MYTHICAL UNICORNS AND HOW TO FIND THEM: THE DISCLOSURE REVOLUTION

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Our federal and state securities laws are centered around two vital requirements for economic growth: capital formation and investor protection. Section 12(g) sits in the middle of these two concepts by attempting to ensure the latter without jeopardizing the former. However, since the passage of the Jumpstart Our Business Startups ("JOBS") Act in 2012, exempt capital formation in the unregulated private market has increased dramatically. At the same time, new ways of investing in these spaces have been opened for retail investors. The result has been the exposure of an increasing amount of the public's capital to riskier investments in a sphere where information is unavailable in the best of times and deliberately hidden in the worst.

For founders of large private tech companies and their sophisticated investors, this structure remains advantageous. They are capable of raising large sums of capital, something normally only done by public companies, while avoiding the costs associated with our disclosure regime. They care little about the corporate governance responsibilities of running large companies and protect their interests above that of the company as a whole. Minority investors, primarily employees and, in increasing numbers, retail investors, are left in the dark without an ability to diversify and mitigate risk.

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This Article gives recommendations on reforms to Section 12(g) in order to bring more companies into the public reporting sphere without jeopardizing the capital formation process.

I. INTRODUCTION

> "Working people's money should not be the play toys of a bunch of idiots . . . There's a lot of people in this who make a lot of money off of just a lot of hoohah."

- The Hon. Leo Strine

Section 12(g) of the Securities Exchange Act of 1934 ("'34 Act") has been referred to as "an obscure provision" and increasingly irrelevant for nearly two decades. Yet for all of its supposed irrelevance, it was amended in 2012 via the Jumpstart Our Business Startups Act ("JOBS Act") to remove what little regulatory teeth it had left. Following these supposedly needed changes and combined with the other provisions of the JOBS Act, we have seen fundamental shifts in how capital is raised and in the expected IPO cycles. Thanks to the increase in Section 12(g) thresholds and the easing of exempt capital raising restrictions under Regulation

D, it is far easier for companies to stay private longer and grow to staggering sizes.

We present empirical findings to suggest that in the ten-year period since the passage of the JOBS Act, the average number of shareholders of record in unicorn IPOs doubled (and had the limits remained, the average unicorn IPO now would be in violation of 12(g)).[1] Relying on a hand-collected data set consisting of SEC public filings, we found that many companies have substantially more beneficial owners than their shareholder of record count would indicate.[2] We also show that there is an increasing number of companies that are going public in violation of the new 12(g) limits.[3] Finally, we shed light on new practices that these companies are using which indicate that they are fully aware that they are in violation of relevant securities laws. We look at the fact that their own disclosures on Edgar show that they are using a variety of techniques to avoid 12(g), either overtly or in spirit.

Given the market-leading role of these large firms, one must ask whether the regulation requires an update, or rather a restoration, to ensure that it addresses the original intent behind its passage. In our opinion, it is failing dramatically in its current form. When Congress implemented Section 12(g) in 1964 at the behest of the Securities and Exchange Commission ("SEC"), it did so to address companies which already had significant exposure to the investing public but were not required to comply with the typical reporting regime associated with public trading. Congress designed the regulation to address widely held and widely traded private companies.

However, much has changed in the past six decades regarding how we own and trade securities, how we maintain information about these securities, and the size and scale of companies. The purpose behind all of our securities regulations, to protect investors and allow for efficient allocation of capital by providing access to accurate

[1] *See infra* Section IV

[2] *See infra* Section IV.

[3] *See infra* Section IV.

information, is unchanged. On the other hand, many of the provisions implemented as a result of limitations to technology have not been updated to reflect the modern features of our current market environment.

The SEC is preparing to change this and demand more transparency from large venture-backed technology firms valued at over $1 billion or more, called "unicorns."[4] Regulators are concerned with the lack of oversight of the private fundraising that has fueled the rise of these firms.

The obvious question would be: Why should Section 12(g) be reformed before any other regulation? Some would argue that targeting the exemptions for unregistered offerings may have more of an impact. In our view, however, Section 12(g) is squarely situated within the middle of the problem: a loophole at the point at which capital formation and investor protection clash. Its thresholds allow companies to raise capital from large pools of investors, both public and private, and avoid making the disclosures typically associated with such formation activities. From the outset, it must be noted that our largest concern stems from the increase in public capital, particularly from pension funds and other retirement vessels, flowing into private markets with few disclosure mechanisms in place to protect it.

If the SEC seeks to liberate access to participation in these private markets, there must be at least some consideration given to protective measures. While we do not object to this liberation as we believe it may be beneficial in addressing systemic economic inequality, it must be done responsibly.

In addition to protecting public capital, minority shareholders and later-stage investors are at significant risk should Section 12(g) not be reformed. Employees, the largest group of minority shareholders, do not have access to information normally provided by disclosure mechanisms to

[4] Paul Kiernan, *SEC Pushes for More Transparency from Private Companies*, WALL ST. J. (Jan. 10, 2022), https://www.wsj.com/articles/sec-pushes-for-more-transparency-from-private-companies-11641752489 [https://perma.cc/YXM9-TFEU] ("'Unicorn' firms have a huge impact and 'absolutely no visibility' for regulators, says SEC Commissioner Allison Lee.").

allow them to assess both their economic prospects and career options. Instead, they receive blindfolds to go along with their "golden handcuffs." Large investors who may be late to the initial party also face increasing prices for less and less equity. Newer players in the world of capital formation are using their capital earlier to protect their equity stakes contractually, favoring preferred equity rachets to save percentages, rather than addressing legitimate corporate governance concerns. By the time more responsible and traditional investors come in, their ability to address problems has been diluted.[5]

The increase in valuations points to even larger problems associated with the efficiency of our markets. As we will discuss, there are legitimate concerns that unicorns and other large private companies are dramatically overvalued. The lack of disclosure has allowed this problem to escalate. With the increases in Section 12(g) limits, not only are more companies staying private longer, but more companies are deciding to "go dark." The resulting shrinkage of public equity markets may be leading to increased inefficiencies in our public market valuations to go hand in hand with private market inefficiencies. While there was hope that the creation of secondary markets would allow for some liquidity, they remain largely inefficient and unable to address the problem like disclosure would.[6]

With the increase of public capital inflows, risks to smaller investors, and the inefficiencies of public and private markets, we have also seen a fundamental shift in how venture capital and its new competition behave. In some instances, these shifts have led to a veritable democratization of venture capital. VC investors are better positioned to negotiate with funds, allowing them to invest more specifically and for shorter periods of time, thanks in large part to the use of special purpose vehicles ("SPVs").

SPVs have the added benefit of allowing the venture capital funds themselves to play outside the typical restrictions imposed upon them by the funds' investors. They

[5] *See infra* Section II.
[6] *See infra* Section III.

also run the risk of further exacerbating the systemic inequality that the SEC seeks to address by liberating private markets. As more venture capital funds sponsor more SPVs, they turn to their preferred clients to reward them first before opening up to other potential investors.

Situated in the center of this pool of problems is Section 12(g). Section 12(g) and the associated SEC rules set a two-part threshold for private companies. If a class of equity issued by a company crosses both thresholds, then it is obliged to register those securities with the SEC and make all the appropriate current and ongoing regulatory disclosures that a publicly traded company would have to make. The first part is an asset test requiring at least $10 million in assets. In the world of multibillion-dollar unicorns completing exempt fundraising rounds in excess of $250 million, this is a nominal amount at best. The second is a shareholder of record count limit. For any one class of equity, there can be no more than 2,000 total shareholders of record or 500 unaccredited investors who are also considered shareholders of record.

With the reality of ease of access to capital, companies can tap into private capital directly and public capital indirectly without needing to make disclosures, allowing them to reap the rewards while shifting away the risk. By addressing the threshold requirements under Section 12(g), we believe we can rebalance the equilibrium, provide the necessary protection to investors, and continue to appropriately and safely liberate markets to allow for a greater range of participation from a variety of sources.

In Section II of this paper, we examine how equity ownership has been consolidated, both for purposes of record-holding and in reality, despite an overall increase in market participation as a percentage of the population. While more Americans invest in equities, both in volume and in value, there are fewer and fewer record holders on paper. We then examine how the manipulation of Section 12(g) to avoid its original intent of ensuring that necessary disclosures are being made.

We also discuss the legislative history of Section 12(g), which indicates the Congress which passed this provision would have it dramatically updated to reflect modern technology. In addition, we examine how the SEC itself views Section 12(g), the practical limitations it sees on the enforcement of the provision in the post-JOBS Act world, and how it and members of academia have viewed the possibility for significant reform under the SEC's own rulemaking powers.

We also address the dramatic increase in capital formation resulting from adjustments to Section 12(g) and other provisions of our securities laws. This capital stems from an increasing multitude of sources, many of which are excluded from regulatory counts.

In Section III, using our data set, we examine the practical effects of the combination of the factors from Section II. We show what has occurred as a result of the consolidation of equity ownership, the explosion of exempt offerings in size and scale, and the reality of near unenforceability of our existing securities law protections.

In Section IV, we show the results of allowing this capital formation to happen largely in the dark and the implications of maintaining a veil of secrecy over increasingly large companies. We then address why we believe there should be an adjustment of the methodology for determining "shareholders of record."

Finally in Section V, we present our suggested reforms for returning Section 12(g) to its original Congressional intent. In doing so, we see a far more accurate reflection of the ownership of these enterprises, thus requiring those who seek indirect access to the investing public's capital to comply with the same rules that those who directly seek such access must follow. While Congressional action is needed for several of these reforms, the SEC, with its considerable own rulemaking authority, has the ability to make changes to give Section 12(g) its regulatory teeth back.

II. CLEARING THE "STREET" FOR PRIVATE GROWTH

When most investors purchase shares in a firm, they often make the reasonable assumption that, as beneficial owners, their shares are held in their own name.[7] They receive the dividends and proxy materials, and retain the right to vote the shares.[8] However, the ultimate named record holder for purposes of Section 12(g) is often the brokerage firm the investor uses to purchase the shares, or the company owning the brokerage firm.[9] This standard procedure is known as "street name" registration.

