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THE BREAKDOWN OF THE PUBLIC–PRIVATE DIVIDE IN SECURITIES LAW: CAUSES, CONSEQUENCES, AND REFORMS

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As a regulatory scheme, U.S. securities law has traditionally been designed around a set of lines—the "public–private divide"—which separate public companies, public capital, and public markets, from private companies, private capital, and private markets. Until the early 2000s, the lines were successful in establishing two largely coherent legal realms—a highly regulated public realm and a lightly regulated private realm. A series of bold and often-inconsistent reforms between 2002 and 2020, however, have transformed this longstanding regime into a low-friction system wherein public capital flows to both public and private companies, private capital is ever more abundant, and firms can effectively eschew public company status, which is both more costly and much less essential to firm success than ever before. This Article contends that, taken together, these developments have led to the breakdown of the public–private divide: in effect, the boundaries between the regulated and unregulated realms have been removed and the public–private distinction has lost its descriptive and explanatory power as an organizing principle of securities law. The Article contributes to the literature by (1) putting forward a novel and comprehensive analytical account of the breakdown of the public–private divide (up through the completion of the deregulatory cycle), (2) identifying the consequences of these developments with respect to specific firm constituencies and on a systemic level,

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and (3) investigating possible reforms and their expected effectiveness in returning securities law to a state of conceptual coherence. The scale of the problems suggests that the necessary reforms are likely to be foundational. Given past experience with hasty and crisis-driven legislation enacted by Congress, the Article urges the SEC to commence a broad deliberative process involving multiple stakeholders to rethink the appropriate structure of securities law. The outputs from this process will be particularly valuable whenever the next window of opportunity for change arises.

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Introduction

The first two decades of the 21st century were a busy and turbulent time for securities law. The regulatory regime, which had grown in a slow and adaptive fashion since its inception during the 1930s, was transformed in fundamental ways by three landmark bills—the Sarbanes–Oxley Act of 2002, the Dodd–Frank Act of 2010, and the 2012 JOBS Act—and a series of related rulemakings by the Securities and Exchange Commission (SEC).[1] Many of these reforms were decidedly pro-regulatory and served to heighten the disclosure and governance obligations of public companies in the name of "investor protection"—the original mainstay of securities law—alongside looser, public-regarding goals such as transparency and accountability.[2] But just as many of the reforms were deregulatory, seeking to change securities law in order to promote

1. *See infra* Sections II.A–B.
2. *See infra* Section I.C.

"capital formation," a more recent mainstay.[3] Comparing securities law in 2021 to securities law in 2001, prior to the Sarbanes–Oxley Act, one cannot help but observe that there is a lot more regulation today than there was two decades ago, but that this regulation covers fewer firms and is easier than ever to avoid.

As a regulatory scheme, U.S. securities law has traditionally been designed around a set of lines—the "public–private divide"—which separate public companies, public capital, and public markets, from private companies, private capital, and private markets. The divide has always been imperfect and, its foundational role notwithstanding, somewhat undertheorized.[4] Until the early 2000s, however, it was successful in establishing two largely coherent legal realms—a highly regulated public one and a lightly regulated private one.

A wide-lens analysis of the myriad of changes in securities law over the past two decades reveals that the public–private divide is no more. Even though the law still distinguishes between public and private companies, capital, and markets, the two coherent legal realms have been supplanted by a low-friction system in which public capital flows to private companies, private capital is ever more abundant, and firms can effectively eschew public company status, which is both more costly and much less essential to firm success than ever before.

Consider the following regulatory paradox: it is possible today for two firms that are *identical* in virtually every respect—business model, size and scope of operations, enterprise value, access to capital, number of shareholders, number of employees, and so on—to have *widely different* regulatory obligations. The firm that is a public company (Firm A) would need to provide public disclosure on a regular basis about its results of operations, financial condition, trends and risks affecting the business, executive compensation, corporate governance arrangements, and various other topics. It would need to estab-

3. *See infra* Section II.B.

4. *See infra* Section I.A. For the first and now-classic analysis of securities law reforms with respect to a "public–private divide" and the introduction of the term to the literature, see Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337 (2013); *see also* Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public–Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573 (2013).

lish and maintain robust internal controls and procedures over financial reporting. Its board of directors would need to have specially designated committees with strict qualification requirements for those serving on them.[5]

By contrast, the firm that is a private company (Firm B) would have to do none of that. It could operate in secrecy, avoid public scrutiny, and eschew the internal governance structures required of public companies.[6] And while both firms would be covered by the anti-fraud provisions of SEC Rule 10b-5, Firm A would still be much more likely to face an enforcement action.[7] There are even spillover effects beyond securities law.[8] The key to understanding the paradox is that (1) public company regulation generally kicks in only if a firm elects to finance itself on the *public* capital markets instead of the *private* capital markets, and (2) that private markets are now just as abundant, which renders public company status virtually irrelevant from an access-to-capital point of view. The public company regulatory paradox is a direct consequence of the breakdown of the public–private divide in securities law described in this Article.

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5. The Sarbanes–Oxley Act requires public companies to have an audit committee and disclose whether the committee has a member who is a financial expert. The Dodd–Frank Act requires public companies to have a compensation committee comprised of independent directors. The New York Stock Exchange listing requirements, which are, in effect, mandatory for public companies, add an overlay by requiring public companies seeking a listing to have a nominating or corporate governance committee. *See infra* Section I.C.1.

6. To be sure, the two firms will be subject to the entity laws of their respective states of organization. If both are corporations incorporated in Delaware, for example, they would be subject to the Delaware General Corporation Law. State corporate codes, however, are consciously designed to be "enabling"; as a result, they generally avoid mandatory rules and instead rely primarily on default rules and opt-in rules. *See generally* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1417 (1989).

7. *See, e.g.*, Verity Winship, *Private Company Fraud*, 54 U.C. DAVIS L. REV. 663, 724–29 (2020) (presenting data on SEC enforcement actions against private companies, which remain rare).

8. As an "issuer" of securities, Firm A would be subject to all provisions in the Foreign Corrupt Practices Act (FCPA), whereas Firm B would be subject to a limited subset and would, again, face less scrutiny and less enforcement. *See* Foreign Corrupt Practices Act of 1977, 15 U.S.C. §§ 78dd-1–3, 78m(a) (distinguishing the categories of "domestic concern" and "issuer of securities").

In addition to being illogical, the new regulatory reality is deeply problematic for the way it thwarts core goals of the modern administrative state. Congress enacted the original securities laws to protect investors from the types of market abuses that precipitated the stock market crash of 1929 and the ten-year Great Depression that followed. Much of the complex and costly infrastructure of securities regulation was built to protect investors by placing conditions on firms' access to capital, as well as restrictions on ordinary investors' ability to invest in non-public companies.[9] This expansive investor protection framework notwithstanding, another element of the regulatory paradox is that an investor today can invest with the same ease in *both* Firm A and Firm B—benefitting from investor protections in the first case but not in the second. Even more bizarrely, both firms would likely be contained in the broadly diversified portfolios that have become a staple of standard 401(k) retirement plans and other popular investment vehicles. Accordingly, it would be difficult for an investor to avoid putting money in the unregulated firm (Firm B), even if this were an express goal based on an informed choice. Today's investors, in other words, are routinely exposed to both regulated and unregulated firms, which undermines the logic of investor protection.[10]

What this Article calls *the public company regulatory paradox* has been a creeping phenomenon taking shape over a number of years. The idiosyncratic architecture of U.S. corporate law, with responsibility for regulation effectively shared by the federal government and the states, and with built-in regulatory competition among the states, has always been predisposed to some degree of inconsistency.[11] However, the present moment represents an inflection point of singular import, which requires us to recognize the paradox and reckon with it head-on. There are at least three reasons for this. First, a fuller picture is starting to emerge of the far-reaching consequences of a deregulatory cycle in the area of capital markets, which began with the 2012 JOBS Act, continued with the 2015 FAST Act,

9. *See infra* Section I.A.

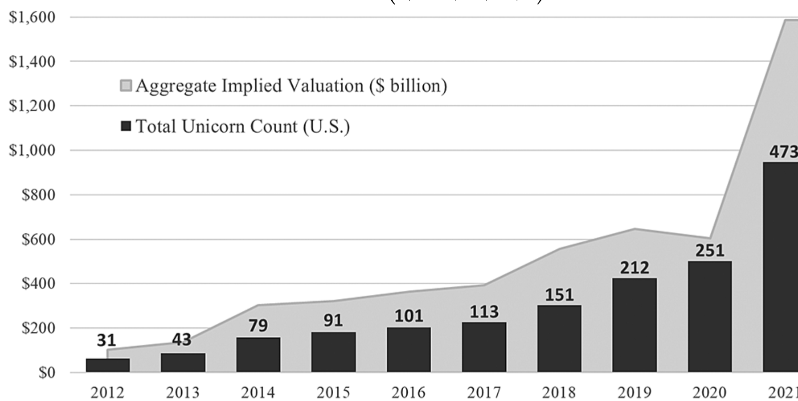
10. *See infra* Section III.C.

11. *See, e.g.*, John C. Coates IV, *Private vs. Political Choice of Securities Regulation: A Political Cost/Benefit Analysis*, 41 VA. J. INT'L L. 531 (2001); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588 (2003).

and was completed in November 2020 during the last days of the Trump administration.[12] Second, there is now a growing appetite for developing targeted solutions to various problems in the capital markets; any new reform proposals, however, should be cognizant of the breakdown of the public–private divide and the changed metastructure of securities law. Third, and relatedly, the sheer scale of the trends suggests that the existing framework needs to be rethought.

Consider, for example, the dramatic rise of "unicorns"—private firms with an implied market valuation of at least $1 billion; such once-rare firms are among the most prominent manifestations of the deregulation of capital raising during the 2010s. Figure 1 presents relevant data.

FIGURE 1: NUMBER AND AGGREGATE VALUATION OF U.S.-BASED UNICORNS (2012–2021)[13]



Whereas there were approximately 43 unicorn firms in the United States when the term was coined in 2013, at the end of December 2020 their number stood at 251. Just eleven months later, at the start of December 2021, it had nearly doubled to 473. The aggregate implied valuation of U.S. unicorns now stands at $1.58 trillion, which is an eleven-fold in-

12. *See infra* Section II.B. For a summary of the expansive November 2020 reforms, see *infra* notes 165–66 and accompanying text.

13. This data has been compiled by the author from the current and historical editions of the unicorn list maintained by CB Insights. *See The Complete List of Unicorn Companies*, CB INSIGHTS, https://www.cbinsights.com/research-unicorn-companies. The data for 2021 is as of December 3, 2021.

crease since 2013, and a nearly three-fold increase in 2021 alone.[14]

The tectonic shifts in capital markets are by no means limited to the arrival and proliferation of unicorns. The annual number of initial public offerings (IPOs) in the United States has fluctuated considerably over the past 30 years, from a peak of over 500 IPOs per year for much the late 1990s, to fewer than 100 IPOs per year for parts of the 2000s, to over 400 IPOs in 2020 and over 900 in 2021.[15] Whereas the number of U.S. public companies exceeded the number of U.S. private equity-owned companies by a considerable margin in 2000, two decades later these positions have been reversed.[16] Assets under management in the U.S. buyout industry, a key source of private capital, have grown steadily—and more than ten-fold—between 1990 and 2019.[17] While data on capital raising in the opaque private markets is incomplete, it still shows that during the 2010s more capital was raised on the private markets than on the public markets.[18] Today's unicorns rely on the private markets for the growth-intensive stages of their lifecycle, whereas older-generation tech companies, such as Amazon, Google/Alphabet, and Facebook, relied predominantly on the public markets.[19] The typical age of tech firms going public was 7.8 years between 1980 and 2011; since 2012, the year of the passage of the JOBS Act, it has increased to 11 years.[20]

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14. In considering this data, it is important to bear in mind that the number of unicorns is a function of both entry and exit. The total number of unicorns increases each time a private startup reaches a $1 billion valuation, and it decreases when a startup goes public via an IPO (thereby losing its unicorn status) or gets acquired by another unicorn or by a public company. As a result, at any given point in time the total number of unicorns and the aggregate valuation of all unicorns depend on macroeconomic factors, private capital-raising conditions, the state of the public markets (which provide a reference point for private company valuations), IPO conditions, M&A activity, and other factors. Because of its symbolic nature, the $1 billion benchmark has not been adjusted for inflation; the valuation data is presented in current-year dollars.

15. *See infra* Appendix, Figure A–1.

16. *See infra* Appendix, Figure A–2.

17. *See infra* Appendix, Figure A–3.

18. *See infra* Appendix, Figure A–4 and Figure A–5. A global comparison of the growth of public market capitalization and private equity net asset values over time reveals a similar trend. *See infra* Appendix, Figure A–6.

19. *See infra* notes 198–200; *see also infra* Appendix, Figure A–7.

20. *See infra* note 59 and accompanying text.

The headline story that emerges from these datapoints is clear: not only have U.S. capital markets been in a state of flux, but the balance between the *public* and *private* sides has shifted for companies, capital, and markets. As we will see, regulatory policy (*both* regulation and deregulation) is an inextricable part of understanding and explaining this transformation: many of the trends have been driven, at least to some degree, by regulatory policy; many of them have served as a justification for significant changes in regulatory policy, and, today, these trends have implications for regulatory policy.

A seminal article on contemporary securities regulation written by Donald Langevoort and Robert Thompson in 2013 opens by observing that "[s]ecurities regulation is under extraordinary stress today."[21] Langevoort & Thompson's article was prescient about many of the effects of the JOBS Act and spurred an extensive literature; its framing observation is true today more than ever. Writing in 2017, Elisabeth de Fontenay highlighted the deregulation of private capital and linked it to the decline of the public company, ultimately concluding that the existing legal arrangements likely are not sustainable.[22] In analyzing emerging developments, a number of other scholars touched on the broader theme of the eroding distinction between the public and private sides of securities regulation, as did financial and legal commentators.[23] All the while, the SEC continued to shift the foundations of securities law—a process that concluded only at the start of 2021 with the arrival of a new administration.

This Article contributes to the literature in three primary ways. First, it puts forward a novel and comprehensive analytical account of the breakdown of the public–private divide. This account includes an analysis of the full deregulatory cycle, including the major changes to the capital raising framework adopted in late 2020. The account goes further in its assessment of the nature and extent of the changes—the use of "breakdown" as opposed to merely "erosion" is intentional—and it identifies the public company regulatory paradox as a major manifestation of the breakdown. The analytical account

21. Langevoort & Thompson, *supra* note 4, at 337.

22. *See* Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 447 (2017).

23. *See* sources cited in Parts I–IV.

also weaves in extensive evidence about the history, political economy, and capital market impact of the regulatory developments. Second, the Article contributes by analyzing the consequences from the breakdown of the public–private divide on specific firm constituencies (investors and employee-investors) and on a systemic level; the systemic consequences in particular are surprising but heretofore unexamined. Finally, the Article contributes to the literature by investigating possible reforms, including a proposal likely to show up on the SEC's regulatory agenda, and by assessing these proposals' expected effectiveness in returning securities law to a state of conceptual coherence. In this regard, the Article intentionally avoids making substantive recommendations and instead proposes a deliberative process whereby the SEC and relevant stakeholders can arrive at the most appropriate substantive solutions.

The Article proceeds in four main parts, each of which is previewed below.

Part I begins by describing the classic public–private divide in the securities law. More than anything, the public–private divide is a convenient device for conceptualizing the structure of securities law. The locus and nature of the public–private divide has traditionally been a function of the two regulatory spheres established on either side of it: a heavily regulated "public realm" where public companies raise capital from the investing public on the public markets, and a lightly regulated (and often unregulated) "private realm" where private companies raise private capital from special classes of investors on non-public markets. After defining the public–private divide, Part I discusses the various mechanisms for becoming a public company, the evolving rationales for making this choice, and the ever more complex framework regulating the disclosure and governance obligations of public companies.

Part II focuses on the road to the breakdown of the public–private divide. The story starts with the 2002 Sarbanes–Oxley Act, adopted in the aftermath of massive accounting fraud at Enron, WorldCom, Tyco, and elsewhere, which I argue served as the system shock that set into motion many of the developments that followed. By imposing new substantive and disclosure mandates on public companies, Sarbanes–Oxley represented a signal step in the "federalization" of corporate governance, a much-criticized development.

The 2010 Dodd–Frank Act, adopted in the aftermath of the financial crisis and massive taxpayer-funded corporate bailouts of 2008–2009, imposed additional regulation and deepened the role of the federal government in corporate law. The transformative changes put in place by Sarbanes–Oxley and Dodd–Frank coincided with a growing sense of alarm over the apparent decline of U.S. public capital markets at the time, as evidenced by the declining annual number of IPOs and the overall number of public companies, which in turn raised concerns about a loss of global competitiveness.[24]

The two contemporaneous developments were quickly bundled together to suggest that there was a causal relationship: (over)regulation as the cause of economic trouble. Although subsequent research revealed other, more plausible explanations for the decline in public capital markets, and although the decline in IPOs proved to be a temporary phenomenon, the overregulation narrative had already taken hold in the media and among policymakers.[25] The result was the JOBS Act, passed with bipartisan support in 2012, which set off what this Article calls a deregulatory cascade: a cycle of deregulatory measures aiming to facilitate firms' capital raising, which continued through 2020. As we will see, some of these measures exacerbated the very problems they set out to address, which, in turn, became the rationale for yet more deregulation.[26] Two figures included in this Part provide a simplified visual representation of the shifting trends in the flows of capital among public and private firms, and public and private markets since the early 2000s due to the various deregulatory developments. Ultimately, these developments have led to the breakdown of the foundational public–private divide in securities law and the full realization of the present-day public company regulatory paradox.[27]

24. *See infra* Section II.A.
25. *See infra* Section II.A.
26. *See infra* Section II.B. The deregulatory cascade entailed the following six developments, some of which are mutually-overlapping: enabling the rise of unicorns; emphasizing private markets over public markets; enabling the dramatic rise of private equity; allowing public capital into private companies; transforming public capital into private capital; and promoting regulation-lite regimes. *See infra* Section II.B.
27. *See infra* Section II.C.

Part III shifts the focus from causes to consequences. It finds that the consequences of the breakdown of the public–private divide have been profound both on a conceptual and practical level and that they implicate multiple constituencies within and outside the firm. Four broad themes emerge. First, the federalization of corporate governance, much criticized in academic and policy circles over the past two decades, today looks more like *quasi-federalization*: the regulatory provisions at issue are tied to public capital raising and can now be easily avoided or circumvented by raising capital on the private markets instead. This is a backdoor, market-based "issuer choice" regulatory regime, whose merits remain contested in the academic literature and have never been seriously considered, much less endorsed, by policymakers.[28] Second, and relatedly, the breakdown of the public–private divide has undermined the regulatory capacity of securities law: firms can avoid important disclosure and governance mandates by delaying or never going public, by going private, or by selling off "bad" assets to a private company. Since public company regulation has come to fulfill important roles in ensuring corporate transparency and accountability—and to the extent this development is a desirable one—the breakdown of the public–private divide is a problem not just for capital market participants, but for society as a whole.[29]

The third and fourth sets of consequences relate to mainstream investors and employee-investors, respectively. As regards mainstream investors, there has been a decoupling of the exclusive relationship between public companies and mainstream investors and, consequently, an attenuation of the logic of investor protection upon which much of securities regulation rests. The investor protection issues concern both efficient pricing, i.e., the most basic term of any securities transaction, and matters such as the difficulties in maximizing risk-adjusted returns within an investment portfolio due to information asymmetries, suboptimal corporate governance, and inadequate access to appropriate investment opportunities.[30]

In addition, the breakdown of the public–private divide compounds the problems faced by a special class of inves-

28. *See infra* Section III.A.
29. *See infra* Section III.B.
30. *See infra* Section III.C.

tors—employees of startup companies who usually receive a considerable amount of their total compensation in illiquid and hard-to-value private company stock and stock options and who are incapable of mitigating through diversification the firm-specific risk associated with their investment of both financial and human capital via the employment relationship. Unlike in the past, these problems are no longer capped in size or duration, because startups can now raise unlimited amounts of private capital (with larger private startups having more employees and, accordingly, more employee-investors), and because startups can remain private, and thus untouched by federal corporate governance regulation, virtually indefinitely.[31]

Part IV considers possible avenues for reform. One set of options relates to *rebuilding the public–private divide*—either by filling various regulatory gaps in the lightly-regulated private realm, or by adjusting regulation to expand the size of the public realm.[32] As an example of the latter, SEC Commissioner Allison Herren Lee recently put forward a simple, yet bold proposal: The SEC should revise the concept of "shareholder of record" used in existing legislation to more accurately capture the true number of beneficial owners—a change that will automatically push a number of large private companies into the heavily-regulated public realm. An analysis of this proposal suggests that it will be an effective tool for rebuilding the original public–private divide—and a blunt one at that, which, somewhat counterintuitively, puts its feasibility into question. While Commissioner Lee's proposal will address most of the problems stemming from the breakdown of the public–private divide, it does not solve, and will likely exacerbate, problems related to employee-investors.[33]

A second set of reform options entails *circumventing the public–private divide* rather than rebuilding it. This can be done by shifting some of the economic regulation that currently operates through securities law to other regulatory domains, in effect lowering the distinction between public and private companies.[34] These options are not mutually exclusive but

31. *See infra* Section III.D.
32. *See infra* Section IV.A.
33. *See infra* Section IV.A.3.
34. *See infra* Section IV.B.

they are likely to be difficult and costly to implement. Given historical patterns of regulation, as well as the political and logistical roadblocks to reform, the Article posits that securities law may well need to wait until the next big market crisis—or its next "critical juncture"—before the public company regulatory paradox can be addressed.[35]

Despite its unspecified timing and outcome, this conclusion need not be viewed as defeatist. There is much that the SEC, capital market participants, and other corporate governance stakeholders can do now to ensure that when the opportunity for reform arises, it will be used to optimize the regulatory landscape. The recent history of securities regulation is replete with examples of hastily implemented reforms that did not enjoy broad support,[36] making careful deliberation all the more important. The recent breakdown of the public–private divide around which securities regulation has been organized since the 1930s puts the field in disarray but it also offers opportunities for blue sky thinking. In order to be able to seize on these opportunities for innovation, it is crucial to understand exactly where we are today and how we got here—a key goal of this Article.

Before proceeding with the main exposition, a brief note about scope, approach, and nomenclature. While the Article touches on all *major* trends and regulatory developments in U.S. capital markets since the early 2000s that are relevant to the topic, it does not catalog every rule change; indeed, to do so in this context would be impossible. In addition, while the Article contains extensive technical detail, it ultimately seeks to translate and analyze discrete legal developments on a conceptual level—in line with the fact that the public–private divide is a conceptual device for thinking about the regulation of capital raising and capital markets. This makes it necessary to balance generality and specificity, with all the attendant trade-offs. To facilitate the translation process, the Article also

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35. *See infra* Section IV.C.

36. The 2012 JOBS Act is the most prominent recent example. As discussed in Section II.B, the JOBS Act was heavily influenced by industry lobbyists. Even though some of its provisions dealt with highly-technical aspects of securities law, and even though the SEC (as the competent administrative agency) expressed skepticism about some of the bill's provisions, the SEC's objections barely registered and failed to prevent passage of the bill. *See infra* notes 161–63 and accompanying text.

purposefully avoids various specialized terms from the securities law rulebook unless their use is required by context,[37] and, where the context permits, it uses other, more general terms, which have a commonly-understood meaning in the legal and policy community, but no statutory definition.[38] Finally, the Article identifies various trends with the help of available data, and analyzes their legal and economic determinants as well as their policy implications. It is worth keeping in mind, of course, that in certain circumstances data is limited or imperfect, and that causal inferences are always open to contestation.[39]

I.
The Architecture, Goals, and Means of the Regulatory Regime

To set the stage for the analytical core of the Article, this Part provides an overview of the structure and scope of securities law as it pertains to public and private companies, public and private investor capital, and public and private markets. It does so by discussing the legal provisions that serve to construct the public–private divide, the reasons for and mechanics

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37. This includes using "public company" in lieu of specialized terms such as "issuer," "registrant," and "reporting company," unless those are required in order to draw a meaningful distinction.

38. These terms include "public capital" (generally, capital raised or traded on the public capital markets and/or capital raised from or traded by investors not subject to qualification restrictions), "private capital" (generally, capital raised or traded on private capital markets and/or capital raised from or traded by qualified investors in line with specific regulatory exemptions), "public investors" (generally, mainstream investors whose access to investment opportunities is regulated and, traditionally, has been more limited), and "private investors" (investors who qualify for special and less-regulated investment opportunities in addition to the opportunities available to public investors).

39. The following quote from John Coates applies to many of the matters discussed in this Article: "[C]orporate governance is not rocket science—in fact, it is much more complicated than rocket science. . . . [T]here are few consensus views among researchers about any non-trivial topic . . . and evidence tends to emerge slowly, is rarely uncontested, and is subject to constant (and often dramatic reevaluation)." *Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance: Hearing Before the Subcomm. on Sec., Ins., & Inv. of the S. Comm. on Banking, Hous., & Urb. Affs.*, 111th Cong. 45 (July 29, 2009) (statement of John C. Coates IV, Professor, Harvard Law School).

of becoming a public company, and the far-reaching regulatory consequences of taking on public company status.

