Changes in the Model Business Corporation Act—Proposed Amendments to Chapter 16

By the Corporate Laws Committee, ABA Business Law Section

The Corporate Laws Committee of the ABA Business Law Section (the “Committee”) from time to time develops and proposes changes to the Model Business Corporation Act (the “Act”).

The Committee has approved, on a second reading, amendments to section 16.20 and to certain provisions of other sections of chapter 16 of the Act (the “Amendments”) that address, among other things, the obligations of corporations to make financial statements available to shareholders, the maintenance of corporate records, and the inspection rights of shareholders and directors of corporations. The Committee invites comments on the Amendments, which should be addressed to Karl John Ege, Chair, Corporate Laws Committee, 1201 3rd Avenue, Suite 4900, Seattle, Washington 98101, or sent to him by email at kege@perkinscoie.com. Comments should be received by May 20, 2016, in order to be considered by the Committee before adoption of the Amendments.

Section 16.20, as proposed to be amended, requires a corporation, upon the written request of a shareholder, to deliver or make available annual financial statements. However, as amended, section 16.20 will no longer (1) require a corporation to prepare formal financial statements for purposes of delivering or making them available to a shareholder; (2) provide normative standards for the preparation of financial statements, in recognition that whether a corporation prepares financial statements and the form of any such financial statements depend on the nature and complexity of the corporation’s business and the requirements of third parties such as banks, suppliers, and taxing authorities.\(^1\)

The Amendments also include corresponding changes to the provisions of chapter 16 regarding the maintenance of financial statements and the right to inspect financial statements and accounting records upon demand by shareholders or directors of a corporation. The Amendments also reorganize and, in some instances, revise the provisions of chapter 16 addressing the maintenance of corporate records and the inspection rights of shareholders and directors to more

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1. The amendments to section 16.02 will also require amendments to the references in sections 13.20 and 13.24 to the financial statements currently specified in section 16.02. The Committee will be proposing such changes as part of a forthcoming overall revision of the Act.
closely reflect modern recordkeeping practices and the balance between the in-
terests of the corporation and the interests of the shareholder with respect to
c confidential or competitively sensitive information.

The Amendments are set forth below. Changes to the existing provisions are
marked with deletions shown by strikeouts and additions by double underscor-
ing. The unmarked text of chapter 16, as proposed to be amended, follows the
marked version.

Records and Reports

Subchapter A.

RECORDS

§ 16.01. Corporate records
§ 16.02. Inspection rights of records by shareholders
§ 16.03. Scope of inspection right
§ 16.04. Court-ordered inspection
§ 16.05. Inspection rights of records by directors
§ 16.06. Exception to notice requirements

Subchapter B.

REPORTS

§ 16.20. Financial statements for shareholders
§ 16.21. Annual report for secretary of state

Subchapter A.

RECORDS

§ 16.01. Corporate records

(a) A corporation shall keep as permanent records minutes of all meetings of
its shareholders and board of directors, a record of all actions taken by the
shareholders or board of directors without a meeting, and a record of all
actions taken by a committee of the board of directors in place of the
board of directors on behalf of the corporation.

(b) A corporation shall maintain appropriate accounting records.

(c) A corporation or its agent shall maintain a record of its shareholders, in a
form that permits preparation of a list of the names and addresses of all
shareholders, in alphabetical order by class of shares showing the number
and class of shares held by each.
(d) A corporation shall maintain its records in the form of a document, including an electronic record or in another form capable of conversion into paper form within a reasonable time.

(e) A corporation shall keep a copy of the following records at its principal office:

1. its articles or restated articles of incorporation, all amendments to them as currently in effect, and
2. any notices to shareholders referred to in section 1.20(k)(5) regarding facts on which a filed document is dependent if those facts are not included in the articles of incorporation or otherwise available as specified in section 1.20(k)(5);
3. its bylaws or restated bylaws and all amendments to them as currently in effect;
4. resolutions adopted by its board of directors creating one or more classes or series of shares, and fixing their relative rights, preferences, and limitations, if shares issued pursuant to those resolutions are outstanding;
5. the minutes of all shareholders’ meetings, and records of all action taken by shareholders without a meeting, for the past three years;
6. all written communications within the past three years to shareholders generally within the past three years, including the financial statements furnished for the past three years under section 16.20;
7. minutes of all meetings of, and records of all actions taken without a meeting by, its shareholders, its board of directors, and board committees established under section 8.25;
8. a list of the names and business addresses of its current directors and officers; and
9. its most recent annual report delivered to the secretary of state under section 16.21.

(b) A corporation shall maintain all annual financial statements prepared for the corporation for its last three fiscal years (or such shorter period of existence) and any audit or other reports with respect to such financial statements.

(c) A corporation shall maintain accounting records in a form that permits preparation of its financial statements.

(d) A corporation shall maintain a record of its current shareholders in alphabetical order by class of shares showing the number and class of shares held by each shareholder.
A corporation shall maintain the records specified in this section in a manner that may be made available for inspection within a reasonable time.

CROSS-REFERENCES

Articles of incorporation, see § 2.02.
Articles of amendment, see § 10.06.
Bylaws, see § 2.06, ch. 10B.
Committees of board of directors, see § 8.25.
“Deliver,” see § 1.40.
Directors’ action without meeting, see § 8.21.
Inspection of corporate records, see §§ 16.02 & 16.04.
Meetings of board of directors, see § 8.20.
Officers, see § 8.40.
“Principal office”: defined, see § 1.40.
designated in annual report, see § 16.21.
Reports of corporation, see §§ 16.20–16.21.
Restatement of articles of incorporation, see § 10.07.
Series of shares, see § 6.02.
Shareholders’ action without meeting, see § 7.04.
Shareholders’ meeting, see §§ 7.01–7.03.
Shareholders’ voting list, see § 7.20.

OFFICIAL COMMENT

Section 16.01 describes in general terms the records every corporation must keep or maintain, the form in which they may be maintained, and, to a limited extent, where the records must be kept.

1. RECORDS TO BE MAINTAINED

Section 16.01(a) requires certain basic records to be maintained by the corporation. The Act does not generally specify how records must be maintained other than in a manner in which they may be made available for inspection within a reasonable time, where they must be located or, with the exception of section 16.02(a), where they must be available. They may be maintained in one or more offices within or without the state and, in some cases, such as shareholder records, may be maintained by agents of the corporation; indeed, in the case of records in nonwritten form, it may be impossible to determine “where” they are located.
2. MINUTES AND RELATED DOCUMENTS

Section 16.01(a) requires a corporation to “keep” as permanent records the minutes of meetings of its shareholders and board of directors, and a record of actions taken by consent by its shareholders or board of directors. In addition, each corporation must “keep” a record of all actions taken by a committee of the board of directors when acting on behalf of the board of directors for the corporation; this includes, for example, action taken by an executive committee between meetings of the board and final action of a special litigation committee authorized to act on behalf of the board. Section 16.01(a) does not require a record of actions taken by a committee when the committee is not acting in place of the board of directors, e.g., when the committee is discussing policy and formulating recommendations for action by the board of directors. Also, it does not require either minutes or a record of committee deliberations under any circumstances. Committee meetings are preserved as forums for open and frank discussion and discussion of sensitive corporate data without fear of recordation or disclosure.

Section 16.01 also does not address the amount of detail that should appear in the minutes of meetings of shareholders or the board of directors—the content of minutes is largely fixed by tradition and no inference about their content should be drawn from the section’s treatment of the records of committee deliberation and action.

2. SHAREHOLDERS’ LISTS

Section 16.01(a) does not address the amount of detail that should appear in minutes or written actions. Minutes of meetings customarily include the formalities of notice, the time and place of the meeting, those in attendance, and the results of any votes. Minutes of meetings and written actions without a meeting show formal action taken. The extent to which further detail is included is a matter of judgment which may depend upon the circumstances. Section 7.04, which addresses written actions taken by shareholders, requires that written actions by shareholders be delivered to the corporation for filing with corporate records.

3. FINANCIAL STATEMENTS AND ACCOUNTING RECORDS

The Act does not provide normative standards for the financial statements and accounting records to be prepared or maintained. The financial statements to be maintained under section 16.01(b) are those that the corporation prepares in the operation of its business, including in response to third party requirements. The form of the financial statements prepared by a corporation depends to some extent on the nature and complexity of the corporation’s business and third party requirements such as those governing the preparation and filing of tax returns with applicable tax authorities. To accommodate the needs of the many different types of business corporations that may be subject to these provisions, including closely held corporations, the Act does not require that the corporation prepare and maintain financial statements on the basis of generally accepted accounting principles (“GAAP”) if it is not otherwise required to prepare GAAP financial
statements. The Act does not define what accounting records must be main-
tained or mandate how long they must be maintained. The accounting records
to be maintained under section 16.01(c) depend upon the form of the corpora-
tion’s financial statements. For example, annual tax returns filed with the rele-
vant taxing authorities may be the only annual financial statements prepared
by small businesses operating on a cash basis and, in those instances, the requi-
site accounting records to be maintained may consist of only a check register,
vouchers and receipts.

4. SHAREHOLDERS’ LISTSSections 16.01(b) and (c) require the corporation to
“maintain” appropriate accounting and shareholder records. The word “main-
tain” is used to denote current records only and does not require the corporation
to keep on hand as permanent records, data, or information of historical interest
only; the periods for which these records, data, or information should be kept is
not addressed by the Model Act.

