which took place during the year, realizing that this figure was not completely accurate but believing that it would furnish a reliable standard. The study found that it was not until the level of 200 shareholders was reached that more than one-half of the corporations studied reported at least twenty-five record transfers in the year. However, one corporation with less than twenty-five shareholders reported between 200 and 499 transfers, and one corporation with fewer than 100 shareholders reported between 500 and 999 transfers. The data contained in Table IX-a, id., pt. 3, at 21, shows that some record transfers take place even in corporations with a small number of shareholders. Knauss, supra note 49, at 626, interprets this data to indicate that "companies with 200 or more shareholders should probably be included under the disclosure requirements."

\(^{76}\) See note 78 infra. Until 1955, the Ford Motor Company had no public ownership of its shares. All of the voting stock was held by members of the Ford family. 1 F.H. O'Neal, Close Corporations, supra note 42, § 103, at 7.

\(^{77}\) Special Study, supra note 8, pt. 3, at 26.
financial disclosure. In these corporations, as well as the more typical small corporation, monitoring of the actions of management should take place. Shareholders are in the best position to perform that role but they require information with which to undertake the task.

Other benefits of an indirect nature would follow from the extension of disclosure requirements to small corporations. Compulsory disclosure has an impact on the quality and quantity of information contained in disclosures which are not required. Large corporations which must make accurate reports of specific information tend to also make accurate statements in nonrequired disclosures, such as press releases and reports to shareholders. In this way even minimal disclosure requirements can have a substantial impact.

Although shareholders enjoy a common law right to inspect the books and records of a corporation in which they own shares, that right is not a sufficient disclosure device even in a small corporation where inspection is more feasible than in a large corporation. Management can often stall or impede the progress of an interested shareholder, forcing him to resort to action in the courts to compel the corporation to grant access to the books. Moreover, exercise of the right requires affirmative action by the shareholder, deterring exercise of the right in some cases. Required dis-
Disclosure would place financial information before all of the shareholders, not simply those who chose to and could afford to avail themselves of the inspection right.

Disclosure, however, should not completely supplant inspection, even though its adoption would probably lessen resort to this right. Any information disclosed will not be as complete as the information contained in the books and records themselves, and some shareholders will always desire this more comprehensive data. Inspection will also enable shareholders to determine whether the information disclosed is accurate. Where the information disclosed is not accompanied by the opinion of an independent public accountant the availability of such verification may be especially useful.

B. Burdens

Several arguments have been raised in opposition to the extension of disclosure requirements to small corporations. The most commonly advanced, and probably the most persuasive, is that compliance with disclosure requirements would place a heavy financial and administrative burden on the small corporation. For this reason the Special Study did not urge the extension of federal securities regulation to corporations with less than 300 shareholders. However, required disclosure of a more simplified nature than that considered by the Special Study would be less vulnerable to such an objection.

The cost of any disclosure requirement will vary with the type of preparation and degree of verification required. When this is coupled with the variety of corporations, it becomes impossible to estimate with great certainty the dollar cost of required disclosure. However, it is reasonable to estimate that the cost to a small corporation of having outside personnel prepare financial statements could range from a few hundred dollars for the preparation of a tax return and unaudited financial statements prepared from this return, to several thousand dollars for the preparation of audited financial statements accompanied by a public accountant’s opinion regard-

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a situation in which relatively meager use is made of the reports by the financial community.

Id. at 34.

The cost and time involved in exercising the right to inspection, together with the baffling complexity of financial records before they have been distilled and organized, further decreases the value of the right to inspection as a disclosure device.

87 N. Lattin, The Law of Corporations 349 (2d ed. 1971). But see Nev. Rev. Stat. § 78.257 (1971), which gives a statutory right of inspection to any 15 percent shareholder but does not extend the section to the shareholder of any corporation listed and traded on any recognized exchange or of any corporation which “furnishes to its stockholders a detailed, annual financial statement.”