A. *The Public–Private Divide*

The public–private divide is a useful conceptual device for making sense of much of the original design of U.S. securities law.[40] Each of the securities law statutes, including the Securities Act, the Securities Exchange Act, and the Investment Company Act, covers certain economic actors or economic activities while exempting other economic actors or economic activities from regulation; in other words, each of the statutes draws lines. In the aggregate, these lines create two regulatory spheres: a heavily-regulated "public realm" where public companies raise capital from the investing public on the public markets, and a lightly-regulated (and often unregulated) "private realm" where private companies raise private capital from special classes of investors on non-public markets. The *public–private divide* is what separates the public and private—regulated and unregulated—realms. The "breakdown of the public–private divide," then, refers to the removal of the boundaries between these two realms and the notion that, functionally, the public–private distinction has lost both its descriptive and its explanatory power as an organizing principle of securities law.

The genesis of the public–private distinction is Congress' observation in 1933 that the Securities Act, the first of the modern securities laws, should not regulate transactions "where the public benefits are too remote."[41] The Securities Act put this principle in practice by distinguishing between public (or "registered") offerings, which are subject to extensive disclosure requirements and communication restrictions,[42] and "transactions by an issuer not involving any public

40. *See* Langevoort & Thompson, *supra* note 4, at 339 (2013) (conceptualizing the public–private divide and noting that it "has long been an entirely under theorized aspect of securities regulation").

41. Comm. on Interstate & Foreign Com., House Report on Securities Act of 1933, H.R. Rep. No. 73–85, at 5 (1933).

42. The disclosure requirements at the offering stage under the Securities Act are a subset of the disclosure requirements described in Section I.C.1 *infra*; the publicity restrictions relate to gun-jumping and other communication prohibitions. *See* LATHAM & WATKINS LLP, U.S. IPO GUIDE (2021), https://bit.ly/3rCzt0m.

offering," which are exempt from registration.[43] Since the term "public offering" was left undefined in the statute, it fell to the SEC, with a subsequent assist from the Supreme Court, to map out the public–private line in the Securities Act.

Early on, the SEC focused on a multi-factor approach that reflected an expansive understanding of publicness.[44] In 1953, the Supreme Court held that an offering to investors who can "fend for themselves" was not a public offering.[45] In 1982, the SEC issued Regulation D, which largely codified existing practice and anchored the public–private divide with reference to factors such as aggregate offering price, number and status of investors, and publicity.[46] Significantly, Regulation D placed heavy reliance on the category of "accredited investors"—sophisticated investors who can "fend for themselves" and who are allowed to participate in private offerings because they do not need the full protections of the Securities Act.[47] Institutions fit easily within the logic of this concept. In the case of individual investors, however, sophistication was much more difficult to capture and the SEC used high income and high net worth as proxies.[48] Issuers could avoid registration—and the bulk of securities regulation—as long as they conducted a

43. *See* Securities Act of 1933 (Securities Act) § 4(a)(2), 15 U.S.C. § 77d(a)(2). Even though private offerings fall inside the unregulated private realm, private offerings must still comply with various procedures in order to attain and retain their "private" status.

44. *See* Letter of General Counsel, Securities Act Release No. 285, 1935 WL 27,785 (Jan. 24, 1935). The release covered the following considerations with respect to whether or not an offering constituted a "public offering": "(1) [t]he number of offerees and their relationship to each other and to the issuer[,] . . . (2) [t]he number of units offered[,] . . . (3) [t]he size of the offering," and "(4) [t]he manner of offering." *Id.*

45. SEC v. Ralston Purina Co., 346 U.S. 119, 120 (1953).

46. *See* Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, Release No. 33–6389 (Mar. 8, 1982), 47 Fed. Reg. 11,251.

47. It is a less-known fact that the "accredited investor" concept was created by Congress, not the SEC, pursuant to the Small Business Incentive Act of 1980. *See id.*, at 11,251–52.

48. Among other criteria, Regulation D defines as accredited investors individuals with an annual income over $200,000 or net worth of at least $1 million. 17 C.F.R. §§ 230.501(a)(5)–(6). Because this definition has never been updated to account for inflation, these thresholds are much lower in real terms today than they were in 1982. In other words, it takes significantly less wealth today than it did in 1982 for an investor to be deemed sophisticated. *See infra* note 183 and accompanying text. The changes implemented

small offering, to a limited number of sophisticated investors, and without engaging in general solicitation and general advertising.[49] As we will see in Section II.B, the deregulatory cascade of the 2010s has had a particularly erosive effect on these categories, which has contributed to the breakdown of the public–private divide.

The Exchange Act also helps structure the public–private divide. For one, it defines the content of public company regulation (discussed in Section I.C.1), since it sets out the requirements for "reporting companies"—this is the content of the regulation in the regulated public realm.[50] In addition, the Exchange Act draws the line between public and private companies: As discussed in more detail in Section I.B, public companies are those that have conducted a registered offering of securities, elected to list securities on a national securities exchange, or fall above certain size thresholds pertaining to number of investors and value of assets.

The Exchange Act complements the Securities Act, but also reflects a different and somewhat inconsistent approach: Whereas the focus of the Securities Act is on *investor qualification*, as determined by wealth and sophistication, the Exchange Act generally focuses on the *funding choices and size attributes* of the issuer.[51] (The JOBS Act introduced further inconsistency by importing the concept of accredited investor into Section 12(g) of the Exchange Act;[52] because Section 12(g) has become largely irrelevant, however, the significance of this change is more symbolic than practical.)

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in November 2020 expanded the definition by adding indicators of financial literacy as qualifying factors. *Id.*

49. Regulation D, Rules 504–06, 17 C.F.R. §§ 230.504–06.

50. *See infra* Section I.C.1.

51. The inconsistency in the public–private lines under the Securities Act and the Exchange Act was first discussed in works by Donald Langevoort & Robert Thompson, and Adam Pritchard. *See* Langevoort & Thompson, *supra* note 4 (noting a "gross inconsistency in how the two main securities statutes—the Securities Exchange Act of 1934 and the Securities Act of 1933—approach [the public–private] divide"); A.C. Pritchard, *Revisiting "Truth in Securities" Revisited: Abolishing IPOs and Harnessing Private Markets in the Public Good*, 36 SEATTLE U. L. REV. 999, 1000 (2013) ("Both the Securities Act and the Exchange Act reflect a public–private divide, but they take very different approaches to drawing that line.").

52. *See infra* note 77 and accompanying text.

The final building block of the public–private divide relates to the regulation of *pools of capital.* The basic distinction here is between registered investment companies, such as mutual funds and money-market funds, which are subject to stringent regulation under the Investment Company Act of 1940, and private investment companies, including private equity funds and hedge funds, which are generally exempt from registration.[53] As we will see in Section II.B, the deregulation of this sphere has increased the supply of private capital; this increased supply has been able to satisfy the increased demand for private capital, which has been driven by the deregulation of matters governed by the Securities Act and the Exchange Act.

B. *Becoming a Public Company*

All mainstream business entities in the United States are organized under state law. Among those, corporations incorporated in Delaware are the most common type of entity that chooses to become a public company by following one of the pathways established by federal securities law.[54] An entity that has not chosen to become a public company is referred to as a private company. The sections that follow discuss two key background matters: why firms become public companies, and how they go about doing it. Despite the seeming continuity of U.S. capital markets, the answers to both questions have evolved in

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53. For a comprehensive and original analysis of the public–private divide as it pertains to investment companies, see Cary Martin Shelby, *Are Hedge Funds Still Private? Exploring Publicness in the Face of Incoherency*, 69 S.M.U. L. REV. 405 (2016). For an insightful analysis of the historical origins of the distinctive public–private line in this area, see John D. Morley, *Collective Branding and the Origins of Investment Management Regulation*, 6 VA. L. & BUS. REV. 341 (2012).

54. Note that while the corporation is the most common type of public company, limited partnerships, limited liability companies, and other entity types may also opt into the public company category established by federal law. Foreign business entities, somewhat confusingly referred to as "foreign *private* issuers," may also opt into all or, more commonly, a subset of U.S. public company regulation. Delaware's dominance as the preferred jurisdiction of incorporation for public companies is illustrated by the fact that in 2020 nearly 68% of Fortune 500 companies were registered in Delaware and approximately 93% of new U.S. IPOs were conducted by Delaware-registered entities. *See* DEL. DIV. CORPS, 2020 ANNUAL REPORT STATISTICS (2020), https://bit.ly/317nqNq.

recent years as a result of market developments and in response to regulation.

1. *Motivations for Going Public*

On a conceptual level, becoming a public company entails a bargain: a heretofore private company gains access to large and highly liquid pools of public capital, which enables it to raise funds quickly, efficiently, and at low cost, but, in return, the company becomes subject to an extensive federal regulatory regime. The foundational rationale for this regime's existence is the need to protect the "investing public"—the investors, i.e., suppliers of capital, who buy and sell securities on the public markets.[55]

The access-to-capital justification for going public has always had the greatest currency, but it increasingly fails to account for the observed market reality. The expanded supply of *private capital* due to the deregulatory cascade of the 2010s makes access to *public capital* much less of a growth imperative.[56] Tech firms such as Uber, Airbnb, and Dropbox were able to support their growth with private capital for years before they chose to go public, in each case reaching a previously-unimaginable scale and attaining the status of "unicorns" (private valuation of at least $1 billion), and, subsequently, "decacorns" (private valuation of at least $10 billion).[57] With so much private capital on offer, the process of going public—and becoming subject to federal corporate governance regulation—can be put off for a long time: the median age of U.S.

55. *See, e.g.,* Michael D. Guttentag, *Protection from What? Investor Protection and the JOBS Act*, 13 U.C. DAVIS BUS. L.J. 207, 221–22 (2013); JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 19, 50 (1982).

56. *See infra* Sections II.B–C.

57. *See, e.g.*, George S. Georgiev, *Securities Laws are Speed Bumps that Prevent Uber-Sized Wrecks*, HILL (June 29, 2017), https://bit.ly/3D3b5aa [hereinafter Georgiev, *Uber-Sized Wrecks*] (discussing the rise of unicorns and associated regulatory issues). The most recent additions to the unicorn nomenclature are the terms "hectocorn" and "centicorn," which refer to a private company with an implied valuation of over $100 billion. While unicorns are now commonplace, hectocorns or centicorns do remain rare. *See* Michael Sheetz, *Elon Musk's SpaceX Hits $100 Billion Valuation After Secondary Share Sale*, CNBC (Oct. 8, 2021), https://cnb.cx/3rhq3XD (noting that SpaceX has become the first, and so far the only, U.S.-based company to reach an implied private valuation over $100 billion).

tech firms going public in 1999 was 4 years, whereas in 2020 it was 12 years.[58] Based on 40 years of data, the pre-JOBS Act (1980–2011) average median was 7.8 years (notwithstanding the dot-com bust and the global financial crisis, both of which delayed many IPOs and skew this number upwards), whereas the post-JOBS Act (2012–2020) average median had increased considerably to 11 years.[59]

Beside public versus private capital, another relevant distinction for explaining the changed market realities relates to the increased importance of *non-financial capital* relative to financial capital. Evidence suggests that firms in certain industries have more difficulty attracting human capital than financial capital, and, simultaneously, that human capital has become more important than financial capital to many firms' success.[60] A recent study observed that "[p]ossibly for the first time in history, we're talent-constrained instead of [financial] capital-constrained."[61]

The increase in the relative importance of human capital as a result of changes in the economy has impacted the IPO calculus: At many firms, the going-public decision, ostensibly about raising new financial capital, has become subordinate to concerns about attracting and keeping human capital, i.e., the skills and knowledge embodied in the firm's employees. Startups often use their own equity to cover part of the compensa-

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58. *See* JAY R. RITTER, INITIAL PUBLIC OFFERING: UPDATED STATISTICS 12 tbl. 4a (2021), https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf [hereinafter *Ritter's IPO Database*].

59. Author's calculations based on data contained in *Ritter's IPO Database*. A prominent discontinuity in the trend occurred in 2008: In the period 1980–2007, the median IPO age ranged between 4 and 9 years; in the period 2008–2020, it ranged between 9 and 14 years. *Id.* Ritter's annual data is reported as a median; my calculations for multiple-year periods take the average of the annual median figures, hence the references to "average median."

60. *See, e.g.*, Vijay Govindarajan et al., *Why We Need to Update Financial Reporting for the Digital Era*, HARV. BUS. REV. (June 8, 2018), https://bit.ly/3rxRpJn (noting that "[f]inancial capital is assumed to be virtually unlimited, while certain types of human capital are in short supply").

61. Eric Ries, *Foreword* to SCOTT KUPOR, SECRETS OF SAND HILL ROAD: VENTURE CAPITAL AND HOW TO GET IT, at xi (2019). *See also* George S. Georgiev, *The Human Capital Management Movement in U.S. Corporate Law*, 95 TUL. L. REV. 639 (2021) [hereinafter Georgiev, *Human Capital Management*] (discussing firms' adaptive responses to the increased significance of human capital).

tion packages for executive and non-executive employees.[62] Doing so has considerable advantages: saving on salary expenses, managing liquidity, and aligning performance incentives. However, by the time a firm has a sizeable workforce and/or has been in existence for some time, there is also a sizeable (and often vocal) group of stakeholders—the firm's employees—who have a vested interest in the firm going public.[63] Employees prefer for the stock they receive as part of their compensation to be publicly traded because public company stock is free of trading restrictions, has greater liquidity, and may command a premium over otherwise-identical private company stock.[64] The human capital justification for going public does not apply consistently across the economy; instead, it is a consideration predominantly at tech firms that have a substantial need for professionals whose skills are scarce.

To be sure, any IPO decision is unlikely to be driven by a single factor. Beside human capital, there are a number of other ancillary considerations and explanations that do not revolve around the need to raise new equity capital.[65]

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62. *See, e.g.,* Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155 (2019) (describing the process and associated legal challenges).

63. *See, e.g.*, Erin Griffith, *Inside Airbnb, Employees Eager for Big Payouts Pushed It to Go Public*, N.Y. TIMES (Sept. 20, 2019), https://nyti.ms/3HXxdqd (noting tensions among Airbnb's 6,000-person workforce due to delays in the IPO process).

64. For an overview of the relevant considerations, see Eric D. Schoenborn, *Equity Compensation at Private Firms: How to Compete for Executive Talent*, SOC'Y FOR HUMAN RES. MGT. (Jan. 15, 2009), https://bit.ly/31b9D8s.

65. For example, going public gives firms opportunities to adjust their capital structure. For one, it enables firms to *return equity capital* to existing investors by making it possible to borrow more efficiently on the *public debt markets*. Alternatively, it enables them to replace one set of investors (venture capital and private equity funds) with another set of investors (those investing through the public markets). Separately, firms may pursue an IPO because public companies are widely covered in the financial and general press and enjoy a significant amount of free publicity relative to private companies; this is of particular value to consumer-facing businesses. Public company stock can also serve as an acquisition currency, meaning that an acquisitive firm would benefit from public company status. Finally, going public may send a positive signal about a firm's maturity and the quality of its corporate governance: the decision to go public can function as a bonding mechanism, which might yield real benefits in terms of the cost of capital. *See, e.g.*, John C. Coffee, Jr., *The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, *in* GLOBAL MARKETS, DOMESTIC INSTITUTIONS 437 (Curtis J. Milhaupt ed., 2003) (discussing the benefits of

2. *Pathways to Going Public*

Whereas the justifications for taking on public company status come from the realm of business strategy, the process of doing so is driven by law. Becoming a public company generally involves a carefully choreographed, multi-stage process that requires financial advisors (underwriters), legal advisors, auditors, public relations experts, and others. By far, the most common and most well-known scenario involves conducting an IPO under the Securities Act of 1933 by issuing new securities as a means of raising additional equity capital.[66] Traditional IPOs involve a great degree of intentionality, planning, and expense,[67] all of which have contributed to recent deviations from the default approach.

Another path to going public involves listing already-existing securities on a national stock exchange; this process triggers public company status through the registration requirements contained in the Securities Exchange Act of 1934.[68] While relatively uncommon until recently, this avenue for taking on public company status gained more prominence after Spotify's direct listing transaction in 2018 and the New York Stock Exchange's subsequent efforts to amend its listing requirements to facilitate such transactions.[69] Spotify's direct listing resulted in a near-instantaneous $30 billion public com-

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U.S.-style public company regulation in terms of access to capital); Amir N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, 4 CHI. J. INT'L L. 141 (2003) (discussing the nexus between listing on the regulated public markets and enhanced access to capital).

66. *See* Securities Act § 5(c), 15 U.S.C. § 77e(c) (2012) (prohibiting the sale of any security unless a registration statement is effective); *id.* § 77d(a)(2) (declaring that the prohibition does not apply to "transactions by an issuer not involving any public offering"). The specific prescriptions of the Securities Act, as well as the liability provisions that apply to issuers, their directors and officers, and to underwriters have made the traditional IPO process both structured and standardized.

67. *See, e.g.*, LATHAM & WATKINS LLP, *supra* note 42 (providing a detailed guide to the mechanics of the traditional IPO process).

68. *See* Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78l(d) (2011).

69. *See* Marc D. Jaffe et al., *Spotify Case Study: Structuring and Executing a Direct Listing*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 5, 2018), https://bit.ly/3FZO8GN (discussing Spotify's innovative direct listing transaction). Other companies that have taken advantage of this route include Slack, Palantir, Asana, and Thryv Holdings. *See* Anna T. Pinedo et al., *Primary Direct Listings: A Hybrid Approach to a Traditional IPO Alternative*, HARV. L. SCH. F. ON

pany valuation.[70] One considerable advantage to direct listings is the cost saving. Whereas companies pursuing traditional IPOs pay as much as 7% of the IPO proceeds in fees to their underwriters and often deliberately underprice the stock to ensure an "IPO pop" on the first day of public trading, companies going public through direct listings can avoid these costs.[71] Relatedly, removing underwriters from the process also removes the risk of misaligned incentives in IPO pricing.[72]

Mergers, acquisitions, and spin-off transactions are also used to create public companies, or take on public company status, without conducting a traditional IPO. SPAC transactions—controversial but booming—involve the public listing of a shell company (a special-purpose acquisition vehicle), which uses the IPO proceeds to acquire an existing operating company; the upshot is that the operating company attains public company status without going through the disclosure and due diligence process associated with a traditional IPO.[73] As illustrated by Figure A–1 in the Appendix, such transactions have experienced a dramatic resurgence since 2017, having previously enjoyed a brief spell of popularity immediately

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CORP. GOVERNANCE (Jan. 24, 2021), https://bit.ly/3leYdYc (discussing precedent transactions and the SEC's evolving approach to direct listings).

70. *See* Katie Roof, *Spotify Opens at $165.90, Valuing Company at Almost $30 Billion*, TECHCRUNCH (Apr. 3, 2018), https://tcrn.ch/3rejoh7.

71. *See* Matt Levine, *How to Disrupt the IPO Pop*, BLOOMBERG OP. (Oct. 4, 2019), https://bloom.bg/3D1uxE0. Evidence suggests that the average IPO is underpriced by approximately 20% to ensure that the stock price rises on the first day of trading, which benefits large institutional investors that received initial allocations. *See Ritter's IPO Database*, *supra* note 58, at 4 (reporting that "money left on the table" for all IPOs conducted between 1980 and 2020 averaged 20.1% of proceeds on a proceeds-weighted basis); *see also* John C. Coffee, Jr., *The Irrepressible Myth That SEC Overregulation Has Chilled IPOs*, COLUM. L. SCH. BLUE SKY BLOG (May 29, 2018), https://bit.ly/3pbqa4j (discussing IPO mechanics and associated costs).

72. *See, e.g.*, Patrick M. Corrigan, *Footloose with Green Shoes: Can Underwriters Profit from IPO Underpricing?*, 38 YALE J. ON REG. 908, 914 (2021) (noting that "[g]reen shoe options break the incentive alignment of underwriters and issuers to price IPOs as high as possible, since underwriters maximize the value of green shoe options by pricing the IPO as *low* as possible").

73. *See, e.g.*, John Detrixhe, *IPOs Are Popping Like It's 1999, and Executives Are Fed Up*, YAHOO (Sept. 3, 2020), https://yhoo.it/3E7kYF1. The securities law liability implications of both SPACs and direct listings are as-yet uncharted territory. *See* John C. Coates, *Statement by Acting Director Coates on SPACs, IPOs and Liability Risk Under the Securities Laws*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 9, 2021), https://bit.ly/3D30FaD.

prior to the 2008 financial crisis.[74] Using somewhat similar mechanics, reverse mergers are another non-conventional (and similarly controversial) way to gain public company status.[75] Though largely overlooked in the literature, spin-off transactions in accordance with SEC Staff Legal Bulletin No. 4 are another means of creating a public company. In a spin-off, an already-existing public company carves out business assets, bundles them into a new company, and distributes the shares of this new company as a tax-free dividend to its existing public shareholders.[76]

The final mechanism for going public is very important for purposes of this Article, but it is largely irrelevant for capital market participants; indeed, it is important here precisely because it has grown to be irrelevant. Under Section 12(g) of the Exchange Act, if a private company reaches a certain number of public "shareholders of record" and a certain minimum asset size (jointly, an imperfect proxy for firm size), the company automatically becomes subject to the reporting requirements of the Exchange Act and, thus, a public company. In effect, a business entity could become a public company without taking any affirmative steps to raise capital or improve secondary market liquidity. Congress initially set the registration trigger at 500 shareholders of record in 1964. In 2012, it raised the overall registration trigger to 2000 shareholders of record, added an additional registration trigger at 500 non-accredited investors, and expressly excluded employee-investors from the

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74. The SPAC trend may be curtailed if litigation filed by law professors John Morley and Robert Jackson in 2021 is successful. Morley and Jackson have argued that SPACs should be regulated as investment funds (and not merely as operating companies), which would result in stricter oversight under the Investment Company Act of 1940. *See, e.g.*, Andrew Ross Sorkin et al., *A SPAC Counterattack*, N.Y. TIMES (Aug. 30, 2021), https://nyti.ms/3lAv61K.

75. *See, e.g.*, Thompson & Langevoort, *supra* note 4, at 1588–98 (discussing the law and economics of reverse mergers). Definitionally, reverse mergers are transactions whereby "a private company directly or indirectly merges into a shell company that has established itself as a public issuer under the [Exchange] Act." *Id.* at 1589.

76. *See* SEC Staff Legal Bulletin No. 4 (CF) (Sept. 16, 1997). On the governance implications of spin-offs, see Young Ran (Christine) Kim & Geeyoung Min, *Insulation by Separation: When Dual-Class Stock Met Corporate Spin-Offs*, 10 U.C. IRVINE L. REV. 1 (2019).

count.[77] (Arguably, the legislative change was initiated to accommodate Facebook, which, at the time, was on course to reach the 500-shareholder threshold before it was ready to go public.[78])

The higher threshold for mandatory registration post-2012, the exclusion of employee-investors from the count, and the evolution of technologies that artificially deflate the count, have rendered this provision essentially meaningless. The original rationale behind it, however, is worth bearing in mind: in 1964, Congress determined that firms of a certain size (and, implicitly, societal footprint) should be subject to federal regulation irrespective of those firms' capital raising needs and irrespective of their preferences regarding public company status.

There are certain other categories of companies that can be described as semi-public: because of various characteristics—most notably small size, infancy, and foreign status—they are subject to a subset of public company regulations, either permanently or, as in the case of emerging growth companies, for up to five years.[79] The level of heterogeneity and complex-

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77. Section 12(g) of the Exchange Act, as amended by the JOBS Act, requires a company to register its securities under the Exchange Act if it has $10 million or more in total assets and a class of equity securities "held of record" by 2000 or more persons (or 500 or more persons who are not "accredited investors"). *See* Exchange Act § 12(g)(1)(A), 15 U.S.C. § 78l(g)(1)(A) (2012). Importantly, both numbers exclude shareholders who received the securities through an employee compensation plan exempt from registration. *Id.* § 781(g)(5).

78. *See* Richard Waters, *Effects of the JOBS Act Are Hard to Predict*, FIN. TIMES (Apr. 4, 2012), https://on.ft.com/3E2gsaZ. *See also* Langevoort & Thompson, *supra* note 4, at 355–59 (discussing the issue of Facebook's pre-IPO capital raising in the context of the Exchange Act).

79. For example, "smaller reporting companies," which generally have a public float of less than $250 million, are required to disclose less historical financial information. They also receive exemptions from certain provisions of the Sarbanes–Oxley and Dodd–Frank Acts, and have more time to file their reports. Additionally, the JOBS Act created the category of "emerging growth company" (EGC) for firms with gross annual revenue of less than $1 billion (indexed to inflation and subject to periodic update). EGCs enjoy substantially reduced disclosure requirements, both under the Securities Act as part of the IPO process, and under the Exchange Act for purposes of their ongoing reporting obligations (for up to five years). Regulation A and Regulation CF (Crowdfunding) enable firms to raise small amounts of capital without complying with the full disclosure regime. Foreign companies issuing securities in the United States also benefit from certain exemptions. *See*

ity in the securities laws has expanded considerably as a result of the developments discussed in Section II.B. This Article focuses on the paradigmatic public company, which is subject to all the public company regulations described in Section I.C.

C. *Regulatory Means and Ends*

Public company regulation—the public realm of securities law—comprises a set of interwoven SEC rules and regulations,[80] various liability provisions,[81] stock exchange listing rules,[82] and public company accounting standards.[83] Taken together, these are most accurately described as a loosely-coordinated system of federal corporate governance, which sits atop the corporate governance provisions contained in applicable state law statutes.[84] Because of its accretive nature and the absence of a single legislative or administrative instrument containing all relevant provisions, public company regulation is sometimes dismissed as merely a system of investor-oriented disclosure rules and procedural shareholder voting rules that are flawed or, at best, ineffectual. Such descriptions, however, are both reductive and incomplete: certain provisions framed as disclosure rules extend beyond the dissemination of information and shape internal governance arrangements or corporate behavior; other provisions directly impose substantive mandates.