Section 16.01(b) relates to accounting records. The word “appropriate” is used
to indicate that the nature of the financial records to be kept is dependent to
some extent on the nature of the corporation’s business; the phrase “adequate
records” is used in some state statutes to convey essentially the same meaning.
“Appropriate” records are generally records that permit financial statements to
be prepared which fairly present the financial position and transactions of the
corporation. In some very small businesses operating on a cash basis, however,
“appropriate” accounting records may consist only of a check register, vouchers,
and receipts.

Section 16.01(c) requires the corporation to maintain such records of its
shareholders as will permit it to compile a list of current shareholders when re-
quired. These records may consist of vary from stubs from which certificates have
been detached in the case of corporations with a few shareholders or of, to elab-
orate electronic data retrievable only by modern technology in the case of large;
publicly held corporations, whose shares are publicly traded. The record may be
retained maintained by the corporation or an agent, who traditionally is the trans-
fer agent but may be another agent. A corporation may maintain additional in-
formation regarding its shareholders, such as a list of nominees and nonobject-
ing beneficial owners if its shares are publicly traded.

3. FORM OF RECORDS

Section 16.01(d) generally authorizes corporations to retain records in the
form of a “document,” which includes a writing as well as an “electronic record,”
or in another form capable of conversion into paper form in a reasonable time.
See subsections 1.40(6A), (7B), and (28). The basic requirement is that the
method chosen must be capable of reduction to paper form within a reasonable
time. In addition, in the case of the record of shareholders, the method must per-
mit the development of an alphabetical list of shareholders of record as required
by section 16.01(c).
4. Keeping Records at Principal Office

Section 16.01(e) requires certain basic records to be kept at the principal office of the corporation, including minutes of shareholders’ meetings for the preceding three years and records of shareholder action taken without a meeting during the same period. This requirement is imposed because these records must be available for inspection by any shareholder at that office. See section 16.02(a). The “principal office” of the corporation is defined in section 1.40 to be the location of the executive offices of the corporation and its address must be set forth by the corporation in its annual report required by section 16.21. The Model Act does not generally specify where records other than those described in section 16.01(e) must be kept. They may be kept in one or more offices within or without the state; indeed, in the case of records kept in nonwritten form, it may be impossible to determine “where” they are located.

§ 16.02. Inspection Rights of Records by Shareholders

(a) A shareholder of a corporation is entitled to inspect and copy, during regular business hours at the corporation’s principal office, any of the records of the corporation described in section 16.01(e), excluding minutes of meetings of, and records of actions taken without a meeting by, the corporation’s board of directors and board committees established under section 8.25, if the shareholder gives the corporation a signed written notice of the shareholder’s demand at least five business days before the date on which the shareholder wishes to inspect and copy.

(b) A shareholder of a corporation is entitled to inspect and copy, during regular business hours at a reasonable location specified by the corporation, any of the following records of the corporation if the shareholder meets the requirements of subsection (c) and gives the corporation a signed written notice of the shareholder’s demand at least five business days before the date on which the shareholder wishes to inspect and copy:

(1) the financial statements of the corporation maintained in accordance with section 16.01(b);

(2) accounting records of the corporation;

(3) excerpts from minutes of any meeting of, or records of any actions taken without a meeting by, the corporation’s board of directors and board committees maintained in accordance with section 16.01(a); and

(4) the record of shareholders maintained in accordance with section 16.01(d).
A shareholder may inspect and copy the records described in subsection (b) only if:

1. the shareholder’s demand is made in good faith and for a proper purpose;
2. the shareholder’s demand describes with reasonable particularity the shareholder’s purpose and the records the shareholder desires to inspect; and
3. the records are directly connected with the shareholders’ purpose.

The corporation may impose reasonable restrictions on the confidentiality, use or distribution of records described in subsection (b).

For any meeting of shareholders for which the record date for determining shareholders entitled to vote at the meeting is different than the record date for notice of the meeting, any person who becomes a shareholder subsequent to the record date for notice of the meeting and is entitled to vote at the meeting is entitled to obtain from the corporation upon request the notice and any other information provided by the corporation to shareholders in connection with the meeting, unless the corporation has made such information generally available to shareholders by posting it on its website or by other generally recognized means. Failure of a corporation to provide such information does not affect the validity of action taken at the meeting.

A shareholder of a corporation is entitled to inspect and copy, during regular business hours at a reasonable location specified by the corporation, any of the following records of the corporation if the shareholder meets the requirements of subsection (d) and gives the corporation a signed written notice of the shareholder’s demand at least five business days before the date on which the shareholder wishes to inspect and copy:

1. excerpts from minutes of any meeting of the board of directors or a committee of the board of directors while acting in place of the board of directors on behalf of the corporation, minutes of any meeting of the shareholders, and records of action taken by the shareholders, board of directors, or a committee of the board without a meeting, to the extent not subject to inspection under section 16.02(a);
2. accounting records of the corporation; and
3. the record of shareholders.

A shareholder may inspect and copy the records described in subsection (e) only if:

1. the shareholder’s demand is made in good faith and for a proper purpose;
(2) the shareholder describes with reasonable particularity the shareholder's purpose and the records the shareholder desires to inspect; and

(3) the records are directly connected with the shareholder's purpose.

(e) The right of inspection granted by this section may not be abolished or limited by a corporation's articles of incorporation or bylaws.

(f) This section does not affect:

(1) the right of a shareholder to inspect records under section 7.20 or, if the shareholder is in litigation with the corporation, to the same extent as any other litigant; or

(2) the power of a court, independently of this Act, to compel the production of corporate records for examination and to impose reasonable restrictions as provided in section 16.04(d), provided that, in the case of production of records described in subsection (b) at the request of a shareholder, the shareholder has met the requirements of subsection (c).

(g) For purposes of this section, “shareholder” means a record shareholder, a beneficial owner whose shares are held in a shareholder's behalf, and an unrestricted voting trust or by a nominee on the shareholder's behalf.

**CROSS-REFERENCES**

Articles of incorporation, see § 2.02.
Bylaws, see § 2.06, ch. 10B.
Committees of board of directors, see § 8.25.
Corporate records required, see § 16.01.
Court-ordered inspection, see § 16.04.
“Deliver,” defined, see § 1.40.
Directors' action without meeting, see § 8.21.
Effective date of notice, see § 1.41.
Meeting of board of directors, see § 8.20.
Notices and other communications, see § 1.41.
Notice to corporation, see § 1.41.
“Principal office”:

defined, see § 1.40.
designated in annual report, see § 16.21.
“Shareholder” defined, see § 1.40.
Shareholders' action without meeting, see § 7.04.
Shareholders' list inspection, see § 7.20.
Shareholders' meeting, see §§ 7.01–7.03.
Voting trusts, see § 7.30.
OFFICIAL COMMENT

1. Section 16.02(a)

Section 16.02(a) provides that each shareholder is entitled, upon delivery of a signed written demand at the principal office of the corporation, to inspect documents described in section 16.01(e). These documents all deal with the shareholder’s interest in the corporation. The right to inspection includes the right to make copies, as such in the corporation, further described in section 16.03. While some of these documents may also be a matter of public record in the office of the secretary of state, a shareholder should not be compelled to go to a public office that may be physically distant to examine the basic documents relating to the corporation. The “principal office” of the corporation is defined in section 1.40 to be the location of the executive offices of the corporation and its address must be set forth by the corporation in its annual report required by section 16.21.

2. Section 16.02(b)

Section 16.02(b) gives all shareholders the right to inspect minutes of meetings of, and written actions taken without a meeting by, shareholders, a shareholder is entitled to inspect only excerpts of meetings of, and records of written actions taken by, the board of directors and board committees related to the purpose of the inspection. A shareholder is entitled to inspect the shareholders’ list under section 16.02(b) without regard to the size or value of the shareholder’s holding. This right is independent of the right to inspect a shareholders’ list immediately before a meeting under section 7.20.

3. Section 16.02(c)

Section 16.02(c) permits inspection of the financial statements and records described in section 16.02(b) by a shareholder only if the demand is made in good faith and for a “proper purpose.” Although not defined in the Act, “proper purpose” under section 16.02(c) has been defined in case law to involve a purpose that is reasonably relevant to the demanding shareholder’s interest as a shareholder.

Section 16.02(c) requires that a shareholder designate “with reasonable particularity” the purpose and the records he or she desires to inspect. Also, the records demanded must be “directly connected” with that purpose. If disputed by the corporation, the “connection” of the records to the shareholder’s purpose may be determined by a court’s private examination of the records.

4. Section 16.02(d)

The reasonable restrictions on the confidentiality, use or distribution of financial statements and records permitted by section 16.02(d) allow for the protection of confidential or proprietary information in the corporation’s records or
sensitive matters that might be disclosed in a shareholder inspection. Such re-
strictions might include, for example, requiring the demanding shareholder to
sign a confidentiality and use agreement. A similar provision is found in section
16.04(d) in connection with court-ordered inspections.

5. Section 16.02(e)

Section 16.02(e) provides shareholders of a corporation the right to receive
from the corporation the notice and other information provided by the corpora-
tion to shareholders in connection with a meeting if the record date for voting is
subsequent to the record date for notice and the shareholder became entitled to
vote after the record date for notice. The information is to be provided on re-
quest, except that the corporation may satisfy this requirement by making the
information generally available on its website or by other generally recognized
means. The failure of the corporation to provide the information does not affect
the validity of the action taken at the meeting. This provision does not apply to
information provided to shareholders by persons other than the corporation.

