THE ONCE AND FUTURE IRRELEVANCY OF SECTION 12(G)

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Among more fundamental reforms, the JOBS Act of 2012 amended Section 12(g) of the Securities Exchange Act and sought to increase the number of shareholders (from 500 to 2000) that a firm must have before it must make public disclosures. Argument on the floor of Congress focused on the undue burden the provision placed on companies. This Article examines data that invalidates those anecdotal concerns.

Indeed, the data reveal important insights: First, my hand-collected dataset shows that, contrary to public concerns about Section 12(g)'s onerous burdens, it only affects a few firms—(less than three percent of those going public). Second, my research relates to questions of the relative merits of Congress and the SEC with respect to fact-finding and the risk of capture. Finally, the Article answers the critical question the JOBS Act obscured: when, if ever, should we force private firms public?

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I. INTRODUCTION

Section 12(g) of the Securities Exchange Act ("Exchange Act") forces a certain class of private firms—until recently, those that had over 500 shareholders of record—into the limelight of public disclosure, effectively forcing them to go public unwillingly (the "500-shareholder rule").[1] Conventional wisdom has it that the old 500-shareholder threshold triggered the initial public offerings ("IPO"s) of Apple, Google, and Facebook.[2] Congress responded to the plight of such reluctant public firms in the 2012 Jumpstart Our Business Startups ("JOBS") Act by raising the threshold to 2000 shareholders and providing that many employee shareholders not be counted.[3]

This Article looks past the largely anecdotal debate on the floors of Congress by examining data on the number of shareholders firms have when they actually do go public. With respect to the shareholder threshold itself, I find that Section 12(g) probably forced very few firms public: between 2000 and the JOBS Act's passage, only 2.94% of firms (35 out of 1192) went public with over 400 shareholders.[4] To be precise, only 2.94% of companies *may have* been forced public by the rule. Keeping in mind that firms with more shareholders have more voices clamoring for liquidity, it is uncertain that even these firms went public *because of* Section 12(g), merely that they *may* have. Thus, examples like Google and Facebook may be salient, but they are outliers.

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1. To be precise, firms with assets over $10 million and a class of equity security held by five hundred or more persons had to register under the Securities Exchange Act of 1934. Securities Exchange Act of 1934, 15 U.S.C. § 78 (1964) (amended 2012). Section 12(g)(1) of the Exchange Act in reality specifies a $1 million cutoff, but Rule 12g-1 of the Exchange Act exempts firms with $10 million or less in total assets. *See* 17 C.F.R. § 240.12g-1 (2013). Registering under the Exchange Act means that a firm must file a Form 10 with the SEC describing its business in detail. Once registered, a firm must make periodic filings and comply with proxy regulations. *See* William K. Sjostrom, Jr., *Questioning the 500 Equity Holders Trigger*, 1 HARV. BUS. L. REV. ONLINE 43, 43 (2011).

2. *See infra* notes 49–50 and accompanying text.

3. Jumpstart Our Business Startups (JOBS) Act of 2012, Pub. L. No. 112-106, 126 Stat. 306, 325. Additionally, it exempted crowdfunding investors from the cap and provided a lower cap for unaccredited investors. *Id.* at 315.

4. *See infra* Part IV.B.

The case study of Section 12(g) reform presented by this Article offers several basic lessons—the first one dealing with the relative virtues of administrative and legislative action. These events raise crucial policy questions about where to draw the line between public and private firms. A logical choice, and one in keeping with the original intent behind the 1964 amendments that introduced Section 12(g),[5] might have imposed disclosure on firms that, though private, are actively traded. Indeed, Professor John Coffee made this suggestion, echoed by widely-respected securities scholar Professor Jay Ritter.[6] Such a line would protect the hiring and capital-raising interests of one firm that lobbied for increasing the threshold—Wawa—and other traditional widely-held companies, but it would not have worked with the model of SecondMarket, another would-be reformer which provided a venue for the active trading of private company shares.[7] SecondMarket's engagement with reforming Section 12(g)[8] may explain why the public float suggestion went nowhere.

Part I of this Article outlines the legislative history and original purpose of Section 12(g), stressing that the legislation was the product of a meaningful and data-informed debate, and that its goal was to capture firms already being publicly traded over the counter. It then documents how subsequent rulemaking rendered the original purpose obsolete, and how Section 12(g) thus evolved to become a trap for unlucky widely-held private firms like Facebook. Part II describes the debate on the congressional floor, where argument by anecdote prevailed. Part III provides some data that cast doubt on the existence of a problem at all. Finally, Part IV offers lessons from the data.

II. THE HISTORY AND FUNCTION OF SECTION 12(G)

U.S. securities law drags some companies into the public markets against their will.[9] Or it used to. Up until April 5, 2012, Section 12(g) of the Exchange Act required that firms with assets of over $10 million, and a class of securities held by over 499 shareholders of record, register their securities under the Exchange Act.[10] Although not originally intended to ensnare companies not publicly traded, over time (and especially with

5. *See infra* Part II.A.

6. *Testimony of Jay R. Ritter before the S. Comm. on Banking, Hous., & Urban Affairs*, 112th Cong. 10 (2012) (statement of Jay R. Ritter, Cordell Professor of Finance, Warrington College of Business Administration, University of Florida).

7. Under the SecondMarket model, investors purchased private company shares from earlier investors or employees looking to sell. *See* Usha Rodrigues, *Securities Law's Dirty Little Secret*, 81 FORDHAM L. REV. 3389, 3392 (2013).

8. *The Private Company Burden: Solutions for Entrepreneurs, Job Creation and Innovation: Hearing Before the H. Comm. on Oversight and Gov't Reform*, 112 Cong. 9–10 (2011) (written testimony of Barry E. Silbert, Founder & CEO, SecondMarket).

9. Sjostrom, *supra* note 1, at 43 ("Today, the practical effect of this rule is to force certain types of firms into the public markets earlier than is desirable.").

10. U.S. SEC. & EXCH. COMM'N, REPORT ON AUTHORITY TO ENFORCE EXCHANGE ACT RULE 12G5-1 AND SUBSECTION (B)(3), 1 n.3 (2012) [hereinafter *SEC REPORT ON RULE 12G5-1 AND (B)(3)*], *available at* http://www.sec.gov/news/studies/2012/authority-to-enforce-rule-12g5-1.pdf.

the rise of the practice of granting employees stock options), some private firms approached the 500-shareholder threshold and went public because, in effect, they had to: registration under the Exchange Act subjects private companies to the same periodic reporting that public companies undertake, so most conclude that they "might as well" go public so as to reap the benefits of an IPO.[11]

Forcing public status on a company marks an "extraordinarily significant change in its legal obligations and freedom to maneuver."[12] Registration under the 1934 Act means that companies must file quarterly reports, an annual report, and periodic updates on Form 8-K when certain material events occur.[13] They must follow detailed regulations governing proxy solicitation.[14] Officers and other insiders face more ready exposure of possible violations of insider trading and short swing profit rules.[15] Being public increases the stress of running an organization. Mistakes are scrutinized not only by analysts, short sellers, and the market in general, but also by plaintiffs' attorneys.[16] The idea of forcing an unwilling company public is thus "ideologically charged."[17]

A. The Origins of Section 12(g)

There are two key points to take away from the history of Section 12(g). First, it was originally the product of a significant and meaningful debate.[18] The regulatory reformers had the benefit of several studies on their side, and those resisting regulation argued that specific thresholds would overburden both firms and the SEC.[19] Second, the legislation's original purpose was to impose disclosure on firms that were already trading over the counter ("OTC")—and thus where, as a practical matter, a public market already existed.[20]

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11. *See* Sjostrom, *supra* note 1, at 43–44 (arguing that Facebook probably would go public since it was nearing the 500 holders of record threshold that requires it to "file public company reports regardless" and that Google did go public because it reached the 500 holders of record threshold).

12. Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO L.J. 337, 338 (2013).

13. Securities and Exchange Act of 1934, 15 U.S.C. § 78m (2012).

14. 15 U.S.C. § 78n (2012).

15. 15 U.S.C. § 78p (2012).

16. *See* William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: The Irony of "Going Private"*, 55 EMORY L.J. 141, 147 (2006) ("Litigation costs will rise with rising disclosure costs . . . .").

17. Langevoort & Thompson, *supra* note 12.

18. *See* Michael D. Guttentag, *Patching a Hole in the JOBS Act: How and Why to Rewrite the Rules that Require Firms to Make Periodic Disclosures*, 88 IND. L.J. 151, 166 (2013) (tracing suggestions similar to the 1964 Securities Act Amendments back to 1938).

19. *Id.* at 166–68.

20. *See* 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.").

The original 1964 amendments were the product of empirical investigation and debate on the merits.[21] From 1955 onward, the operators of the national exchanges agitated for the government to impose comparable disclosure requirements on stocks traded over the counter.[22] In 1955, the Senate Banking and Currency Committee conducted a study on the subject.[23]

The SEC commissioned a second 120-page report in 1963 that, taking as a given the need for extending reporting requirements to the OTC market, focused on the appropriate contours of investor protection.[24] If investor protection were the only goal driving the SEC, it could have applied the Exchange Act provisions to all OTC issuers, but it was also mindful of the burden these expanded requirements would have placed not only on the issuers but on the agency itself.[25] Thus, where to draw the line became a key question.[26]

The SEC Report recommended extending reporting requirements to issuers with over 300 shareholders of record.[27] Industry representatives pushed back, with the Investment Bankers Association proposing a cutoff for filings of 1000 shareholders.[28] In response, the SEC pointed out that this high threshold would "deprive investors in some 1,400 companies" of its proposed protections.[29] It also noted that these companies were substantial in size, and that many of them made use of notoriously bad proxy practices.[30]

The study looked at several possible reporting benchmarks aside from the number of shareholders, including "transfers of stock, concentration of holdings, and trading interest in interdealer markets."[31] The SEC felt that because "it [was] difficult to conceive of any direct test [of market activity] that could ever be meaningful and workable," the number-of-shareholder litmus offered the most viable substitute, even though it provided only a "rough, indirect measure of activity."[32] It observed that the number of shareholders encompassed the "number of transfers"

21. *See* Guttentag, *supra* note 18, at 166–68.

22. *Id.* at 166 ("Those who ran the national exchanges were clearly dissatisfied with the disparate regulatory treatment that depended solely upon where a firm's securities were traded.").

23. *See generally* SEN. REP. NO. 84-376 (1955).

24. H.R. DOC. NO. 88-95, pt. 1, at 2–3 (1963).

25. *Id.* at 2.

26. *Id.* at 7.

27. *Id.*

28. U.S. SEC. & EXCH. COMM'N., SPECIAL STUDY OF SECURITIES MARKETS, H.R. Doc. No. 88-95, pt. 3 (1964) [hereinafter SEC REPORT], *reprinted in* 1 SECURITIES ACT AMENDMENTS OF 1964, at 78 (1964) (Statement of Mr. Hudson B. Lemkau, Board of Governors of the National Association of Securities Dealers).

29. Memorandum of the Securities and Exchange Commission with Respect to Modifications of S. 1642 Proposed by the Investment Bankers Association of America, *reprinted in* 1 SECURITIES ACT AMENDMENTS OF 1964, at 282 (1964).

30. *Id.* at 283.