George S. Georgiev, *Too Big to Disclose: Firm Size and Materiality Blindspots in Securities Regulation*, 64 UCLA L. REV. 602, 614–16 (2017) [hereinafter Georgiev, *Too Big to Disclose*].

80. This includes rules and regulations promulgated by the SEC pursuant to specific mandates in federal legislation, such as the Sarbanes–Oxley and Dodd–Frank Acts, as well as the SEC's broad authority over disclosure.

81. *See generally* THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION §§ 7.0–7.17, 12.1–13.2, Westlaw (database updated 2021).

82. Stock exchange listing rules are commonly viewed as an integral part of public company regulation. Some of these rules stem from the Sarbanes–Oxley and Dodd–Frank Acts, whereas others do not but have the same effect in practice. *See generally* Geeyoung Min & Kwon-Yong Jin, *Relational Enforcement of Stock Exchange Rules*, 47 BYU L. REV. (2021).

83. *See, e.g.*, Corporate Accounting Practices: Is There a Credibility GAAP?: Hearing Before the H. Subcomm. on Cap. Mkts., Ins., and Gov't Sponsored Enters., Comm. on Fin. Servs., 107th Cong. 152–64 (2002) (statement of Robert K. Herdman, Chief Accountant, U.S. Sec. & Exch. Comm'n).

84. *See* MARC I. STEINBERG, THE FEDERALIZATION OF CORPORATE GOVERNANCE 19–20 (2018).

The overview that follows pays special attention to these points because they are vital to appreciating the full range and depth of the regulatory regime. It is also worth emphasizing that this regime represents a significant difference between private companies, which are subject only to state law rules, and public companies, which are subject to the comprehensive federal regulatory scheme described here *in addition to state law rules*. The overview highlights the deeply problematic nature of firms' ability to treat this regime as elective and the resulting public company regulatory paradox described in the Introduction. The question about the goals of the regulatory regime is discussed at the end of this section.

1. *The Public Company Regulatory Regime*

The majority of public companies, as well as the paradigmatic public company, are subject to the full range of public company regulation.[85] The requisite information, including, in the case of substantive requirements, confirmations of compliance, is disclosed publicly according to timelines devised by the SEC.[86] The regulatory requirements are backed up by an elaborate liability and enforcement regime, which includes private enforcement by shareholders (and, in certain cases, bondholders), public enforcement by the SEC (and, in certain cases, the DOJ), and a regime of sanctions maintained by the stock exchanges.[87] Enforcement of state law claims often bene-

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85. Recall, however, that firms that fall in certain categories are exempt from some of the rules, either generally or for a limited time. *See* Georgiev, *Too Big to Disclose*, *supra* note 79 and accompanying text.

86. Depending on the rule in question, disclosure may be called for periodically (yearly or quarterly), on a current basis (promptly upon the occurrence of significant corporate events), or episodically, in connection with certain major transactions. See DIV. CORP. FIN., U.S. SEC. & EXCH. COMM'N, FINANCIAL REPORTING MANUAL 19, 36 (2008). For example, the SEC's Form 10-K sets out information to be disclosed on an annual basis, Schedule 14A sets out information required to be filed in connection with matters subject to a shareholder vote (usually at the annual general meeting), and Form 10-Q sets out information to be disclosed on a quarterly basis. *Id.* The current reporting requirements are set out in Form 8-K, which must be filed within four business days of the occurrence of the relevant event. *Id.* at 38. As an example of episodic disclosure, a tender offer would necessitate the filing of information required under Schedule TO. *Id.* at 349–50.

87. As part of enforcement proceedings, the SEC routinely enters into one-off settlement agreements with public companies whereby the companies voluntarily undertake to make substantial changes to their governance

fits substantially from information disclosed as a result of regulatory requirements under federal law.[88] The public nature of disclosure also guarantees that firms will be subject to public scrutiny from the media, academics, public interest organizations, politicians, and others.

The most familiar elements of public company regulation require the reporting of historical information about a firm's business activities, financial condition, and results of operations, as well as more forward-looking information about material trends and uncertainties, risks facing the business, and exposure to legal proceedings, among other business and operational issues.[89] The shareholder meeting process is also regulated through a set of requirements that put in place procedural safeguards and mandate disclosure of additional information in connection with matters subject to a shareholder vote. Such matters include the election of board members, amendments to the firm's organizational documents, approval of certain types of transactions, non-binding resolutions contained in shareholder proposals, and non-binding approval of executive compensation arrangements.[90]

Financial reporting is another heavily regulated area. The relevant rules implicate both the nature and format of information required to be disclosed and, importantly, the internal procedures and oversight mechanisms within public companies. As a basic matter, public companies are required to file audited financial statements with the SEC.[91] These statements, which often include lengthy expositions in the form of "notes," provide a wealth of information in a standardized for-

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practices that go beyond what the law requires. *See* STEINBERG, *supra* note 84, at 142–45.

88. *See, e.g.*, *In re* Clovis Oncology Derivative Litig., No. 2017-0222-JRS, 2019 WL 4850188 at *5, *7, *9 (Del. Ch. Oct. 1, 2019) (relying on required periodic disclosure filings to support review of duty of oversight claim under Delaware law).

89. These requirements are contained, respectively, in the following provisions of SEC Regulation S-K: Item 101, Item 303, Item 503(c), Item 305, and Item 103. *See* 17 C.F.R. § 229 et seq.

90. *See* Schedule 14A, 17 C.F.R. § 240.14a-101 (2020). The votes on shareholder proposals and executive compensation arrangements are advisory to the board. *See* Rule 14a-8, 17 C.F.R. § 240.14a-8 (2020); Regulation S-K Item 402, 17 C.F.R. § 229.402 (2020).

91. *See* Regulation S-K Item 302, 17 C.F.R. § 229.302 (2020); Regulation S-X Rule 10-01, 17 C.F.R. § 210.10-01 (2020).

mat.[92] The process for promulgating accounting standards, administered by the Financial Accounting Standards Board (FASB) and overseen by the SEC, also amounts to a form of public company regulation.[93] A separate regulatory body, the Public Company Accounting Oversight Board (PCAOB), sets and oversees standards for preparing audit reports.[94]

The regulation of public company financial reporting covers not just the outputs but also the process. The CEO and CFOs of public companies are required to certify in periodic reports filed with the SEC that the financial statements and other disclosures contained in such reports are accurate, and fairly and accurately present the company's operations and financial condition.[95] In connection with making this certification, the officers are responsible for establishing and maintaining "disclosure controls and procedures"[96] and "internal control over financial reporting."[97] Guidance on how to meet these mandates is extensive and fairly prescriptive.[98] Relatedly, companies are required to assess and report on the effectiveness of their internal control structure and, if material weaknesses are identified, disclose those to shareholders.[99] The internal controls must also be inspected and reported on by an

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92. *See* Regulation S-X Rule 10-01, 17 C.F.R. § 210.10-01.

93. *See Standard-Setting Process*, FIN. ACCT. STANDARDS BD., https://bit.ly/2ZAfqny.

94. Sarbanes–Oxley Act of 2002 § 101, 15 U.S.C. § 7211 (2012); *Public Company Accounting Oversight Board (PCAOB)*, INVESTOR.GOV, https://bit.ly/3xzMxVe. While the PCAOB is independent, its members are appointed by the SEC. *Id.*

95. Sarbanes–Oxley Act of 2002 § 302.

96. Exchange Act Rule 13a–15, 17 C.F.R. § 240.13a-15 (2020).

97. Exchange Act Rule 15d–15, 17 C.F.R. § 240.15d-15 (2020). The CEO and CFO certification requirements in respect of these matters are contained in Regulation S-K Items 307 & 308, 17 C.F.R. § 229.307–308 (2020).

98. *See, e.g.*, PROTIVITI, GUIDE TO THE SARBANES–OXLEY ACT: INTERNAL CONTROL REPORTING REQUIREMENTS (4th ed. 2007), https://bit.ly/3o0hnTC. On the difference between SOX sections 302 and 404, see Shanna Nasiri, *The Differences Between SOX 302 and 404 Requirements*, RECIPROCITY (Dec. 5, 2019), https://bit.ly/3pazMwd.

99. Sarbanes–Oxley Act of 2002 § 404(a). The results of the testing must be reviewed by management, and all control testing failures identified must be categorized as a deficiency, significant deficiency, or material weakness. The company is required to report on deficiencies to the Audit Committee and the Board of Directors, and material weaknesses must be disclosed in the company's annual 10-K filing with the SEC. *See* PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD, AUDITING STANDARDS (AU) Section 325: COM-

external auditor.[100] In short, the provisions related to financial reports and the financial reporting process are complex and extensive.

Certain SEC rules and practices have the effect of imposing higher standards of conduct upon public companies than what is required under state law. For example, an SEC rule requires disclosure of any transactions amounting to more than $120,000 between a public company and any of its executive officers or directors (and their affiliates),[101] which serves to discourage self-dealing and the suboptimal use of corporate resources. Another SEC rule requires a public company that is undertaking a transaction whereby existing public shareholders are cashed-out to disclose whether it "reasonably believes that the [relevant] transaction is fair or unfair" to such shareholders, and the "material factors" upon which this belief is based.[102] Because disclosing that the transaction is "unfair" (or disclosing fairness without an adequate basis) would subject the company to litigation, this rule in effect requires public companies to ensure the fairness of such transactions. To safeguard the economic rights of the shareholders of the acquisition target, the SEC has also engaged in extensive rulemaking in the context of acquisitions via a tender offer.[103]

Public company regulation is particularly expansive in the areas of board structure and composition as well as executive

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MUNICATIONS ABOUT CONTROL DEFICIENCIES IN AN AUDIT OF FINANCIAL STATEMENTS, https://bit.ly/3d43lKd.

100. Sarbanes–Oxley Act of 2002 § 404(b).

101. Regulation S-K Item 404, 17 C.F.R. § 229.404 (2020). The extension of this rule to affiliates substantially expands its scope due to the broad definition of affiliate under federal law. *See* Vladimir Atanasov, Bernard Black & Conrad S. Ciccotello, *Law and Tunneling*, 37 J. CORP. L. 1, 11 (2011); *see also Statement of Financial Accounting Standards No. 57: Related Party Disclosures*, FIN. ACCT. STANDARDS BD. 10 (1982), https://bit.ly/3E2vygH (defining "affiliate"). On the interaction between state and federal law, see Geeyoung Min, *The SEC and the Courts' Cooperative Policing of Related Party Transactions*, 2014 COLUM. BUS. L. REV. 663 (2014).

102. Regulation M-A Item 1014, 17 C.F.R. § 229.1014 (2020); *see* Rule 13e-3, 17 C.F.R. § 240.13e-3 (2020); Schedule 13E-3 Item 8, 17 C.F.R. § 240.13e-100 (2020).

103. *See Information for Certain Types of Transactions and Filers*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/corpfin/omalinks (last visited Oct. 30, 2021); STEINBERG, *supra* note 84, at 140–42. In so doing, the SEC has gone beyond what is strictly required by the relevant federal statute (the Williams Act of 1968). *Id.* at 141 n.150.

compensation. The relevant provisions are of fairly recent vintage: virtually all stem from Sarbanes–Oxley, Dodd–Frank, stock exchange listing requirements adopted in the early 2000s, and independent (i.e., not congressionally-mandated) SEC rulemaking from the 1990s and 2000s. These provisions have also been subject to the most criticism because they lock in place arrangements in areas that had theretofore been subject to private ordering due to the lack of state law requirements.[104] The net result of the various federal regulatory provisions is a fairly standardized public company governance model, which is described in a stylized fashion below. By contrast, there is no standardized governance model for private companies.[105]

Some of the defining features of the public company governance model pertain to board structure and composition. Public company boards are comprised of a majority of independent directors and usually have three major committees in common: an audit committee (with at least one person who qualifies as a "financial expert"), a compensation committee, and a nominating committee.[106] Each of these committees has specified responsibilities.[107] Public companies are required to provide detailed information about the skills and qualification

104. *See, e.g.*, Jill E. Fisch, *Leave It to Delaware: Why Congress Should Stay Out of Corporate Governance*, 37 DEL. J. CORP. L. 731 (2013). *See also* sources cited in Section II.A *infra*.

105. *See, e.g.*, Renee M. Jones, *The Unicorn Governance Trap*, 166 U. PA. L. REV. ONLINE 165 (2017). Private companies that are seeking to go public, however, would eventually conform to the public company model. *Id.* at 167, 170–71. Some private companies have also adopted elements from the public company governance model in the wake of scandals. *See* Georgiev, *Uber-Sized Wrecks*, *supra* note 57 (highlighting Uber's voluntary adoption of governance structures that mirror the SEC's corporate governance requirements).

106. *See* Martin Edwards, *Expert Directors*, 90 U. COLO. L. REV. 1051, 1052, 1060–61 (2019); *see also* STEVEN M. BAINBRIDGE & M. TODD HENDERSON, OUTSOURCING THE BOARD: HOW BOARD SERVICE PROVIDERS CAN IMPROVE CORPORATE GOVERNANCE 160–61, 165–66 (2018).

107. The audit committee oversees internal and external financial reporting; the compensation committee determines executive compensation and prepares a compensation discussion and analysis (CD&A) report for inclusion in the company's proxy statement; the nominating committee is tasked with selecting new board members. *See* NYSE LISTED CO. MANUAL, §§ 3.03A.07, 303A.05 & 3.03A.04, https://bit.ly/3xWySre.

of directors,[108] as well as information about individual board members' meeting attendance records.[109] The relevant rules also require information about the board's leadership structure, and, in particular, whether the CEO also serves as the chair of the board.[110] There is also a requirement to disclose whether or not the company has adopted a code of ethics.[111] Again, disclosure is a significant—but by far not the only—way to effectuate public company regulation. In the area of executive compensation, for example, both Sarbanes–Oxley and Dodd–Frank mandated so-called "clawback" provisions in respect of erroneously-awarded incentive-based compensation.[112]

Controversially, the public company regulatory regime also contains disclosure requirements pertaining to various miscellaneous matters. Mainly stemming from the Dodd–Frank Act, these specialized rules require public companies to disclose information about the pay received by their median worker and the ratio between median worker pay and CEO pay;[113] information on the use within their supply chains of "conflict minerals" originating in the Congo and adjoining countries;[114] information about payments made to a foreign government or the U.S. federal government for the purpose of commercial development of oil, natural gas, or minerals

108. *See* Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334, 68,343 (Dec. 23, 2009); Regulation S-K Item 401(e), 17 C.F.R. § 229.401(e) (2020).

109. Regulation S-K Item 407(b), 17 C.F.R. § 229.407 (2020).

110. *See* Dodd–Frank Act § 972, 15 U.S.C. § 78n-2 (2010). In the case of CEO/Board Chair duality, the stock exchange rules require the appointment of an executive director and the holding of executive board sessions (without the CEO present). *See* NYSE LISTED CO. MANUAL, § 303A.03 & Commentary, https://bit.ly/31wyggj; *see also* NASDAQ REG., 5605(b)(2), https://bit.ly/3DpL8Sf.

111. Sarbanes–Oxley Act of 2002 § 406. The stock exchange listing rules elevated this provision from a disclosure to a substantive mandate by requiring that listed public companies adopt a code of ethics meeting certain standards.

112. *See* Steven A. Bank & George S. Georgiev, *Paying High for Low Performance*, 100 MINN. L. REV. HEADNOTES 14, 23-27 (2016). The Sarbanes–Oxley clawback rule is in effect but can be enforced only by the SEC; the Dodd–Frank clawback rule has not been finalized as of this writing.

113. Dodd–Frank Act § 953(b).

114. *Id.* § 1502.

(known as "resource extraction payments");[115] information about mine health and safety (if applicable);[116] and information on whether they have engaged in activities covered by the Iran Sanctions Act.[117] These specialized disclosure rules have been subject to criticism among academic commentators and even by individual members of the SEC.[118] Many were targeted for legislative repeal[119] and two were challenged in court,[120] but, with very limited exception, the rules survived and are in force today.[121]

The expansive regulatory framework discussed here has often been described critically as the "federalization of corpo-

115. Section 1504 of the Dodd–Frank Act added Section 13(q) to the Securities Exchange Act of 1934. The original rule promulgated by the SEC was invalidated by Congress in 2017 pursuant to the Congressional Review Act. The SEC adopted a revised version of the rule in December 2020. *See* Disclosure of Payments by Resource Extraction Issuers, Exchange Act Release No. 34–90,679, Dec. 16, 2020, https://www.sec.gov/rules/final/2020/34-90679.pdf.

116. Dodd–Frank Act § 1503.

117. *See* Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRA), Pub. L. No. 112-158, 126 Stat. 1214. Section 219 of the ITRA added a new Section13(r) to the Securities Exchange Act of 1934. *Id.*

118. *See, e.g.*, Michael S. Piwowar, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks at the 34th Annual Current Financial Reporting Issues Conference (Nov. 16, 2015), https://www.sec.gov/news/speech/piwowar-current-financial-reporting-issues-conference.html (criticizing the SEC's adoption of congressionally-mandated pay ratio and conflict minerals disclosure rules and arguing that "[t]he focus on non-material, special interest disclosure provisions is a deplorable corruption of our mission to protect investors, to ensure fair, orderly, and efficient markets, and to facilitate capital formation").

119. Between 2011 and 2017, at least five distinct House bills targeted various Dodd–Frank provisions; none of these bills became law. *See* H.R. 10, 115th Cong. (2017); H.R. 5983, 114th Cong. (2016); H.R. 414, 114th Cong. (2015); H.R. 1135, 113th Cong. (2013); H.R. 1062, 112th Cong. (2011).

120. *See* Nat'l Ass'n of Mfrs. v. SEC, 956 F. Supp. 2d 43, 46 (D.D.C. 2013) (ruling on a challenge to the conflict minerals rule on First Amendment and APA grounds by the National Association of Manufacturers, the Chamber of Commerce, and the Business Roundtable); Am. Petroleum Inst. v. SEC, 953 F. Supp. 2d 5, 8 (D.D.C. 2013) (ruling on a challenge to the resource extraction payments rule).

121. The D.C. Circuit struck down part of the conflict minerals rule but upheld most of it. *See* Nat'l Ass'n of Mfrs. v. SEC, 800 F.3d 518, 170 (D.C. Cir. 2015). For the sake of completeness, it should be noted that even though the Dodd–Frank disclosure mandates discussed here ultimately survived, the SEC did suffer a significant loss at the D.C. Circuit in connection with a different Dodd–Frank rule. *See* Bus. Roundtable v. SEC, 647 F.3d 1144, 1146 (D.C. Cir. 2011) (striking down the SEC's proxy access rule).

rate governance."[122] This is true, but only up to a point. Because "public company" has become a truly elective category, a more apt characterization would be "*quasi*-federalization": there is indeed a federal regulatory regime, but firms now have a meaningful choice about whether to opt into federal regulation, with all the attendant obligations, or whether to avoid those obligations and remain subject only to state corporate law. This argument is explored in more detail in Section III.A.

2. *Investor Protection, Capital Formation, and Beyond*

After describing the means of public company regulation, it is worth considering its goals. Unfortunately, due to the size and scope of the regulatory framework, as well as its age and the haphazard patterns through which it has evolved, there is no absolute consensus about these goals as a positive matter—and even less so as a normative matter. The original statutes and the extensive lore of securities law focus repeatedly on investor protection. The term, however, is left undefined and open to interpretation.[123] The putative objects of protection—investors—have been growing ever more heterogeneous over time.[124] This suggests that not only do they need different types of protection but also that their interests may be in direct

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122. STEINBERG, *supra* note 84. *See also* STEPHEN M. BAINBRIDGE, CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS 21, 27–28 (2012).

123. *See, e.g.*, Guttentag, *supra* note 55, at 210 (outlining four distinct conceptions of "investor protection" consistent with legislative history and regulatory practice: protecting investors from fraud; protecting investors from informational asymmetries; protecting investors from tunneling of resources; and protecting investors from making irrational or harmful investment decisions). Separately, if investors' interests are taken to encompass non-financial goals, alongside traditional financial ones, then the scope of investor protection expands considerably and approaches total societal welfare. When investors are fully-diversified "universal owners" holding a slice of the broad economy, they would be rationally interested in maximizing the aggregate value of that slice rather than the value of any individual firm within the investment portfolio. For a modern interpretation and a novel normative framework, see Jeffrey N. Gordon, *Systematic Stewardship* (Eur. Corp. Governance Inst., Working Paper No. 566/2021), https://ssrn.com/abstract=3782814.

124. *See, e.g.*, Tom C.W. Lin, *Reasonable Investor(s)*, 95 B.U. L. REV. 461 (2015) (presenting a typology of heterogeneous investors).

conflict.[125] Even after these matters are settled, there is still the difficult question about the effectiveness of particular regulatory interventions in achieving the investor protection goal.

Since 1996, the securities law statutes also include a triad of additional goals: "promot[ing] efficiency, competition, and capital formation."[126] Among these, the SEC, Congress, and the policy community have focused almost exclusively on capital formation, which is often presented as a foil to investor protection.[127] The concept of capital formation, however, is also undefined; far from having any deep meaning that can guide policymaking, in securities law the term is usually used simply as a stand-in for firms' ability to raise capital.[128] For our purposes, we can ponder whether the goal should be capital formation on the *public* markets or the *private* markets, and what is the *efficient level* of capital formation. From a total welfare point of view, one goal of economic regulation should be allocative efficiency—allocating resources, in this case capital, to their most productive use. Unconstrained capital formation can be in direct conflict with this goal.[129]

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125. *See id.*; *see also* Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561 (2006) (discussing heterogeneity in investor profiles and interests).

126. *See* Securities Act of 1933, 15 U.S.C. § 77b(b) (2012); Exchange Act of 1934, 15 U.S.C. § 78c(f) (2012). In 1999, the same provision was added to the Investment Company Act of 1940 and applies to rulemaking thereunder. Investment Company Act of 1940, 15 U.S.C. § 80(a)-2(c) (2012).

127. For a discussion of the relevance and importance of competition to the SEC's mission, see Georgiev, *Too Big to Disclose*, *supra* note 79, at 658–62.

128. Curiously, the term "capital formation" was imported into mainstream securities regulation discourse *as recently as the 1990s*, without any elaboration. The term was embedded into law by the National Securities Markets Improvements Act of 1996 via the amendments cited in note 126 *supra*. In macroeconomics and neoclassical growth theory, the areas of inquiry where the term has been theorized, capital formation refers to long-term investment as a function of intertemporal choices about saving and consumption. A report to Congress from 1980 that discussed "federal actions that could promote capital formation" only lists macroeconomic and public finance policies, such as reducing the size of the federal deficit, changing various aspects of the tax system, stabilizing the regulatory environment and inflation, and assessing the availability of federal credit. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, PAD-80-24, AN ANALYTICAL FRAMEWORK FOR FEDERAL POLICIES AND PROGRAMS INFLUENCING CAPITAL FORMATION IN THE UNITED STATES v (1980), https://www.gao.gov/assets/pad-80-24.pdf.

129. This point is not merely academic. The rise of private capital has led to very significant losses at firms such as Theranos and many unicorns do not

Increasingly, securities law spills over beyond investor protection and capital formation. Some of the specific public company disclosure rules, particularly rules stemming from Sarbanes–Oxley and Dodd–Frank, are difficult to square with traditional notions of investor protection and capital formation, which suggests that Congress may have had in mind other goals, even if it did not clearly articulate them.[130] Writing in 2013, Langevoort & Thompson noted that "the extent to which—purely as a descriptive matter—securities regulation is about social, political, and economic interests, in addition to investor protection and capital formation, has been seriously underestimated" and characterized securities regulation as "a joint project of experimentation in investor protection coupled with a public-driven demand for more transparency, voice, and accountability . . . as to systemically significant business enterprises."[131] Though this trend continues to meet heavy resistance,[132] it is descriptively accurate, and a further complication to the ambiguities that bedevil both investor protection and capital formation.

Based on the foregoing discussion, one way to summarize the goals of securities law is by thinking about a regulatory scheme that enables investors to maximize risk-adjusted returns on invested capital and firms to maximize funding opportunities (including by minimizing the cost of capital). The question of whether securities law should focus on minimizing societal externalities remains subject to debate, as do questions about allocative efficiency and the proper balance among the various goals. As we will see in the following Part, these definitional and conceptual issues have made it easier to justify different types of legislation, thereby contributing to the breakdown of the public–private divide; unless resolved, these same definitional and conceptual issues are also likely to pre-

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turn a profit. *See infra* note 176 and accompanying text. On the financial performance of unicorns, see *infra* notes 225 & 235 and accompanying text.

130. *See, e.g.*, Ann M. Lipton, *Beyond Internal and External: A Taxonomy of Mechanisms for Regulating Corporate Conduct*, 2020 WIS. L. REV. 657, 658–61 (2020) (noting a tendency to frame regulatory interventions with reference to shareholder/investor protection even when the subject matter does not justify this).

131. Langevoort & Thompson, *supra* note 4, at 372–73.

132. *See, e.g.*, Piwowar, *supra* note 118.

sent a challenge to repairing the public–private divide and securities law more generally.