3. Sections 16.02(c) and (g)

The prohibition in section 16.02(d) the right to inspect three classes of corpo-
rate records:

1. Excerpts from minutes of meetings of the board of directors, records of
action of committees of the board of directors when acting in place of
the board on behalf of the corporation, and minutes of meetings of share-
holders (to the extent they do not fall within section 16.02(a)). The cor-
poration is required to make available only relevant excerpts of minutes
and need not make available minutes of entire meetings merely because
a portion of the minutes is directly connected with the shareholder's
purpose.

2. The accounting records of the corporation. The Act does not attempt to
define what accounting records must be kept. See the Official Comment
to section 16.01.

3. The record of shareholders, subject to section 16.03(c). If a shareholder
makes a demand in good faith and with a proper purposeapply to an
agreement permissible under section 16.02(d), the shareholder is entitled
to inspect the shareholders' list under section 16.02(c) without regard to
the size or value of his holding. This right is independent of the right to
inspect a shareholders' list immediately before a meeting under section
7.20.16.02(f).
4. **Section 16.02(d)**

Section 16.02(d) follows earlier versions of the Model Act and permits inspection of the records described in section 16.02(c) by a shareholder only if the demand is made in good faith and for a “proper purpose.” A “proper purpose” means a purpose that is reasonably relevant to the demanding shareholder’s interest as a shareholder. Some statutes do not use the phrase “proper purpose”; the Model Act continues to use it because it is traditional and well understood language defining the scope of the shareholder’s right of inspection and its use ensures that the very substantial case law that has developed under it will continue to be applicable under the revised Act.

As a practical matter, a shareholder who alleges a purpose in general terms, such as a desire to determine the value of his or her shares, to communicate with fellow shareholders, or to determine whether improper transactions have occurred, has been held to allege a “proper purpose.” Section 16.02(d) thus attempts to require more meaningful statements of purpose, if feasible, by requiring that a shareholder designate “with reasonable particularity” the purpose and the records he or she desired to inspect; the records demanded must also be “directly connected” with that purpose. If disputed by the corporation, the “connection” of the records to the shareholder’s purpose may be determined by a court’s in-camera examination of the records.

5. **Sections 16.02(e) and (f)**

Section 16.02(e) states that the inspection rights granted by this chapter are inherent rights of shareholders and may not be abolished or limited by the articles of incorporation or bylaws; the subsection is based on California Corporations Code Annotated section 1600(d). No inference of any kind should be drawn from this subsection as to whether other, unrelated sections of the Model Act may be modified by provisions in the articles of incorporation or bylaws.

Section 16.02(f) provides that the right of inspection granted by section 16.02 is an independent right of inspection that is not a substitute for or in derogation of rights of inspection that may exist (1) under section 7.20, to inspect the shareholders’ list following the establishment of a record date for a meeting; (2) as part of a right of discovery that exists in connection with litigation; and (3) as a “common law” right of inspection, if any is found to exist by a court, to examine corporate records. Section 16.02(f) simply preserves whatever independent rights of inspection exist under these referenced sources and does not create or recognize any rights, either expressly or by implication.

6. **Section 16.02(g)**

Section 16.02(g) extends the inspection rights provided by section 16.02 to beneficial owners of shares held by a nominee or in a voting trust. It was
added as a technical correction to the revised Model Act in 1986. A shareholder also has the right to obtain financial statements under section 16.20.

§ 16.03. Scope of Inspection Right

(a) A shareholder may appoint an agent or attorney to exercise the same inspection and copying rights as the shareholder represented under section 16.02.

(b) The corporation may, if reasonable, satisfy the right of a shareholder to copy records under section 16.02 includes, if reasonable, by furnishing to the right to receive copies by xerographic photocopy or other means; chosen by the corporation including copies furnished through an electronic transmission if available and so requested by the shareholder.

(c) The corporation may comply at its expense with a shareholder’s demand to inspect the record of shareholders under section 16.02(b)(3) by providing the shareholder with a list of shareholders that was compiled no earlier than the date of the shareholder’s demand.

(d) The corporation may impose a reasonable charge, covering the costs of labor and material, for providing copies of any documents provided to the shareholder. The charge may not exceed the estimated costs based on an estimate of production, reproduction or transmission of the records.

Cross-References

Corporate records, see § 16.01.
Court-ordered inspection, see § 16.04.
“Electronic transmission” defined, see § 1.40.
Inspection right generally, see § 16.02.
Shareholders’ list inspection, see § 7.20.

Official Comment

The right Section 16.03(a) provides that the rights of inspection set forth and copying granted to shareholders in section 16.02 includes the general right to copy the documents inspected. Section 16.03 follows precedent established under earlier statutes and extends the right may be exercised by agents and attorneys of shareholders appointed by shareholders to conduct such inspection to an agent or attorney of a shareholder as well as the shareholder. The right to copy means more than a right to copy by longhand and extends to the right to receive among alternative delivery methods for copies made by copying machines or through an electronic transmission with the cost of reproduction and transmission being paid in section.
16.03(b), including by the shareholder. The requirement of availability with respect to electronic transmissions, is intended to insure that the corporation can provide the document electronically and that an undue burden is not placed on the corporation to provide copies through an electronic transmission or other similar means.

Section 16.03(c) is designed to give the corporation the right to provide a reasonably current list of its shareholders instead of granting the right of inspection; a “. A list will be reasonably current” if the list is defined in section 16.03(c) as one compiled no earlier than the date of the written demand, which under section 16.02(b) must provide at least five days’ notice.

Many corporations make available to shareholders without charge some or all of the basic documents described in section 16.01(e). Section 16.03(d) authorizes the corporation to charge a reasonable fee based on reproduction costs (including labor and materials) for providing a copy of any document. The phrase “estimated cost of production, reproduction or transmission of the records” in section 16.03(d) refers to the cost of assembling information and data to meet a demand as well as the cost of reproducing and transmitting documents that are already in existence.

Under applicable law, a list of shareholders generally will include underlying information in the corporation’s possession relating to stock ownership, including, where applicable, breakdowns of stock holdings by nominees and nonobjecting beneficial ownership (NOBO) lists. However, a corporation generally is not required to generate this information for the requesting shareholder and is only required to provide NOBO and other similar lists to the extent such information is in the corporation’s possession.

Section 7.20 creates a right of shareholders to inspect a list of shareholders in advance of and at a meeting that is independent of the rights of shareholders to inspect corporate records under chapter 16.

Section 16.03(d) permits the corporation to be reimbursed for the expense of providing copies of documents to a shareholder.

§ 16.04. COURT-ORDERED INSPECTION

(a) If a corporation does not allow a shareholder who complies with section 16.02(a) to inspect and copy any records required by that subsection to be available for inspection, the court of the county where the corporation’s principal office (or, if none in this state, its registered office) is located may summarily order inspection and copying of the records demanded at the corporation’s expense upon application of the shareholder.

(b) If a corporation does not within a reasonable time allow a shareholder who complies with section 16.02(b) to inspect and copy any other record the records required by that section, the shareholder who complies
with section 16.02(b) and (c) may apply to the [name or describe court] in the county where the corporation’s principal office (or, if none in this state, its registered office) is located for an order to permit inspection and copying of the records demanded. The court shall dispose of an application under this subsection on an expedited basis.

(c) If the court orders inspection and copying of the records demanded, it may impose reasonable restrictions on their confidentiality, use or distribution by the demanding shareholder and it shall also order the corporation to pay the shareholder’s expenses incurred to obtain the order unless the corporation proves establishes that it refused inspection in good faith because the corporation had a reasonable basis for doubt about the right of the shareholder to inspect the records demanded.

(d) 1) a reasonable basis for doubt about the court orders inspection and copying right of the shareholder to inspect the records demanded, it may impose; or

(2) required reasonable restrictions on the confidentiality, use or distribution of the records by demanded to which the demanding shareholder had been unwilling to agree.

CROSS-REFERENCES

Corporate records, see § 16.01.
“Principal office”:
   defined, see § 1.40.
   designated in annual report, see § 16.21.
“Expenses” defined, see § 1.40.
“Principal office:”:
   defined, see § 1.41.
   designated in annual report, see § 6.21.
Registered office:
   designated in annual report, see § 16.21.
   required, see §§ 2.02 & 5.01.
Service on corporation, see § 5.04.
Shareholders’ list inspection, see § 7.20.
Voluntary inspection, see § 16.02.

OFFICIAL COMMENT

Section 16.04 provides a judicial remedy if a corporation refuses to grant the right of inspection provided by section 16.02.

If the right of inspection under section 16.02(a) is invoked and the corporation refuses to grant inspection, the shareholder may seek a summary order compelling inspection at the corporation’s expense. A summary order is appropriate
since the right of inspection under this subsection section 16.02(a) is either automatic or subject only to a determination that the person is in fact a shareholder of the corporation. By contrast, if inspection is demanded under section 16.02(b), a number of matters may be at issue, including the shareholder's good faith and proper purpose. Alternatively, under section 16.02(b) or the reasonableness of the restrictions required by the corporation on the confidentiality, use or distribution of the records. Accordingly, section 16.04(b) directs the court to handle the proceeding "on an expedited basis," instead of in a summary proceeding. The purpose of this phrase is to discourage dilatory tactics to avoid or delay inspection without requiring the court to resolve these issues on a summary basis. This language does not mandate any specific procedure by which these issues are to be resolved.