31. SEC REPORT, *supra* note 28, at 18.

32. *Id*. at 34 ("In theory, a criterion expressed in terms of market activity might be appealing, but it is difficult to conceive of any direct test that could ever be meaningful and workable in practice and it has been seen that the shareholder criterion itself is at least a rough, indirect measure of activity.").

criteria, as "comparison of numbers of record shareholders with numbers of record transfers revealed a general correspondence between the two."[33] As to the amount of a company's assets, the study determined there was "no discernible shareholder-to-assets pattern," which, in combination with the philosophy that the smallest companies were the ones for which reporting requirements were most needed, led it to initially be left out of the SEC's recommendations.[34] The final amendments reflected a compromise of 500 shareholders,[35] with the additional qualification that the Act would apply only to companies with over $1 million worth of assets.[36] Ultimately, the SEC concluded that the "[n]umber of shareholders has always been recognized, and obviously is, the most direct and simple criterion of public-investor interest."[37]

The origins of Section 12(g) make clear that Congress never intended for the provision to have the effect of forcing illiquid private companies into making public disclosures.[38] The 1964 amendments dealt with a completely separate issue: bringing securities that were *already trading over the counter* within the purview of SEC reporting requirements,[39] thus providing investor protection to OTC investors "comparable" to that of exchange investors.[40] This intervention was needed because, at the time, an active secondary market existed over the counter. Indeed, the estimated dollar volume of OTC securities in 1963 had grown to sixty-one percent of the national security exchanges.[41] Going further, Congress reasoned, would have been too burdensome, and it deemed 500 a good compromise number that encompassed most of the OTC market, since requiring universal reporting of OTC-traded securities would have been too burdensome on firms with the most thinly traded OTC stocks and also would have threatened to overwhelm the SEC's regulatory staff.[42]

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33. *Id.* at 20; *see* LOUIS LOSS AND JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 1757 n.1.

34. SEC REPORT, *supra* note 28, at 26. Though an asset-based criterion was ultimately included in the bill, its inclusion was for pure cost-benefit reasons, for "defining a limit where burdens may be disproportionate to needs." *Id.* at 18.

35. Securities Acts Amendments of 1964, Pub. L. No. 88-467, § 2, 78 Stat. 565, 567 (1964) (amended 2012).

36. Memorandum of the Securities and Exchange Commission With Respect to Changes in H.R. 6789 Between Its Submission to the Industry Liaison Committee and Its Introduction to Congress, Pub. L. No. 88-467, 78 Stat. 565, 566–67 (1964), *reprinted in* 1 SECURITIES ACT AMENDMENTS OF 1964 (1964) ("The $1 million asset test was evolved by the Commission, primarily in the belief that in the case of companies having less than $1 million of assets the expense to the issuer and the administrative burden upon the Commission would outweigh the benefits to stockholders which would result.").

37. *Id.*

38. *See* Sjostrom, *supra* note 1, at 44–45 (highlighting that the 1964 amendments were targeted at issuers with sufficiently liquid shares).

39. H.R. REP. NO. 88-1418, at 1 (1964), *reprinted in* 1964 U.S.C.C.A.N. 3013, 3013–14. The original 1934 Act applied only to securities traded on the national exchanges apparently because "too little was known about the over-the-counter market in 1934 to enable Congress feasibly to devise provisions as specific as those relating to listed securities." SEC REPORT, *supra* note 28, at pt. 3.

40. S. REP. NO. 73-1455, at 68 (1934).

41. S. REP. NO. 88-379, at 14 (1963).

42. *See* Michael Greenstone et al., *Mandated Disclosure, Stock Returns, and the 1964 Securities Acts Amendments*, Q. J. ECON., May 2006, at 411 & n.9.

This history indicates that robust debate and empirical research surrounded the enactment of Section 12(g) in 1964. Congress thought hard about the number of shareholders and the size of the asset test that would serve the public interest in investor protection without being too burdensome both for the agency and for the firms themselves. The SEC was deeply involved along the way, including by generating the critical initial proposal after conducting an in-depth study of the issue.

Another key takeaway from this history is that the 500 number was intended as a compromise in an effort to capture the appropriate category of companies *already publicly traded* over the counter. Primary supporters of the legislation were the national exchanges that were already subject to disclosure requirements,[43] who viewed the OTC markets as competitors operating unfairly free of regulation. Indeed, the SEC later noted that "the registration requirement of Section 12(g) was aimed at issuers that had 'sufficiently active trading markets and public interest and consequently were in need of mandatory disclosure to ensure the protection of investors.'"[44]

Once technology drove down monitoring and compliance costs, this sort of rough compromise was no longer necessary. On January 4, 1999, the SEC promulgated rules requiring all domestic OTC Bulletin Board ("OTCBB") firms to comply with the 1934 Act's reporting requirements by June 2000.[45] From that time forward, all firms save traded on the Pink Sheets were subject to reporting requirements. Today all other firms traded over the counter are now subject to reporting requirements of some kind. This development reflects the logical culmination of the original impetus behind the 1964 Act reforms: by 1999, technology had advanced to a point where the law could require almost all publicly traded firms to make periodic disclosures. This move rendered the original intent of the 500-shareholder threshold moot: now all actively traded firms had to make periodic disclosures.[46] As a result, the sole effect of the 500-shareholder threshold became to force unwilling private companies,

43. *See* Guttentag, *supra* note 18, at 166 (discussing a 1938 NYSE suggested amendment requiring mandatory disclosure under the Exchange Act).

44. Reporting by Small Issuers, Exchange Act Release No. 23,407, 1986 WL 703825 at *2 (July 8, 1986).

45. Press Release, Financial Industry Regulatory Authority, NASD Announces SEC Approval of OTC Bulletin Board Eligibility Rule, (Jan. 6, 1999), *available at* http://www.finra.org/Newsroom/NewsReleases/1999/P010106; *see also* Brian J. Bushee & Christian Leuz, *Economic Consequences of SEC Disclosure Regulation: Evidence from the OTC Bulletin Board*, 39 J. ACCT. & ECON. 233, 234–35 (2005). More accurately, to trade on the OTCBB one must be a 1934 Act reporting company or report to a banking or insurance regulator. *OCTBB Frequently Asked Questions: Eligibility Requirements*, FINRA, http://www.finra.org/Industry/Compliance/MarketTransparency/OTCBB/FAQ/#300 (last visited Apr. 20, 2015) ("Domestic issues quoted on the OTCBB are limited to the following securities: securities of issuers that make current filings pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 ('Act') . . . ."). Firms trading on the Pink Sheets do not need to be reporting companies. *Our Three Tiered Marketplaces*, OTCMARKETS, http://www.otcmarkets.com/learn/otc-market-tiers (last visited Apr. 20, 2015) ("The Open Marketplace").

46. Bushee & Leuz, *supra* note 45, at 234–35. Or, if a bank or bank holding company, they must be current in their reports to the Federal Reserve. 12 U.S.C. § 1844(c) (2012).

whose shares were widely held but not traded over the counter, into the public realm.[47]

At first, it seemed that Section 12(g) would subside into irrelevance after 1999. Yet over time, as private companies stayed private longer, and employee stock option plans and multiple rounds of investment increased the number of many private firms' shareholders, even some companies that never traded over the counter bumped up against the 500-shareholder threshold.[48] The result was that firms that Congress never intended to capture with the 1964 amendments were nevertheless swept into its net. Indeed, following the SEC's 1999 rulemaking, these became the only companies where Section 12(g) continued to bite.

B. Salient Section 12(g) Victims

The most salient recent examples of private companies being "forced" to go public are Facebook and Google.[49] Like Apple before them,[50] each was a huge private company that seemed content to stay private. Section 12(g), however, left these firms no option because at the time it required companies with more than 500 shareholders to register and become reporting companies.[51] Because these firms were compelled to make periodic disclosures under the Exchange Act already, each decided to register under the 1933 Securities Act and complete an IPO. This Section will provide a brief summary of the effect of Section 12(g) on each.

In 2004, Google was a successful private company.[52] Profitable nearly from day one, it was able to finance its operations, growth, and acquisitions without recourse to the public markets.[53] But, because of "an obscure provision of securities law," as the *New York Times* termed Section 12(g),[54] Google would have been forced to make filings under the

47. *See* Bushee & Leuz, *supra* note 45, at 235 ("By eliminating the possibility to trade on the OTCBB without filing, the eligibility rule essentially forces these firms to choose their next-best alternative."); Sjostrom, *supra* note 1, at 43 ("Today, the practical effect of this rule is to force certain types of firms into the public markets earlier than is desirable.").

48. Sjostrom, *supra* note 1, at 45.

49. *See also* Nicholas Carlson, *Why The SEC Will Force Facebook To Go Public*, BUSINESS INSIDER (Jan. 4, 2011, 11:34 AM), http://www.businessinsider.com/ why-the-sec-will-force-facebook-to-go-public-2011-1 (explaining the special circumstances underlying SEC investigation); Danny Sullivan, *Facebook to IPO in 2008 (It'll Have To)*, SEARCH ENGINE LAND (Oct. 26, 2007, 2:03 PM), http://searchengineland.com/facebook-to-ipo-in-2008-itll-have-to-12547 (quoting reports that Exchange Act requirements forced Google's offering).

50. *Apple Computer Plans Initial Public Offering Of Common This Year*, WALL ST. J., Aug. 19, 1980, at 37, *available at* http://pqasb.pqarchiver.com/wsj/doc/134511831.html?FMT=ABS&FMTS=ABS:AI&date=Aug+19%2C+1980&author=&pub=Wall+Street+Journal+%281923+-+Current+file%29&edition=&startpage=&desc=Apple+Computer+Plans+Initial+Public+Offering+Of+Common+This+Year.

51. *See supra* notes 46–49.

52. 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.

53. *See* Chris Gaither, *A Google IPO could be a headache*, BALT. SUN, Apr. 27, 2004, http://articles.baltimoresun.com/2004-04-27/business/0404270245_1_google-search-ipo.

54. Markoff, *supra* note 52.

Exchange Act because it stood on the brink of surpassing the 500-shareholder limit.[55] Thus, it made sense to file for an IPO,[56] which wound up netting $2.7 billion, giving it the third highest market capitalization in the Internet sector at the time.[57] Without the impetus of Section 12(g), this tech behemoth may have remained private for longer, perhaps much longer. Indeed, shortly after the Google IPO, the SEC issued a rule stating that it would no longer count optionholders in its shareholder census, but only consider employees as shareholders once their stock actually vested and was purchased.[58] No longer would companies be forced to go public simply because they issued too many options, so long as those options remained unexercised.

Following issuance of the SEC's new options rule, Section 12(g) affected only private companies that (1) issued a significant number of options, and (2) operated long enough for those options to vest and for the underlying shares to be bought by employees.[59] In theory, these would not be many firms. Take, as an example, the prototypical technology startup, which relies heavily on options. The ideal for most startups is to grow the company towards one of two liquidity events: an IPO or an acquisition.[60] If the IPO window is open or acquisitions are common, then Section 12(g) does not pose much of a problem. But when paths to liquidity are less easy, or if a company does not desire such an exit, it becomes increasingly possible that a firm might get caught in the 500-shareholder rule's net.[61]

Facebook is the most salient example of this type of company. As with Google, revenue from advertising sales had funded Facebook's operations for many years.[62] But Facebook had "too many shareholders": it had been private for eight years, and as employee optionholders became stockholders, it was bumping up against the 500-shareholder threshold.[63]

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55. *See id.* (noting that speculation about Google's plan to go public was because the company had widely distributed stock options to employees, presumably putting it near the 500 mark). Indeed, it had already passed the 500 shareholder mark by December 31, 2003. *See* William K. Sjostrom, *Questioning the 500 Equity Holders Trigger,* 1 HARV. BUS. L. REV. 43, 44 (2011), *available at* http://www.hblr.org/2011/03/questioning-the-500-equity-holders-trigger/.

56. Gaither, *supra* note 53.

57. Cynthia L. Webb, *Google's IPO: Grate Expectations*, WASH. POST (Aug. 19, 2004, 9:43 AM), http://www.washingtonpost.com/wp-dyn/articles/A14939-2004Aug19.html.

58. Exemption of Compensatory Employee Stock Options From Registration Under Section 12(g) of the Securities Exchange Act of 1934, Exchange Act Release No. 34-56887 (Dec. 3, 2007).

59. *Id.* at 69563.

60. *See* Thomas A. Smith, *The Zynga Clawback: Shoring up the Central Pillar of Innovation,* 53 SANTA CLARA L. REV. 577, 602–03 (2013) (stating that an IPO or acquisition of a successful startup is the "much hoped for liquidity event" that allows founders to actually realize the gains of their success).