II.
THE ROAD TO THE BREAKDOWN OF THE PUBLIC–PRIVATE DIVIDE

This Part examines the numerous, often confounding regulatory and market developments related to public companies since the early 2000s. In the aggregate, these developments have led to the breakdown of the public–private divide. This was a gradual process, whose roots can be traced back to the Sarbanes–Oxley Act in 2002; it gained traction due to the decline in the number of public companies in the 2000s, and ultimately culminated with a long series of deregulatory measures between 2012 and 2020. Because those measures have been self-reinforcing, this Article refers to them as a deregulatory cascade. These developments are described thematically in Section II.B and illustrated by two figures in Section II.C. The bottom line is that the capital raising process in 2021 looks nothing like the capital raising process just two decades prior.[133]

A. *SOX as Shock . . . and Scapegoat*

The Sarbanes–Oxley Act of 2002 (known colloquially as "SOX") was the most ambitious federal law pertaining to public companies since the 1930s. It resulted from the financial scandals in the early 2000s that involved accounting fraud at well-known firms such as Enron, WorldCom, Global Crossings, Tyco, Adelphia, and others.[134] The scandals resulted in bankruptcies, the loss of approximately $1.5 trillion in market

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133. Based on a close reading of the available evidence, this Article makes the case that the most consequential changes that ultimately transformed securities regulation can be traced back to the 2002 Sarbanes–Oxley Act. To be sure, even though securities regulation was more stable during the prior decades, it was certainly not static. There were several developments that expanded private markets and the availability of exemptions in primary offerings, such as the initial adoption of Regulation D in 1982 and subsequent amendments. On this and other points, a different telling of the deregulation story that follows is certainly possible.

134. *See generally* Jonathan R. Macey, *A Pox on Both Your Houses: Enron, Sarbanes–Oxley and the Debate Concerning the Relative Efficacy of Mandatory Versus Enabling Rules*, 81 WASH. U. L. Q. 329 (2003).

value, and hundreds of thousands of jobs.[135] It also contributed to a general unease about the state of U.S. capitalism at the turn of the 21st century. Thus, SOX sought to restore financial disclosure transparency and revitalize investor confidence in the integrity of U.S. financial markets. As described in Section I.C, for example, SOX requires the CEO and CFO to certify the company's financial statements, and to establish and maintain "disclosure controls and procedures" and "internal control over financial reporting."[136] The Act also focused on the boards of directors of public companies, putting in place various provisions related to director independence and requiring that public companies establish audit committees, with certain membership requirements.[137]

In effect, SOX acted as a shock on the regulatory framework and increased the compliance costs of maintaining public company status. There was widespread skepticism about the Act's benefits among practitioners and prominent academics, one of whom notoriously labeled the legislation "quack corporate governance."[138] This epithet stuck and was applied again when the Dodd–Frank Act came around just eight years later.[139]

The Sarbanes–Oxley Act's provisions were not self-executing but, instead, required implementation through lengthy SEC rulemaking. During this process, many of them were debated and heavily contested.[140] The SEC enjoys broad exemptive authority,[141] so it had the power to delay the effectiveness

135. *See* Catherine Valenti, *A Year After Enron, What's Changed?*, ABC NEWS (Nov. 27, 2002), https://abcnews.go.com/Business/story?id=86817 (describing the economic toll of Enron's downfall). For an academic analysis, see generally William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275 (2002).

136. *See supra* notes 96–97 and accompanying text.

137. Sarbanes–Oxley Act of 2002 § 301, 18 U.S.C. § 1350.

138. Roberta Romano, *The Sarbanes–Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1523 (2005).

139. *See* Stephen M. Bainbridge, *Dodd–Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1781, 1821 (2011).

140. *See, e.g.*, Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817, 1818–19 (2007).

141. In 1996, Congress added Section 36 to the Exchange Act (under which the relevant rules fall), providing the SEC with sweeping general exemptive authority in respect of the Act's provisions "to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors." 15 U.S.C. § 78mm(a)(1).

of some of the Act's provisions and to water down others considerably. As part of the notice-and-comment rulemaking process at the SEC, which lasted for more than half a decade, the Act's opponents focused repeatedly on the high compliance costs imposed by the new rules. This period also saw greater competition from international capital markets; notably, London gained attention by promoting its light-touch regulation approach.[142] Two prominent working groups were formed to examine the competitiveness of U.S. capital markets. The resulting reports highlighted the high compliance costs associated with Sarbanes–Oxley's prescriptive mandates,[143] particularly as contrasted with the well-branded "principles-based regulation"[144] approach in the United Kingdom.[145]

The narrative about compliance costs was bolstered by an easily observable and troubling phenomenon: a substantial decline in new IPOs, which was rationally (though still hastily)

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142. *See, e.g.*, Roel C. Campos, Comm'r, U.S. Sec. & Exch. Comm'n, SEC Regulation Outside the United States (Mar. 8, 2007), https://www.sec.gov/news/speech/2007/spch030807rcc.htm (criticizing the "light touch" regime in the United Kingdom).

143. A 2007 McKinsey and New York City Economic Development Corporation report, which came to be known as the Bloomberg–Schumer Report, considered New York's and the United States' role within global financial markets. One of its headline findings was that "recent legislative and regulatory actions are hurting America's financial competitiveness." *See* MCKINSEY & CO. & N.Y.C. ECON. DEV. CORP., SUSTAINING NEW YORK'S AND THE US' GLOBAL FINANCIAL SERVICES LEADERSHIP ii, 86–87 (2007), https://on.nyc.gov/3D6zMSR. A contemporaneous report by the Committee on Capital Markets Regulation concluded that "[b]y any meaningful measure, the competitiveness of the U.S. public equity market has deteriorated significantly in recent years." COMM. ON CAP. MKTS. REGUL., THE COMPETITIVE POSITION OF THE U.S. PUBLIC EQUITY MARKET 1 (2007), https://bit.ly/3xEn5Ob.

144. The term "principles-based regulation" in corporate law and financial regulation has long functioned as a means of encouraging deregulation. *See, e.g.*, Lawrence A. Cunningham, *A Prescription to Retire the Rhetoric of 'Principles-Based Systems' in Corporate Law, Securities Regulation and Accounting*, 60 VAND. L. REV. 1411 (2007).

145. The perception of stagnation in the United States at the time was also driven in part by the significant openness to experimentation in capital markets in other jurisdictions. *See, e.g.*, Ronald J. Gilson, Henry Hansmann & Mariana Pargendler, *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the United States, and the European Union*, 63 STAN. L. REV. 475 (2011) (discussing capital market innovations in the European Union and Brazil).

attributed to the increased costs of being a public company.[146] Another element of this narrative was the "going dark" phenomenon, where public companies delisted their securities and thus exited the public company regulatory sphere.[147] By the start of the 2010s, the total number of public companies in the United States had shrunk by half, from a peak of 8,025 in 1996 down to 4,101 in 2012; the U.S. decline ran counter to international trends and was taken as evidence of a significant "listings gap."[148] The scale and persistence of this phenomenon gave further credence to the over-regulation narrative, which had always appeared intuitive. The business press regularly ran articles about the death or decline of the public com-

146. *See, e.g.*, *The Lure of the Private Firm*, ECONOMIST (Nov. 17, 2004), https://econ.st/3dUF6yy ("The Sarbanes-Oxley legislation . . . has imposed on public companies much onerous corporate-governance compliance—a source of constant complaint from bosses in America and beyond."); Russ Garland, *Fixing Public Markets' "Systemic Dysfunction,"* WALL ST. J. (Nov. 9, 2009), https://on.wsj.com/3I5JUzk (reporting "evidence of a serious and systemic dysfunction" in public markets and asserting that Sarbanes–Oxley rules are "the main scapegoat") (internal quotations omitted); *Uncuffing Capitalism*, ECONOMIST (Mar. 31, 2012), https://econ.st/3xvT439 (noting that "onerous regulations" such as Sarbanes–Oxley and Dodd–Frank are to blame for an "IPO drought").

147. The "going dark" phenomenon did not occur spontaneously. Regulatory changes from the mid-2000s greatly facilitated the process of delisting, i.e., the exit of public companies from the regulated public realm. Some of those changes were overdue and much needed. But they may have been overbroad in that they created a rush to the exits, which became known as "going dark." This decreased the overall size of public markets and may have resulted in the delisting (and thus, deregulation) of firms that should have remained public. *See* Jesse M. Fried, *Firms Gone Dark*, 76 U. CHI. L. REV. 135, 140–43 (2009) (describing the delisting process); *see also* Elisabeth de Fontenay, *Private Equity Firms as Gatekeepers*, 33 REV. BANKING & FIN. L. 115, 123 n.33 (2013). This also routinized "going private" transactions, which involve one investor (or a group of investors), such as a private equity fund, acquiring the publicly held stock of a company, whether through a merger or tender offer; some firms have used this process—traditionally thought of as a once-in-lifecycle transaction—with some frequency and in value-destroying ways. *See, e.g.*, David Scigliuzzo et al., *How Private Equity Works, and Took Over Everything*, BLOOMBERG BUSINESSWEEK (Oct. 3, 2019), https://bloom.bg/3p5Urlf.

148. *See* Craig Doidge et al., *The U.S. Listing Gap* 2 (Nat'l Bureau of Econ. Rsch., Working Paper No. 21,181, 2015) ("The number of U.S. listings fell from 8,025 in 1996 to 4,101 in 2012, whereas non-U.S. listings increased from 30,734 to 39,427.").

pany, public capital markets, and IPOs.[149] Commentators and policymakers began to consider measures to reverse these phenomena by decreasing the subset of companies to which Sarbanes–Oxley, and the rest of public company regulation, applies.[150] In short, Sarbanes–Oxley catalyzed the erosion of the public company regulatory sphere and, for a long time, market data provided the oxygen to keep this process going.

Well over a decade after Sarbanes–Oxley's adoption, it turned out that the over-regulation narrative was not just oversimplified but also wrong. High-quality empirical studies found that other factors caused the decline in IPO activity and the number of public companies. One study showed that the decline in small-firm IPOs started in 1998, well before the adoption of Sarbanes–Oxley and Dodd–Frank, and is attributable to a decrease in demand by institutional investors rather than to supply-side factors such as the cost of being a public company.[151] Another study noted that "market forces *independent of regulation*" (including increased M&A activity, greater availability of private capital, and changes in investment patterns) explained the decline in IPOs.[152] The study also highlighted the fact that the decline in IPOs was primarily a de-

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149. *See, e.g.*, Jason Zweig, *The Demise of the IPO—and Ideas on How to Revive It*, WALL ST. J. (June 25, 2010), https://on.wsj.com/3D39mlc (analyzing various challenges to IPO activity and stating that the IPO market is in "suspended animation"); Alix Stuart, *Missing: Public Companies – Why is the Number of Publicly Traded Companies in the U.S. Declining?*, CFO MAG. (Mar. 22, 2011), https://bit.ly/3xEnCj9 (discussing data on the decrease in the number of public companies and new IPOs and advocating for "a completely different market model" (quoting Edward Kim, capital markets senior advisor at Grant Thornton)); Brad Stone, *Silicon Valley Cashes Out Selling Private Shares*, BLOOMBERG BUSINESSWEEK (Apr. 21, 2011), https://bloom.bg/3E7ep5m (noting that "[o]wing to the Sarbanes-Oxley Act and other regulatory changes to capital markets over the past decade, the IPO is no longer an attractive goal for many companies"); Andrew Ross Sorkin, *C.E.O.s Meet in Secret over the Sorry State of Public Companies*, N.Y. TIMES (July 21, 2016), https://nyti.ms/3xFzf9G (asserting that "[p]ublicly listed companies in the United States have become something of a dying breed").

150. *See supra* note 141 and accompanying text.

151. *See* Robert P. Bartlett III, Paul Rose & Steven Davidoff Solomon, *The Small IPO and the Investing Preferences of Mutual Funds*, 47 J. CORP. FIN. 151, 163, 165 (2017).

152. *See* Paul Rose & Steven Davidoff Solomon, *Where Have All the IPOs Gone: The Hard Life of the Small IPO*, 6 HARV. BUS. L. REV. 83, 87 (2016) (emphasis added).

cline in small-firm IPOs, not IPOs across the board.[153] A third empirical study similarly rejected the "regulatory overreach" hypothesis.[154] Neither the findings of these studies, which never truly penetrated the policymaking community,[155] nor the recovery in the annual number of IPOs during much of the 2010s,[156] were successful in stopping the deregulatory cascade, which at that point was well underway. As we will see, the 2012 JOBS Act and the SEC's concerted push to deregulate capital raising during the tenure of Chairman Jay Clayton scrambled the internal logic of securities regulation and set off a process of regulatory line-drawing, re-drawing, and, ultimately, erasure.

Another point, discussed in more detail in Section III.B, deserves mention here. The high compliance costs of Sarbanes–Oxley and Dodd–Frank were blamed for causing the demise of the "public company" as a type of business entity. Yet, "public company" is merely a regulatory category that captures certain entities if they meet a set of pre-defined characteristics.[157] As we will see, Sarbanes–Oxley and Dodd–Frank may have caused the near-demise of "public company" as a regulatory category by feeding into the over-regulation narrative and instigating the deregulatory cascade of the 2010s.

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153. *Id.* at 87, 120.

154. *See* Xiaohui Gao, Jay R. Ritter & Zhongyan Zhu, *Where Have All the IPOs Gone?*, 48 J. FIN. & QUANT. ANALYSIS 1663, 1669–71 (2013) (rejecting a "regulatory overreach" hypothesis for the decline in the number of small-firm IPOs in favor of an "economies of scope" hypothesis that focuses on the advantages enjoyed by large firms). As I have discussed in prior work, these large-firm advantages also stem from the application of a key tool of securities regulation—the *TSC Industries* materiality standard embedded in a number of disclosure rules, which does not take into account firm size. *See* Georgiev, *Too Big to Disclose*, *supra* note 79, at 652–62 (suggesting that materiality functions as a "regulatory subsidy for bigness" since it often enables large firms to disclose less information than small firms).

155. Congress continued to hold hearings themed around solving the purported problem of regulatory overreach. *See, e.g.*, *The Cost of Being a Public Company in Light of Sarbanes Oxley and the Federalization of Corporate Governance: Hearing Before the Subcomm. on Cap. Mkts, Sec., & Inv. of the H. Comm. on Fin. Servs.*, 115th Cong. (July 18, 2017).

156. *See infra* Appendix, Figure A–1.

157. *See supra* Section I.B.1.

B. *The Deregulatory Cascade*

The public model of financing, whereby a growing company needs to go public in order to access additional capital and, as part of this process, commits to public company regulation, was the dominant model for much of the 20th century and at the dawn of the 21st century. Just two decades later, in 2021, this is no longer the case. The transformation of the capital raising ecosystem has been the product of numerous actions taken by Congress and the SEC, mostly during the 2010s, that have touched and altered virtually every aspect of the regulatory system governing firms' capital raising activities: the types of capital, the types of investors, and types of markets that firms of different kinds can access in exchange for undertaking certain legal obligations.

This section starts by analyzing the political economy of the deregulatory cascade and then thematically sets out the many technical deregulatory developments that have occurred, primarily since the passage of the JOBS Act in 2012. The figures in Section II.C provide a schematic illustration of these developments. At the outset, I should note that not every individual development that is part of the deregulatory cascade is problematic as a matter of policy; indeed, some were well-advised and overdue. But their execution—and the combination of sensible changes and changes hastily put in place to serve ideological goals—render the deregulatory cascade a negative development as a whole.

After the Dodd–Frank Act was signed into law in July 2010, many in the media and policy establishment in Washington, D.C. assumed that the mission of preventing a repeat of the 2008 financial crisis had been accomplished and moved on to other hot-button issues. Others immediately shifted their attention to the fraught process of agency rulemaking needed to implement the Act's provisions.[158] But less than two years later (and working in Dodd–Frank's shadow), Congress hastily passed another important piece of financial legislation, which

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158. *See, e.g.*, Steven A. Bank & George S. Georgiev, *Securities Disclosure As Soundbite: The Case of CEO Pay Ratios*, 60 B.C. L. Rev. 1123, 1128–29, 1139 (2019) (discussing the protracted process of implementing the pay ratio disclosure mandate contained in the Dodd–Frank Act).

received relatively little popular attention: the strategically-titled JOBS Act of 2012.[159]

The JOBS Act contained a smorgasbord of provisions related to equity crowdfunding, amendments to various securities offering rules, the creation of a new, time-limited regulatory category—the "emerging growth company" (EGC), and a directive to the SEC to study further changes to the securities disclosure regime. The only broad themes that can be discerned in the JOBS Act are *laissez-faire* capital formation and an attempt to reverse the supposed regulatory overreach of Sarbanes–Oxley and Dodd–Frank.[160] It likely would have been impossible to sell this grand deregulatory design politically if it had been clearly reflected in the JOBS Act. Instead, the JOBS Act proceeded piecemeal through a series of small and easy-to-overlook rule amendments, exemptions, and efforts to "modernize" the regulatory framework.

The political economy of the JOBS Act is worth noting because it challenges the view of securities regulation as a technocratic enterprise—a special and highly-specialized type of economic regulation that is relatively free of interest group lobbying and political influence. The JOBS Act was heavily supported by tech companies in Silicon Valley during an era of unbridled tech optimism among policymakers and the media;[161] shortly after, Amazon, Facebook, Google/Alphabet, Microsoft, and Apple joined the ranks of the world's largest companies, which they hold to this day. The Obama adminis-

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159. The Act's awkward full title—the Jumpstart Our Business Startups Act—illustrates the linguistic gymnastics its drafters employed to arrive at the palatable acronym "JOBS." Though very little, if anything, in the Act was substantively related to boosting jobs and employment, the JOBS moniker made it more difficult to oppose the bill during a period of high unemployment and the lagging recovery from the 2008 financial crisis.

160. The SEC's approach in implementing congressional mandates and amending its own rules during the 2010s, at least as exemplified by the rhetoric of a number of SEC Commissioners and senior staff, has focused on capital formation, with more always being better. This basic premise is flawed when viewed from the point of view of financial economics and management science. To mention just a few possibilities, firms can easily become overleveraged, capital may be misallocated, and too much capital may lead to corporate waste and inefficiencies.

161. *See* James Freeman, *Kate Mitchell: How Silicon Valley Won in Washington*, WALL ST. J. (Apr. 6, 2012), https://on.wsj.com/3lCsQaz (discussing the role of tech firm lobbying in generating bipartisan political backing for the JOBS Act).

tration was firm in its support of the JOBS Act,[162] even though investors, other stakeholders, academics, and the Obama-appointed SEC Chair raised a series of concerns.[163] Even the name of the legislation, meant to evoke job creation, was a brilliant stroke of Silicon Valley marketing. A link between the JOBS Act's provisions and actual jobs was never demonstrated and has not materialized. In fact, to the extent the JOBS Act contributed to the rise of the gig economy exemplified by firms such as Uber and DoorDash where workers are independent contractors instead of employees and do not benefit from various worker protections, the JOBS Act may have contributed to the destruction of conventional jobs.

By facilitating the raising of capital on the *private* markets, certain JOBS Act provisions resulted in decreased *public* capital formation. Recall, however, that public capital formation was the problem, whether real or imagined, that the JOBS Act was supposed to solve. When the solutions did not come, Congress doubled down by adding provisions deregulating capital formation (dubbed JOBS Act 2.0) in the infrastructure-focused FAST Act in 2015.[164] The SEC quickly implemented the provisions of the FAST Act, even though the agency still had a back-

162. The genesis of many of the specific ideas contained in the JOBS Act can be traced back to a report prepared by the IPO Task Force, an ad hoc group dominated by Silicon Valley entrepreneurs, venture capitalists, and the bankers, lawyers and accountants representing them. *See* IPO TASK FORCE, REBUILDING THE IPO ON-RAMP: PUTTING EMERGING COMPANIES AND THE JOB MARKET BACK ON THE ROAD TO GROWTH (2011), https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf; *see also* Freeman, *supra* note 161 (noting how a Democratic venture capitalist shepherded the JOBS Act); *see also* Pritchard, *supra* note 51, at 1008–09 (noting that President Obama signed the bill into law because he was "anxious to portray himself as 'pro-growth' while facing an economy still plagued by high levels of unemployment").

163. *See* 158 Cong. Rec. 1698–99 (2012) (letter of SEC Chairman Mary L. Schapiro) (expressing the SEC's concern with various provisions in the draft version of the bill, which ultimately became law). Academic commentators also raised concerns. *See* John Coates & Robert Pozen, *Bill to Help Businesses Raise Capital Goes Too Far*, WASH. POST (Mar. 14, 2012), https://wapo.st/3FVm6fv; *Spurring Job Growth Through Capital Formation While Protecting Investors: Hearing Before the S. Comm. on Banking, Housing, & Urb. Affs.*, 112th Cong. 13 (2011) (statement of John C. Coffee, Jr., Professor, Columbia University Law School).

164. *See* Stacy Kanter, *FAST Act: Capital Formation Changes and Reduced Disclosure Burdens*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 29, 2015), https://bit.ly/3HZ2Yz5. The FAST Act included technical changes, such as

log of unfinished, congressionally-required rulemakings under the Dodd–Frank Act from five years prior. Thus, the SEC continued to prioritize the deregulation of the *private* markets in the name of *public* capital formation.

The deregulatory cycle was completed just a day before the November 2020 presidential election, with the looming prospect of a new administration, new composition of the SEC, and a policy reversal. On a split 3–2 vote, the agency adopted extensive rule amendments ostensibly seeking to "harmonize and improve" the "patchwork" private offering framework.[165] In reality, however, the SEC retained the "patchwork" and merely increased the size of the constitutive exemption "patches." Among other matters, the amendments changed existing limits on the timing and size of private offerings.[166] In effect, they permitted larger and more frequent private offerings to be offered more widely to the general public. Notably, the SEC was also tasked by Congress with taking some steps that modernized the regulatory framework by updating rather than eroding it. Updating Form D to make it more informative and updating the wealth thresholds under the definition of "accredited investor" are a case in point.[167] The SEC

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codifying the informal Section 4(a)(1½) exemption for private resales and it also expanded further the accommodations provided to EGCs. *Id.*

165. *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Harmonizes and Improves "Patchwork" Exempt Offering Framework (Nov. 2, 2020), https://www.sec.gov/news/press-release/2020-273 [hereinafter Summary of November 2020 Amendments]; *see also* Adam Fleisher et al., *SEC Harmonizes Regulation and Improves Access to Capital in Private Markets,* HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 8, 2020), https://bit.ly/3rA1HIZ (describing amendments and noting the 3–2 vote).

166. *See* U.S. Sec. & Exch. Comm'n, Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, Final Rule, Rel. No. 33-10,884 (adopted Nov. 2, 2020), 86 Fed. Reg. 3496 (Mar. 15, 2021) (including amendments to: raise offering limits for certain exempt offerings; relax investment limitations for certain investors; shorten the integration safe harbor period from six months to 30 days; expand the use of test-the-waters communications across all exempt offerings and for all types of investors; reduce disclosure requirements under Regulation D; and permit the creation of a crowdfunding special purpose vehicle, among other matters).

167. The SEC has failed to finalize its 2013 proposal to amend Form D to enhance investors' ability to evaluate offerings under Regulation D. *See* Amendments to Regulation D, Form D, and Rule 156, 78 Fed. Reg. 61,222 (proposed July 10, 2013). In addition, it has failed to adjust the accredited

placed these low on its priority list and, as of this writing, has not completed the required rulemakings.

The late stages of the deregulatory cascade of the 2010s were also characterized by a curious shift in rhetoric. Previously, lobbyists had used "capital formation" as the primary justification for deregulation; while poorly defined, the term "capital formation" is part of the SEC's mission.[168] In light of the growth of private markets, the rise of unicorns, and the recovery of the IPO market, however, it is becoming increasingly difficult to argue that firms are having a difficult time raising capital. To account for this, lobbying efforts leading up to the November 2020 amendments focused on giving retail investors appropriate investment opportunities, which included giving them access to the unregulated private markets.[169] The SEC enthusiastically picked up on the "investor opportunity" leitmotif in the proposing and adopting releases pertaining to the November 2020 amendments. This was done with little regard for the risks inherent in such opportunities and traditional notions of investor protection.[170] Another way to frame this set of initiatives that similarly conceals their prob-

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investor wealth thresholds to account for inflation. *See infra* note 183 and accompanying text.

168. *See, e.g.*, *What We Do*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/Article/whatwedo.html (last modified Nov. 22, 2021) (stating the SEC's mission as "protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation"). *See also* discussion *infra* Section I.C.2.

169. *See, e.g.*, COMM. ON CAP. MKTS. REGUL., EXPANDING OPPORTUNITIES FOR INVESTORS AND RETIREES: PRIVATE EQUITY (2018), https://bit.ly/3y1mK8C (advocating for a number of deregulatory changes which were subsequently adopted, with reference to "expanding opportunities").