If a court enters a summary order directing inspection under section 16.02(a), the expense of reproducing the records, if any, is placed on the corporation. Section 16.04 does not address who should bear the expense of reproducing other records ordered by the court; this is a matter for the courts to decide in light of the policy of the Model Act that expenses of reproduction are generally the responsibility of the requesting shareholder and should be assessed against such shareholder.

The principal sanction against unreasonable delay or refusal to grant inspection is provided by section 16.04(c), which imposes on the corporation the plaintiff's expenses unless the corporation can establish that it acted reasonably. The corporation may avoid these expenses by showing that the corporation refused inspection in good faith because it had a reasonable basis for doubt about the right of the shareholder to inspect the records demanded. This normally will involve reasonable doubt whether the shareholder had the necessary good faith and proper purpose or whether the records demanded are directly connected to the shareholder's purpose. The phrase "in good faith because it had a reasonable basis for doubt" establishes a partially objective standard, in that the corporation must be able to point to some objective basis for its doubt that the shareholder was acting in good faith or had a purpose that was proper. For example, a corporation may point to earlier shareholder's expenses unless the corporation establishes that it refused inspection in good faith on the grounds specified in section 16.04(c)(1) or (2). For example, a corporation may point to conduct of the shareholder involving improper use of information obtained from the corporation in the past as indicating that reasonable doubt existed as to the shareholder's present purpose. A corporation may not avoid the imposition of expenses under this section merely by showing it had no information one way or the other about corporation refused inspection because the issues in controversy shareholder had been unwilling to agree to reasonable restrictions on the confidentiality, use or distribution of the records demanded.

Earlier versions of the Model Act and the statutes of many states imposed a penalty upon the corporation or its officers for refusal to permit inspection of books and records by shareholders who (1) had been shareholders for at least six months or (2) owned 5% or more of the outstanding shares. This provision
has been omitted. A penalty unrelated to the expenses of securing inspection was arbitrary and, as a result, was seldom actually enforced; further, a qualification based on the size or duration of the shareholder’s holding unrelated to the shareholder’s actual purpose was subject to the criticism that it constituted unreasonable discrimination against small shareholders.

§ 16.05. Inspection Rights of Records by Directors

(a) A director of a corporation is entitled to inspect and copy the books, records and documents of the corporation at any reasonable time to the extent reasonably related to the performance of the director’s duties as a director, including duties as a member of a committee, but not for any other purpose or in any manner that would violate any duty to the corporation.

(b) The [name or describe court] of the county where the corporation’s principal office (or if none in this state, its registered office) is located may order inspection and copying of the books, records and documents at the corporation’s expense, upon application of a director who has been refused such inspection rights, unless the corporation establishes that the director is not entitled to such inspection rights. The court shall dispose of an application under this subsection on an expedited basis.

(c) If an order is issued, the court may include provisions protecting the corporation from undue burden or expense, and prohibiting the director from using information obtained upon exercise of the inspection rights in a manner that would violate a duty to the corporation, and may also order the corporation to reimburse the director for the director’s expenses incurred in connection with the application.

Cross-References

Corporate records, see § 16.01.
Court-ordered inspection, see § 16.04.
“Expenses” defined, see § 1.40.
Director standards of conduct, see § 8.30.
Functions of board of directors, see § 8.01.
“Principal office:” defined, see § 1.41.
designated in annual report, see § 6.21.
Registered office:
designated in annual report, see § 16.21.
required, see §§ 2.02 & 5.01.
OFFICIAL COMMENT

The purpose of subsection 16.05(a) is to confirm the principle that a director always is entitled to inspect books, records and documents to the extent reasonably related to the performance of the director’s oversight or decisional duties provided that the requested inspection is not for an improper purpose and the director’s use of the information obtained would not violate any duty to the corporation. The statute attempts to reconcile and balance competing principles articulated in the common law which suggest that a director has a nearly “absolute” right to information subject only to limitation if it can be shown that the director has an improper motive or intent in asking for the information or would violate law by receiving the information. In addition, the statutory provision In addition, section 16.05 sets forth a remedy for the director in circumstances where the corporation improperly denies the right of inspection.

Under subsection (a), a director typically would be entitled to review books, records and documents relating to matters such as (i) compliance by a corporation with applicable law, (ii) adequacy of the corporation’s system of internal controls to provide accurate and timely financial statements and disclosure documents, or (iii) the proper operation, maintenance and protection of the corporation’s assets. In addition, a director would be entitled to review records and documents to the extent required to consider and make decisions with respect to matters placed before the Board.

Section 16.05(b) provides a director with the right to seek for court order on an expedited basis a court order permitting inspection and copying of the books, records and documents of the corporation, at the corporation’s expense. There- because there is a presumption that significant latitude and discretion should be granted to the director, and the corporation has the burden of establishing that athe director is not entitled to inspection of the documents requested. Circumstances There may be circumstances where the director’s inspection might be denied include requests which (i) are not reasonably related, for example, when it would be contrary to performance the interest of a director’s duties (e.g., seeking a specified confidential document not necessary for the performance of a director’s duties), (ii) impose an unreasonable burden and expense on the corporation (e.g., compliance because of adversity with the request would be duplicative of information already provided or would be unreasonably expensive and time consuming), (iii) violate the director duty to and the corporation (e.g., the director could reasonably be expected to use or exploit confidential information in personal or third-party transactions), or (iv) violate any applicable law (e.g., the director does not have the necessary governmental security clearance to see the requested classified information).

broad discretion to address these circumstances. Section 16.05 does not directly deal with the ability of a director to inspect records of a subsidiary of which he or she is not also a director. A director’s ability to inspect records of a subsidiary generally should be exercised through the parent’s rights or power, and section 16.05(a) does not independently provide that right or power to a
director of the parent. In the case of wholly owned subsidiaries, a director’s ability to inspect should approximate his or her rights with respect to the parent. In the case of a partially owned subsidiary, the ability of the director to inspect is likely to be influenced by the level of ownership of the parent (this ability can be expected to be greater for a subsidiary which is part of a consolidated group than for a minority owned subsidiary). In any case, the inspection by a director of the parent will be subject to the parent’s fiduciary obligation to the subsidiary’s other shareholders.

Section 16.05(c) provides that the court may place limitations on the use of information obtained by the director and may include in its order other provisions protecting the corporation from undue burden or expense. Further, the court may order the corporation to reimburse the director for expenses incurred in connection with the application. The amount of any reimbursement is left in the court’s discretion, since it must consider the reasonableness of the expenses incurred, as well as the fact that a director may be only partially successful in the application.

Subchapter B.
REPORTS

§ 16.20. FINANCIAL STATEMENTS FOR SHAREHOLDERS

(a) Upon the written request of a shareholder, a corporation shall deliver or make available to such requesting shareholder by posting on its shareholders’ website or by other generally recognized means annual financial statements, which may be consolidated or combined statements for the most recent fiscal year of the corporation and one or more of its subsidiaries, as appropriate, that include a balance sheet as of the end of the fiscal year, an income statement for that year, and a statement of changes in shareholders’ equity for the year unless that information appears elsewhere in the financial statements for which annual financial statements have been prepared for the corporation. If financial statements have been prepared for the corporation on the basis of generally accepted accounting principles, for such specified period, the corporation shall deliver or make available such financial statements to the requesting shareholder and if the annual financial statements must also be prepared on that basis.

(b) Delivered or made available to the annual financial statements requesting shareholder are audited or otherwise reported upon by a public accountant, the report must accompany them. If not, the statements must be accompanied by a statement of the president or the person responsible for the corporation’s accounting records shall also be delivered or made available to the requesting shareholder.
(1) stating such person’s reasonable belief whether the statements were prepared on the basis of generally accepted accounting principles and, if not, describing the basis of preparation; and

(2) describing any respects in which the statements were not prepared on a basis of accounting consistent with the statements prepared for the preceding year.

c) Within 120 days after the close of each fiscal year, the b) A corporation shall send the annual, deliver, or make available and provide written notice of availability of, the financial statements required under subsection (a) to each the requesting shareholder. Thereafter, on within five business days of delivery of such written request from a shareholder to whom the statements were not sent, the corporation shall send the shareholder the latest financial statements. A public

c) A corporation may fulfill its responsibilities under this section by delivering the specified financial statements, or otherwise making them available, in any manner permitted by the applicable rules and regulations of the United States Securities and Exchange Commission.

d) Notwithstanding the provisions of subsections (a) and (b) of this section:

(1) as a condition to delivering or making available financial statements to a requesting shareholder, the corporation may require the requesting shareholder to agree to reasonable restrictions on the confidentiality, use and distribution of such financial statements; and

(2) the corporation may, if it reasonably determines that the shareholder’s request is not made in good faith or for a proper purpose, decline to deliver or make available such financial statements to that shareholder.

e) If a corporation does not respond to a shareholder’s request for annual financial statements pursuant to this section in accordance with subsection (b) within five business days of delivery of such request to the corporation:

(1) The requesting shareholder may apply to the [name or describe court] for an order requiring delivery of or access to the requested financial statements. The court shall dispose of an application under this subsection on an expedited basis.

(2) If the court orders delivery or access to the requested financial statements, it may impose reasonable restrictions on their confidentiality, use or distribution.