A. Consolidation of Equity

There are obvious benefits for such a methodology of ownership. It allows for investing practices many consider standard today such as limit orders, borrowing on margin, and near-instant trading.[10] It avoids the expensive and time-consuming process of selling physical shares, as well as the risks of losing the shares themselves.[11] While this system does often delay the dispersal of dividends by a few days, in the grand scheme, the benefits typically outweigh the risks. As a result, purchases are typically automatically held in street name unless specific investor instructions are given to the contrary.[12]

Issuers prefer this form of ownership for several reasons. First, it places the onerous burden on the brokerage firms, or other nominated parties, to send out proxy materials, provide tax information, and distribute annual reports.[13] More importantly for non-public issuers, however, it allows for the dramatic reduction of the record count for Section 12(g)

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7 *It's Your Stock, Just Not in Your Name: Explaining 'Street Names'*, FINRA (Financial Industry Regulatory Authority) (Dec. 21, 2015), https://www.finra.org/investors/insights/its-your-stock-just-not-your-name-explaining-street-names [https://perma.cc/J4UA-RKWM] [hereinafter FINRA].

8 *Investor Bulletin: Holding Your Securities*, SEC (Mar. 4, 2003), https://www.sec.gov/reportspubs/investor-publications/investorpubsholdsechtm.html. [https://perma.cc/T2BA-ZHSY].

9 *Id.*

10 *Id.*

11 *Id.*

12 *Id.*

13 *Id.*

purposes. If 200 investors purchase shares through a single brokerage firm, that firm reduces the record count to just one shareholder of record.[14]

Since the passage of the '34 Act and the Securities Act of 1933 ("'33 Act"), the ownership of public equity has shifted dramatically. Prior to the end of World War II, institutional investors held around 5% of equities in the United States.[15] By 2010, that had increased to 67%.[16] In the decade that followed, the number has steadily risen.[17] Of the 10 largest publicly traded companies, the average exceeds 75%.[18] However, our securities laws have not adapted to reflect this reality. While more and more Americans are investing their wealth into equities, they are often doing so via vehicles such as mutual funds, 401(k)s, IRAs, and other institution-managed funds.[19] For the increasing minority that does hold shares outright, many do so via brokerage funds.[20] These funds are considered to be the shareholders of record, holding

[14] *"Going Dark" – A Process for Delisting and Deregistration of Public Company Securities*, DUDNICK, DETWILER, RIVIN & STIKKER, LLP, https://www.ddrs.com/going-dark-a-process-for-delisting-and-deregistration-of-public-company-securities/ [https://perma.cc/U7UK-QJJ3] (last visited Jan. 24, 2022).

[15] Marshall E. Blume & Donald B. Keim, *Institutional Investors and Stock Market Liquidity: Trends and Relationships* 4 (Jacobs Levy Equity Mgmt. Ctr. for Quantitative Fin. Rsch. Paper), (Aug. 21, 2012) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2147757 [https://perma.cc/924T-883B].

[16] *Id.*

[17] *Id. 80% of Equity Market Cap Held by Institutions*, PENSIONS & INVS. (Apr. 25, 2017), https://www.pionline.com/article/20170425/INTERACTIVE/170429926/80-of-equity-market-cap-held-by-institutions [https://perma.cc/9KLR-UH42].

[18] *Id.*

[19] *What Percentage of Americans Own Stock?*, USA FACTS (Mar. 9, 2021), https://usafacts.org/articles/what-percentage-of-americans-own-stock/ [https://perma.cc/Q5VD-XBPK].

[20] *It's Your Stock, Just Not in Your Name: Explaining 'Street Names'*, FINRA (Dec. 21, 2015), https://www.finra.org/investors/insights/its-your-stock-just-not-your-name-explaining-street-names.

the shares in their "street name" while giving the ultimate benefit to the beneficial investors.[21]

Further complicating this matter is the rise of special purpose vehicles ("SPV"), developed by sophisticated players ostensibly as liability shielding mechanisms. As part of a fundraising round, a firm may raise funds from several large investors. Rather than holding the shares outright on their books, however, these investors may pool their assets in a newly created special purpose vehicle. This SPV holds the equity on behalf of the investors and provides a degree of liability protection. Should the investee go under, the exposure is limited to the SPV, rather than potentially having a broader exposure to the investor fund where a bad investment may shake the confidence of the fund as a whole. The added benefit stems from a further reduction in overall shareholders of record for the investee company.

Finally, we have seen an increase in companies with multiple classes of equity.[22] The limits of Section 12(g) apply to each individual class of equity, not the company as a whole.[23] Provided the shareholders approve the creation of a new class, the company could very well avoid ever approaching the thresholds outlined below by simply creating new classes of equity with different rights. This serves the additional purposes of tailoring investments to the liquidation option demands of large investors and allowing founders to more easily maintain control.[24]

By using these multi-equity structures, founders of unicorn firms are often able to control the board of directors, allowing them to maintain their positions within their own

[21] *Id.*

[22] Rani Molla, *More Tech Companies Are Selling Stock that Keeps Their Founders in Power*, VOX.COM (Apr. 11, 2019), https://www.vox.com/2019/4/11/18302102/ipo-voting-multi-dual-stock-lyft-pinterest [https://perma.cc/VF7A-B7T7].

[23] 17 C.F.R. § 240.12g–1 (2016) ("The class of equity securities was held of record by fewer than 2,000 persons and fewer than 500 of those persons were not accredited investors[.]").

[24] *See* Anat Alon-Beck, *Alternative Venture Capital: The New Unicorn Investors*, 87 TENN. L. REV. 983, 991–92 (2020).

firms.[25] Broughman and Fried further show that the ex-ante likelihood of founders reacquiring control via IPO is extremely low, especially if "we focus on control that is both strong (founders have enough voting power to ensure they remain in the saddle) and durable (control lasts at least three years)."[26]

While beyond the subject of this paper, there remains disagreement regarding how best to eliminate dual-class equity structures. Regardless of this disagreement, institutional investors, academics, and others have long agreed they need to be addressed and their continued allowance remains a controversial subject. Even the key policy makers within the SEC have expressed opposition to such structures, including former Commissioner Robert J. Jackson, Jr.[27] and Rick Fleming, Director of the Office of the Investor Advocate.[28] Commissioner Jackson noted that while the vast majority of companies going public fail to include dual class structures, of those that do, "nearly half . . . gave corporate insiders outsized voting rights in perpetuity," requiring investors to not just trust visionary founders, but their descendants as well.[29] However, this number of companies is

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[25] *See id.* at 1003; *see also* Joann S. Lublin & Spencer E. Ante, *A Fight in Silicon Valley: Founders Push for Control*, WALL ST. J., (July 11, 2012), https://www.wsj.com/articles/SB10001424052702303292204577519134168240 [https://perma.cc/698N-PR5R]. According to Broughman and Fried, however, only fifteen percent of VC-backed IPOs from 2010 to 2012 were dual class. Brian J. Broughman & Jesse M. Fried, *Do Founders Control Start-Up Firms That Go Public?*, 10 HARV. BUS. L. REV. 49, 64 tbl.2 (2020).

[26] Broughman & Fried, *supra* note 25.

[27] Robert J. Jackson Jr., *Perpetual Dual-Class Stock: The Case Against Corporate Royalty*, SEC (Feb. 15, 2018), https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty [https://perma.cc/GAV7-VVFP].

[28] Rick Fleming, *Dual-Class Shares: A Recipe For Disaster*, U.S. SEC. & EXCH. COMM'N (Oct. 15, 2019), https://www.sec.gov/news/speech/fleming-dual-class-shares-recipe-disaster [https://perma.cc/XQL9-ATEZ].

[29] Jackson, *supra* note 27, at par. 16–17. *See* Lucien A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 606 (2017) ("Furthermore, dual-stock structures may enable the transfer of a lock on control to an heir of the founder, who might not be as

growing according to data compiled by Jay Ritter.[30] Controllers face little of the negative risks for their actions while remaining well insulated from the "disciplinary force of the market" which they would face should they lack voting control.[31]

There is even evidence to suggest that dynastic ownership of firms leads to underperformance relative to other firms.[32] An empirical study of dual-class companies, published after Commissioner Jackson's remarks, by Bebchuk and Kastiel, found that in over 80% of firms with such a structure, controllers needed less than a 10% equity stake to maintain their control over these firms, with many requiring less than 5%.[33] Fleming argued that dual-class structures may result in a "wave of companies with weak corporate governance" and force investors into the same game as "late-stage venture capitalists . . . willing to pay astronomical sums while ceding astonishing amounts of control to founders."[34]

B. Disclosure Arbitrage

The fundamental purpose of our regulatory regime is to ensure that the reasonable investor is equipped with sufficient knowledge to make informed investment decisions.[35] Regulators like the SEC, however, must balance this purpose with the reality that companies require some

able, talented, skilled or driven as her predecessor. This problem is known in the economic literature as the problem of the 'idiot heir.'").

[30] *See* Jay Ritter, *Initial Public Offerings: Dual Class Structure of IPOs Through 2021*, https://site.warrington.ufl.edu/ritter/files/IPOs-Dual-Class.pdf [https://perma.cc/3UHY-BPDE].

[31] Bebchuk & Kastiel, *supra* note 29, at 602.

[32] *Id.* at 605.

[33] Lucian A. Bebcuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453, 1457 (2019).

[34] Fleming, *supra* note 28, at par. 11.

[35] *See generally* Section 2, Securities Exchange Act of 1934, 15 U.S.C. § 78b; *see also The Laws that Govern the Securities Industry*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry [https://perma.cc/JTU6-W6FW] (last visited Jan. 24, 2022).

degree of flexibility over their operations and capital structure in order to grow, function, and innovate effectively. As Congress acknowledged when passing the initial iteration of Section 12(g), when a company has crossed the set limits, the likelihood of exposure to the public is enough to offset the potential privacy concerns of the company.[36]

If a company goes over the threshold, Congress has determined investors are sufficiently exposed to the company in ways normally only associated with a company complying with the disclosure regime. In establishing this threshold, Congress, based on the limitations of available technology at the time of legislation, attempted to provide investor protection by including securities that were already trading over the counter in the scope of the SEC's reporting requirements.[37] Section 12(g) has been called obsolete in substance, but in reality, the methodology of using these thresholds to define exposure is the true obsolescence. The underlying purpose in passing such a threshold is still very much relevant. But the ability to largely ignore the limits has removed any regulatory strength from it.