88 N. Lattin, supra note 87, at 349.

89 Id.

90 See note 128 and accompanying text infra.

91 See, e.g., Jenkins Report, supra note 31, §§ 58-61, at 20-22; Benston, supra note 52, at 64.

92 See Harris, supra note 29, at 204.

93 Special Study, supra note 8, pt. 3, at 17, 33-35.
ing the financial statements.\textsuperscript{94} In the former case, the marginal cost of requiring financial statements prepared on the basis of a corporation's tax return\textsuperscript{95} is minimal since the corporation must prepare and submit a tax return even without the requirement of disclosure. In light of the expected benefits of required disclosure, a slight burden on the corporation should not be a sufficient argument to defeat the enactment of disclosure requirements.\textsuperscript{96}

It is also argued that disclosure of the remuneration paid to officers and directors, and other aspects of the affairs of small corporations, would open up an essentially private matter to the view of the community.\textsuperscript{97} This argument may have validity in a purely family corporation, or one in which the shareholders are all active in management, but loses some of its force whenever there are outside shareholders. Whenever there are public shareholders, those not actively involved with the day-to-day activities of the corporation, it can be argued there is a greater need for the protective benefits of required disclosure.\textsuperscript{98} As a practical matter such information is already available to shareholders, either through their right to inspect the corporation's books and records,\textsuperscript{99} or through the right of a 1 percent shareholder to examine the income tax returns of his corporation.\textsuperscript{100} Ultimately, consideration of this issue involves a balancing of the protections necessary for outside shareholders against the interest of the corporation and corporate officers in privacy. The Jenkins Committee implicitly resolved this in favor of shareholder protection when it recommended the abolition of the "exempt private company" in England.\textsuperscript{101}

Finally, it is argued that there is a risk of "snooping" by competitors of a small company, and that disclosure of items such as sales and net profit margin of a small corporation might be used to great advantage by a larger

\textsuperscript{94} Telephone interview with a C.P.A., practicing in St. Paul, Minnesota, Dec. 25, 1975. His estimates are based on a familiarity with auditing procedures for both large and small corporations.

\textsuperscript{95} See notes 129-33 and accompanying text infra.

\textsuperscript{96} Blumberg, \textit{supra} note 6, at 1053-54, points out that the exercise of a shareholder's right to inspection inevitably disrupts the operations of a corporation while the inspection takes place since it requires physical marshalling of the books and records of the corporation for the shareholder and requires corporate personnel to supervise the inspection process. This must be done largely at the convenience of the shareholder since the corporation must comply with the request for inspection within a reasonable time.

An affirmative disclosure requirement would help to relieve this burden in two ways. A system of annually required disclosure should lessen the incidence of the exercise of inspection rights by shareholders. N. LATTIN, \textit{supra} note 87, at 349. If this is the case, then in making disclosure to its shareholders the corporation will be able to control the inevitable disruption and allocate its resources more efficiently in making the disclosure.

\textsuperscript{97} JENKINS REPORT, \textit{supra} note 31, § 59, at 20-21; Benston, \textit{supra} note 52, at 64.

\textsuperscript{98} See \textit{SPECIAL STUDY}, \textit{supra} note 8, pt. 3, at 17; \textit{cf. id.} pt. 3, at 33.

\textsuperscript{99} See note 24 and accompanying text supra.

\textsuperscript{100} INT. REV. CODE OF 1954, § 6103(c).

\textsuperscript{101} JENKINS REPORT, \textit{supra} note 31, § 63, at 22; Harris, \textit{supra} note 29, at 204-5.
Disclosure by Small Corporations

It can be countered that such a risk is minimal with respect to the type of information required by proposals for financial disclosure, but, if this risk is considered significant, it again becomes necessary to balance the interests of the shareholder and those of the corporation. This argument, too, was implicitly rejected by the Jenkins Committee. In any case, if the competitor is intent upon gaining access to such information, he can, under current law, become a shareholder of the corporation and obtain information by exercising the right to inspect corporate books and records or by inspecting the corporation's income tax return. The fact that the shareholder requesting information is also a competitor is not enough in itself to defeat an otherwise valid purpose for inspection. Even if a competitor is not a shareholder, it may have access to this information through a shareholder.