(3) In such proceeding, if the corporation has declined to deliver such financial statements because the shareholder had been unwilling to agree to restrictions proposed by the corporation on the confidential-
ity, use and distribution of such financial statements, the corporation shall have the burden of demonstrating that the restrictions proposed by the corporation were reasonable.

(4) In such proceeding, if the corporation has declined to deliver such financial statements pursuant to section 16.20(d)(2), the corporation shall have the burden of demonstrating that it had reasonably determined that the shareholder’s request was not made in good faith or for a proper purpose.

(5) If the court orders delivery or access to the requested financial statements it shall order the corporation to pay the shareholder’s expenses incurred to obtain such order unless the corporation establishes that it had refused delivery or access to the requested financial statements because the shareholder had refused to agree to reasonable restrictions on the confidentiality, use or distribution of the financial statements or that the corporation had reasonably determined that the shareholder’s request was not made in good faith or for a proper purpose.

CROSS-REFERENCES

“Deliver” defined, see § 1.40.
Inspection of records, see § 16.02.
“Shareholder” defined, see § 1.40.
Shareholder agreements, see § 7.32.

OFFICIAL COMMENT

The requirement that a corporation regularly provide some financial information to shareholders is appropriate considering the relationship between corporate management and the shareholders as the ultimate owners of the enterprise. This requirement was first added as an amendment in 1979 to the 1969 Model Act.

Section 16.20 has its principal impact on small, closely held corporations, since enterprises whose securities are registered under federal statutes are required to supply audited financial statements to shareholders. The securities of the vast majority of corporations in the United States are not registered under federal law. It is these corporations that section 16.20 principally affects.

Section 16.20 requires every corporation to prepare and submit to shareholders annual financial statements consisting of a balance sheet as of the end of the fiscal year, an income statement for the year, and a statement of changes in shareholders’ equity for the year. The last statement may be omitted if the data that normally appears in that statement appears in the other financial statements or in the notes thereto. Consolidated statements of the corporation and any subsidiary, or subsidiaries, or combined statements for corporations under common
control, may be used. Section 16.20 does not require financial statements to be submitted. **SECTION 16.20(a)**

Although section 16.20 requires a corporation, upon the written request of a shareholder, to deliver or make available annual financial statements that have been prepared, it does not require a corporation to prepare financial statements. This recognizes that many small, closely held corporations do not regularly prepare formal financial statements unless required by banks, suppliers or other third parties.

Section 16.20 does not limit the financial statements to be delivered or made available to shareholders to financial statements prepared on the basis of generally accepted accounting principles (“GAAP”). Many small corporations have never prepared financial statements on the basis of GAAP. “Cash basis” financial statements (often used in preparing the tax returns of small corporations) do not comply with GAAP. Even closely held **smaller** corporations that keep accrual basis records, and file their federal income tax returns on that basis, frequently do not make the adjustments that may be required to present their financial statements on a GAAP basis. In light of these considerations, it would be too burdensome on some small and closely held corporations to require GAAP statements. Accordingly, internally or externally prepared financial statements prepared on the basis of other accounting practices and principles that are reasonable in the circumstances, including tax returns filed with the Federal U.S. Internal Revenue Service (if that is all that is prepared), will suffice for these types of corporations and they may satisfy their obligations under section 16.20 by delivering or making available the requested financial statements in whatever form that they have been prepared for other purposes. If a corporation does prepare financial statements on a GAAP basis for any purpose for the particular year, however, it must send or make available those statements to the requesting shareholder as provided by the last sentence of section 16.20(a). A corporation whose shares are registered under the federal securities laws is, of course, required to provide annual audited financial statements to shareholders.

**SECTION** The last sentence of section 16.20(ba) requires an accompanying report or statement in one of two forms: (1) that if the financial statements to be delivered or made available have been reported upon by a public accountant, that report must be furnished; or (2) in other cases, a statement of the president or the person responsible for the corporation’s accounting records must be furnished (i) stating such person’s reasonable belief as to whether the financial statements were prepared on the basis of generally accepted accounting principles, and, if not, describing the basis on which they were prepared, and (ii) describing any respects in which the financial statements were not prepared on a basis of accounting consistent with those prepared for the previous year.

Section 16.20 refers to a “public accountant.” The same terminology is used in section 8.30 (standards of conduct for directors) of the Model Act. In various states different terms are employed to identify those persons who are permitted
under the state licensing requirements to act as professional accountants. Phrases like “independent public accountant,” “certified public accountant,” “public accountant,” and others may be used. In adopting the term “public accountant,” the Model Act uses the words in a general sense to refer to any class or classes of persons who, under the applicable requirements of a particular jurisdiction, are professionally entitled to practice accountancy.

In requiring a statement by the president or person responsible for the corporation’s financial affairs, it is recognized that in many cases this person will not be a professionally trained accountant and should not be held to the standard required of professional. To emphasize this difference, section 16.20 requires a “statement” (rather than a “report” or “certificate”) and calls for the person to express “reasonable belief” (rather than “opinion”) about whether the statements are prepared on the basis of GAAP or, if not, to describe the basis of presentation and any inconsistencies in the basis of the presentation as compared with the previous year. The person providing the statement is not required to describe any inconsistencies between the basis of presentation and GAAP. If the statements are not prepared on a GAAP basis, the description would normally follow guidelines of the accounting profession as to the reporting format considered appropriate for a presentation which departs from GAAP. See, e.g., “Statement on Auditing Standards No. 14” of the American Institute of Certified Public Accountants. For example, the description might state, with respect to a cash basis statement of receipts and disbursements, that the statement was prepared on that basis and that it presents the cash receipts and disbursements of the entity for the period but does not purport to present the results of operations on the accrual basis of accounting.

Section 16.20(c) specifies that annual financial statements are to be sent to each shareholder within 120 days after the close of each fiscal year, further emphasizing that the statements required to be delivered are annual statements and not interim statements. In addition, if the corporation’s latest annual financial statements were not sent to a shareholder, he may obtain them on written request. See also section 16.01(e)(5).

A shareholder may also seek access to the financial statements of the corporation through the inspection rights established in section 16.02.

Failure to comply with the requirements of section 16.20 does not adversely affect the existence or good standing of the corporation. Rather, failure to comply gives an aggrieved shareholder rights to compel compliance or to obtain damages, if they can be established, under general principles of law.

2. SECTION 16.20(d)

In establishing restrictions with respect to confidentiality, use or distribution that are reasonable under the circumstances, a corporation may consider a number of factors, including the potential competitive harm to the corporation and its other shareholders that could result if the confidential financial information were used to compete with the corporation or disclosed to third parties such
as competitors. As provided in section 16.20(d)(2), a corporation may withhold delivery or making available its financial statements to a requesting shareholder if it reasonably determines that the shareholder’s request is not made in good faith and for a proper purpose.

3. Section 16.20(e)

If a corporation fails to comply with section 16.20(b) in a timely manner, the judicial remedy of 16.20(e) directs the court to handle the proceeding on an expedited basis in order to discourage dilatory tactics to avoid or delay delivery or access to financial statements, but does not require the court to resolve these issues on a summary basis. Section 16.20(e), like section 16.04, establishes a sanction against unreasonable delay or refusal to deliver or provide access to financial statements by imposing on the corporation the shareholder’s expenses unless the corporation can establish that the shareholder had been unwilling to agree to reasonable restrictions on the confidentiality, use or distribution of the requested financial statement or the corporation had reasonably determined that the shareholder’s request was not made in good faith or for a proper purpose.

§ 16.21. Annual Report for Secretary of State

(a) Each domestic corporation, and each foreign corporation authorized to transact business in this state, shall deliver to the secretary of state for filing an annual report that sets forth:

(1) the name of the corporation and the state or country under whose law it is incorporated;

(2) the address of its registered office and the name of its registered agent at that office in this state;

(3) the address of its principal office;

(4) names and business addresses of its directors and principal officers;

(5) a brief description of the nature of its business;

(6) the total number of authorized shares, itemized by class and series, if any, within each class; and

(7) the total number of issued and outstanding shares, itemized by class and series, if any, within each class.

(b) Information in the annual report must be current as of the date the annual report is signed on behalf of the corporation.

(c) The first annual report must be delivered to the secretary of state between January 1 and April 1 of the year following the calendar year in which a domestic corporation was incorporated or a foreign corporation was authorized to transact business. Subsequent annual reports must be deliv-
ferred to the secretary of state between January 1 and April 1 of the following calendar years.

(d) If an annual report does not contain the information required by this section, the secretary of state shall promptly notify the reporting domestic or foreign corporation in writing and return the report to it for correction. If the report is corrected to contain the information required by this section and delivered to the secretary of state within 30 days after the effective date of notice, it is deemed to be timely filed.

**Cross-References**

Administrative dissolution for failure to file annual report, see § 14.20.
Annual report form prescribed by secretary of state, see § 1.21.
Authorized shares, see § 2.02.
“Deliver,” defined, see § 1.40.
Effective date of notice, see § 1.41.
Effective time and date of filing, see § 1.23.
Filing fees, see § 1.22.
Filing requirements, see § 1.20.
Issuance of shares, see §§ 6.01–6.03.
Notices and other communications, see § 1.41.
Notice to the corporation, see § 1.41.
Officers, see § 8.40.
“Principal office” defined, see § 1.40.
Registered agent, see §§ 5.01 & 15.07.
Registered office, see §§ 5.01 & 15.07.
Revocation of certificate of authority for failure to file annual report, see § 15.30.
Series of shares, see § 6.21.