61. *See id.* at 624–25 (discussing how private companies who issued options to employees may be forced to make disclosures under Section 12(g) when these options are exercised).

62. Palash Ghosh, *Facebook's Postponed IPO: A Wise and Patient Strategy*, INT'L BUS. TIMES NEWS (Sept. 21, 2011, 9:45 AM), http://www.ibtimes.com/facebooks-postponed-ipo-wise-patient-strategy-211547.

63. Steven Davidoff Solomon, *Facebook May Be Forced To Go Public amid Market Gloom*, N.Y. TIMES DEALBOOK (Nov. 29, 2011, 7:58 PM), http://dealbook.nytimes.com/2011/11/29/facebook-may-be-forced-to-go-public-amid-market-gloom/?_r=0.

Facebook's IPO did not fare as well as Google's, but for our purposes the crucial point is that Section 12(g) impelled the company to go public before it would otherwise have done so—at least according to popular accounts.[64]

Significantly, outside of the traditional slow-to-IPO firm, Section 12(g) directly threatened two firms offering a new type of trading platform. SecondMarket[65] and SharesPost,[66] both of which debuted in 2009,[67] began providing a market for the secondary trading of private shares.[68] Others, including myself, have already written extensively about this market;[69] for the purposes of this Article, I need to highlight only a few crucial features of these firms.

First, these platforms provided a new venue in which interested parties could buy and sell shares of private companies in a way that was impossible before. Secondary markets in private equity predated SecondMarket and SharesPost, but they were largely *ad hoc*.[70] Interested buyers found it difficult to identify willing sellers, and vice versa.[71] Moreover, each buyer had to conduct her own research, without the benefit of information on prior sales or any semblance of a market price.[72] SecondMarket and SharesPost made these transactions faster, cheaper, easier, and more visible.

Second, the market could be a robust one: pre-IPO auctions for Facebook moved as much as 100,000 shares in a day.[73] After Facebook's IPO, this market stalled, but it has shown new signs of life.[74] On March 5,

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64. *Id.*

65. SECONDMARKET, https://www.secondmarket.com (last visited Mar. 5, 2015).

66. SHARESPOST, https://www.sharespost.com (last visited Mar. 5, 2015).

67. Usha Rodrigues, *Securities Law's Dirty Little Secret*, 81 FORDHAM L. REV. 3389, 3402 (2013).

68. *Id.* At the time of the JOBS Act's passage, two companies, SecondMarket and SharesPost, dominated the market, although some competitors have since emerged. *Id.*; *see also* Tom Johansmeyer, CROWDED: *SecondMarket, SharesPost Get Yet Another Competitor*, BUS. INSIDER (Dec. 20, 2011, 11:24 AM), http://www.businessinsider.com/crowded-secondmarket-sharespost-get-yet-another-competitor-2011-12 ("Knight Capital Group, the electronic trading firm, is joining the likes of SecondMarket and SharesPost –and GFI Group and Liquidnet and Cantor Fitzgerald.").

69. *See, e.g.*, Zachary J. Gubler, *Public Choice Theory and the Private Securities Market*, 91 N.C. L. REV. 745 (2013); Elizabeth Pollman, *Information Issues on Wall Street 2.0*, 161 U. PA. L. REV. 179 (2012); Rodrigues, *supra* note 67.

70. *See* Joe Light, *Facebook's Early Buyers Burned, Too*, WALL ST. J. (June 7, 2012, 9:42 AM), http://online.wsj.com/news/articles/SB10001424052702303506404577448651877204794 ("Secondary markets have existed for years, with behind-the-scenes brokers hooking up buyers and sellers. [SharesPost and SecondMarket attempt] to provide more transparency to private transactions and a more uniform process of buying and selling.").

71. Darian M. Ibrahim, *The New Exit in Venture Capital*, 65 VAND. L. REV. 1, 21 (2012).

72. *Id.*

73. Tom Johansmeyer, *Volume Increases in Facebook on SharesPost, Valuation Steady*, BUS. INSIDER (July 21, 2011, 7:35 AM), http://www.businessinsider.com/volume-increases-in-facebook-on-sharespost-valuation-steady-2011-7; *see also* Evelyn M. Rusli & Peter Lattman, *Losing a Goose That Laid the Golden Egg*, N.Y. TIMES DEALBOOK (Feb. 2, 2012, 9:26 PM), http://dealbook.nytimes.com/2012/02/02/losing-the-goose-that-laid-the-golden-egg/ (describing that SharesPost's facilitated $625 million in transactions in 2011, and SecondMarket almost $600 million, with Facebook constituting about a third of that volume).

74. *See* Rusli & Lattman, *supra* note 73 (highlighting, for example, that Facebook's "trades [made] up the bulk" of SecondMarket's transactions).

2014, SharesPost and NASDAQ OMX launched a joint venture called the NASDAQ PrivateMarket, LLC.[75] SecondMarket facilitated over forty transactions of more than $10 million in 2013, allowing employees and early investors to sell their shares.[76]

Third, firms whose shares traded on the secondary market increasingly risked bumping up against the 500-shareholder threshold. Employees or ex-employees made up most of the seller population.[77] Often they sold only a portion of their shares.[78] An employee might, for example, sell half of her vested options in order to finance a new house but keep the rest in order to benefit from a hoped-for increase in share price in a later IPO. Founders and existing venture capitalists likewise used these secondary markets to obtain a modicum of liquidity, without fully exiting their investment.[79] Thus, each sale—rather than substituting new shareholders for old—added to the growing shareholder-of-record tally. It was therefore vital to SecondMarket's business model that the 500 number be lifted. And, as I detail in a separate article, SecondMarket spent $380,000 on lobbying for Section 12(g), while its employees made significant campaign contributions to supporters of reform.[80]

Finally, these markets are not open to the general public. Buyers are required to be accredited investors[81]—those with over $200,000 in income or $1 million in assets.[82] Because these transactions took place not on a public exchange like the NYSE, but instead in a private market limited to accredited investors, they could transpire outside the reach of the SEC's 1999 rule on OTC trading.[83] No disclosure necessary.

75. Press Release, NASDAQ Private Market, NASDAQ Private Market Launches New Marketplace for Private Companies (Mar. 5, 2014), *available at* http://globenewswire.com/news-release/2014/03/05/615856/10071210/en/NASDAQ-Private-Market-Launches-New-Marketplace-for-Private-Companies.html.

76. Yuliya Chernova, *Startup Employees Cash In Stock Options Early*, WALL ST. J.: THE ACCELERATORS (Feb. 3, 2014, 12:46 PM), http://blogs.wsj.com/accelerators/2014/02/03/startup-employees-cash-in-stock-options-early.

77. Kim-Mai Cutler, *Employees Made Up Nearly Two-Thirds of Private Stock Sellers on SecondMarket Last Year*, TECHCRUNCH (Jan. 30, 2013), http://techcrunch.com/2013/01/30/employees-made-up-nearly-two-thirds-of-private-stock-sellers-on-secondmarket-last-year/.

78. *See* Rodrigues, *supra* note 67, at 3411 (discussing one advantage of SecondMarket was that it allowed employees to sell portions of their shares); Chernova, *supra* note 76 ("Now, many large startups are offering employees a chance to sell a portion of their stake, at the same time as continuing to hold onto the rest.").

79. *See* Rodrigues, *supra* note 67, at 3405 (stating the approximately four percent of sellers are investors or founders—a percentage that was increasing over time).

80. *See infra* note 127.

81. Barry Silbert, *Not All Markets Are Created Equal*, TECHCRUNCH (Mar. 28, 2012), http://techcrunch.com/2012/03/28/secondmarket-sec/ ("Only 'accredited' investors are eligible to buy private company stock on SecondMarket, and we have established a process to ensure that only accredited investors buy stock.").

82. 17 C.F.R. § 230.501(a)(5)–(6) (2013).

83. 17 C.F.R. § 200.2(b) (1999).

III. DEBATE ON THE CONGRESSIONAL FLOOR

A small constellation of bills converged to create what would become the JOBS Act of 2012. Title V, the main shareholder-of-record provision, began as the Private Company Flexibility and Growth Act ("PCFG Act"), introduced in June 2011 by Representative David Schweikert of Arizona.[84] It not only sought to raise the Section 12(g) threshold from 500 to 1000, but also to exclude from the definition of holders of record both accredited investors and employee compensation plans.[85]

The storyline of the reform camp was clear: the 500-shareholder rule discouraged growth—and by extension, job creation—by impeding hiring and capital-raising. A group of Silicon Valley CEOs and investors presented a letter to Congress offering a classic statement of the argument: "The 500 Shareholder Rule is outdated, overly restrictive, and limits U.S. job creation and American global competitiveness."[86] The writers made two arguments about why Section 12(g)'s threshold should be increased. First, stock options are a valuable employee-motivational tool, and as companies take longer to go public, options vest and employees exercise them, creating more and more private-firm shareholders. "Thus, the 500 Shareholder Rule has created a disincentive for private companies to hire and/or provide equity-based compensation to new employees."[87] Second, the letter reasoned that the rule constrained private companies' financing decisions: given only 500 total "slots" for both employees and investors, firms were forced to "[limit] the pool of potential individual and institutional investors."[88] In essence, the letter argued, the 500-shareholder rule forces firms to choose between forgoing hiring (at least with the use of stock options) or forgoing funding. Contemporary commentary echoed this concern: one technology journalist called the 500-shareholder rule "one of the Valley's biggest pain points,"[89] arguing that entrepreneurs know best when it comes to the relative merits of public versus private: "[m]ost entrepreneurs believe private companies can move quicker and innovate faster, so forcing someone to go public because of an arbitrary rule that pre-dated modern practices like granting stock options seems absurd."[90]

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84. Private Company Flexibility and Growth Act, H.R. 2167, 112th Cong. (2011).

85. H.R. 2167 §§ 2–3.

86. Douglas MacMillan & Joshua Gallu, *Twitter, Gilt CEOs Fight SEC's 500-Shareholder Rule for Startups*, BLOOMBERGBUSINESS (Dec. 13, 2011, 11:01 PM), http://www.bloomberg.com/news/articles/2011-12-14/twitter-gilt-ceos-fight-sec-s-500-shareholder-limits-on-private-startups.

87. *Examining Investor Risks in Capital Raising: Hearing Before the Subcomm. on Sec., Ins., and Inv. of the Comm. on Banking, Hous., and Urban Affairs,* 112th Cong. 92 (2011) (statement of Barry E. Silbert, Founder and Chief Executive Officer, SecondMarket, Inc.).

88. *Id.* at 93.

89. Sara Lacy, *After Some Initial Doubts, I'm Sold on the JOBS Act*, PANDODAILY (Mar. 17, 2012), http://pando.com/2012/03/17/after-some-initial-doubts-im-sold-on-the-jobs-act/.