170. *See, e.g.*, Press Release, Allison Herren Lee, Comm'r, U.S. Sec. & Exch. Comm'n, Public Statement on Amendments to the Exempt Offering Framework (Nov. 2, 2020), https://www.sec.gov/news/public-statement/lee-harmonization-2020-11-02. SEC Commissioner Hester Peirce has defined "investor opportunity" as "the chance for investors to try new products and services, to include in their portfolios new types of assets, to use the latest technologies, to get in on the ground floor of new opportunities, to experiment and learn from investment successes and failures." *See* Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks at Meeting of Investor Advisory Committee (Sept. 9, 2021), https://www.sec.gov/news/public-statement/peirce-iac-090921.

lematic nature has been as an effort to "democratize" capital markets.[171]

Zooming out, the developments that made up the deregulatory cascade were not only highly technical but also piecemeal. The discussion that follows organizes these developments around themes. The thematic approach adopted here and in the two figures in Section II.C offers a big-picture overview of how the many individual developments from the 2010s have transformed the legal framework for capital raising. The deregulatory cascade is defined by decisions from Congress, the SEC, and, in one instance, the Department of Labor, along the following six overlapping dimensions: (1) enabling the rise of unicorns; (2) emphasizing private markets over public markets; (3) enabling the dramatic rise of private equity; (4) allowing public capital into private companies; (5) transforming public capital into private capital; and (6) promoting regulation-lite regimes.

(1) Enabling the Rise of Unicorns: Perhaps the most visible development in capital markets during the 2010s has been the rise of "unicorns": firms with valuations over $1 billion that have not (yet) conducted an initial public offering and are not public companies. Fast-growing firms like SpaceX (private valuation: $100.3 billion), Stripe ($95 billion), Instacart ($39 billion), Juul Labs ($12 billion), Ripple ($10 billion), Reddit ($10 billion), and MasterClass ($2.75 billion) are just some of the more familiar names that currently fall in this category; Uber, Lyft, Box, Dropbox, Airbnb, Doordash, Spotify, and Robinhood, among many others, are ex-unicorns.[172] As noted in the Introduction, the growth in the number and implied market value of unicorns has been staggering: from 43 unicorns when the term was first coined in 2013 to 473 unicorns

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171. *See, e.g.*, Anat Alon-Beck, *Alternative Venture Capital: The New Unicorn Investors*, 87 TENN. L. REV. 983, 994–1000 (2020) (discussing "democratization" of private markets). The benign-sounding rhetoric of democratizing markets echoes the marketing efforts of ill-fated fintech startups, such as Robinhood. *See, e.g.*, Jared Dillian, *Robinhood Is Not About the Democratization of Markets*, BLOOMBERG OP. (Aug. 11, 2021), https://bloom.bg/3q592xB (discussing Robinhood's marketing rhetoric and noting that "[r]etail trading of meme stocks is just a massive transfer of wealth from the unsophisticated to the sophisticated").

172. *See The Complete List of Unicorn Companies*, CB INSIGHTS, https://www.cbinsights.com/research-unicorn-companies (last visited Dec. 3, 2021).

in early December 2021, reaching an aggregate implied valuation of $1.58 trillion, which is an eleven-fold increase since 2013, and a nearly three-fold increase in 2021 alone.[173] These developments are not limited to the United States, as shown by Figure A–8 in the Appendix, but extend to capital markets in China and the rest of the world.

Though private, unicorns look and behave like public companies in terms of market capitalization, number of employees, global reach, and potential for inflicting externalities. They have been able to raise capital and sustain their growth without tapping the public markets. The previous generation of fast-growing tech companies, such as Google, Amazon, and others, had to conduct an IPO much earlier in their lifecycle and, correspondingly, achieved the bulk of their present-day market capitalization in the public markets (as shown by Figure A–7 in the Appendix). Today, unicorn companies are so ubiquitous in the U.S. economy that the unicorn label seems like a misnomer.

The rise of unicorns was a regulatory development due to the much wider availability of "private capital."[174] In addition, the JOBS Act raised the mandatory registration thresholds contained in Section 12(g) of the Exchange Act, enabling companies to acquire a much larger investor base before mandatory registration (and federal corporate governance regulation) is required.[175] As discussed below, the SEC has also adopted various rules that encourage private placements, which permit unicorns to raise substantial capital without trading unicorn status (and the associated freedom and secrecy) for public company status (and the associated regulatory compliance obligations and transparency). The SEC and Congress failed to anticipate and account for the informational

173. *See supra* Figure 1 & notes 13–14 and accompanying text.

174. *See* de Fontenay, *supra* note 22, at 447.

175. Recall that Section 12(g) of the Exchange Act, as amended by the JOBS Act, requires a company to register its securities under the Exchange Act if it has $10 million or more in total assets and a class of equity securities "held of record" by 2000 or more persons (or 500 or more persons who are not "accredited investors"). *See supra* note 77 and accompanying text. The question about the reach of Section 12(g) is not a simple one. Usha Rodrigues, for example, has argued that the rule was irrelevant even before the JOBS Act. *See* Usha R. Rodrigues, *The Once and Future Irrelevancy of Section 12(g)*, 2015 U. ILL. L. REV. 1529 (2015).

problems raised by unicorns, and these problems quickly morphed into governance problems, as illustrated by the multiple scandals at WeWork, Uber, Theranos, and elsewhere.[176]

(2) Emphasizing Private Markets Over Public Markets: The expansion of exemptions from public registration, most prominently under Rule 506,[177] has made it easier and easier for firms to attain scale solely based on the investment of accredited investors. Rule 701 has made it easier for private companies to pay employees in stock and stock options; while the rule has been around since the 1980s, the growth in the number of unicorns and their total employee headcount during the 2010s, as well as the doubling of relevant offering limits in 2018, has amplified the rule's significance.[178] New, creative ways of doing the same have been under consideration;[179] these would, for instance, allow private platform companies, like pre-IPO Uber and Airbnb, to pay non-employee drivers and hosts, respectively, with stock. These private transactions further undermine the need for public markets, from the per-

176. *See, e.g.,* Rani Molla & Shirin Ghaffary, *The WeWork Mess, Explained*, VOX (Oct. 22, 2019), https://bit.ly/3rf663J (discussing governance problems at WeWork); Georgiev, *Uber-Sized Wrecks*, *supra* note 57 (discussing Uber); John Carreyrou, *SEC Charges Theranos CEO Elizabeth Holmes With Fraud*, WALL ST. J. (Mar. 14, 2018), https://on.wsj.com/3lgMYyN (discussing Theranos).

177. 17 C.F.R. § 230.506 (2021). Though the availability of aggregate data is limited, the SEC's Concept Release suggests that most private capital is raised using the exemptions provided in Rule 506(b) and Rule 506(c). *See* U.S. Sec. & Exch. Comm'n, Concept Release on Harmonization of Securities Offering Exemptions, 84 Fed. Reg. 30,460, 30,466 (June 26, 2019).

178. SEC Rule 701, adopted in 1988, allows private companies to offer and sell securities as part of compensatory arrangements without the need to register the securities. *See* Compensatory Benefit Plans and Contracts, Securities Act Release No. 33–6768, 53 Fed. Reg. 12,918–19 (Apr. 20, 1988). While this provision is not new, its use increased considerably in the post-JOBS Act capital markets ecosystem. In addition, as directed by the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018, the SEC increased from $5 million to $10 million the 12-month offering threshold in excess of which firms are required to deliver additional information to employee-investors. *See* U.S. Sec. & Exch. Comm'n, Press Release, SEC Adopts Final Rules and Solicits Public Comment on Ways to Modernize Offerings Pursuant to Compensatory Arrangements (July 18, 2018), https://www.sec.gov/news/press-release/2018-135.

179. *See* Concept Release on Compensatory Securities Offerings and Sales, Exchange Act Release No. 33–10,521, 83 Fed. Reg. 34,958–59 (July 24, 2018).

spective of both firms and investors. The so-called Regulation A+ enables firms to raise certain amounts of capital from public investors without becoming subject to public company regulation.[180]

The November 2020 amendments to the securities laws changed existing limits on the timing and size of private offerings. For example, the SEC raised the offering limit in Regulation Crowdfunding from $1.07 million to $5 million, while at the same time removing the cap on the amounts accredited investors can invest in each offering.[181] This affected both the supply and demand sides of these transactions. Similarly, the SEC doubled the limit for offerings under Rule 504 of Regulation D, from $5 million to $10 million.[182]

One notable feature of the November 2010 amendments is that even though the SEC raised the offering limits, presumably, at least in part, to account for inflation, it did not raise the thresholds under the definition of "accredited investor." Recall from Part I that this category seeks to capture certain wealthy investors, who are presumed to be less sensitive to financial losses, and/or more financially-sophisticated investors. Failing to update qualification requirements for inflation has led to a 550% increase in the percentage of households qualifying as accredited investors since 1983 (from 2% of all U.S. households to 13% of all U.S. households).[183] In practice, this means that there has been a 550% increase in the share of households that can be exposed to unregulated (and often risky) financial instruments.

(3) Enabling the Dramatic Rise of Private Equity: Private assets under management have grown more than five-fold since

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180. Adopted in April 2015, the rules referred to as Regulation A+ revise Regulation A to create two separate tiers of exempt securities offerings not exceeding $20 million and $50 million, respectively, in any 12-month period. *See* Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), Securities Act Release No. 9741, Exchange Act Release No. 74,578, Trust Indenture Act Release No. 2501, 80 Fed. Reg. 21,806 (Apr. 20, 2015). These limits were raised through the November 2020 amendments discussed below. The market performance of firms taking advantage of these provisions has been dismal. *See infra* note 226 and accompanying text.

181. *See* Summary of November 2020 Amendments, *supra* note 165.

182. *Id.*

183. *See* Amending the "Accredited Investor" Definition, Securities Act Release No. 10,824, Exchange Act Release No. 89,669 (Aug. 26, 2020).

2000: from less than $1 trillion in 2000 to more than $5 trillion in 2017.[184] The existence of this sizeable pool of private capital has gradually undermined the essential nature of public markets to capital raising.[185] The rise of private equity has resulted from a combination of active deregulation and abstention from regulating new types of transactions that are functionally equivalent to transactions that had been regulated in the past.

(4) Allowing Public Capital into Private Companies: The SEC permits mutual funds to invest up to 15% of their assets in the stock of private companies.[186] Mutual funds represent trillions in capital that originates from prototypical "public" investors, i.e., unsophisticated investors who should get protection from the securities laws. For example, in 2018, the 12th-largest investment in Fidelity's $25 billion Blue Chip Growth Fund was a $438 million stake in Juul (a private company that does not seem to fit the "blue chip" label in the fund's name); the fund's investment in unicorn Juul was greater than its investment in true "blue chip" firms like MasterCard and Netflix.[187] The investor protection concerns associated with this development are many and varied.[188] The expansion of the offering exemptions discussed under item (2) above represents another mechanism through which more and more public capital can flow into private companies.

(5) Transforming Public Capital into Private Capital: In addition to allowing public capital into private companies directly, there are now multiple other, indirect ways for public capital to end up in private companies. A 2020 rule change from the Department of Labor allowed defined contribution plans to

184. Frank Partnoy, *The Death of the IPO*, ATLANTIC (Nov. 2018), https://bit.ly/3rf677N.

185. *See id.*; *see also infra* Appendix, Figure A–3 (showing growth in assets under management for the U.S. buyout industry) & Figure A–6 (showing global growth of the private equity industry).

186. *See* U.S. Sec. & Exch. Comm'n, Revisions of Guidelines to Form N-1A, Investment Company Act Release No. 18,612 (Mar. 12, 1992) (setting out 15% limit on holdings of restricted securities or other assets not having readily available market quotations, an increase from the 10% limit previously in effect).

187. *See* Partnoy, *supra* note 184.

188. For a normative analysis of this phenomenon, see Jeff Schwartz, *Should Mutual Funds Invest in Startups? A Case Study of Fidelity Magellan Fund's Investments in Unicorns (and Other Startups) and the Regulatory Implications*, 95 N.C. L. REV. 1341 (2017).

offer private equity as an investment option.[189] In effect, this allows public investors to route retirement savings into private equity funds; those funds can, in turn, invest freely in private companies. This move was endorsed by SEC Chairman Jay Clayton and fit with the agency's broader agenda at the time of allowing "main street" investors to access the private markets.[190] This development was foreshadowed by legal changes from 2006, which narrowed the scope of ERISA restrictions and gave more public pension plans access to private equity.[191]

(6) Regulation-Lite Regimes: The JOBS Act also created a new, time-limited category, the Emerging Growth Company, which is subject to what the SEC calls "scaled" regulation, in an effort to induce companies to go public.[192] If they qualify based on certain thresholds, newly-public companies in the first five years of their lifecycle are subject to less regulation.[193] Separately, the "smaller reporting company" category allows certain companies that are publicly traded to avoid public company regulation based on size thresholds related to shares outstanding and revenues.[194] Regulation A+ IPOs, discussed under item (2) above, are another prominent example. The SEC has been raising the applicable qualification thresholds during the 2010s, thereby increasing the number of companies subject to such regulation-lite regimes.

189. U.S. Dep't. of Labor, Div. of Fiduciary Interpretations, Opinion Letter (June 3, 2020), https://bit.ly/3o1Eflz.

190. *See* Press Release, U.S. Dep't. of Lab., U.S. Department of Labor Issues Information Letter on Private Equity Investments (June 3, 2020), https://bit.ly/3xwLncQ. The press release quotes SEC Chairman Jay Clayton praising the move because it would "provide our long-term Main Street investors with a choice of professionally managed funds that more closely match the diversified public and private market asset allocation strategies pursued by many well-managed pension funds as well as the benefit of selection and monitoring by ERISA fiduciaries." *Id.*

191. *See* Pension Protection Act of 2006, Pub. L. No. 109–280, 120 Stat. 780 (codified as amended in scattered sections of 29 U.S.C.).

192. *See Emerging Growth Companies*, U.S. SEC. EXCH. & COMM'N., https://www.sec.gov/smallbusiness/goingpublic/EGC (last modified July 24, 2019). For an academic analysis, see Jeff Schwartz, *The Law and Economics of Scaled Equity Market Regulation*, 39 J. CORP. L. 347 (2014) (discussing the mechanics and effects of scaled securities regulation).

193. *See* 15 U.S.C. § 77g(a)(2) (setting out registration requirements for EGCs); JOBS Act, Pub. L. No. 112–106, 126 Stat. 306, §§ 102–104 (2012).

194. *See Smaller Reporting Companies*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/smallbusiness/goingpublic/SRC (last modified Mar. 15, 2021).

C. *Capital Raising in 2021 vs. 2000: An Illustration*

Taken together, the changes discussed in Section II.B have transformed the capital raising regulatory regime. Figures 2 and 3 provide a graphic illustration by showing the functional changes between the applicable regulatory framework before the 2000s and the applicable regulatory framework in 2021.

FIGURE 2: SIMPLIFIED OVERVIEW OF THE CAPITAL RAISING REGULATORY REGIME BEFORE THE 2000S

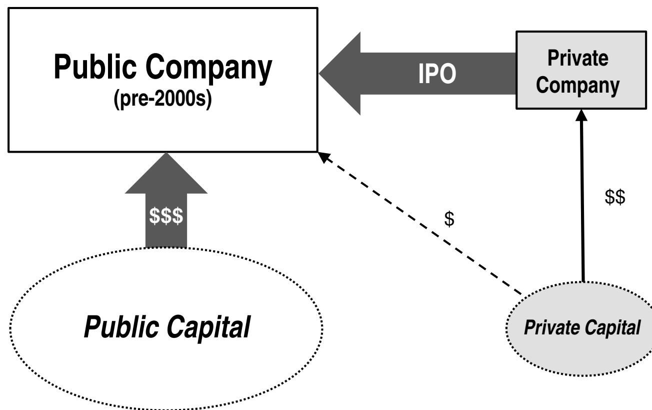
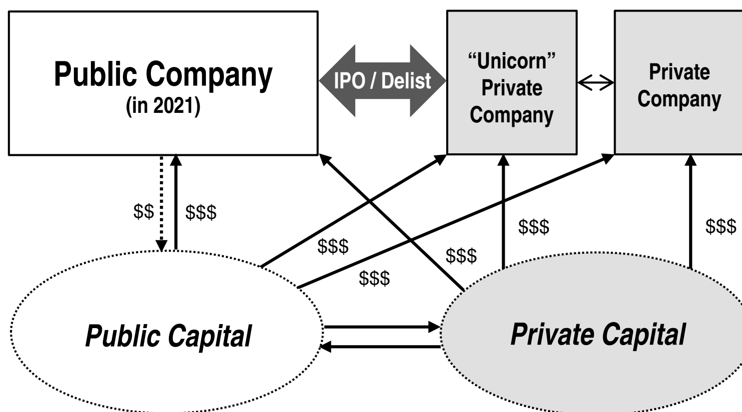


FIGURE 3: SIMPLIFIED OVERVIEW OF THE CAPITAL RAISING REGULATORY REGIME IN 2021



As illustrated by Figure 2, before the 2000s, public companies sat at the center of the capital markets. Most capital was public capital (invested through the public markets). The public markets were also the primary way public companies financed themselves. The private (i.e., unregulated) markets were small and underdeveloped. Public companies could finance themselves through private capital in very limited circumstances.[195] Moreover, public capital generally could not flow to private companies. Private companies had to finance themselves with private capital, but the smaller size of the private capital pool made this a limited option. If a private company wanted to grow, it had to gain access to public capital by going through the traditional IPO process discussed in Section I.B.2. And, once public, it was virtually impossible for a public company to revert to private company status. As shown in Figure 2, going public was a one way street.

Figure 3, which illustrates today's capital raising regulatory regime, paints an altogether different picture. As a result of the deregulatory cascade of the 2010s discussed in Section II.B, the pool of private capital is substantially expanded, and, in addition, public capital can easily morph into private capital. Private companies can benefit from this expanded pool of private capital and, in addition, can now also receive public capital. This makes the need to go public—and enter the regulated realm—much less urgent and may indeed obviate it. By raising ever-greater amounts of private capital, private companies can take on "unicorn" status and look very similar to public companies, but without the attendant regulatory obligations. When unicorns do decide to go public, they can do so via an IPO (or direct listing), but, importantly, this decision is now much easier to reverse through a delisting: going public is a two-way street. Moreover, the flow of capital between public markets and public companies is also bidirectional because of the buyback phenomenon, whereby significant amounts of capital are returned to shareholders.[196] There is another

195. So-called PIPE (Private Investment in Public Equity) transactions represent the most prominent example. For a description of PIPE transactions, see Thompson & Langevoort, *supra* note 4, at 1598–1601.

196. *See* Matt Phillips, *This Stock Market Rally Has Everything, Except Investors*, N.Y. TIMES (Feb. 25, 2019), https://nyti.ms/3o04fOc; *see also infra* Appendix, Figure A–9 (showing the substantial rise in stock buybacks in the United States during the 2010s).

prominent source of capital for private firms, which is not shown in Figure 3: private firms' own equity, which they use to cover more and more of their labor costs. As discussed in Section I.B.1, unicorns pay for human capital by granting employees stock and stock options. Their ability to do so further diminishes the importance of public markets as a source of capital.

Compare the two figures: The streamlined nature of Figure 2 highlights the fact that before the 2000s, there was a divide between public and private capital (even if it was somewhat porous). By contrast, no such divide can be observed in Figure 3. Public capital flows freely into both public and private companies; private capital, which is now greater in size due to deregulatory developments, can also flow freely into both public and private companies. In effect, public and private capital and public and private markets have now become fungible for a large subset of firms seeking financing.

D. *The Fungibility of Public and Private Capital*

In response to the changes in capital formation practices in recent years, the widely-followed financial commentator Matt Levine has observed that "the private markets are the new public markets."[197] One way to interpret this statement is that public capital and private capital have become fungible. But recall that the structure of the current public company regulatory regime is premised on the separation, or non-fungibility, of public and private capital.

The regulatory cascade has facilitated the flow of capital among public and private investors, public and private companies, and public and private markets. Functionally, capital is now free-flowing: what used to be hard regulatory prohibitions are now merely compliance items. A private company can enjoy the same access to finance as a public company by hiring bankers and lawyers to structure capital raising transactions in ways that comply with a complex set of exemptions, carve-outs, and capital raising formalities. Problematically, this state of affairs is actually worse than a universe where capital truly flows freely, since the vestigial regulations are mere formalities that can be avoided, but at the cost of hiring investment bankers

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197. *See* Matt Levine, *Private Markets Might Be Too Nice*, BLOOMBERG (Oct. 31, 2019), https://bloom.bg/3CVM4O4.

and lawyers. In other words, for a firm determined to avoid public company regulation, the securities laws have come to be little more than transaction costs.

Unsurprisingly, public capital raised on public markets is becoming increasingly irrelevant; instead, public markets are more important for the purpose of providing liquidity and adjusting the investor base than for raising new capital. Consider again the contrast between newer- and older-generation tech companies. The implied valuation of Uber in the private market was significantly higher than the total value created in the IPO.[198] For a long time, the company's actual market capitalization was below what its initial IPO price indicated.[199] In other words, Uber was built on the private markets, and the public markets were not a part of Uber's growth story. By contrast, as of August 2020 virtually none of Amazon's $1.3 trillion in market capitalization was raised in the private markets, and only 3% of the value created by Alphabet/Google, and 17% of the value created by Facebook, was raised in the private markets.[200]

III.
Consequences of the Breakdown of the Public–Private Divide

In the aggregate, the myriad of legal interventions described in Part II have led to the breakdown of the foundational public–private divide in securities law. But the fact that the transformation of the legal framework for capital raising has been dramatic does not automatically suggest that the resulting regulatory landscape is problematic. This Part makes the case that it is. As we will see, the breakdown of the public–private divide and the resulting public company regulatory paradox have had significant adverse consequences along four dimensions. The first two are primarily conceptual: Securities law has gone from a mandatory regulatory scheme to one that is largely elective and subject to "issuer choice," which, in turn,

198. *See* Mike Isaac et al., *How the Promise of a $120 Billion Uber I.P.O. Evaporated*, N.Y. Times (May 15, 2019), https://nyti.ms/32IjFP5.
199. *See* Annie Palmer, *Uber Falls to All-Time Low as Investors Grow More Skeptical*, CNBC (Aug. 12, 2019), https://cnb.cx/3xxhmJQ.
200. Matt Levine, *Public Markets Don't Matter Like They Used To*, Bloomberg (Aug. 5, 2020), https://bloom.bg/3E4Szzh.

has diminished the federal government's ability to regulate certain types of economic activity through securities law. The third and fourth sets of consequences pertain to important constituencies: The breakdown of the public–private divide has led to the fragmentation of investor protection across the capital markets and, in addition, it has increased the vulnerability of employee-investors. Whereas prior manifestations of the latter two developments have received attention in the academic literature, the first two developments have largely escaped notice.

A. *Elective Regulation, Quasi-Federalization, and "Issuer Choice"*

The mandatory nature of securities regulation, particularly following the 1964 expansion of the Exchange Act through the addition of Section 12(g), has long been subject to critical scrutiny in the legal and finance literature. At its core, the classic case in favor of mandatory disclosure is based on a market failure argument: in the absence of a government mandate, firms cannot be expected to reveal the information, *both positive and negative*, that investors need in order to make investment decisions.[201] Law-and-economics scholars have countered by arguing that capital market efficiency obviates the need for the mandatory disclosure regime, since market forces, notably the competition for scarce investor capital, will induce firms to provide the requisite information.[202] Researchers have conducted numerous empirical studies seeking to assess the relative benefits of public company regulation via mandatory disclosure requirements.[203]

Some of the most concerted and well-known arguments against mandatory securities disclosure are associated with

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201. *See, e.g.*, John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 747 (1984).

202. *See* Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 CARDOZO L. REV. 909, 928 (1994).

203. *See, e.g.*, George J. Benston, *An Appraisal of the Costs and Benefits of Government-Required Disclosure: SEC and FTC Requirements*, 41 LAW & CONTEMP. PROBS. 30, 42 (1977) (expressing skepticism about the benefits of mandatory securities disclosure); Christian Leuz & Peter D. Wysocki, *The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research*, 54 J. ACCT. RSCH. 525 (2016) (reviewing a large sample of empirical studies of disclosure regulation).

Roberta Romano, who made a forceful case against regulation in a 1998 article. Romano found that "little empirical evidence suggests that the federal [securities regulation] regime has affirmatively benefited investors," which led her to argue in favor of investor empowerment via "issuer choice"—a system whereby there are a variety of different regulatory frameworks on offer and firms decide whether or not to opt into securities regulation.[204] Romano's article gave rise to one of the most prominent academic debates in securities regulation, which in essence was a debate about the very need for such regulation.[205] Even though the vast majority of scholars have been supportive of some form of mandatory securities regulation,[206] this debate was never settled. The issuer choice idea, however, fell by the wayside in the early 2000s as a result of new market developments that were both unexpected and inconvenient: the dot-com crash and the accounting scandals of the early 2000s.

These market developments stymied whatever interest there may have existed in scaling back securities regulation. Instead of regulatory retrenchment, the federal response to

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204. *See* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2372 (1998).

205. For a direct rejoinder to Romano, see Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335 (1999) (arguing in favor of mandatory disclosure and interpreting empirical evidence as supportive of this position). The debate between Romano and Fox continued over the next few years. *See* Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQUIRIES L. 387 (2001); Merritt B. Fox, *The Issuer Choice Debate*, 2 THEORETICAL INQUIRIES L. 563 (2001). Many other scholars wrote about this debate or some aspect of it. *See, e.g.*, Stephen Choi, *Regulating Investors Not Issuers: A Market-Based Proposal*, 88 CAL. L. REV. 279, 282–84 (2000) (proposing a system allowing sophisticated investors to decide what, if any, disclosure they require); Stephen M. Bainbridge, *Mandatory Disclosure: A Behavioral Analysis*, 68 U. CIN. L. REV. 1023, 1034 (2000) (criticizing securities regulation via the mandatory disclosure regime on behavioral grounds); Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 CARDOZO L. REV. 675 (2002) (updating the case in favor of a mandatory securities disclosure regime).