**Official Comment**

The requirement relating to the annual report that each corporation must submit to the secretary of state has been modified in section 16.21 in an effort to make it a limited information document for use by the secretary of state, members of the general public, and shareholders. The purpose of the annual report is to show the location of the principal office of the corporation, the names and business addresses of its directors and principal officers, the general nature of the corporation’s business, and its capital structure. It permits members of the general public to ascertain the identity of the corporation and communicate directly with it. It also establishes the alternative to the registered office for service of process and related matters. The “principal office” of the corporation is defined in section 1.40 as the location of its executive office in section 1.40.
The reference to “principal officers” in section 16.21(a)(4) is intended to simplify reporting requirements of corporations with very large numbers of employees who have some managerial responsibility and who, for business reasons, are designated as officers. The “principal officers” of a corporation include at least the chair of the board of directors, the chief executive officer, and the officers performing the traditional functions performed by the corporate secretary and treasurer, no matter what their designation.

The annual report is required of both domestic corporations and foreign corporations qualified to transact business in the state. The failure to file the annual report, like the failure to satisfy other mandatory requirements of the Act, is a ground for administrative dissolution or revocation of the certificate of authority to transact business. See section 15.03.

* * *

As proposed to be amended, chapter 16 would read as follows:

Records and Reports

Subchapter A.

RECORDS

§ 16.01. Corporate records
§ 16.02. Inspection rights of shareholders
§ 16.03. Scope of inspection right
§ 16.04. Court-ordered inspection
§ 16.05. Inspection rights of directors
§ 16.06. Exception to notice requirements

Subchapter B.

REPORTS

§ 16.20. Financial statements for shareholders
§ 16.21. Annual report for secretary of state

Subchapter A.

RECORDS

§ 16.01. CORPORATE RECORDS

(a) A corporation shall maintain the following records:
   
   (1) its articles of incorporation as currently in effect;
(2) any notices to shareholders referred to in section 1.20(k)(5) specifying facts on which a filed document is dependent if those facts are not included in the articles of incorporation or otherwise available as specified in section 1.20(k)(5);

(3) its bylaws as currently in effect;

(4) all written communications within the past three years to shareholders generally;

(5) minutes of all meetings of, and records of all actions taken without a meeting by, its shareholders, its board of directors, and board committees established under section 8.25;

(6) a list of the names and business addresses of its current directors and officers; and

(7) its most recent annual report delivered to the secretary of state under section 16.21.

(b) A corporation shall maintain all annual financial statements prepared for the corporation for its last three fiscal years (or such shorter period of existence) and any audit or other reports with respect to such financial statements.

(c) A corporation shall maintain accounting records in a form that permits preparation of its financial statements.

(d) A corporation shall maintain a record of its current shareholders in alphabetical order by class of shares showing the number and class of shares held by each shareholder.

(e) A corporation shall maintain the records specified in this section in a manner that may be made available for inspection within a reasonable time.

CROSS-REFERENCES

Articles of incorporation, see § 2.02.
Articles of amendment, see § 10.06.
Bylaws, see § 2.06, ch. 10B.
Committees of board of directors, see § 8.25.
Directors’ action without meeting, see § 8.21.
Inspection of corporate records, see §§ 16.02 & 16.04.
Meetings of board of directors, see § 8.20.
Officers, see § 8.40.
“Principal office”:
   defined, see § 1.40.
   designated in annual report, see § 16.21.
Reports of corporation, see §§ 16.20–16.21.
Restatement of articles of incorporation, see § 10.07.
Series of shares, see § 6.02.
Shareholders’ action without meeting, see § 7.04.
Shareholders’ meeting, see §§ 7.01–7.03.
Shareholders’ voting list, see § 7.20.

OFFICIAL COMMENT

1. RECORDS TO BE MAINTAINED

Section 16.01(a) requires certain basic records to be maintained by the corporation. The Act does not generally specify how records must be maintained other than in a manner in which they may be made available for inspection within a reasonable time, where they must be located or, with the exception of section 16.02(a), where they must be available. They may be maintained in one or more offices within or without the state and, in some cases, such as shareholder records, may be maintained by agents of the corporation; indeed, in the case of records in nonwritten form, it may be impossible to determine “where” they are located.

2. MINUTES AND RELATED DOCUMENTS

Section 16.01(a) does not address the amount of detail that should appear in minutes or written actions. Minutes of meetings customarily include the formalities of notice, the time and place of the meeting, those in attendance, and the results of any votes. Minutes of meetings and written actions without a meeting show formal action taken. The extent to which further detail is included is a matter of judgment which may depend upon the circumstances. Section 7.04, which addresses written actions taken by shareholders, requires that written actions by shareholders be delivered to the corporation for filing with corporate records.

3. FINANCIAL STATEMENTS AND ACCOUNTING RECORDS

The Act does not provide normative standards for the financial statements and accounting records to be prepared or maintained. The financial statements to be maintained under section 16.01(b) are those that the corporation prepares in the operation of its business, including in response to third party requirements. The form of the financial statements prepared by a corporation depends to some extent on the nature and complexity of the corporation’s business and third party requirements such as those governing the preparation and filing of tax returns with applicable tax authorities. To accommodate the needs of the many different types of business corporations that may be subject to these provisions, including closely held corporations, the Act does not require that the corporation prepare and maintain financial statements on the basis of generally accepted accounting principles (“GAAP”) if it is not otherwise required to prepare GAAP financial statements. The Act does not define what accounting records must be main-
tained or mandate how long they must be maintained. The accounting records to be maintained under section 16.01(c) depend upon the form of the corporation’s financial statements. For example, annual tax returns filed with the relevant taxing authorities may be the only annual financial statements prepared by small businesses operating on a cash basis and, in those instances, the requisite accounting records to be maintained may consist of only a check register, vouchers and receipts.

4. Shareholders’ Lists

Section 16.01(d) requires the corporation to maintain such records of its shareholders as will permit it to compile a list of current shareholders when required. These records may vary from stubs from which certificates have been detached in the case of corporations with a few shareholders, to elaborate electronic data in the case of large corporations whose shares are publicly traded. The record may be maintained by the corporation or an agent, who traditionally is the transfer agent but may be another agent. A corporation may maintain additional information regarding its shareholders, such as a list of nominees and nonobjecting beneficial owners if its shares are publicly traded.

§ 16.02. Inspection Rights of Shareholders

(a) A shareholder of a corporation is entitled to inspect and copy, during regular business hours at the corporation’s principal office, any of the records of the corporation described in section 16.01(a), excluding minutes of meetings of, and records of actions taken without a meeting by, the corporation’s board of directors and board committees established under section 8.25, if the shareholder gives the corporation a signed written notice of the shareholder’s demand at least five business days before the date on which the shareholder wishes to inspect and copy.

(b) A shareholder of a corporation is entitled to inspect and copy, during regular business hours at a reasonable location specified by the corporation, any of the following records of the corporation if the shareholder meets the requirements of subsection (c) and gives the corporation a signed written notice of the shareholder’s demand at least five business days before the date on which the shareholder wishes to inspect and copy:

1. the financial statements of the corporation maintained in accordance with section 16.01(b);
2. accounting records of the corporation;
3. excerpts from minutes of any meeting of, or records of any actions taken without a meeting by, the corporation’s board of directors and board committees maintained in accordance with section 16.01(a); and
(4) the record of shareholders maintained in accordance with section 16.01(d).

(c) A shareholder may inspect and copy the records described in subsection (b) only if:

(1) the shareholder's demand is made in good faith and for a proper purpose;

(2) the shareholder's demand describes with reasonable particularity the shareholder's purpose and the records the shareholder desires to inspect; and

(3) the records are directly connected with the shareholder's purpose.

(d) The corporation may impose reasonable restrictions on the confidentiality, use or distribution of records described in subsection (b).

(e) For any meeting of shareholders for which the record date for determining shareholders entitled to vote at the meeting is different than the record date for notice of the meeting, any person who becomes a shareholder subsequent to the record date for notice of the meeting and is entitled to vote at the meeting is entitled to obtain from the corporation upon request the notice and any other information provided by the corporation to shareholders in connection with the meeting, unless the corporation has made such information generally available to shareholders by posting it on its website or by other generally recognized means. Failure of a corporation to provide such information does not affect the validity of action taken at the meeting.

(f) The right of inspection granted by this section may not be abolished or limited by a corporation's articles of incorporation or bylaws.

(g) This section does not affect:

(1) the right of a shareholder to inspect records under section 7.20 or, if the shareholder is in litigation with the corporation, to the same extent as any other litigant; or

(2) the power of a court, independently of this Act, to compel the production of corporate records for examination and to impose reasonable restrictions as provided in section 16.04(d), provided that, in the case of production of records described in subsection (b) at the request of a shareholder, the shareholder has met the requirements of subsection (c).