If the possibility that the information disclosed will be used by competitors to their advantage or that the information is truly of a private nature is considered significant, it would be possible to require that disclosure be made only to shareholders, or to allow an administrative agency or the courts to order the filed documents to be kept confidential when cause is shown. Disclosure only to shareholders does not eliminate the possibility that such information will become public or fall into the hands of competitors, but it would reduce the possibility of unnecessarily broad public dissemination.

102 Jenkins Report, supra note 31, § 59, at 20; Benston, supra note 52, at 64.
103 See 1 F.H. O'Neal, Close Corporations, supra note 42, § 3.63, at 90, which concludes with respect to the right to inspect that the risk of snooping by competitors is minimal in a close corporation.
104 See note 101 supra.
105 See notes 24, 100 and accompanying text supra.
107 Cf. State ex rel. Paschall v. Scott, 41 Wash. 2d 71, 247 P.2d 543 (1952). In this case a shareholder of a corporation was denied a writ of mandamus to inspect books and records relating to marketing practices, sales, and customers. She had initiated contact with competitors of the corporation and intended to communicate information she garnered from her examination to such competitors. The court felt that she had an interest contrary to the best interests of the corporation and denied her the writ.
108 In Michigan, every corporation is required to distribute a "statement of income" to its shareholders at least once a year, but this statement is not required as part of the report to be filed with the state and open to the public. Compare Mich. Comp. Laws Ann. § 450.1901 (1973) with Mich. Comp. Laws Ann. §§ 450.1911, 450.1915 (1973).
A proposal\textsuperscript{110} that corporations of all sizes be required to mail a financial statement to their shareholders within 120 days of the end of their fiscal year was formulated in 1975 as a suggested amendment to section 52 of the Model Business Corporation Act.\textsuperscript{111} This financial statement could be prepared either on the basis of generally accepted accounting principles, or, if the books of the corporation were not kept on that basis, then on the same basis as that used to prepare the corporation's income tax return.\textsuperscript{112}

This proposal implicitly recognizes the value of financial disclosure by small corporations, and is a step in the right direction, but a more extensive disclosure requirement would have additional beneficial effects. For that reason it is useful to consider the outlines of the more thoroughgoing disclosure proposal presented below.\textsuperscript{113}

\section*{A. Contents of Financial Report}

Shareholders in every corporation are entitled to financial information through the medium of annually disseminated financial reports about the corporation. With the limited exceptions described below,\textsuperscript{114} every corporation should be required to report this information to its shareholders at least once a year. The form of this report should be less elaborate than SEC Form 10-K\textsuperscript{115} and should resemble the annual reports presently prepared by major American corporations covered by SEC rules. These annual reports are recognized as being more widely read by the average investor than are other required disclosures,\textsuperscript{116} and it should be the goal of disclosure to provide information which will come to the attention of investors and serve a wide variety of their needs.\textsuperscript{117} The contents of the report should be clearly delineated so that corporate management knows what it must disclose.\textsuperscript{118} By operating on this "bright-line" principle it will