If we are expected to accept reasoning for provisions based solely on the intent of Congress in choosing to implement the limits in the form in which they did, we must also acknowledge the intent of Congress passing the whole statute in the first place. If these do not complement each other, it is only logical to place the statute's purpose above the purpose of the constrained methodology available to Congress at the time of passage. At the time of the passage of Section 12(g) in 1964, the SEC and Congress conceded that setting the limits

[36] Usha Rodrigues, *The Once and Future Irrelevancy of Section 12(g)*, 2015 U. ILL. L. REV. 1529, 1532–33 (2015) (citing Allen Ferrell, *Mandatory Disclosure and Stock Returns: Evidence from the Over-the-Counter Market,* 36 J. LEGAL STUD. 213, 219–22 (2007)); Richard M. Phillips & Morgan Shipman, *An Analysis of the Securities Acts Amendments of 1964,* 1964 DUKE L.J. 706, 706 (1964) ("The main feature of this portion is an extension of the registration, periodic reporting, proxy and insider trading provisions of sections 12, 13, 14, and 16 of the Exchange Act to larger over-the-counter companies. These provisions were formerly applicable only to listed companies.").

[37] Rodrigues*, supra* note 36, at 1533–34.

based on shareholders of record was only a "rough, indirect measure of activity."[38] Any other method available to them at the time of measuring "market activity" was not feasible, meaningful, or workable.[39] The SEC further noted that shareholders of record is "the most direct and simple criterion of public-investor interest."[40]

As Rodrigues points out, Congress "never intended for the provision to have the effect of forcing illiquid private companies into making public disclosures" but rather bringing companies which were already trading via over-the-counter ("OTC") markets into the public reporting sphere.[41] Companies were trading on these then-unregulated markets at increasing rates without oversight and the protections afforded to investors by our securities laws. Retail investors were at significant risk of exposure to investments which may or may not have been riskier. At the time of the passage of Section 12(g) in 1964, the OTC markets had grown to nearly 61% of the trading volume of national exchanges, but received none of the investor protections associated with them.[42]

However, in 1999, Congress forced nearly all OTC traded firms to make at least a bare minimum of public disclosures. For many, this was viewed as the point of irrelevancy for Section 12(g). Indeed, between 2000 and the passage of the new limits under the JOBS Act, less than 3% of firms which went public were over 400 shareholders and thus approaching the upper limits.[43] There is also no indication that the majority of these firms went public for the sole reason that they were approaching, or in the case of some, exceeding these

[38] U.S. SEC. & EXCH. COMM'N, SPECIAL STUDY OF SECURITIES MARKETS, H.R. Doc. No. 88–95, at 34 (1964).

[39] *Id.*

[40] *Id.*

[41] Rodrigues, *supra* note 36, at 1534; *see also* William K. Sjostrom, Jr., *Questioning the 500 Equity Holders Trigger,* 1 HARV. BUS. L. REV. ONLINE 43, 44–45 (2011) (highlighting that the 1964 amendments were targeted at issuers with sufficiently liquid shares).

[42] S. REP. NO. 88-379, at 14 (1963).

[43] Rodrigues, *supra* note 36, at 1547.

limits. As we discuss in Section V, there are a multitude of reasons for completing an IPO.

All of this then begs the question of if Section 12(g) is "largely irrelevant" or "an obscure provision of securities laws,"[44] why change the thresholds at all? To answer this, we must examine the intent behind the change and its ultimate effects.

While the intent behind the change was to allow widely held, but seldom traded companies to continue to avoid the high costs associated with the mandatory disclosure regime, the ultimate effect has been far broader.[45] With the explosion of unicorns in the decade since the passage of the JOBS Act, it is not a stretch to find a causal connection between the updates to various securities law provisions, including Section 12(g), and these firms' growth via the reduction of regulation in private markets.

These companies will continue to be able to raise even more capital and remain private if the law is not updated. As noted by de Fontaney, "There is no evidence that capital is scarce today for good U.S. firms—whether public or private—and much evidence to the contrary."[46] The reality is that traditional investors in private markets, VCs and PEs, are competing with non-traditional investors over investments in unicorn firms.[47] With these non-traditional investors joining

[44] John Markoff, *Google Flirts; Investors Wonder About Date*, N.Y. TIMES (Apr. 24, 2004), http://www.nytimes.com/2004/04/24/business/google-flirts-investors-wonder-about-date.html [https://perma.cc/9CH7-BJAX].

[45] *See supra* notes 41 & 42. Congress concede shareholder count was "a rough, indirect measure of activity" and measuring "market activity" was preferable but unfeasible at the time of 12(g)'s original passage.

[46] *Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment: Hearing Before the Subcomm. on Inv. Prot., Entrepreneurship, & Cap. Mkts. of the H. Comm. on Fin. Servs.*, 116th Cong. 13 (2019) (written testimony of Elisabeth de Fontenay, Professor of Law, Duke University).

[47] It should be noted that there is a distinction between an innovation driven entrepreneurial firm and a small medium business enterprise. This article will only address policy with regards to unicorns, which are large innovation driven enterprises. For more, see Anat Alon-Beck, *The Coalition Model, A Private-Public Strategic Innovation Policy Model for Encouraging*

the pool, rather than firms competing over a limited pool of funding, investors are competing over a limited group of investee companies. This serves to flip the power dynamic between capital and investee, giving less leverage to extract governance concessions to ensure proper management of firms.

The JOBS Act changes, accompanied by more recent changes to rules on the solicitation of 401(k) funds by hedge funds also encouraged more investors, which include non-accredited investors, to join traditional and non-traditional groups and invest in private markets.[48] However, private markets do not offer the same protections and disclosure of information as public markets. Given the risks associated with investing in private firms, it is only logical that there should be additional investor protections, not less.

SEC Commissioner Alison Lee also expressed reservation about these developments operating in conjunction with proposed changes to the definition of accredited investors, and stated that "[t]hese proposed changes [to accredited investor thresholds] all go in one policy direction—toward expanding the pool of investors in the opaque, and indisputably high-risk, private markets."[49] Former SEC Commissioner Robert

Entrepreneurship and Economic Growth in the Era of New Economic Challenges, 17 WASH. U. GLOBAL STUD. L. REV. 267 (2018); *see also* William Aulet & Fiona Murray, *A Tale of Two Entrepreneurs: Understanding Differences in the Types of Entrepreneurship in the Economy* (May 2, 2013), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2259740 [https://perma.cc/3DWV-LTER] (on the difference between the two definitions).

[48] Paul Kiernan, *SEC Gives More Investors Access to Private Equity, Hedge Funds*, WALL ST. J. (Aug. 26, 2020), https://www.wsj.com/articles/sec-gives-more-investors-access-to-private-equity-hedge-funds-11598452858 [https://perma.cc/APH5-5SSB].

[49] Allison Herren Lee, *Statement by Commissioner Lee on Proposed Expansion of the Accredited Investor Definition*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 20, 2019), https://corpgov.law.harvard.edu/2019/12/20/statement-by-commissioner-lee-on-proposed-expansion-of-the-accredited-investor-definition [https://perma.cc/56AN-G2BE]. Commissioner Lee criticized the final rule for weakening investor protection (especially for seniors), and for failing to index for inflation going forward.

Jackson also suggested that we need to adequately analyze the relevant data prior to expanding these definitions and changing our laws.[50]

C. Practical Enforcement and Modernization

Under Section 504 of the JOBS Act, the SEC was required to commission a study to study its authority and ability to enforce the limits imposed by Section 12(g) and the related Rule 12g5-1.[51] Of particular concern to Congress was the ability of the SEC to enforce the anti-evasion provision included in Rule 12g5-1(b)(3). This subsection requires the number of beneficial owners to be used as the record count if an issuer knows or has reason to know that the manner of holding an issuer's securities is used primarily to circumvent Section 12(g).

We must acknowledge that there is debate on whether or not the SEC on its own rulemaking authority has the ability to redefine the term "held of record," despite the fact that they have already exercised this authority.[52] Some cite to parts of the legislative history of Section 12(g) and the interpretation of securities law provisions in the years since its passage to argue that only Congress retains the power to redefine this term. In particular, proponents of this position cite the attempts in 2012 by Democrats to insert into the JOBS Act provisions explicitly authorizing the SEC to make the

[50] Robert J. Jackson Jr., Comm'r, Sec. & Exch. Comm'n, Statement on Reducing Investor Protections Around Private Markets (Dec. 18, 2019), https://www.sec.gov/news/public-statement/statement-jackson-2019-12-18-accredited-investor [https://perma.cc/NAP9-2WJC].

[51] Jump Start Our Business Startups Act of 2012, Pub. L. No. 112-106, 126 Stat. 326.

[52] SEC Compliance and Disclosure Interpretation 152.01, https://www.sec.gov/divisions/corpfin/guidance/exchangeactrules-interps [https://perma.cc/47VX-RP78] ("Institutional custodians, such as Cede & Co. and other commercial depositories, are not single holders of record for purposes of the Exchange Act's registration and periodic reporting provisions. Instead, each of the depository's accounts for which the securities are held is a single record holder.").

necessary changes without congressional approval.[53] However, this debate does not point in one direction or the other. If, as we believe, the SEC retained this power before the passage of the JOBS Act, Congress need not have passed any statute granting them a power that they already had. Some of the opponents of explicit authorization even conceded that they believed the SEC already held the rulemaking authority to redefine this term. For example, Republican Congressman David Schweikert stated he believed the SEC had this authority when asked whether "the SEC [was] currently empowered to take these actions on their own without Congressional approval."[54] He would later backtrack his statements by saying if the SEC does have this authority, Congress should be responsible for the ultimate policy and thus actually retains the authority.[55]

However, there is strong evidence suggesting that the SEC does, in fact, have this authority, beyond their previous exercise of it. If we examine the SEC's powers before the inconclusive debate in 2012, the key provision to consider is Section 36 of the '34 Act. Passed in 1996, it provides the SEC with expansive general exemptive authority to permit rulemaking to the extent that it is "necessary or appropriate in the public interest, and is consistent with the protection of investors." Professor George Georgiev argues that this indicates the SEC's authority to redefine "held of record" is "beyond question," even if he believes that it may be practically infeasible.[56] A similar position was adopted by

[53] Alexander I. Platt, *Legal Guardrails for a Unicorn Crackdown,* 120 MICH. L. REV. ONLINE 89, 99–100 (2022).