(h) For purposes of this section, “shareholder” means a record shareholder, a beneficial shareholder, and an unrestricted voting trust beneficial owner.
CROSS-REFERENCES

Articles of incorporation, see § 2.02.
Bylaws, see § 2.06, ch. 10B.
Committees of board of directors, see § 8.25.
Corporate records required, see § 16.01.
Court-ordered inspection, see § 16.04.
“Deliver” defined, see § 1.40.
Directors’ action without meeting, see § 8.21.
Effective date of notice, see § 1.41.
Meeting of board of directors, see § 8.20.
Notices and other communications, see § 1.41.
Notice to corporation, see § 1.41.
“Principal office”: 
defined, see § 1.40.
designated in annual report, see § 16.21.
“Shareholder” defined, see § 1.40.
Shareholders’ action without meeting, see § 7.04.
Shareholders’ list inspection, see § 7.20.
Shareholders’ meeting, see §§ 7.01–7.03.
Voting trusts, see § 7.30.

OFFICIAL COMMENT

1. Section 16.02(a)

Under section 16.02(a), each shareholder is entitled to inspect documents that deal with the shareholder’s interest in the corporation. The right to inspection includes the right to make copies, as further described in section 16.03. While some of these documents may also be a matter of public record in the office of the secretary of state, a shareholder should not be compelled to go to a public office that may be physically distant to examine the basic documents relating to the corporation. The “principal office” of the corporation is defined in section 1.40 to be the location of the executive offices of the corporation and its address must be set forth by the corporation in its annual report required by section 16.21.

2. Section 16.02(b)

In contrast to the right to inspect minutes of meetings of, and written actions taken without a meeting by, shareholders, a shareholder is entitled to inspect only excerpts of meetings of, and records of written actions taken by, the board of directors and board committees related to the purpose of the inspection. A shareholder is entitled to inspect the shareholders’ list under section 16.02(b) without regard to the size or value of the shareholder’s holding.
This right is independent of the right to inspect a shareholders’ list immediately before a meeting under section 7.20.

3. Section 16.02(c)

Section 16.02(c) permits inspection of the financial statements and records described in section 16.02(b) by a shareholder only if the demand is made in good faith and for a “proper purpose.” Although not defined in the Act, “proper purpose” under section 16.02(c) has been defined in case law to involve a purpose that is reasonably relevant to the demanding shareholder’s interest as a shareholder.

Section 16.02(c) requires that a shareholder designate “with reasonable particularity” the purpose and the records he or she desires to inspect. Also, the records demanded must be “directly connected” with that purpose. If disputed by the corporation, the “connection” of the records to the shareholder’s purpose may be determined by a court’s private examination of the records.

4. Section 16.02(d)

The reasonable restrictions on the confidentiality, use or distribution of financial statements and records permitted by section 16.02(d) allow for the protection of confidential or proprietary information in the corporation’s records or sensitive matters that might be disclosed in a shareholder inspection. Such restrictions might include, for example, requiring the demanding shareholder to sign a confidentiality and use agreement. A similar provision is found in section 16.04(d) in connection with court-ordered inspections.

5. Section 16.02(e)

Section 16.02(e) provides shareholders of a corporation the right to receive from the corporation the notice and other information provided by the corporation to shareholders in connection with a meeting if the record date for voting is subsequent to the record date for notice and the shareholder became entitled to vote after the record date for notice. This provision does not apply to information provided to shareholders by persons other than the corporation.

6. Sections 16.02(f) and (g)

The prohibition in section 16.02(f) does not apply to an agreement permissible under section 7.32. No inference should be drawn from the prohibition in section 16.02(f) as to whether other, unrelated sections of the Act may be modified by provisions in the articles of incorporation or bylaws.

Section 16.02(g) preserves whatever independent rights of inspection exist under the referenced sources and does not create any rights, either expressly or by implication. A shareholder also has the right to obtain financial statements under section 16.20.
§ 16.03. Scope of Inspection Right

(a) A shareholder may appoint an agent or attorney to exercise the shareholder’s inspection and copying rights under section 16.02.

(b) The corporation may, if reasonable, satisfy the right of a shareholder to copy records under section 16.02 by furnishing to the shareholder copies by photocopy or other means chosen by the corporation including copies furnished through an electronic transmission.

(c) The corporation may comply at its expense with a shareholder’s demand to inspect the record of shareholders under section 16.02(b)(4) by providing the shareholder with a list of shareholders that was compiled no earlier than the date of the shareholder’s demand.

(d) The corporation may impose a reasonable charge to cover the costs of providing copies of documents to the shareholder, which may be based on an estimate of such costs.

Cross-References

Corporate records, see § 16.01.
Court-ordered inspection, see § 16.04.
“Electronic transmission” defined, see § 1.40.
Inspection right generally, see § 16.02.
Shareholders’ list inspection, see § 7.20.

Official Comment

Section 16.03(a) provides that the rights of inspection and copying granted to shareholders in section 16.02 may be exercised by agents and attorneys of shareholders appointed by shareholders to conduct such inspection and copying. Providing the corporation with the right to choose among alternative delivery methods for copies in section 16.03(b), including by electronic transmissions, is intended to reduce burdens on the corporation.

Section 16.03(c) gives the corporation, at its option and expense, the right to provide a reasonably current list of its shareholders instead of granting the right of inspection. A list will be reasonably current if the list is one compiled no earlier than the date of the written demand, which under section 16.02(b) must provide at least five days’ notice.

Section 16.03(d) permits the corporation to be reimbursed for the expense of providing copies of documents to a shareholder.

§ 16.04. Court-Ordered Inspection

(a) If a corporation does not allow a shareholder who complies with section 16.02(a) to inspect and copy any records required by that section
to be available for inspection, the [name or describe court] may summarily order inspection and copying of the records demanded at the corporation’s expense upon application of the shareholder.

(b) If a corporation does not within a reasonable time allow a shareholder who complies with section 16.02(b) to inspect and copy the records required by that section, the shareholder who complies with section 16.02(c) may apply to the [name or describe court] for an order to permit inspection and copying of the records demanded. The court shall dispose of an application under this subsection on an expedited basis.

(c) If the court orders inspection and copying of the records demanded, it may impose reasonable restrictions on their confidentiality, use or distribution by the demanding shareholder and it shall also order the corporation to pay the shareholder’s expenses incurred to obtain the order unless the corporation establishes that it refused inspection in good faith because the corporation had:

(1) a reasonable basis for doubt about the right of the shareholder to inspect the records demanded; or

(2) required reasonable restrictions on the confidentiality, use or distribution of the records demanded to which the demanding shareholder had been unwilling to agree.

**CROSS-REFERENCES**

Corporate records, see § 16.01.

“Principal office”: defined, see § 1.40.

designated in annual report, see § 16.21.

“Expenses” defined, see § 1.40.

“Principal office”: defined, see § 1.41.

designated in annual report, see § 6.21.

Registered office: designated in annual report, see § 16.21.

required, see §§ 2.02 & 5.01.

Service on corporation, see § 5.04.

Shareholders’ list inspection, see § 7.20.

Voluntary inspection, see § 16.02.

**OFFICIAL COMMENT**

Section 16.04 provides a judicial remedy if a corporation refuses to grant the right of inspection provided by section 16.02.
If the right of inspection under section 16.02(a) is invoked and the corporation refuses to grant inspection, the shareholder may seek a summary order compelling inspection at the corporation’s expense. A summary order is appropriate since the right of inspection under section 16.02(a) is either automatic or subject only to a determination that the person is in fact a shareholder of the corporation. By contrast, if inspection is demanded under section 16.02(b), a number of matters may be at issue, including the shareholder’s good faith and proper purpose for demands under section 16.02(b) or the reasonableness of the restrictions required by the corporation on the confidentiality, use or distribution of the records. Accordingly, section 16.04(b) directs the court to handle the proceeding “on an expedited basis” instead of in a summary proceeding. The purpose of this phrase is to discourage dilatory tactics to avoid or delay inspection without requiring the court to resolve these issues on a summary basis.

The principal sanction against unreasonable delay or refusal to grant inspection is provided by section 16.04(c), which imposes on the corporation the shareholder’s expenses unless the corporation establishes that it refused inspection in good faith on the grounds specified in section 16.04(c)(1) or (2). For example, a corporation may point to conduct of the shareholder involving improper use of information obtained from the corporation in the past as indicating that reasonable doubt existed as to the shareholder’s present purpose or by showing that the corporation refused inspection because the shareholder had been unwilling to agree to reasonable restrictions on the confidentiality, use or distribution of the records demanded.

§ 16.05. Inspection Rights of Directors

(a) A director of a corporation is entitled to inspect and copy the books, records and documents of the corporation at any reasonable time to the extent reasonably related to the performance of the director’s duties as a director, including duties as a member of a committee, but not for any other purpose or in any manner that would violate any duty to the corporation.

(b) The [name or describe court] may order inspection and copying of the books, records and documents at the corporation’s expense, upon application of a director who has been refused such inspection rights, unless the corporation establishes that the director is not entitled to such inspection rights. The court shall dispose of an application under this subsection on an expedited basis.

(c) If an order is issued, the court may include provisions protecting the corporation from undue burden or expense, and prohibiting the director from using information obtained upon exercise of the inspection rights in a manner that would violate a duty to the corporation, and may also order the corporation to reimburse the director for the director’s expenses incurred in connection with the application.
OFFICIAL COMMENT

The purpose of section 16.05(a) is to confirm the principle that a director always is entitled to inspect books, records and documents to the extent reasonably related to the performance of the director’s duties provided that the requested inspection is not for an improper purpose and the director’s use of the information obtained would not violate any duty to the corporation. In addition, section 16.05 sets forth a remedy for the director in circumstances where the corporation improperly denies the right of inspection.