\begin{itemize}
\item\textsuperscript{110} Buxbaum, Stark & Scriggens, Memorandum to the Corporate Laws Committee of the American Bar Association, Feb. 11, 1975 (rev. March 8, 1975) [hereinafter cited as Buxbaum].
\item\textsuperscript{111} ABA-ALI Model Bus. Corp. Act § 52 (1971).
\item\textsuperscript{112} Buxbaum, supra note 110.
\item\textsuperscript{113} Another proposal to extend disclosure requirements to any "publicly-held" corporation is contained in Schulman, supra note 12.
\item\textsuperscript{114} See notes 139-44 and accompanying text infra.
\item\textsuperscript{115} SEC Form 10-K, 17 C.F.R. § 249.310 (1975), cited in R. Jennings & H. Marsh, Selected Statutes, Rules and Forms Under the Federal Securities Laws 483-95 (1975). If the form of the report were simplified, disclosure would be less of a burden on the small corporation and the force of one of the arguments against disclosure in small corporations also would be lessened. See notes 92-96 and accompanying text supra.
\item\textsuperscript{116} See Kant, The New Annual Report to the Shareholders, 20 Vill. L. Rev. 273 (1975); Sommer, supra note 11, at 1097-1100.
\item\textsuperscript{117} SPECIAL STUDY, supra note 8, pt. 3, at 59-60. See Axelson, A Businessman's Views on Disclosure, J. Acctncy., July, 1975, at 42-46. See generally note 86 supra.
\item\textsuperscript{118} Comment, supra note 48, at 1276.
\end{itemize}
also be easier to evaluate the degree of management compliance.

The report should include items which go beyond those normally disclosed in the annual reports of major corporations in order to more fully serve the purposes of disclosure. The following items should be considered for inclusion in the contents of such a report:

1. A statement of the major activities of the corporation and any changes in such activities. The shareholder has a right to know the areas in which his corporation is operating.

2. The identity of the executive officers and directors, the stock holdings of each of these individuals, and the identity of all shareholders whose interest exceeds a specified percentage. The shareholder also has a right to know who is in control of the corporation in which he has an interest.

3. A statement of profit and loss (income statement) and a comparative balance sheet which accurately reflects the financial condition of the corporation. This financial information is the cornerstone of any disclosure requirement. Many shareholders make their investment decisions solely on the basis of financial information and it is here that mismanagement and shareholder victimization will often be revealed. Financial information is also recognized as essential to a proper valuation of shares of stock.

4. The salaries paid to all shareholders who are officers or directors of the corporation, and of all officers who receive more than a specified amount. If managing shareholders wish to receive a larger return on their investment to the exclusion of other shareholders they will often do so through the vehicle of excessive compensation.

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120 See, e.g., SEC Form 10-K Items 8, 11, 12, 17 C.F.R. § 249.310 (1975), cited in R. Jennings & H. Marsh, supra note 115, at 489-90; Companies Act 1967, c. 81, §§ 6, 8.

In a state which allows cumulative voting for directors this percentage should be the least amount necessary to guarantee the shareholder the power to elect one director. In other states this percentage must be set somewhat arbitrarily, since the degree of control which one can exercise in a corporation varies with the size of the corporation. In a corporation with only two shareholders a holder of 49 percent of the stock can exercise little control. However, in a corporation with a larger number of shareholders a much smaller holding of stock will often be sufficient to exercise significant control.


English companies must disclose the compensation of employees who receive over £10,000 (approximately $20,000 at current exchange rates). SEC Form 10-K requires the corporation to disclose each director whose remuneration exceeds $40,000 and the three highest paid officers whose remuneration exceeds that amount.

124 See notes 43-44 supra; Schwingle, supra note 60, at 557.
holders should be informed of officers' and directors' compensation so that they can challenge excessive amounts.

5. A disclosure of all substantial transactions between the corporation and individuals who are shareholders of the corporation or corporations in which those individuals have a substantial interest. While many of these contracts will withstand scrutiny, there are contracts which shareholders will wish to attack on the basis of unfair self-dealing.

6. A calculation of "earnings per share" and "book value per share." While these figures are largely the result of a mechanical calculation, once the data on which they depend are revealed, they are often used by investors as short-cut indicators of performance.

7. A statement of the accounting standards used to keep the books and prepare the statements. In reading and understanding these data it is essential that the shareholder know the basis on which they are prepared.

8. A statement by an independent public accountant, or the president or treasurer of the corporation, that the disclosed reports accurately reflect the financial condition of the corporation.