[54] 158 Cong. Rec. H1280 (daily ed. Mar. 8, 2012) (statement of Congressman David Schweikert).

[55] *Id.* at H1281 ("If you are with us and agree, we're literally looking at two tracks here. The SEC does hold authority. At the same time, we also want this brought back to us if the SEC does see an issue. That's the proper venue.").

[56] George S. Georgiev, *The Breakdown of the Public-Private Divide in Securities Law: Causes, Consequences, and Reforms*, 18 N.Y.U. J.L. & BUS. 221, 302 (2021).

Tyler Gellasch and Lee Reiners from Duke's Global Financial Markets Center.[57]

Donald Langevoort and Robert Thompson argue that the SEC could presumably change the rule, citing back to a proposed rulemaking change in 2006.[58] They go on to argue that the better test for "publicness" should not be the record ownership, but rather a metric like average daily trading volumes is better for the purposes of "gauging the extent of investor interest in and need for disclosure."[59] They also note that such information is already collected via monthly disclosures as required under existing SEC rules.[60]

Finally, the SEC itself believes it has the authority to do so. When such changes were initially proposed by Commissioner Allison Herren Lee, she suggested that it should be done within the SEC's rulemaking authority.[61] In the SEC report written as required under Section 504 of the JOBS Act, the SEC noted it "has the authority under Exchange Act Section 12(g)(5) to define the term 'held of record' as it deems 'necessary or appropriate in the public interest or for the protection of investors in order to prevent circumvention of the provisions' of Section 12(g)."[62] They also

[57] Tyler Gellasch & Lee Reiners, *From Laggard to Leader: Updating the Securities Regulatory Framework to Better Meet the Needs of Investors and Society*, GLOB. FIN. MKT. CTR. AT DUKE L. 11 (Feb. 2021), https://web.law.duke.edu/sites/default/files/centers/gfmc/From-Laggard-to-Leader.pdf [https://perma.cc/6C3G-A5VE].

[58] Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation after the JOBS Act*, 101 GEO. L.J. 337, 359 (2013) (citing SEC, ADVISORY COMM. ON SMALLER PUB. COS., FINAL REPORT 76–80 (Apr. 23, 2006), https://www.sec.gov/info/smallbus/acspc/acspc-finalreport_d.pdf [https://perma.cc/9MP4-FL5K]).

[59] *Id.* at 359–60.

[60] *Id.* at 360–61 (citing 17 C.F.R. § 242.302(b)).

[61] Allison Herren Lee, Comm'r, U.S. Sec. & Exch. Comm'n, Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy, Remarks at The SEC Speaks in 2021 (Oct. 12, 2021), https://www.sec.gov/news/speech/lee-sec-speaks-2021-10-12 [https://perma.cc/V57Z-BN34].

[62] U.S. SEC. & EXCH. COMM'N. REPORT ON AUTHORITY TO ENFORCE EXCHANGE ACT RULE 12G5-1 AND SUBSECTION (B)(3), 7 (Oct. 15, 2012),

noted, in the same report, that immobilized record ownership came about in "the late 1960s and early 1970s", after the initial passage of Section 12(g).[63] In 1964, 23.7% of shares were held in nominee and street names. By 1975, this number has risen to 28.6% and by 2010, the SEC estimated this number had risen to over 85%.[64]

It should be noted that under the recently passed Corporate Transparency Act of 2021, the Financial Crimes Enforcement Network ("FinCEN") is now required to create a registry of entities formed and permitted to do business in the United States.[65] This registry would require beneficial owners of these entities who either exert substantial control or own at least 25% of their equity to disclose their names and other information to FinCEN.[66] There are, however, twenty-three exceptions to these requirements and FinCEN is still revising the proposed rule under notice and comment rulemaking. The information, therefore, is already largely being collected, albeit for tax and anti-terrorism enforcement purposes.

D. Exempt Offerings

The ability to raise large amounts of capital affects the unicorn firm. Unicorns redefine the model for startups, demonstrating that new companies are no longer dependent on an IPO (or trade sale) to raise sufficient capital and reduce IPOs down to liquidity events.[67] Capital-raising is a secondary

https://www.sec.gov/files/authority-to-enforce-rule-12g5-1.pdf [https://perma.cc/9GDP-L6WZ].

[63] *Id.* at 8 and n.26.

[64] *Id.*

[65] Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. 59,591, 59,592 (Sept. 30, 2022) (to be codified at 31 C.F.R. pt. 1010).

[66] *Id.* at 59,532, 59,594.

[67] Les Brorsen, *Looking Behind the Declining Number of Public Companies*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 18, 2017), https://corpgov.law.harvard.edu/2017/05/18/looking-behind-the-declining-number-of-public-companies/ [https://perma.cc/858M-RQC5];*see* Sergey Chernenko, Josh Lerner & Yao Zeng, *Mutual Funds as Venture Capitalists? Evidence from Unicorns*, 34 REV. FIN. STUD. 2362, 2364–65 (2021); MCKINSEY & CO., MCKINSEY GLOBAL PRIVATE MARKET REVIEW 2018, THE RISE AND RISE OF PRIVATE MARKETS (2018),

consideration, with the primary focus on liquidity and perhaps the intangible of the prestige associated with going public. Thanks to alternative venture capitalists ("AVCs"), unicorn founders are able to raise large amounts of money in mega deals, pushing their companies to stay private longer than eleven years,[68] negotiate contractual "founder friendly" terms and maintain control over the management of the firm.[69]

If we compare the IPOs of "old" successful startups, for example, Apple,[70] Amazon,[71] Google[72] or Facebook,[73] and the IPOs of unicorns, such as Uber, we will find many differences.

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https://www.mckinsey.com/~/media/McKinsey/Industries/Private%20Equity%20and%20Principal%20Investors/Our%20Insights/The%20rise%20and%20rise%20of%20private%20equity/The-rise-and-rise-of-private-markets-McKinsey-Global-Private-Markets-Review-2018.ashx [https://perma.cc/852T-SM4Q]; Matt Levine, *The Unicorn Stampede is Coming*, BLOOMBERG OP. (Mar. 22, 2019, 11:58 AM), https://www.bloomberg.com/opinion/articles/2019-03-22/the-unicorn-stampede-is-coming [https://perma.cc/XJ4P-FW44].

68 *See* Alon-Beck, *supra* note 24, at 1003. Alon-Beck coined the term "AVC." *See* Sungjoung Kwon, Michelle Lowry & Yiming Qian, *Mutual Fund Investments in Private Firms*, 136 J. FIN. ECON. 407, 425 (2020). Kwon et al. further show that these large amounts of capital "should enable the companies to stay private longer."

69 *See* Alon-Beck, *supra* note 24, at 1003, 1021, 1046–49 (explaining the "founder friendly" terms).

70 *See* Alex Wilhelm, *A Look Back in IPO: Apple, the Early PC Purveyor*, TECHCRUNCH (Sept. 15, 2017, 6:00 PM), https://techcrunch.com/2017/09/15/a-look-back-in-ipo-apple-the-early-pc-purveyor/ [https://perma.cc/Z6QW-R5ZE].

71 Amazon's IPO was in 1997. *See* Alex Wilhelm, *A Look Back in IPO: Amazon's 1997 Move*, TECHCRUNCH (June 28, 2017), https://techcrunch.com/2017/06/28/a-look-back-at-amazons-1997-ipo/?_ga=2.187316328.1573799404.1558549549-98431006.1558549549 [https://perma.cc/JQE5-9566].

72 Alex Wilhelm, *A Look Back in IPO: Google, the Profit Machine*, TECHCRUNCH (July 31, 2017), https://techcrunch.com/2017/07/31/a-look-back-in-ipo-google-the-profit-machine/ [https://perma.cc/767V-FCP4].

73 Alex Wilhelm, *A Look Back in IPO: Facebook's Trailing Profit and Mobile Intrigue*, TECHCRUNCH (Aug. 22, 2017), https://techcrunch.com/2017/08/22/a-look-back-in-ipo-facebooks-trailing-profit-and-mobile-intrigue/?_ga=2.76050645.1993016262.1558632407-1496323933.1558632407 [https://perma.cc/933Y-WHMP].

These differences include valuations, growth periods, revenue expansions, timeline to IPO, and capital raising methods.

Unicorns are able to raise large amounts of capital from AVCs by relying on exemptions from registration with the SEC. According to federal and state securities laws, any offer or sale of securities is subject to registration unless there are exemptions from registration.[74] Registered offerings are subject to comprehensive disclosure requirements and higher compliance costs,[75] and provide access to a broad group of potential investors.[76]

A series of reforms to the federal securities laws, which began about fifteen years ago,[77] provide exemptions from the old registration requirements.[78] The main legislative efforts that allow companies to use exemptions are the Jumpstart Our Business Startups Act of 2012 ("JOBS Act"), the Fixing America's Surface Transportation Act of 2015 (the "FAST Act") and the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (the "Economic Growth Act").[79] These were in addition to the passage of the National

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[74] There is a debate on whether it contributed to the reduction of information asymmetry and agency costs. *See* Darian Ibrahim, *Public or Private Venture Capital*, 94 WASH. L. REV. 1137, 1144 (2019) ("Mandatory disclosure reduces the costs of acquiring information by forcing corporations to release information to the markets at pre-set times."); *see also* Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 716, 738 (2006).

[75] *See* Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. CHI. L. REV. 1047, 1076 (1995).

[76] *See* Eva Su, CONG. RSCH. SERV., R45221, CAPITAL MARKETS, SECURITIES OFFERINGS, AND RELATED POLICY ISSUES 3 (2018).

[77] *See Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment: Hearing Before the Subcomm. on Investor Protection, Entrepreneurship, and Cap. Mkts. of the H. Comm. on Fin. Serv.*, 116th Cong. 6 (2019) (written testimony of Renee M. Jones, Professor of Law and Associate Dean for Academic Affairs, Boston College Law School) [hereinafter Jones, Written Testimony].