Section 16.05(b) provides for court order on an expedited basis because there is a presumption that significant latitude and discretion should be granted to the director, and the corporation has the burden of establishing that the director is not entitled to inspection of the documents requested. There may be circumstances where the director’s inspection right might be denied, for example, when it would be contrary to the interest of the corporation because of adversity with the director, and the courts have broad discretion to address these circumstances. Section 16.05 does not directly deal with the ability of a director to inspect records of a subsidiary of which he or she is not also a director. A director’s ability to inspect records of a subsidiary generally should be exercised through the parent’s rights or power, and section 16.05(a) does not independently provide that right or power to a director of the parent.

Subchapter B.

REPORTS

§ 16.20. Financial Statements for Shareholders

(a) Upon the written request of a shareholder, a corporation shall deliver or make available to such requesting shareholder by posting on its website or by other generally recognized means annual financial statements for the most recent fiscal year of the corporation for which annual financial state-
ments have been prepared for the corporation. If financial statements have
been prepared for the corporation on the basis of generally accepted ac-
counting principles for such specified period, the corporation shall deliver
or make available such financial statements to the requesting shareholder
and if the annual financial statements to be delivered or made available to
the requesting shareholder are audited or otherwise reported upon by a
public accountant, the report shall also be delivered or made available
to the requesting shareholder.

(b) A corporation shall deliver, or make available and provide written notice
of availability of, the financial statements required under subsection (a) to
the requesting shareholder within five business days of delivery of such
written request to the corporation.

(c) A corporation may fulfill its responsibilities under this section by deliver-
ing the specified financial statements, or otherwise making them available,
in any manner permitted by the applicable rules and regulations of the
United States Securities and Exchange Commission.

(d) Notwithstanding the provisions of subsections (a) and (b) of this section:

(1) as a condition to delivering or making available financial statements to
a requesting shareholder, the corporation may require the requesting
shareholder to agree to reasonable restrictions on the confidentiality,
use and distribution of such financial statements; and

(2) the corporation may, if it reasonably determines that the shareholder’s
request is not made in good faith or for a proper purpose, decline to
deliver or make available such financial statements to that shareholder.

(e) If a corporation does not respond to a shareholder’s request for annual
financial statements pursuant to this section in accordance with subsec-
tion (b) within five business days of delivery of such request to the
corporation:

(1) The requesting shareholder may apply to the [name or describe court]
for an order requiring delivery of or access to the requested financial
statements. The court shall dispose of an application under this sub-
section on an expedited basis.

(2) If the court orders delivery or access to the requested financial state-
ments, it may impose reasonable restrictions on their confidentiality,
use or distribution.

(3) In such proceeding, if the corporation has declined to deliver such fi-
nancial statements because the shareholder had been unwilling to
agree to restrictions proposed by the corporation on the confidential-
ity, use and distribution of such financials statements, the corporation
shall have the burden of demonstrating that the restrictions proposed by the corporation were reasonable.

(4) In such proceeding, if the corporation has declined to deliver such financial statements pursuant to section 16.20(d)(2), the corporation shall have the burden of demonstrating that it had reasonably determined that the shareholder’s request was not made in good faith or for a proper purpose.

(5) If the court orders delivery or access to the requested financial statements it shall order the corporation to pay the shareholder’s expenses incurred to obtain such order unless the corporation establishes that it had refused delivery or access to the requested financial statements because the shareholder had refused to agree to reasonable restrictions on the confidentiality, use or distribution of the financial statements or that the corporation had reasonably determined that the shareholder’s request was not made in good faith or for a proper purpose.

CROSS-REFERENCES
“Deliver” defined, see § 1.40.
Inspection of records, see § 16.02.
“Shareholder” defined, see § 1.40.
Shareholder agreements, see § 7.32.

OFFICIAL COMMENT
1. SECTION 16.20(A)

Although section 16.20 requires a corporation, upon the written request of a shareholder, to deliver or make available annual financial statements that have been prepared, it does not require a corporation to prepare financial statements. This recognizes that many small, closely held corporations do not regularly prepare formal financial statements unless required by banks, suppliers or other third parties.

Section 16.20 does not limit the financial statements to be delivered or made available to shareholders to financial statements prepared on the basis of generally accepted accounting principles (“GAAP”). Many small corporations have never prepared financial statements on the basis of GAAP. “Cash basis” financial statements (often used in preparing the tax returns of small corporations) do not comply with GAAP. Smaller corporations that keep accrual basis records, and file their federal income tax returns on that basis, frequently do not make the adjustments that may be required to present their financial statements on a GAAP basis. Internally or externally prepared financial statements prepared on the basis of other accounting practices and principles that are reasonable in
the circumstances, including tax returns filed with the U.S. Internal Revenue Service (if that is all that is prepared), will suffice for these types of corporations and they may satisfy their obligations under section 16.20 by delivering or making available the requested financial statements in whatever form that they have been prepared for other purposes. If a corporation does prepare financial statements on a GAAP basis for any purpose for the particular year, however, it must send or make available those statements to the requesting shareholder as provided by section 16.20(a). A corporation whose shares are registered under the federal securities laws is, of course, required to provide annual audited financial statements to shareholders.

The last sentence of section 16.20(a) requires that if the financial statements to be delivered or made available have been reported upon by a public accountant, that report must be furnished. Section 16.20(a) refers to a “public accountant.” The same terminology is used in section 8.30 (standards of conduct for directors). In various states different terms are employed to identify those persons who are permitted under the state licensing requirements to act as professional accountants. Phrases like “independent public accountant,” “certified public accountant,” “public accountant,” and others may be used. In adopting the term “public accountant,” the Act uses the words in a general sense to refer to any class or classes of persons who, under the applicable requirements of a particular jurisdiction, are professionally entitled to practice accountancy.

A shareholder may also seek access to the financial statements of the corporation through the inspection rights established in section 16.02.

Failure to comply with the requirements of section 16.20 does not adversely affect the existence or good standing of the corporation.

2. Section 16.20(d)

In establishing restrictions with respect to confidentiality, use or distribution that are reasonable under the circumstances, a corporation may consider a number of factors, including the potential competitive harm to the corporation and its other shareholders that could result if the confidential financial information were used to compete with the corporation or disclosed to third parties such as competitors. As provided in section 16.20(d)(2), a corporation may withhold delivery or making available its financial statements to a requesting shareholder if it reasonably determines that the shareholder’s request is not made in good faith and for a proper purpose.

3. Section 16.20(e)

If a corporation fails to comply with section 16.20(b) in a timely manner, the judicial remedy of 16.20(e) directs the court to handle the proceeding on an expedited basis in order to discourage dilatory tactics to avoid or delay delivery or access to financial statements, but does not require the court to resolve these issues on a summary basis. Section 16.20(e), like section 16.04, establishes a
sanction against unreasonable delay or refusal to deliver or provide access to financial statements by imposing on the corporation the shareholder's expenses unless the corporation can establish that the shareholder had been unwilling to agree to reasonable restrictions on the confidentiality, use or distribution of the requested financial statement or the corporation had reasonably determined that the shareholder's request was not made in good faith or for a proper purpose.

§ 16.21. Annual Report for Secretary of State

(a) Each domestic corporation, and each foreign corporation authorized to transact business in this state, shall deliver to the secretary of state for filing an annual report that sets forth:

(1) the name of the corporation and the state or country under whose law it is incorporated;

(2) the address of its registered office and the name of its registered agent at that office in this state;

(3) the address of its principal office;

(4) names and business addresses of its directors and principal officers;

(5) a brief description of the nature of its business;

(6) the total number of authorized shares, itemized by class and series, if any, within each class; and

(7) the total number of issued and outstanding shares, itemized by class and series, if any, within each class.

(b) Information in the annual report must be current as of the date the annual report is signed on behalf of the corporation.

(c) The first annual report must be delivered to the secretary of state between January 1 and April 1 of the year following the calendar year in which a domestic corporation was incorporated or a foreign corporation was authorized to transact business. Subsequent annual reports must be delivered to the secretary of state between January 1 and April 1 of the following calendar years.

(d) If an annual report does not contain the information required by this section, the secretary of state shall promptly notify the reporting domestic or foreign corporation in writing and return the report to it for correction. If the report is corrected to contain the information required by this section and delivered to the secretary of state within 30 days after the effective date of notice, it is deemed to be timely filed.
OFFICIAL COMMENT

The purpose of the annual report is to show the location of the principal office of the corporation, the names and business addresses of its directors and principal officers, the general nature of the corporation’s business, and its capital structure. It permits members of the general public to ascertain the identity of the corporation and communicate directly with it. It also establishes the alternative to the registered office for service of process and related matters. The “principal office” of the corporation is defined in section 1.40 as the location of its executive office.

The reference to “principal officers” in section 16.21(a)(4) simplifies reporting requirements of corporations with very large numbers of employees who have some managerial responsibility and who, for business reasons, are designated as officers. The “principal officers” of a corporation include at least the chair of the board of directors, the chief executive officer, and the officers performing the traditional functions performed by the corporate secretary and treasurer, no matter what their designation.

The annual report is required of both domestic corporations and foreign corporations qualified to transact business in the state. The failure to file the annual report, like the failure to satisfy other mandatory requirements of the Act, is a ground for administrative dissolution or revocation of the certificate of authority to transact business. See section 15.03.