90. *Id.*

No data supported these conclusions; instead, argument by anecdote prevailed. One House representative referred to "a company in Newport, Vermont, that has been under a lot of regulatory pressure. They can't go over that 500 threshold."[91] Montana Senator Tester cited a seventy-five year old "Montana-grown company" that "has always believed in rewarding its employees so they can have a stake in the success of the firm, which now operates in 16 States," but faced the choice of "costly public registration or potentially eliminating existing employee shareholders."[92] Senator Toomey of Pennsylvania expressed the concern in these words:

> There are many companies throughout Pennsylvania, across the country, that are successful. They are thriving, they are growing, but they have a number of shareholders that is bumping up against their limit. They are close to 500. They need to raise capital. They do not want to go public, and they have plenty of people who would like to invest in their successful business so they can grow. But they cannot do it because they are so close to the threshold.[93]

At the same time that the PCFG bill was wending its way along, H.R. 1965—the precursor of Title VI of the JOBS Act—proposed raising the threshold for banks and bank-holding companies.[94] Its proponents stressed the importance of the community bank: "Community banks are the life blood of our local economies. These are the banks we need to see lending to small businesses and homeowners, but they are hamstrung in their attempt to raise capital by outdated SEC registration requirements. This one is over half a century old."[95]

Reformers also emphasized that this proposal made good sense because banks are highly regulated, so that revamping disclosure requirements would not eliminate investor protections.[96] Advocates for raising the threshold in the bank context emphasized over and over again that banking was a regulated industry:

> Now, it might be asked is this prudent? And the answer to that question, of course, is that the banks and the bank holding companies are very heavily regulated by their prudential regulators. From the moment they are chartered, they are overseen by State and Federal entities that are designed to keep them from any sort of fraud from imprudent activities, and so this is an industry that is already heavily regulated, even for those companies who remain private.[97]

91. 158 CONG. REC. H1279 (daily ed. Mar. 8, 2012) (remarks of Rep. Welch).
92. 158 CONG. REC. S1886 (daily ed. Mar. 21, 2012) (remarks of Sen. Tester).
93. 158 CONG. REC. S1968 (daily ed. Mar. 22, 2012) (remarks of Sen. Toomey).
94. H.R. 1965 § 1, 112th Cong. (2011).
95. 157 CONG. REC. H7227 (daily ed. Nov. 2, 2011) (remarks of Rep. Hoyer).
96. 157 CONG. REC. H7227 (daily ed. Nov. 2, 2011) (remarks of Rep. Himes) (addressing the prudence of raising the shareholder-reporting threshold for banks by noting that banks are already heavily regulated).
97. 157 CONG. REC. H7227 (daily ed. Nov. 2, 2011) (remarks of Rep. Hoyer); *see also Legislative Proposals to Facilitate Small Business Capital Formation and Job Creation: Hearing on H.R. 2167 Be-*

Thus, two distinct arguments concurrently played out on the Hill. Advocates for raising the shareholder threshold for banks emphasized that it was already a highly regulated industry. Advocates for raising the shareholder threshold for regular firms stressed that the burdensome regulation stifled growth and hiring.

Contrary voices did signal caution, but they failed to understand the true impact of Section 12(g). SEC Commissioner Luis Aguilar urged that investor protection would suffer.[98] A push from Senator Jack Reed to change the method for counting holders from record to beneficial holders failed.[99] Remarkably, it was premised on a mistaken perception of the impact on Section 12(g). "Street name" is the practice of brokerages naming themselves as the record holders of the stock of individual investors, who remain the beneficial holders.[100] Originally intended to streamline paperwork processing when stocks change hands multiple times in a month or even a week, the practice of holding in street name means that a single entity could count as one holder of record despite owning shares on behalf of hundreds or even thousands of beneficial owners, each of whom buy and sell the underlying shares.[101] Holding in street name means that the shareholders of record measure drastically undercounts the number of beneficial—that is, actual—holders of stock.

Yet, Aguilar and his supporters elided a crucial point: hardly any private company shares are held in street name.[102] There are some notable private exceptions to the one-beneficial-holder-to-one-shareholder-of-record rule, but these should be captured by the SEC's anticircumvention rule, Rule 12g5-1(b)(3).[103] In general, in the private company context, a shareholder of record means a beneficial holder.[104]

Misbegotten as the argument about looking through to beneficial holders was, the pro-regulatory camp used it to gain concessions: most

fore the Subcomm. on Capital Mkts. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs., 112th Cong. 6 (2011) (statement of Rep. James Himes, Member of Subcomm. on Capital Mkts. & Gov't Sponsored Enters.) ("I take some comfort in that; [banks] are much more regulated than most other commercial entities."); 158 CONG. REC. S1828 (daily ed. Mar. 20, 2012) (remarks of Sen. Landrieu).

98. Luis A. Aguilar, Commissioner, Sec. Exch. Comm'n, Remarks Regarding Interactive Data Releases (Dec. 17, 2008), *available at* http://www.sec.gov/news/speech/2008/spch121708laa.htm.

99. *See* 158 CONG. REC. S1884 (daily ed. Mar. 21, 2012) (failing a voice vote).

100. *Holding Your Securities—Get the Facts*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/investor/pubs/holdsec.htm (last visited Apr. 20, 2015).

101. *See* REPORT ON AUTHORITY TO ENFORCE EXCHANGE ACT RULE 12g5-1 AND SUBSECTION (b)(3), U.S. SEC. & EXCH. COMM'N, 7–11 (Oct. 15, 2012), *available at* http://www.sec.gov/news/studies/2012/authority-to-enforce-rule-12g5-1.pdf [hereinafter SEC Report on Rule 12g5-1 and (b)(3)].

102. *Cf.* 158 CONG. REC. H1280 (daily ed. Mar. 8, 2012) (discussing the widespread use of "street name" holdings in public companies).

103. The Rule states that "[i]f the issuer knows or has reason to know that the form of holding securities of record is used primarily to circumvent the provisions of Section 12(g) . . . of the Act, the beneficial owners of such securities shall be deemed to be the record owners thereof." 17 C.F.R. § 240.12g5-1 (2012).

104. In contrast, in the context of publicly traded delisting or going dark, immobilization means that, as Rep. Capuano put it, "[b]roker-dealers can hold investments on behalf of thousands, an unlimited number of people." 158 CONG. REC. H1280 (daily ed. Mar. 8, 2012). For public companies, then, using the shareholder-of-record measure drastically undercounts the number of beneficial holders. But this is a problem relating to delisting, a topic that was never on the table for the JOBS Act.

important, the specialized cap of 500 unaccredited investors was inserted in the legislation,[105] and the Commission would study its anticircumvention powers.[106] We will revisit this compromise again later in our story.

So much for the debate over Section 12(g) on the House and Senate floors. The policy arguments made in its favor were two-fold: the rule constrained capital formation and firm hiring. Anecdotes proved the point, and the parallel move to raise the shareholder threshold in the banking sector lent legitimacy to the move—even though the main rationale for raising the threshold in the banking context, that it was a highly regulated industry, did not apply to the rank-and-file firms of Title V. The bill was swept up in a larger bipartisan, probusiness spate of lawmaking.[107]

Two distinctive and related features of Section 12(g) make it an unusually good candidate for a deeper study of how securities law—and perhaps law in general—gets made today. The first characteristic of this lawmaking process is that relevant data were available.[108] Indeed, the SEC was conducting a study, as it emphasized repeatedly while Section 12(g) reforms were hammered out.[109] Yet, its research was ultimately pushed to the side as irrelevant.[110]

IV. THE DATA BEHIND THE DEBATE

No studies undertook to demonstrate that the challenged 500-total-shareholder number was in fact problematic. Rather, the centerpiece of the case for change took the form of anecdotal evidence about companies from their home states.[111] No one researched how extensive the

105. Jumpstart Our Business Startups (JOBS) Act of 2012, Pub. L. No. 112-106, § 501, 126 Stat. 306, 325 (2012).

106. *Id.* at § 504, 126 Stat. at 326. In an October 15, 2012, report, the Commission concluded that it had adequate tools to bring a case for violations of 12(g). SEC Report on Rule 12g5-1 and (b)(3), *supra* note 101, at 31.

107. Guttentag, *supra* note 18, at 173.

108. *See* SEC Report on Rule 12g5-1 and (b)(3), *supra* note 101, at 3 n.6 (discussing the data reviewed to create the SEC's report).

109. *See, e.g.*, *Spurring Job Growth Through Capital Formation While Protecting Investors—Part I: Hearing Before the Comm. on Banking, Hous., & Urban Affairs*, 112th Cong. 10, 25, 30, 35 (2011) [hereinafter *Spurring Job Growth*] (statement of Meredith Cross, Director, Sec. & Exch. Comm'n); *Crowdfunding: Connecting Investors and Job Creators: Hearing Before the Subcomm. on TARP, Fin. Servs. & Bailouts of Pub. & Private Programs of the H. Comm. on Oversight and Gov't Reform*, 112th Cong. 91 (2011) (statement of Meredith Cross, Director, Sec. & Exch. Comm'n); *Fixing the Watchdog: Legislative Proposals to Improve and Enhance the Securities and Exchange Commission: Hearing Before the H. Comm. on Fin. Servs.*, 112th Cong. 22, 37 (2011) (statement of Mary Schapiro, Chairman., Sec. & Exch. Comm'n); *Legislative Proposals to Facilitate Small Business Capital Formation and Job Creation: Hearing Before the H. Subcomm. on Gov't Sponsored Entities of the H. Comm. on Fin. Servs.*, 112th Cong. 11, 14–15, 20 (2011) (statement of Meredith Cross, Director, Sec. & Exch. Comm'n).

110. *See* discussion *infra* Part IV.

111. *See, e.g.*, 158 CONG. REC. H1279 (daily ed. Mar. 8, 2012) (statement of Rep. Welch) ("We've got a company in Newport, Vermont, that has been under a lot of regulatory pressure. They can't go over that 500 threshold."); 158 CONG. REC. S1886 (daily ed. Mar. 21, 2012) (statement of Sen. Tester) ("For example, changes to the SEC's 500 shareholder rule would ensure companies, such as investment brokerage D.A. Davidson in Great Falls, can continue to provide their employees with stock in

problem actually was and whether reform of the 500-shareholder benchmark would remediate it. Moreover, agency specialists from the SEC's Corporation Finance Division testified on several occasions that the agency was working on an empirical report.[112] Division Director Meredith B. Cross also pointed out that the 1964 reforms had been based on an extensive SEC report.[113] Yet the 2012 legislation proceeded without the benefit of any new data. Concentrating on the reach of Section 12(g), I have gathered here the sort of relevant data Congress did not consider. In particular, this original dataset focuses on how many firms in fact found themselves compelled to go public because of the much-criticized 500-shareholder rule.

A. Methodology

I seek to uncover the effect of Section 12(g) by looking at firms that have gone public and the number of shareholders they have when they do so. These data are available because Item 201(b) of Regulation S-K requires firms to disclose "the approximate number of holders of each class of common equity . . . as of the latest practicable date."[114] And Section 12(g) requires registration for issuers with "a class of equity security (other than an exempted security) held of record by . . . 500 [post-JOBS Act, 2,000] persons."[115] To my knowledge, no other scholar has examined these data before.

The hypothesis to be tested in considering these data is whether Section 12(g) motivates some firms to go public. It merits emphasis that this hypothesis is nearly impossible to test conclusively. There are many reasons why firms may choose to go public as their number of shareholders grows. To posit but a few, firms with more shareholders may (1) tend

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the company without having to go through a costly and time-consuming registration process with the SEC. This Montana-grown company dates back over 75 years and has always believed in rewarding its employees so they can have a stake in the success of the firm, which now operates in 16 States. Without these changes, a company such as D.A. Davidson would be faced with the choice of costly public registration or potentially eliminating existing employee shareholders."); 158 CONG. REC. S1968 (daily ed. Mar. 22, 2012) (statement of Sen. Toomey) ("There are many companies throughout Pennsylvania, across the country, that are successful. They are thriving, they are growing, but they have a number of shareholders that is bumping up against their limit. They are close to 500. They need to raise capital. They do not want to go public, and they have plenty of people who would like to invest in their successful business so they can grow. But they cannot do it because they are so close to the threshold.").

112. *See generally Spurring Job Growth*, *supra* note 109 (statement of Meredith Cross, Director, Sec. & Exch. Comm'n).

113. *Legislative Proposals to Facilitate Small Business Capital Formation and Job Creation*, *supra* note 109, at 69 (statement of Meredith Cross, Director, Sec. & Exch. Comm'n); *Spurring Job Growth*, *supra* note 109, at 10 (statement of Meredith Cross, Director, Sec. & Exch. Comm'n).

114. 17 C.F.R. § 229.201(b) (2013).