206. *See, e.g.*, Reinier H. Kraakman, *Disclosure and Corporate Governance: An Overview Essay*, *in* REFORMING COMPANY AND TAKEOVER LAW IN EUROPE 95, 96 (Guido Ferrarini et al. eds., 2004) (reporting a "consensus" among most academics and regulators, premised on disclosure's benefits for the efficient pricing of securities, and "practical concerns associated with the governance and regulation of public companies").

the accounting scandals was the Sarbanes–Oxley Act, which represented the most significant expansion of federal securities regulation since the 1930s. The reigning debate in securities law soon became about the new regulatory reality—described as the "federalization" of corporate governance—and its merits and demerits.[207] The passage of another ambitious federal bill, the Dodd–Frank Act, less than a decade later expanded federal corporate governance even further and reinforced these concerns.[208]

Today's regulatory reality, epitomized by the breakdown of the public–private divide, is different and it disrupts the federalization narrative. While it is certainly true that Sarbanes–Oxley and Dodd–Frank "federalized" a number of matters of corporate governance that had previously been within the exclusive purview of state corporate law, it is important to remember that these laws' provisions have always applied *only* to public companies. At the time when public company status (and the access to public capital via the plentiful public markets it provided) was essential to corporate success, the federalization label was accurate as a descriptive matter. With very limited exceptions,[209] the choice to go public was not much of a choice, since access to public capital was a prerequisite for growth.

As described in Section II.B, however, the deregulatory cascade of the 2010s has transformed the funding landscape for U.S. firms. The virtually-unlimited availability of private capital, and the new rules allowing public capital to flow into private firms, renders "going public" truly a *choice* rather than

207. *See* Romano, *supra* note 138; Langevoort, *supra* note 140; John C. Coates IV, *The Goals and Promise of the Sarbanes–Oxley Act*, 21 J. ECON. PERSPS. 91 (2007).

208. *See* Bainbridge, *supra* note 139. While the larger point about the federalization effects of Sarbanes–Oxley and Dodd–Frank still stands, it is also useful to remember that most of the provisions in these statutes did not *displace* or *override* already-existing state corporate law rules; rather, the provisions sought to *fill* regulatory gaps in state corporate law.

209. The relevant exceptions are a few large, mostly family-owned firms that never went public, including Cargill, Koch Industries, Albertsons, and Mars. Professional firms, such as Deloitte, PricewaterhouseCoopers, and Ernst & Young have also been private traditionally. *See* Chloe Sorvino, *Silent Giant: America's Biggest Private Company Reveals Its Plan To Get Even Bigger,* FORBES (Oct. 22, 2018), https://bit.ly/3cXfuAH (listing the largest private companies other than unicorns).

an *imperative*. As private companies, unicorns are not subject to federal corporate governance notwithstanding their size, large investor base (which increasingly includes retail investors), and societal footprint. The federalization label, therefore, is no longer apt. Instead, it is more accurate to speak about Sarbanes–Oxley and Dodd–Frank as causing *partial* or *quasi-federalization*: These laws have added a federal corporate law layer on top of the state law provisions for *some* firms in the economy, but definitely not for *all* firms. What is more, the subset of firms to which the federal layer applies is driven by private ordering, not mandatory regulation.[210] Despite the considerable time and effort Congress and the SEC have devoted to developing the federal corporate governance regime over the course of almost nine decades, the federal government has no means to force a firm into the regime.

The latter observation takes us back, and full circle, to the notion of issuer choice and the academic debates related to it before the advent of Sarbanes–Oxley. Even though the merits of the issuer choice model remain contested in the academic literature, the breakdown of the public–private divide has brought about, quietly but surely, the realization of Roberta Romano's intellectually-ambitious vision for *elective* federal securities regulation. In effect, the provisions of the federal securities laws are *mandatory*, but only after an issuer has *elected* to opt into the regime by taking on public company status. Whether to do so is—to echo Romano's phrase—the issuer's choice.

The suggestion that changes in federal securities law over the past two decades have brought about an issuer choice model is an important but overlooked point in the assessment of securities law's recent trajectory. To be sure, issuer choice is not an implausible model and one can imagine a set of circumstances under which it could garner political support and become formally embedded in law. What is notable here, however, is that issuer choice was never mentioned in debates over the JOBS Act and the initiatives that comprised the deregu-

210. Recall that there is only one provision that "forces" a firm into public company status, Section 12(g), which has little practical effect. *See supra* notes 77–78 and accompanying text. As discussed in Section IV.A.3, one of the most clearly fleshed out reform proposals coming out of the SEC focuses on reforming this very provision.

latory cascade detailed in Section II.B. In other words, the issuer choice model was not subjected to democratic scrutiny and did not win a battle of policy ideas. Instead, the issuer choice outcome is simply an unintended consequence of the breakdown of the public–private divide in securities law.

B. *Securities Law's Diminished Regulatory Capacity*

As discussed in Section I.C, over the years, securities regulation has come to fulfill important roles in ensuring corporate transparency and accountability, in addition to investor protection and capital formation.[211] Firm-specific information released pursuant to the requirements of the mandatory securities disclosure regime provides a window into corporate activity that is useful not just to investors but also to employees, customers, suppliers, competitors, and society at large.[212]

From the vantage point of federal lawmaking, securities law via disclosure mandates provides a relatively easy channel for adopting general economic regulation: the "public company" regulatory category is already in existence, as is the disclosure regime and the powerful regulator in charge of it, the SEC. Accordingly, and as we saw in Section I.C, Congress has used the securities laws to require disclosure pertaining to various miscellaneous topics, such as conflict minerals, extractive payments, mine safety, corporate pay equity, and corporate activity in countries under economic sanctions, such as Iran.[213] Proposed legislation would use the public company category to impose a variety of disclosure obligations pertaining to ESG topics.[214] Nevertheless, the optimal volume of disclosure obligations and the scope of the disclosure regime are heavily contested,[215] and usually hinge on one's policy preferences.

Irrespective of the policy choices on the latter points, the breakdown of the public–private divide has undermined the

211. *See supra* notes 131–32 and accompanying text.

212. *See, e.g.,* Georgiev, *Too Big to Disclose*, *supra* note 79, at 652–54.

213. *See supra* notes 113–17 and accompanying text.

214. *See* Corporate Governance Improvement and Investor Protection Act, H.R. 1187, 117th Cong. (2021).

215. *Compare* Jill Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L. J. 923 (2019) (arguing in favor of securities disclosure mandates on sustainability-related topics), *with* Amanda M. Rose, *A Response to Calls for SEC-Mandated ESG Disclosure*, 98 WASH. U. L. REV. 1821 (2021) (arguing against the expansion of the disclosure regime to cover ESG topics).

regulatory capacity of securities law: young firms can now avoid important disclosure and governance mandates by never going public, whereas already-public firms can go private or sell "bad" assets off to a private company. As long as the public company category is elective, the federal government cannot use it to effectively regulate business activities and practices it has deemed undesirable.[216]

Climate change regulation provides a case in point. There has been a powerful push in the Biden administration to mobilize all federal administrative agencies, including the SEC, to address climate change.[217] In the case of the SEC, this will likely entail adopting new disclosure rules concerning firms' activities that might contribute to climate change and the risks firms face due to climate change—rules that are subject to considerable controversy.[218] Importantly, under the current regulatory framework any new SEC disclosure rules would apply *only* to public companies. This fact would not be problematic if all the biggest polluters were public companies, but it turns out that the opposite is the case. According to a recent report, small, non-public oil and gas drilling companies have become the biggest polluters in the United States in terms of methane and other greenhouse gases.[219] The report notes that these firms' pollution is "wildly large relative to their production" and that the firms have escaped the type of public scrutiny leveled on large oil and gas companies, even though in

216. The manifestations and implications of this phenomenon deserve more detailed treatment, which I provide in related work. *See* George S. Georgiev, *Is "Public Company" Still a Viable Regulatory Category?*, 13 HARV. BUS. L. REV. 1 (forthcoming 2022) (draft on file with author) [hereinafter Georgiev, *Regulatory Category*].

217. *See* Exec. Order No. 14,030, 86 Fed. Reg. 27,967 (May 25, 2021) (announcing a policy to "advance consistent, clear, intelligible, comparable, and accurate disclosure of climate-related financial risk"); *see also* Exec. Order No. 14,008, 86 Fed. Reg. 7619 (Feb. 1, 2021) (announcing a "government-wide" approach to climate change mitigation).

218. *See, e.g.*, Rose, *supra* note 215 (opposing climate change disclosure rules on materiality and institutional competency grounds). For arguments in favor of climate change disclosure mandates on the grounds that they are consistent with the SEC's mission, including investor protection and the unjustifiably-neglected goal of promoting competition, see George S. Georgiev, Comment Letter to the SEC on Climate Change and Other ESG Disclosure (June 22, 2021), https://ssrn.com/abstract=3874186.

219. *See* Hiroko Tabuchi, *Here Are America's Top Methane Emitters. Some Will Surprise You*, N.Y. TIMES (June 2, 2021), https://nyti.ms/317ur0t.

many cases the small private polluters have bought their high-polluting assets from larger public companies.[220] This reallocation of high-polluting assets is a win–win proposition for the firms, if not for the public. In effect, the large public companies are "cleaning up" their investor- and public-facing disclosure reports by offloading the problematic assets and freeing up financial capital. The small private companies, in turn, get to exploit the same assets with little public oversight, without incurring reputational harm, and, most likely, without paying a higher cost of capital.

The upshot of this example is that private firms like the smaller high-polluting firms can avoid important climate change disclosure rules at the federal level by simply avoiding the public capital markets and public company status.[221] As we saw in Part II, the deregulatory cascade of the 2010s and the wide availability of private capital make this a feasible option. The negative implications are twofold. First, government regulation by way of SEC disclosure mandates fails to capture a significant segment of entities across the economy. In this regard, the ready opportunities for regulatory arbitrage result in an adverse selection problem—the rules fail to cover precisely the types of firms to which they are most relevant. Second, because a growing number of public investors can now invest in private firms not subject to SEC disclosure obligations, those public investors would not obtain disclosure in respect of their pri-

220. *Id.* This trend is projected to continue and intensify over time. The report notes that by the end of the 2020s, "the world's largest oil and gas companies will divest from more than $100 billion of assets as they adjust to the [clean] energy transition." *Id.*

221. To be sure, other federal agencies have the power to require disclosure of all firms, not just public companies. The point here is about the diminished regulatory capacity of securities law, which in recent years has been a preferred vehicle for seeking to impose new economic regulation. During the 116th Congress, between 2019 and 2021, there were 18 unique bills that sought to regulate various aspects of general economic activity via the public company regulatory category. These bills pertained to matters such as employee representation in corporate governance and disclosure concerning diversity in corporate leadership, human capital management, the value of digital assets, corporate political spending, outsourcing practices, internal compensation trends, ESG metrics, cybersecurity risk and internal cybersecurity expertise, financial dealings with firearms manufacturers, measures taken to address illegal activities in the supply chain, and various other topics. *See* Georgiev, *Regulatory Category*, *supra* note 216 (manuscript at 13–17).

vate company investment and would not reap the investor protection benefits of the rules. The latter point illustrates the fragmentation of investor protection due to the breakdown of the public–private divide, a topic to which we turn next.

C. *Fragmented Investor Protection*

Perhaps the most immediate question raised by the changes in public and private markets relates to the impact of these changes on investor protection. Accordingly, scholars who have written about the underlying developments have considered their implications for investor protection rigorously and from different perspectives.[222] The analysis that follows builds upon this fine work, but it takes a somewhat different conceptual approach. As a point of departure, I inquire into the systemic impact of the breakdown of the public–private divide on investor protection (rather than the impact of specific private capital developments). I also assess investor protection at the *portfolio level* under the assumption that mainstream investors' portfolios today include a mix of public and private firms as a result of the various deregulatory measures discussed in Part II.

Viewed systemically and at the portfolio level, the impact of the breakdown of the public–private divide on investor protection can be described as the *fragmentation* of investor protection. Fragmentation is an apt label because different components of the portfolio are subject to different degrees of investor protection: whereas public companies (whose securities would still comprise the largest share of a capitalization-weighted fully-diversified portfolio) are subject to the expansive regulatory scheme described in Section I.C.1, private companies (whose securities would comprise a smaller but steadily increasing share of the portfolio) remain unregulated. As noted in Section I.C.2, there are different ways to define investor protection,[223] but, notably, the point about fragmentation applies regardless of the chosen definition. As long as legal interventions applying to public companies offer a degree of protection that has been deemed *necessary* for the protection

222. *See, e.g.*, Elizabeth Pollman, *Private Company Lies,* 109 GEO. L.J. 353 (2020); Winship, *supra* note 7; Alon-Beck, *supra* note 171; *see also* sources cited in Section IV.A *infra.*

223. *See supra* notes 123–25 and accompanying text.

of mainstream investors, then exposing these investors to both public and private firms diminishes the overall level of investor protection within the portfolio.

Despite the rhetoric about "investor opportunity" which is usually tied to a quest for higher returns,[224] it is at best unclear that mixing public and private firms in the portfolio contributes to higher returns. Empirical evidence shows that private markets, on average, do not outperform public markets in terms of investor returns.[225] Relatedly, the track record of unregulated IPOs under Regulation A+ has been dismal.[226]

Expanding investor opportunity should not occur at the expense of overriding investor choice, but this may be one unintended consequence of the breakdown of the public–private divide. Because private company securities are finding their way into the diversified funds that comprise a majority of 401(k) retirement savings, it would be very difficult (or, in the very least, it would be burdensome) for an investor to *exclude* private companies from the portfolio even if this were a deliberate strategy based on an informed choice. The entry of private company securities into the investments of "public" investors is not a remote possibility but a reality. The big-three asset managers already invest in private companies and the biggest of them, BlackRock, has recently indicated plans for further expanding its investment in private company equity.[227] (While

224. *See supra* note 169.

225. *See* Erik F. Gerding, *The Cost to Retail Investors and Public Markets of "Harmonizing" Securities Offering Exemptions*, COLUM. L. SCH. BLUE SKY BLOG (Oct. 1, 2019), https://bit.ly/3Ix9n4D (providing a detailed overview of relevant studies and concluding that "[t]he best evidence suggests that, on average, *even institutional investors may be doing no better in the private markets than they would investing in a broad index of public securities*") (emphasis in original).

226. *See, e.g.*, Leo Imasuen, *Most Regulation A+ IPOs Are Outright Uninvestable*, SEEKING ALPHA (Oct. 31, 2017), https://bit.ly/3qlupv5. Crowdfunding represents a relatively similar method of capital raising, but data on profitability is more limited. Because of the relatively modest amounts raised, both Regulation A+ IPOs and crowdfunding fall outside the scope of this Article. Conceptually, crowdfunding also has implications for the public–private divide. *See* Joan MacLeod Heminway, *Crowdfunding and the Public/Private Divide in U.S. Securities Regulation*, 83 U. CIN. L. REV. 477, 503 (2014) ("An analysis of the regulation of [crowdfunded] offerings of securities . . . exposes new and emerging complexity in distinguishing between public and private offerings . . . and between public and private companies . . . .").

227. *See, e.g.*, Simon Jessop & Ross Kerber, *Insurers Plan to Ramp Up Private Market Investments, BlackRock Says*, REUTERS (Nov. 15, 2021), https://reut.rs/

there is an academic case to be made for diversification along related lines, it assumes legitimate variation in legal arrangements rather than what is in effect regulatory arbitrage.[228])

What are the harms of allowing investors who, in the words of the Supreme Court, "cannot fend for themselves," to invest in public firms? The classic story with respect to the merits of public markets as opposed to private markets relates to the advantages of public markets in terms of price discovery, liquidity, and information quality.[229] The harms of holding both private and public company securities are many, but perhaps the most significant one relates to private markets' reduced capacity to value firms accurately compared to public markets. The price at which an investor buys or sells a security is the most important term in a securities transaction, which makes stock price accuracy a key element of investor protection.[230] Private markets are inferior in pricing to public markets. According to Jesse Fried and Jeff Gordon, structural features of private markets, particularly tech startups in Silicon Valley, contribute to valuation and governance bubbles.[231] They note that "[a] market that makes it difficult and costly to express negative sentiments is prone to a bubble and thus an abrupt collapse when negative fundamentals finally become too pervasive to ignore."[232]

3EB8JAG; *see also supra* note 187 and accompanying text (discussing Fidelity's investment in Juul).

228. Kelli Alces has made such an argument, though her approach does not call for mixing public and private companies, but, rather companies with different legal arrangements. *See* Kelli A. Alces, *Legal Diversification*, 113 COLUM. L. REV. 1977, 1977 (2013) (explaining that "[l]egal diversification protects investors from the risk that a particular method of minimizing agency costs will prove ineffective").

229. *See, e.g.*, Coffee, *supra* note 201, at 747.

230. *See, e.g.*, Merritt B. Fox et al., *Law, Share Price Accuracy, and Economic Performance: The New Evidence*, 102 MICH. L. REV. 331, 370–81 (2003); *see also* Allen Ferrell, *Measuring the Effects of Mandated Disclosure*, 1 BERKELEY BUS. L.J. 369, 372 (2004) (providing an assessment of the various empirical studies and noting that "[t]he concept of stock price accuracy is well accepted and commonly employed in the accounting and finance literature"); *see also* Marcel Kahan, *Securities Laws and the Social Costs of "Inaccurate" Stock Prices*, 41 DUKE L.J. 977 (1992).

231. *See* Jesse M. Fried & Jeffrey N. Gordon, *The Valuation and Governance Bubbles of Silicon Valley*, COLUM. L. SCH. BLUE SKY BLOG (Oct. 10, 2019), https://bit.ly/3rk1glU.

232. *Id.*

Empirical evidence bears this out. According to a Morgan Stanley report, "[v]aluing young companies is an inherently tricky task."[233] The same report notes the results of a 2020 survey of venture capitalists on unicorn valuations: more than 90% of the respondents believed that unicorns were "'significantly' overvalued," even though 40% of them had themselves invested in unicorns.[234] On an aggregate level, the report also notes that in the period between 2011 and 2019, "about one-third of the companies that went public had a valuation below that implied by the final round of private financing."[235]

At a most basic level, accurate asset prices are key to investor protection and without a public listing, asset prices cannot be guaranteed to be accurate.[236] Relatedly, the rise of private markets inhabited by private firms that do not produce public disclosure reduces the overall level of firm-specific information that is available to market participants, which has the potential to affect the accuracy of securities prices for *public* firms.[237] The investor protection harms, in other words, are not limited to investors in private firms, but, rather, extend systemically across all capital markets. As a result, the diminished availability of information about private firms due to the rise of private capital has significant implications for allocative efficiency in the overall economy.

There is also the potential for investor losses due to poor corporate governance, inadequate information, and poor monitoring, as illustrated by the cases of WeWork, Uber, Theranos, and others.[238] At each of these companies, there were

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233. *See* MICHAEL J. MAUBOUSSIN & DAN CALLAHAN, MORGAN STANLEY, PUBLIC TO PRIVATE EQUITY IN THE UNITED STATES: A LONG-TERM LOOK 48 (2020), https://mgstn.ly/31CaMpV.

234. *Id.* at 47–48.

235. *Id.* at 47.

236. *See* James J. Park, *Investor Protection in an Age of Entrepreneurship*, HARV. BUS. L. REV. (forthcoming 2022), https://ssrn.com/abstract=3911454; Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and Its Legal Underpinnings* (Eur. Corp. Governance Inst., Working Paper No. 594/2021), https://ssrn.com/abstract=3707249.

237. *See* de Fontenay, *supra* note 22.

238. *See supra* note 176 and accompanying text; *see also* discussion *infra* Section IV.A. For an additional analysis of the investor protection implications, see Ann Lipton, *The Eroding Public/Private Distinction*, BUS. L. PROF. BLOG (Feb. 1, 2020), https://bit.ly/3DukFTw. For a contrarian analysis, see Platt, *infra* note 247.

governance failures despite the involvement of sophisticated venture capital and other institutional investors. Contrary to what we might expect by simply analyzing those investors' incentives, they did not bargain for information or exercise oversight in an effective manner. It appears likely that these firms' private status contributed to their governance problems. As is so often the case in corporate law, however, the counterfactual, whether public company status would have prevented the associated scandals, cannot be proven. But on balance, it does appear that, at least for large firms, public company status is more conducive to better governance (with all the associated benefits in terms of mitigating fraud and waste) than private company status.

There are two additional considerations. First, public markets may provide firms with greater resilience in times of crisis. The availability of private capital is more cyclical and private markets remain smaller overall; they are less liquid even during the best of times. Therefore, a regulatory policy that encourages firms to take on public company status may offer systemic benefits in terms of firms' ability to access capital when they experience distress. The second consideration relates to diversification. Diversification is key to maximizing risk-adjusted returns. Yet, it is considerably more difficult for individual investors constructing an individual portfolio to diversity effectively with private securities, because there is significantly less information available about private companies and because of the diminished liquidity of private company securities.

D. *Increased Vulnerability of Employee-Investors*

In addition to mainstream investors, the breakdown of the public–private divide compounds the problems faced by a special class of investors—employees of startup companies who usually receive a considerable amount of their total compensation in illiquid and hard-to-value private company stock and who are incapable of mitigating through diversification the firm-specific risk associated with their investment of both financial and human capital.[239] As discussed in Parts I and II, changes to industry practices as well as various economic and

239. *See, e.g.*, Yifat Aran, *Making Disclosure Work for Start-Up Employees*, 2019 COLUM. BUS. L. REV. 867 (2019).

regulatory changes from the past two decades have complicated the economic relationship between certain firms and their employees, giving rise to a hybrid economic actor: the employee-investor.

In the case of unicorns, stock options are a source of significant and well-documented problems relating to valuation, tax, contracting, lack of liquidity, and other matters.[240] Comprehensive data on employee ownership stakes in unicorns is lacking, but it is generally assumed that in late-stage startups approximately 15% of the market capitalization is reserved for employees.[241] An examination of headcount data from the current cohort of U.S.-based unicorns shows that 112 of them have 1000 or more employees, and a further 141 have between 500 and 999 employees.[242] Applying the general rule of thumb that approximately 80% of startup employees receive stock options, it stands to reason that there are hundreds of thousands of startup employees who are exposed to the stock of their employers. From a firm's point of view, trading equity capital for human capital is an attractive financial proposition, because it diminishes the need to seek external financing and delays the going-public decision, as discussed in Section I.B.1. Moreover, as discussed in Section I.B.2, employee-investors do not count for purposes of the mandatory registration thresholds under Section 12(g).

Unlike in the past, these problems are no longer capped in size or duration, because startups can now raise unlimited amounts of private capital (larger private startups tend to have more employee-investors) and because they can remain private, and unregulated from an investor-protection point of view, virtually indefinitely. As a result, the unique problems faced by employees investing in the stock of their employer are compounded. In the case of an employee receiving stock options as part of their compensation, the employee repeatedly has to make at least three types of difficult and highly conse-

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240. *See, e.g.*, Anat Alon-Beck, *Unicorn Stock Options—Golden Goose or Trojan Horse?*, 2019 COLUM. BUS. L. REV. 107 (2019).

241. *See* Alexander Davis, *IPO Bonanza Leaves Out Some Tech Workers Over Unexercised Stock Options*, PITCHBOOK (Dec. 17, 2020), https://bit.ly/3dton5h (quoting an estimate from a compensation expert).

242. Author's calculations based on data from PitchBook as of December 5, 2021. Aggregate data on unicorn headcount and the evolution of unicorn headcount over time is not available publicly.

quential investment decisions: (1) trading their human capital for stock options (a process which implicitly assigns a net present value to the stock option investment); (2) holding on to the stock options by continuing their employment at the company, or, if they decide to terminate their employment, either forfeiting the stock options or paying an exercise price plus applicable taxes within a limited period post-termination; and (3) deciding whether to exercise the options prior to their expiration date. The more human capital an employee trades in for stock options, the more consequential and risky the latter two decisions become. And, for each of these three types of decisions, an employee needs sufficient information about the firm's long-term prospects, which is not always available or forthcoming.[243]

It is important to keep in mind that all of the harms pertaining to investors discussed in Section III.C apply here as well. Moreover, the issue is not limited to the missed benefits of public company regulation and diversification. To the extent that there is a greater incidence of fraud at private companies, such fraud harms employee-investors disproportionately.[244] In short, employee-investors are exposed to both the harms faced by a firm's employees and the harms faced by a firm's investors.

IV.
REFORMS: CONCEPTUAL APPROACHES AND ROADBLOCKS

As documented in Part II, the regulatory system governing firms' capital raising activities—the types of capital, types of investors, and types of markets that different types of firms can access if they undertake certain legal obligations—is in a state of flux. This stands in contrast with the ordered nature of the original system described in Part I: public firms raising public capital from public investors on the public markets, and private firms obtaining private capital from a narrow class of qualified investors through the much-smaller private markets. As we saw in Part III, the implications of this change,

243. *See* Abraham J.B. Cable, *Fool's Gold? Equity Compensation & the Mature Startup*, 11 VA. L. & BUS. REV. 613 (2017).

244. *See, e.g.*, Urska Velikonja, *The Cost of Securities Fraud*, 54 WM. & MARY L. REV. 1887 (2013) (discussing the significant and idiosyncratic costs of corporate fraud for non-investor constituencies, including employees).

heretofore largely unacknowledged, are far-reaching and impact multiple constituencies both within and outside the firm.