B. Accounting Standards

Those corporations to which disclosure requirements will be extended for the first time by this proposal need not necessarily be compelled to keep their records in accordance with generally accepted accounting principles (GAAP). GAAP have the advantage of a large measure of consistency developed by the SEC and the accounting profession over many years, but it is also possible for the books and records to be kept in

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126 Earnings per share is a required disclosure on Form 10-K. SEC Form 10-K Item 2, 17 C.F.R. § 249.310 (1975), cited in R. Jennings & H. Marsh, supra note 115, at 486.

127 This idea has been incorporated into the opinions of the Accounting Principles Board.

When financial statements are issued purporting to present fairly financial position, changes in financial position, and results of operations in accordance with generally accepted accounting principles, a description of all significant accounting policies of the reporting entity should be included as an integral part of the financial statements.


129 One of the arguments against extending disclosure requirements to small corporations is the burden that would be placed on them by requiring them to conform to standard accounting practices. Harris, supra note 29, at 204.

accord with other standards which accurately reflect the financial condition of the corporation.\textsuperscript{131}

The proposal submitted to the Corporate Laws Committee of the American Bar Association would allow the preparation of the financial statements either on the basis of GAAP, or on the same basis as that used for filing of the corporation's income tax return.\textsuperscript{132} This would lessen the burden of disclosure requirements on small corporations not currently using GAAP, but would at the same time provide some measure of consistency and uniformity for similarly situated companies. Since there are differences in the standards sanctioned by these two methods,\textsuperscript{133} the statements of a company prepared on the basis of GAAP would reflect certain differences from a statement prepared by a similar, or even the same, company on the basis of tax accounting standards. Resort to tax accounting standards, however, would eliminate any need on the part of the corporation to keep two sets of books, one for use in the preparation of annual reports to be disseminated to the shareholders and the other for tax purposes.

It might be desirable to enact different standards for corporations of different sizes. Many legislatures have recognized,\textsuperscript{134} as often is evidenced

\textsuperscript{131} Maine requires that financial statements be prepared in accordance with sound accounting practices:

3. Not later than 5 months after the close of each fiscal year, each corporation which is not a close corporation [one with twenty or fewer shareholders] shall prepare, in accordance with good accounting practices, a balance sheet . . . and a profit and loss statement . . . .

\textsuperscript{132} Cf. OHIO REV. CODE ANN. § 1701.38(B) (Page Supp. 1974).


A committee of accountants has recognized that such differences exist because of the different functions of the two systems. Congress and the IRS are concerned with the collection of revenue and other matters of fiscal policy. The accounting profession and shareholders are interested in an accurate measure of business performance. The committee felt that Congress should move towards the adoption of GAAP for tax purposes as nearly as possible, but that notwithstanding the tax laws, the accounting profession should continue to use GAAP in the preparation of financial statements. Committee on Concepts and Standards Underlying Corporate Financial Statements, \textit{Accounting Principles and Taxable Income Supplementary Statement No. 4}, 27 ACCTG. REV. 427 (1952). Recognition of the different purpose underlying the accounting standards required by the tax laws should be considered in any proposal which would allow the substitution of tax accounting principles for GAAP. If, however, the choice narrows to one of allowing the use of tax accounting principles for required disclosure, or of not requiring disclosure at all because of the burden caused by requiring small corporations to conform to GAAP, the former alternative would be preferable.

\textsuperscript{134} Cf. W. CARY, supra note 11, at 362-63.
by separate close corporation statutes,\textsuperscript{135} that not all corporations need to be similarly treated.\textsuperscript{136} It is not unreasonable to suggest, therefore, that corporations of different sizes, either in terms of number of shareholders or asset size, meet different standards of disclosure. For instance, corporations with a larger number of shareholders or greater assets could be required to prepare their financial statements on the basis of GAAP, while corporations with lesser assets or fewer shareholders could be given the option of choosing the method to use.\textsuperscript{137} Similarly, large corporations might be required to have their reports "certified" by an independent public accountant while other corporations could merely include the opinion of an officer of the corporation that the statements are accurate.\textsuperscript{138} Although it can be argued that this would make disclosure requirements more complex administratively, and that the line between larger and other corporations must be drawn arbitrarily, this would be another way to lessen the force of the argument that the burden of disclosure will fall most heavily on small corporations with few shareholders to protect.