115. 15 U.S.C. § 78l (2012). Under section 12(g)(5) of the Exchange Act, "class" means "all securities of an issuer which are of substantially similar character and the holders of which enjoy substantially similar rights and privileges." *Id.* This means that an issuer could have 499 preferred shareholders and 499 common shareholders and still avoid registration. Harold S. Blumenthal & Samuel Wolff, *Exchange Act Section 12(g)–Class of Equity Securities*, § 7:6 SEC. AND FED. CORP. L. (2d ed. 2015). There is little evidence, however, that many firms have attempted to maintain large numbers of both preferred and common shareholders.

to be larger, and larger firms may go public at a higher rate than smaller firms, (2) have more investors agitating for exit, (3) be older companies with investors who accordingly have lost patience with holding onto illiquid stock, or (4) make bargained-for disclosure more costly, so that economies of scale make committing to mandatory public disclosure more attractive. Even so, if very few firms go public with close to 500 shareholders, then we can say with some confidence that Section 12(g) is *not* causing firms to go public. If, on the other hand, many firms go public at close to 500 shareholders, their decision to go public *might* be because of Section 12(g). Pure causation can only be determined in the negative.[116]

I examined a sample of firms that went public between June 1, 2000, and May 16, 2013. A regulatory change dictated the start of the sample period. In 1999, the SEC approved the NASD's OTC Bulletin Board Eligibility Rule, which limited OTCBB trading to firms that reported current financial information to the SEC, banking, or insurance regulators.[117] These regulations phased in over the course of eighteen months, and the new rule applied to all companies as of June 2000.[118] I assume in the months prior to June 2000 some set of firms that would otherwise prefer to remain private went public to comply with the new rule. My interest is in comparing the population of firms that go public voluntarily and those that go public because of the 500-shareholder rule, so I begin the sample as soon as the rule was fully implemented with respect to the OTCBB.

I searched the Compustat database[119] for firms with an IPO date from June 1, 2000, to May 16, 2013, that list a number of common shareholders, a variable it denominates "*cshr*."[120] Compustat describes the "*cshr*" category as representing "the actual number of shareholders of common/ordinary capital as reported by the company."[121] Note that Section 12(g) requires registration when a firm reaches $10 million in assets and "a class of equity security . . . held of record by 500 persons" (now 2000 persons or 500 persons who are not accredited investors).[122] I did not combine preferred and common holders when they were report-

116. To be sure, it is possible that firms with fewer than 400 shareholders might choose to go public because they anticipate nearing the 500 threshold at some future time.

117. Bushee & Leuz, *supra* note 45, at 239; Press Release, Fin. Indus. Regulatory Auth., NASD Announces SEC Approval of OTC Bulletin Bd. Eligibility Rule (Jan. 6, 1999), *available at* http://www.finra.org/Newsroom/NewsReleases/1999/P010106.

118. *See* Bushee & Leuz, *supra* note 45, at 240 ("The eligibility rule became immediately effective for new OTCBB quotations, but provided a phase-in period for issuers with securities quoted as of January 4, 1999. Each issuer was assigned a phase-in date between July 1999 and June 2000 based on its ticker symbol as of January 4, 1999.").

119. S&P CAPITAL IQ, http://www.compustat.com (last visited Apr. 20, 2015).

120. *Id.*

121. *Part II: Data Definitions A–FO*, COMPUSTAT (GLOBAL) DATA 156 (Aug. 2, 2002), http://140.137.101.73:8008/ri/manual/globdata/Part2a.pdf.

122. 15 U.S.C. § 78l(g) (2012).

ed separately, because the statute refers to a "class of equity security."[123] I counted whichever class, preferred or common, had more holders.

Compustat's data for the IPO year is systematically inaccurate with respect to the initial shareholder numbers. Take, for example, a firm that goes public in 1998 and reports in its S-1 (the document that it files in order to go public) that it has 200 shareholders of record. After trading for a year, its 1998 10-K reports that it has 600 common shareholders. Compustat generally reports that the firm had 600 shareholders in 1998. In other words, it reports the post-IPO number instead of the pre-IPO number. For this reason, to find accurate data about the pre-IPO shareholder population, it is necessary to look up each S-1 or prospectus and locate the shareholder number in that document. With the help of research assistants who individually reviewed each document filed closest to the IPO date, I gathered these data for the full 2002–2013 period. I had two research assistants hand-collect these data to check Compustat's figures.[124]

B. Results

In the process of collecting this information a few minor complications arose. In nine instances, I could not locate the firm, and twenty-one had filed no S-1 (because, for example, they went public via reverse merger). Twenty-three firms completed their IPO before the period began (for example, Compustat reported a blank-check company's acquisition as an IPO). I eliminated 211 more transactions because they did not involve U.S. corporations, thus rendering Section 12(g) inapplicable, including firms such as partnerships and other noncorporate entities (seventy-nine), real estate trusts (eighty-nine), and foreign firms (seventy). Also eliminated were offerings involving thirty-four closed-end investment companies, nineteen firms that went public by way of an S-4 (for business combinations, spin-offs, and the like), and one firm that went public by way of S-1 in conjunction with a merger. Finally, I eliminated fifty firms as spin-offs, reasoning that spinoffs by definition are not driven by shareholder number.

The result was that 1249 firms remained, of which 1192 went public before the JOBS Act was passed. See Table I.

123. *Id.*

124. Post-IPO, Compustat sometimes reports the number of beneficial owners instead of holders of record, or combines the two figures. This problem is not relevant for this paper. *See Part II: Data Definitions A–FO*, *supra* note 121, at 156.

TABLE 1

Pre-JOBS firms Number of shareholders at IPO	1	2-50	1-50	51-100	101-150	151-200	201-250	251-300	301-350	351-400	401-450	451+	500+
Number of firms	71	312	383	156	122	79	46	45	20	13	6	25	19
% of firms reporting (n =895)	7.93%	34.86%	42.79%	17.43%	13.63%	8.83%	5.14%	5.03%	2.23%	1.45%	0.67%	2.79%	2.12%
% of sample firms (n = 1192)	5.96%	26.17%	30.66%	13.09%	10.23%	6.63%	3.86%	3.78%	1.68%	1.09%	0.48%	2.10%	1.59%

The lessons of the data are limited but clear. I choose 400 shareholders as a cutoff number that I hypothesize will capture most of the firms that went public because of Section 12(g). The law may of course have some *in terrorem* effect even below the 400 shareholder threshold, but I predict that this effect would be marginal. Despite the rhetoric of congressmen and SecondMarket, very few firms went public with 400–500 shareholders—only thirty-one firms, or 2.60% of the sample. In addition, if one focuses on firms with more than 450 shareholders, the percentage drops to 2.10%. Moreover, we cannot say conclusively that Section 12(g) *caused* even these firms to go public. As discussed above, there are other natural reasons why a company with many shareholders might choose to go public, without regard to the effect of the 500-shareholder rule.

The data face another limit: they cannot shed light on all of the impacts of Section 12(g). For example, as firms approach the limit they might curtail stock option grants, restrict capital raising, or engage in costly maneuvers such as reverse stock splits to avoid the bite of the 500-shareholder rule. For every firm that the 500-shareholder rule actually forced into public disclosure, then, there might be five, ten, or one hundred that in another way felt its effect. This limitation is intrinsic to the data: all they can and do show is that few firms were actually forced public—as opposed to adapting while remaining private—by the 500-shareholder rule.

I break out firms with a sole shareholder because I expected to see a large number of those. I then include them in the 1–50 category. The data show that the majority of firms reporting a number of shareholders of record (60.22%) go public with 100 or fewer shareholders of record. Only 7.15% of firms reporting a number of shareholders of record go public with over 300 shareholders. Contrary to my expectations, fewer firms with more shareholders seem to go public than those with fewer shareholders. See Tables II & III.

TABLE 2

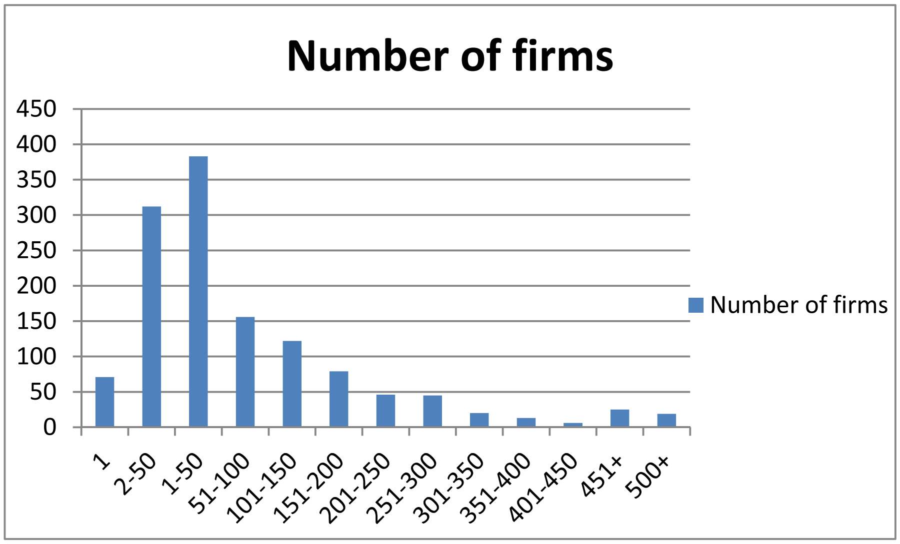
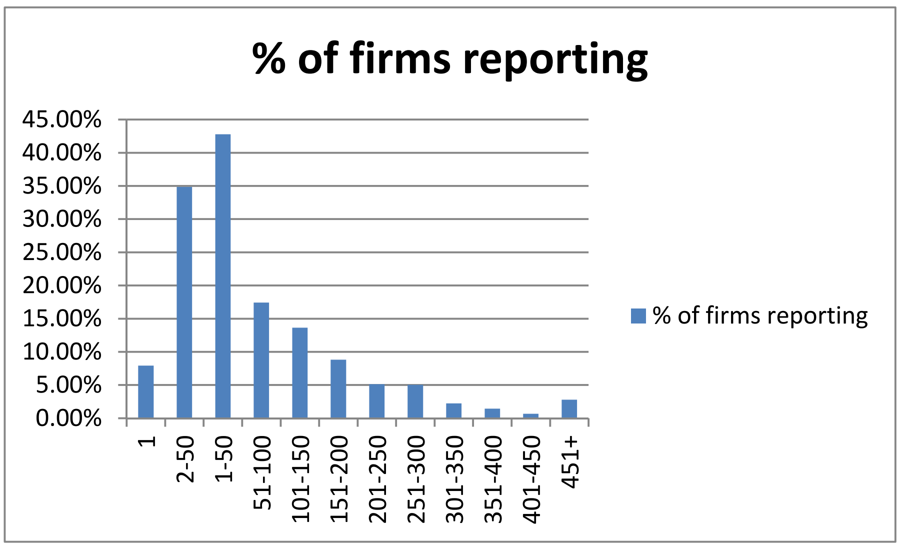


TABLE 3



Finally, the data show that some firms might flout the law, either by disclosing that they had more than 499 shareholders of record at IPO or by failing to disclose a shareholder-of-record number at all. Notably, nineteen pre-JOBS firms went public with 500 or more shareholders of record and did not begin registering under the 1934 Act when the law required them to do so. Indeed, two of the most prominent companies thought to have been captured by the reach of Section 12(g) overshot the threshold by a significant margin. Facebook went public with 1305 Class

B Common shareholders of record (and 115 Class A), more than twice as many shareholders as the 1934 Act permitted.[125] Google went public with 1242 Class B Common holders, and 845 Class A Common holders.[126] The SEC appeared, at least in these two cases, to allow the firms considerable leeway in complying with the rule.