Regulatory flux and incoherence can be lasting conditions, though hopefully not permanent ones. Even though some observers believe that the capital markets are over-regulated,[245] whereas others believe that they are under-regulated,[246] both groups are likely to agree that capital markets today are mis-regulated.[247] If and when change becomes possible, what might it look like? What are the roadblocks to reform and can they be overcome? The discussion that follows outlines two conceptual approaches—rebuilding the public–private divide and lowering the stakes in capital raising decisions by circumventing the public–private divide and shifting some of the economic regulation that currently operates through securities law to other regulatory domains.

Instead of endorsing a specific proposal or set of proposals, this Article analyzes the preconditions for reform and then argues in favor of new deliberative mechanisms for determining the optimal structure of securities regulation in the wake of the breakdown of the public–private divide.

245. *See, e.g.*, Center for Capital Market Competitiveness, Comment Letter on Concept Release on Harmonization of Securities Offering Exemptions (Sept. 24, 2019), https://www.sec.gov/comments/s7-08-19/s70819-6193319-192490.pdf (urging substantial further deregulation consistent with the Chamber of Commerce's "longstanding effort to examine how SEC regulatory burdens may diminish access to capital and to remove those barriers").

246. *See, e.g.*, Elisabeth D. de Fontenay, Erik Gerding, et al., Securities Law Professor Comment Letter on Concept Release on Harmonization of Securities Offering Exemptions (Sept. 24, 2019), https://www.sec.gov/comments/s7-08-19/s70819-6193340-192501.pdf (criticizing the rise of private capital and arguing against further deregulation by way of capital raising exemptions).

247. There is also a case for avoiding reforms in either direction. Some academics have recently pushed back against the prevailing critical views of the rise of private capital, and of unicorns in particular. *See, e.g.*, Alexander I. Platt, *Unicorniphobia*, HARV. BUS. L. REV. (forthcoming 2022), https://ssrn.com/abstract=3915793 (expressing skepticism about arguments that unicorns pose investor protection and other problems, as well as about the expected efficacy of the policy interventions proposed by other scholars); Abraham J.B. Cable, *Time Enough for Counting: A Unicorn Retrospective*, YALE J. ON REG. (BULLETIN), Sept. 21, 2021, https://bit.ly/3D0BCF7 (analyzing the investment outcomes of 32 "original" unicorns and suggesting that "private ordering by founders, employees, and investors is proving an effective alternative to ambitious regulatory reform").

A. *Rebuilding the Public–Private Divide*

While a complete picture of the breakdown of the public–private divide, along with its causes and consequences, is just emerging, a number of observers have analyzed the various changes in capital markets occurring during the 2010s and offered a range of discrete reform recommendations. From the vantage point of the public–private divide, these reform proposals can be classified into two general categories: (1) increasing regulation in the private realm in order to solve various investor-protection problems resulting from the changes in the capital markets ecosystem discussed in Part II; and (2) changing regulation to expand the public realm. One idea in the latter category—the "shareholders of record" solution proposed in October 2021 by SEC Commissioner Allison Herren Lee—deserves special attention both because of its sweeping nature and because the SEC can implement it fairly easily by acting on its existing authority, without the need for additional congressional action.

1. *Regulating the Private Realm*

As a point of departure, the analyses that fall within this rubric do not take a categorical stance against the rise of private capital markets and the expansion of the private realm, along with the key underlying phenomena: the rise of unicorns, the greater equity stakes held by private company employee-investors, and the expanded opportunities for retail investor participation in private company capital raising. Recognizing various problems caused by these phenomena, however, commentators have offered proposals for increasing the regulation of the newly-expanded private realm.

The reforms in respect of regulation of the private realm include the creation of special disclosure regimes for unicorns,[248] requiring additional disclosure for the benefit of em-

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248. *See* Jennifer Fan, *Regulating Unicorns: Disclosure and the New Private Economy,* 57 B.C. L. REV. 583, 585 (2016) (arguing that "once a private company reaches unicorn status, it should be subject to some of the same reporting obligations as public companies to provide greater transparency and protect minority stockholders"); *see also* Michael D. Guttentag, *Patching a Hole in the JOBS Act: How and Why to Rewrite the Rules that Require Firms to Make Periodic Disclosures*, 88 IND. L.J. 151 (2013) (arguing for expanded disclosure requirements for certain large private companies). For an early and prescient analysis of emerging problems in private markets, see Elizabeth Pollman, *Informa-*

ployee-investors in private companies,[249] whistleblower protections for private company employees,[250] more stringent enforcement of the anti-fraud provisions of the securities laws, which apply to private companies,[251] facilitating trading of private company securities in order to improve stock price accuracy,[252] and placing regulatory restrictions on trading in the absence of adequate disclosure.[253]

The key advantage of these proposals is that they offer one or more targeted solutions, which facilitates both assessment and implementation; a potential downside is that they each focus on a subset of the problems caused by the breakdown of the public–private divide and that the suggested interventions, while targeted, are not systemic. These proposals merit careful consideration during future policymaking rounds and should form a core part of the broad deliberative process envisioned by Section IV.C.

2. *Expanding the Public Realm*

Instead of regulating the private realm directly, it is also possible to intervene by expanding the size of the public realm, which will, in turn, shrink the private realm. Under this approach, the number of entities subject to the already-existing regime for regulating public companies would increase, while the number of entities that fall in the unregulated private realm would decrease. To achieve this, commentators have suggested, for example, to require or nudge late-stage private companies to take on public company status.[254] Changing the definition of the term "shareholder of record," a pro-

tion Issues on Wall Street 2.0, 161 U. PA. L. REV. 179, 222 (2012) (discussing the rise of secondary markets for private company securities and arguing that the SEC should require "a specified minimum level of disclosure" for trading in such markets).

249. *See* Aran, *supra* note 239; Alon-Beck, *supra* note 171.

250. *See* Winship, *supra* note 7.

251. *See* Pollman, *supra* note 222; Winship, *supra* note 7.

252. *See* Matthew Wansley, *Taming Unicorns*, 97 IND. L.J. (forthcoming 2021), https://ssrn.com/abstract=3801131.

253. *See* Jones, *supra* note 105, at 186–87 ("Policymakers can act by restricting trading in Unicorn shares in the absence of adequate disclosure.").

254. *See* Donald C. Langevoort & Hillary A. Sale, *Corporate Adolescence: Why Did "We" Not Work?*, 99 TEX. L. REV. 1347, 1382 (2021); Amy Deen Westbrook, *We'(re) Working on Corporate Governance: Stakeholder Vulnerability in Unicorn Companies,* 23 U. PA. J. BUS. L. 505, 570 (2021).

posal discussed in detail in Section IV.A.3 below, offers a blunt and automatic solution to expanding the public realm; these attributes work both in the proposal's favor and against it. Apart from the "shareholders of record" solution, the mechanics associated with expanding the public realm are complex and uncertain. Moreover, implementation would require congressional action, which is highly unlikely absent a crisis (as discussed further in Section IV.C below).

A report from the Global Financial Markets Center at Duke Law School published in February 2021 offers an illustration of various possible ways to expand the public realm.[255] The report suggests that "all large companies [ought to be] public," and lists the following triggers for imposing public company status:

- revenues above a threshold (e.g., $100 million annually);
- a "market cap" above a threshold (e.g., $1 billion) based on private market valuations;
- a "public float" in a private trading venue above a threshold (e.g., $75 million);
- a number of beneficial owners of "securities" above a threshold (e.g., 500), irrespective of "accredited investor" status; [. . .]
- a threshold number of employees (e.g., 250 full-time equivalents); [and]
- receiv[ing] more than a certain dollar amount in revenues directly from government contracts or funds (e.g., $25 million).[256]

The menu of options offered by the report reflects the evolving indicators of what it means to be a public company and deserves careful consideration. While the proposed thresholds are merely indicative, it is worth noting that they are set at relatively low levels and that, as presented, exceeding any one of them would be sufficient to push a firm into public company status. As a practical matter, then, this would subject most firms across the economy, except the smallest firms, to

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255. *See* TYLER GELLASCH & LEE REINERS, FROM LAGGARD TO LEADER: UPDATING THE SECURITIES REGULATORY FRAMEWORK TO BETTER MEET THE NEEDS OF INVESTORS AND SOCIETY (Glob. Fin. Mkts. Ctr. at Duke L., 2021), https://bit.ly/31cXO1H.

256. *Id.* at 11.

federal corporate law. It is also important to acknowledge again that adopting these recommendations would require congressional action, which appears unlikely as of this writing. By virtue of the way they change the regulatory treatment of private firms, the recommendations themselves will be disruptive to capital market participants, even with a phase-in period. Finally, international regulatory competition is another likely barrier to adoption. Forcing large and medium-sized U.S. private companies into public company status, and the full complement of public company regulation discussed in Section I.C.1, is a significant and costly step that might lead at least some of them to consider changing their domicile of incorporation. The rise of private capital is a global phenomenon and so is the proliferation of unicorns, as illustrated by Figure A–6 and Figure A–9, respectively.

3. *The "Shareholders of Record" Solution*

In an October 2021 speech, SEC Commissioner Allison Herren Lee offered an important and relatively easy-to-implement proposal for expanding the public realm.[257] Commissioner Lee focused on the "shareholders of record" trigger for public company status and made the case that the concept should reflect the *actual* number of investors, which would push many now-private firms beyond the threshold for registration and thus "create" a number of new public companies.[258]

Recall that under Section 12(g) of the Exchange Act, issuers of equity securities with at least $10 million in assets and more than 2000 shareholders of record (or more than 500 shareholders of record who are not accredited investors) are required to register the securities under the Exchange Act and thereby become subject to the periodic reporting requirements for public companies.[259] In other words, private compa-

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257. *See* Allison Herren Lee, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks at The SEC Speaks in 2021, Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy (Oct. 12, 2021), https://www.sec.gov/news/speech/lee-sec-speaks-2021-10-12.

258. *Id.*

259. *See supra* note 77 and accompanying text. Note that the technical term is "equity securities . . . held of record by . . . persons"; in line with other commentators, I refer to "shareholders of record" for the sake of clarity.

nies must become public companies upon exceeding the asset and shareholder-base thresholds. The definition of "shareholders of record," which dates back to the 1960s, does not account for the fact that shares are held predominantly in "street name" accounts, i.e., in the names of the intermediaries through which they were purchased or institutions where they are held, and not in the name of the underlying beneficial owners.[260] The SEC has estimated that "over 85% of the holders of securities in the U.S. markets hold through a broker-dealer or a bank that is a Depository Trust Company participant."[261] For this reason, at public companies and, importantly, at private companies that have gone through several funding rounds, the shareholders of record number *significantly understates* the number of beneficial owners. The SEC's original proposal for Rule 12g5-1 in 1964 contained a "look through" provision (looking through the street name holder to get to, and count, the customers who hold the underlying economic interest), but the final rule opted not to require this.[262] Today, redefining "shareholders of record" to reflect a firm's actual investor base would automatically push many private companies into public company status. According to Commissioner Lee, doing so would be desirable in light of market developments and justifiable in light of the legislative history of Section 12(g).[263]

260. *See* Lee, *supra* note 257.

261. *See* U.S. SEC. & EXCH. COMM'N, REPORT ON AUTHORITY TO ENFORCE EXCHANGE ACT RULE 12G5-1 AND SUBSECTION (B)(3) 8 n.26 (Oct. 15, 2012), https://www.sec.gov/files/authority-to-enforce-rule-12g5-1.pdf [hereinafter SEC Rule 12g5-1 Study]. The same SEC Staff Report concluded that "issuers with more than 2000 beneficial owners, but less than 2000 holders of record, can be actively traded in the over-the-counter markets or in private secondary markets, without triggering the threshold requirements to report under the Exchange Act." *Id.* at 11.

262. *See* Langevoort & Thompson, *supra* note 4, at 356. The authors also note that even though Rule 12g5-1 does not require look-through, other SEC rules do provide for look-through under various circumstances; in other words, look-through is not outside the norm. *Id.* They explain that "[t]he absence of a look through widens the range of trading that can occur without 1934 Act regulation because beneficial owners can, and do, make individual decisions to sell their stock, so that one broker-dealer as record owner may reflect the reality of hundreds of investors trading." *Id.*

263. *See* Lee, *supra* note 257. (Commissioner Lee's speech appeared as this Article was being finalized and the present analysis is not intended to be comprehensive.)

Even though the notion of "shareholders of record" has long attracted criticism,[264] and even though it was subject to some scrutiny in connection with Congress' consideration of the JOBS Act,[265] all without any resolution, Commissioner Lee's recent focus on this issue is noteworthy. Unlike most of the other proposals for rebuilding the public–private divide, changing the "shareholder of record" definition can be done by the SEC acting on its existing authority and without the need for congressional authorization.[266] Given the need to address problems in the public markets reflected in Commissioner Lee's speech and the very low likelihood of cooperation from Congress, the "shareholders of record" solution is one of the few available avenues for reform.

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264. *See, e.g.*, Petition from Institutional Investors for Commission Action to Require Exchange Act Registration of Over-the-Counter Equity Securities (July 3, 2003), https://www.sec.gov/rules/petitions/petn4-483.htm (noting, inter alia, that "Rule 12g5-1 fails to properly effectuate the Congressional intent expressed in Section 12 or the policy goals of the Exchange Act" and making a detailed case for reform); GELLASCH & REINERS, *supra* note 255, at 11 (noting that "the SEC's curious definition of 'shareholder of record' permits issuers, executives, and other interested parties to easily avoid the Section 12(g) trigger by simply aggregating owners into ownership vehicles or at a small number of broker-dealers" and arguing for reform).

265. *See* Letter from North American Securities Administrators Association, to Senator Jack Reed (Mar. 22, 2012), https://bit.ly/31csG2l (asserting that "[t]he current 'holder of record' definition creates confusion and threatens investor confidence in the marketplace"); *The Future of Capital Formation: Hearing Before the H. Comm. on Oversight & Gov't Reform*, 112th Cong. 16 (2011) (statement of Mary L. Schapiro, Chair, U.S. Sec. & Exch. Comm'n) (noting that "since the definition of 'held of record' was put into place, a fundamental shift has occurred in how securities are held in the United States"). In addition, Section 504 of the JOBS Act required the SEC to undertake a narrowly-focused study in respect of the anti-evasion provisions applicable to the concept of "shareholders of record"; because most of the problems associated with the concept stem from its underinclusive nature (rather than from active efforts to evade the rules), however, those problems fell outside the study's narrow scope. *See* SEC Rule 12g5-1 Study, *supra* note 261.

266. *See* Lee, *supra* note 257 ("[T]he Commission can and should act now within our existing authority to restore transparency in capital markets. That means, at a minimum, it's time to revisit how we define shareholders of record under [Section] 12(g)."); *see also* GELLASCH & REINERS, *supra* note 255, at 11 (asserting that "adopting a rule revising [the SEC's] interpretation of the 'shareholder of record' to reflect the actual owners of securities" represents a "change [that] can be made without legislation").

The expected impact of any proposal would depend on the nature of the proposal; since no detailed proposal exists at present, specific predictions can easily miss the mark. Nevertheless, we can observe with some certainty that moving the concept of "shareholder of record" closer to the idea of "beneficial owner" would be a highly effective, albeit blunt and controversial, tool for reversing the breakdown of the public–private divide. Doing so will push many, and possibly most, unicorns into public company status. Notably, it would do so not by incentivizing them to undertake an IPO, but by subjecting them to public company regulation automatically and as a result of the size of their investor base.

The "shareholders of record" move is likely to be controversial for at least two reasons. First, the differences between public and private company status and the associated costs and obligations have grown to be very substantial, as illustrated in Section I.C.1; any change in regulatory treatment, therefore, will be highly-consequential for day-to-day operations and regulatory obligations. Second, even though the change to the SEC rulebook would be fairly minor (simply amending the definition of "shareholder of record"), the consequences from it would be profound: the resurrection of a now-forgotten mechanism for forcing emerging companies into public company status, and, correspondingly, the sudden end of the "issuer choice" regime described in Section III.A. Therefore, it should not be a foregone conclusion that the SEC would be willing to take on, or, indeed, be equipped to withstand, the likely pushback from market participants. Whereas the deregulatory cascade described in Section II.B unfolded over the course of almost a decade, piecemeal and with little fanfare, the re-regulation of private companies by amending the "shareholder of record" definition is likely to be abrupt and highly-visible, no matter the implementation approach.

How would the "shareholders of record" solution fare with respect to the four concerns identified in Part III? As noted already, it will eliminate the current "issuer choice" regime under which firms are able to acquire a broad investor base and still avoid public company regulation by raising capital on the private markets. Resurrecting the Section 12(g) triggers for public company status will diminish the relative importance of the markets on which shares are sold, since the size of the investor base, measured by the number of beneficial own-

ers of shares, will push a number of firms into public company status. Like before, special circumstances may still allow a limited number of firms to achieve scale without the need to raise capital from a broad investor base.[267]

Relatedly, the "shareholders of record" solution will also restore most of securities law's diminished regulatory capacity, the second major consequence of the breakdown of the public–private divide. By using the true size of the investor base as a regulatory trigger, public company regulation will capture a larger number of firms, including smaller and younger firms.[268] At the same time, if the goal is to use parts of securities law to regulate firms with a large societal footprint—or firms characterized by "publicness"[269]—the size of a firm's investor base would be a less-than-perfect proxy, since this metric fails to take into account a firm's impact on non-shareholder constituencies, such as employees, customers, suppliers, communities, and the environment. In addition to being imprecise, zeroing in only on a firm's investors when assessing its overall societal footprint is normatively objectionable.[270]

The "shareholders of record" solution is likely to be effective, albeit indirectly, in addressing the fragmented nature of investor protection, which was the third major consequence of the breakdown of the public–private divide discussed in Part III. Forcing private firms to become public companies upon acquiring an investor base of a certain size would do nothing to foreclose the many new mechanisms through which main-

267. *See supra* note 209 and accompanying text (noting the existence of a limited number of large private companies that pre-date the rise of unicorns during the 2010s).

268. As discussed in Section I.C.2 and Section III.B, the extent to which securities regulation should be used to advance goals beyond classic investor protection is open to debate. The point here is simply that imposing regulation through the "public company" regulatory category would become much more effective, since the "shareholders of record" solution would cause many more firms to fall within the definition of "public company."

269. *See infra* notes 273–77 and accompanying text.

270. *See, e.g.*, Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. ON REG. 499 (2020) (criticizing the use of the investor-focused disclosure regime as a means of supplying important information to non-investor audiences); Daniel Hemel & Dorothy S. Lund, *Sexual Harassment and Corporate Law*, 118 COLUM. L. REV. 1583, 1671–73 (2018) (noting that analyzing the harms caused by sexual harassment through the lens of corporate law can create additional, "discursive harms").

stream, non-accredited investors can invest in both *private* and *public* companies, which were discussed in Section II.B; it will, however, reduce the overall supply of private company stock because it will reduce the number of private companies. As a result, the share of private company securities in the portfolios of mainstream investors will decrease, which, in turn, will mitigate the investor protection harms stemming from the breakdown of the public–private divide.

Finally, the "shareholders of record" solution would be unable to address, and may in fact exacerbate, the increased vulnerability of employee-investors—the fourth major consequence discussed in Part III. Recall that pursuant to the JOBS Act, employee-investors are expressly excluded from the "shareholders of record" count.[271] Even though the SEC has the authority to amend the definition of "shareholders of record," it cannot amend it in a way that captures employee-investors, since this will be in direct conflict with congressional intent to exclude employees from the count. Moreover, a world in which investors cannot be bundled together through the existing definition of "shareholders of record" is a world in which *every* individual investor counts for purposes of the 2000 shareholder-of-record threshold *except for* employee-investors. As a result, employee-investors would become the only source of private capital that does not trigger Exchange Act registration and regulation. We can expect that as firms approach the 2000 shareholders-of-record threshold for registration, they would place greater reliance on sourcing capital from employee-investors, with all of the attendant problems discussed in Section III.D.

In sum, the "shareholders of record" solution would not resolve all the consequences from the breakdown of the public–private divide in securities law discussed in this Article. It would, however, represent a bold step toward rebuilding the original public–private divide by making it impossible for firms to acquire a sizeable investor base while maintaining private company status, which, in turn, would automatically increase the number of public companies. The blunt nature of this solution raises questions about its practical feasibility, even if the SEC's authority to pursue it is beyond question. Importantly, the "shareholders of record" solution will not address the

271. *See supra* note 77 and accompanying text.

problems faced by employee-investors and may exacerbate them. Ultimately, the limits of the "shareholders of record" solution highlight the difficulties the SEC is likely to encounter if it sets out to rebuild the public–private divide in securities law without comprehensive assistance from Congress. (Whether and when such assistance might be forthcoming is a question I take up in Section IV.C below.)

B. *Circumventing the Public–Private Divide*

The fact that the breakdown of the original public–private divide has caused a series of problems does not automatically suggest that the only way to solve these problems is by rebuilding the divide. Another conceptual approach to addressing the problems identified in this Article may be to reduce the regulatory stakes of the public–private distinction in securities law. The two approaches are not mutually exclusive—it is possible to both reduce the stakes of the public–private distinction and to rebuild a version of the public–private divide.

Why might lowering the regulatory stakes of the public–private company distinction be desirable? As illustrated by the public company regulatory paradox discussed in the Introduction, otherwise-identical firms can inhabit entirely different regulatory universes depending on their public or private company status. Importantly, the regulatory universe in which a firm finds itself now hinges solely on the firm's capital raising choices. As we saw in Section I.C, public companies are heavily regulated in respect of various disclosure and corporate governance matters, whereas private companies are not. Moreover, the volume of regulation at issue has increased dramatically over the past two decades, as has the range of matters covered by such regulation. This, in turn, has heightened the compliance costs and the overall stakes of being a public company. Many of the deregulatory reforms described in Section II.B can be viewed as reforms aimed at extending to private firms benefits previously available only to public firms.

The difference between the regulatory treatment of public and private companies can be reduced by (1) narrowing the scope of securities regulation to matters most closely related to financial investors' buy/sell and voting decisions, and (2) making aspects of what is now public company regulation applicable to all business entities that meet certain criteria,

without regard to public company status. This approach would represent a substantial expansion of the role of the federal government in the regulation of business entities, but it would also reduce the weight of any individual firm's decision with respect to becoming a "public company" and make it possible to rationalize the regulatory regime for capital raising.

Take disclosure regulation as an example. If all firms, whether public or private, that meet certain pre-defined criteria *unrelated to capital market activity* become subject to a new stakeholder-focused mandatory disclosure regime, then the going-public decision is less likely to be affected by the perceived costs of the existing investor-focused mandatory disclosure regime. Ann Lipton has made the case for just such a new stakeholder-focused mandatory disclosure regime on the grounds of the social utility of providing stakeholders with firm-specific disclosure and the inadequacy of existing investor-focused disclosure for non-investor audiences.[272] Lipton's proposal for a separate stakeholder-focused disclosure regime has the important additional benefit of removing the secrecy advantage enjoyed by private firms vis-à-vis public firms and streamlining the regulatory calculus embedded in the going-public decision.

The insight motivating this conceptual approach is a reaction to the public company regulatory paradox: a firm's capital raising choices should not determine, in a binary fashion, whether or not it is subject to the extensive public company regulatory regime that today covers many matters that are only loosely-related to investor protection and may be better described as regulation in the service of business accountability, transparency, efficiency, and other goals. Relatedly, even if there is a robust public–private line for capital raising purposes, a firm's obligations in respect of general economic regulation should not be determined by the side of this line on which the firm finds itself.

Shifting federal economic regulation that currently operates through the public company category outside the realm of securities regulation would require the creation of new, alternative regulatory categories that are not tied to a firm's access-to-capital choices. Such alternative regulatory categories could encompass metrics such as number of employees, revenues, as-

272. *See* Lipton, *supra* note 270.

sets, and other indicators of a firm's societal footprint, i.e., a firm's potential to generate societal externalities that ought to be disclosed and/or regulated regardless of the firm's financing choices. Hillary Sale has developed a theory of "publicness" that links federal economic regulation to a firm's overall societal footprint.[273] Regulating on the basis of publicness can be done with or without reference to a firm's financing activities.[274]

Consider two specific examples, one concerning legislation from outside the United States and one concerning proposed U.S. legislation. The United Kingdom introduced a new regulatory regime in 2018 requiring large private companies to provide certain disclosures and comply with the substantive provisions of its new Corporate Governance Code.[275] While the public–private divide in the United Kingdom was never as pronounced as that in the United States, the new U.K. Corporate Governance Code circumvents the public–private divide entirely and imposes regulation that had previously applied on the basis of a company's status as a stock-exchange listed entity to all companies that meet certain criteria.[276] Contemporaneous amendments to other parts of U.K. corporate law require all companies (both public and private) with more than 250 U.K.-based employees to provide a statement describing any employee empowerment initiatives pursued by the company and summarizing "how the directors have engaged with employees" and "how the directors have had regard to employee interests, and the effect of that regard, including on the princi-

273. *See* Hillary A. Sale, *The New "Public" Corporation*, 74 LAW & CONTEMP. PROBS. 137, 137–38 (2011); Hillary A. Sale, Essay, *J.P. Morgan: An Anatomy of Corporate Publicness*, 79 BROOK. L. REV. 1629, 1630–31 (2014); Hillary A. Sale, *The Corporate Purpose of Social License*, Geo. L. Fac. Pubs. No. 2171 (2019), https://scholarship.law.georgetown.edu/facpub/2171.