C. Provision for Waiver

In certain corporations, disclosure would not be necessary.\textsuperscript{139} The clearest example would be a corporation with only a few shareholders, all of whom are active in its management.\textsuperscript{140} As a general rule, corporations in this category tend to be small both in terms of number of shareholders, and in terms of assets and complexity of operations. These corporations should be excused from the requirements of disclosure.

However, rather than deciding that a corporation with an arbitrarily chosen number of shareholders is exempt from disclosure requirements,\textsuperscript{141} release should be affected on a case-by-case basis. Any corporation which

\textsuperscript{137} See notes 129-33 and accompanying text supra.
\textsuperscript{138} See note 128 and accompanying text supra.
\textsuperscript{140} Schulman, supra note 12, at 616-17, proposes the extension of annual disclosure requirements to any corporation whose securities are "publicly held." He arbitrarily draws this line at twenty-five shareholders. No corporation with fewer shareholders would be considered publicly held, although a corporation with more than twenty-five shareholders could petition to have itself exempted from the requirement.
\textsuperscript{141} Even where all the shareholders of a corporation are in its employ, however, there remains the possibility that they will be unaware of all of its operations, and may still benefit from disclosure. Cf. 1 F.H. O'Neal, Close Corporations, supra note 42, § 3.63, at 89.
\textsuperscript{141} See note 139 and accompanying text supra.
seeks to excuse itself from the requirements of disclosure should be required to obtain the unanimous consent of its shareholders. If it does not procure this waiver from all of its shareholders, it should be required to make disclosure, at least to those shareholders who refuse to waive their right to disclosure.\textsuperscript{142} Some states have allowed corporations to exempt themselves from disclosure requirements through enactment of a by-law.\textsuperscript{143} This procedure, however, continues to leave a minority shareholder at the mercy of the majority and underscores the need for a unanimous waiver.\textsuperscript{144}

Once a waiver has been given, it cannot be assumed that the conditions on which the shareholder relied in making the waiver will continue to exist. The shareholder should be protected either by allowing him to revoke his waiver upon reasonable notice to the corporation, or by making the waiver valid for a limited time with a requirement that the waiver be reestablished periodically.

The above proposal for required disclosure with the limited exemption from disclosure procured through waiver protects shareholders of even the smallest corporations while not unduly burdening corporations where such protection is unnecessary. Corporations, which legitimately seek to be excused from the requirements of disclosure can do so with the permission of their shareholders. Shareholders in other corporations, no matter how small, will still be protected by the disclosure requirements.

\textit{D. Implementation}

Disclosure requirements could be implemented under either federal\textsuperscript{145} or state law, but state implementation would be preferable for several reasons.