[78] *Id.* at 5–6.

[79] For more on these Acts, see Anat Alon-Beck, *Unicorn Stock Options—Golden Goose or Trojan Horse*?, 2019 COLUM. BUS. L. REV. 107 (2019); *see also* Press Release, U.S. Sec. & Exch. Comm'n, SEC Seeks Public Comment on Ways to Harmonize Private Securities Offering Exemptions

Securities Markets Improvement Act ("NSMIA") in 1996, which was passed with the aim of simplifying securities regulation by significantly curtailing the scope of state blue sky laws.

A private placement (private offering or unregistered offering) is an offering of securities to potential investors which is exempt from registration with the SEC and is not subject to broad disclosure requirements. As noted, the Securities Act provides a number of exemptions from registration.[80] Investors most frequently used exemptions from registration applicable to private placements are contained in Section 506 under Regulation D of the Securities

(June 18, 2019). The other pieces of legislation are: 1. The Financial CHOICE Act of 2017, which includes modernizing the Regulation D offering process and creates the "venture exchanges." 2. Crowdfunding regulations that were adopted by the SEC, which allow companies to use a crowdfunding platform (intermediary) for raising small amounts of equity capital (less than $1 million annually) from potentially large pools of investors over the internet. *See* Joan M. Heminway, *Securities Crowdfunding and Investor Protection* (Univ. of Tenn. Legal Studies Research Paper No. 292, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2810757 [https://perma.cc/6XAV-3SN4]. Equity offerings under Regulation A+ of Title IV of the JOBS Act (Reg A+), which increased a private company's ability to make unregistered public offerings to a maximum of $50 million to the public in any twelve-month period, along with expansions under Regulation D of the 1933 Act, allowed companies to raise capital via public markets without providing disclosures found in S-1s and other registration statements.

80 Section 3 of the Securities Act identifies classes of securities that are exempt from the registration requirements. 15 U.S.C. § 77c. Section 4 of the Securities Act identifies a number of transactions that are exempt from the registration requirements. 15 U.S.C. § 7d. Both public and private companies can use unregistered offerings (private placements) to raise funds from investors. This Article will focus on offerings made by private companies and their investors.

Act.[81] According to a concept release by the SEC,[82] in 2018 companies raised approximately $1.5 trillion using Rule 506(b) of Regulation D [83] and $211 billion using Rule 506(c) of Regulation D.

The policymakers' intention and rationale behind the JOBS Act was to facilitate the emerging growth companies' "access to the public capital markets."[84] The Act reduced SOX regulatory requirements in the hopes of encouraging private companies to go public.[85] However, the JOBS Act's biggest achievement is "radical deregulation."[86] The exemption allows private firms to keep material information private longer, as

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[81] *See Rule 506 of Regulation D*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/rule-506-regulation-d [https://perma.cc/JNV8-P5AZ] (last visited Jan. 24, 2022); *see also* Abraham J.B. Cable, *Fending for Themselves: Why Securities Regulations Should Encourage Angel Groups*, 13 U. PA. J. BUS. L. 107, 132 (2010); Rutheford B. Campbell, Jr., *The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC's Crown Jewel Exemptions*, 7 OHIO ST. ENTREPRENEURIAL BUS. L.J. 287, 295 (2012); Ibrahim, *supra* note 74, at 1162–63.

[82] *See* Concept Release on Harmonization of Securities Offering Exemptions, Securities Act Release No. 10649, Exchange Act Release No. 86192, Investment Company Act Release No. 33512, 84 Fed. Reg. 30,460, 30,466 tbl.2 (June 26, 2019).

[83] *Id. See also* 17 C.F.R. § 230.506(b) (2016).

[84] *See* Usha Rodrigues, *Securities Law's Dirty Little Secret*, 81 FORDHAM L. REV. 3389 (2013); Robert B. Thompson & Thomas C. Langevoort, *Rewarding the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573 (2013); *see also* Paul Rose & Steven Davidoff Solomon, *Where Have All the IPOs Gone? The Hard Life of the Small IPO*, 6 HARV. BUS. L. REV. 83, 84 (2016); Usha Rodrigues, *The JOBS Act at Work*, CONGLOMERATE (Sept. 11, 2015), http://www.theconglomerate.org/jobs-act/ [https://perma.cc/8MZE-RCWY] (criticizing the JOBS Act's unrealistic endeavors to boost IPOs).

[85] According to Rose and Solomon, "The JOBS Act is primarily a response to the regulatory theory, but also takes some aims towards market structure by loosening restrictions on research analysts." Rose & Solomon, *supra* note 84, at 85.

[86] *See Examining Investor Risks in Capital Raising: Hearing Before the Subcomm. on Sec., Ins., and Inv. of the S. Comm. on Banking, Hous., and Urban Affairs*, 112th Cong. (2011); *see also* Michael D. Gutentag, *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, 175 (2013).

they are now required to disclose according to the federal periodic disclosure requirements.[87] Thanks to the JOBS Act, the threshold that triggered registration with the SEC has changed.[88]

III. THE EFFECTS OF 10 YEARS IN THE WILD WEST

The original intent behind instituting limits on shareholders of record was to capture firms which were already broadly trading. This methodology for limitation was chosen, however, merely as a compromise based on the limitations of implementable solutions. With the technology available today, these limitations no longer exist. It is relatively easy to calculate the volume of trading across markets of even private companies. While the thresholds were ostensibly raised to address concerns by widely held, but seldom traded companies, the practical effect was to shield these companies as well as companies trading at higher volumes.

By redefining shareholders of record into a term more akin to beneficial owners, but placing limits in place for trading volume, we can restore Section 12(g) to its original intent of protecting investors while also encouraging companies to disperse their equity simultaneously. In addition, rather than slowing capital formation, it will encourage companies to turn to the public markets for necessary capital, allowing for more investors to invest in a broader range of companies. Instead of

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[87] *See* Gutentag, *supra* note 86, at 152.

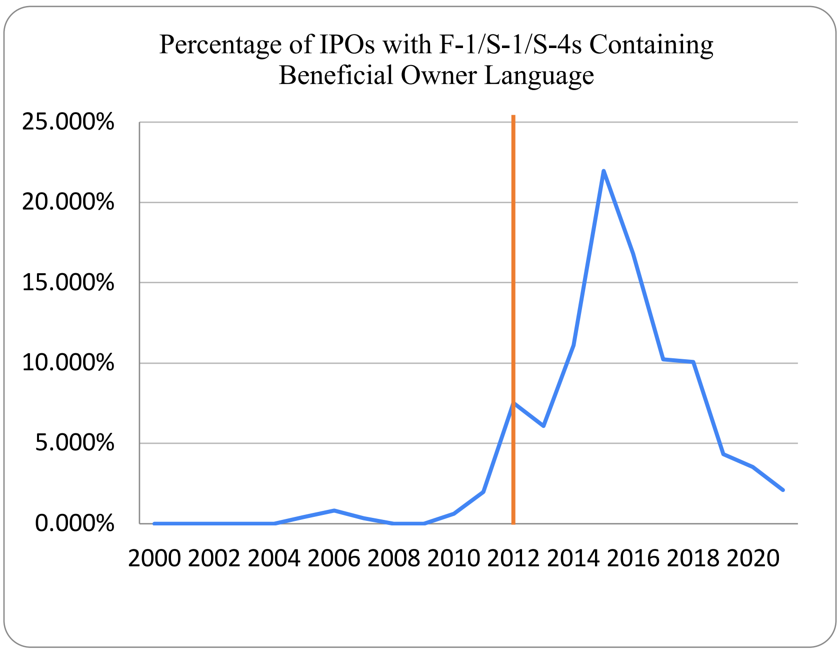
[88] MORRISON & FOERSTER, Late Stage Financings Presentation (Apr. 26-27, 2016), https://media2.mofo.com/documents/160426latestagefinancings.pdf. ("[T]he JOBS Act related changes affecting the private market may be more significant[:] Title V and Title VI changes to the Exchange Act Section 12(g) threshold[,] Changes to Rule 506[, and] Legal certainty for matchmaking platforms.").

[88] U.S. SEC. & EXCH. COMM'N, *Changes to Exchange Act Registration Requirements to Implement Title V and Title VI of the JOBS Act*, 12 (2016) https://www.sec.gov/rules/final/2016/33-10075.pdf [https://perma.cc/PE73-3FMP].

allowing for companies to remain illiquid, but continue to grow, companies will be subject to the more efficient forces of the public free market while also providing their shareholders, especially employees, an ability to have and make more informed investment decisions.

We examined whether firms are instituting any limits on shareholders of record. Relying on a hand collected data set consisting of SEC public filings, we found that many companies have substantially more beneficial owners than their shareholder of record count would indicate.

Table 1: Percentage of IPOs with F-1/S-1/S-4s Containing Beneficial Owner Language



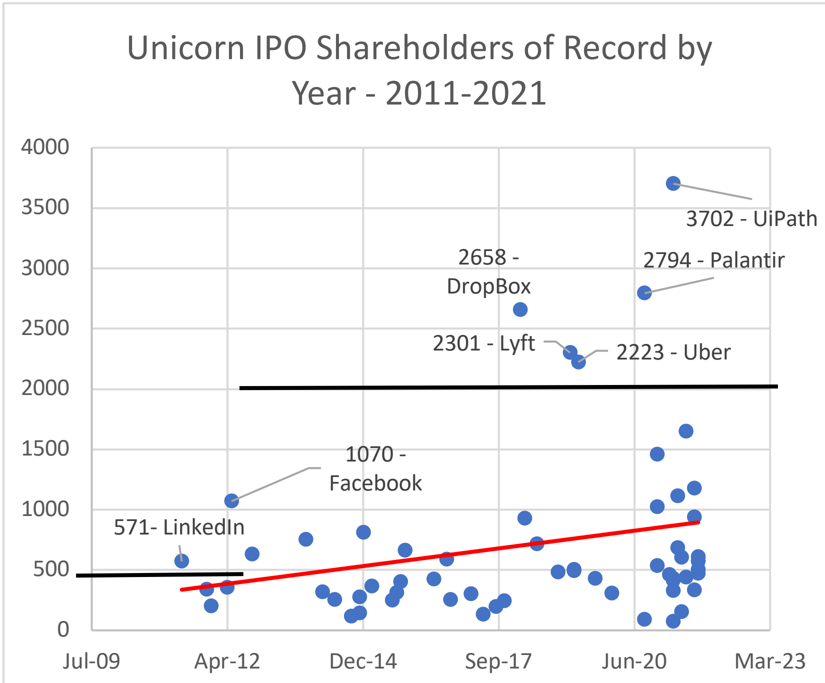
In prospectuses filed with the SEC, companies began inserting the provision outlined below. The provision had no legal effect but did acknowledge in a public filing that companies are aware of several key facts. First, they have substantially more beneficial owners than their shareholder of record count would indicate. When viewed within the context of an S-1 or S-4, it also indicates that they know precisely who these shareholders are, their present equity holdings in the company, and how to contact them to deliver the requisite materials needed to vote on major transactions such as approving an IPO or sale of the firm.