Out of the total sample of 1249 firms, 311 (24.90%) failed to disclose any number of shareholders of record, despite that figure being required by law. On one hand, this nondisclosure might not be surprising. Potential IPO investors likely care far more about a firm's revenue and business prospects than the number of shareholders it has. Similarly, the SEC may not place much emphasis on the shareholder-of-record number in its pre-effective-date reviews of the issuer's registration statements. It is likely far more concerned that the issuer is not being unduly optimistic in its assertions and that any numbers and projections it reports are accurate or at least substantiated. On the other hand, it may be that a large number of these nonreporting firms actually have significantly more than 500 shareholders and are attempting to avoid the embarrassment of an ongoing violation by omitting to disclose the number. There is no way to know.

To summarize, this is the story of Section 12(g): It started out to protect investors from firms trading over the counter without disclosures. Subsequent rulemaking rendered that function obsolete, so that its sole function became to force firms public. A concentrated lobby, led in spending by the one firm that, as a repeat player, was the most threatened by the provision, built an attack on the 500 number into a larger JOBS Act narrative about freeing firms from pernicious regulation.[127] All participants ignored publicly available data, which (as this Part reveals) cast doubt on the existence of the problem as an empirical matter.

With the JOBS Act, the overall shareholder number has now increased to 2000 and excludes those who receive stock from employee compensation plans.[128] Although it is true that the limit remains 500 for unaccredited investors,[129] the data show that few firms approached that number pre-IPO. Including post-JOBS Act firms, thirty-six out of 1249 went public with over 400 shareholders, or 2.88% of the sample (3.46% of firms reporting a shareholder number at IPO). Even more importantly, the old number counted employee stockholders,[130] while the post-JOBS Act shareholder-of-record count excludes them. Thus, the post-

125. Facebook, Inc., Amendment No. 7 to Registration Statement (Form S-1) 149 (May 15, 2012), *available at* https://www.sec.gov/Archives/edgar/data/1326801/000119312512232582/d287954ds1a.htm.

126. Google, Inc., Prospectus 105 (Aug. 18, 2004), *available at* https://www.sec.gov/Archives/edgar/data/1288776/000119312504143377/d424b4.htm#toc59330_17.

127. SecondMarket spent $380,000 in lobbying and its employees made significant campaign contributions, as detailed in a separate article. Usha R. Rodrigues, *The Price of Corruption*, J.L. & POL. (forthcoming 2015) *available at* http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2486720.

128. *See supra* note 84 and accompanying text.

129. *See supra* note 114 and accompanying text.

130. *See supra* note 86 and accompanying text.

JOBS Act Section 12(g) will be unlikely to affect more than a handful of firms.

V. LESSONS

My research reveals that, despite the conventional wisdom accepted without question on the Hill, Section 12(g) likely affected very few firms. Despite the lack of evidence of a problem, Title V of the JOBS Act changed the shareholder threshold. This Part offers some lessons from the story of Title V's passage.

A. Finding the Superior Fact-Finder

Common understandings, which are reflected in our law, suggest that Congress is a good fact-finder—at least in comparison to the judiciary. Historically, there has been a good deal of judicial deference to congressional fact-finding, as long as Congress presented sufficient facts.[131]

What about Congress' fact-finding capabilities relative to administrative agencies? In 1964, when Congress first adopted Section 12(g), the SEC was deeply involved in the reform process—so much so that the SEC's 1963 report formed the basis for the legislation.[132] While it is true that the SEC initially proposed a cutoff of 300 shareholders, when the Investment Bankers Association proposed a cutoff of 1000 shareholders, the SEC was able to look to the data it had collected to argue that this threshold would deny protection to the shareholders of 1400 companies.[133]

In contrast, the SEC was continually playing catch-up in 2012. During the PCFG Act debate, the SEC repeatedly alluded to the fact that it was in the middle of conducting a study of shareholder numbers.[134] As Part III reveals, the data available would have suggested that the 500-shareholder threshold affected relatively few firms' decision about going public. Yet Congress did not wait for that study.

One reason why Congress failed to wait may be that it faced no penalty for acting with dispatch. In particular, congressional fact-finding—or the lack of it—has little impact on judicial review of legislation of this kind. In matters of economic regulation, the judiciary long has deferred to congressional judgments, including by hypothesizing plausible rationales for its actions, even when the legislative record sug-

131. Williamson v. Lee Optical of Okla., Inc., 348 U.S. 483, 487 (1955) ("[I]t is for the legislature, not the courts, to balance the advantages and disadvantages of the new [law]."). *But see, e.g.*, United States v. Lopez, 514 U.S. 549, 562 (1995) (describing a government concession that the Gun-Free School Zones Act and its associated legislative history did not contain a finding of facts connecting gun possession in school zones to interstate commerce).

132. *See supra* Part II.A.

133. *See id.*

134. *See supra* note 109 and accompanying text.

gests that Congress was not careful or was misled by self-serving interest groups.[135]

Of particular importance, the unlikely prospect of judicial invalidation of legislation in the securities field contrasts sharply with the reality of close judicial scrutiny of SEC action. Take, for example, the rigorous cost-benefit analysis the D.C. Circuit applied in *Business Roundtable v. SEC*.[136] In that case, the SEC promulgated and adopted rules on proxy access, requiring public companies to allow shareholders the ability to include their nominees on the proxy card that companies send out for annual shareholder elections.[137] The court found the proxy access rule to be "arbitrary and capricious" under the APA.[138] According to the court, the SEC "inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters."[139]

The *Business Roundtable* court upbraided the SEC repeatedly for failing to consider relevant factors, including underestimating the intensity of companies' opposition to the shareholder-nominated candidates,[140] not estimating the costs to companies of campaigning against these candidates,[141] and neglecting costs to companies from the use of proxy access by special interests like union and government pension funds.[142]

Of particular interest, the court took the SEC to task for its selective use of data that concerned whether the proposed rule would actually improve board performance. It scolded that, although there were "numerous studies" that found the opposite result, the SEC "completely discounted" those studies[143]—even though, by the court's own account, the agency discounted the studies "because of questions raised by subsequent studies, limitations acknowledged by the studies' authors, or [its] own concerns about the studies' methodology or scope."[144]

Notably, the court leveled these criticisms at the SEC even though it had, in fact, relied on two empirical studies, one of which (unlike the studies cited by the court) was published in a respected peer-reviewed journal.[145] The SEC did acknowledge in footnotes cited by the court that

135. *See, e.g.*, Geoffrey P. Miller, *The True Story of* Carolene Products, 1987 SUP. CT. REV. 397 (showing that filled milk legislation was the product of special interest lobbying); Dan T. Coenen, *The Pros and Cons of Politically Reversible "Semisubstantive" Constitutional Rules*, 77 FORDHAM L. REV. 2835, 2866 (2009) (discussing *U.S. Railroad Retirement Board v. Fritz*).

136. 647 F.3d 1144, 1149–51 (D.C. Cir. 2011).

137. *Id.* at 1147.

138. *Id.* at 1148.

139. *Id.* at 1148–49.

140. *Id.* at 1149.

141. *Id.* at 1149–50.

142. *Id.* at 1152.

143. *Id.* at 1150–51.

144. *Id.* at 1151 (quoting Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668-01, 56,762–63 (Sept. 16, 2010) (to be codified at 17 C.F.R. pt. 200)).

145. *See id.* (noting the studies relied upon by the Commission).

there were limitations to one of its studies, and that some of its implications on the question at hand were "difficult to interpret."[146] Relying in part on these conclusions, the court dismissed the studies themselves as "relatively unpersuasive."[147]

The lessons of this story are clear, if unappetizing. Because of governing separation of powers principles, courts defer to congressional fact-finding to a fundamentally greater extent than they defer to agency action. Especially in the case of controversial matters like proxy access, judicial review can be rigorous—indeed, downright nitpicky. It follows that the most effective way for a private actor to seek bullet-proof change is to go straight to Congress.

Judicial deference to congressional fact-finding enables Congress to make law—particularly obscure securities law—by anecdote rather than by data. The SEC lacks this capacity. And the result—as illustrated by the reworking of Section 12(g) in 2012—is that self-interested parties may rush to the congressional forum, at least when the winds of broad reform are in the air, to secure targeted legal change that serves their distinctive interests.

B. Agency Capture v. Public Choice

Representatives and senators strive for reelection, "since legislators who fail to do so quickly become ex-legislators."[148] Public choice theory suggests that these legislators are disproportionately likely to favor special interest groups, because they are better informed, well-positioned to influence prospective voters, and inclined to make sizeable campaign contributions.[149]

The story of Section 12(g) exemplifies the operation of these forces. The driver behind the legislation was really Title I, which aimed to make it easier for firms to go public.[150] Raising the shareholder threshold was a footnote in a larger reform agenda. The official reports on the JOBS Act do not even mention shareholder-reporting thresholds.[151] Even so, conditions for altering the 500-shareholder threshold were distinctly favorable in 2012. To be sure, the JOBS Act hit at a moment when bipartisan legislation was almost nonexistent.[152] But the economy was bad, and there was a strong sense that doing "something" to help would be popular among voters.[153] The catchily titled JOBS Act was hard to resist, although it had

146. *Id.*
147. *Id.*
148. DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 81 (2001).
149. *Id.*
150. Guttentag, *supra* note 18, at 173 n.118.
151. *Id.* at 174 n.119.
152. Jonathan Weisman, *Final Approval by House Sends Jobs Bill to President for Signature*, N.Y. TIMES, Mar. 27, 2012, http://www.nytimes.com/2012/03/28/us/politics/final-approval-by-house-sends-jobs-bill-to-president-for-signature.html?_r=0.
153. 158 CONG. REC. H1241 (daily ed. Mar. 7, 2012) (statement of Rep. Robert Dold).

nothing to do with jobs, as more than one member of Congress observed.[154]

The story of the lobbying and campaign contributions behind Section 12(g)—which I detail in a separate piece—shows how a surgically targeted reform effort can influence legislation, especially if it acts under the cover of a larger agenda. This reform effort cost little in terms of monetary outlays. Total lobbying expenditures were less than $500,000 and campaign contributions were a fraction of that number.[155]

Section 12(g) also suggests that the risks that special interests pose may be different with this type of targeted, distributive (as opposed to redistributive or dedistributive) legislation where there is a narrow class of beneficiaries and uncertain public cost on the other side. Legislative change may come relatively cheaply under these conditions because the opportunities for counterinfluence are remote.

Still, the lack of data analysis in the Section 12(g) debates suggest that the risk of agency capture might present the lesser of two evils, at least when it comes to securities law. In particular, the slow pace of agency action on the front end greatly complicates efforts to score a quick win by sliding pet provisions into a large legislative package *sub rosa*. Public notice and comment allows all interested parties, including the public, to make their opinions known. Agencies must conduct a cost-benefit analysis, and the very real prospect of judicial review helps ensure that they do a credible job. Additionally, structural mechanisms such as restrictions on executive branch oversight,[156] as well as independent agency funding, restrictions on hiring and subsequent employment to counter the "revolving door problem," and relationships with other agencies, help insulate agencies from capture.[157]

Two considerations militate against channeling legislative-type work to agencies. The first is a concern for preserving democratic values. And, to be sure, the responsibility for crafting our securities laws should not belong entirely to the SEC. Indeed, the large questions the next section will address—about when to force firms into public disclosure—strike me as a subject ultimately for Congress, not the SEC. But when it comes to technical, data-driven questions like tinkering with numerical thresholds, the agency may well be the superior decision-maker, precisely because in

154. 158 CONG. REC. H1241 (daily ed. Mar. 7, 2012) (statement of Rep. Steny Hoyer).

155. *See* Usha Rodrigues, *The Price of Corruption*, J. L. & POL. (forthcoming 2015), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2486720; *see generally* Samuel Issacharoff, *On Political Corruption*, 124 HARV. L. REV. 118, 132 ("But for pursuing direct interests, lobbying is a more effective means of securing desired ends, and the amounts spent on lobbying rather than on campaign activities (even in states that permit contributions) reflect corporate understanding that the work of securing a compliant government is best carried out in the legislative rather than electoral arena.").