274. *See, e.g.*, Onnig H. Dombalagian, *Principles for Publicness*, 67 FLA. L. REV. 649 (2016); Guttentag, *supra* note 248.

275. *See Corporate Governance for Private Companies: Restoring Trust in Big Business*, LINKLATERS, https://bit.ly/3o36jFu.

276. The Code's corporate governance reporting requirements apply to non-listed U.K. companies that meet one of two thresholds: (1) have more than 2000 employees globally, or (2) have annual turnover over £200 million and a balance sheet over £2 billion. *Id.*

pal decisions taken by the company during the financial year."[277]

In the United States, the Accountable Capitalism Act proposed by Senator Elizabeth Warren in 2018 constructs a new regulatory category, "large entity," defined as any domestic entity engaged in interstate commerce with more than $1 billion in annual gross receipts.[278] Defined this way, the category captures both public and private companies. Under the Act's proposal, large entities would be subject to a variety of corporate governance regulations; previous proposals in respect of some of these regulations were limited to public companies only.[279]

The purpose of this discussion is to outline an alternative conceptual approach with respect to the future of the public–private divide in securities law rather than to analyze or endorse any of the specific proposals that have been mentioned. The more work the public–private divide is asked to do (and, particularly, work beyond the regulation of capital raising), the more pressure there is on the public–private distinction. If there are new regulatory categories that circumvent the public–private distinction, the effectiveness of the regulations employing those categories would likely be enhanced; such an approach would also make it easier to recalibrate the existing investor protection standards for public capital markets.

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277. *See* The Companies (Miscellaneous Reporting) Regulations 2018, SI 2018/860 (UK); *see also* Georgiev, *Human Capital Management*, *supra* note 61, at 658–59 and sources cited therein. The same category of companies are also required to disclose the gender pay gap on an annual basis. *See* Aleksandra Wisniewska et al., *Gender Pay Gap: How Women Are Short-Changed in the UK*, FIN. TIMES (Sept. 25, 2020), https://ig.ft.com/gender-pay-gap-UK.

278. Accountable Capitalism Act, S. 3348, 115th Cong. § 2 (2018). Aggregation rules based on the IRS Code safeguard against evading regulation by splintering entities to fall beneath the $1 billion threshold. *Id.* Large entities would be required to obtain a charter as a "United States corporation" from a newly-created Office of United States Corporations within the Department of Commerce. *Id.*

279. For example, whereas the Accountable Capitalism Act would require that employees of *large entities* (i.e., registered "United States corporations") be given the power to elect at least 40% of the board (*Id.* at § 6(b)(1)), the Reward Work Act, proposed by Senator Tammy Baldwin, would give employees of *public companies* (but not private companies) the power to elect one-third of directors. *See* Press Release, Off. of Sen. Tammy Baldwin, U.S. Senator Tammy Baldwin Reintroduces Legislation to Rein in Stock Buybacks and Give Workers a Voice on Corporate Boards (Mar. 27, 2019), https://bit.ly/3rhFaR7.

C. *Reform Preconditions and Process*

The reform options discussed above are likely to be difficult and costly to implement. Given historical patterns of regulation,[280] as well as the political and logistical roadblocks to reform,[281] securities law may well need to wait until the next big market crisis before the public company regulatory paradox can be addressed.

What are the preconditions for change? Using a "critical junctures" framework, a recent paper by Steven Bank and Brian Cheffins suggests that a stock market crash may not be a sufficient condition for corporate law change.[282] Bank & Cheffins find that, in addition to a stock market crash, major reforms require "a lengthy period of depressed share prices and a perception amongst contemporaries that business wrongdoing precipitated or was otherwise integrally related to the slump."[283] If these patterns hold, it may well be a long time before there is a window of opportunity to return securities law to a state of conceptual coherence. As significant as they are, the immediate consequences of the breakdown of the public–private divide are not guaranteed to result in a stock market crash, a lengthy bear market, and a turn in public opinion connecting market problems to business wrongdoing. A market calamity of such proportions is much more likely to be caused by macroeconomic imbalances, financial engineer-

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280. *See* Stuart Banner, *What Causes New Securities Regulation? 300 Years of Evidence*, 75 WASH. U. L. Q. 849, 855 (1997) (asserting that regulatory surges do not occur randomly and that the catalyst is a crash).

281. *See* Lucian Bebchuk & Assaf Hamdani, *Federal Corporate Law: Lessons from History*, 106 COLUM. L. REV. 1793, 1799–1816 (2006); John C. Coffee, Jr., *The Political Economy of Dodd–Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019 (2012).

282. *See* Steven A. Bank & Brian R. Cheffins, *Corporate Law's Critical Junctures*, BUS. LAW. (forthcoming 2022), https://papers.ssrn.com/id=3877329. The authors explain that "[i]n the social sciences context, a critical juncture is an historical moment during which substantially greater change is possible than during the preceding and subsequent periods of stability." *Id.* at 3.

283. *Id.* at 4. The authors further note that "the prolonged downturn and the discrediting of the status quo provide an opening for major change absent under normal circumstances," which includes strong investor and public interest in regulation and, importantly, the inability of "incumbent financial and business interests" to stave off major reform due to their temporarily weakened position. *Id.* at 4–5.

ing gone awry, a natural disaster, or a "black swan"-type event. Of course, none of this can be predicted.

Recognizing that urgent reform may be impossible even if it seems necessary allows the luxury of time to reconsider the institutional design of securities regulation—the allocation of responsibility amongst the SEC, Congress, and courts, as well as the liability structure of securities law.[284] This deliberative approach may resemble the foundational debates around the adoption of the original securities laws during the 1930s. As we saw in Section I.C, both the means and the ends of public company regulation have grown more uncertain and more controversial over time. Questions such as the appropriate scope of the public company regulatory regime, the meaning of the statutory goals of "investor protection" as well as "efficiency, competition, and capital formation," the relevance of unstated-yet-manifested goals such as business transparency and accountability, the allocation of regulatory responsibility between state and federal law, among others, can all benefit from considered examination.

It is often said that "a crisis is a terrible thing to waste"[285]—but so is the time before a crisis. There is a lot that the SEC can do today to ensure that when the next opportunity for change arises, it will be ready to contribute to the legislative process drawing upon its authority and technical expertise. Specifically, the SEC should as soon as possible initiate a broad deliberative process involving multiple stakeholders to come up with a blueprint for capital market regulatory reform to address the breakdown of the public–private divide. Even if this blueprint is not put into immediate use due to congressional inaction, having such a blueprint will help the agency navigate the next occasion when Congress is focused on financial and capital market regulation. It will also make it more difficult for special interests to take over the regulatory process; as we have seen, in the absence of an SEC blueprint, pri-

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284. Scholars have made the case for examining securities law's institutional design due to a variety of different concerns. *See, e.g.*, Zachary J. Gubler, *Reconsidering the Institutional Design of Federal Securities Regulation*, 56 WM. & MARY L. REV. 409 (2014); MARK I. STEINBERG, RETHINKING SECURITIES LAW (2021); DONALD C. LANGEVOORT, SELLING HOPE, SELLING RISK: CORPORATIONS, WALL STREET, AND THE DILEMMAS OF INVESTOR PROTECTION (2016).

285. *See* Jack Rosenthal, *A Terrible Thing to Waste*, N.Y. TIMES MAG. (July 31, 2009), https://nyti.ms/3yreIpG (discussing the history of the quote).

vate actors supply their own blueprints which often turn into a regulatory agenda.[286]

A change of approach on a more procedural level may also be advisable. Notice-and-comment rulemaking in respect of specific proposals is not an effective means of surveying a wide range of regulatory options or considering foundational regulatory questions such as those listed in the preceding paragraphs; the SEC's use of "concept releases" as a step-zero in notice-and-comment rulemaking, which grew more widespread during the 2010s, is a minor improvement at best. The SEC has used special committees comprised of internal and external experts in prior decades and it should renew this practice. Each of the policy proposals discussed in Sections IV.A and IV.B above deserves careful consideration. In addition, the SEC should focus on data gathering and analysis of private capital raising, most of which still occurs in the shadows. Finally, the SEC should use its authority to engage in investor testing in connection with major policy proposals, which Congress reaffirmed in 2010 through Section 912 of the Dodd–Frank Act.[287] Drawing on the outputs of a well-designed deliberative process and armed with adequate evidence, the SEC can steer the policy conversation with respect to the public–private divide at securities law's next critical juncture, whenever it might occur.

Conclusion

This Article started by identifying a public company regulatory paradox, which motivated the present inquiry: it is possible today for two virtually identical firms to be subject to widely different regulatory obligations, which depend solely on the firms' financing choices. Public companies must comply with

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286. *See supra* note 161 and accompanying text (noting the wholesale adoption of deregulatory proposals contained in the IPO Task Force Report through the JOBS Act) & *supra* note 169 and accompanying text (noting the wholesale adoption of deregulatory proposals advocated in a 2018 report from the Committee on Capital Markets Regulation).

287. *See* Dodd–Frank Act § 912, 15 U.S.C. § 77s(e) (providing that the SEC may "(1) gather information from and communicate with investors or other members of the public; (2) engage in such temporary investor testing programs as the Commission determines are in the public interest or would protect investors; and (3) consult with academics and consultants, as necessary . . . .").

an extensive and elaborate disclosure and governance framework related to investor protection, transparency, and accountability, whereas private companies are free to operate without disclosure and governance oversight at the federal level. As we saw, the present-day regulatory paradox is a manifestation of the breakdown of the longstanding public–private divide in securities law.

The Article then presented an account of how the public–private divide has lost its descriptive and explanatory power as an organizing principle of securities law. The breakdown of the divide has been a function of numerous, often-incremental deregulatory policies in the service of capital formation during the 2010s, which were, in turn, spurred by significant evolutionary shifts in capital markets and justified with reference to the massive expansion of public company regulation through the Sarbanes–Oxley Act of 2002 and the Dodd–Frank Act of 2010. In addition to highlighting the breakdown of the divide, the Article identified serious systemic and stakeholder-specific consequences: the now-elective nature of public company regulation, the diminished regulatory capacity of securities law, the fragmentation of investor protection, and the increased vulnerability of employee-investors. Addressing these problems, by rebuilding the divide, circumventing it, or through other means, will likely require foundational changes to the regulatory regime. It will also require policymakers and regulators to update the notions of investor protection, capital formation, efficiency, competition, and, more generally, what it means to regulate capital markets in the public interest.

The Article's focus on the public–private divide should not obscure several analytical points. First, private capital certainly has a role to play in the modern economy; *small, early-stage* private companies are often a source of significant innovation, which results in benefits to society. There is, for example, much hope that startups focused on clean energy will help with the transition to a greener economy. Nothing here suggests that securities law should treat such firms in the same way as their mature counterparts; as noted throughout, the focus is on larger private companies, such as unicorns, that have been in existence for some time and that have acquired a substantial footprint in terms of implied valuation, investor base, number of employees, and various other metrics. Second, while the public (regulated) vs. private (unregulated) markets dichot-

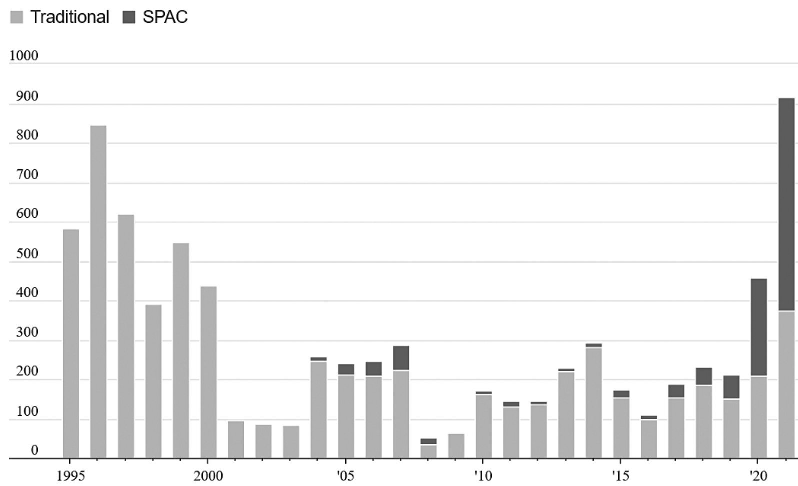
omy is helpful, it does not imply that public markets are perfect; certain specific aspects of the regulation of public markets are the subject of lively academic and policy debates, which lie outside the scope of this Article. Finally, as a factual matter, most large private firms do eventually elect to transition to public company status. One could therefore posit that intervention is unnecessary, because the problems identified here resolve themselves over the long run and at the level of individual firms. This Article has shown that the problems that arise over the short- and medium-run, as well as on a systemic level, are serious enough to warrant regulatory attention.

Zooming out, it is worth noting that because financial capital is both highly mobile and highly morphable, regulating it has never been easy. Political, macroeconomic, technological, and even epistemological challenges abound. More so than in other areas, law here plays a dual rule: not only to proscribe harmful activities, but also to actively enable beneficial ones. In 2021, there are various capital market phenomena that straddle the line between harmful and beneficial, including SPACs, stablecoins, other cryptocurrencies, and certain stock trading platforms. There are also various phenomena that are clearly problematic, such as unaccounted for risks (including climate and cybersecurity), asset valuation issues pertaining to human capital, data assets, and other intangibles, and, as always, issues related to fraud, capital market microstructure, and international competition.

The SEC's ability to solve these problems and future ones, as well as the nature of the solutions, will in large part turn on the renegotiation of the public–private divide. The regulatory future is uncertain, but it is safe to say that securities law's most interesting and challenging years lie ahead.

APPENDIX:
SELECTED DATA ON TRENDS IN CAPITAL MARKETS

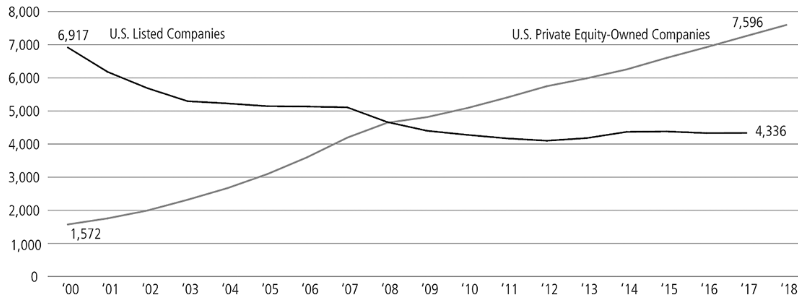
FIGURE A–1: NUMBER OF U.S. LISTED IPOS (1995–2021)



Note: 2021 data through Nov. 16

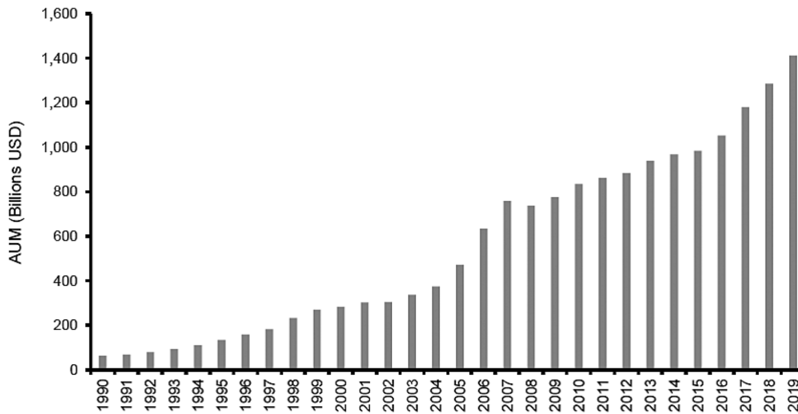
Source: Corri Driebusch, *IPOs Keep Jumping Higher. How Long Will the Ride Last*, WALL. ST. J. (Nov. 19, 2021), https://on.wsj.com/3lkKAHj (reporting data from Dealogic).

FIGURE A–2: NUMBER OF U.S. LISTED AND U.S. PRIVATE EQUITY-OWNED COMPANIES (2000–2017)



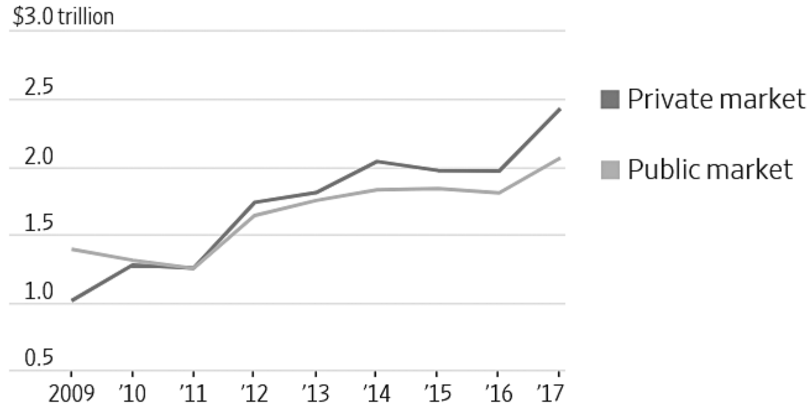
Source: *Capital Raising Goes Back to the Future*, NEUBERGER BERMAN, https://bit.ly/32M3IYc (last visited Nov. 30, 2021) (reporting data from World Bank, World Federation of Exchanges, PitchBook, Credit Suisse).

FIGURE A–3: ASSETS UNDER MANAGEMENT FOR U.S. BUYOUT INDUSTRY (1990–2019)



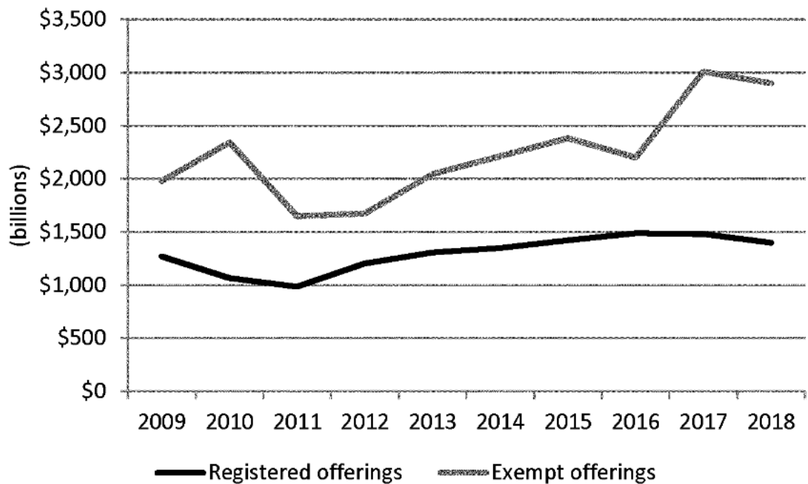
Source: MICHAEL J. MAUBOUSSIN & DAN CALLAHAN, MORGAN STANLEY, PUBLIC TO PRIVATE EQUITY IN THE UNITED STATES: A LONG-TERM LOOK 34 (2020), https://mgstn.ly/31CaMpV (reporting data from PitchBook, NVCA, and Counterpoint Global).

FIGURE A–4: VOLUME OF CAPITAL RAISED BY U.S. COMPANIES IN PUBLIC AND PRIVATE MARKETS (2009–2017)



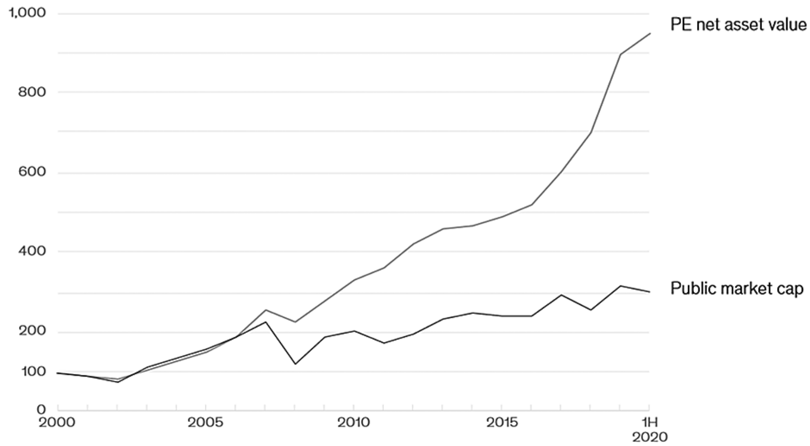
Source: Jean Eaglesham & Coulter Jones, *The Fuel Powering Corporate America: $2.4 Trillion in Private Fundraising*, WALL. ST. J. (Apr. 3, 2018), https://on.wsj.com/3xz1B5m (reporting data from Dealogic and an analysis of SEC filings).

FIGURE A–5: VOLUME OF CAPITAL RAISED BY U.S. COMPANIES IN EXEMPT AND REGISTERED OFFERINGS (2009–2018) (SEC)



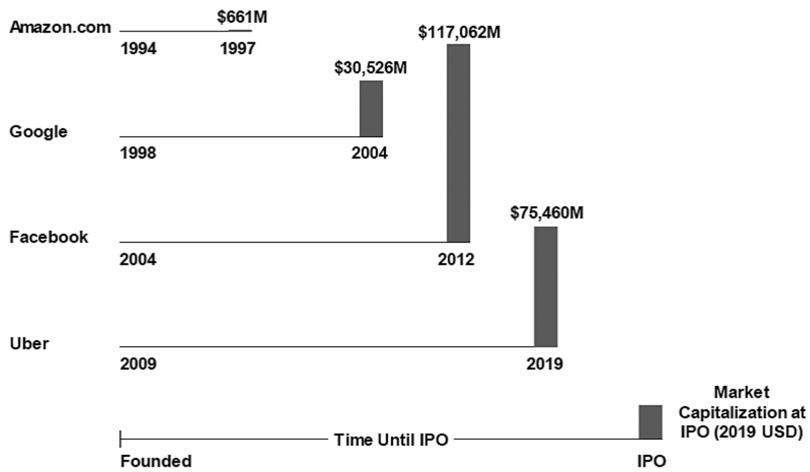
Source: U.S. Sec. & Exch. Comm'n, Concept Release on Harmonization of Securities Offering Exemptions, Securities Act Release No. 33–10,649, 84 Fed. Reg. 30,460, 30,465 (proposed June 26, 2019) (reporting data from the SEC Division of Economic and Risk Analysis).

FIGURE A–6: GROWTH OF GLOBAL PRIVATE EQUITY AND PUBLIC EQUITY (%) (2000–2020)



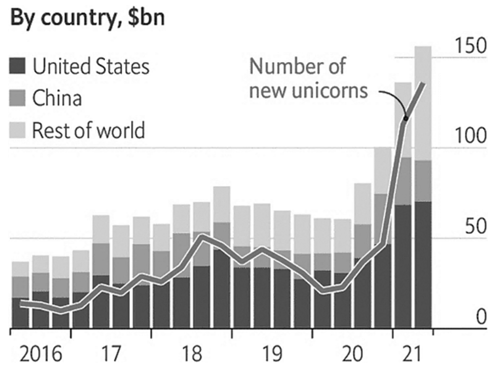
Source: MCKINSEY, MCKINSEY'S PRIVATE MARKETS ANNUAL REVIEW 19 (2021), https://mck.co/3o6olXp (reporting data from World Federation of Exchanges and Preqin).

FIGURE A–7: TIME TO IPO AND MARKET CAPITALIZATION AT IPO: AMAZON, GOOGLE, FACEBOOK, UBER



Source: MICHAEL J. MAUBOUSSIN & DAN CALLAHAN, MORGAN STANLEY, PUBLIC TO PRIVATE EQUITY IN THE UNITED STATES: A LONG-TERM LOOK 49 (2020), https://mgstn.ly/31CaMpV (reporting data from company SEC filings and Counterpoint Global).

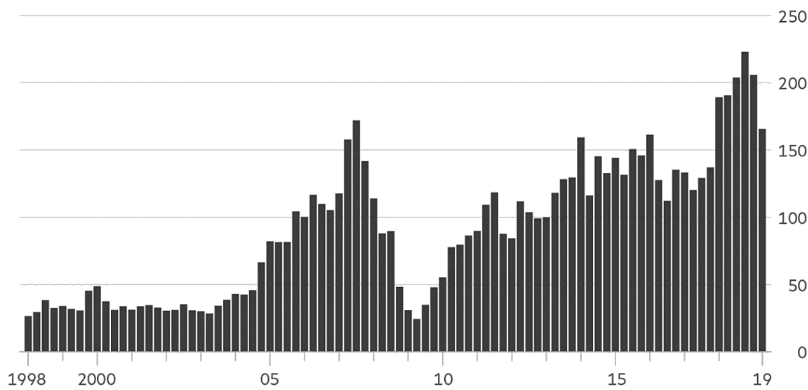
Figure A–8: Number of Unicorns and Total Capital Raised by Unicorns in United States, China, and Rest of the World (2016–2021)



(Data reported on a quarterly basis.)

Source: *Technology Unicorns Are Growing at a Record Clip*, Economist, Jul. 24, 2021, https://econ.st/3IxkXwT (reporting data from CB Insights).

Figure A–9: Quarterly Stock Buybacks by S&P 500 Companies (1998–2019)



(Data shown in billions of U.S. dollars.)

Source: Richard Henderson, *Fall in Share Buybacks Poses Threat to US Stocks*, Fin. Times (Aug. 23, 2019), https://on.ft.com/3ox4Ln8 (reporting data from S&P Dow Jones Indices).