The earliest example of such a provision was found in 2005. In the 12 years before the passage of the JOBS Act, it was found in a total of 11 unique companies' filings. After the passage of the JOBS Act, this number increased an average of 49 unique companies annually. This chart represents the percentage of IPO which had prospectuses or merger proxies (S-1, F-1, or S-4) containing such a statement.

Here is an example provision from Linkedin's S-1 (pre-JOBS Act):

> As of September 30, 2011, we had 22 holders of record of our Class A common stock and 571 holders of record of our Class B common stock. The actual number of stockholders is greater than this number of record holders, and includes stockholders who are beneficial owners, but whose shares are held in street name by brokers and other nominees. The number of holders of record also does not include stockholders whose shares may be held in trust by other entities.

Table 2: Unicorn IPO Shareholders of Record by Year - 2011-2021



This table represents the number of shareholders of record of the largest classes of equity in unicorn IPOs immediately before and in the decade since the passage of the JOBS Act. The black lines represent the previous 500 shareholder of record threshold and its new level at 2,000 following Section 12(g)'s amendment. The red line is a linear trendline based on the data.

The table in Appendix I below represents the raw data points presented visually above. Any red highlighted box denotes a company which went public in violation of the Section 12(g) thresholds at the time of its S-1 filing. Any orange highlighted box denotes a company which has gone public since the passage of the JOBS Act and would be in violation of the previous 500 shareholder of record limit.

The result of this data would indicate that after the passage of the JOBS Act, unicorn firms were more than willing to allow for an increase in the overall number of shareholders of record. Even with the increased usage in SPVs, the average number has more than doubled. This flies in the face of the reality that Congress decided in 1964 that 500 shareholders was the appropriate threshold and 500 shareholders in 1964 is still 500 shareholders in 2022. The level of exposure of public investors to the private market has only increased, diminishing the ability of Section 12(g) to protect them. The protections and provisions are not any less relevant, but the changes in how most investors invest now was apparently not taken into account when the adjustments were made.

Methodology

As a company prepares to go public, each company must file a registration statement with the Securities and Exchange Commission depending on the method of going public transaction the company chooses to complete. The most common form of registration statement is Form S-1. In each S-1, a description of each class of outstanding capital stock is included. As part of this, each company is required to disclose the number of record holders of each class of capital stock which will remain issued by the company upon the effective date of the S-1. It is typical that this form is amended repeatedly as it goes through the approval process with the SEC. These are referred to as "S-1/As". They are publicly available and searchable via the SEC's Electronic Data Gathering and Retrieval System ("EDGAR").

Using a list of IPOs valued in excess of $1 billion which occurred between May 1, 2011 and October 31, 2021 sourced from CrunchBase, we hand-collected the data from each S-1 to obtain the number of shareholders of record disclosed on the S-1 for the most widely owned class of capital stock. Each S-1 or S-1/A that was used was the version filed with the SEC closest to the actual IPO date. Section 12(g) does not apply on a company level, but rather a class level. The data was then input into an Excel spreadsheet where a linear regression was conducted based on the passage of time.

IV. GOING DARK

The "explosive growth of private markets" is the most important development in securities markets in the new millennium, according to Commissioner Lee.[89] The shift in equities in the United States from public markets to private markets has significant implications for different stakeholder groups. As companies continue to stay private longer and raise more capital in private markets, our regulators are pressured into changing the current trend. There are two main approaches that regulators take, either democratizing access of retail investors to private markets or forcing private companies into public markets.

A. The Growth of Private Markets

Legal and regulatory structures influence the shift in equities from public markets to private markets. While the amendments to the '34 Act were implemented ostensibly to encourage capital formation, there was considerable lobbying by major tech companies who were rapidly approaching the limits, or in the case of some, already over these limits. Facebook, one of the largest IPOs in history, went public before the JOBS Act limits went into effect with more than double the number of allowed shareholders.[90] WorkDay, which went public shortly after the limits went into effect would have been in violation had the increase not occurred.[91] LinkedIn, who went public in late 2011, initially filed under the limit, but the ultimately effective registration statement

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[89] Allison Herren Lee, Commissioner, U.S. SEC. & EXCH. COMM'N, *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 [https://perma.cc/7K5Q-C9TG].

[90] Facebook (now Meta Platforms) S-1/A, Mar. 27, 2012, https://www.sec.gov/Archives/edgar/data/0001326801/000119312512134663/d287954ds1a.htm [https://perma.cc/VQ9A-YYPA].

[91] WorkDay, Inc., Pre-Effective Amendment No. 3 to Form S-1, Registration Statement 111 (Form S-1/A) (Oct. 11, 2012) https://www.sec.gov/Archives/edgar/data/0001327811/000119312512420693/d385110ds1a.htm#toc385110_16 [https://perma.cc/RRZ9-78PC].

was in excess of the existing limits.[92] They even noted in their registration statement that "[t]he actual number of stockholders is greater than this number of record holders, and includes stock holders who are beneficial owners, but whose shares are held in street name by brokers and other nominees."[93]

While this is a commonly acknowledged reality of our investing world, it is not a genuine reflection of how investors participate in these companies. In fact, large asset managers are beginning to pass through voting privileges to their investors previously maintained by the record holder, rather than beneficial owner. BlackRock recently announced that they were expanding their Voting Choice program to return shareholder proxy voting power to the underlying clients.[94] This would return the voting rights to investors currently holding $1.8 trillion in assets. Record holders are capable of acknowledging beneficial holders when they choose.

After the passage of the JOBS Act, the limits allowed companies to stay private longer. However, we are now seeing companies going public in violation of the new higher limits. Palantir upon their IPO via direct listing had nearly 2,800 shareholders of record.[95] As companies continue to stay private longer and grow even larger with continued rounds of capital raising, it is likely this is to be an increasingly common occurrence.

For decades, debate has raged on whether we should ever force a company to join the public markets and at what point the line for obligation is crossed. Congress and the SEC have

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[92] LinkedIn Corp., Amendment No. 2 to Form S-1, Registration Statement 35 (Form S-1/A) (Nov. 16, 2011), https://www.sec.gov/Archives/edgar/data/1271024/000119312511314369/d250692ds1a.htm [https://perma.cc/X3NB-7EPC].

[93] *Id.*

[94] *Empowering Investors Through BlackRock Voting Choice* (Sept. 30, 2022) https://www.blackrock.com/corporate/about-us/investment-stewardship/blackrock-voting-choice [https://perma.cc/Z7Z8-77BN].

[95] Palantir Techs. Inc., Amendment No. 5 to Form S-1, Registration Statement 217 (Form S-1/A) (Sept. 21, 2020), https://www.sec.gov/Archives/edgar/data/1321655/000119312520249544/d904406ds1a.htm [https://perma.cc/4SV2-4TZ7].

recognized that once this genie is let out the proverbial lamp, there is no going back. Instead of pulling the cork, regulators have instead adopted the carrot and the stick approach of gently nudging companies in the direction of the path countless firms have taken on their own accord: an IPO.

There are a variety of reasons for these companies to complete an IPO.[96] Capital formation and providing liquidity for existing shareholders are the obvious reasons.[97] There is considerable prestige associated with being a publicly traded company.[98] Finally, subsequent efforts in capital formation were now generally considered easier given the access to public investors an IPO granted.[99]

However, with the dramatic acceleration of capital formation in private markets over the last two decades, as well as slackening in regulatory requirements, much of the reason to go public has evaporated. The policy changes enacted under the JOBS Act, SOX, and others have resulted in a self-defeating regulatory arc.[100] As disclosure obligations increase for public companies, private markets have been largely deregulated in the hopes of jumpstarting capital formation.[101] Yet, there is no indication that such a policy goal was ever in need of addressing.

Capital formation in the private markets is considerably easier and is preferred for a variety of reasons by large private firms.[102] No longer do these firms, predominantly unicorns or soon-to-be unicorns, need access to the public's capital to continue their growth. The creation of secondary markets and increasingly sophisticated exit mechanisms negotiated by large institutional investors has decreased the attraction of

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[96] Rodrigues, *supra* note 36, at 1544–45.

[97] *Id.*

[98] *Id.* at 1554.

[99] *Id.*

[100] Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of Public Companies*, 68 HASTINGS L.J. 445, 451 (2017).

[101] *Id.*

[102] Rodrigues, *supra* note 36, at 1538.

liquidity mechanisms for much of the shareholder base.[103] Finally, the consolidation of ownership of equity in the United States into largely institutional holders has diminished the prestige associated with going public. Companies who go public may very well find their overall ownership changes only minimally following an IPO.