156. *See* Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 TEX. L. REV. 15, 26 (2010) ("[T]he President's ability to remove an agency head only for cause, which has been the defining feature of an independent agency; freedom from oversight by the President's Office of Information and Regulatory Affairs; and a multimember design that is the structural setup of most agencies with heads removable only for cause.").

157. *Id.* at 42–58.

such contexts the electoral accountability of Congress renders it susceptible to interest group exploitation.

C. The Unasked Question: Should We Ever Force Private Companies to Make Public Filings?

Cynics may find little interest in the saga of Section 12(g). So what, they might ask, that Congress failed to acknowledge the underlying questions, or at least to debate them robustly with the benefit of the data available at the time? This is more a "dog bites man," rather than "man bites dog" story.

This line of thinking, however, misses one below-the-radar point of great importance. The point is that the reform effort surrounding Section 12(g) did not focus at all on the broader question of whether we should impose public disclosure requirements on unwilling private companies. This question is, however, a pressing one. Congress' consideration of the JOBS Act, and of Section 12(g) in particular, presented the chance to consider this fundamental problem of securities law. This episode thus reflects a lost opportunity to discuss this vital subject. The first part of this Section will explain why the question is one of urgency, and the second will outline four different pathways policymakers might take as they seek to navigate in the future.

1. The Coming Proliferation of the Large Private Firm

Companies go public for all kinds of reasons: to raise money, to obtain liquidity for founders and investors, and to gain the prestige and reputational benefits of being a publicly traded company.[158] Yet plenty of companies resist the siren song of public company status for many years, growing into multi-billion-dollar private-firm giants. Indeed, the four largest private companies in the United States—Cargill,[159] Koch Industries,[160] Mars, Inc.,[161] and Bechtel Corporation[162]—are all multi-

158. *See* Jay R. Ritter & Ivo Welch, *A Review of IPO Activity, Pricing and Allocations*, 57 J. FIN. 1795, 1796–98 (2002).

159. Cargill is the United States' largest privately held company. *Top 20 Largest Private Companies 2012: #1 Cargill*, FORBES, http://www.forbes.com/pictures/eggh45mfh/1-cargill-3/ (last visited Apr. 20, 2015). Its 2012 revenue of $134 billion would have put it at eleventh on the Fortune 500, in between Ford Motor Company and Hewlett Packard. *Cargill, Incorporated*, MARKETLINE, http://store.marketline.com/Product/cargill_incorporated?productid=3704832B-FC30-4430-AA6F-39267548510B (last visited Apr. 20, 2015); FORTUNE 500, FORTUNE, http://fortune.com/fortune500/2012/ (last visited Apr. 20, 2015). Founded in 1865, it has remained private throughout its existence. Neil Weinberg & Brandon Copple, *Going Against the Grain*, FORBES (Nov. 25, 2002), http://www.forbes.com/forbes/2002/1125/158.html.

160. *America's Largest Private Companies*, FORBES, http://www.forbes.com/companies/koch-industries/ (last visited Mar. 5, 2015) (showing Koch Industries as the second largest private company in America after Cargill).

161. With revenue in 2012 totaling $33 billion, Mars, Inc. is the third largest privately held company in the United States. *Top 20 Largest Private Companies 2012: #3 Mars*, FORBES, http://www.forbes.com/pictures/eggh45mfh/3-mars-4/ (last visited Mar. 5, 2015). It has remained private since its incorporation in 1922. Joel Glenn Brenner, *Life on Mars: The Mars Family Saga Has All the Classic*

billion dollar businesses that have remained in private hands since their founding. Such firms have always been a part of the American corporate landscape: they generally have stable share ownership concentrated in the hands of a few shareholders, who are often members of the same family.

Thus, going public and entering the world of mandatory federal disclosure obligation is by no means inevitable. Nor is it uncontroversial. The scope of our public disclosure regime has been the subject of heated debate for decades.[163] Much, too, has been written about the costs and perils of being a public firm.[164] In short, this literature shows that going public creates both direct and indirect costs for firms.[165] Direct costs include legal and accounting fees incurred in connection with complying with Exchange Act requirements and SEC proxy regulation.[166] Indirect costs include increased exposure to private and public lawsuits, with attendant increases in directors and officers insurance liability premiums, and legal fees and management distraction if a suit is filed.[167] Being a public firm is hard.

Moreover, Title II of the JOBS Act relaxed the ban on general solicitation, making it easier for private firms to raise money.[168] Before the Act took hold, to qualify for an exemption under Rule 506 of Regulation D, firms could not engage in general advertising when selling their shares.[169] Shares had to be *offered to*, as well as ultimately purchased by,

Elements, INDEP., July 26, 1992, http://www.independent.co.uk/arts-entertainment/life-on-mars-the-mars-family-saga-has-all-the-classic-elements-1535722.html.

162. With revenue of $32.9 billion, Bechtel Corporation is the fourth largest privately held company in the United States. *Top 20 Largest Private Companies 2012: #4 Bechtel*, FORBES, http://www.forbes.com/pictures/eggh45mfh/4-bechtel/ (last visited Mar. 5, 2015). Founded in 1898, it has been in family hands ever since. Matthew Brunwasser, *Steamrolled: A Special Investigation into the Diplomacy of Doing Business Abroad*, FOREIGN POL'Y (Jan. 30, 2015), http://foreignpolicy.com/2015/01/30/steamrolled-investigation-bechtel-highway-business-kosovo/.

163. *See* Brian J. Bushee & Christian Leuz, *Economic Consequences of SEC Disclosure Regulation: Evidence from the OTC Bulletin Board*, 39 J. ACCT. AND ECON. 233, 234 (2005) ("[T]he economic consequences of mandatory disclosures are theoretically far from clear and heavily debated." (internal citation omitted)); Stephen M. Bainbridge, *Mandatory Disclosure, A Behavioral Analysis*, 68 U. CIN. L. REV. 1023, 1024 (2000) ("Back in the 1980s, there was an extensive scholarly debate, which pulled in many leading corporate law academics, but ultimately proved inconclusive."); *see generally* John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717 (1984) (outlining an economic-based argument for a mandatory disclosure system in that mandatory disclosure will reduce costs); Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669 (1984) (discussing the interest-group and public interest explanations of securities regulation).

164. *See, e.g.*, Carney, *supra* note 16, at 144–53.

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

166. *Id.* at 435–36.

167. *Id.* at 438.

168. SEC, FACT SHEET: ELIMINATING THE PROHIBITION ON GENERAL SOLICITATION AND GENERAL ADVERTISING IN CERTAIN OFFERINGS (2013), *available at* http://www.sec.gov/news/press/2013/2013-124-item1.htm ("By requiring the SEC to remove this general solicitation restriction, Congress sought to make it easier for a company to find investors and thereby raise capital.").

169. 17 C.F.R. § 230.502(c) (2013).

accredited investors.[170] The JOBS Act, however, directed the SEC to eliminate this limitation, as long as "all purchasers of the securities" turned out to be "accredited investors."[171] This change in SEC rules means private companies can now for the first time seek capital by advertising via radio, television, and the internet without fear of breaching the securities laws.[172] The ability to reach a wider audience will presumably lead to quicker, easier and more successful fundraising efforts. As never before, then, we face the possibility of the proliferation of large firms that are privately held on the understanding that they could remain so indefinitely.

2. *A Missed Opportunity for a Real Debate*

Advocates for raising Section 12(g)'s threshold had a ringer argument that no one made: namely that the provision was never intended to force public disclosures on companies that were not being traded. Wawa, Twitter, and other firms approaching the threshold could argue that, based upon the concerns of Congress in 1964, the 500-shareholder rule should not have applied to them at all, since their shares were not being traded. SecondMarket, however, could not make this argument, since it by *raison d'etre* served as a trading platform. The end result was argument by anecdote, untethered to actual data coupled with facile claims that, after fifty years, the threshold needed to be "modernized."

The rule established in 1964 captured firms with over 500 shareholders and total assets exceeding $1 million. The SEC gradually raised the asset threshold, first to $3 million (1982), then to $5 million (1986), then to $10 million (1996). Reformers argued that the shareholder threshold likewise should be increased.[173] This "let's modernize the threshold" argument made little sense, however, for a simple reason: clearly a dollar-value threshold in its nature cries out for modernization in the form of inflation adjustment, but 500 shareholders today are the same as 500 shareholders in 1964.

If 500 was too many shareholders to adequately police agency costs, or to coordinate information demands in 1964, then it might well be an appropriate threshold today as well. Indeed, given the vast effects of technology, 500 shareholders are undoubtedly a much more disparate

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170. Manning Gilbert Warren, III, *A Review of Regulation D: The Present Exemption Regimen for Limited Offerings Under the Securities Act of 1933*, 33 AM. U.L. REV. 355, 374–78 (1984).

171. Jumpstart Our Business Startups (JOBS) Act § 201(a)(1), Pub. L. No. 112-106, 126 Stat. 306, 313–14 (2012).

172. SEC, ELIMINATING THE PROHIBITION AGAINST GENERAL SOLICITATION AND GENERAL ADVERTISING IN RULE 506 AND RULE 144A OFFERINGS: A SMALL ENTITY COMPLIANCE GUIDE (2013), *available at* http://www.sec.gov/info/smallbus/secg/general-solicitation-small-entity-compliance-guide.htm.

173. *Legislative Proposals to Facilitate Small Business Capital Formation and Job Creation: Hearing Before the Subcomm. on Capital Mkts. and Gov't Sponsored Enters. of the H. Comm. on Fin. Serv's.,* 112th Cong. 25 (2011) (statement of Rep. Steve Stivers, Member, Subcomm. of Capital Mkts. and Gov't Sponsored Enters.).

group today than fifty years ago. Or perhaps technology has made coordination and information dispersal easier, so that the number should in fact be raised. Considerations exist on both sides. Yet no one moved beyond superficial "modernize the number" rhetoric. Congressman Himes opined, "the securities laws that were initially established in 1933 and 1934 could evolve and adapt to be more germane to today's markets."[174] Later Congressman Hoyer referred to registration requirements that had become "outdated."[175]

3. *Alternatives*

So what should be done about securities law disclosure requirements today? The data show that few private firms now find themselves forced public. Recent legal reforms also suggest that there is a coming wave of large private firms. I conclude by beginning a conversation about what to do about this brave new world in which IPOs may be commonly eschewed, rather than aggressively pursued. I discuss four choices: (1) no longer impose public disclosure requirements on private firms at all; (2) condition Section 12(g) on the number of beneficial shareholders, rather than shareholders of record as we do now; (3) require that firms of a certain size go public; or (4) impose public disclosure requirements on firms that are widely traded, using a version of "public float" for privately held firms—the choice I endorse.

a. Eliminate Forced Public Disclosure

First, we could abandon the field entirely, allowing all firms to decide on their own whether and when they will go public or otherwise assume (commonly by contract) disclosure obligations to other shareholders and the general public. This approach has the attraction of history. The last time thorough examination of the matter came was in 1964, as the then newly-proposed Section 12(g) was considered.[176] As Part I explained, this provision was intended to bring to heel the many companies trading over the counter without making the disclosures required of firms that traded on the national exchanges. Subsequent SEC action has made this original purpose obsolete, however, because rules independent of Section 12(g) now impose public disclosure requirements on those firms that trade over the counter.[177] In short, because Section 12(g) has outlived its purpose, a serviceable reform might be to repeal its strictures altogether.

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174. 157 CONG. REC. H7227 (daily ed. Nov. 2, 2011) (statement of Rep. Jim Himes).

175. 157 CONG. REC. H7227 (daily ed. Nov. 2, 2011) (statement of Rep. Steny Hoyer).

176. Richard M. Phillips & Morgan Shipman, *An Analysis of the Securities Acts Amendments of 1964*, 1964 DUKE L.J. 706, 716–19 (1964).

177. *See, e.g.*, SEC, MICROCAP STOCK: A GUIDE FOR INVESTORS (2013), *available at* http://edgar.sec.gov/investor/pubs/microcapstock.htm.