\begin{itemize}
\item \textsuperscript{142} The proposal before the Corporate Laws Committee, Buxbaum, \textit{supra} note 110, contains a paragraph which would allow any shareholder to waive submission of the financial statement. Adoption of this paragraph is not recommended by the authors of the proposal. If the proposal is adopted without this paragraph, every corporation will be required to disclose.
\item \textsuperscript{143} \textit{See} note 13 \textit{supra}.
\item \textsuperscript{144} In Finberg v. Coin Automatic Laundry Equipment Co., Inc., 54 Pa. D. & C.2d 644, 649 (C.P. Delaware County 1971), a preliminary injunction against the holding of a shareholders meeting at which an amendment to the by-laws which would have removed the requirement of sending financial reports to the shareholders was to be voted on was dissolved. The suit had been brought by a minority shareholder who owned 29 percent of the stock. The court affirmed the right of the corporate majority to amend the by-laws to remove the requirement.
\item \textsuperscript{145} Implementation under federal law might be challenged on the basis that some small corporations do not engage in interstate commerce. If this contention is accepted, federal implementation would be beyond the enumerated powers granted to Congress. However, the interstate commerce requirement has generally been accorded an expansive interpretation by the Supreme Court. \textit{See}, e.g., Katzenbach v. McClung, 379 U.S. 294 (1964); Heart of Atlanta Motel, Inc. v. United States, 379, U.S. 241 (1964).
\item \textit{See also} 15 U.S.C. § 78l(g)(1) (1970), which states:
\begin{itemize}
\item Every issuer which is engaged in interstate commerce, or in a business affecting interstate commerce, or whose securities are traded by use of the mails or any means or instrumentality of interstate commerce shall
\end{itemize}
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\item register such security.
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reasons. The federal government has the administrative experience necessary in the SEC to implement such a disclosure program, but the extension of disclosure, under requirements similar to those now in force, would result in a greatly increased administrative burden.\textsuperscript{146} One method of relieving this burden might be to eliminate the need for small corporations to “file” their reports with the SEC and only require that they be sent to the Commission as is now done with annual reports.\textsuperscript{147} But even that procedure may be too cumbersome when one considers that more than 99 percent of United States corporations are not now reporting information to the SEC.\textsuperscript{148} In addition to this practical limitation, it can be argued that further intrusion by the federal government into the affairs of small corporations should be halted, and that states stand in the proper relation to such corporations to implement a disclosure proposal.\textsuperscript{149} Although disclosure requirements for large corporations have been accepted as properly within the federal sphere, other aspects of corporation law have traditionally been handled at the state level.\textsuperscript{150}

Disclosure provisions can be enacted at the state level;\textsuperscript{151} as a general rule, however, the vast majority of states have shown a reluctance to enact provisions of this type, spurred perhaps by a competitive quest for incorporation and franchise fees.\textsuperscript{152} The correct solution may lie in implementation through the states, subject to specific minimum standards enacted by federal legislation.\textsuperscript{153} This approach would insure some minimum level of disclosure without excessive encroachment of the federal government into the affairs of small corporations, although federal legislation of this type might also run afoot of the commerce clause.\textsuperscript{154}

V. CONCLUSION

A large majority of corporations in this country are not compelled to disclose financial information to their shareholders. In the absence of such a requirement, shareholders frequently receive no, or at best incomplete, financial information on the corporations in which they have invested. Non-disclosure leads to situations which make it easier for management to violate its fiduciary duties to its shareholders and makes valuation of shares in such corporations difficult.

\textsuperscript{146} Schulman, supra note 12, at 591-92; see SPECIAL STUDY, supra note 8, pt. 3, at 17, 61.

\textsuperscript{147} See Kant, supra note 116, at 277, 291; cf. Knauss, supra note 49, at 626-27.

\textsuperscript{148} See note 8 supra.

\textsuperscript{149} Schulman, supra note 12, at 588-89.

\textsuperscript{150} Professor Cary notes, In the management of corporate affairs, state statutory and case law has always been supreme, with federal intrusion limited to the field of securities regulation.

Cary, supra note 23, at 663.

\textsuperscript{151} See note 12 supra.


\textsuperscript{153} See Cary, supra note 23; cf. Schulman, supra note 12, at 590.

\textsuperscript{154} See note 145 supra.
The purposes which led to the enactment of federal disclosure requirements for major corporations, and the benefits which justify their continuation today, apply with substantial force to smaller corporations. The type and form of required disclosure can be shaped to minimize the force of arguments which weigh against disclosure.

This article has offered a proposal for required disclosure which would extend to all corporations, with the exception of those whose shareholders waive this disclosure. The recognized benefits of disclosure should prompt states to enact legislation which will ensure that these benefits are enjoyed by all investors.

—Russell J. Bruemmer