Of course, for minority shareholders, particularly employees, the liquidity an IPO provides is still desperately sought after. The restrictions they face associated with their stock options and equity grants often serve as an increasingly tightening pair of "golden handcuffs."[104]

Given the access to the capital necessary for these companies to grow found in the private markets, the downsides of going public are thrust to the forefront. There are very real direct and indirect costs associated with going public.[105] Companies face the large accounting, auditing, and legal expenses necessary to comply with the '34 Act requirements and SEC proxy regulations.[106] The indirect costs are often even greater, with heightened exposure to liability, increases in D&O insurance costs, public scrutiny, and the distractions to the leadership of the firm associated with all of these.[107] For founders and majority shareholders, it throws open the door for costly proxy fights and increases the chance of takeover bids from which there is little hope to recover the control they have become accustomed to.[108]

With the lack of a need for access to public markets and the increased emphasis placed on the negatives associated with being public, it is no wonder there has been a dramatic

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103 *See generally* Anat Alon-Beck, *Unicorn Stock Options—Golden Goose or Trojan Horse?*, 2019 COLUM. BUS. L. REV. 107 (2019); Anat Alon-Beck, *Alternative Venture Capital: The New Unicorn Investors*, 88 TENN. L. REV. 985 (2020); Anat Alon-Beck, *Bargaining Inequality: Employee Golden Handcuffs and Asymmetric Information*, 81 MD. L. REV. 1165 (2022).

104 *See generally* Alon-Beck, *Unicorn Stock Options*, *supra* note 103.

105 William K. Sjostrom, Jr., *The Birth of 144A Equity Offerings,* 56 UCLA L. REV. 409, 435–41 (2008).

106 *Id.* at 435–36.

107 *Id.* at 438.

108 *See* Broughman & Fried, *supra* note 25.

downturn in IPOs over the last 40 years. According to research by Gao, Ritter, and Zhu, the average number of IPOs from 1980 to 2000 hovered at just over 300 per year.[109] Between 2001 and 2012, that number has fallen to just 99 per year, with significant drops for smaller firms.[110] For the last two years, the number has accelerated to record levels with 480 in 2020 and over 1,000 so far in 2021.[111] However, this number is driven overwhelmingly by the volume of Special Purpose Acquisition Companies ("SPACs") entering the market.[112] The sheer number of these companies searching within an increasingly limited pool of potential targets is a further indicator of the easy access to large amounts of capital.

As a result, the desire to avoid these negatives for many firms far outweighs the positives of conducting an IPO. The question for management then shifts from when and how to prepare the company for an IPO to the methods necessary to prevent the need to conduct one from ever arising. If capital formation is no longer an issue and access to public equity is no longer needed, regulatory thresholds effectively requiring companies to make public disclosures is the last hurtle to staying dark. Clearly, for firms of any consequential size, the $10 million asset threshold is effectively irrelevant, especially when viewed in the context of the listing requirements on any national stock exchange. Thus, the only relevant position would be the shareholder of record thresholds, the true target of the amendments of the JOBS Act.

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[109] Xiaohui Gao, Jay R. Ritter & Zhongyan Zhu, Where Have All the IPOs Gone? 2 (Aug. 26, 2013), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1954788/ [https://perma.cc/TC78-56GR].

[110] *Id.*

[111] *IPO Statistics*, STOCK ANALYSIS, https://stockanalysis.com/ipos/statistics/ [https://perma.cc/T8DL-W92W] (last visited Jan. 25, 2022).

[112] Sara B. Potter, *US IPO Market: SPACs Drive 2020 IPOs to a New Record,* FACTSET (Jan. 7, 2021*),* https://insight.factset.com/u.s.-ipo-market-spacs-drive-2020-ipos-to-a-new-record./ [https://perma.cc/8FJG-TTES].

B. The Impact on Investors and the Economy

The current market trends are affecting policymakers, shareholders, investors, employees, markets, and the public at large. Private markets are plagued with asymmetric information, illiquidity, and long holding periods. This needs to be taken into account in any serious policy response.

The transparency associated with public markets only remains effective so long as a sufficient number of firms actually participate in public markets. As these numbers fall, the transparency of public markets will diminish.[113] Instead, opacity will once again become the norm in equity markets, likely causing a diminishment of support for the corporate sector in the long term. However, regulators and the market itself will more likely require public market-like disclosures to come into the private markets as more public capital flows into it. As its role in capital formation begins to accelerate and influence our corporate world in ways that exceed public markets, it will face significant pressure from both to give some degree of transparency. We see this already with increased disclosure requirements on OTC markets being implemented in 1999 and renewed efforts now to push for increased transparency during the Biden Administration.

No one denies that there are benefits associated with both public and private capital markets. Indeed, the ability to seek capital from either has facilitated decades of economic growth. The fact that the financing for intangible assets is better sourced from private markets is a reality any regulator will be faced with when attempting to broaden disclosure requirements.

Nonetheless, as more money from an increasing variety of sources flows in, there must be some degree of protection implemented to ensure investors of all sophistication can make informed decisions. To maintain support for our corporate sector, the transparency of private markets must increase as society's access increases to them.

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113 Craig Doidge, Kathleen M. Kahle, G. Andrew Karolyi & René M. Stulz, *Eclipse of the Public Corporation or Eclipse of the Public Markets*?, 30 J. APPLIED CORP. FIN. 8, 15 (2018).

First, regulators should enhance, not reduce, disclosure standards and investor protections. Initially, our securities laws were designed to protect all investors, including employees as investors. That meant that all the companies in the United States were required to disclose financial and other information about the offering firm, prior to offering securities to the public. Our laws, specifically the Securities Act of 1933 (the "Securities Act"), required that a company that offers to sell its securities must first register the securities with the SEC. During the registration process, the issuing company disclosed certain facts, including certified financial statements, a description of its assets and business operations, management composition and more.

One of the largest sources of pressure to go public came from the largest group of minority shareholders: the firm's own employees.

Things changed. Startups today enjoy several exemptions from registration, thanks to a series of reforms to the federal securities laws, which began in 1988.[114] The following changes dramatically reduced the ability of this group to pressure for an IPO. First, with the passage of the JOBS Act in 2012, Section 12(g) of the '34 Act was amended to increase the number of shareholders of record a company was permitted to have from 500 persons to 2000 persons.[115] Second, the '34 Act was further amended to remove employees who received shares as part of exempt employee compensation plans from the shareholder of record count.[116]

There is consensus that there is a need for more disclosure. However, there is also debate on what information private companies should disclose to alleviate this problem. There are several approaches to disclosure. According to Yifat Aran, they include a maximalist, minimalist, and intermediate

[114] *See* Jones, Written Testimony, *supra* note 77 (citing Alon-Beck, *supra* note 103).

[115] *See Jumpstart Our Business Startups Act*, § 501, Pub. L. No. 112-106, 126 Stat. 306 (2012), https://www.govinfo.gov/content/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf [https://perma.cc/UD87-XPCZ].

[116] *See id.*

approach.[117] One thing is clear though, we need a better disclosure regime to "prevent the market for equity-based compensation from becoming a market for lemons."[118] Aran warns that employees will lose trust in equity compensation arrangements. This is already happening, as evident from employees complaining on public platforms such as Glassdoor and PaySa.[119] Some employees, as shareholders, turn to the courts for help.

Other stakeholders affected by the high private market demand include retail investors and the public at large. There is pressure on deal valuations. The rise in dry powder, along with reported and perceived reductions in illiquidity premiums, suggest a market that may be overheating.

Despite the fact that the institutional investor base has long-term liabilities, private company assets are highly illiquid. These investors might face issues with short-term cash flow obligations in the event that the private markets will enter a negative downturn correction. Note that some institutional funds have restrictive requirements, such as maintaining daily liquidity requirements.

There is a need to examine the systemic implications of growing private market exposure among institutional

117 It should be noted that there are several views in academia and practice on the type of information that should be provided to employees. According to Aran, I represent the maximalist approach (for more, see Alon-Beck, *supra* note 103), practitioners represent a minimalist one, and Aran proposes an intermediate approach to the regulation of disclosures to start-up employees. *See* Yifat Aran, *Making Disclosure Work for Start-Up Employees,* 2019 COLUM. BUS. L. REV. 867 (2019).

118 *See* Alon-Beck, *Unicorn Stock Options*. *See* Aran, *Making Disclosure Work for Start-Up Employees,* 2019 COLUM. BUS. L. REV. 867 (2019).

119 These sites rank the "Best Companies to Work For" and employees pay "careful attention . . . to Employee Engagement Scores that link corporate reputation, employee motivation, and productivity." Judy Samuelson, *Why Do We Still Call It Capitalism?*, QUARTZ (Apr. 9, 2018), https://work.qz.com/1247835/spotifys-ipo-should-make-us-consider-why-we-still-use-the-term-capitalism/ [https://perma.cc/736W-UG5F]. Unicorn employee complaints are not private anymore, as the "conversation has moved to employee hangouts, both virtual and real, to interview rooms on college campuses, and to public conversations about Board diversity, the glass ceiling, and in the talent pool." *Id.*

investors such as pension funds. There is a rise in the exposure of AVC investors to private markets, such as sovereign wealth funds, government plan sponsors and pension funds. Their exposure affects the end users, the investors that our securities laws are supposed to protect, the savers and retirees.

V. SUGGESTIONS FOR REFORM

Given the high thresholds and the penchant for companies to avoid them through commonly accepted methods of business, there is a growing call for reform on Section 12(g) to restore it to its original purpose: ensuring investors are protected when companies reach a certain level of exposure to the public markets. SEC Chairman Gary Gensler announced examining Section 12(g) as part of his agenda for both 2022 and 2023[120] and Commissioner Allison Lee had previously called for such reforms. It will undoubtedly be an uphill battle with two Republican commissioners already announcing their opposition to changes which, in their view, threaten the facilitation of capital formation.

We do not share the views of Commissioners Pierce and Roisman on this matter. There is no indication that the large companies which would be most affected by reforms are having any difficulty seeking capital. Since the passage of the JOBS Act, the number of unicorns has increased from around a dozen to nearly 1,000 worldwide, with nearly half being found in the United States. This number continues to grow nearly exponentially. With more and more money flowing into our private markets and with greater access being given to retail investors, we must take active steps to ensure investors are properly protected.

[120] The Division is considering recommending that the Commission propose amendments to the "held of record" definition for purposes of section 12(g) of the Exchange Act. *See Revisions to the Definition of Securities Held of Record*, REGINFO.GOV, https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202204&RIN=3235-AN05 (last visited Aug. 15, 2023).

Potential reforms are wide-ranging, with many requiring Congressional action. Given the divisions we currently face in Washington, substantial reform is unlikely. However, there are actions the SEC can take under its independent rule-making authority which would still lead to a bare minimum increase in protective measures. We begin by outlining the reforms requiring Congressional approval and then move on to those under the SEC's rulemaking power.