Militating against this deregulatory move is the existence of the once-robust, if now moribund, secondary trading market of SharesPost, SecondMarket, and others.[178] As previously noted, there are signs of life in these private secondary markets. On March 5, 2014, SharesPost and NASDAQ OMX launched a joint venture called the NASDAQ PrivateMarket, LLC.[179] And SecondMarket itself has increased both the level and volume of its sales in the past year.[180]

Even if the private secondary markets disappear, there is also evidence that private companies are using private funds to obtain liquidity and increase beneficial, although not record, ownership. In January 2013, a Blackrock fund invested $80 million in Twitter.[181] To be more specific, the capital went not to the company, but rather to liquidate employee shareholders.[182] And that was not the first time Twitter, founded in 2006, helped its employees obtain liquidity; half of an $800 million investment in 2011 from DST Global went to employees and investors.[183] Pinterest did something similar, selling $30 million of early investor shares to an angel fund.[184]

In other words, SecondMarket may have taken the genie of private firm liquidity out of the bottle. While firms may have clamped down on the practice of using that trading platform, as firms' exit horizons stretch beyond a decade or more, employees and early investors will invariably agitate for exit, particularly if general solicitation means that large private firms do become more viable and more common. As but one example, one new startup purports to allow the employees of other companies to sell the economic rights to their shares without selling the shares themselves.[185] And such trading, although generally among accredited in-

178. *See* Lee Spears, *SecondMarket Acts to Offset Facebook Fees Selling Wine, Art*, BLOOMBERG (May 17, 2012, 10:10 AM), http://www.bloomberg.com/news/2012-05-17/secondmarket-acts-to-offset-facebook-fees-selling-wine-correct-.html (discussing SecondMarket's struggle replace its business with Facebook after Facebook's IPO).

179. *NASDAQ Private Market Launches New Marketplace for Private Companies,* GLOBENEWSWIRE (Mar. 5, 2014, 9:00 AM), http://globenewswire.com/news-release/2014/03/05/615856/10071210/en/NASDAQ-Private-Market-Launches-New-Marketplace-for-Private-Companies.html.

180. *See* Chernova, *supra* note 76.

181. Douglas MacMillan & Alexis Leondis, *Twitter Is Said to Be Worth $9 Billion as BlackRock Buys Shares*, BLOOMBERG (Jan. 26, 2013, 12:01 AM), http://www.bloomberg.com/news/articles/2013-01-26/twitter-is-said-to-be-worth-9-billion-as-blackrock-buys-shares ("Twitter Inc. was valued at about $9 billion after early employees sold $80 million in shares to a fund managed by BlackRock Inc., three people with knowledge of the matter said.").

182. *Id.*

183. *Id.* ("The company allocated half of its $800 million investment from DST for buying shares back from employees and investors, people said at the time.").

184. Alyson Shontell, *Early Pinterest Investors Are Rich, Thanks to SV Angel's $30 Million Investment*, BUS. INSIDER (Jan. 24, 2013), http://www.businessinsider.com/a-bunch-of-early-investors-and-employees-at-pinterest-will-soon-be-rich-thanks-to-sv-angels-30-million-investment-2013-1) (collecting examples of investor and employee liquidity from buybacks); Alexia Tsotsis, *SV Angel Bought $30M in Pinterest Secondary Sale*, TECHCRUNCH (Jan. 23, 2013), http://techcrunch.com/2013/01/23/sv-angel-invested-30m-in-pinterest-secondary-sale/.

185. William Alden, *Start-up Aims to Circumvent Rules on Private Stock Sales*, N.Y. TIMES DEALBOOK (Jan. 31, 2014, 11:17 AM), http://dealbook.nytimes.com/2014/01/31/start-up-aims-to-circumvent-rules-on-private-stock-sales/?_php=true&_type=blogs&_r=0.

vestors and thus outside the reach of the SEC's OTC trading rule, nonetheless raises serious questions about investor protection—at least if one believes, as many scholars do—that accredited investor status does not equate to sophistication.[186]

b. Look Through to Beneficial Holders

Second, we could continue to use shareholders as a metric, but look through to beneficial holders. SEC Commissioner Luis Aguilar advocated this approach.[187] Holders of record is, as other commentators have pointed out, a flawed metric,[188] falling short in two distinct areas. The first problem is that it is easily gamed, as an episode late in Facebook's life as a private company illustrated. Pre-IPO Facebook made a widely publicized (and ultimately unsuccessful) effort to evade the reach of the 500-shareholder rule while still raising capital from a variety of private investors.[189] The scheme involved bundling the interests held by multiple parties together into a single investment vehicle.[190] Through the use of this device, hundreds, if not thousands, of individuals could receive an ownership interest in Facebook while Section 12(g) remained inoperative, because there would still not be 500 shareholders of record.[191]

The second problem with the shareholder record metric is that even when a firm's shares begin trading on an exchange, these shares are held in street name. As Langevoort and Thompson make clear, the result is dysfunctional; record ownership is untethered to real ownership, for all intents and purposes.[192] Indeed, some legislators specifically recognized and discussed this problem while debating amendments to the JOBS Act.[193]

186. *See, e.g.*, Howard M. Friedman, *On Being Rich, Accredited, and Undiversified: The Lacunae in Contemporary Securities Regulation*, 47 OKLA. L. REV. 291, 291 (1994); Warren, *supra* note 171, at 382; C. Edward Fletcher, III, *Sophisticated Investors Under the Federal Securities Laws*, 1988 DUKE L.J. 1081, 1122–23 (1988); Langevoort & Thompson, *supra* note 12, at 362; Felicia Smith, *Madoff Ponzi Scheme Exposes "The Myth of the Sophisticated Investor"*, 40 U. BALT. L. REV. 215, 253 (2010).

187. SEC, PUBLIC STATEMENT BY COMMISSIONER: INVESTOR PROTECTION IS NEEDED FOR TRUE CAPITAL FORMATION: VIEWS ON THE JOBS ACT (Mar. 16, 2012), *available at* http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1365171490120#.VNEFm1XF9Aw.

188. *See* Sjostrom, *supra* note 1, at 45.

189. Langevoort & Thompson, *supra* note 12, at 338.

190. *Id.*

191. *See id.* at 338–39; Liz Rappaport, Aaron Lucchetti & Geoffrey A. Fowler, *Goldman Limits Facebook Offering*, WALL ST. J. (Jan. 18, 2011, 12:01 AM), http://online.wsj.com/news/articles/SB10001424052748703396604576087941210274036.

192. *See* Langevoort & Thompson, *supra* note 12, at 355 (referring to the "dysfunction" caused by Section 12(g)'s "size test").

193. *See, e.g.*, 158 CONG. REC. S1767 (daily ed. Mar. 19, 2012) (remarks of Sen. Jack Reed) ("Through our hearings on this matter, it is clear that many big firms are getting around this requirement by pooling shares in a street name, such as an investment company like JP Morgan."); 158 CONG. REC. S1970 (daily ed. Mar. 22, 2012) (remarks of Sen. Richard Durbin) ("This effect is magnified by the fact that the reporting threshold only counts records holders, excluding the potentially unlimited number of beneficial owners who hold their shares in 'street name' with banks and brokerage companies, and thus are not considered record holders.").

One episode at the tail end of the JOBS Act's passage suggests that looking through to beneficial holders might be politically difficult. Senator Jack Reed introduced an amendment seeking to look through to beneficial holders.[194] Banks, like Goldman Sachs and JPMorgan Chase & Co., perceived a threat to their investment business, and they reacted vehemently, inserting themselves for the first time into the JOBS Act debate.[195] Thus, powerful repeat players on Capitol Hill might well thwart any reform effort aimed at regulators keyed at the beneficial holder level.

c. Use a Simple Size Test

Third, we could abandon the shareholder metric entirely: instead, lawmakers could endorse a simple size-based test—asset-level, for example, or market capitalization. This approach, however, is a flawed one. It may be true that some portion of securities regulation attempts to create more accountability for "large, economically powerful business institutions that [are] only loosely coupled with orthodox (and arguably more measurable) notions of investor protection."[196] Indeed, Professors Langevoort and Thompson have explained and documented this point.[197] But just because securities law to some extent focuses regulatory policy on larger firms does not mean that it *should* do so and certainly does not mean it should do so in pursuing the goals that underlie Section 12(g). Identifying this accountability aspect of securities law, I argue that it would be wrong to subject companies who would rather remain private to the panoply of public company regulations merely because regulators deem them to be too large or too important to the economy.

The United States has always had large, private companies play a major role in its public life.[198] In general, when we have regulated them, we have done so by way of generally applicable laws having to do with environmental laws, antitrust, labor and employment, duties, and the like. In short, we have regulated these businesses' business practices. We have not forced them into the public disclosure regime, nor do I think we should do so merely because they are large or powerful. Langevoort and Thompson concede that we cannot and should not prohibit large private companies as such.[199] But forcing these companies to go public to comply

194. Edward Wyatt, *Senate Delays Vote on Start-Ups Bill for 2 Amendments*, N.Y. TIMES (Mar. 21, 2012), http://www.nytimes.com/2012/03/22/business/senate-delays-vote-on-start-ups-bill-for-2-amendments.html?_r=0.

195. Phil Mattingly & Robert Schmidt, *Startup Act Shows Silicon Valley Clout Growing in DC*, BLOOMBERG (May 31, 2012, 12:01 AM), http://www.bloomberg.com/news/2012-05-31/startup-act-shows-silicon-valley-clout-growing-in-dc.html. According to Bloomberg, "[l]obbyists and lawyers from the banks flooded Senate offices with calls and analysis papers, according to two aides with knowledge of the efforts who spoke on condition of anonymity because the talks were private." *Id.*

196. *See* Langevoort & Thompson, *supra* note 12, at 340. They cite conflict mineral disclosures as an example of regulation reflecting political motives rather than strict investor protection. *Id.* at 367.

197. *Id.* at 379–83.

198. *See supra* notes 159–62 and accompanying text.

199. *See* Langevoort & Thompson, *supra* note 12 at 365.

with size-based disclosure obligations is the same thing as prohibiting "large private companies" from existing at all.

d. Mandate Public Disclosure for Widely Traded Firms

Finally, we could impose disclosure only on firms whose shares are in fact traded. John Coffee proposed this solution in testimony before Congress, stating:

> I think we should junk the idea of shareholders of record, which can be gamed, and turn instead to the concept of public float. Public float looks at the market value of the securities held by public shareholders, not employees, not affiliates, but that is the test that tells us the need for disclosure. And I think if you used a test like $500 million of public float, that would give you a much better test that could not be manipulated.[200]

Professor Jay Ritter, a well-respected expert on the capital markets, also endorsed this public-float approach.[201]

The idea of looking at the value of shares that are freely tradable and trading has great appeal. It circles back to the core idea that gave rise to the adoption of Section 12(g) in 1964. Moreover, developing a workable public-float standard would not be hard to do. Lawmakers could, for example, fix a numerical standard based on the value of a private firm's shares no longer held by employees, affiliates, or original investors, providing that once that number is exceeded, Section 12(g)-like disclosure obligations apply. This approach would protect firms' ability to raise capital and use options to hire employees. But if the firm or its investors began to make serious use of secondary trading options or otherwise obtain liquidity via investors outside the firm, then new duties would arise. This result makes sense because after a certain amount of secondary sales, coordination costs increase and agency costs become harder to police. Moreover, the risks of insider trading become exponentially greater as more trading occurs.

Perhaps, in the end, this "public float" solution will not provide the right answer to the question of whether the law should force a firm into the world of public disclosure. But certainly it is a question worth asking.

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200. *Spurring Job Growth Through Capital Formation While Protecting Investors-Part I: Hearing Before the Subcomm. on Banking, Hous., & Urban Affairs*, 112th Cong. 15 (2011) (statement of John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School).

201. *See supra* note 6 and accompanying text.