Congress should repeal Section 502 of the JOBS Act which specifically excludes employees who receive shares under an employee compensation plan from the shareholder of record count. This provision dramatically undercuts the employees' ability to pressure companies to ever go public and further restricts their ability to escape their golden handcuffs. It also relegates them to a proverbial second-class status as investors. They are required to make investment decisions without access to information simply because they are employees. There is no indication that the average employee is privy to the inside information necessary for them to make informed choices. In fact, there are signs that many employees never exercise their options because of an inability to make that informed choice.[121] Congress has enabled these companies to force employees to gamble with their own financial future and by doing so removed their power as shareholders.

Congress should also consider implementing a float-based test akin to one suggested by Professor John Coffee. Other academics have long endorsed such a method as being a more accurate reflection of the public exposure to a company. If there is significant OTC trading associated with an enterprise, it is indicative that a sufficient portion of the investing public may have the ability to obtain such shares. By implementing a provision to include both the expanded shareholder of record test and the public float test, large private companies who have long remained private may

[121] Schwab Study: Equity Plan Participants Average Nearly $100,000 in Vested Stock; Less Than Half Have Ever Sold or Exercised Their Shares (11/13/2019) https://www.aboutschwab.com/press-releases [https://perma.cc/54QJ-MXYW].

continue to do so. But companies who are actively trading, but on smaller secondary markets, cannot escape the regulatory schemes designed to protect the smaller retail investors who do not have the leverage or sophistication necessary to obtain information.

On September 15, 2022, Senators Jack Reed, Catherine Cortez Masto, and Elizabeth Warren introduced the Private Market Transparency and Accountability Act ("PMTA").[122] This bill would add two new threshold tests for Section 12(g). The first is based on the valuation of the company, requiring any issuer with a valuation exceeding $700 million, excluding the value of shares held by affiliates of the issuer, to make disclosures. The second is a two-part test, requiring disclosures from companies with an excess of $5 billion in revenue and more than 5,000 employees. We do not believe this is the most effective method of addressing the problems with Section 12(g). As we have discussed, there are numerous problems with accurately determining valuation and the PMTA Act provides no specific method of valuation to be used by regulators. Even if it did, valuation likely is specific to each individual company and the adjustments which would be necessary due to complex contractual provisions would represent an extraordinary burden on private industry and regulators alike. The second test is equally troublesome. Revenue and employee count has little to do with protecting investors. Size of operations is not reflective of how the company is owned.

Under its own acknowledged and previously used rulemaking power, the SEC should redefine the term "held of record" to more accurately reflect those who are making and benefitting from the investment decision to hold the shares in question. By redefining the term to reflect those who are actually voting the shares, the count will better reflect who is really the investor. Even if the shares are owned under the street name of the beneficial owner's broker, the beneficial owner still ultimately receives the proxy materials and the

[122] S. 4857 – Private Market Transparency and Accountability Act (2022), https://www.congress.gov/bill/117th-congress/senate-bill/4857/text [https://perma.cc/CU56-AW86].

right to vote their shares. The company is required to pass the material along to the appropriate shareholders. This is not a new concept. During the comment stage of rulemaking following the JOBS Act passage, there were calls for a "proxy count" to be implemented instead of a "record count" to avoid the reduction in numbers resulting from street name ownership, SPVs, and other layering methods. Based on the actions of institutional managers like BlackRock with their Voting Choice program, such efforts are already underway within the private market. But we cannot leave this to inconsistent applications and the assumption that ethical decision-making will occur across the market.

The implementation of look-through efforts would take even less effort with the passage of the Corporate Transparency Act of 2020, the Financial Crimes Enforcement Network ("FinCEN") is now required to implement a registry of beneficial owners of nearly all domestic entities formed under state corporate law and foreign entities registered to do business in the United States. The beneficial owners are required to report this information and it is expected that broker dealers will have an obligation to crosscheck the information their clients provide with this registry. While the primary purpose of creating such a registry is to combat money laundering, tax evasion, and terrorist financing, it could easily be applied to a broader definition of the shareholder of record.

The SEC should also amend Rule 12g5-1(b)(3) to remove the "primary" requirement from the catch-all provision of record holder. If the company knows or has reason to know that a particular method of ownership is being used to avoid or reduce the record count, the count should be reflective of the true beneficial owner. This is particularly true when companies like AngelList are holding SPVs out as methods to deliberately keep cap table line items at one investor, rather than many individuals. In its 2012 report on the SEC's enforcement authority of the anti-circumvention provision, the SEC itself conceded that the rule "may be applicable only in limited circumstances."[123]

In addition, the SEC should consider modernizing the limits for accredited investors. The minimum income and net worth requirements for accreditation status were implemented in 1982 and have not been adjusted since.[124] In that time, the number of households capable of qualifying for status has increased by more than tenfold.[125] On top of this, the SEC has also expanded the definition to encompass even more investors who would qualify based on professional credentials, as opposed to net worth. While many of these individuals would have qualified already, it still represents a willingness to continue the self-defeating arc of regulation. The SEC is required to review the definition every four years under Section 413(b)(2)(A) of Dodd-Frank and the next review is set to occur in 2023.[126]

Finally, the SEC should consider narrowing the definition of employee compensation plan to reflect only equity grants, rather than stock options. Equity grants are truly compensation in that moment as outright income. Stock options, on the other hand, are instead the ability to make an investment decision. The decision to exercise or not, however, ultimately remains with the employee. By narrowing the definition, the rule would be more reflective of the term "compensation" and allow for these employees to be viewed as what they truly are: minority shareholders.

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[123] U.S. SEC. & EXCH. COMM'N, REPORT ON AUTHORITY TO ENFORCE EXCHANGE ACT RULE 12G5-1 AND SUBSECTION (B)(3)
21–22.

[124] U.S. SEC. & EXCH. COMM'N, REPORT ON THE REVIEW OF THE DEFINITION OF "ACCREDITED INVESTOR" 18–19 (2015) https://www.sec.gov/files/review-definition-of-accredited-investor-12-18-2015.pdf [https://perma.cc/4ML2-283N] [hereinafter SEC REPORT].

[125] *See also, id.* at 48 (In the report, the Commission acknowledged that even if the 1983 thresholds were left in place, but adjusted for inflation, the number of households encompassed by the status would still have tripled as of 2015); Paul Kiernan, *SEC Gives More Investors Access to Private Equity, Hedge* Funds, WALL ST. J. (Aug. 26, 2020), https://www.wsj.com/articles/sec-gives-more-investors-access-to-private-equity-hedge-funds-11598452858.

[126] *See* SEC REPORT, *supra* note 124.

VI. CONCLUSION

While our securities laws were implemented to ensure both smooth capital formation and sufficient investor protection, there must be a balance sought between them. If one is continually favored, with the other neglected, the underlying reasoning is defeated. With the passage of the JOBS Act, capital formation has never been easier. By any metric, be it size, frequency of deal, or percentage of the market, exempt offerings have come to play the leading role in this arena.

Because of these exempt offerings, in our view, the Section 12(g) loophole is squarely situated at the point at which capital formation and investor protection clash. Its thresholds allow companies to raise capital from numerous investors while avoiding public disclosure requirements. They are allowed to see tremendous growth at the expense of good governance, prudent disclosure, and investor protection. By addressing the threshold requirements under Section 12(g), we believe we can rebalance the equilibrium, provide the necessary protection to investors, and continue to liberate the markets to allow for a greater range of participation from a variety of sources.

With the SEC moving to allow retail investors to play a part in these offerings, both directly and indirectly, it is imperative that we take the steps necessary to protect their capital. Regulators have a duty to watch on behalf of all investors, not just those with the loudest voices. The paradigm of an ordinary investor making a reasonable investment decision only works if they have the information necessary to make it an informed one. It is our obligation to ensure that they do and bringing about change to Section 12(g) is an important step to making this a reality.

Appendix I

The table below represents the raw data points presented visually above. Any red highlighted box denotes a company which went public in violation of the Section 12(g) thresholds at the time of its S-1 filing. Any orange highlighted box denotes a company which has gone public since the passage of the JOBS Act and would be in violation of the previous 500 shareholder of record limit.

Year	**Company**	**Shareholders of Record**
May-11	LinkedIn	571
Nov-11	Groupon	341
Dec-11	Zynga	200
Apr-12	Okta	355
May-12	Facebook	1070
Oct-12	WorkDay	630
Nov-13	Twitter	755
Mar-14	Quotient Technology	321
Jun-14	GoPro	255
Oct-14	Wayfair	116
Dec-14	Lending Club	275
Dec-14	New Relic	145
Jan-15	Box	810
Mar-15	MuleSoft	367
Aug-15	Sunrun	252
Sep-15	Cloudflare	313
Oct-15	Pure Storage	402
Nov-15	Square	665
Jun-16	NantHealth	426
Sep-16	Nutanix	591
Oct-16	Coupa	257

Mar-17	Snap Inc	305
Jun-17	Blue Apron	133
Sep-17	Roku, Inc.	198
Nov-17	Stitch Fix	247
Mar-18	DropBox	2658
Apr-18	Pivotal	931
Jul-18	Bloom Energy	715
Dec-18	Moderna Therapeutics	484
Mar-19	Lyft	2301
Apr-19	Pinterest	505
Apr-19	Slack Technologies	494
May-19	Uber	2223
Sep-19	Peloton	428
Jan-20	One Medical	308
Sep-20	JFrog	92
Sep-20	Palantir	2794
Dec-20	Airbnb	1457
Dec-20	DoorDash	537
Dec-20	Snowflake	1026
Mar-21	Oscar Health	461
Apr-21	AppLovin	72
Apr-21	Coinbase	430
Apr-21	Compass	414
Apr-21	Twilio	329
Apr-21	UiPath	3702
May-21	Flywire	687
May-21	Squarespace	1112
Jun-21	Confluent	607
Jun-21	WalkMe	153
Jul-21	Duolingo	442
Jul-21	Robinhood	1650

Sep-21	Amplitude	334
Sep-21	Freshworks	1178
Sep-21	Toast	939
Oct-21	AvidXchange	503
Oct-21	Gitlab	612
Oct-21	Rent the Runway	575
Oct-21	Udemy	471